Understanding the Complexities of a Family Business

Family businesses are a cornerstone of Malta's economy, driving growth, creating jobs, and fostering long-term stability, contributing over 70% of Small and Medium-Sized Entities (SMEs).

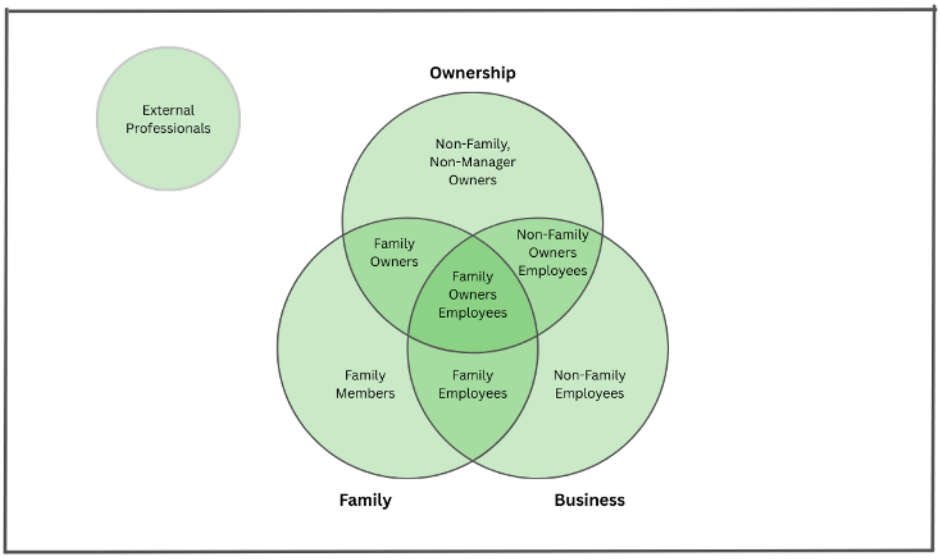
What is a Family Business?

A family business typically involves **family members** working together, often across generations. These businesses can range from **small enterprises**, like a self-employed individual working with a relative, to **larger operations** employing dozens. In all cases, emotional ties and familial relationships shape how the business is run.

How is a Family Business Shaped?

Understanding the **roles** within these businesses is essential to identifying how responsibilities are distributed, decisions are made, and conflicts are managed.

Even in the smallest setups, key roles naturally emerge, some focused on daily operations, others more strategic or ownership related. The following diagram illustrates how these roles typically overlap and interact.



- **<u>Family Members</u>** – These are relatives who may not be directly involved in the business but may still have a vested interest. In some cases, they influence decisions informally, especially in closely held businesses.
  Example: A sibling not involved in the company who nonetheless voices opinions during family discussions about the business.

- **<u>Family Owners</u>** – These are family members who own part of the business but are not involved in its daily management. They may still participate in important decisions or attend strategic meetings.
  Example: A parent who has retired from the business but still owns shares and joins key planning sessions.

- **<u>Family Employees</u>** – Family members who work in the business but do not hold any ownership stake. They may still hold senior positions and contribute significantly to operations.
  Example: A cousin who works as a head of sales in the business but doesn't own any shares.

- **<u>Family Owners Employees</u>** – These are family members who both own part of the business and work in it actively. They are typically involved in decision-making and daily operations.
  Example: A sibling who co-owns a family company, manages daily operations, and helps shape its future direction.

- **Non-Family Employees** – Employees who work in the business but have no family ties or ownership. They are typically focused on fulfilling operational roles.
  Example: A shop assistant or technician hired from outside the family who supports daily business functions.

- **Non-Family Owners Employees** – These individuals are not part of the family but have become owners, perhaps through investment or long-term involvement, and also work in the business.
  Example: A trusted manager who has worked in the business for years, earned shares, and now helps lead operations.

- **Non-Family, Non-Manager Owners** – These are external individuals who have invested in the business but do not work there or participate in day-to-day management. They may still offer input or attend important discussions.
  Example: A family friend who invested in the business and occasionally gives advice but isn't involved in its regular activities.

- **External Professionals –** These are independent experts, such as lawyers, accountants, or consultants, who are brought in to give professional advice and help guide strategic decisions. They provide an outside perspective.
  Example: An accountant who regularly attends planning meetings to advise on financial strategy and help assess risk.

Problems Arising in a Family Business

The structure of a family business, with their deeply personal nature and close-knit management structure present unique **challenges**, one of which relates to corporate governance.

Corporate Governance relates to the system by which companies are directed and controlled, with the responsibility ultimately resting within the company's directors. In the context of family businesses in Malta, governance challenges are common, not only in larger family-run companies but also in smaller setups, such as family businesses between two members of a family or even self-employed individuals involving a relative.

It has been revealed that many family businesses lack a functioning **board of directors**, or where a board exists, it is often composed solely of family members. This is highlighted as an issue as there is a positive correlation between the Board's Independence and financial performance. While smaller businesses may not only have little need for a formal board, they often also lack the numbers to form one, such as in cases where the business consists of just two family members. Finding governance solutions that are practical and proportionate to the size and nature of the family business is key to long-term success.

In many cases, corporate governance challenges occur due to **concentration of power** issues as well. Family members tend to take multiple, overlapping roles in a business with different interests; from family welfare, return on investment, to day-to-day running of the business. Thus, this may lead to conflict of interest when family members pursue family interest rather than business interest, reducing accountability and transparency.

While family businesses offer unique strengths, their structure can also introduce complexities that, if left unaddressed, may hinder long-term success. Recognising the potential risks is a vital first step.

This is addressed in future articles, where we will explore practical solutions, showing how even the smallest family-run enterprises can adopt effective practices to support stability, fairness, and future growth.

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