Governance and the Enterprising Family

By Fredda Herz Brown

During a recent presentation on sustainability in the family enterprise, I was discussing the role of family governance as a necessary component of a family's ability to survive as an economic unit beyond three generations. A young woman in the audience raised her hand and asked: "I hear everyone using the term 'governance' and then 'family governance.' What does governance mean, and where did the term come from? I don't get it. Should I know something more?"

I realized how these important questions speak to the essence of understanding not only families who share assets, but also to the evolution of the field that serves them. It seems prudent first to define governance; and then to look at the increasing need for it as families evolve from one generation to the next; and finally to show how generational shifts may require different kinds of structures and processes. But first, the definition.

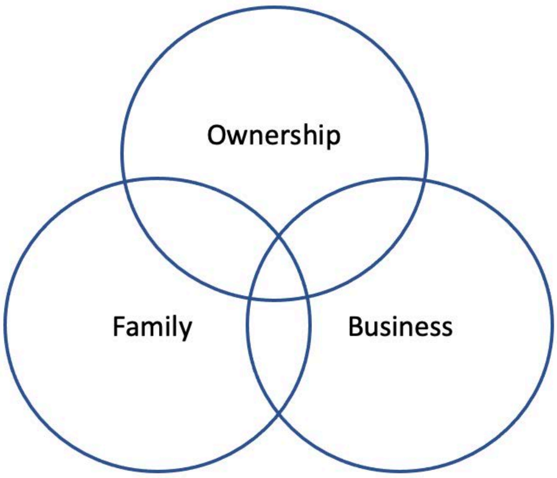
For me, the term *governance* brings to mind the idea of *government*. In the most general sense, it is the way an organization of any kind controls its actions. It is a system of guidelines and protocols that manage the often competing and interrelated interests of various constituent groups. It also provides a set of processes that enable families to determine a sense of direction, make decisions, and communicate shared values, mission, and vision to the various stakeholders.

At the same time, governance provides the family with a tool that helps them not only to recognize their own particular family dynamics, but also to manage them. Family dynamics provide an informal governance structure where emotional relationships and/or generation define how decisions will be made and how values will be shared. Without a more systematic approach to the process, the informal (and at times not so helpful) processes take over.

Relative Solutions

While there is great debate about what to call families who build an economic unit together, the field began more than twenty years ago with a focus on families who owned businesses together. This was, and I would say continues to be, the way most families build wealth over time. Years ago, families had no adequate roadmap to define the kind of transition that would be necessary for a succession process to occur from the first generation entrepreneur or business owner to the next generation. A fairly elegant model, known as the "three-circle model," provided a roadmap by delineating the arenas that would impact and be impacted by the succession. The model identified three groups, or circles, that needed representation, i.e. to be heard in the process. See Figure 1.

Figure 1: The Three-Circle Model of Family Business

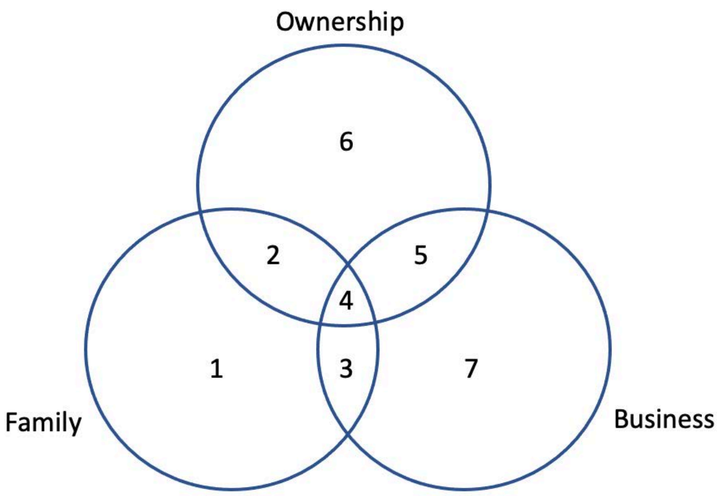


Adapted from Renato Tagiuri and John A. Davis's, Three-Circle Model of Family Business, which was first discussed in the article, "On the Goals of Successful Family Companies", Family Business Review, March 1992; vol 5: pp. 43-62. Reprint with permission from Sage Publications.

