



Paper Trails

A no-nonsense guide to essential documents for family businesses.

BY JOSHUA NACHT

When the Caladan family gathered for its biannual shareholder meeting, there were a number of significant topics to discuss. The most important was a clarification of some items in the buy-sell agreement. Prior to the meeting, each family shareholder had access to a digital version of the family constitution. Everyone was expected to be prepared to discuss the topics on the meeting agenda. The family council had printed relevant family documents for reference during the discussions. The family was also due for its scheduled review of the family employment policy, which had become outdated for the current generation and was up for its review right on schedule. When the meeting began, the family read their vision and values statements out loud, and family leaders reminded everyone of their code of conduct. The meeting conversation was civil, spirited and effective because all the necessary information was close at hand.

Contrast this with the Laggertons, who operate without a set of clearly defined policies or documentation. The three siblings had begun to argue over how their advisory board meetings should be conducted and what matters required a vote versus verbal consensus. Without a board charter or by-laws, there was no clarity on this topic beyond how their father informally ran the meetings. To complicate matters, the father

had not yet updated his estate plan after his divorce, and the three siblings had no idea of the possibilities of future ownership. The three of them were aligned in theory but had never really discussed their goals and vision for the future of the business. The meetings tended to devolve by the afternoon, with the dad becoming exasperated and the youngest sibling checking his email and social media. Without clear guidelines, the Laggertons operate in an atmosphere of confusion.

In numerous practical ways, families are guided and held together by the documents they create and share. The essential documents that help give business families fundamental organization range from complex legal estate planning documents to simple yet powerful vision and purpose statements.

Essential documents help families define, structure and sustain success across generations. The most successful multi-generational enterprising families and family offices utilize a variety of operational descriptions or “moral” agreements as the means to manage the complexity of having family and business mixed together. The intention is not to add bureaucracy but to add organization and clarity so that family members of all ages can better understand the system they are a part of. It is critical to consider those documents that you already have in place, those that may need updating and those that you need to invest time and energy into creating.





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LEGAL DOCUMENTS

Estate Planning and Trust Documents

Benefits: Legal protections for owners and tax minimization

Challenges: Lack of understanding of roles (beneficiaries and trustees), and the possibility of beneficial owners becoming very distant from meaningful roles and involvement

Estate planning documents delineate how assets are transferred from one generation to the next. These documents often create trusts that can affect the wealth for generations to come and can be a significant way of creating structure for how the family has influence and control over assets.

Estate planning documents are created by attorneys along with the grantor(s). The documents are often designed to minimize taxation when the wealth is transferred, with varying levels of effect on the subsequent owners of the business, since these documents also often define the shape of ownership for generations to come. In the case of a trust, the appointment of trustees, along with their relationship with beneficiaries, has important implications for future ownership, since technically the trust will own the shares, not family members directly. Estate planning must happen throughout the system, as any gap in planning, even for owners with small ownership percentages, can have implications for other owners throughout the family.

A lack of estate planning can threaten the survival of the family enterprise because taxation at the highest, most unfavorable rates can force an unwanted partial or full sale of the company. Proper estate planning creates clarity and certainty for the family and the business if there is good transparency about the plans. If there is not a clear understanding of roles and the implications of the trust structures, confusion and consternation may emerge, particularly from beneficiaries who are now bound by something they did not have a hand in creating. Additionally, some trust structures create so much distance between beneficiaries and ownership that a feeling of disconnection from their enterprise can be unintentionally created.

Shareholder Agreement/ Buy-Sell Agreement

Benefits: Clear framework and rules regarding ownership

Challenges: Creating agreements that work for all stakeholders

Shareholder agreements (which often include buy-sell provisions) outline how shareholders interact

with their ownership interests. These are legal documents, created by a qualified business attorney. Shareholder agreements can spell out numerous aspects of being an owner of a family business, including ownership valuation, ownership transfer or sale options, voting rights and selection of board members. Absent these legal provisions, owners are governed by state laws, which may not be favorable to you and your particular family business situation. These are some of the most important documents for business-owning families to create as they form the legal basis for how shareholders manage their ownership interests. Shareholder groups that are aligned on their purpose will find it relatively easy to create these agreements with the proper investment of time and energy.

