KPMG

المركز الوطني للمنشآت العائلية
National Center
For Family Businesses

Conflict resolution

Managing conflicts and preventing disputes in family businesses

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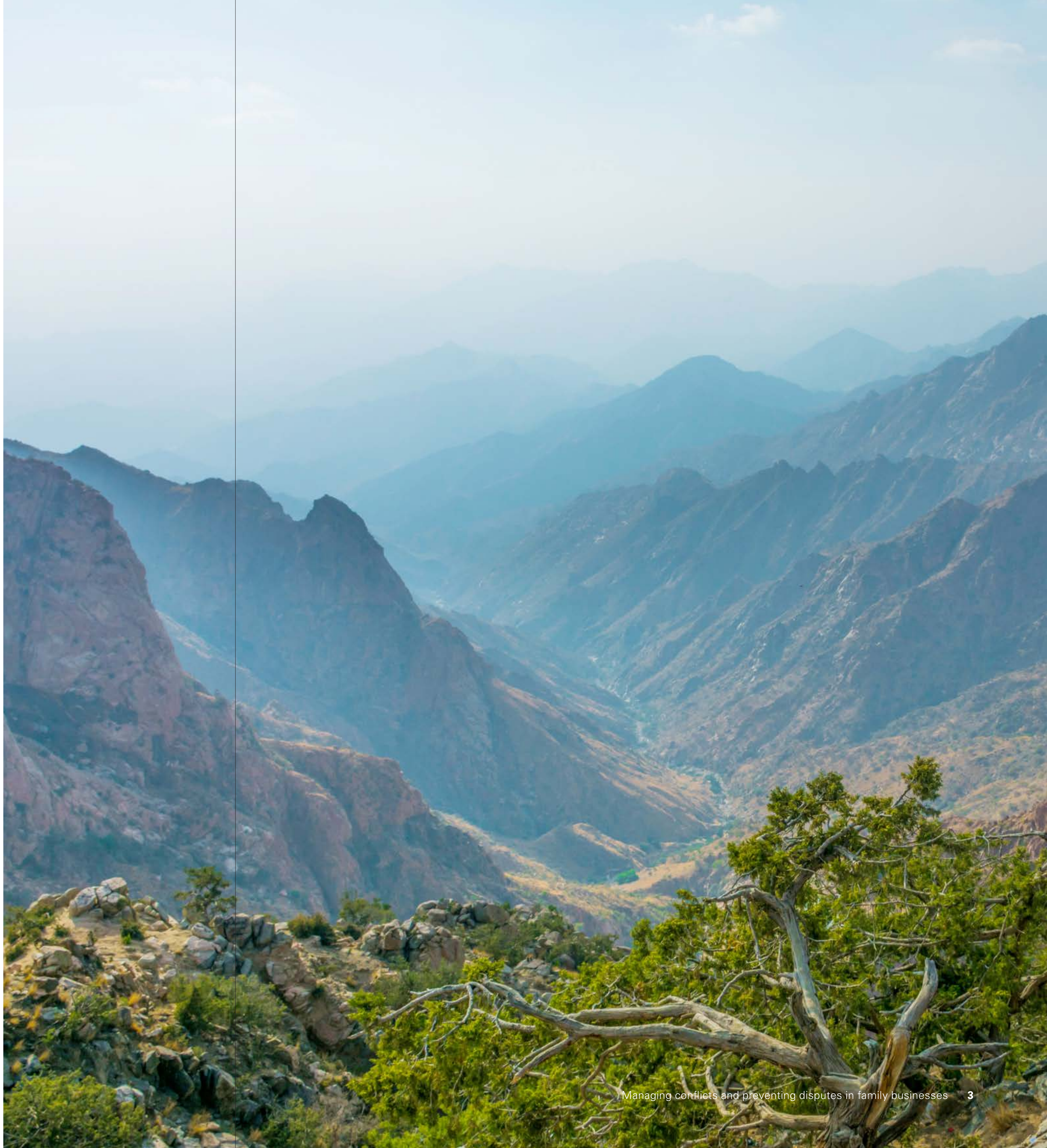
KPMG Professional Services

Content



Foreword

Since the announcement of Vision 2030, Saudi Arabia has been witnessing unprecedented transformation in various domains. As one of the Vision's main objectives is to achieve a long-term economic diversification, a significant role is placed on the private sector. When we talk about the private sector in Saudi Arabia, we inevitably have to consider family businesses as they make up 63% of the sector and make significant economic contributions to the economy – whether GDP or employment. For those familiar with research on family businesses, it is known that the rate of survival of family businesses drops significantly as the business transitions from one generation to another. What makes family businesses unique in the Kingdom compared to other countries outside the region, is that majority are fairly young – established during the 1960s – and have either gone through one succession or none yet.

As we do believe in the significance of family businesses for this country's economy, the National Center of Family Business (NCFB) and KPMG continue to be committed to supporting the family business ecosystem so that family businesses can contribute significantly to the economy and to job creation. For these reasons, NCFB and KPMG embarked on this research project, led by two distinguished Saudi researchers and practitioners in the family business field namely Dr. Hanoof Abokhodair and Dr. Dalal Alrubaishi. We hope that family businesses within the Kingdom and beyond do find it useful.

We would like to extend our gratitude and appreciation to all the prominent Saudi Arabian business families who gave us some of their precious time to be part of this publication. Without their contribution, this could not have been possible.

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Introduction

Family businesses differ from non-family businesses due to the presence of the family as major owners in the family enterprise, and their specific style of involvement in managing the business. With family ownership comes the family's desire to sustain the business for generations. At the same time, however, the family includes many family members who might not have shared values that unify them under one mission. Family owners who might have different views about the decisions they need to make as an owner group, and family manager in the business who might not be aligned with other non-active owners. In many cases, clear family protocols to guide family members around the areas in which they hold different views are missing. On top of that, the deep-rooted family ties involve a lot of emotions around the family and the business which could further complicate disagreements. Thus, the presence of an ungoverned family in the business creates an inherent risk of family conflicts and feuds, which is the main challenge to achieve the sustainability objective of family enterprises.

Many of us have heard stories of business empires that collapsed due to family feuds over the business. This makes conflict one of the greatest concerns that business families have. Conflict is indeed one of the most critical challenges to understand; in order for business families to protect against its destructive effects.

While it is a critical topic, there has not been enough available and applicable content, especially in the Middle East and North African (MENA) region, to help business families detect conflict at a deeper level and find ways to prevent and manage it. Much of what we observe about family business conflicts is that conflicts are inevitable, especially as family enterprises transition to the third generation. Conflict is often described as risky and destructive. One of the most effective approaches to manage conflict in business families is through agreeing on governance protocols for the family and the business. Indeed, many of these ideas hold true to a great extent. However, the topic of conflict is wider and deeper.

Conflicts are indeed inevitable in business families, they come in a variety of forms and at any point of time during the life cycle of the family business whether during the founders' stage or in subsequent generations. While conflicts might be under the surface during the founder's presence due to respect and other cultural considerations, they always emerge after the founders or after the elder generation are no longer there. When these conflicts are not addressed or properly managed before they arise, they linger and accumulate resulting in more sever and complex conditions, making it difficult to trace its root cause and harder to solve. Therefore, it is essential to identify the sources of conflicts in family businesses and understand their different types as well as approaches to deal with them when they arise. Strategies also help to prevent potential conflicts from developing in the future.

We hope that by exploring business family conflict in greater depth, we will help business families change how they think about conflict and find ways to prevent and manage it. To this end, we have embarked on a research project about family business conflict in Saudi Arabia to build greater understanding of the topic with the objective of providing deeper insights that could contribute to the understanding and management of conflict in business families in our region.

Methodology, demographics and definitions

We conducted nineteen in-depth interviews with family business leaders, experts specialized in family business matters, and lawyers.

Of the nineteen interviews, thirteen interviews were conducted with family business leaders from across the country where 46 percent of those family businesses are from Riyadh region, 31 percent from the Eastern Province, and 23 percent from Jeddah. They operate in various industries including consumer goods, contracting, automotive, energy, IT services, engineering, and investment. Their businesses' age range between 44 to 130 years old with an average of 74 years old, and their size range between 50 to 10,000 employees with an average of approximately 3,400 employees. The majority (77 percent) of the family businesses we interviewed have a legal structure of closed joint stock, and the remaining 23 percent are limited liability companies (LLCs).

