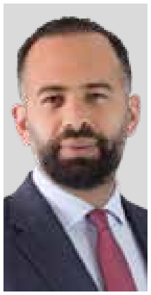
Introducing a Second Generation

The Main Challenges Facing Founders of Family-Owned Companies



By Suhaib Sharif*

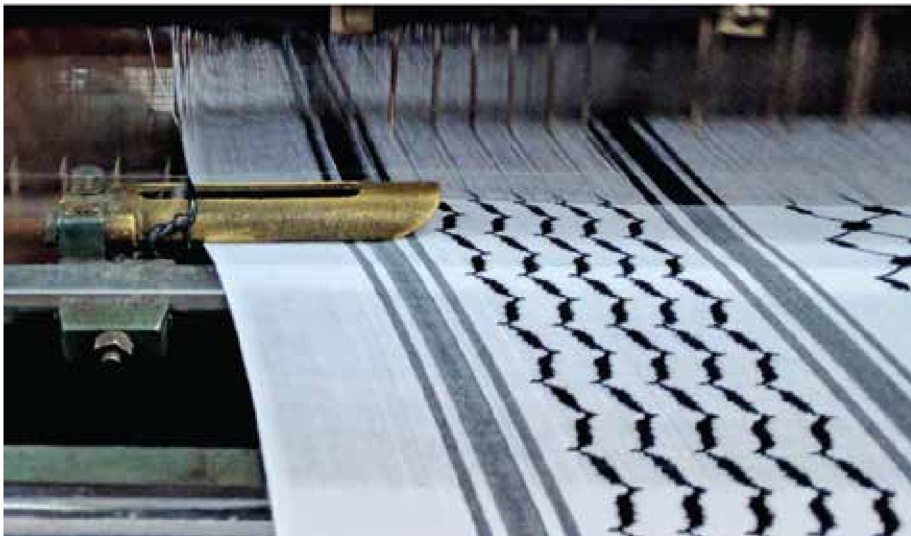
Founders of family-owned companies know well that family ties are significant factors in a company's success or failure because they understand that challenges grow and risks increase whenever family ties overshadow company regulations and policies. Private shareholding companies and general partnerships need clear structures that outline the matrix of authority within the company and a clear business and financial plan. In Palestine, however, many businesses operate without a clearly defined mission and vision, even though they may exist in the founder's mind. Strategic planning is not an integral part of the local culture. The occupation exacerbates this situation because the related stresses and developments frequently render planning irrelevant, and unforeseen circumstances must be dealt with. The combination of these factors leaves Palestinian family-run companies particularly exposed to the three main challenges that every such business faces: timing the inclusion of second-generation family members as shareholders, managing internal competition, and defining roles and responsibilities while adopting appropriate structures to ensure the company's success.

Including the second generation as shareholders in family-owned companies is challenging. Business founders must be able to separate family conflicts from the company's business and reasonably accept the innovative growth and expansion plans and strategies that the fresh minds of the new generation might suggest. Ideally, family-owned companies are structured in a manner that allows the shareholders to flexibly benefit from the enthusiasm of the new generation while relying on the rich experience of the older one, bearing in mind that the process of including the second generation may vary from one family-owned company to another, depending on the family ties and business nature of each company.

Before including the second generation as shareholders of a family-owned company, the founder must ensure that the new shareholders are well-prepared for this career stage. New members must be fully aware of the advantages and disadvantages of working in a family-owned company. For example, both generations must agree on the answer to the question, "Does the company serve and support the family – or does the family serve and support the company?" Moreover, the new generation must be trained thoroughly through an internship or transitional period that links the two generations. The younger members must learn the significance of disciplined hard work

Family-owned companies constitute 85 percent of small and medium-sized enterprises and employ 45 percent of the workforce within this sector in Palestine. They thus play a constructive role in the Palestinian economy. The challenges they face include a lack of governance, structure, and formal planning and the filling of managerial positions with family members and relatives who may be underqualified or compete amongst each other.**

The Hirbawi factory, founded by Yasser Hirbawi, has woven the authentic Palestinian keffiyeh since 1961.



and continuity within a system of institutionalized and clear standards. Thirdly, the proper timing of including a second generation as shareholders may vary from one company to another, depending on the company's status and the nature of its business. Generally, a company should either have settled into the market or require a new energy and mindset to better run its business and support its growth before including a new generation of shareholders. However, this heavily depends on the second generation's readiness to act as company shareholders.

