Family Business Governance

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How a few rules can save your business – and family.

Governance is a hot topic. Shareholders, managers, and business advisors are demanding improved governance of family businesses by strengthening their boards of directors and developing more responsive shareholder relations.

But it gets tricky when your board of directors is also your family.

The governance of a family business is more complicated than for non-family owned companies because of the central role of the family that owns and typically leads the business. In a family business, the business, the family, and the ownership group all need governance. Families in business without some sort of governance often get messy, and the lack of governance is a major cause of problems in the organization. Love, power, and money can be a powerful force to grow the business, but can just as easily blow it up.

Let's start with a definition.

Governance is a process that helps family businesses make better, more informed decisions. According to John Davis, Harvard Business School, good governance produces the following two outcomes:

- Generates a sense of direction, values to live or work by, and well-understood and accepted policies that tell organization members how they should behave or what they should do in certain circumstances.
- Brings the right people together at the right time to discuss the right (important) things.

No organization is effective for long without doing these things. Effective governance systems should be measured by these outcomes, not by the boards and councils you put in place. If your organization does not have these outcomes—a clear sense of direction, clear values, a corer purpose, well-understood sensible policies, does not assemble the right people in a timely way to discuss and decide the big issues facing your organization—then your governance system is likely flawed and needs improvement.

Most people find it difficult to confront especially sensitive issues and to plan ahead. Some degree of formality often helps people focus on their issues, work toward their goals, and resolve their differences. As Davis points out, “a few well-composed and well-managed governance structures greatly increase the performance and on-going legacy of your family business”. Additionally, attracting and retaining talent requires a solid governance policy or they simply won’t come. No one wants to work for a family business, including the kids, in which the rules are unknown, things change on a whim, and there is no clarity on the direction of the organization.

The family business system generates a mixture of business, family, and ownership concerns that can make these systems emotionally charged environments for planning and problem solving. In these systems individuals must manage issues within and across three overlapping groups: the family, the business, and the ownership group (see Figure 1). The overlap among the three groups often leads to differing points of view among individuals depending on their location in the three circles. This is the classic 3-circle model designed by Davis and Professor Renato Tagiuri in the 1970s.

For example, family shareholders not employed in the business often have different views about the proper level of dividends than do non-family management who work in the business. Both viewpoints are typically legitimate and must be reconciled in a respectful way to set direction for the family business and preserve harmony in the family. Strong communication and decision making skills are required to effectively manage business, family, and ownership concerns within and across the family, the business, and the ownership groups.

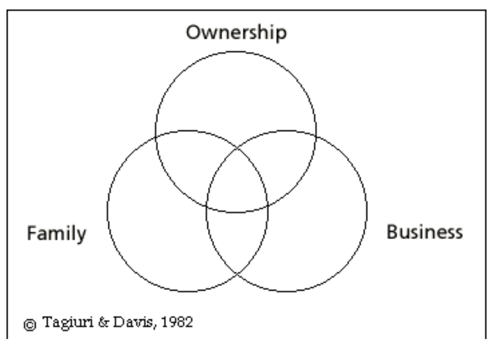

Figure 1: The "3-circle" model of family business

It's well known that family businesses struggle with communication and conflict, and reconciling these diverse concerns can be very difficult. According to Davis, too often, family firms employ dysfunctional and short-sighted approaches to handle tensions, such as:

- Exclusion and secrecy—keeping some family members or shareholders out of conversations and keeping too many secrets from employees, owners or family members.
- Divide and conquer—relying on the support of some allies and excluding others from information and decision making.
- Bribery—hiring relatives who do not deserve jobs, paying relatives more than they deserve, distributing more funds from the company than is responsible for the sake of preserving family harmony or maintaining certain individuals' power.

These methods of addressing business-family-ownership tensions can provide some short-term relief but rarely resolve issues and predictably intensify them.

It is important to note that effective governance does not eliminate tensions in the family business. But it can reduce tensions, improve decision making, and maintain harmony of these systems by clarifying family- business-ownership needs and managing the conversations needed to agree on goals, values, and policies. Good governance is a communication and decision making road map for family business systems.

Good governance contributes three fundamental ingredients for family businesses to function well:

- Clarity on roles, rights, and responsibilities for all members of the three circles;
- Encouraging family members, business employees, and owners to act responsibly;
- Regulating appropriate family and owner inclusion in business discussions.

Governance System Structures

Governance models vary somewhat based on the size of the family business, size and diversity of the ownership group, and the generation of the business. Suffice it to say, the earlier governance is introduced, the likelihood of success for your business increases exponentially.

Some of the companies that I have worked with are worried governance is going to 'slow down their business and create bureaucracy', but the opposite is true. Good governance leads to clarity and trust, both of which lead to speed. And speed leads to lower costs and higher profits.

Before outlining the basic forms of governance, it is important to note that family business governance is an iterative process. Just like your strategic plan (you have one, right?), it changes as you learn and as the environment around you changes.

Most family enterprise systems can be governed by a few structures, shown in Figure 2 below:

- Executive Management Group;
- Board of Directors (or Board of Advisors);
- Family Council and;
- Owner's Council.

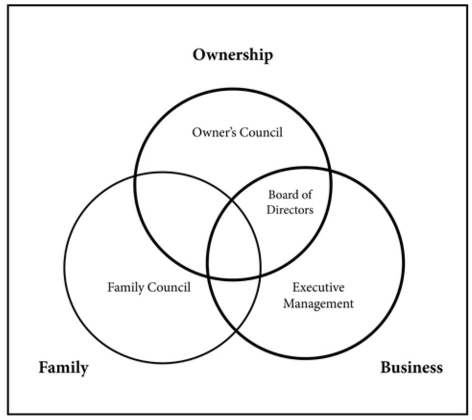

Figure 2: Basic governance structures of the family business system

The membership and functions of these governance structures need to evolve as the business, family, and ownership groups change over time. A first-generation family business may only require (or tolerate) a small, informal advisory board rather than a board of directors. A third-generation family may need a family council to bring together, for example, 50 family members on an annual basis to learn about and discuss the family business, set policy for the family member employment, or learn about the business history and its future. As ownership of the family business becomes more divided over generations, Board composition, Owner's Council composition, and the role of the Family Council need to change.

My advice to get started is to create your Owner's Council, Board of Directors, and Family Council (in that order) to meet your current needs and to periodically discuss how to update these structures to meet the needs of your changing system. Briefly, the roles of the three governance structures:

- The Owner's Council makes decisions on the big picture goals of the family and communicates these to the board;
- The Board of Directors sets policy for the business, approves the Executive Management Team's strategic plan, ensures key position succession planning, and may also make recommendations to the Owner's Council and Family Council in matters that concern the business. They should all coordinate their work, but not overstep into each other's domains.
- The Family Council sets policy for the family and recommends policy that concerns the family to the board (e.g. policy about family employment in the business).

If your family business is struggling with direction, communication, growth, or simply trying to function, take a look at how some governance can help. And to those family businesses that are cruising along just fine, remember, the skies do not remain that way forever. Storms are on the horizon. You never know when one is going to blow in. Good governance is going to help you prevent what could go terribly wrong when it does.

Compass Point *is a business consulting firm specializing in family-owned companies. We work primarily with companies in the manufacturing, construction & professional service industries. We provide hands-on consulting & coaching to help businesses close performance gaps; give owners practical, actionable tools that drive growth; develop leaders and position the business for successful ownership transition – all on their terms.*

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