Age of firm

Between **44-130** years

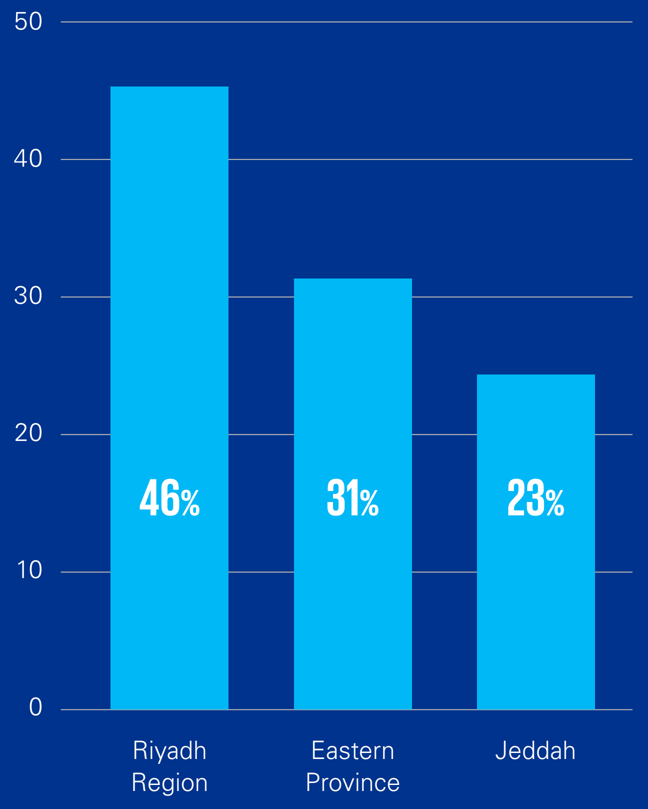
Average **74** years

Number of employees

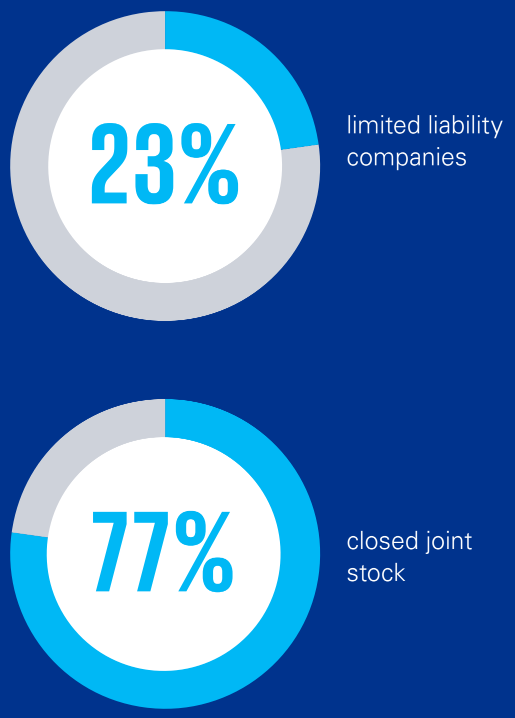
Between **50-10,000** employees

Average **3,400** employees

All family members board

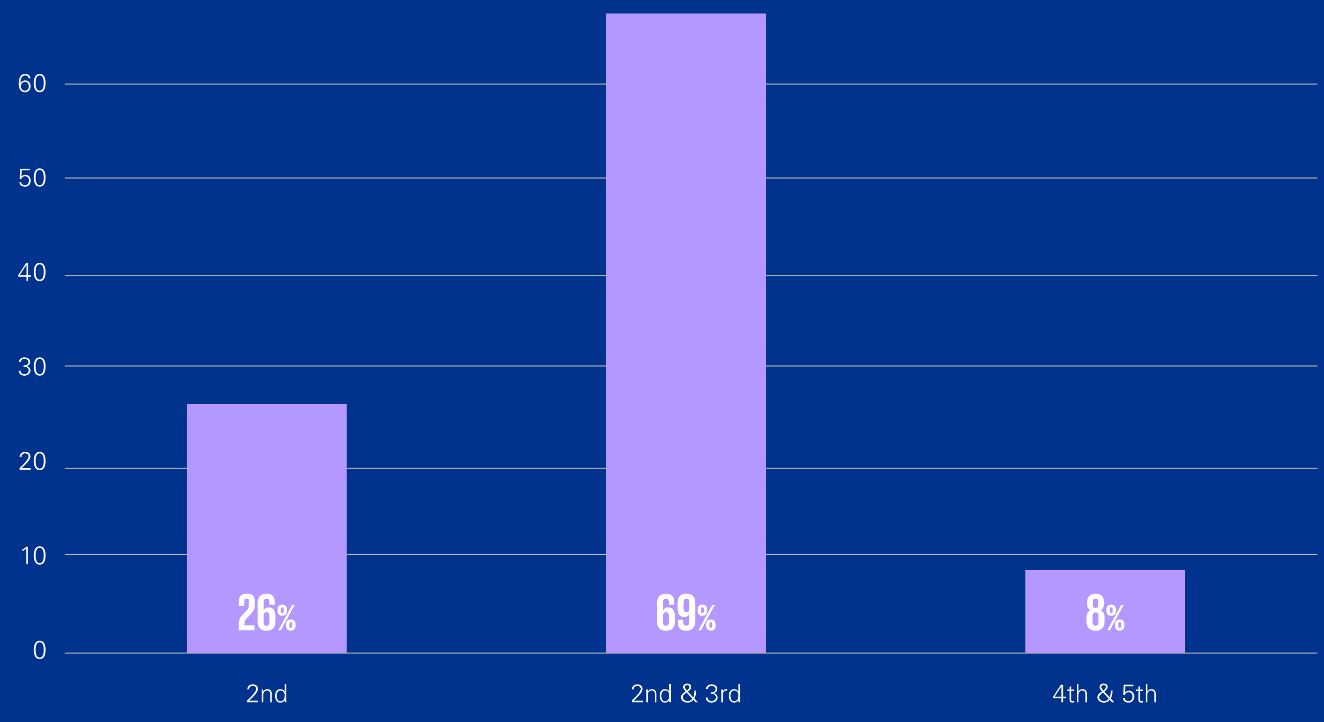


Legal structure



Of those interviewed, 26 percent of their family businesses are run by the second generation, 69 percent are run by the second and third generation, and 8 percent are run by the fourth and fifth generations. All the family businesses are managed by a non-family CEO except for one. Half of them have an all-family board of directors and the other half have a mixed board comprising family and non-family members.

Generation managing the business



What is conflict?

We often use the word conflict to describe situations where disagreements among members in business families have escalated and became more intense. Scholars define conflict as ***"perceived incompatibility, or perceptions by the parties involved that they hold discrepant views, or have incompatible wishes and desires." (Jehn, 1995, p.257)***

There are indeed different intensities to conflicts. Incompatible perspectives could result in mere "disagreements" over certain topics that the family could overcome smoothly, "disputes" which are more intense where family members' positions harden, or "family wars" where each of the conflicting parties forms allies, hire a lawyer, and file court cases.

There are different types of conflicts in business families that are triggered by different reasons. For the purpose of preventing and managing conflict, it is important for business families to understand what type of conflict they are likely to face or will experience at a given time and situation. It is also useful to understand where the different types of conflict occur. This is because each conflict type requires a specific strategy. Also, it is important to not only deal with the manifestations of conflict but with the drivers behind them.

In the following sections, we will first explain the five general types of conflicts in family enterprises to help business families understand the nature of the conflicts they face. Then based on our interviews with family business leaders, we will illustrate the main areas where the different types of conflicts arise in Saudi family businesses and how family members react to these conflicts, followed by some advice on ways to minimize potential conflicts from arising and explore some ways to manage existing conflicts before they escalate to become disputes. Finally, based on our findings from interviewing legal experts in the family business field, we will discuss some common mistakes that often lead to unforeseen conflicts.

What types of conflict are there?

Family business research identified five broad types of conflicts:

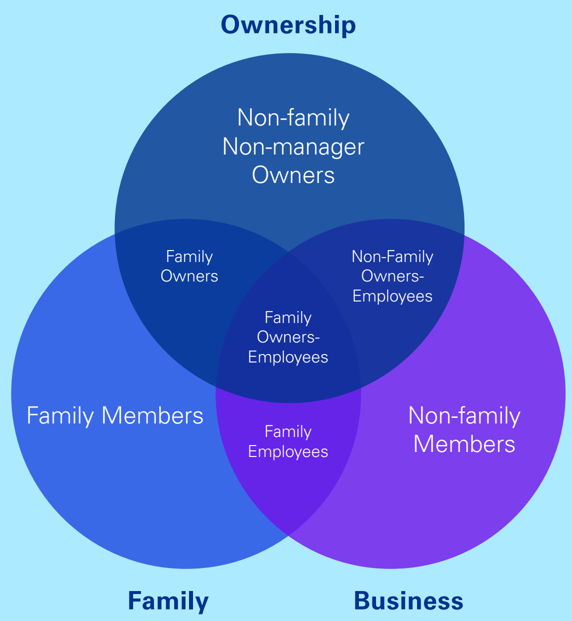
1. Conflict of interest
2. Conflict of roles
3. Conflict of goals
4. Conflict over processes
5. Conflict in relationships

In the following section, we will illustrate each type with examples from our interviews to clarify why and how each type of conflict occurs in family businesses.