Furthermore, the founders of family-owned companies must be aware that second-generation company shareholders enjoy rights and privileges according to the applicable company law. They have the right to participate in meetings and vote on decisions (the vote count should be based on the total number of shares owned by the voting shareholder). New shareholders have the right to access information related to the company's status, any issue that might affect its financial situation, and any topic listed on the agenda of general assembly meetings. In addition, new shareholders have the right to receive dividends whenever distributed based on their share in the company's capital. Moreover, they may share accountability, participate in the company's control, monitor its performance, and ensure that policies and decisions are implemented appropriately and effectively. Finally, they have the right to challenge general assembly decisions: one or more company shareholders have the right to take legal measures to challenge the legality and the validity of general assembly meetings or their decisions before the competent court.


Adjusting the weaving loom.

As Palestinian society remains rather patriarchal in nature, particularly in rural and traditional communities, such rights and privileges may not always be granted easily, which is a potential source of conflict.

The founders of family-owned companies must be aware that competition may develop between individuals of the two generations or between individual shareholders of the second generation. This competition tends to vary from one company to another and frequently is a conflict of entitlement. To avoid the potential negative impact on company performance, the founders must ensure a minimum level of understanding and alignment between newly introduced shareholders. Ideally, they will steer competition in a friendly direction that safeguards everyone's benefit. Competent business founders adopt policies that foster openness and transparency while balancing loyalty and ambitions to maintain company status and strength. They focus on increasing the capabilities and qualifications of the second generation through training and experience, gradually granting powers and emphasizing the importance of cooperation.

One of the most impactful results of believing in the second generation and their integration within family businesses, while equipping them with proper training and guidance, is being able to take advantage of their innovation and nuance and thereby enhancing the company. In addition, such an empowering inclusion gives the second generation a goal and purpose, an incentive to stay in their homeland to develop and nourish a cause. It may even encourage the Palestinian second generation in the diaspora to return to Palestine and have a voice in running their family businesses. Thus, the engaging and retaining of talent in the country benefits not only the individual business but also the entire Palestinian economy.

The sustainability of family-owned companies depends heavily on proper governance and planned succession. Professional and structured planning are essential factors in overcoming business challenges, maximizing opportunities, and ensuring sustainability. The qualifications and capabilities of successors must be examined well to ascertain whether they are ready to become "shareholders" or require training and more practical experience. While developing their business and succession plans, founders must strategically and appropriately separate company ownership from its management while examining the possibility of including shareholders who are not family members.

Implementing the rules of governance within family-owned companies is a complex process that must aim to create harmony and balance between two significant institutions: the family and the company. When family-owned businesses include the second generation as company shareholders, their governance structures should buttress transparency and confidence between the generations, enhance the second generation's skills, reinforce their leadership and strategic capabilities, and achieve the desired balance between the family and the company.

The ability to correct rather than avoid (acknowledging) mistakes is a significant rule of governance. Therefore, founders must set up a system that clearly defines roles and responsibilities within the company, evaluates performance, and allows shareholders to be held accountable by tracking mistakes and providing suitable solutions to correct them. Founders must notably refrain from allowing any duality of powers within the company, such as differentiating between actual and official positions that remain only on paper. One of the main problems of family-owned companies is the presence of active and influential persons who immensely affect the company while staying in the shadows. In this context, major mistakes have been made in family-owned companies by remaining attached to the methods and means of the older generation, who tend to stick to traditional ways of doing business rather than accepting or trusting the capabilities of the new generation in running the family business.

The fact that Palestinian popular culture highly values impressions, reputation, and saving face makes it generally somewhat difficult to acknowledge mistakes, particularly if one considers the patriarchal tradition and deep respect for elders. Moreover, directness is less popular than in other cultures, which can make the processes of addressing mistakes and finding solutions more difficult.

It is important to remember that family-owned businesses are facing similar challenges and can learn from the experiences of others to avoid repeating their mistakes. A qualified advisory board can support a family-owned company to overcome challenges and maximize opportunities. Likewise, it is essential to carefully choose appropriate legal and business consultants that build the most suitable governance system within the company. And finally, it is necessary to have a general awareness of cultural conventions and restraints and be willing to deal with customs that may not serve the company's success.

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TO SHARE

[*] With contributions by Daliah al Taweel, a trainee lawyer.

[**] The role and number of family-owned businesses in Palestine has not been researched sufficiently. Bank of Palestine cites 98 percent ("Bank of Palestine sponsors the Palestinian Family Business Conference in Nablus," no date, available at https://bop.ps/en/about/news/465), whereas an article in *Middle East Business Journal* (in Arabic) cites 85 percent (see Majd Zghyer, "Palestinian Family Businesses Need to Get into the Entrepreneurship Scene," October 31, 2021, available at https://www.linkedin.com/pulse/palestinian-family-businesses-need-get-scene-majd-zghyer/). This discrepancy is partly due to the lack of a precise definition, as large corporations may not be recognized as family businesses due to their size.