Corporate Governance

Family Business Governance

Corporate Governance Program, IFC Advisory Services, MENA
Amman, Jordan
May 2015
Purpose: Understanding the Characteristics & Challenges of FOEs

AGENDA

1. Family Governance Awareness
2. Board & Management Structures
3. Family Governance Mechanisms
4. Annex 1: Case Study, Family Board Transformation
5. Annex 2: Family Institutions
6. Annex 3: Family Businesses & IPOs
FAMILY GOVERNANCE AWARENESS
When you hear “family business,” what comes to your mind?
When you hear “family business,” what comes to your mind?

- PAI RICO, FILHO NOBRE, NETO POBRE
- FU BU GUO SAN DAI
- PADRE RICO, HIJO CABALLERO, NIETO PORDIOSERO

3%
When you hear “family business,”
what comes to your mind?

“Yes, Timmy, someday this will all be yours, instead of
someone more qualified.”

Nepotism
When you hear “family business,” what comes to your mind?

- Mr. Ambani Sr. died in 2002 without leaving a will. Mukesh and Anil became the undisputed heirs of his legacy.

- Differences soon surfaced: their mother mediated in 2005 to partition the Reliance assets.

- Mukesh was given oil, gas, and petrochemicals, while Anil received control of the power, finance, and telecommunications businesses.
When you hear “family business,” what comes to your mind?
A family business refers to a company where...

- the voting majority is in the hands of the controlling family, including the founder(s), who
- intend to pass the business on to their descendants.

Source: Abouzaid, 2011
Family business is the most prevalent form of business in the world

“Between 75% and 90% of all the world’s business is carried on by family companies.”

Family Governance Awareness

Importance of FOEs to the Economy

Over 85% of EU/US businesses are family run, MENA is not different!

Families around the world have grown some impressive empires...
Family businesses account for 30% of all companies with sales in excess of $1 billion

• Sabanci Holding is the parent company of Sabanci Group, Turkey’s leading industrial and financial conglomerate.

Sabanci Group companies are market leaders in their respective sectors that include financial services, energy, cement, retail and industrials. Listed on the Borsa Istanbul, Sabanci Holding has controlling interest in 10 companies that are also listed on the Borsa Istanbul.

• Sabanci Group companies currently operate in 18 countries and market their products in regions across Europe, the Middle East, Asia, North Africa, North and South America.
Family businesses outshine their peers, especially when the economy slumps
Families can maintain control even when they go public

Proportion of listed firms belonging to family business groups

Source: Carnegie Mellon University, 2011
Family business can survive succession — successfully

717

46 Generations

1,300 years of history
Family businesses are the most prevalent form of business in the world, and can be very...

- large
- profitable (even more than non-family)
- sustainable
- socially crucial
- innovative
- meritocratic
Family businesses have many strengths...

- commitment of family management to their company (continuity)
- long-term view in decision-making (consistent with investors)
- possibility of unconventional strategy (flexibility)
- desire to build a business for future generations (sustainability)

= The family business edge (profit)
Family businesses face many challenges…

Stages of growth in a family business:

• The founder(s)
  ▪ Strong commitment and limited governance issues (e.g., succession)

• The sibling partnership
  ▪ More governance issues (e.g., maintaining harmony among siblings, formalizing procedures, preparing next leaders)

• The cousin confederation
  ▪ Different generations and branches of the family lead to more complex governance issues (e.g., succession, family employment, family shareholding, dividends, etc.)
More challenges for family businesses...

• Additional complexity (the family)
• Managing conflict and expectations (business and family)
• Managers and shareholders have multiple, complex and sometimes conflicting roles and loyalties
• Need to distinguish family and company relationships (especially financial relationships and accounts)
• Informality (personal involvement of family members in the business)
• Lack of discipline (succession planning, family member employment, etc.)
• Challenges only increase as the family grows more complex with succeeding generations
Family members, and the business as a whole, should be encouraged to utilize strengths of family owned businesses, such as high commitment, knowledge continuity between generations of family members, and reliability and pride associated with business products and/or services.

Simultaneously, family members should recognize the weaknesses associated with family owned businesses, including complicated family issues, informality, and lack of discipline.