1 Conflict of interest

Conflict of interest is the most common type of conflict that families in business face. This type of conflict is naturally embedded in business families since family members normally have different interests and priorities in the business. Conflict of interest is best explained through the below Three-Circle Model.

Three-Circle Model of the Family Business System (Tagiuri and Davis, 1982)[1]



Family members often fall under any of the seven areas in the family business system. For example, there are family members who own shares but are not active in the business, and there are family members who do not own shares but are active in the business. Family owners who do not work in the business are naturally interested in dividends and would prioritize dividends distribution. On the other hand, a family manager would likely prioritize retained earnings over distribution because his career is dependent on the success of the business. Similarly, family members who are not owners or managers might be interested in employment in the business regardless of their fit with business needs, which again conflicts with the interest of owners and/or managers. Clearly. The above-mentioned family members have different priorities in the family enterprise, thus their interests naturally conflict.

Some of the family business leader we interviewed described conflict of interest as follows:

> **"Owners have different objectives. However, they don't share their objectives when the founders are still in charge. As soon as the founder passes away, conflicts arise between owners because they start sharing their different objectives, which leads to conflicts.**

> **"There will always be people who would never agree on holding a leadership position, but will criticize the ones who do.**

Conflict of interest could also arise among the group within each of the seven areas in the Three-Circles Model because they would be competing on the resources they receive as owners, managers, or employees. It is human nature that people feel they deserve to have more, thus, a family owner might want to own larger shares than others. Family managers might compete over leadership positions in the business, and family members could feel entitled to employment in the business on the expense of other members. Hence, conflict of interest is an expected and common situation in business families. It is a reality that has to be well managed through proper communication and governance to achieve sustainability.

[1] The Three-Circle Model of the Family Business System was developed by Renato Tagiuri and John Davis at Harvard Business School, and was circulated in working papers starting in 1978. It was first published in Davis' doctoral dissertation, The influence of life stages on father-son work relations in family companies (1982). In 1996, the Family Business Review published it in Tagiuri and Davis' classic article, Bivalent Attributes of the Family Firm.

2 Conflict of roles

Role conflict is another type of conflict in business families. It is caused by the overlapping roles of two domains, the family and the business. It often arises between those who wear more than one hat, like cousins, siblings, or sons and parents who work together in the business. On the one hand, they are family relatives, and on the other, colleagues, managers, or subordinates to one another. We cite a phrase we heard in one of our interviews to illustrate role conflict through an example.

> **I used to be my cousin's manager, and he wasn't good at his job. Because of that, we had an argument once and I reported it to my uncle. The next day, I sent my cousin a message apologizing because I wasn't feeling right about it, to which he responded by questioning my qualifications. My uncle then intervened by telling my cousin that I am his boss and if he can't accept it, he should resign.**

Role conflict is an issue because family members often confuse which roles they play in which situations, and most of the time, they mix their family and business roles. As explained by the family member we interviewed, his cousin was experiencing role conflict because he responded to the cousin not to his manager while having a business discussion. When family members have overlapping roles, each role entails different behaviours which can create identity issues and tensions if clear and identified boundaries between the two domains are not well maintained.

3 Conflict of goals

As indicated by the name, goal conflict arises when there are disagreements on the goals or objectives to pursue. Family members may hold various views of what goals are worthy of pursing and what direction should the company take, this mainly depends on the background, education, training and experience of those involved. We found examples of goal conflict in our interviews with family business leaders as described below.

> **It seems that the third generation is more oriented toward investment than on operations, but I am purely an operational guy. The family wants to remove all emotional attachment and explore ways to divest; they think that there is not enough of us to handle the operations. I however want to stay and help our business grow. They view responsibility as a headache, extra work, but I believe we are creating value in our community.**

In this case, family members held different views on what objectives they should pursue as a family-in-business, whether to continue being an operating family business or move away from operations to wealth management and become an investing family. In another family, the same goal conflict over an investment was escalated to a higher level of tension between family members as they did not deal with it in a constructive way.

> **We once had a meeting where one of my uncles suggested to invest in a big deal, but my eldest uncle refused. It was a tense meeting and my eldest uncle got really upset. It was our first big family problem. My other uncle then left the operations but remained a shareholder.**

4 Conflict over processes

Similar to goal conflict, process conflict arises when members hold different views about the process to be followed in order to achieve a task or a goal, such as responsibilities, resource allocation, financing, etc. The disagreements in process conflict revolve around how work should be done and how goals should be accomplished or organized. Process conflict is very common because there are numerous processes that families in business have to run.

> **I believe that I have a responsibility in front of Allah, my father, and the company employees. At times, some of our employees ask for loans. It is a challenge because my cousins get angry when I accept their requests for loans, then they start investigating how much I spend from the company.**

Family members in this case held different views about HR processes. And it seems they did not address their conflict constructively, rather, reactively by conducting investigations when loans are given to employees. It also illustrates that family members are not aligned when it comes to values as they hold conflicting views on how they need to treat their employees. Indeed, such reactionary responses to family member's conflict over the HR processes disrupts the business and employees in some ways and have negative implications.

5 Conflict in relationships

Relationship conflict is the most difficult since it intersects with all conflict types and is not based on rational matters, rather, on emotions which are very hard to elucidate and address. It arises when family members experience difficult emotional events that affect their relationships negatively.

The family is a complex social system where family members form emotionally intense relationships based on close interactions, long histories, and shared memories. Such emotional closeness can positively create great support (protectiveness, loyalty, and sacrifice) or negatively build tension (competition, expectations, false assumptions, status and power dispute). The events and accompanying emotions that form relationship conflict between family members are often in their past histories and interactions, mainly rooted in dynamics like their competition for parents' attention and approval, perception of unfair treatment they had received as family members in the family or in the business, or deeper emotional wounds they have unconsciously experienced which leave them with emotions of anger, envy, jealousy.

We found numerous examples of relationship conflict during our conversations with family business leaders. We list some of the comments below to illustrate.

> **Differences in personalties can present a big challenge, many conflicts are based on ego and personal revenge.**

> **In most cases, conflicts in family businesses are personal. Sometimes you'll even find family members looking for each other's mistakes to find a case to take to court.**

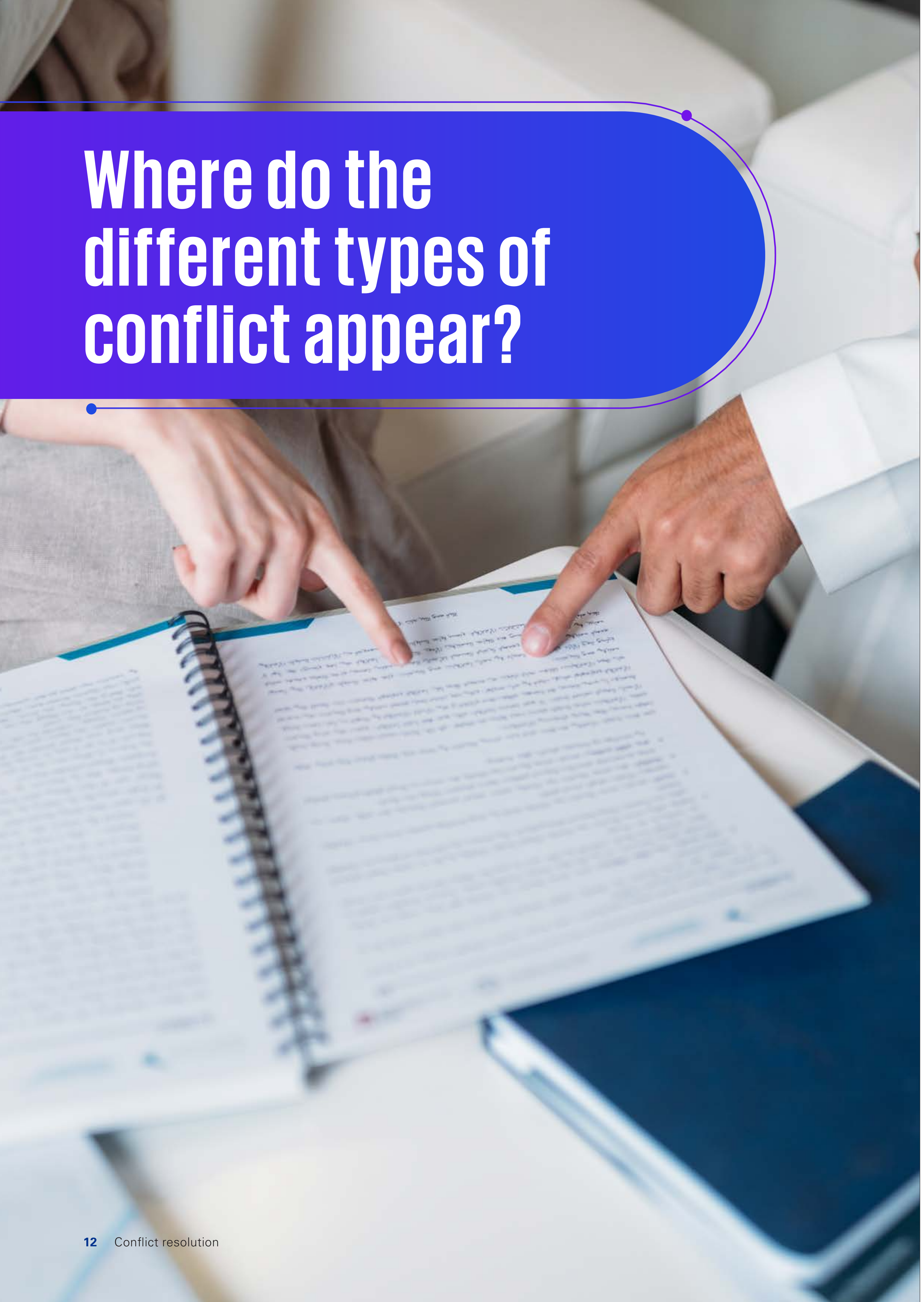
> **My brothers are not talking to each other, and I have to deal with their conflict. Their conflict is not over business, it is family-related.**

