What is the Point of Family Enterprise Governance?

An excerpt from Wealth of Wisdom by Tom McCullough and Keith Whitaker

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**IF YOU ARE ASKING** If you are asking this question it is likely that you are a first-generation founder wondering why you would want to bother with a “real” Board or a Family Council. You are probably asking: Why complicate things? Why involve people unnecessarily in decisions that are beyond their expertise? Doesn’t everyone understand that the main thing is to continue growing and developing the business?

Or you may be a second-generation sibling partnership and just beginning to see that you might need some more meetings to cope with issues that the first generation did not need to debate, such things as, How do we work together as a sibling team? How do we deal with owners who do not work in the business? And, how do we plan our estates so that the business is protected? As a second-generation family business, you begin to understand that the business, ownership and family issues are intertwined in a way that is going to get very complicated, but often these issues are still not as compelling as the immediate needs of the business. Why have any more meetings than are absolutely necessary? Why involve others? Doesn’t everyone understand that we need to focus on managing the transition from our parents while running the business and making sure we have money for some dividends?

But unless you are going to “prune” back the ownership of the business and return to a model that concentrates ownership in a single owner (or in very small group of owners), you have a growing group of stakeholders that want, expect, and need a voice regarding the family enterprise. The question now becomes: How much voice should they have, in what decisions, and where do these decisions get made? Family members working in the business will expect a say in major business decisions, though, of course, a family member who is a mid-level manager should not expect to have the same voice as his or her CEO cousin. Family shareholders not working in the business may expect to be able to influence business and ownership decisions, but they are not necessarily in a position to understand all the factors that are involved in these decisions. As family shareholders begin to understand how the family business decisions affect their and their children’s finances, careers, and family relationships, their voices get louder over time. It is then that business, ownership and family issues can erupt into heated and rather chaotic discussions resulting in ineffective decisions and complicated personal reactions. Some-
times such discussions create scars that last years.

This is when you need an effective family governance system with the purpose of appropriately channeling the voice and involvement of all the stakeholders into decision-making forums that demarcate their legitimate spheres of influence. In thinking about how best to organize their involvement, it can be helpful for family business owners to imagine that the company they own is a large jetliner. As with any investment, the shareholders have a very legitimate right to expect a certain level of return, define an overall risk-reward ratio, to require that the plane be used in accordance to their fundamental values, and to insist that pilots flying the plane be competent. Even though they own the plane, owners do not have a right to enter the cockpit and fly the plane themselves—unless of course they are competent, licensed pilots, selected to do so. In the first generation, the owners are almost always the pilots and there is no need to separate out the issues into separate decision-making forums. As the enterprise moves into later generations, however, it is the time to decouple governance and management roles. Yes, you can still have owners in the cockpit if they are qualified and there is room, but other owners should be directed into governing entities where owners both can, and should, be involved.

The place to start as you transition to more complex forms of ownership is the development of a Board of Directors that goes beyond the "rubber stamp" version typical of the founding generation stage, and the creation of a Family Owners Council that goes beyond the "kitchen table" discussions typical of first and second-generation businesses. It is helpful to develop both of these in tandem, so that you can begin to triage questions and concerns to the right group. Over time, you can consider other governance structures such as a Family or Shareholders Assembly for all family members, a Career Committee for family members entering the business, and a family management team for those working in the business. Depending on how your enterprise develops, you may want to consider other structures such as a Family Foundation, a Family Office or a Private Trust Company. These additional governing bodies usually link into the Council and the Board, which continue to serve as the pillars of the evolving governance structure.

The Board needs to become the forum for overseeing the growth and performance of the business, and is the place where the fundamental strategic issues facing the company are addressed. Management proposes the strategy, but it is the Board’s role to test the underlying assumptions and ensure that management has thought it through. Once the strategy is duly vetted and approved, the Board oversees the effective implementation and holds management accountable. Boards usually develop over time to match the needs of the business and the family owners, often moving from the pro-forma, on-paper Board, to a Board of Family Directors who are selected for their knowledge and experiences, to an advisory Board of Family Directors and Independent Directors, and ultimately to a Fiduciary Board with a majority of Independent Directors. Effective Boards move to meeting four to six times a year and develop the professional structure of business review and strategic planning. Family Directors, as elected or selected representatives, should bring the values and views of the family shareholders as a whole to the Board meetings. This structure provides a way to have family shareholders have a voice in critical decisions such as growth aspirations, risk, debt, dividends and major acquisitions, without Board members getting bogged down with family issues or family members dipping too far into the business. The Board also serves to formalize oversight and accountability for the enterprise, which is always critical, but even more so when the CEO is a family member.
The Family Owners Council becomes the forum for discussing ownership and family matters and guides the development of the family shareholder group. An effective Council provides guidance to the Board regarding ownership and family interests, as well as concerns, and manages activities that provide continuity in family values, identity, and education. A Council might typically meet three or four times a year and take on such activities as periodic reviews with the Chairman, discussions with family shareholders, resolution of family ownership concerns, development of ownership policies, educational events for family members, and assistance with the annual meetings.

These two fundamental governing bodies can be mapped onto the familiar three-circle model which shows the interlocking stakeholder groups of business, owners, and family. The Board of Directors, which serves the shareholders, rightly belongs in the boundary between the Ownership and Business circles. The Council, which serves the family and the shareholders, finds its place on the boundary of the Owners and Family circles. Later on as the business grows and becomes even more formalized, it may be necessary to separate the family and the ownership forums by creating a family council to address the family’s evolving needs and a formal shareholders’ assembly to attend to the owners concerns.

The family enterprise is like a home with four separate rooms: strong family businesses need to separate decision-making into the owner, board, management and family rooms (see Harvard Business Review reference below). Effective family businesses become skilled at directing the decisions to the appropriate rooms. These rooms are not just empty boxes—they must be filled with the right people, who can effectively make the decisions for that area of the enterprise. For many families, once the boxes are set up, it becomes easier to define the skill sets that are needed for each room and the selection process needed to select the right people. If done well, family owners understand that they have a legitimate voice regarding the family and ownership decisions, and a place to discuss these matters responsibly. And, business leaders, in turn, also have the appropriate forums to tackle the fundamental strategic, financial and operational issues impacting the enterprise.

While the architecture of governance matters hugely, any governing structure needs the right processes and people to make them work. The information sharing channel between the Board and the Family Owners Council is of particular importance, along with additional communication lines between any of the evolving governing bodies. Effective Boards and Councils find ways of letting all the stakeholders know what is being discussed and decided. For example, one highly successful enterprise sends out quarterly letters from the Board and the Council after every quarterly meeting letting shareholders know what was discussed in the quarterly meetings. These letters are complemented by reports and summaries in their annual meeting along with periodic phone calls and surveys with family shareholders. At the same company, the Chairs of the Board and the Council meet regularly to coordinate their efforts and to ensure that the issues are being channeled appropriately to the right forums.

A founder might scratch his or her head at all these meetings and letters, but the siblings and
the cousins who follow know that they are building a structure that will give them the best chance of succeeding for generations. The key is to keep in mind that as ownership fragments with the passing of the generations someone will be making decisions on all of these fundamental issues. Your choice is not whether things will change or not with the passage of time—they will. Your only choice is whether you want to manage the transition to the future or not. Experience and a growing body of research show that if the design of governance is not attended to responsibly, the likelihood of continuity will be seriously compromised.

References


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