



THE GOVERNANCE PARADOX IN FAMILY BUSINESSES

Family enterprises face an inherent strategic paradox: they must preserve multigenerational stewardship while delivering competitive market performance. As ownership structures expand and operational complexity increases, the informal governance mechanisms that once enabled rapid decision-making and alignment become sources of ambiguity and inefficiency. High-performing family businesses address this by implementing structured governance frameworks that replace ad-hoc decision-making with institutional mechanisms across six pillars of a **Family Business Governance Wheel**:





Ownership & Exit

A.

Balancing the interests of active (working) and passive (non-working) family shareholders & distributing the dividends on a regular (e.g., annual) basis.

As family ownership broadens, two competing views of profit emerge. Active members—employed in the business—see profits as fuel for reinvestment and growth, already drawing liquidity from salaries and bonuses. Passive members—outside the business—view profits as predictable income and a means to diversify wealth.

This divergence creates principal–principal conflicts that, without structured dividend policies, surface as boardroom debates over growth, risk appetite, and investment horizons. As ownership diffuses, pressure for cash distributions rises, and differing views of “distributable profits” spill into decisions on capital expenditure, leverage, and governance credibility.

B.

Having a policy that governs the process of family members wishing to exist.

Exit events, while infrequent, can create significant operational and financial disruption if not properly managed through pre-established frameworks. The primary risks include:

Unexpected liquidity demands that strain corporate balance sheets

Contentious valuation disputes, particularly regarding control premiums and marketability discounts

Operational buyouts that increase leverage ratios and constrain future investment capacity



Governance

A.

Having an active Board of Directors, and some of the board members are NOT from the family

Ceremonial rather than functional boards remain a critical governance gap in family enterprises. While 89% of family firms in the Middle East and Africa report formal board structures, fewer than 40% show active, independent oversight. These boards often meet infrequently, focus narrowly on operations, and are constrained by family dynamics.

The absence of independent directors compounds blind spots—groupthink, informational homogeneity, and status-quo bias—leaving strategic decisions skewed toward family harmony over shareholder value.

While **89%** of family firms in the Middle East and Africa report formal board structures, only a few of them show active, independent oversight¹.

B.

Having a responsible individual (family or non-family) managing the strategy of family investments.

Family investment governance frequently falters due to the absence of a clear steward—family or non-family—accountable for strategy. In that vacuum, deal flow defaults to personal networks, portfolios tilt toward the preferences of the most vocal, and risk accumulates without a documented framework. The UBS survey of global family offices reports that:

44%

of family offices report a governance framework².

44%

have a documented investment process³.

Without a formal Investment Policy Statement (IPS) or equivalent, families tend to oscillate between over-allocating to trends and paralysis during downturns. In multi-branch families, accountability blurs and performance debates devolve into narratives rather than data.

C.

Having a process/policy to allocate funds for family bonding and entertainment activities.

A critical but often overlooked governance component is systematic investment in family social capital. Without resources and structured forums—such as shareholder assemblies, next-generation programs, and family retreats—families underinvest in the trust and coordination needed for effective decision-making. **The result is greater conflict, slower consensus, and higher agency costs as monitoring and coordination demands rise.**

¹ Middle East leads globally in establishing formal board structures in family businesses - Khaleej Times

² Many Global Family Offices Aren't Prepared to Transfer Their Wealth, UBS Survey Finds – Penta

³ Many Global Family Offices Aren't Prepared to Transfer Their Wealth, UBS Survey Finds – Penta



Leadership & Succession

A.

Including a healthy mix of family and non-family professionals in the leadership team.

Leadership development in family enterprises often suffers from biases that favor relationships over competence, creating vulnerabilities that compound across transitions. Exclusively family-based leadership narrows talent pools and stifles dissent, while over-reliance on outsiders risks diluting identity, trust, and culture. The challenge deepens when selection lacks transparent criteria, objective assessments, and consistent competency requirements for both family and non-family candidates.

B.

Having a succession planning process for preparing future family & non-family business leaders.

Succession planning often exposes vulnerabilities when treated as a one-time event rather than a continuous process. Many families delay decisions until transitions are imminent, creating uncertainty for leadership candidates.

Only **one-third of family firms globally** maintain documented succession plans, leaving most exposed to disruption.

The absence of systematic succession planning creates multiple risk categories:

Leadership gap risks when key positions become vacant without prepared successors

Talent retention risks as high-potential candidates seek opportunities with clearer advancement pathways

Strategic continuity risks when leadership transitions occur without adequate knowledge transfer or relationship continuity with key stakeholders.

These risks compound during unexpected transitions caused by health events, family conflicts, or external opportunities that accelerate departure timelines.

C.

Founders embracing innovation and supporting digital transformation initiatives introduced by the next generation.

Next-generation family leaders, as digital natives, often push for technology integration—from e-commerce to advanced analytics and AI. Founding generations, by contrast, prioritize socio-emotional wealth—legacy, control, and harmony—driving resistance to disruptive investments.