The challenge with relationship conflict is that it underlies and sparks other four types of conflicts, charge them with negative emotions that block possibilities to resolve them in a constructive way. That's why when conflicts arise in family businesses, the "business" is often not the root cause of conflicts but rather is a battlefield in which family members resolve their relationship/emotional conflicts that originated from the family system. As expressed by scholars, "family members rarely fight about what they say they are fighting about." (Pieper, Astrachan, & Manners, 2013, p.492)

> **Some of our family members were jealous of me. The reason is because they wanted to hold positions of management and I have the best reputation for those leading positions. For example, I used to be in charge of all branches, but one of my cousins said he wanted to take the management of the XYZ branch. They told him he had to report to me and he refused, which lead to the start of our conflict.**

For example, the family business leader in the quote above realizes that jealousy (resulting from relationship conflict) is fuelling conflict over the process of reporting in the business. Thus, the real conflict in this case was not a process conflict, rather, a relationship conflict in essence. Such relationship issues could be there since childhood resulting from faulty upbringing practices such as favouritism, or could develop during adulthood. For example, in-laws could sometime fuel relationship conflicts like wives comparing other family members' lifestyle to theirs.

Conflicts that are based on rational issues arise from misaligned views between family members and could be resolved by evaluating alternatives relationally using facts and data. However, when conflicts are based on negative emotions of injustice, inequality, envy, or jealousy, then the conflict is not about the goal, process, or role but rather about the need to release emotional tension. Such conflicts are complex since there is a root cause behind the disagreement, which needs to be resolved first. The complexity and hidden nature of relationship conflict and its transferability to other types of conflict is the main reason why relationship conflict is by far the most dangerous.



Where do the different types of conflict appear?

We often think of dividends, family employment, leadership roles, inheritance and so forth as sources of conflict in business families. However, those are just areas where the different types of conflicts explained above arise. Our research revealed numerous examples where the different types of conflicts have manifested around vision and objectives, and in the areas of inheritance, share transfer and exit, shared family assets, waqfs, control of the business, dividends distribution, business governance, and family members employment. Thus, we believe it is useful to illustrate examples and explain the types of conflict that occur in these areas based on our interviews with family business leaders. That said, this is not an exhaustive list of areas where conflict arises, there are indeed other areas of conflict that are not covered here. Although the list is not exhaustive, we believe that there are merits to sharing the process of analysing the different conflicts and areas. This should help business families follow the same process of analysis as they experience conflicts, hopefully to later find the best ways to address each type based on its nature, as we will explain in the coming sections.

Vision and objectives

It is very common that family members hold different views about who they are as a family-in-business and what are they envision to do. When these differences are not resolved, they generate goal conflict explained above. We found goal conflict occurring around these high-level questions in many cases during our interviews, whether the family is an investment or operational family, or whether they are traditional or professional family. Obviously, a lot of goal conflict arises between the current and next generations. It is common to see the older generation who are in power identifying themselves as a traditional operational family while the next generation often view the goal to become an investing professional family.

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The mentalities of family members differ. Some family members wished to follow in the footsteps of my father, who used to do a lot of work, and was very involved. In the past, this was manageable, but not anymore. His emotional attachment to investments that are not succeeding and to employees who are no longer capable is becoming frustrating.

Inheritance, share transfer and exit

Inheritance, share transfer and exits are other areas where a lot of conflict between family members occurs. Understandably, this is an area where individual interests between family owners collide, thus, it easily triggers process conflict on how inheritance, share transfer and exit should be arranged. We see many cases where family members disagree and conflict over what is a fair distribution of shares, especially as they are transferred to the next generation. Who should inherit what and in what proportion? Who should own and who should be restricted? Will women be allowed in ownership or bought out? In case of arranging share transfer during lifetime, will they own equally as men or according to Sharia laws? And what is a fair exit process? Since ownership brings financial resources to those owning, when inheritance and share transfer are not clearly managed during the owner’s life, it becomes one of the main areas where members in business families take the case to the courts.

“

It is very common to see court cases where heirs try to acquire more shares than others, especially in cases of divorced wives.

“

The family wants it to stay a family business, and it is not an easy exit. Some of the shareholders hinted that we are expropriating their inheritance.

“

When my brother wanted to exit, I took a personal loan to finance the deal sparing the siblings out of good faith. Immediately after the deal was closed, I announced it, but one of the family members said: “how can you buy behind our backs! Do not act as a guardian, the transaction is void, and we intend to negotiate.“

Business governance

Because the governance of the business allows family owners proximity to the business and also power over strategic decisions, it is also an area where much conflict occurs. As the case with shares, corporate governance is a fertile ground for conflict of interests that trigger process conflict on who should be allowed to become a board member, what criteria to adopt, what decisions should be with the board to make, how are board members nominated, elected, and terminated, and above all, how are board members compensated. Driven by their interests, either individual interests or concern for the wider family's interest, family members often conflict on how to design each of these processes. At times these conflicts are contained, and at others, they escalate to disputes.

When my father passed away, I developed the business and became the chairman, which some brothers complained about. They claimed it is dictatorship, saying: "You were handling the business during our father's time, and you want to have control now as well?"

Some of the board members are not qualified to have these roles, which is a big concern. I believe that in family businesses those who are not qualified should leave. Some brothers view being a part of the board as prestige. Board member qualification is an issue that most family businesses face.

Board members' compensations are often decided without clear criteria and hidden from the rest of the owners by those in the business. The reason for this is because when other owners find out, they react negatively.

Corporate governance is also an area where role conflict arises. We see many cases where family members are not able to see the differences between their roles as family owners and board members. Many confuse ownership with governance and think of board seats as positions to which they are entitled given their ownership of the business.

We are trying to have qualified family members in our boards and committees. The business is our priority and it is important to preserve it, and have a well-functioning board based on merits, like any other company. When our father passed away, some family members felt entitled to having a seat in our board. Many family members try to be in the board for emotional reasons, and if they are not accommodated, they behave like enemies.

Another common role conflict in corporate governance is that when family members mix their family role and board role such as the cases where family members act based on their family relationships and the expectations that come with these relationships, in the board room.

Business management

Management positions are like governance positions. They provide whose occupying them with benefits of control, status, prestige, and financial resources. Thus, management is another area where much conflict happens. Many families find themselves conflicting over processes of selecting leaders who should take over the business and succeed the older generation, the criteria of selection, competence, qualification, the process of developing the leaders, their compensation, and above all, how to terminate those who do not perform.

I am the only family member who actually worked in the company and that is why I'm part of the management. While some of the other family members wanted to come and take the management immediately without any qualifications. However, my father and uncle did not trust them with management and refused, which of course created a lot of conflict.

