THE FAMILY BUSINESS CONSULTING GROUP

Linking Family and Business Governance in Later Generations

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A common conception about family business throughout the world holds that the first generation builds the business and later generations harvest the business rather than reinvesting for long-term success. Nonetheless, many family businesses strive to achieve a lasting legacy. A strong, independent board of directors is one tool to strengthen the business. But the board alone cannot ensure survival. A supportive family ownership group, organized to work in support of the board and the business, is crucial as well.

As the shareholder base expands and becomes more diverse over time, ensuring healthy shareholder relations becomes more important and more complicated. Harnessing the power of a cohesive, committed family shareholder base provides great strength to a company. Conversely, managing disparate family interests can sap management energy and distract the CEO from pressing business issues. And, while an effective independent board can be of great help in perpetuating the family business, directors must enjoy the trust of family shareholders and communicate well with them to exercise needed creativity and insight.

Stages in the Evolving Family Business

Shareholder relations in family businesses typically become more complex as the second generation of family owners grows older and their offspring (the third generation) approach the age at which they will assume an important ownership role. (This transition may happen earlier in large families with in-laws involved.) The ties binding the family can loosen or fray at this point. Often, the cohesive influence of the founder or other early business leaders is waning. Further, the death of key first-generation family members may weaken the shareholders' sense of unity and common origin.

The emerging generation of shareholders may have differing expectations of the business. Cousins are usually not bonded as closely as brothers and sisters. They may demand greater financial freedom, including a liquid market for their shares. They may disagree on appropriate levels of dividends, debt, growth and profitability for the business. Their expanding numbers may complicate the selection of future managers. They may have conflicting views on how family members should be employed and compensated in the business. In a growing business, the changing strategic needs of the company can complicate management at the same time, heightening capital requirements and sometimes demanding an entirely new style of management or even a new corporate structure.

All of these conflicts and hurdles are perfectly normal and natural. Yet, failure to anticipate them can waste an opportunity to harness the power of an expanding, potentially committed shareholder base. At worst, it can lead to serious shareholder disputes, liquidity and capital problems or management crises that profoundly affect the role of the board and may even force many family businesses into extinction.

How can owners and directors anticipate these hurdles and plan to surmount them effectively? As best practices around family business governance become more widely known and understood, an increasing number of family businesses are developing formal, carefully structured family governance systems to manage the burgeoning array of ownership issues and to serve as a complement and interface to the board of directors. Family ownership groups that invest in such an effort are typically able to consider a wider range of ownership options, as these family governance systems facilitate communication and better decision-making. A well-designed family governance system enables owners to think through their options and arrive at an approach that makes the best sense for the family as a group, the business going forward and the needs of the individual owners.

Establishing a Family Council

A board with independent directors can be invaluable in helping solve the problems of family businesses in all stages. (NOTE: An independent board is a recommended practice for family businesses in second generation or beyond to provide accountability of management to owners and sound, objective advice to management.) But a board of directors, no matter how experienced, cannot function effectively without a clear mandate of support from the shareholders. This mandate is best provided by an educated, cohesive shareholder group that has established a means for resolving conflict, articulating its interests and educating itself on the business and the responsibilities of shareholders.

By the third generation of ownership, a carefully structured family council is often needed to provide education, resolve conflict, make important family decisions and clarify the needs and expectations of shareholders. The family council can also create a sense of common purpose among family members and provide an opportunity for owners to participate outside the business itself. Perhaps most importantly, the family council allows the family to speak with one voice to the board.

The Role of the Family Council

The role of the family council is to find consensus on matters where the owners' wishes matter most, as well as to perform certain functions unique to the family. Ideally, it can provide family members with a sense of identity and mission that transcend their role as mere financial stakeholders in a business.

The typical family council faces a variety of important questions: What is the family's philosophy of doing business? What is its mission, both within and outside of the company? How are members to resolve conflicts? How should family values be manifested in relation to the business?

Just as important is a long list of capital-related issues, such as dividend policy, liquidity, terms of liquidity, profit goals, growth goals and the character and risk of the corporate investment portfolio. What businesses should we be in? Should we do startups? Where should we invest most heavily? Do we want to be highly leveraged? Do we want to invest in high-risk businesses?

The family council can also take responsibility for certain functions unique to the family. Preserving family traditions and values and educating family shareholders about the business are two important examples. Often, family education is required for family members to make informed decisions on such matters as appropriate debt, profit, growth and dividend levels for the business, the role of the shareholder and other matters. A significant effort needs to be made to educate shareholders about the rights, responsibilities and privileges that come with ownership.

Many family councils establish criteria and facilitate preparation of family members interested in serving on the board or in other governance roles. They also assure early exposure and education to good governance practices for younger family members.

Topics Important to the Family Council:

- Allocation of capital; appropriate dividend, profit, debt and reinvestment levels for the business
- Liquidity for shareholders
- Family business philosophy
- Family tradition in the business
- Family history and its role in the business
- Family culture and its role in the business
- Family values and their role in business strategy
- Performance of investments
- Estate planning by owners
- Family mission
- Family members' role in the business
- Family members' participation in the business

- Role in society; philanthropy, civic activities, politics
- Family responsibilities as business owners
- Family visibility in the public domain
- The role of the business in supporting family members' goals
- Education of family members in all these areas

The family council serves as a channel for communication to shareholders, in some cases through memos from the council to the shareholder group at large, in others through meetings, and in some through newsletters or websites. In addition, some family councils take on various non-business issues, such as philanthropy, family history and family investment, among others. Committees formed to address these topics may report to a gathering of the whole family at family meetings or through other family communication channels.

Most family councils meet two to four times a year. Many combine business-related meetings and activities, such as plant visits or reports on business performance, with recreation at annual gatherings at a resort or hotel. Some invite family business consultants or other outside experts to these sessions to deliver education sessions or to facilitate family decision-making. Larger families may engage a family business consultant to support the council on an ongoing basis and assist in planning council meetings.

Some families arrange meetings around the board's schedule to air family matters and views before directors meet. This gives the family a chance to communicate with the board. It also encourages family members who hold seats on the board to air personal feelings and opinions outside the boardroom to avoid consuming board time with matters more appropriate to the family council.

Finally, the family council can cultivate among members a sense of cohesiveness and purpose completely separate from the goals of the business. Ideally, in a well-run business, the family council fosters among its members a sense of trust in managers and directors to oversee strategic objectives with only an appropriate level of involvement from shareholders.

In turn, shareholders' energy can be channeled into more productive activities, helping to transform unhappy family members into a collective source of energy and support for the family business. Equally important, the family council provides an outlet for contributions of family members whose skills and experience may not be ideally suited to participating in the business or on the board. kindness and patience.

A chapter excerpt from the book: *Building a Successful Family Business Board*

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