

Meeting Ownership Responsibilities Through a Working Family Council

By Glenn R. Ayres

Family-owned companies are a wonderful, sometimes terrifying blend of family and business. There is no “going home” from a family business or “hiding out” at work. Their unique culture is a product of the interlocking of two very different systems: the business system and the family system. The business system is, of course, logic based and is characterized by such fundamentals as “competence,” “profitability,” and “change.” The family system, on the other hand, is emotion based and its fundamentals are dominated by “love,” “loyalty,” and “maintenance of the status quo.” Some would describe the two systems as the polar opposites of one another, yet it is just this unique blend of systems that has made family business the dominant form of non-governmental, business ownership in the world.

On an everyday basis, family businesses often look like and operate like any other form of business ownership, but in an atmosphere of rapid, fundamental change they often perform very differently than their publicly traded peers. When they function well, they can make decisions quickly; they have access to patient capital; and they can plan and measure success in ways that the public market simply will not tolerate. When they do not function so well, it is frequently the undisciplined, competing needs of the family and the business systems that will limit their potential or even precipitate their failure. How well the two systems complement—as opposed to compete—with one another depends upon the application of good governance practices.

Director Summary: Wise family-business owners create a family council, where the family’s wishes, called “the voice of the family,” can articulate an ongoing culture that is upheld and respected by non-family directors and management.

Good Governance

In family business, good governance has three distinct characteristics beyond the best practices of the corporate boardroom:

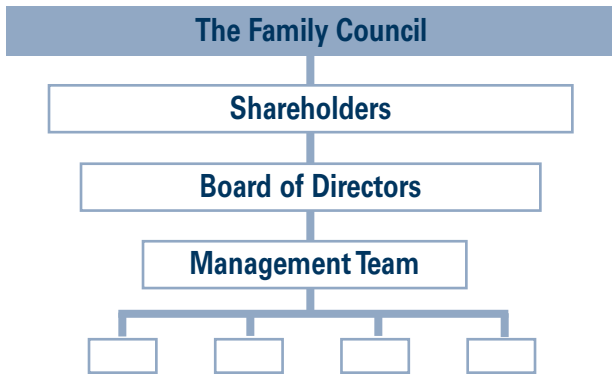
Voice of the family. Because of the significant differences between the needs of the family and the needs of the business, the enterprise-owning family must learn to how to keep family conflict and second-guessing out of their dialog with their board of directors and their senior management team in order to avoid chaos. But it is their business, so they must also learn how to communicate their values, strategic objectives, and economic expectations in a way that can be heard and acted upon. This is the ownership “voice of the family.” It is around these themes where communication among the family, the board, and the senior management team is not only appropriate, it is essential.

Separation of powers. The ownership family, the board of directors, and the management team all understand, respect, and work hard to maintain the boundaries between the legitimate functions of owners, board members, and managers. In other words, there is a separation of powers among these three spheres of influence.

Family council. The ownership family has created a place, outside of the boardroom or the halls of the business, where it can stay informed, educate future generations, and set the family ownership and participation policies that ensure business continuity, fair access to opportunity, and a believable perception of fairness that keeps family disputes out of the business. This place is a fully functioning “family council.”

A Forum of Trust

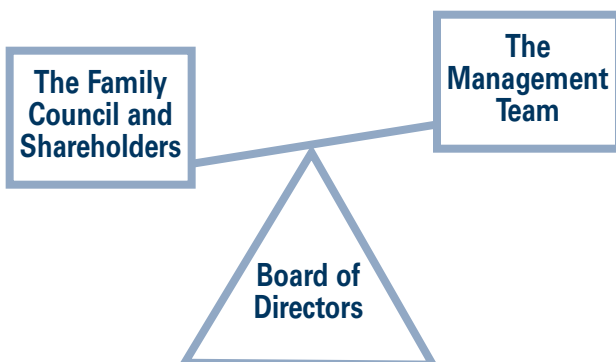
The voice of the family is developed in the family council and the need to build and maintain the separation of powers is also taught and reinforced through activities of the family council. Perhaps some family companies can create and maintain these characteristics across the generations without something like a family



council, but this author has never seen it done successfully over time. Rapid growth, succession, new ventures, new people, even new technologies are just some of the major change dynamics multi-generational family businesses confront on a regular basis. Major change is often too threatening to the emotionally based family system for the business and the family to co-exist without a trusted forum where the family can work out its differences and its fears.