Out of jealousy, they always question why I am the leader. The answer to their question is tenure. I started in 2005, while they started in 2019.

Business management is also an area where role conflict often arises. As illustrated in the sections above, we see many cases where family members confuse their family and business roles in the business. We see scenarios where a cousin questions the authority of his manager/ cousin or a sibling refusing to report to his brother. We also see cases where a son or a nephew not able to openly communicate business views to his manager / father or uncle out of respect.

Dividends

As explained previously, dividends distribution is one major area where business families have conflict between those who are owners and those who work in the business. Again, conflict of interest triggers different views about all processes related to dividends such as ratio to distribute, frequency of distribution, whether to base distributions on business performance or have them fixed, etc. Neglecting the financial needs of family members who are not working in the business and depend on the returns that the business generates often is a source of dispute, as those involved in the business are often compensated for their roles and get benefits and they would like to reinvest in the company to continue the growth. However, those not involved would like to receive some income to justify continuing in the business.

When we started the business, we decided that we are not distributing dividends for ten years. There was consensus back then, but the family grew and has got many responsibilities and expenses now, so they are not accepting it anymore. This is like the 80/20 rule. Financial issues are usually the reason for most conflicts.

Family employment

Like everyone else, members of business families need to secure a source of income that enables them to maintain their lifestyles. With the family owning a business, jobs in the business become of interest to family members in many cases, and especially if there is no clear dividends policy. Some family members also develop interest to join the family business for emotional reasons such as family legacy, reputation, and identity. Whatever their reasons, their interests in job opportunities might collide, generating conflict of interest that also triggers process conflict. Who can join the family business? Should family members be treated as non-family employees or have differentiated career paths; how should they be compensated? And what can be done about those who are not performing? It is easy to terminate non-family members but with family members, family relationships might suffer.

After having successfully completed a career in Jeddah, I was not offered the position I wanted by my uncle when I came to Riyadh. "I want you to be a product manager," he said, which I perceived as an insult. My response and attitude astonished him.

A family member once told me: "My son doesn't have a job, why can't your company hire him?" His son is incompetent. Accordingly, I responded: "If you do not trust him with your wealth, how do you expect me to hire him?"

Relationship conflict and all conflict areas

Each of the areas where conflicts arise is prone to having relationship conflict hidden underneath the types of conflict explained. Negative emotions and wounded family relationships magnify and fuel those other conflicts, whether conflict of interests, role conflict, process or goal conflicts wherever they appear, be it over vision, business governance, management, dividends, or family employment. Thus, relationship conflict can be anywhere and everywhere. In fact, when there is relationship conflict underneath the surface, it is likely to appear in any of the conflict areas where the conflicting parties interact, whether in the family or the business.

These shareholders should not overwhelm the business with their family emotions and dreams.

When relationship conflict is present, the nature of conflict changes as it becomes emotional. With emotions come irrationality and conflicts, which then cannot be resolved through rational means and processes.

It is important for family businesses to differentiate between the actual type of conflict and the areas in which each type often manifests or takes form. Reflecting on these factors whenever family members are experiencing conflict will help them understand what is exactly going on and what are the best approaches to prevent conflicts and to deal with those that arise. When family members, for example, realize that the area in which most of their conflict arise are family employment or dividends and that they have process conflict most of the time, it becomes easier to consciously try to navigate the different solutions to that particular type and area. We will discuss possible solution in the following sections; however, we first wish to illustrate what we found families doing in response to the conflicts they are experiencing in our discussions with them.

How do family members react to the conflicts they experience?

This chapter shows some examples of the most common responses to conflicts which we found in our research. We observed many examples where family members reacted to conflict as they did not have a clear approach to minimize it before it arises and to manage it when it arises. We believe there are great learnings as we illustrate the reality on the ground before we explain what should be done as best practices to minimize and manage conflicts in business families.

1 Avoidance

"My brothers have the right to protect their wealth. One brother, however, abuses this right. He sometimes takes us to court over silly things such as dividend delays, even though he didn't send the required documents. Whenever we asked him for something he would say send me an email. He is clearly trying to obstruct, but when he asks for something, he demands our respect. What's surprising is that when we meet in person, he never talks about business.

"My half-sibling filed a case against my father. Now when we see each other we only talk about the weather and other things, but never about the case.

"If there is consensus, we always avoid conflict, stay in the status quo, no development. This is harmful in the long run since we are not pursuing advancing things anymore.

This is a case where family members are experiencing relationship conflict due to their family structure, which triggers process conflict in many business and ownership areas, and they have court cases. However, when they meet, they never talk about business or discuss their conflict openly because they hold respect as one of their values.

We found many examples of this response to conflict. Another family business leader who has been taken to court by his brother told us:

Avoidance strategy is dealing with conflicts passively by denying the existence of a conflict or choosing to ignore it. While this strategy works well when the issue is not important or at the beginning of a conflict by providing some time to cool down, continued avoidance of confrontation could escalate the conflict further. This is because not discussing or addressing disagreements do not resolve them, rather, it extends the time they are boiling under the surface and build up frustrations. This very likely escalates conflict from disagreement to disputes as family members eventually are forced to vent out the accumulated frustration and silenced anger.

We tend to think that family businesses move into disputes very easily every time they face a disagreement. However, avoiding conflicts as a response to conflict is one way through which simple disagreements are escalated to disputes over time. What makes avoidance more complex is that many family members confuse avoidance with not having conflict. We have seen many families that are experiencing deep silenced disagreements and frustrations who told us that they do not have any conflicts.

The prevalence of this reaction to conflict in our region is understandably due to the culture and values we have. In many cases, families avoid confrontation because they believe it is not respectful to confront other family members who are of age or experience. We all know that respect in our culture is a very strong value that many families uphold and encourage. Thus, the value of respect has its effect on business families as it discourages open communication between family members and hinders venting out disagreements in views, especially between individuals from different age groups, such as the father and sons, older and younger siblings, etc. Understanding the origins of the tendency to avoid conflicts in our region should help business families understand this tendency and critically evaluate its effect on the family and the business.

2 Dominance

When family members are not seeing eye to eye due to having any of the conflicts described above, often the ones in control or a dominant group/branch use their authority to force a solution or settle a dispute regardless of the concerns of other family members. They use their authority without giving voice to others, a response to conflict called dominance. We found examples of dominance in our research which we share below for illustration.

> **I am the one leading this change. I always put the company above empathy, and as a result I always get abuse for it.**

Dominance is also a very common strategy that we observed in our research. In many cases, families that avoid conflicts which are not urgent or escalated, respond to the more urgent conflict through dominance, where the conflicting party who is in power have it their way. Clearly, this response to conflicts also does not address the conflict or resolve it. Like avoidance, dominance escalates conflicts as it represses the views or interests of the other family members in the conflict, thus, feeding it with negative emotions, built up frustrations, resentment, and anger. Dominance also creates a winner-loser dynamic that further complicates the situation. In many cases, those whose views are discarded by a powerful party often take the matter personally and turn into dispute mode, not because they wish to escalate conflicts, but because they feel injustice and a need to prove their rights to having their voice heard. Dominance often starts a series of escalated disputes that are very dangerous for business families and in many cases is the beginning of family wars.

