Avoid the Pitfall of Systemic Uncertainty When Making Decisions About Shared Family Assets

By: David Lansky, Ph.D., The Family Business Consulting Group

Primogeniture is the right, by law or custom, of the firstborn legitimate son to inherit his parent's estate, in preference to shared inheritance among all children…

The law of primogeniture in Europe has its origins in Medieval Europe which, due to the feudal system of ownership, necessitated that the estates of land-owning feudal lords be kept as large and united as possible to maintain social stability as well as the wealth, power and social standing of their families. In western democracies today, primogeniture, while still existing in some forms, is generally considered atavistic, regressive or a throwback to less civilized times, because as a practice it is viewed as representing patriarchal, autocratic, anti-democratic, sexist or exclusionary thinking. Indeed, in some parts of the western world, "forced heirship" laws have been passed to ensure that estates are shared equally among inheritors, resulting in the purposeful dilution of family assets, and dispersion of decision-making authority — exactly the opposite of the goal of primogeniture practices.

All that being said, the practice of primogeniture has at least one positive correlate: *that ownership and control of an estate are securely vested in one party, with no uncertainty or ambiguity as to who has decision rights and obligations to keep the assets secure.*

Contrast that with contemporary estate and wealth transfer plans in which assets are transferred from a single wealth creator to a group of inheritors and beneficiaries. Whereas this transfer may equalize the ownership of a family's assets, it is potentially one of the most challenging matters an enterprising family can face, because shared ownership may be accompanied by a shared sense of uncertainty or ambiguity as to who has the right to make which decisions, and under what circumstances.

Whether the assets consist of an operating business, a portfolio of invested securities, a family foundation, real estate holdings or other shared holdings, this ownership transition, involving a shift from a single controlling owner with a single voice in decision making, to potentially many family owners with many voices in decision making, could introduce a level of *systemic uncertainty* into the family system.

Five Sources of Systemic Uncertainty

Consider these five ways in which the transfer of ownership from a single controlling owner to potentially many family owners may lead to uncertainty in a family system:

1. Equal ownership conveys equal say, even when the parties differ in experience, competence, skill, etc. A family may struggle with uncertainty in deciding whether all equally owning parties should have equal authority, even for matters in which some parties have little or no expertise, while others have great expertise.
2. Voting and non-voting shares are created in the course of an ownership transition as a way of ensuring that certain family members (e.g., those working in the business) have authority over certain decisions. Families frequently lack clear understanding of the implications of these different classes of ownership, in particular, a clear understanding of the specific rights that voting shares convey and the specific

rights that are withheld from those holding non-voting shares.

3. Actual ownership of family assets is clear, but it is not clear who should participate, in what manner, in which decisions. Because asset-sharing families often choose to be inclusive in their decision making, some family members may be invited to participate in decisions to which they are not entitled, raising questions such as how much influence minority shareholders should have and how much weight their opinions should carry.

4. Not having articulated "What is yours, mine or ours?", a family sharing responsibility for financial assets will occasionally find themselves taking responsibility for other family matters such as how a sibling's children are raised or how a cousin manages alcohol use. Because they are sharing responsibility for financial capital, do they also share any responsibility for human capital? If so, how much responsibility do they share and for what matters?

5. "Is this a democracy?" Transitioning shared ownership might naturally lead some family members to believe that they are governed by a democratic system ("We are all equal owners of this real estate, so we all have a say in how it will be developed"), when the system is actually autocratic in nature ("Granddad transferred ownership to us, but he is still the ultimate decision maker"). In sociocultural terms this kind of system bears similarity to an "illiberal democracy", i.e., a democracy in which elections take place but decisions are actually made by a central authority. The uncertainty that evolves from a family's illiberal democracy may result in tension, conflict or disengagement of key parties from what feels to them like a disingenuous system.

Consequences of Systemic Uncertainty in a Family System

Although there may be other sources of uncertainty in a family system in addition to those discussed above, whatever the source of that uncertainty, there are three consequences that I believe are most significant in their impact on the family and on the shared assets:

1. Competition and conflict among individual family members or between family factions about decision authority for investments, operations, acquisitions, divestitures or other actions.

2. Psychological stress and tension, leading to disengagement by family members who wish to leave an unpleasant situation, either physically or psychologically by opting out of any possibly contested matters.

3. Appropriation of authority by non-family executives, trustees, external advisors or even family members who observe weakness or indecisiveness in the family ownership group.