A Purposeful Separation of Powers

The ongoing work of the family council is to create the voice of the family. In so doing, the family council does not negate the statutory responsibility of the company's actual shareholders to vote their stock for qualified directors and, when called upon, to vote their shares for major business decisions requiring shareholder approval (e.g., sale, liquidation, merger, etc.). But most well-run family businesses soon discover that when the family council is working well and making timely decisions in an atmosphere of trust, the shareholders almost always vote their stock in accordance with the guidance and wisdom of the council. How then does the voice of the family emerge from the work of the council beyond simply keeping family members informed on the operation of the business, the conditions operating in the marketplace, and their unique traditions of family ownership?



The family system is emotion based and its fundamentals are dominated by love, loyalty, and maintenance of the status quo.

To be the voice of the family, the council needs to create an ownership culture that both understands and appreciates the division of responsibilities among ownership, governance, and management. This begins with the council and its members learning which issues belong exclusively to the family—and that it is important for the council to stay away from the strategic issues of the board and the operating issues of the management team. The council members then need to commit themselves to continually addressing their family issues. Without this voice, regularly and clearly articulated by the family, the board of directors cannot adequately supervise the management team, and the management team does not know where the family wants to take the business. In short, without such a voice, the family has quite literally turned over its business and, in many cases, its most valuable asset, to someone else.

This voice is about the family issues of expectations, risk tolerance, and vision. It is not about personalities, controlling the board of directors, or second-guessing the work of the management team on how it operates the company day-to-day.

The Family Council at Work

Using this division of responsibilities as a backdrop, the voice of the family is born and maintained through the council in the following ways:

Vision. After harvesting their common values, members of the family council articulate their vision for the business—where they want the company to be in three to five years.

Return on capital. In support of that vision, the family council articulates the family's expectation for a return on their capital. This may be in the form of capital growth, dividend distributions, or a combination.

Risk tolerance. In further support of that vision, the family council also articulates the family's risk tolerance. This may speak to the level of personal guarantees they are willing to shoulder, the corporate ratio of debt to equity, the use of outside financing sources, or even their tolerance for high-risk strategies such as mergers, acquisitions, or the use of venture capital.



If business is to compete in a sophisticated marketplace, the board and management must operate as a meritocracy.

Ownership and participation policies. The family council also strives to articulate those ownership and participation policies that cannot and should not be determined by anyone other than the family, including:

- *Stock ownership policies.* (To include exit strategies available to shareholders.) These are incorporated into timely prepared and maintained buy-sell agreements to which the corporation is normally a party.
- *Employment policies.* These provide guidance to family members who wish to work in the business and include required education and the scope of outside work experience necessary for entry. These policies are also frequently strengthened with requests to the board of directors that family member promotions and/or terminations be conducted in a certain manner to provide the transparency and confidence—to both the family and the non-family employee base—that such decisions will be consistently fair and in the best interests of the enterprise.
- *Philanthropy.* This activity frequently centralizes diverse family charitable largess and often extends to assisting the business itself with community service initiatives it maintains.
- *Building human capital.* These policies and initiatives range from scholarships, to new venture opportunities, to preparing family members for potential board service or as goodwill ambassadors for important community or employee-based functions.

Code of conduct. These policies are sometimes reinforced within the family by the creation of codes of conduct or family constitutions that articulate what the family members expect from each other by way of education, public department, community service, the timely maintenance of their estate and financial plans; how they will protect both their fellow shareholders and the corporation itself from liability; and their individual responsibilities for family council attendance and involvement.

Succession. For many family councils, a major struggle is how to deal with the issues of ownership and management succession when there is no longer a single, natural successor to the founder or current senior family executive. Sometimes more than one of the next

generation wants to make a career in the family business; sometimes no one wants to participate as employees, or those who do want to participate either do not have the required skill set or have no interest in reaching for the presidency. At this critical crossroads, a well-run and well-respected family council may be the only forum where family members can come to understand that being an owner into the next generation may be a bloodline function, but if their business is to continue to grow and compete in an ever more sophisticated marketplace, the ranks of the board and the senior management team must operate as a meritocracy. Such a general understanding does not arise by accident or by being lucky; it emanates from candid discussions and policies created by the family council. It is in such councils where the professional cultures of today's great family businesses are maintained.

Role of the board of directors. The family council is also where the family articulates its expectations for how the board and its directors will function to include the use of their diverse backgrounds, their independence, their expertise, and their skill and willingness to direct, as opposed to simply offering their advice. When the company needs additional directors, or the terms of existing directors are about to expire, the family council often offers the nominating committee its advice regarding replacement directors. After the board's nominating committee develops its slate for directors, the family council normally studies that slate and recommends certain directors to the shareholders for their consideration.