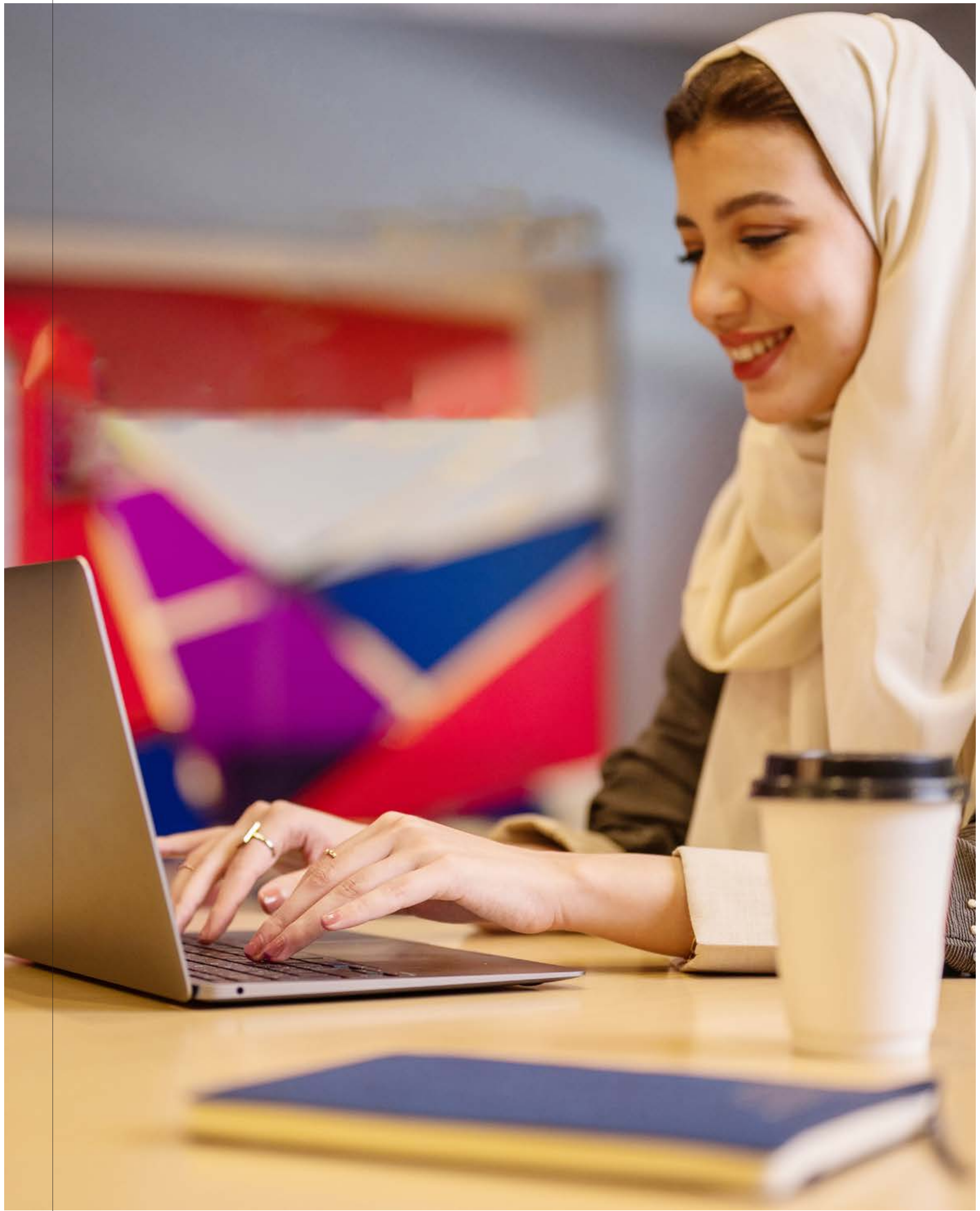
3 Separation

Family businesses use separation strategy either to deal with an existing conflict or to avoid a potential one. Separation strategy is achieved by structurally separating family owners in different legal entities or family members working in the business in different divisions/subsidiaries/businesses to minimize their interaction. Separation could also happen through separating ownership from management by prohibiting family members from working in the business (restrict family members to governance roles) and hiring a non-family CEO and management team. Depending on the situation, separation could be a useful strategy at times, however, it also does not tackle the conflict itself. Once the conflicting parties have to interact on any of the matters around which they conflict, conflict will arise again. Thus, if structural separation is not permanent, there is always the risk that family members will start conflicting once the structure that separates them from interacting changes or when family members move to different places in the same structure.

None of the above reactions to conflict allow family members the space to share their concerns, discuss their priorities openly, voice out their frustrations, and make joint decisions on the matter of conflict. Thus, we invite families to reflect on how they are reacting to their conflicts and assess whether their responses are resolving the conflicts or only delaying them as they get charged with negative emotions that escalate those conflicts over time.

> **Eventually, they bought us out in country X and we bought them out here. Buying each other out of the business helped a lot in reducing the conflict between my brother and uncle.**

> **To avoid conflict, we are fortunate to have a few businesses employing women and men of the family in different sectors.**



How can you minimize potential conflicts from arising?

After understanding the types of conflicts, where they manifest, and how some Saudi family businesses react to them, we highlight, next, ways to minimize potential conflicts before they arise.

There are two main areas to work on for minimizing future conflicts from arising in business families. Indeed, developing governance structures and protocols is one of them, but it is not sufficient on its own. The other side of conflict prevention is building strong trusted relationships between family members. Cohesive families that have bonded, trusting, and close family members are in better position to deal with differences and less likely to have severe relationship conflicts. As pointed out by one of our interviewees

"Some families have created formal or informal trust. Governance might also build trust, but it is not the same as having it organically. The human side is of equal importance or even stronger than the structural side.

1 Build a cohesive family

Family members experience conflicts because they carry incompatible views, possibly wounded relationships, and, in many cases, a culture that does not encourage open constructive communication. Thus, to reduce some of the potential conflicts that we have unravelled, it is important for families to systematically address the root causes that generate the conflicts and try to overcome them.

Family members learn what is an appropriate behaviour in a given situation from their parents through upbringing. Thus, the parents can influence what family members learn as behaviours that are valued in the family. Dealing with conflicts constructively entails certain behavioural norms to be embedded in the family's culture through upbringing and education. Such behavioural norms could include how family members treat one another, deal with differences between them, address disagreements, and be comfortable with open communication, to name a few. Encouraging healthy and positive conflict resolution behaviours in the family early on is invaluable in preventing potential conflicts from arising.

"Our family has values of not allowing conflict to affect our family relationships, and we still go by these values. After two-three weeks of a conflict arising, we have a tendency to gather again. We were raised on this, whenever we have personal conflict, one day we calm down and conversations are presumed.

"It is very important for the next generation to be ethical, because the future is theirs. It is always my goal to instill in them the founders' values, how to be honest and have good relationships.

It is also essential to avoid some upbringing traps that could create future relationship conflict such as magnifying competition among children or favouring one of them. Some of those practices are also carried on to the business. We found in our research many family business leaders having a favourite son/daughter who receive privileged treatment in the business compared to other siblings. We also found the prevalence of the "test and fire" approach where siblings/ cousins are assigned equal tasks without evaluating whether they are at the same level of competence. As a result, performers are retained and non-performers are fired, often leading to jealousy and relationship damage between those members. Such practices might not cause conflicts in the short term, especially during the father's presence, but certainly magnifies siblings' or cousins' rivalry in the future. Treating all family members fairly reduces the possibilities of relationship conflict arising and enhances relationship quality between family members.

Another important element in building a cohesive family is interacting and spending time together through periodic gatherings and retreats, especially as the family grows. Such events would create spaces for interaction between family members where trust and bonding develop between them.

We have special programs that focus on building family bonds, one of the most important things. We have programs for family members starting at six years old. We have them spend time together, no friends, just family. We sometimes bring coaches to help them socialize with their cousins.

Finally, we cannot stress enough the importance of open channels of communication and transparency in preventing potential conflicts. Indeed, avoidance, dominance, and separation, are all reactions to conflicts that include everything except communication. In addition to lack of communication being a result of a previous conflict, it could trigger conflict by itself. Many conflicts we found in our research go back to lack of communication and transparency due to respect or other cultural norms. For example, we have observed lack of communication between those controlling the business and other family owners to spark many conflicts in business families.

The most common reason for conflict is miscommunication! In the absence of communication between male and female family members, women feel left in the dark. Most of the time, it isn't intended.

And when those conflicts arise, we saw family members still not able to address them through constructive communications to come to joint decisions.

When you don't phrase your questions properly, you are seen as going against the family's interests. Especially in the case of young family members questioning older ones.

Most conflicts can be addressed through constructive communication, especially relationship conflict. We encourage business families to reflect on their communication norms and style, and assess how it influences conflicts between family members, to find ways to enhance their communication and transparency. Better communication reduces speculations and the negative outcomes of gossips.

2 Set your governance before conflicts arise

We often hear that governance is the first line of defence against family conflicts. We agree, though we consider it the second line after building family cohesion.

Not all families have family constitutions or charters, but every family has rules that govern their interactions. Those who do not have the constitution, have their rules unwritten but embedded in the family's culture informally. Thus, developing family constitutions is the process of moving the family's governance from being informal to being formal, and enhancing it to address the areas that the informal governance does not cover.

Setting family business governance right, indeed helps in minimizing conflicts in business families. This is because it allows families the opportunity to collectively discuss and agree on how they would deal with the areas around which they have different conflicts. Moreover, good governance fosters agreeing on how the family will manage conflicts as they arise (conflict resolution protocol).

Imagine family members coming together to identify the areas around which their views and interests diverge, such as leadership of the business, inheritance, shares, and exit, etc. Then for each area, they explore the possible options to pursue, the pros and cons of each, and collectively decide on given goals and processes to follow. Then, they put these agreements in writing, communicate them to the rest of the family, and initiate a journey of applying those agreements and protocols. Such a process allows family members to agree their disagreements before they arise. Thus, it substantially reduces the potential of conflicts arising when decisions have to be made in areas where family members hold different views and interests. Such a process of setting family governance is powerful in minimizing potential conflicts because it creates spaces where family members process their differences, make compromises and accommodate each other's views for the greater good.

