

# 8<sup>th</sup> International OFEL Conference



## Corporate Governance Guideline Relevance to Maltese Family Public Interest Companies *A Small State Viewpoint*

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**OFEL**  
INTERNATIONAL CONFERENCE

17<sup>th</sup> - 18<sup>th</sup> April 2020  
Dubrovnik, Croatia

# CG Guideline Relevance to Maltese Family Public Interest Companies

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- The Cadbury Committee (1992) defined CG as the “*the system by which companies are directed and controlled*” (Para. 2.5).
- According to Muscat (2007) and Farrugia (2010), this definition was later adopted by the Maltese Working Group on CG which was set up by the Malta Stock Exchange (MSE) in 2001.
- In the same year, the Malta Financial Services Authority (MFSA) issued The Code of Principles of Good CG for Listed Entities (“the Code”).

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## The Corporate Governance Framework in Malta

Corporate  
Governance Manual  
for Directors of  
Investment  
Companies and  
Collective Investment  
Schemes

Corporate  
Governance  
Guidelines for  
Public Interest  
Companies

Code of Principles of  
Good Corporate  
Governance for Listed  
Entities

Company Law

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## The Family Company

Three elements that constitute the making of a family business

- *ownership representation* which refers to the percentage of ownership held by one family;
- *management representation* which refers to the degree to which family members occupy senior management positions; and
- *board representation* which refers to the degree to which family members occupy the Board.

(Hnilica and Maecek, 2015)

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## The Distinctive Attributes of Family Companies

- Concentration of power
- Emotional ties
- Covert communication lines
- Illiquidity of shares
- Propensity to distribute profits

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## Weaknesses

- Suppressed growth
- Principal-principal agency problem
- Disparity among family and non-family members
- Disputes and family conflict

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## Important Aspects of Governance in Family Companies

- Composition of the board
- Chief Executive Officer
- Family Constitution
- Family-constituted bodies
  - Family assembly
  - Family council
  - Family office

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## The Family Governance Plan

- Documenting the family's principles, vision, and mission in a formal and transparent manner.
- Experts and Company Secretaries ("Cosecs") agreed that formally documenting the family's vision and mission with respect to the business would enhance CG.
- CG guidelines should require a '*continuity plan*', or a '*governance plan*' in terms of where the family wishes to position itself in the medium to long-term.
- The document needs to be formulated at the time when the family and the company are most stable



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## The Family Fora

- Important to establish a *forum* where family members can meet to provide and receive information in relation to the business.
- Both Experts and Cosecs agreed that establishing a governance body specifically for family members to meet and discuss would contribute to good CG.

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## The Chief Executive Officer

- The question on whether the role of CEO should be occupied by a family member remains a contentious one.
- One cannot preclude a family member from occupying this position simply because of an affiliation with the family.
- The Board should ensure that its assessment of the CEO is not influenced by the affiliation with the family.
- Family CEO should be counterbalanced by an independent, non-family chairperson leading the Board

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## The Composition of the Board

- The Boards of family PICs should not be composed of a majority of family members.
- The departure of dominant, founding family members causes disruption
- Independent, non-family directors become extremely important when *“the second or third generations take over from the first generation”*.
- Appointing an independent, non-family chairperson may re-instil order and authority

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## Tenure of Family Appointments

- Research participants generally agreed with prescribing the retirement age of family directors to enhance CG in family PICs.
- Having top positions occupied indefinitely might lead to a culture that resists innovation.
- A system that inhibits long tenures and that is equally applicable to family and non-family members should be consistently applied across the board.

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## Family Competencies (1)

- Composition of the board
- Chief Executive Officer
- Family Constitution
- Family-constituted bodies
  - Family assembly
  - Family council
  - Family office

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## Family Competencies (2)

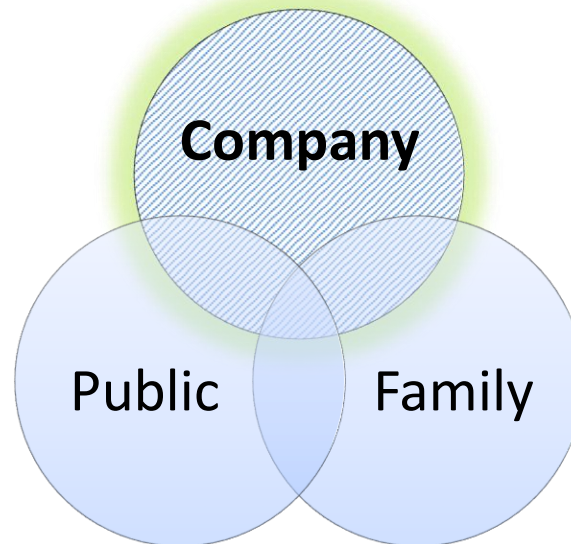
- Prescribing a minimum level of competencies required from directors is beneficial to CG.
- Training programmes are likely to be effective from an early stage before directors are appointed to the Board.
- Family-constituted bodies such as a family council provide an ideal place to mandate a training programme for potential board members as noted by Weiste (2013).

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## The Family Public Interest Company (1)

In the context of the peculiarities displayed by family companies, the going concern with a public interest dimension is to have its foremost place in CG guideline formulation.



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## **The Family Public Interest Company (2)**

- The company's interests in terms of its business continuity is therefore clearly to be given more weight in view of the family and public interest dynamics.
- Guiding principles need to spell out the importance of other stakeholders' interests, especially in the case of companies dominated by families.
- Recognising this concept would protect the interests of family shareholders because they stand to gain most from business continuity. It would also protect the public interest from short-termism, bad management, and conflicts of interest



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## The Family Public Interest Company (3)

- In the context of a dominant group of family shareholders, the public dimension of a family company may render the distinction between the interests of a company and its shareholders more apparent.
- The distinctive attributes of a family public interest company thus renders it a more fragile creature compared to its non-family peers.

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## Other Considerations

- Instilling a culture that requires some form of continuous professional education for family directors is seen as a favourable measure contributing towards better CG.
- The validation of remuneration levels in line with market benchmarks by external consultants would contribute to more transparency and better CG of family PICs that are not expected to have a remuneration committee
- Performance reviews should extend equally to all board directors irrespective of their affiliation with the family.

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## Conclusion/1

- Guidelines for PICs adopt a one-size-fits-all approach which in most cases is not relevant to the needs of family PICs in Malta.
- Clearer guidance should be provided on the process of appointing independent directors and engaging senior managers in the context of dominant family interests.

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## Conclusion/2

- The Board should endeavour to appoint an independent, non-family chairperson when the power is distributed amongst multiple families.
- The continued existence of a family company is more important in the context of family public interest companies.

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THANK YOU