The model showed three interlocking circles representing family, business, and ownership. It demonstrated that each member of the family could wear several "hats," referring to their role and responsibility in the succession. The three circles each had their own governance structure: the business had its executive team, the family had a family council, and the owners had a board of directors. I believe that while the model primarily defined the family and other stakeholders as important participants in the transition process, it also defined seven different subgroups with separate agendas/ needs, or voices, in the process. These seven subgroups include family members (1), family who are owners (2), and family who are managers (3), family owners who are also managers (4), managers/employees who are also owners (5), investors/owners who are non-family (6), and managers/employees (7).

Hearing the view of each of these and considering their changing needs became a significant endeavor as family enterprises moved to third and fourth generations, increasing their number and diversity. See Figure 2.

Figure 2: Stakeholder Groups of the Family Business



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What the model did not provide was a way to consider the evolution of the family and its enterprise over time. What would happen, for example, in succeeding generations, when the three circles tend to pull apart, or when the number of family members who were not owners increased? It became clear to me and others that we needed to address what was likely to be a larger, more diverse family group;

perhaps one with ownership in an original legacy business, several businesses, or perhaps none. Without building a portfolio of assets and evolving their economic base over time, a family is unlikely to maintain, no less grow, their wealth to provide opportunities to the ever-expanding membership. They must make decisions with consideration of both the economic and emotional impact spanning succeeding generations.

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I, like many others in the field, began to search for ways to think and speak about what it takes to grow these economic, social, political, intellectual, and emotional assets of the family. It became important to define a way to capture how families could make appropriate decisions about their asset development and deployment. My own interest in family governance grew out of these needs. Family governance answers the question "How does a family organize itself to balance the tensions and complexities of being emotionally and economically connected to one another? That is, how do they manage the 'business' of being together as a family in an economic way while being connected emotionally?" Governance is the family's way to provide structures and processes that allow them to formalize the "business" aspects of being an economic entity, without losing or compromising the emotional aspects of their lives together. It provides a framework for their decision-making, leadership, and representation.

The emphasis here is on the *family*, not the assets they have created. While the physical and fiscal assets are important and may need their own governance, assets are secondary to what the family defines. Governance begins with a family's vision and mission, its *raison d'être* for where it wants to go. Thinking out over at least three generations permits a family not only to ask "why are we staying together and what is it that we want to do together," but also to consider the longer term focus and consequence of their wishes. For instance, if a family wants to preserve their wealth and to provide opportunities for the next several generations, the members will have to consider how they will sustain the current assets to do that.

A clearly thought out sense of purpose(s) can provide a roadmap—a set of structures and processes that permit the family to comfortably make decisions over time to ensure its survival as an economic unit. We have found that most missions and consequent governance structures need to be reexamined at every major family transition. Most families consider their basic purposes to be growing legacy assets, growing other financial assets, philanthropy, education, and family connections. At different transitions, one or the other of these purposes/missions becomes more predominant; such is the nature of the family evolution. In addition, while there may be some common basic principles of governance, most families quickly realize that governance captures each family's uniqueness as it strains to manage the tensions of being together and yet separate.

Case in Point: Defining a New Mission and Governance Structure For a Family in Transition

Eight years ago, I was asked to assist two brothers and their father, who were struggling with the transition of their family legacy company from a second generation of ownership/management to a third generation. The younger brother, Justin, had gone into the business straight from college and had moved up in the sales side, eventually rising to president of the firm. His older brother, Jamie, had joined after working as a lawyer in the financial industry. Jamie was a man of many ideas and quickly developed other avenues for the family to make money. He expanded the family's real estate holdings and quietly developed several businesses that were adjuncts to the original business. A third and youngest brother was a physician; while he never intended to come into the business, he was invested in it as something that belonged to the family, and so he wanted to support it in some way. Their father, Herb, felt that the company belonged to the family whether they worked in it or not.

Sometimes the need for a new mission and structure grow out of normative changes in a family's life course. Other times, a conflict such as one regarding the role of a family member in the family's holdings, can trigger change.

In this example, whenever Jamie and Justin met, the discussion centered on succession in the legacy business. Jamie felt unrecognized; he believed his efforts were critical to the family's long-term success. Justin understood his brother's concern, but other than promoting him from vice president to executive vice president of the company, he could not see any way to satisfy his brother's desire for recognition. In addition, Justin himself felt that he was not being recognized for his contribution in taking the company into a new league of six-figure profits.