Conclusion

A true separation of powers, articulated and enforced by the voice of the family, is what makes governance work in family enterprises. Beyond the first generation, such governance may well be the critical factor in preserving a family business's competitive advantage in the marketplace, and in creating lasting value for the families that own them. There may never be another founding entrepreneur, but there can be a team whose members understand their role and celebrate the contributions of others. In this context, the family council provides the board and management team with the assurance that the ownership family has confidence in their skills, and that the shareholder base will be there for the long haul. ■

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The Hudson Family Council: Where New Dreams are Built

For four generations, the Hudson family has owned and operated a highly respected community bank. It has always had a board of directors (for the bank regulators required one), but for most of its history, both its strategic direction and its management have been driven by a progression of Hudson men who all served both their community and their customer needs with dedication, sound banking principles, and a passion for the Hudson legacy.

Crossroads. Today, the bank is at a crossroads. While the current patriarch was no less successful or any less respected than his forebears, he now has four grown children and none of them aspires to succeed him. They are smart, ambitious young people who simply have chosen career goals other than being the fifth-generation president of the family enterprise.

The senior generation struggled with what to do for several years. They didn't want to sell their heritage for they knew that unless they got very lucky indeed, the new buyer would not serve the best interests of either their loyal employee base or the community they love.

The senior generation understood intuitively that they needed a place where they could work through this critical question with their now-grown children, but before launching directly into decision making, they asked their children to candidly examine all the facts surrounding the disposition of their bank and then give them some honest input on what they (the successor generation) thought would be best for the family, the community, and the bank itself.

The family council is born. These young people (ages 32 to 42) soon organized themselves into what was ultimately to become the Hudson family council. With their parents' cooperation and the help of business advisors and the bank board, the council was

supplied with all the information it requested, from management make-up, to board composition and activity, to the unvarnished financial realities of the bank, and the current tax climate of both the bank and the family. The work was slow and somewhat conflicted at the start; there seemed to be a million issues to consider. While these young people all grew up in the same household, they were four quite independent individuals who were pursuing their own dreams. In a not so subtle way, they soon discovered that they didn't know each other all that well.

Their breakthrough came when they set aside the numbers and the goals of their parents and began to explore their own values. What they discovered was that they in fact shared a number of the same core values. That ignited a series of animated conversations about how they wanted those values manifest in their own lives. They quickly recognized that they enjoyed being together as adult brothers and sisters, that they shared the same essential life goals, and so seized on the work of the council as a way to build on this new-found bond.

Successor generation. Over the course of the next two years the Hudson family council (still only the successor generation at this time) became the place where they could get educated on the needs of the banking business, the character of the marketplace in which the bank operated, and the economic and social realities of what it would mean to be owners, but not managers, of their own bank.

These young people say they will always remember the council session near the end of this initial investigative stage when the consultants graphically reviewed with them all the things that could go wrong if they stayed the path of ownership. Family conflict, illness, death, even bankruptcy and divorce were all put on the table. They were also shown just how much would

come their way (even after paying Uncle Sam) if the bank was simply sold. That particular meeting lasted for about two and a half days, but in the end they made a sound business decision that was also a unifying family decision: If their mother and father were willing, they would like to take on the responsibilities of being the fifth generation of Hudson family bank shareholders.

About six months later they provided their parents with the requested input with a presentation that was thorough, well documented, and moving; for better than two hours they presented their findings as a well-rehearsed team. They articulated their shared values and how they had incorporated them into a vision statement for the bank that spoke to a family ownership commitment built on patient capital, a professional management team, and a board of directors with the skills and willingness to truly direct. They also produced a code of conduct on the responsibilities of family ownership, communication, and ongoing education.

New vision. After an emotional and prideful acceptance of this input, the senior generation officially joined the Hudson family council and so added their knowledge, wisdom, and commitment to this ongoing work. Today, the board is in transition with Dad and two of his children holding seats. A search is currently underway for a new non-family president; the new vision has been adopted by the board and is now the centerpiece for management recruiting and strategic planning. While there is still a great deal of work to be done, the bank now has four new, very dedicated shareholders and the employees, customers, and community are all confident that their financial cornerstone will continue to be well run and well governed, now that the Hudson family has committed to carrying on for yet another generation. **G.R.A.**