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Decisions, Decisions, Decisions: An Introduction to Governance in a Family Business System

"There is little less trouble governing a private family than a whole kingdom." - MICHEL DE MONTAIGNE, Renaissance Scholar And Writer

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NOV 27, 2012

Given the many corporate scandals we have seen during the past decade, and the subsequent rise of investor demand for executive "say on pay" policies, one can hardly escape the topic of corporate governance and corporate governance reform. Public perception of poor corporate governance practices is partly responsible for motivating the Canadian Department of Finance to update and better maintain its reports on how it is working to strengthen regulations for corporate governance in this country (Treasury Board of Canada Secretariat, 2005). However, there is a notable lack of accessible, authoritative information or research on the fundamentals of governance for family enterprise, specifically—in both the public and private sectors. Authors Lane, Astrachan, Keyt and McMillan consider governance for family enterprise "a critical subtext" which "has been missing from this often searing debate" (Lane et al., 2006) in the corporate world. Many more general articles by practitioners and consultants in the mainstream media tend to emphasize "best practices"—but they aren't necessarily effective educational tools for the purpose of educating business families on the fundamentals of governance. In this paper, we define governance in a family business system, describe the basic tenets of governance in a family enterprise, and outline some of the academic research on governance which would be of most practical relevance to business family members. This paper aims to introduce the fundamentals of governance to business families who may benefit from the implementation of governance structures in their enterprise.

There is little doubt about the relevance of family enterprises to the Canadian and global economies, given that family firms create an estimated 45 to 60 per cent of Canadian GDP—nearly half of the workforce in the country is employed by a family enterprise. Inherently relevant to the success or failure of these companies, is the implementation and use of effective governance structures. While many family enterprises are public companies with mandated governance requirements, the relevance of effective governance—whether public or private—applies nonetheless: "the matter of governance in family firms does matter in Canada" (Klein, Shapiro & Young, 2004). A founding father in the field of family enterprise studies, John A. Davis, notes that "all types of organizations. . . benefit from having a healthy identity, a motivating direction and strong discipline" (Davis, 2007) as a result of governance, whether the organization is a business or not.

Defining Governance, Corporate Governance, and Governance Structures

At its very base level, governance is an organizational structure which helps groups to make decisions; it is a mechanism to facilitate the decision-making process in a group, and increase communication. According to the International Finance Corporation's (IFC)

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Family Business Governance Handbook, governance is defined as:

- the structures and processes for the direction and control of companies

And according to John A. Davis, governance is:

- . . . defin[ing] and maintain[ing] the basic direction of the organization through certain processes, structures, plans and policies, rules and agreements (Davis, 2007)

When authors, practitioners and business family members talk about governance in a family enterprise, the term "governance" can sometimes refer to overall governance of the family business system,

"all types of organizations benefit from having a healthy identity, a motivating direction and strong discipline" (John A. Davis)

or it could refer to any of the three specific types of governance for each of the three subsystems in a family business system (see Figure 1). Davis, creator of the widely accepted and referenced three-circle model and a leading expert on family firm governance, describes the three types of governance structures within a family business system as one structure for each of the subsystems: the family, the owners and the business. The "family business system" refers to the interdependence and overlapping nature of the three subsystems (groups). This three-circle model is widely used amongst scholars, practitioners and instructors in the field as a tool and frame of reference in order to identify and differentiate between the three subsystems of the family business system. Here, we will refer frequently to Davis' teachings on governance.

We must therefore be careful to clarify which part of the family business system we are referring to when speaking about governance. While the terms used for each of these subsystems are almost always consistently called 'family,' 'owners,' and 'business' among different sources of literature in the field, the terms used for the types of governance systems for each of these subsystems is not. For the purposes of clarity and simplicity, we will refer to the specific types of governance structures as: family governance for the family group, ownership governance for the group of owners, and business governance or board governance for the business (and which can include an elected board of directors, board of advisors, or both).