Because of the strong feelings of being unrecognized on both brothers' parts, and because the family continued to view succession as only the passing of the voting shares of the legacy company, I felt compelled to get these intelligent and well-meaning young men to stretch their thinking beyond the usual view of themselves as the owners of a highly successful business. I hoped to assist them in viewing themselves as a family that was bound together economically, and to see that continued growth, economically and otherwise, would demand a different mission and vision for themselves, requiring thinking further into the future than they would typically look.

We met four times over three months. They first painted a picture of the future as they saw it and defined a mission for continued work together as a family. They talked animatedly about the businesses they had built together and their shared excitement about the new ventures. They began to establish principles to guide how they wanted to continue to develop and share assets. They defined their work as a family—their purpose—as being in five areas: their businesses, their liquid investments, their real estate holdings, their philanthropy, and their staying connected as a family. They wanted to continue all these activities together, and to begin involving their own spouses and children, as well as their brother and his family. To define themselves as the stewards and builders of the assets, they wanted the ownership of the assets to be held in a family trust.

Once they had reached agreement on remaining together as an economic unit and had defined the parameters, they were less focused on titles. With less emphasis on the legacy business and more on growing an economy for the family, Jamie jumped into his work on investments and real estate, and continued to grow the family's fortunes, beginning with the development of a family office.

The brothers then began to discuss how decisions could be made regarding their portfolio of assets. We established a task force to consider how family members could get their voices heard and perhaps become working members of the holdings, and how to educate the next generation to deal with the complexity of their activities. The task force recommended the establishment of a family assembly that would meet yearly for fun and education. This group would elect a board consisting of four outside, independent directors and three family members, chosen for their competence and contribution to the areas of the family's efforts. Thus, the mission and vision of the family were beginning to be supported by a definition of structures and processes that could be systematized for everyone in a family constitution.

The details, including selection criteria, terms for participation, and committee structure, were written into the family constitution, which was ratified by the full family at the first family assembly meeting. Over the first few years, the family worked through implementation of the plan very thoughtfully, modifying it as needed. The ability to look beyond the current situation and think into the future, as well as the willingness to build an organization that would permit the family to grow economically, emotionally, intellectually, and philanthropically, was critical to their success. Without defining a structure and process to implement the mission and vision, the old family patterns and dynamics would have continued to play out in their ongoing work together.

As the life cycle shifts and as family holdings expand or contract, every family must entertain the question of "Why are we staying together?" Critical to staying together as an economic family is defining a way to also be separate: how to have a sense of one's own boundaries as individuals and as family households, as well as ways to fairly easily exit the larger unit. In another client family who had sold their legacy business, one of the four families of two original family branches was interested in going out on its own; the other three families wanted to remain together as an economic unit. They wanted to invest together, building their investment and real estate portfolios and developing leadership opportunities for the next generation households. Working out an easy arrangement so that the one family household could continue ongoing family relationships, and yet remain mainly outside of the family's economic investments, was essential for them.

Governance and Managing Complexities

Some clients have suggested that perhaps only large, multi-generational families with many holdings need governance. Almost any family that has one asset has two, and just being an economic family also still involves complexities. Sharing an economy means sharing risks, and that means family members will need to make joint decisions. Providing ways in which shared risks and joint decisions can be accomplished saves a family much difficulty over time. Sharing an economy provides challenges and opportunities. When families are able to surmount the challenges by developing ways to make decisions, develop stewardship, and manage the tension between the emotional and the economic, those families can also develop greater opportunities for all their family members. It is an essential element in family sustainability. Here are some questions that can serve as guidelines for examining how your governance is working for your family:

- Do we have a mission, a purpose for staying together as an economic family?

- Is that mission backed up by values that we can live by?

- Do we have meetings as an economic family?

- Have we outlined a way that the family will make decisions?

- Have we distinguished and communicated the kinds of decisions to be made by family, shareholders, and trustees?

- Do we have a constitution that outlines the details of our membership, committees, and assembly, and is this given to each new member of the family as defined in the constitution?

Families who share assets over time are bound together both economically and emotionally. These binds create both risks and opportunities. In order for the family to enhance the opportunities, they need to find a way to deal constructively and productively with the complexities and the risks. Family governance provides a method for families to evolve and grow as they navigate complex decisions. Ultimately, implementing a family governance system increases the family's ability to sustain itself and its entities.

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Endnotes:

This article was excerpted from A Family's Guide to Wealth: Insights from Thought Leaders and Pioneers. The Guide was published by GenSpring Family Offices in commemoration of the firm's 20th anniversary (1989—2009). Reprinted by permission of the publisher from Family Business Magazine's 20th anniversary issue, Autumn 2009.