This bias correlates with risk aversion toward external partnerships and technology-driven innovations, constraining competitiveness. The challenge deepens when initiatives require external vendors, new systems, or operational changes that disrupt established workflows and relationships.



Employment

A.

Family members going through the same performance appraisal process as other employees.

Employment practices in family enterprises are the clearest signals of fairness and professionalism. When family members bypass evaluations or receive preferential treatment, it implies merit is negotiable, undermining morale and retention among non-family staff. Fair evaluations can drive higher job satisfaction, greater commitment, and higher discretionary effort.

B.

Supporting family members who choose to pursue careers outside the family business.

Equating loyalty with immediate business entry creates risks that weaken both individual growth and organizational effectiveness. Role misalignment places family members in unsuitable positions, while limited outside experience denies them broader perspectives needed for complex environments. When external careers are framed as disloyalty, talented members risk being trapped in suboptimal roles, leading to resentment, reduced performance, and diminished enterprise outcomes.

C.

Encouraging family members to gain experience from outside the family business first.

Market-tested experience outside the family enterprise provides credibility and skill development that internal programs or mentoring cannot match. It builds independent track records, broadens networks, and sharpens strategic thinking through exposure to alternative practices. Without such requirements, organizational credibility with stakeholders erodes, constraining access to top talent, partnerships, and capital markets that demand proof of professional management standards.

D.

Basing employment decisions on business needs & qualifications, rather than entitlement.

Meritocratic employment practices directly drive financial performance, while kinship-based appointments create role mismatches that erode effectiveness and competitiveness. Prioritizing relationships over business needs increases performance gaps that compound into culture challenges, weaker retention, and impaired execution. The impact extends beyond individual roles, shaping talent systems, organizational credibility, and attractiveness in labor markets where professionals value fairness, development, and merit-based recognition.



Conflict of Interest

A.

Having a formal process/policy for resolving business-related disagreements/ conflicts among family members.

Conflict-of-interest risks in family enterprises often surface behaviorally before affecting performance, visible in defensive meetings, disengaged executives, information hoarding, and communication that favors harmony over analysis. Without formal mechanisms, routine frictions escalate into personal disputes that persist across decisions and planning cycles.

The lack of structured resolution processes compounds minor disagreements into major conflicts that consume management attention, delay strategy, and strain family relationships.

B.

Not allowing family members to join competing businesses or establish their own business in competing industry.

Direct competition among family members creates risks spanning business performance, legal obligations, relationships, and strategic positioning, often escalating into costly disputes. Owners owe duties of loyalty that bar competing with the firm, diverting opportunities, or misusing confidential information; breaches can trigger litigation, injunctions, or shareholder oppression claims requiring costly resolution.

C.

Avoiding reporting structures where family members directly manage each other.

Reporting structures where family members directly supervise each other undermine fairness and credibility, reducing employer attractiveness, trust, and retention across the organization.

Research shows kin-to-kin reporting correlates with lower attractiveness ratings, weaker commitment, and higher voluntary turnover among both family and non-family employees.



Family Expenses

A.

Allowing personal expenses (home installment, new car, etc.) to be withdrawn from the company reserves and settled later.

In family enterprises, the boundary between personal and corporate finances often blurs, creating “tunneling”—the extraction of private benefits outside transparent dividend or salary structures.

Personal expenses such as mortgages, vehicles, education, or lifestyle costs routed through company accounts create accounting ambiguity, undermining integrity, compliance, and stakeholder trust.



Risks of this practice

Accounting ambiguity that complicates financial reporting and audit processes.

Compliance exposure in regulated markets where personal benefits must be disclosed and misclassification can trigger regulatory enforcement actions.

Economic costs through shadow dividend distributions that are opaque and disconnected from strategic investment cycles.

Valuation erosion where high related-party transaction levels correlate with weaker earnings quality and lower market valuation premiums.

B.

Having a formal process/policy to support financially distressed family members.

Uncodified financial support to family members creates moral hazard and resentment that undermine fairness perceptions and culture across generations. When some requests are accommodated while others face delay or denial, trust erodes, reducing discretionary effort and driving out talented non-family managers—causing capability loss at critical times.

C.

Periodically reviewing and auditing family-related expenses to ensure fairness and financial discipline.

Disciplined, arms-length reviews of family-related expenses prevent minor leakages from compounding into structural drains that erode earnings quality and heighten governance risk. Unchecked related-party transactions deteriorate earnings metrics and raise risk profiles, directly impacting cost of capital, lending terms, and stakeholder confidence.

Without systematic oversight mechanisms, financial support patterns tend to evolve predictably:

Ad hoc bailouts replace principled support decisions

Individual exceptions harden into broadly expected entitlements

Trust fractures develop as fairness debates spill into organizational culture

Family enterprises sit at the intersection of ownership, kinship, and governance—a position that offers resilience but also unique structural vulnerabilities.

The challenges confronting these organizations are fundamentally governance challenges that determine whether family involvement becomes a strategic asset supporting long-term competitive advantage or an operational liability constraining performance and strategic flexibility. In the following article we will outline the governance, policy, and operating interventions that family enterprises can deploy to overcome these challenges and sustain performance across generations.

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