The timing of this process is a critical factor in its success, the earlier it is done the better. This is because when those rules are agreed before the situations where family members conflict arise, the discussions are objective and are about goals and processes. Once the situation of conflict is already there, the discussion becomes about family members and their interests, thus, the discussion is then subjective and personal. One of the families we interviewed have delayed the process of creating their governance till conflict started, their conflict blocked the very process of governance from taking place. Thus, courts were the only alternative to go.

We started the process of governance with a consulting firm, but we didn't finish because of conflicts between second generation family members.

Moreover, the smaller the family, the fewer family members there are to agree, the easier it is to make joint decisions about the family and the business. When this process is delayed to later generations after the family becomes larger and more complex, it becomes harder to undertake such a process and build alignment.

Setting the family business governance is a very important measure to protect against future conflict in business families. We encourage families to start their governance journey to achieve sustainability. However, as we see many families who have family constitutions on the shelf, we must warn against the ineffective practices in developing family business governance. Resolving family members differences through undergoing a joint decision-making process based on accommodation compromise, and collaboration, should be at the heart of setting family business governance, in order for the process to generate results.

How can you manage conflicts that arise?

So far, we have explained some practices that business families could adopt to reduce potential conflicts from arising. However, as these are only prevention measures, conflicts might still arise between family members. Thus, business families need to be ready with clear and agreed upon protocols to guide them in dealing with conflicts before they escalate to disputes and turn into family wars.

Keep it in the family

The first step in conflict resolution is to try and resolve it in the family. It is important for business families to have conflict resolution protocols for family members to follow whenever conflicts arise. These protocols are very important to agree on as early as possible so that they are ready to be put in place when conflicts arise. Such protocols normally include the processes of trying to contain the conflicts inside the family before engaging third parties.

Once the process of conflict resolution is initiated in the family, we encourage families to hold sessions where conflicting parties discuss their conflict in more constructive ways. It is very helpful to start the discussion by properly analysing the conflicts based on the types and areas we explained. This should help family members better understand the conflict they are experiencing and make more informed choices about how to find a solution. When the nature of conflict is clear to the conflicting parties and those moderating them (if any), it helps to identify a goal to achieve for the process of resolving the identified conflict. Having a goal to achieve makes the process of resolving the conflict more rational and objective. This is true for all types of conflict, except relationship conflict and role conflict.

Conflict of interest, goal, and process

We have illustrated above avoidance, dominance, and separation as some of the common reactions to the conflicts we found in our research on business families. It was clear that none of these approaches generate the best results in terms of conflict resolution. Thus, when family members are undergoing a conflict resolution process to resolve conflict of interest, goal, or process conflicts, we encourage families to explore "compromise, accommodation, and collaboration" as strategies that could address their differences positively. We found examples for those strategies in our conversations with family business leaders as illustrated in these examples.

> **"There are sacrifices to keep this entity. Even with the fees we receive, they do not enter our accounts, rather it enters the group account. We do this to avoid conflicts.**

> **"My aunt once complained that we are tough on her son at work. I asked her do you want dividends or your son's satisfaction? She said dividends.**

> **"Compromise. Our religion asked us to maintain family ties, while also we have a business to run. If you get 70 percent of the deal, accept this as a solutions and be patient. Good compromises take time.**

Families that manage to contain their conflicts have family members who sacrifice to maintain harmony by giving in to reach a middle ground in a conflict or to set an example to avoid escalations. They compromise their own interests or position to accommodate those of others. Compromise and accommodation as means to address conflicts are positive for family relationships and, especially in cooling down relationship conflict that boils underneath the surface in many cases. However, for it to work in the longer term, it has to be reciprocated. If a family member compromises in a given conflict, he or she would expect others to compromise in the next. Compromise is a response which also balances conflict between individuals' interest and the interest of the whole family and the owners. When individual family members compromise their own interest for the whole family, this often addresses some of the main conflict of interests that business families face.

Collaboration is also another way to finding a solution to conflict. Unlike accommodation and compromise, collaboration is about finding a solution that satisfies all involved parties resulting in a win-win situation, thus, none of the family members gives in. Collaboration centres around making joint decisions (participative decision-making) in response to the problem in question by the conflicting parties. For example, if there is conflict of interest between an owner manager and family owner around employment of the family owner in the business, where there is a mismatch between the business needs and the family owner's competencies. An example of a collaborative approach to such a conflict could be to collaborate in establishing a new venture supported by the owner manager group that serves the family owners career interests away from the business and at the same time, generate profits for the owner manager group.

Relationship and role conflicts

As explained previously, relationship conflict is subjective and emotional, that can't be resolved through a rational discussion about alternatives. Thus, this type of conflict is very difficult to address, and, in severe cases, requires seeking professional family therapists. The best advise we can recommend for mild cases of relationship conflict is for family members to have an open conversation about the events that lead to the negative emotions building up between family members, and find ways to pardon each other and move on.

"

You need to manage emotions in the family, to manage jealousy.

Role conflict, on the other hand, is rather unconscious mixing between the roles that family members play, and it is behavioral. Like relationship conflict, role conflict can't be addressed through assessing alternatives rationally. It is subjective and requires constant efforts to highlight it and find ways to set boundaries between the different roles. In our experience, drawing family members' attention to the nature of role conflict when they experience it and untangling the different roles they are mixing often generates the realization which instantly minimizes it. This is because until family members get to see role conflict for what it is, they are mostly not aware of it given its unconscious nature.

Third party intervention

If none of the approaches above succeed in resolving a conflict between family members, or if family members are ready to explore solutions, compromise, accommodate, but are just not able to start the conversation, it is useful to seek third party interventions. Depending on the nature of the conflict, third parties could be neutral family members who are accepted by those in conflict, non-family trusted advisors, professional mediators, therapists, family business advisors, or arbitration centres. Having an outsider to mediate family business conflicts opens up healthy communication channels between family members and provides a mean through which they can vent negative emotions. An important criterion in choosing a third party is that they should have objectivity, independence from the outcome, and understand the family dynamics to avoid being manipulated by any of the parties. The choice of a third party depends on the severity and timing of the conflict. In low to moderate conflicts or at the beginning of a conflict families usually reach out for voluntary interventions from a (respected/trusted) family member or a non-family member close to the family. However, in more severe conflicts, they may look for family business advisors or seek formal mediation and arbitration options such as the National Centre for Family Businesses (NCFB) and the Saudi Centre for Commercial Arbitration (SCCA).

Qualified family business advisors can mediate conflicts among family members using a variety of tools and practices depending on the source and type of the conflict. Advisors work closely with family members by managing mediation sessions to open up communication channels among conflicting parties and align their different point of views. Bringing together in one room parties that would probably never sit together otherwise.

SCCA provides alternative dispute resolution (ADR) services including arbitration and mediation to manage, resolve, and prevent conflicts in commercial organizations in line with international and professional standards. They provide their services to all types of businesses including family businesses. The centre operates under the Council of Saudi Chambers and has a number of branches all over the Kingdom. The services provided by SCCA are characterized by quick and clear procedures and may help in preventing conflicts from escalating to disputes in courts, while users are granted privacy and confidentiality in all procedures.

Common mistakes that lead to conflicts in business families

Before we conclude, we wish to shed light on some common mistakes that we learned about during this research which often led to conflicts in business families. Our conversation with six legal experts in family business disputes and law cases helped us identify certain practices that families have, which often created conflicts that they did not see coming as a result of those practices. Thus, we view these practices as common mistakes that could have easily been avoided. We believe there are great advantages to sharing these common mistakes so that business families can avoid them when working on their governance.

1 Over trust and poor documentation

Traditionally, many family business operations are based on trust and goodwill among family members without proper documentation. Such informal practices lead to conflicts in many cases, especially after the founder departs. For instance, many family business founders grant proxy to one of their sons during their lifetime and overlook documenting the business transactions the founder / father requests. While all deeds done under the proxy are based on the founder's orders, other family members often question those transactions after the founder's death since there is no proof (real evidence) that they were based on his wishes.

In other cases, informal practices based on trust is related to ownership of the business. For example, founders often include some family members as legal partners in an LLC, and leave the partnership of others informal based on agreement with family members. Such practice is in many cases done to address some legal requirements. In many cases after the founder's death, some family members deny the informal agreement and disputes arise to prove partnership.

