

Governance Responsibilities Of The Family as Owners/Stewards

Transitioning from The Legacy Business to a Portfolio of Assets

The Brown family is a third generation family enterprise. They have recently sold their largest and legacy company for 175 million dollars, well above what they thought they would obtain for it. They continue to have a stake in several start - up companies and have accumulated some real estate over the years as they have sought housing for their various ventures together. They also have some joint liquid assets in trusts.

The third generation received ownership of the family assets eight years ago as their father decreased his direct involvement in the business and he and their mother began their estate planning efforts. With five children and 14 grandchildren, Edna and Walter Brown wanted to make sure that everything was fair for their family. Two of the children, the youngest and only sons had been employees of the family wholesale farm and large farming equipment business.

Both Roger and William had worked with their father and then with each other for the past 22 years. While they were paid well, their compensation over the years had been well within the best practices for executives in firms their size in comparable industries. Throughout the years the rest of the family, the three older sisters and their spouses had been kept abreast in structured family meetings, they called a council, of how the compensation packages for the working family members were calculated.

In fact the packages had been calculated by a board established by Walter and the eldest of his two sons, Roger who served as President when his dad moved up to Chairman of the Board 8 years ago. Clearly this was viewed as best practice for a company of their size.

The outsider directors who served the board began their service 15 years ago. The corporate counsel who had served the family for 29 years was asked by Walter to serve on the board as one of two non family directors. The other non family director was a colleague and friend of Walter's who was an investor and had participated in many deals in his career. In fact he was instrumental in assisting the company in the transaction which solidified the recent sale. Walter and Roger served with these two men on the board as well as a non voting representation of the family shareholders, the family council president.

While Walter had transferred his ownership to his children over the last eight years, the non working sibling shareholders had been very comfortable in allowing their brothers,

Roger and William, make the decisions about their asset. This was the way in which the family had trusted the patriarch to make decisions for the business earlier.

In fact the family continued to function within a framework which defined the brother's responsibilities to the family shareholders as making the decisions about their asset for them. They continued to have family meetings yearly and family council meetings quarterly but did not act like a shareholder group. Last year the next generation, 16 years and above joined the family meetings. These meetings were viewed as educational and relational in nature and everyone attended.

Over the years all of the siblings received the same dividends and as the business continued to prosper, the dividends increased proportionately. The non working siblings and their families were extraordinarily supportive of their brothers.

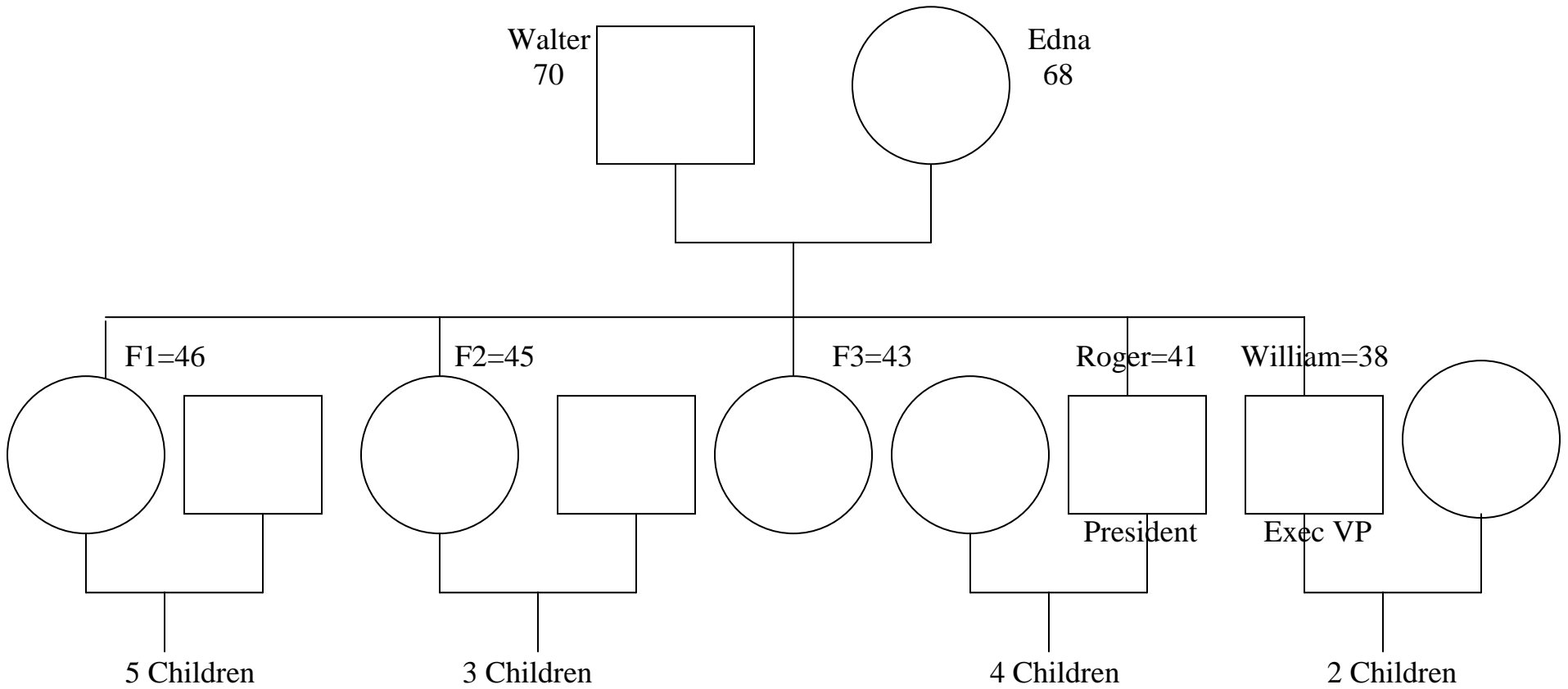
With the sale of the business, there was suddenly a shift in responsibilities and decision making. Roger and William no longer had a business to operate and they initially continued managing the family's liquid, real estate and other assets even though they were less familiar with these kinds of investments. The siblings were appreciative of their assistance but also were clear that they needed more qualified assistance and perhaps also a board and other governance structures that might be more helpful to them in their transition.