Encourage family members to define which stage of growth the business is currently at (founder, sibling partnership or cousin confederation stage), and promote discussion on benefits and challenges of each stage.
Board & Management Structures

Leading Practices / Change Actions

- Support family members to manage multiple roles and responsibilities in the family business.

- Manage/Create clear distinctions between:
  - Owners (shareholders)
  - Managers (senior management)
  - Directors (board of directors)
  - Family members (family and its institutions)

- CEO and senior management succession issues should be addressed.

- Family should be advised to create a form of board that is active in important matters, such as setting the company’s strategy and reviewing its management performance, rather than managing family issues.
Board & Management Structures

Key Corporate Governance Actors

- **SHAREHOLDERS**
  - Provide capital to
  - Provide transparent reporting to
  - Regular reporting and update

- **MANAGEMENT**
  - Guide and supervise

- **BOARD OF DIRECTORS**
  - Elect and dismiss
  - Represent and report to

- **SHAREOWNERS**
  - Family

- **MANAGERS**

*IFC International Finance Corporation Worldwide Banking Group*
Board & Management Structures

General Types of Ownership of Family Business

Source: Business Families Foundation
Board & Management Structures
How can Corporate Governance help FOEs?

SCENARIO 1: YOU ARE AN FOE SEEKING ADDITIONAL CAPITAL

Global Institutional Investors state that they will pay a premium for well governed companies in emerging markets from approx 20% to 30%.


SCENARIO 2: YOU ARE AN FOE THAT IS CONSIDERING GOING PUBLIC

Over 10 years, well-governed companies across a wide range of sectors have seen superior valuation multiples of more than 8% over their badly governed peers.

Metrick, Ishii and Gompers, Corporate Governance and Equity Prices, August 2001

SCENARIO 3: YOU ARE AN FOE THAT WANTS TO STRENGTHEN ITS MANAGEMENT CONTROL

Streamlines business processes, leading to better operating performance & lower capital expenditures.

Gompers, Ishii and Metrick, corporate governance and Equity Prices, August 2001

SCENARIO 4: YOU ARE AN FOE THAT IS CONCERNED ABOUT FUTURE SUSTAINABILITY

Family Businesses have short life span. 95% or more do not survive third generation of ownership. Neubauer and Lank (1998)
Board & Management Structures

Board of Directors - Key Considerations

- The Board of Directors is the central institution in the governance of family-owned business.

- Initial stage of the board is only to comply with the legal requirements but as the business grows.

- As interim step, many family cos. consider Advisory Board that complements the skills and qualifications of their current directors.

Ultimately, the board must transform for long-term sustainability. For example:

- Move to a full professional board with outside members.
- Clearly define the roles of the board and separation between family institutions and senior management.
- Ensure Board has full autonomy to direct and control the organization.
Board & Management Structures

Senior Management - Key Considerations

- Senior managers are an integral part of family governance structure.
- They manage the day to day operations of the business and the direction that is set out by the board of directors.
- The founder(s) initially manage the family business but as it grows in size a formal management structure is required.

Ultimately, Senior Management must transform for long-term sustainability. For example:

- Ensure that the right senior managers are in place.
- Decision-making processes are not unilateral (e.g., only Family CEO/Chairman) – consider Executive Committee
- Remuneration system based solely on performance
- Evaluations of Senior Executives conducted fairly and objectively
**Board & Management Structures**

**CEO and Senior Management Succession**

**Most important issue for family-owned business is Senior Management Succession plan.**

- Poor senior management succession is one of the main reasons family businesses collapse before they reach the third generation.

- Formal succession plan should allow selection of the most competent person (whether it is a family member or not).

- Family members must be involved in the selection process as also the board, key senior managers, and other important external stakeholders and they all must agree on the choice.