Early-stage businesses with only one owner rarely need a shareholder agreement. Most shareholder agreements are created when ownership is passed to the subsequent generation (commonly at the sibling stage) and before the shareholder group becomes too large to agree upon the terms of the agreement. Creating these agreements can pose challenges, especially if the owners have different goals and objectives. Owners who want to pass along the business to the next generation will look for an approach that minimizes share price, allowing shares to be transferred more easily. Conversely, owners hoping to sell their shares for liquidity purposes will look to maximize share valuation and sale price.

Shareholders should understand that they are creating a contract that is binding for their ownership interests and can have long-term implications. Partnership agreements that require partners to buy each other out or give control to a general partner can present barriers to effective family ownership transition planning.

Corporate Bylaws

Benefits: Provides valuable corporate guidance; keeps everyone on the same page

Challenges: Must be reviewed and updated regularly to remain pertinent and current legally

Corporate bylaws are the procedures, rules and standards that govern how the corporation is run. Bylaws are the central reference point for managers in their organization and operation of the business and may also delineate rules for how the board votes. These documents are particularly helpful in creating increased structure to meet the needs of a growing and increasingly complex business.

Bylaws can quickly become outdated and lose their pertinence. I recently worked with a client who was still operating under the same shareholder agreement and corporate bylaws that were created in 1957. At that time, there were three owners; now there are over 70. You can imagine how much has changed in that time and the far-reaching need to update these agreements while still keeping the core tenets in place. Outdated bylaws can present a “sleeper” problem, creating a much more difficult situation for the family. Qualified business attorneys are valuable resources in creating these documents in a proactive manner and helping to ensure a timely review schedule.

ESSENTIAL OPERATIONAL AND MORAL AGREEMENTS

Written Succession Plans (long-term and emergency)

Benefits: Provides transparency, guidance and clarity for an inevitable major event

Challenges: Must be regularly updated to be effective

Many business leaders have thought about a succession plan, but less than one-third of U.S. family businesses have a robust, documented plan in place to govern either a planned transition process or an emergency succession. Because many family businesses desire continuity from one generation to the next, having a written, long-term succession plan can strongly support that goal. This type of plan can bring clarity and stability for both family members and non-family management because they know there is a plan in place, even if they are not privy to all the details.

I hear a lot of people mention a variation on “if X were hit by a bus...,” but how many organizations actually have a plan that accounts for the profound disruption and confusion that can occur in the face of emergency and tragedy? If a crisis occurs, having a written plan can alleviate a lot of pressure on people who are faced with running a business amid a highly emotional event. This document should be written by business leadership, with input from the senior management team as appropriate. Many governance charters (see below) require the CEO and management team to create both a long-term and an emergency succession plan. This type of forethought also allows time to identify gaps in personnel capabilities and to address them strategically.

Governance Charters

Benefits: Everyone knows and understands the rules, roles and boundaries of effective governance

Challenges: Can become outdated if not regularly reviewed and kept current

Any working group needs a charter to define its purpose, goals, roles and responsibilities. This is true for legal entities such as fiduciary boards, for family governance groups such as family councils, and for task forces and committees. Governance charters define the basic structures of these groups and provide the necessary guidelines for them to achieve their goals.

One commonly overlooked aspect of governance charters involves outlining the roles, responsibilities, boundaries and communication channels among governance forums. Having these aspects defined can support effective and optimal function and information flow throughout the system by helping people “stay in their lanes” and operate as part of a team.

Governance charters are not legal documents and thus provide a greater degree of flexibility as the family grows or the environment changes, allowing changes and updates to meet the most current governance needs for the family and business. Family business consultants can be valuable resources for creating and developing these charters.

Family Employment and Compensation Policy

Benefits: Provides shared understanding and increased objectivity for an emotional matter

Challenges: Policies that are too strict can inhibit qualified involvement; the policy must be adhered to in order to be effective

A family employment policy outlines the credentials, expectations and selection criteria for family members who desire to work in the business. These policies are usually created to help protect the business from hiring underqualified family members as well as to give family members themselves defined pathways for their development so they can be excellent candidates for employment. Delineating how family members will be selected for employment can create a more fair and open process that can help manage destructive nepotism. These policies can also provide compensation terms to ensure family members are fairly and consistently compensated.