For the first time there was a realization that they were shareholders with responsibility for their own and shared assets. Rather than being given distributions they were a part of the decision making with regard to the amount of such and were conscious of potential inequities that could develop as the families grew.

Questions to Consider:

- What problems may arise in addressing this family's issues if the board as currently composed remains in place?
- What changes would you suggest to the family and its current board?
 - At what level would the board function?
 - How many outside directors would you recommend?
 - How would the family address these issues at the family council meetings?
 - What would be the options for enhancing communication channels between the board and the family and vice versa?
- How would you define the board's responsibilities? The family's responsibilities

BROWN FAMILY GENOGRAM



GOVERNANCE RESPONSIBILITY OF THE FAMILY AS OWNERS

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When a company begins to grow beyond its early, entrepreneurial stage, most founding families understand they need to move beyond kitchen-table decision-making and form a board of advisers -- or, at least, the families who are making serious plans to eventually transition the business to the next generation do.

As the business expands further -- into different departments, with non-family managers on board -- smart business leaders realize they need to transform that board of advisers into a board of directors, with truly independent members. They realize that having experienced outside directors, ideally from a company that's advanced a stage or two beyond where theirs is, can offer perceptive advice on taking their business to the next level. What's more, outside directors who are truly independent -- not the company's accountant and attorney, and not the CEO's cronies -- can help ensure that the family firm won't get caught up in an Adelphia-type scandal.

So most sophisticated family companies that aspire to grow and prosper have boards of directors in place to ensure proper corporate governance. But in our experience, most of these business owners are slower to recognize that they need a parallel decision-making mechanism on the family side -- namely a family council. Typically, a business family might wait a generation or more after the formation of a business board of directors to even recognize the need for a family council.

Why is this so? There are several reasons. In earlier generations, when the family and the company are relatively small, the family might not realize that as both entities grow, the issues they will have to deal with will become more complex -- they can't envision that even a close family will have areas of disagreement down the line. Alternatively, the family members might be uncomfortable at the prospect of discussing sensitive issues. Or the family members might be spread out all over the country -- or the world -- and the various cousins who don't work in the business may feel disconnected from it.

But eventually, issues will start to arise, little by little, and family members begin to recognize that the business and the family are, in fact, interconnected -- and that some sort of forum needs to be set up so the family can learn what's going on with the business and have a means of making collective decisions. As one member of a large business family described it, the family members realize they need to discuss not only the future of the business, but the future of the family in the business.

Perhaps the company comes to a crossroads, and family members start to wonder why the board has made a particular decision. Or a young family member interested in working for the company begins to ask about the employment policy. Or some relatives start making noises about wanting to cash out. Or the authoritative patriarch dies suddenly, and the rest of the family who until now had blindly accepted his decisions all of a sudden must learn about their asset. Or some family members want to sell the business while others do not.

Boundary issues between family and business can occur at some of the largest family companies in the world. Here's an example from the news: Last April, the *Wall Street Journal* reported that the family shareholders of the giant French grocery retailer Carrefour would dissolve their voting bloc, which had controlled the company, because of disagreements after the founder died in a plane crash in 2003. A friend of the family told the *Journal*, "The family used to be very united. But now there's a generational gap in how to manage the inheritance."