- The purpose of this plan is to ensure the skills and leadership necessary to replace any outgoing senior manager are available when needed.
SECTION 3

FAMILY GOVERNANCE MECHANISMS
Family Businesses

Competitive strengths and performance

- Majority are outperforming competitors in product and service quality, growth, productivity, innovation and financial performance
- 83% believe being a family business helps in surviving economic uncertainty

Family business strengths:
1. Values & shared ethos
2. Family support network
3. Vision & strategy
4. Strong brand
5. Customer service

Conflict can be constructive

- Sources of conflict or ‘creative tensions’:
  1. Visions, goals & strategy
  2. Decision-making
  3. Managing competence of financial
  4. Growing family members
  5. Stress

- 30% use family gatherings to manage conflict

Governance - family and business

- Family firms with formal advisory boards perform better than those without
- 1/3 of family business believe family issues have an equal or greater influence over performance than business-only issues
- In larger businesses:
  - 51% of non-executive directors are non-family members

- 55% have formal governance mechanisms in place to complement their management teams

Satisfaction with achievement

- 70% personal challenge & rewards
- 63% family independence
- 61% recognition & respect in the community

Primary challenges

- 72% balancing family & business issues
- 67% maintaining family control of the business
- 64% preparing and training a successor

Attracting and retaining talent

- 84% believe family values have a considerable or major impact on how their business is operated
- 72% believe the business successes are the employees’ successes

Sharing success:

- 72% believe the business successes are the employees’ successes

“Our people really like working in a family business... they share our values and are committed to our business”

Family business owner

Preparing for succession or exit

- 20% of CEOs are 65+ years old
- 41% of CEOs do not have a retirement plan
- 1/3 are exit or succession ready
- 2/3 intend on passing the business to family members

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## Family Governance Mechanisms

### Key Issues Faced by FOEs

<table>
<thead>
<tr>
<th>Ownership Stage</th>
<th>Dominant Shareholder Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage 1: The Founder(s)</td>
<td>- Leadership transition&lt;br&gt;- Succession&lt;br&gt;- Estate planning</td>
</tr>
<tr>
<td>Stage 2: The Sibling Partnership</td>
<td>- Maintaining teamwork &amp; harmony&lt;br&gt;- Sustaining family ownership&lt;br&gt;- Succession</td>
</tr>
<tr>
<td>Stage 3: The Cousin Confederation</td>
<td>- Allocation of corporate capital: dividends, debt, &amp; profit levels&lt;br&gt;- Shareholder liquidity&lt;br&gt;- Family conflict resolution&lt;br&gt;- Family participation and role&lt;br&gt;- Family vision and mission&lt;br&gt;- Family linkage with the business</td>
</tr>
</tbody>
</table>
Family Governance Mechanisms

How Can Good Family Governance Help?

Well-Functioning Family Governance Structures aim at:

- Communicating the family values, mission, and long term vision to all family members.

- Keeping family members (especially non-executives) informed about major business accomplishments, challenges, and strategic directions.

- Communicating the rules and decisions that might affect family members’ employment, dividends, and other benefits they usually get from the business.

- Establishing formal communication channels that allow family members to share their ideas, aspirations and issues.

- Allowing the family to come together and make any necessary decisions.
Family Governance Mechanisms

Major Constituents

FAMILY GOVERNANCE

FAMILY CONSTITUTION
Clearly states the family vision, mission, values, and policies regulating family members’ relationship with the business

FAMILY POLICIES
Particular policies to govern the business-family relationship

FAMILY INSTITUTIONS
Can have different forms and purposes, e.g. family assembly, family council, and other family committees
Family Governance Mechanisms

Family Constitution - Definition

- A statement of the principles that outline the family commitment to core values, vision, and mission of the business.

- Defines the roles, compositions, and powers of key governance bodies of the business: family members/shareholders, management, and board of directors.

- Defines the relationships among the governance bodies and how family members can meaningfully participate in the governance of their business.

- Although most family companies don’t have a formal constitution, they usually have an informal set of rules and customs that determine the rights, obligations, and expectations of family members and other governance bodies of the business.

- As the family increases in size, it becomes crucial to develop a written and formal constitution that is shared among the governance bodies and all family members of the business.
Family Governance Mechanisms

Family Constitution

Family Constitution helps formally codify many of the family governance structures. Typically defines:

- Family values, mission statement, and vision
- Family institutions, including the family assembly, the family council, the education committee, the family office, etc
- Board of directors (and board of advisors if one exists)
- Senior management
- Authority, responsibility, and relationship among the family, the board, and the senior management
- Key Family Governance Policies (see next)
Family Governance Mechanisms

Key Family Governance Policies

- **Family Employment Policy**: Policies should not discriminate or favor family members. Must establish atmosphere of fairness and motivation for all employees.

