Wong Lu Peen & Tunku Alina

PRACTICALLY SPEAKING SERIES:

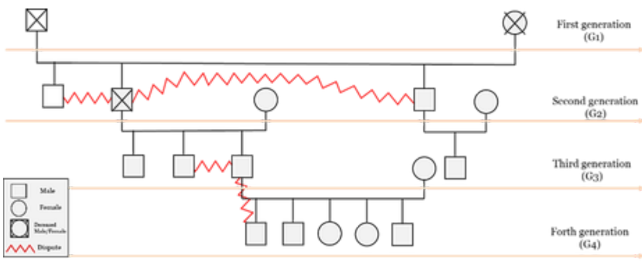
YOU HAVE BUILT YOUR BUSINESS EMPIRE. WILL IT BE A MULTI-GENERATIONAL LEGACY?

Many business owners hardly give this a thought. They just assume they are immortal or their businesses will remain and reach unchartered height. Some things have changed somewhat after the COVID-19 pandemic. There is more awareness and acceptance of mortality. Understandably, there is still some taboo in addressing estate planning or crudely put "death planning". Many feel that writing their will/wasiat alone is enough.

Family owned businesses make up 80-90% of firms worldwide. There is a Chinese adage, "1st generation builds, 2nd generation preserves and the 3rd generation destroys". Does this adage hold true?

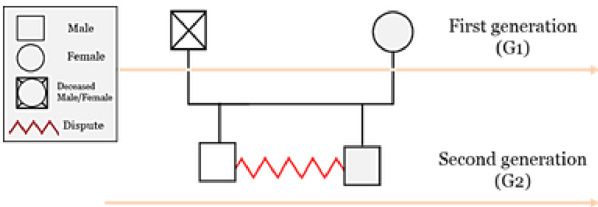
Let's look at the reality or practical issues on the ground against a backdrop of real live scenarios so some perspective can be gained!

SCENARIO 1 : FAMILY A



Disputes spanned over 4 generations. The family food business was founded in 1888 by a patriarch and his wife. There were disputes spanning a few generations. The patriarch's son (G3) then took over the business. After taking over the business empire, the business empire continued to have disputes with his brother resulting in the patriarch's son (G3) buying over his brother's entire share. The son (G3) went on to run the business empire with his 5 children. In 1999, there was a dispute between son (G3) with his own son (G4) that was eventually resolved.

SCENARIO 2 : FAMILY B



Business founded in early 1900's which later became a billion dollar conglomerate. The patriarch died intestate (without a Will) in 2002. His two sons took over the USD 11.2 billion empire as Chairman and Vice Chairman. Legal battles ensued between the 2 brothers over the business that was eventually resolved by the division of the businesses.

There are many examples of **[1]** family disputes some of which are occurring now as we speak.

Some of the family disputes evidence:

- family disputes transcending generations and familial relationships [parents-child, spouse, siblings, uncle-nephews];
- loss of "control" of the business by a family maybe just like in the "Lee Kum Kee sauce" case;
- family legacies created by patriarchs can dissipate;
- **[2]** family disputes span over decades;
- some part of the business may be **[3]** "carved out" to resolve familial disputes; and
- the succession tools used whether **[4]** Wills, **[5]** Trusts or other legal agreements have not prevented dispute.

[1] Cahaya Mata Sarawak, Sapura, Supermax, Ambani (India) and Lippo (indonesia)
[2] The WTK family dispute in Sarawak spanning over 12 years and still on-going
[3] Ambani brothers each took separate business arm to resolve conflict.
[4] Recent case of Genting heir, the late Lim Siew Kim challenges some two (2) wills on grounds of alleged incapacity and undue influence.
[5] Trust arrangement was challenged in the Genting business wherein a nephews sued their uncle over some trust arrangement. In the recent case of Supermax, proceedings to wind-up family holding company initiated.

As such, we can reasonably conclude that succession tools alone are inadequate to transition your business succession. Other elements need to be addressed. What are these?

Why are there family disputes? Some common reasons cited are break down of communication and trust, lack of family cohesiveness or mission, inadequate preparation of heirs, disinterested heirs and poor technical advice.