Characteristics and Benefits

In a business family enterprise, these three groups could potentially benefit from representation in different ways. Overall, governance structures are intended to provide each member of each group with an opportunity to express their voice, and subsequently increase communication between all members.
While governance structures do not guarantee each member a formal vote in the affairs of the business, they create a mechanism in which everyone is able to participate in some way. It is intended to create more inclusivity within each group of the family business system, to select or elect representatives or spokespeople for each group, to facilitate the process of decision-making, and to create paths toward long-term success. Governance is intended to create avenues to increase trust and respect between its members, to help plan strategically for the future, and to ensure the long-term success of an organization. Successful and effective governance can have a huge impact on the long-term identity, direction, motives and commitment of the family members, owners and business representatives in the family business system. Without governance, a family business system can be fraught with problems, including concentrated decision-making to the exclusion of relevant parties, miscommunication or lack of communication between members, a risk of being overrun by emotion or problematic family dynamics, and a host of other problems that could result in failure of the operating business and/or the entire family enterprise.

"Good governance creates the structure and discipline to ensure the right people are given the right information to make the right decision," says Ruth Steverlynck, principal of RES Consulting Group Inc. "Without governance there is a risk that confusion reins, creating the potential for conflicts, misunderstandings and ultimately poor decision-making.
As a family enterprise moves from a unilateral decision making system (the owner-founder) to a more

complex decision making body (siblings and/or cousins) a proper structure supported by good process, such as good governance, becomes increasingly important."

"governance is an organizational structure which helps groups to make decisions; it is a mechanism to facilitate the decision-making process in a group, and increase communication"

Timing and Development

The three types of governance do not necessarily need to be in place all at once, nor do they necessarily need to operate simultaneously in one family enterprise. The type of governance structure that a family firm needs at any one point will depend on the developmental life stage of the business: inception, growth, harvest; and the stage of family ownership: owner-founder, sibling partnership, cousin consortium (Neubauer & Lank, 1998). The best governance structure for a family enterprise is the right type of governance for one family at one time—and it will likely continue to evolve with the family's—and the business'—changing needs. Co-author of *Building a Successful Family Business Board* Dr. Stephanie Pendergast cautions against the use of so-called best governance practices for all family enterprises.

"We're really hesitant to [use that term]," she said in an interview, "because it implies that there is one solution that is best for everybody. We came up with the notion of calling something an 'exemplary practice,' which may be a good thing for [one family] but isn't going to be the right thing for everyone." Any one type of governance structure, therefore, does not work for any or all types of family enterprises; arguably, the most difficult task for family firms is to initiate and develop a governance structure unique to their own family enterprise, which is most effective for them.

Family Governance: the Council or Assembly

The relevance of family governance was perhaps best described by John L. Ward when he said that a strong family can build a strong business, but a strong business cannot build a strong family.

"Families are complex," Steverlynck says. "In a family enterprise, you need to be comfortable with complexity and to manage complexity. Structure is important which is what governance does. The most commonly seen structure for families is the family meeting; and the goal of family meetings is to improve the effectiveness of the family at advancing shared goals."

Family governance is a way of managing long and short-term plans; decisions, rules, policies and values; and of managing conflict between themselves. It is also a way of building consensus and unity in the group regarding the direction and goals of the family enterprise. The family could choose to form a family council, and elect members to be on the council, or hold family assemblies and include all members of the family. Depending on the choices of the family, assemblies or the council could focus time and energy on articulating a vision, a legacy, bonding exercises, team building, or formal meetings. The family council or assembly would represent the entire group of family members when communicating with the owners' council, so that they can make clear their collective desires—and even concrete decisions—which are then subsequently evaluated and potentially relayed to the board. Policies that the family council would create or address could include a mission or values statement, a code of conduct or a constitution, or decisions about philanthropic endeavours.

Steverlynck says that James Hughes, philosopher and author of *Family Wealth—Keeping it in the Family*, recommends that the very first family meeting could include the elder members of a family sharing the family's stories, to help other family members to understand their past and envision their future. Such stories help family members understand what it took to create what the family will steward together, moving forward.

In describing family governance, we must avoid over-simplifying it. It can entail a complicated web of relationships and dynamics that simply would not exist in a non-family firm: "family firms [can be] rife with personal rivalries and self-control problems that are not easily resolved within the context of family governance" (as cited in Carney, 2005). One of the many advantages of a family council is that, with an opportunity to crystallize a vision, values and goals, the ensuing decision making process for the members of the family becomes simpler.