Family employment policies are best created proactively, before multiple family members work in the business, but the reality is that they are often created reactively, after employment challenges arrive. The absence of these types of policies can mean confusion for family and management about the expectations for hiring family members. Even when these policies are created, there can be challenges in adhering to them when the desires of the family conflict with an objective policy.

Business families at some point in their evolution must ask and then subsequently answer the question, “Why are we in business together?”

A family employment policy is usually created by the family, ideally with input from non-family managers and family business consultants. Business families can readily learn from what has worked for other families, and then adapt the details to fit their unique situation.

Vision/Purpose/Goals/Values Statement

Benefits: Alignment and shared orientation

Challenges: True consensus can be hard to forge; need to be updated to ensure relevance for the current generation

Business families at some point in their evolution must ask and then subsequently answer the question, “Why are we in business together?” Families who define and create a strong sense of purpose commonly find strength and alignment in this type of document. This statement can be brief and succinct or quite detailed, depending on

the needs of the family and the business. Some families separate out various aspects of vision, purpose and specific goals into separate documents, while others have a more generalized type of statement. In any case, these statements can provide a meaningful way for the enterprising family to have a common orientation and reference point. A clear statement provides a touchstone for owners, managers and board members alike to help guide their actions on behalf of the business and the family. The process of gathering input from a broad constituency is valuable in order for the statement to have real meaning and for everyone to feel their perspective was taken into consideration.

In addition to a statement of business values, many families create a statement that outlines the family’s most salient values and principles. Documents of this type define, influence and sustain the culture of the family. Values statements can serve as enduring markers of what the family stands for and are also an important reference point for future generations as they subsequently review and refresh the family values. A family business consultant can facilitate this process by guiding the family through various proven exercises to help define and consolidate the most important values for the family. This process can also take place as a review and refresh of existing family values, which would integrate both historical family values and updates for the modern generation. Family meetings can be designed to bring these statements to life by reading them aloud and referring to them regularly to guide decision making.

Code of Conduct/ Communication Ground Rules

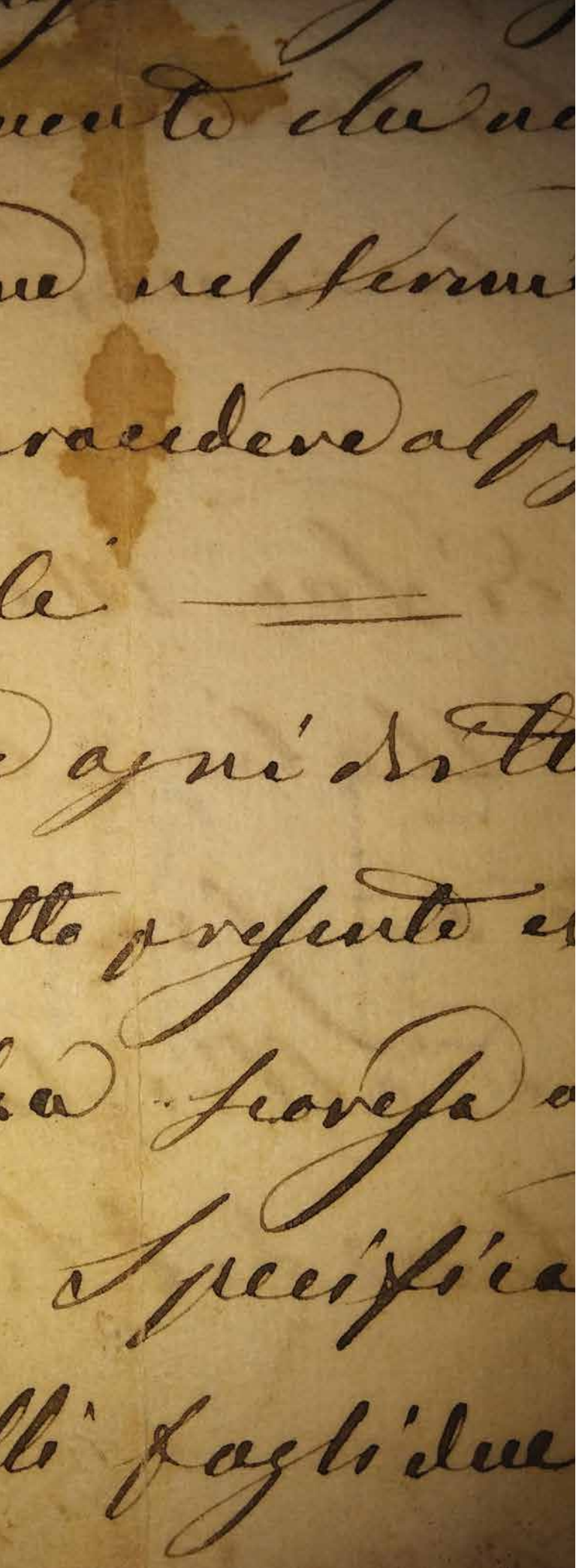
Benefits: Clarity around behavior, interactions, and public visibility