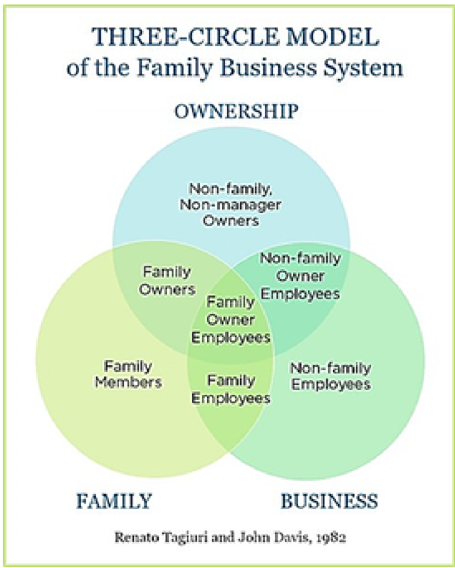
Notwithstanding the numerous reasons cited, we strongly opine that the primary reason that family feuds arise in a business are the lack of “cohesiveness among family members” or “shared purpose” leading to a “mismatch of expectations”. This “shared purpose” is usually lost when the patriarch passes on or hands-over control. We opine this is because the “mettle held by patriarchs” are often unchallenged and the shared purpose is dictated by the patriarchs and followed by all. This “shared purpose” is lost or unknown after the patriarchs pass on.

Some common purposes are maintaining family unity and shared values, minimizing legal and tax complexity, supporting next generation entrepreneurship and independence.

So this then leads to the billion dollar question, how does a family business ensure this shared purpose is reached and can be maintained for generations?

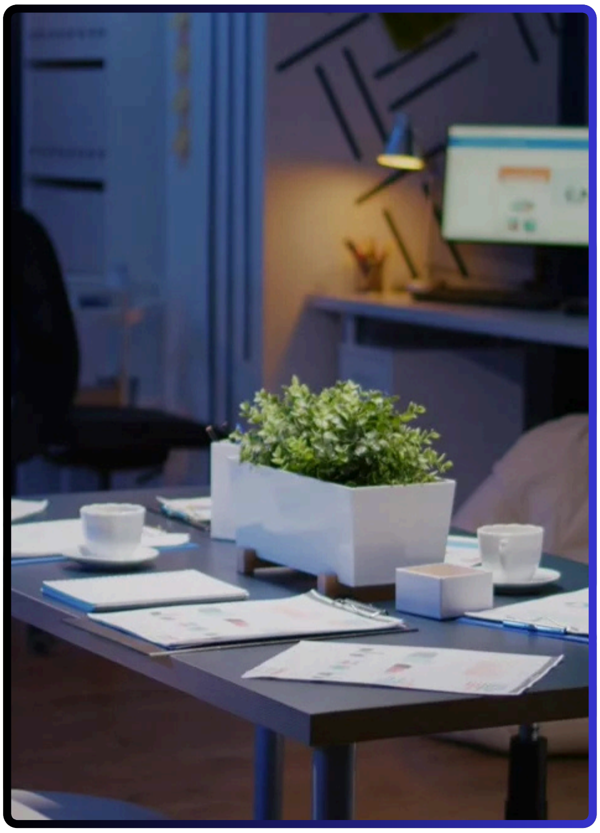
OWNERSHIP VS MANAGEMENT

The chart attached is an illustration how a Family Business System usually runs:



From the chart above, we know that family businesses comprise three (3) components as depicted above. These components must be balanced with diverse interest and expectation of the family members. Each component must have its parameters set out. For example, the ownership component should stipulate who can become a shareholder, what is the maximum equity one can hold in the family business? In many large family conglomerates in developed economies, the families have left the management in the hands of professional managers. This is particularly so when families are multi-generational and large and each family member’s interest is diluted. However, this shift for professional management is lagging in Asian family business.

The diverse interest and expectation of family members cannot be ignored. Family members managing the family business and those who are not, are understandably not at the same level playing field. Any “element of distrust” between managers and non-managers family members can arise. If a non-managing family member has an expectation of “distribution” from the family business, then a non-declaration or reduced quantum will give rise to this distrust, even more so when there is a lack of communication or detailed justification given on the reason for non-declaration or reduced quantum. This “distrust” is further exacerbated if there is a lack of openness and communication between the two (2) groups.



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PRACTICAL TAKEAWAYS FOR PRACTITIONERS

1. Drafting legal agreements such as Wills or Trusts alone is insufficient;
2. Experienced legal practitioners need to deep dive into the family, the business, family dynamics to name a few and understand the nuances which can possibly lead to a "shared purpose";
3. "Shared purpose" may evolve with time. At some juncture, preserving the legacy may no longer be "shared purpose" and "cashing out" may be the preferred option. Hence, solutions are not cast in stone and may evolve so periodical reviews are to be undertaken;
4. "Ownership" and "Business" components in a business need to be examined closely to ascertain which structure suits the family; and
5. No one size that fits all for family businesses. Each business and family differs, and solutions must be curated to meet the needs and address the gaps.

www.wlpta.com.my

About the Writer:

CHITHRA GANESALINGAM
SENIOR ASSOCIATE
LLB (Hons) (Leicester), CLP
chithra@wlpta.com.my
03-2201 8378 (Ext. 236)
www.wlpta.com.my

The Writer's bio is available on our website.