In the third generation and beyond, the family business in many cases is being run, or at least owned, by cousins. By definition, cousins come from different branches of the family and didn't grow up in the same household, so they may have different values. In later generations, there are likely to be family members who own shares but don't work in the business. As my co-panelist Fredda has written: Their understanding of the business and its needs is not based on firsthand experience.

There are other factors at work as a company becomes larger and more complex. Here are a few of them:

- The number of stakeholders in the business has expanded beyond the family shareholders, and the family ownership group thus has responsibilities to employees (perhaps a large number of them), the

community, and maybe business partners around the world. There may also be either actual or prospective investors in the company.

- If the family ownership group is large, rather than having all owners vote on all decisions, it may make more sense to set up a form of representative governance, perhaps with each branch having one vote. This would enable important decisions to be made on a timely basis.
- The family's holdings may have expanded beyond the business to include real estate -- and managing these holdings could provide employment opportunities for qualified family members who may not have an interest in the core business.
- If the family's holdings are diverse, it might make sense to form a family holding company -- for example, to attract outside sources of capital to fund the operating business without affecting their other real estate and other assets.
- If the family is considering ultimately selling the business, it's a good idea to consider how they would jointly manage their financial asset after the sale.
- Another wealth management issue concerns family members who want to invest some assets separately from the family business, or start their own entrepreneurial venture. Perhaps a family bank could be developed to provide a means for relatives to invest in these ventures.

Jack Moore and Tom Juenemann have written that while the board of directors' role is to manage risk and ensure that the business follows the right strategic direction, the family council's ultimate responsibility is achieving continuity of family ownership and legacy. Just as the board oversees the business, the family owners oversee the board. They note that the family should communicate to the board a strategic direction for the company. The family council is the mechanism by which the family exercises and maintains its ownership responsibilities.

Make no mistake: Setting up a family council, and achieving consensus around the form and structure, involves a lot of time and effort -- and blood, sweat and tears. Charlotte Lamp, a third-generation shareholder of a forestry and real estate company in

the Pacific Northwest, has noted in *Family Business Magazine* that the creation of her company's family council took six years of meetings and intensive work sessions -- yes, I said *six years*. And of course, there are costs involved as well, even though the council itself generates no income. Many companies cover the expenses of family members who travel to attend meetings. In addition to easing the way for those family members who may not otherwise be able to afford to attend, the reimbursement emphasizes the importance of these gatherings.

In addition to functioning as a decision-making body, the family council has another role: educating family shareholders about the business and fostering the development of potential future leaders. A recent example from the news emphasizes the importance of this second function. As the Bancroft family debated whether to sell Dow Jones to Rupert Murdoch's News Corporation, a Bancroft family member wrote a letter to his relatives lamenting that their family had no such forum for developing family members. He wrote: "Our real legacy was an inherited lack of awareness as to what it takes to nurture and pass on an effective legacy about what is really required to be responsible, engaged and active owners of a family business."

Here's another example: In July Rohm & Haas, a 99-year-old chemical company in Philadelphia -- just one year shy of its centennial -- announced it would be bought by Dow Chemical Company. Someone familiar with the Haas family's circumstances told the *Philadelphia Inquirer*: "The next generation, as is typical in these cases, are artists, and they have musical interests; they're absolutely not scientific, technical people by education."

A family education program can help the next generation recognize that their attitude toward the business should be one of stewardship rather than entitlement -- that working in the company is not a birthright but is a privilege afforded only to qualified individuals with the right experience, and only in the event that a position is open at the company.

Creating a newsletter, a family intranet or another system of regular communication can help family members understand what is going on with the business. Keeping everyone informed helps them in their decision-making, which can go a long way toward easing tension in the family.

Speaking of easing tension, to smooth debate at council meetings, the family might create a policy on settling disagreements. Fredda has suggested a number of rules for breaking deadlocks. One of them is: “We will keep the focus on what is best for the firm rather than what is best for any individual.” Another is: “We will remain true to our agreed-upon mission, philosophy and values for our firm.”

As Jack Moore and Tom Juenemann note: “Achieving continuity across the generations is a strategic governance challenge that involves a balance between legacy and renewal. The dual governance structures of a board and a family council can help foster the right balance as the family and the business grow.”

In short, creating a family council gives the company’s directors the freedom to do its job, while also providing a forum for the family business owners to set the direction for the board. While it’s true that creating a council involves a lot of hard work, the families who have done so will tell you that it’s well worth the effort.