Ownership governance: the Owner's Council
The governance structure for the ownership subsystem is an owner's council or shareholders' assembly, which consists of representatives elected by the group of owners. While the purpose of an ownership council is significantly different from a family council, a business family member could potentially be a member on both councils. This council is the foundation of the governance system for the business. It is the responsibility of the group of owners to choose or elect which members of its group would be on the council. The ownership council has the ultimate authority to choose members of a board of directors or a board of advisors, as well as the chairperson of a board. If the business is still in the inception or owner-founder stage, an ownership council could even include family members who are not technically "owners" but would prevent decision-making to be concentrated onto a single owner-founder.

"in a family enterprise, the owners, family members and business could potentially benefit from representation in different ways"

The ownership council would address anything related to ownership of the company: decisions on behalf of all shareholders, liquidity issues, generational, succession and transition issues, and how to execute the family's long-term vision. Shareholders' meetings, including all shareholders, would be held as a method of communication and would inform the council of its decisions.

Professor and leading author in family enterprise field, Dr. Ivan Lansberg, likens the owners' council to the owners of a jet plane: they decide the purpose and destination of the plane, but unless they happen to be qualified, experienced pilots, they would never get into the cockpit. The formal, technical skills of the piloting the plane would fall under the purview of the board.

Business Governance or Board Governance: a Board of Directors or a Board of Advisors
The governance structure for the group within the operating business can be either a board of directors or a board of advisors, or both, in some cases. The board of an operating business can include the owners, managers, and/or other non-family members, including professionals chosen based on the specific and strategic needs of the business. It would be at the discretion of the family council and/or the owners' council to determine how the members of the board are chosen, elected or removed. Board members may be known by the family or chosen because they are independent and external to the business.

The board—at least theoretically—holds regular meetings and focusses on:

- Overall strategic direction of the company
- Oversight of management and implementation of strategy
- Relationship among the governing bodies, including communication between all parties; clarity of role, duties, rights and expectations of each of the governing bodies

In reality, there are many instances of so-called "paper boards," which are boards that are just a formality and never actually meet or make decisions regarding the business. This kind of board is intended to circumvent the laws around corporate governance for publicly traded companies.

Since we have already established that family firms can include anything from a single controlling owner to a wide shareholder base, recommendations on how to best assemble a board can vary widely. Most experts, academics and family business advisors who recommend that family firms use boards of directors or boards of advisors emphasize the need for independent or external members on those boards. Certainly, the vast majority of academic research focusses on these boards.

While there is some evidence that governance mechanisms have positive influences on the long-term success of family firms, "the vast majority of work tends to offer family firms the agency [theory]-based prescriptions of having increasingly large, external, diverse and active boards" (Corbetta & Salvato, 2004). Ward writes that "an essential [and] powerful truth [is] that an active, independent board of directors is a most valuable tool for family businesses of all types" (Pendergast, Ward & Brun de Pontet, 2011). The authors of *Building a Successful Family Business Board* say:

"Successful and effective governance can have a huge impact on the long-term identity, direction, motives and commitment of the family members, owners and business representatives in the family business system"

- an active board is a very valuable tool for managing complexity in a family business
- boards with independent directors are viewed as being more effective than boards comprised only of family members
- nonemployed family directors play a pivotal role on family business boards and should receive formal preparation to fulfill this role
- despite the perceived value of an active board, particularly one with independent directors, boards are still underused by most family businesses