> **"Over trust results in a lack of financial transaction documentation.**

Another example of over trust is that after the founder's death, family members over trust the successor, who often times is the closest to the founder and/or most knowledgeable in the business. And after years of granting him full control, they start doubting his actions and revoking past decisions for various reason. Such turn of heart (late wake-up call) might be grounded on actual misdeeds (such as withholding business information, denying access to financial statements, lack of governance practices) or are baseless and triggered by financial and emotional issues (such as decline in business performance, lack of dividends distribution, or family relationship tensions).

> **"A family manager may be the cause of disputes. A company may run for years without disputes, then suddenly they begin to face problems.**

> **"They didn't ask for financial statements for twenty years. Where were they? All those years, family bonding took place, but now things have changed, psychological counselors are needed!**

Another common mistake related to documentation is mixing company and personal assets in ownership documents. There are many cases where families register company assets under a family member for tax reasons. Once these assets are part of inheritance, disputes arise and often times family members take the matter to courts. This is especially the case in relation to real estate assets and equity investments.

While trust is a praised virtue, over trust in business families often fires back to harm not only the business but also family relationships. Thus, we encourage business families to be careful of the effect of over trust in their formal interactions as owners, managers, and colleagues, and ensure all business-related decisions and transactions are properly and legally documented.

2 Inheritance

Inheritance distribution is another fertile area for disputes and court cases. While inheritance law is clear and straight forward, sometimes heirs engage in certain practices when it comes to the ownership of the business which lead to conflict. Decisions on who to stay in ownership and whom to buy-out are sometimes taken by family members in control without a clear and communicated criteria, such as buying out parties (i.e., women, cousins, and half-siblings) without proper evaluation or by using misleading information. While the buyout is done with parties' consensus, it usually happens during times of grief and with family members less knowledgeable of the business. Such practices lead to perceived unfairness and fireback later on when those parties realize the true value of their shares.

There are many cases related to women shareholders. They are in the second generation, and the older brother is in charge. They have no experience, so the shares were valued incorrectly.

In some cases, members in control may disregard updating the articles of association (in LLCs) when someone passes and heirs become owners, since there are currently no legal requirements binding families to update their articles of association whenever new heirs join ownership. Of course, those heirs go to court whenever they find themselves in a situation where this arrangement is not working for them.

As soon as the founder dies, especially if he had a large company and his son worked there, the others join and disputes begin. Disputes arise over who to include or exclude, amendments to the articles of association, or liquidation requests.

Another unforeseen mistake related to inheritance is when families divide inheritance amongst them without seeking legal counsel to ensure their transactions are aligned with the laws. For example, some families decide that male members inherit company shares and female members inherit family assets like real estate. They often do it amongst themselves without assessing the legality of the division properly. In many cases, female members later realize that what was given to them is not equivalent to their rightful inheritance according to laws and disputes then arise leading to courts cases and legal battles.

3 Wills

Wills is also an area where a lot of mistakes happen which lead to conflicts. While Islamic inheritance law has clear rules of how estate is divided among heirs, it leaves room of freedom in one third of the deceased's estate for non-heirs, after deduction of all debts. Our conversations with the legal experts revealed some common negative practices related to wills. For example, in many cases family members write their wills without proper legal counsel and without following the legal processes to document them. In such situations, heirs often challenge their father's will once it is presented to them and disputes begin.

Not documenting the will and having witnesses is often an issue. In some cases, a father leaves a certain amount of income to orphans and those in need. However, because the will is not documented, once he passes away, his sons annul the inheritance.

4 Endowments and waqfs

Many family business founders set up waqf during their lifetime for charitable purposes and/or for family welfare. But waqf may cause conflicts in the future if not developed properly. Examples include not specifying the beholder selection criteria, vague description of beneficiaries of Waqfs serving the family, and narrow specification of ways to spend in charitable waqf. For instance, failing to precisely describe beneficiaries of waqf serving the family may leave room for family dispute on the eligibility of some family members.

Wording of the beneficiaries of the endowment is not clear, it bears several interpretations. Are they the children from the first or second class? For example: it may be understood from the wording of the endowment that the beneficiaries are the kids of the sons and not the kids of the daughters, also who is entitled? Is it based on age? Or having a job?

Another issue with waqfs is that when company shares are included as part of the assets for the waqfs. When waqfs become owners in the family business, this brings additional type of owners with interests and priorities that might be different from the family members, thus, complicates the process of building alignment between owners even more, and in many cases, lead to conflicts between waqfs and the family in their ownership of the family business.

In summary, many of these unforeseen areas of conflict are legal in nature. Although they might not create issue during the time they are processed, these legal misconducts are the ground for conflict between family members. Thus, we encourage members of business families to understand their legal rights as owners of companies and assets, seek proper legal counsel and to carefully consider the legalities of all their actions and transactions to avoid leaving such gaps where conflicts turn into legal family wars.

Often, conflicts in family businesses are psychological, whereby whoever manages it during the father's lifetime takes control and has the upper hand, but suddenly all the mistakes made over the last twenty years appear. Family members were silent because of trust. The origin of the conflict is a psychological matter.

In conclusion

Conflicts in family business is a wide and complex topic that is seldom tapped into. We attempt in this paper to untangle the complexity of this topic by first explaining the five general types of conflicts and then linking them to where they appear in family businesses' daily practices. We also highlight the current practice of Saudi family businesses in dealing with conflicts pointing out the pitfalls of these practices. And provide some practical advice on the best ways to prevent conflicts from emerging and how to manage them when they are out there.

Understanding the type of conflict (conflict of interest, role, goal, process, or relationship conflict) regardless of where it manifests (whether over dividends, family employment, leadership roles, ownership, or inheritance), will enable family members to clearly see the full picture of their disagreement and to determine the best route to take to solve it and prevent it from reoccurring. This holds for all types of conflicts except for relationship conflict where emotions are in charge and rationality is off the table.

Having established business and family governance tools is known to greatly help in minimizing potential conflicts, however, we found from our research and practice that they are not enough in preventing conflicts from arising, especially in families with relationships issues. Building a family with strong bonds has shown to be equally or even more important than governance protocols. Therefore, we encourage families in business to work on their family cohesiveness from early on during the upbringing of their offspring in order to embed family values and build a culture of open communication to minimize the threat of conflicts in the future. We also advise them to avoid practices that lead to relationship conflicts such as favouritism and competition among the next generation which results in rivalry between them in the future.

When conflicts are already in the air, family businesses are advised to actively manage them before they turn into disputes by first employing previously developed conflict resolution protocols in order to understand what type of conflicts they are facing. Families can employ compromise, accommodation, and collaboration strategies to resolve their conflict of interest, goal and process conflicts. In case of role conflict, realizing it is the first and most important step enabling family members to work on setting boundaries between their roles in the family and in the business. However, if relationship conflict is present, then open and frank communication is the first option, and if it is impossible to communicate then considering third party intervention is the way to go.

We embarked on this research with the aim of helping family businesses reach their sustainability objective by shedding light on the under explored topic of conflicts. We hope that families in business benefit from the learnings in this research whether in preventing future conflicts or dealing with current ones.

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About the organizations

KPMG
Private Enterprise

KPMG Private Enterprise & Family Business

KPMG Private Enterprise was established as a sub-brand of KPMG in 2015, focusing on companies with private ownership and High Net Worth Individuals (HNWI). The businesses are typically financed by venture capital, private equity, family offices, or are either standalone private entities or family businesses. Trust drives the relationship with KPMG's Private Enterprise clients. As such, when it comes to family businesses, KPMG provides services that aid, not only the operations of family businesses, but also taps into the family dynamics of business families. KPMG's advantage depends on leveraging on its global network of professionals, ability to provide a technology enabled one stop shop of cross functional services, and expertise in serving businesses across their business lifecycle as the personal and/or family wealth grows.

KPMG Private Enterprise & Family Business is the trusted adviser for a significant number of the major Saudi business families across the service lines of Audit, Tax and Advisory. Being in close touch with the family business ecosystem helps the team in catering KPMG's solutions to fit the needs of business families in the Kingdom. KPMG Private Enterprise is also active in producing research publications and organizing periodic events in the form of summits, webinars, and discussion roundtables to discuss topics which are of great importance to Business Families such as governance, succession, NextGen, and philanthropy, just to name a few. For further details on KPMG Private Enterprise & Family Business services, please visit: https://home.kpmg/sa/en/home/industries/enterprise-and-family-business.html

المـركـز الوطــنــي
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National Center
For Family Businesses

National Center for Family Business

The National Center for Family Business (NCFB) was established under the Royal Decree in 2012, as a joint initiative by the Ministry of Commerce and the Federation of Saudi Chambers. NCFB has been working on achieving its mission through providing services and communicating effectively with family businesses, government organizations; consulting firms, and the public to build an ecosystem that reinforces the sustainability of family businesses.

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