- **Family Shareholding Policy**: Establishes rules for share ownership and transfer to ensure shares are kept in the family when desired (e.g., Share Redemption Fund).

- **Family Dividend Policy**: Establishes guiding principles for family dividend payments to help resolve differing family cash demands.

- **Family Director Nomination Policy**: Guidelines for electing family members to the company Board of Directors.

- **Family Education Policy**: Guidelines for helping family members gain educational and professional training (may include Education fund).

- **Conflict Resolution Policy (and Committee)**: Describes measures to help resolve conflicts between family members within a defined scope.
Family Governance Mechanisms

Examples of Family Institutions

Family Institutions

- **Family Assembly**
  - A formal forum to discuss all business and family issues.

- **Family Council**
  - The governance body for the assembly in coordinating the family members' interest in the business.

- **Family Office**
  - An investment and administrative center that is organized and overseen by the family council.
Family governance can be organized in different ways according to the needs, size, and level of harmony of the family.

<table>
<thead>
<tr>
<th>Stage</th>
<th>Status</th>
<th>Members</th>
<th>Size</th>
<th>No. of meetings</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family meeting</td>
<td>1G</td>
<td>INFORMAL</td>
<td>ALL FAMILY</td>
<td>6-12</td>
<td>EVEN WEEKLY</td>
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<td>Communication</td>
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<td>Discussion</td>
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<td></td>
<td></td>
<td>Preparing</td>
</tr>
<tr>
<td>Family assembly</td>
<td>2G/3G</td>
<td>FORMAL</td>
<td>ALL FAMILY</td>
<td>IT DEPENDS</td>
<td>1 OR 2 A YEAR</td>
</tr>
<tr>
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<td></td>
<td></td>
<td></td>
<td>Discussion</td>
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<td></td>
<td></td>
<td>Approval</td>
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<td></td>
<td></td>
<td></td>
<td>Education</td>
</tr>
<tr>
<td>Family council</td>
<td>2G/3G</td>
<td>FORMAL</td>
<td>REPS</td>
<td>5-9</td>
<td>2 TO 6 A YEAR</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Conflict resolution</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>Policy development</td>
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<td></td>
<td>Planning</td>
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<td></td>
<td></td>
<td></td>
<td>Education</td>
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<td></td>
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<td></td>
<td></td>
<td>Coordination w/board</td>
</tr>
</tbody>
</table>

Source: Abouzaid, 2011

WHAT WORKS FOR ONE GENERATION USUALLY DOESN’T WORK WELL FOR OTHERS
Family Governance Mechanisms

Family Governance Possible Actions

**FAMILY GOVERNANCE**

- Understand the strengths and weaknesses of a family business
- Formalize governance structure with proper board of directors
- Proper institutions (e.g., family council, assembly, advisory board) and a family constitution are in place, as suitable, to help address family governance matters.
- Key family governance policies have been developed (e.g., family employment, family directorship, family shareholding, capital allocation, dispute resolution, and transfer of shares).
- Mechanisms have been created as appropriate to help with the personal and professional development of family members, such as for education and training.
# Family Governance Mechanisms

## Family First vs. Business First

<table>
<thead>
<tr>
<th>Sample Issues</th>
<th>Family First Cos.</th>
<th>Business First Cos.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family Employment</td>
<td>Open-Door Policy for all family members, regardless of qualifications</td>
<td>Qualification-Based Employment, as for any other new hire</td>
</tr>
<tr>
<td>Compensation</td>
<td>Equal pay for all, regardless of their experience or performance</td>
<td>Merit-Based pay, based on experience, performance</td>
</tr>
<tr>
<td>Leadership</td>
<td>Leadership based on Seniority in Family, regardless of merit or qualifications</td>
<td>Leadership granted to the right person (family or non-family), based on merit and qualifications</td>
</tr>
<tr>
<td>Resource Allocation</td>
<td>Business Resources used for personal needs (e.g., loans, grants)</td>
<td>Business resources only used for business purposes – separate family reserve fund utilized for family needs.</td>
</tr>
<tr>
<td>Decision-Making</td>
<td>Unilateral &amp; Concentrated with Senior Family Member (e.g., Chairman/CEO)</td>
<td>Mulit-lateral, based on Defined Governance Structure (e.g., Executive Committee)</td>
</tr>
</tbody>
</table>