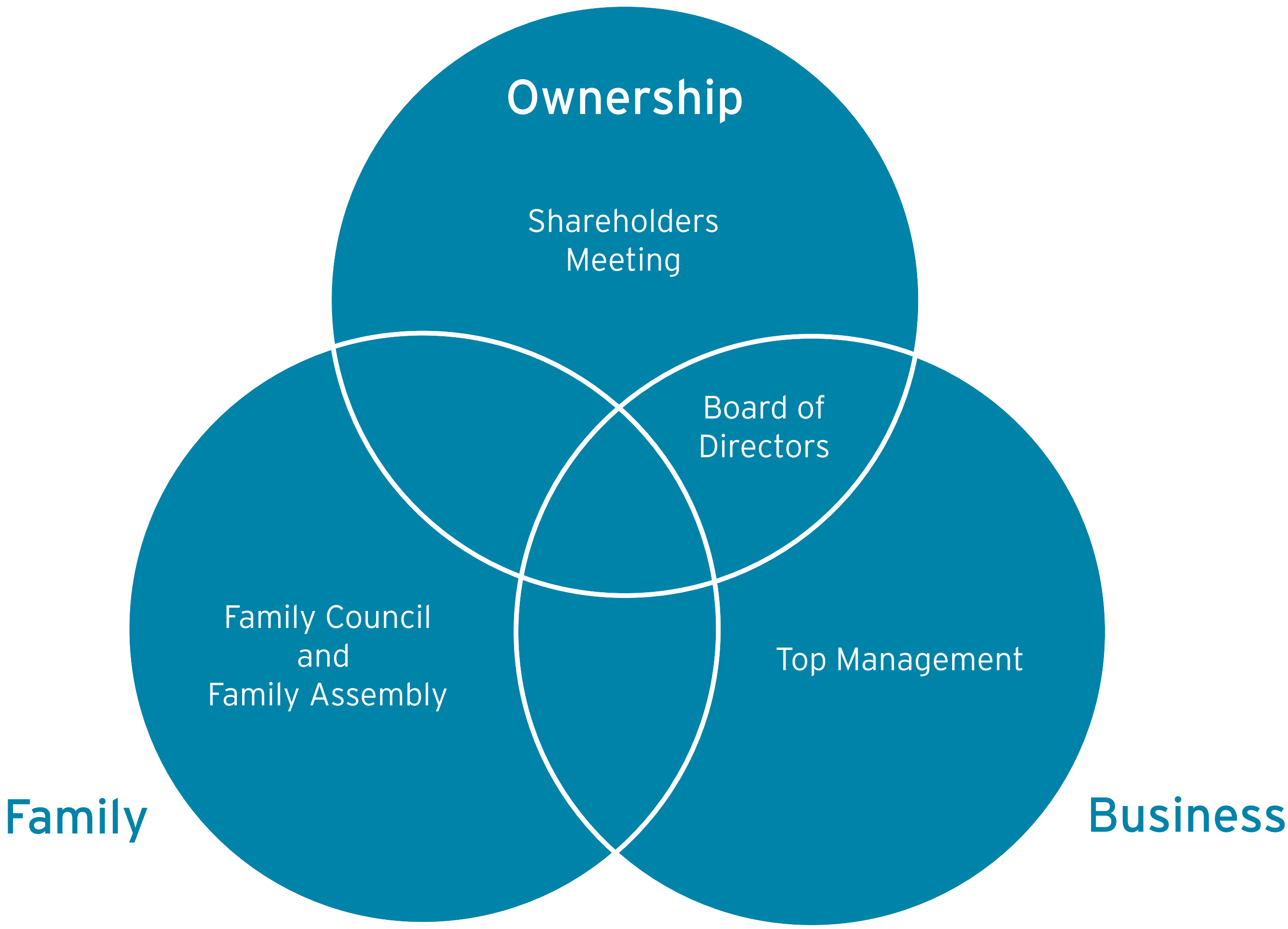
(Pendergast et al., 2011)

Davis says that in his two decades of working with family enterprises of all kinds, "it has been clear that every business able to improve governance reaped lasting benefits" (Davis, 2001). But governance is not the only part of a successful organization, he says: "It's helpful to think of governance as a necessary ingredient in a well-functioning organization, but not a sufficient one. Even when these three governance [structures] are done well, they are generally not sufficient to keep an organization pointed in the "right" direction and performing strongly" (Davis, 2007). He adds that competent management, inspiring leadership, and members with the right skills and values also contribute; good governance of an organization complements these other organizational resources (Davis, 2007).

Here, we have only just begun to explore the vast subject of governance in the family business system: we have defined it and described its basic tenets, and pointed out several relevant authors and researchers who work in the field. We have aimed to increase awareness and education about governance structures in a family enterprise, and we endeavour to inform those business family members, advisors and other professionals who may benefit from the implementation and use of governance structures in a family enterprise. We will further address overall governance of the entire family business system in order to examine its potential pitfalls and degrees of effectiveness in our next issue of Research Matters.

WHAT ARE YOUR EXPERIENCES LIKE WITH GOVERNANCE IN ANY OF THE THREE SUB-SYSTEMS? CLICK ON THE ICONS TO JOIN THE CONVERSATION ON TWITTER, FACEBOOK OR LINKEDIN.

Figure 1
Basic governance structures of the family business system, (Davis, 2001).



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