Challenges: Ensuring accountability

Some of the most sensitive challenges facing family businesses concern interactions among family members, as well as the public visibility of family members. Families who have defined guidelines for behavior and interactions are better able to manage the charged emotional aspects of being family members in business together. A code of conduct provides the “guardrails” for behavior, communication and interactions that can help provide a more objective view for everyone. Communication ground rules can delineate what respectful and effective communication looks like for the family, particularly during a family meeting. Families can refer to these documents when (not if) tensions arise. The documents provide a neutral, mutually agreed-upon set of ground rules for everyone, regardless of position.

These guidelines can also extend to the public actions and visibility of family members. Enterprising families are often well known in the community, and family members’ actions reflect upon the business and the rest of the family. Social media policies are increasingly being developed to ensure that individual family members’ use of social media does not adversely affect others. Consider the case in which an adolescent family member posted sensitive documents on her social media to show her friends “how boring the meeting is.”

These guidelines are often born of past experience, and the language may be interestingly specific to each family based on their history. The process of creating these guidelines can be a powerful way for the family to engage in a meaningful project that is the product of a range of perspectives and generations and can be brought into mean-



ingful action. Family meetings can be guided and kept on track by ensuring buy-in and adherence with these agreements. One creative family threw stuffed animals into the middle of the room when things got off track as a lighthearted way to call out unproductive behavior.

And Don't Forget the Family Constitution

Although perhaps not an “essential” document, the family constitution is a complete set of agreements and documents that help govern the family in their ownership endeavors. All the documents listed here (with the exception of personal estate plans) form segments of the constitution, along with any other documentation, such as family and business historical information. Constitutions should be updated over time, although many elements will be enduring. Think of the constitution as the family guardian — the keeper of the most essential elements that organize and guide you as a business family, and that any family member can easily refer to.

As you consider this list of essential documents, several aspects are worth emphasizing:

- Assess and review your documents regularly by creating a schedule so that they remain pertinent and updated to reflect the current needs of the family. Create the expectation that they will be reviewed and adjusted to incorporate new learning and changes in the family.
- Creating many of these documents can be made more efficient and effective by utilizing a task force to lead the process and gather input from across the family. Additionally, skilled facilitators can make the process more objective, transparent and fair for everyone in the family. Trusted advisers can share examples of what has worked for other families, so you do not have to reinvent the wheel.
- Keep all documents in a secure and reliable place that can be easily accessed by stakeholders. A family intranet site can be a valuable and safe resource.

When you decide to take on the task of creating these essential documents, take a long-term approach. Start by gathering the ones you have and see what portions should be revisited and refreshed. Then identify the documents that are missing and put together a process to address those gaps.

Keep in mind that for many of the family-oriented documents listed here, the outcome is important, but having a fair and inclusive process to develop the documents is vital. Gathering input from all stakeholders while also moving the creation process forward may seem challenging, but it is well worth investing in this effort to arrive at finished results that have the support of everyone affected by the agreement. Also remember that most business families take years to create their documents.

Work through the creation and review process in a consistent and organized manner. This is process that never truly ends, and one hallmark of a successful enterprising family is an ongoing investment in continual development and improvement. ^{FB}

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**Family
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