*Source: IFC Family Governance Handbook*
THANK YOU

Visit us
ifc.org/CorporateGovernance

Email us
yelhusseiny@ifc.org
CASE STUDY: FAMILY BOARD TRANSFORMATION
Family Governance Case Study

CONTEXT - Company X Overview & Current Ownership Structure

- **Sector:** Grain trading & supply, stevedoring, & marine services in MENA
- **# of Employees:** >500
- **Reason for Change:**
  - Expecting sustained growth, including continued expansion in country & outside markets
  - This will likely include the development of new subsidiaries & a group holding company
  - Planning to go public w/in next 12 months
Family Governance Case Study

CHALLENGES - Current Issues with Company X

- Currently, there are **no formal committees**.
- Board **meets once or at the most twice a year**, primarily focusing on the financials of company.
- **Attendance at meetings is poor** whereby some members have not attended for past several meetings.
- Furthermore, some members representing key investors have **rotated frequently** in past several years, compromising group continuity.
- Based on feedback, most **decisions are made mainly by Chairman and CEO** with minimal in-depth consideration by other Board Members.
- Some members mentioned there was **lack of clarity as to full range of roles & responsibilities** that Board should be undertaking. As a result, some areas of responsibility have not been given due attention (or missed altogether).
- Currently, **delineation between Board & Mgt is blurred** on some topics (given strong role of Chairman & CEO in management); while in many other areas, Board Members feel completely out of touch from management.
- Current **terms of members varies** & does not appear to be based on particular policy. Some members have been part of Board for extended periods (over six years), while others seem to turnover on an ad-hoc basis.
## Family Governance Case Study

### CHALLENGES - Current Company X Board Membership

<table>
<thead>
<tr>
<th>Name</th>
<th>Executive / Non-Executive</th>
<th>Representing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chairman</td>
<td>Executive</td>
<td>Family</td>
</tr>
<tr>
<td>CEO</td>
<td>Executive</td>
<td>Family</td>
</tr>
<tr>
<td>Vice-Chairman</td>
<td>Non-Executive</td>
<td>Family</td>
</tr>
<tr>
<td>Wife Chairman</td>
<td>Non-Executive</td>
<td>Family</td>
</tr>
<tr>
<td>Wife Vice-Chairman</td>
<td>Non-Executive</td>
<td>Family</td>
</tr>
<tr>
<td>Investor A Appointee</td>
<td>Non-Executive</td>
<td>Investor A</td>
</tr>
<tr>
<td>Investor A Appointee</td>
<td>Non-Executive</td>
<td>Investor A</td>
</tr>
<tr>
<td>Investor B Appointee</td>
<td>Non-Executive</td>
<td>National Bank</td>
</tr>
<tr>
<td>Investor B Appointee</td>
<td>Non-Executive</td>
<td>National Bank</td>
</tr>
</tbody>
</table>
Family Governance Case Study

RECOMMENDED CHANGES - Board Composition

<table>
<thead>
<tr>
<th>TOTAL SIZE</th>
<th>FAMILY</th>
<th>NON-FAMILY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FAMILY</td>
<td>INVESTOR 1</td>
</tr>
<tr>
<td>Current</td>
<td>9 members</td>
<td>5 family</td>
</tr>
<tr>
<td>Recommended</td>
<td>7 members</td>
<td>3 family</td>
</tr>
</tbody>
</table>

- Downsize Board to seven members & redesign its composition.; Goal is to create a leaner, more efficient Board w/ highly committed, engaged individuals that can offer value-added input to direction & control of company

- Number of appointments by Family & by two major investors based principle of one seat per 20% ownership; Two additional independents would complement those core appointments for a total Board of seven members

