Three ways family governance improves business performance

BY CHARLIE CARR

The controlling owner in a first-generation family business may not fully appreciate the need for family governance. This person built a business, controls the finances and has typically spent more time at the office than at home. Founders' children rarely (outwardly) question their parents' decisions about the business. After all, Mom and Dad have the final vote, and their kids hope they will share the success.

In second and subsequent generations, however, family governance often has a substantive impact on the stability and profitability of the business as the family grows and the number of stakeholders expands. Ideally, the first generation sets the foundation for family governance, and succeeding generations simply need to document and formalize it. More often, members of later generations must design the infrastructure from the ground up.

What is family governance?

"For the family, governance is a means to protect the family wealth and preserve the family legacy, for generations to come," writes Justin Craig, clinical professor of family enterprise and director of the Center for Family Enterprises at Northwestern University's Kellogg School of Management, in *Leading a Family Business: Best Practices for Long-Term Stewardship*.

Similar to a sovereign country, families need mechanisms for making decisions, resolving differences, determining how to spend money and defining their vision for the future. Rather than legislatures and judiciary, these mechanisms in families often involve committees or councils, written policies and guidelines, and an agreement among the family to use this process to maintain unity and cohesion. We often compile a vision statement, policies and guidelines into a single document called a family charter or a family and business charter. Others may call it a constitution, compact or creed.

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Creating such charters takes time — typically six months to a year, although some families have spread the labor out over many years (and others got discouraged along the way). There is a delicate balance between taking too long and pushing to completion too quickly. One family business we worked with several years ago liked the sample charter we provided and decided to streamline the process by changing the names, tweaking the language and using it for their own. It was a nice try, but the shortcut didn't work for them (and likely won't work for you). Creating family governance is a process, and the family must strategize, discuss and reach conclusions that fit their individual circumstances and values. Even though it is not a legal document, we usually ask adult family members to sign the resulting charter to indicate their commitment to work toward the vision and policies specified inside.

Governance looks different for each family, but it generally starts with a statement of who the family is and what is important to them, along with an aspirational vision of the future. This acts as the mission statement for the family and is often referenced at future family gatherings and meetings. We typically incorporate a summary of the family history and specify the key family values that make them who they are. We also incorporate a family code of conduct, social media policies, family employment policies and other guidelines about how family members should behave.

The charter specifies what governance committees or councils will exist, what these governing bodies will do, how often they'll meet and how positions will be filled. The first governing body to be established is usually a family council, which sets direction and policies, organizes annual meetings and other family gatherings, and works to maintain family unity.

Another key provision is a conflict resolution policy. Ask yourself, "How will we handle disagreements to ensure the family and business are not torn apart?" I'm still surprised when I hear about 60-year-old cousins who haven't spoken to each other in more than 20 years and will not attend an event if the other will be present. These sad stories are ubiquitous and have a negative impact on the family business. Fortunately, such situations can be prevented.

How family governance improves business performance

It may be hard to understand how relationships between family members who don't work in the family firm can affect the business. Let's examine three ways in which family governance influences business performance.

1. Family vision: The family's vision sets the tone for who the family is and how they interact in the community, which in turn sets the tone for the business. Hopefully, the vision is well thought out and aspirational for the future.

The family should discuss the vision extensively and agree to align behind it. Among the questions they should address: What is the relative importance of the business compared to the family, and what is the role of the business in the family's vision?

When the family agrees upon and rallies behind a vision, they are less likely to post on social media in ways that will hurt the business's reputation or to argue publicly about distribution or compensation policies. Clear family employment policies should spell out the requirements for working and advancing in the business. While making money to finance their lifestyle is important to each person, the vision can be a rallying point toward a greater purpose, such as a positive impact on the community, high standing in the industry and support for philanthropic causes. It also can lead the company toward the next innovation in the industry or perhaps to a new business line.

A clear vision can help the family and staff work together for greater growth and profitability. It is hard for employees to move toward a vision when the family doesn't know, or doesn't believe in, the vision.

2. Family cohesion: We can share examples of family business staff who were pressured to take sides in a family feud, and even of family boards that consistently vote 2-1 against a particular branch of the family. Consider a family whose dated buy-sell agreement threatens the continuity of the business, but a younger sibling won't consider updating or eliminating it because he sees it as his path to taking over business leadership.

Other families have split their business or faced years of litigation because of family squabbles. Aside from the financial cost of these challenges, the business has a hard time growing or making strategic acquisitions when leadership is distracted by internal battles. Defining and implementing family governance does not guarantee such things won't occur, but it creates an avenue for identifying and managing issues before they become serious — making it less likely that they will harm the business and the family's continued ownership.

3. Employee stability: In PwC's latest U.S. Family Business Survey, nearly 70% of family firms say that attracting and retaining the right talent will be a challenge over the next five years. U.S. Trust's 2018 survey of high-net-worth investors identified the top 10 challenges to business growth, of which the top two were attracting talent and retaining key employees. Quite often, we see continuity projects that were initiated by long-time employees of the business. ("Continuity" is a broader term that encompasses strategic planning and succession.) Such employees have grown with the family and the business and have tied their future to the company's success. They are concerned that unplanned or poorly planned succession, or perhaps family fights, could hurt the business and their career. Family disagreements (or litigation) make their jobs harder and less enjoyable.

No matter how large and talented the family, growing and succeeding in business will involve attracting and retaining talented non-family members. Several studies have shown that employees generally like to work for family firms. Clearly defining and implementing family governance can improve tenure and stability for these non-family employees.

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Strong family governance can help ensure continuity of the family enterprise from generation to generation. Moreover, it can be a key to growing the business and achieving long-term goals. Families who put in the effort to develop governance structures and documents, and adhere to the rules they establish, will find that the work has a high payoff. FB