Managing Systemic Uncertainty

Name It

Systemic uncertainty may be the cause of significant and disruptive dynamics in a family, including tension, hostility, and disengagement. There is a tragic element to this in that it can be easy to blame individuals for the appearance of these disruptive dynamics: "It's the family CEO's fault because he just wants control" or "It's my sister's fault because she doesn't know when to mind her own business," etc. when it's actually the nature of the system — uncertainty — causing the disruption. So, a first step in managing uncertainty is understanding the impact it can have on individual or group behavior by calling it out: "It's not you, it's the system!"

In parallel with naming uncertainty comes the ability to talk about it — how it is manifest, its consequences, etc. This may be more difficult than it seems, because simply raising the question of who has authority for what decisions can sometimes be interpreted as a challenge to those who have actually taken responsibility. Families typically avoid potentially difficult conversations, fearing that such conversations will upset family harmony. As a result, the dynamics described above occur, causing tension in the family, leading to factions, competition, infringement on rights, etc. and may not be identified as a consequence of systemic uncertainty, but instead become private, personalized, unspoken, with blame targeted toward individuals rather than to the dynamics in the system as a whole. This can lead to resentments and underlying conflict in the family — exactly the opposite of what is intended by the avoidance of the matter in the first place!

State What's Certain

One way to approach this dilemma is to view needed conversations as educational efforts whose goal is to truly understand what was intended by the way in which transfer of ownership has been structured. Meetings with attorneys who set up the structures are helpful in this educational process. Voting and non-voting shares may have been created so that only those holding voting shares have a right to make certain decisions; or shares may have been transferred in trust so that only certain trustees have the right to make certain decisions; or a majority of shares may have been transferred to some parties, while others received minority ownership. In each of these cases, it is useful to articulate the kinds of decision authorities that are governed by the ownership structures: What specific authority does this structure provide? It helps to be very clear about the specific rights that are conferred by the ownership structures. For example, equally shared interests in a family foundation might mean that all parties have a say in how foundation funds are distributed; but individuals will still retain the right to make donations on their own, even if those donations are made with the same family name.

Some parties may hesitate to state what is certain, out of concern that such clarity might be more disruptive of the group. For example, granddad might hesitate to state outright that he is the ultimate decision maker, regardless of how ownership has been transferred, because he is concerned that this will demoralize his grandchildren. Similarly, establishing a greater level of certainty among owners could threaten some parties who have otherwise benefitted from the lack of alignment among owners.

While these conversations may be difficult for family members because they could reveal differences which previously had not been realized, if the goal is a unified and functional ownership group, it is in the best interests of the owners as a whole to clarify where things actually stand. The systemic *certainty* resulting from such clarity will be beneficial in the long term.

Clarify Who Gets to Participate

Even when legal structures dictate who gets to make which decisions, who actually gets to participate is not always clear and can be a source of uncertainty. As noted above, families often invite input from parties not legally entitled to decide but whose input may be valued. (e.g. What values should guide our charitable giving?) Families also make decisions about matters that are not at all dictated by legal structures such as who should serve on their family council. Therefore, productive discussion in a family, in addition to what is actually dictated by ownership structures, should focus on who has a right to participate in which decisions: whose opinion is welcome (e.g., only shareholders or all adult family?), whose opinions will be considered in making decisions (e.g., only those holding voting shares or all shareholders?), and who will actually decide. It is important to have these conversations when initially faced with a matter that needs to be addressed. In all cases, it would be helpful to consider the types of experience, talent, skill, education, or engagement that might be necessary for someone to have a say in family matters and in business matters.

Decide on a Decision Process

Along with an understanding of ownership structures, and clarification of who gets to participate in which decision matters, systemic uncertainty should be addressed by deciding how group decisions will be made: By majority vote? Super majority? Unanimity? Consensus?

It is a good idea to establish a decision process early on, as an ownership group develops. My colleagues Christopher Eckrich, Ph.D. and Stephen L. McClure, Ph.D. have authored an excellent white paper on this topic: *Decision Making on Family Business Matters.* (Article can be found on our website: www.thefbcg.com.)

Whatever the process decided upon, it is important to stick to the process agreed to. I have observed systemic uncertainty come sweeping back into a previously well-managed system when family members forget or purposely abandon a decision process they had previously agreed to.

Establish Yours, Mine and Ours

Finally, family ownership groups should build an awareness of the importance of establishing "Yours, Mine and Ours." This is not a matter that will always be of concern, but from time to time, families will be drawn into taking responsibility and making decisions about issues that have nothing to do with ownership of financial assets. Uncertainty in the family will be reduced by first having an open discussion about which matters are legitimately family concerns and which matters are only of concern to the individuals involved.

David Lansky, Ph.D. is a principal consultant of The Family Business Consulting Group.
He can be reached at lansky@thefbcg.com.

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A Family Business Consulting Group, Inc.® Publication

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