- Having two independent Directors is a key threshold to help ensure that Committees consist of a majority of independent Directors (i.e., two of three should be independent)

- Plus, if/when company goes public, this will help ensure board is not totally comprised of individuals from only three investor groups
FAMILY INSTITUTIONS
Family Institutions

Family Assembly - Definition

- A formal forum for discussion for all family members about business and family issues.
- During the founder(s) stage of the business, the family assembly is replaced by a more frequent and informal “Family Meeting”.
- These informal meetings allow the founder(s) to communicate family values, generate new business ideas, and prepare the next generation of the family business’ leaders.
- As the family and the business get more complex (sibling and cousin stages), it becomes crucial to establish a formal family assembly.
Family Institutions

Family Assembly - Purpose

- Family assembly brings family members together so as to reflect on areas of common interest (family and family business issues).

- The family assembly allows all family members to stay informed on business issues and gives them the opportunity to voice their opinions on business development and other family issues.

- These assemblies help avoid potential conflicts that might arise among family members because of an unequal access to information and other resources.
Family Institutions

Family Assembly - Scope

Some of the issues handled during family assemblies include:

- Approval of any change in the family values and vision
- Education of family members about their rights and responsibilities
- Approval of family employment and compensation policies
- Election of family council members (if the council exists)
- Election of other family committees’ members
- Other important family matters
Family Institutions

Family Council - Definition

- The family council is a working governing body that is elected by the Family Assembly among its members to deliberate on family business issues.

- The council is usually established once the family reaches a critical size, i.e. more than 30 members. In this situation, it becomes very difficult for the family assembly to have meaningful discussions and make prompt and qualified decisions.

- The family council is established at this point as a representative governance body for the family assembly in coordinating the interests of the family members in their business.
Family Institutions

Family Council - Duties

The composition, structure and functioning of family councils differ from one family business to another. However, the duties of a typical family council would include:

- Being the primary link between the family, the board, and senior management
- Suggesting and discussing names of candidates for board membership
- Drafting and revising family position papers on its vision, mission, and values
- Drafting and revising family policies such as family employment, compensation, and family shareholding policies
- Dealing with other important matters to the family
Family Institutions

Family Office - Definition & Purpose

- The family office is an investment and administrative center that is organized and overseen by the family council.

- Family offices are usually very common within large and wealthy families in business, whose members express a need for getting personal financial, banking, accounting, and other advice.

- A family office provides advice on personal investment planning, taxes, insurance coverage, estate planning, career counseling and other topics of interest to individual family members.
Family Businesses & IPOs
Family Businesses & IPOs

Going Public

- Many family businesses take the decision of going public at some stage to be able to secure financial resources for the business expansion or to give its shareholders a way of selling their shares in case they prefer to cash them in.

- Going public is a complex process that requires careful consideration of the alternatives, plenty of preparation from the board and the management, and extensive outside specialists’ advice.

- Going public is also a decision that presents many advantages and disadvantages to the family business.
## Family Businesses & IPOs

### Going Public - Advantages & Disadvantages

<table>
<thead>
<tr>
<th><strong>ADVANTAGES</strong></th>
<th><strong>DISADVANTAGES</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved marketability of Shares</td>
<td>Loss of privacy</td>
</tr>
<tr>
<td>Improvement of the Company’s financial position</td>
<td>Loss of autonomy</td>
</tr>
<tr>
<td>Potential increase in the value of shares</td>
<td>Increased liability</td>
</tr>
<tr>
<td>Greater visibility</td>
<td>Possibility of a takeover</td>
</tr>
<tr>
<td></td>
<td>Additional costs</td>
</tr>
</tbody>
</table>
Family Businesses & IPOs
Going Public - Tips

- Going public is a long and complicated process that does not take place overnight.
- Family businesses that are planning to go public have to get professional advice and help in many legal, technical, financial, and marketing areas.
- Nowadays, many investors are requiring the companies that are going public to show a long-term track-record of good corporate governance practices before the actual IPO.
- In particular, investors and the market highly value the company’s practices in the areas of the board of directors, shareholder rights, and transparency and disclosure.
END ANNEXES