

Family Business Governance

by Leslie Dashew

Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

"OECD Principles of Corporate Governance," April 19, 1999

We believe that as families in business involve more people and more complicated assets, the need increases to subject the family to the organizing influence of governance. In this regard we see the Family Council is just as much a structure of governance as a Board of Directors. Constitutions are another tool of governance applicable to families.

Families should consider drafting their own "constitutions" spelling out their agreements and methods of governance. Constitutions are instruments of governance. They establish a framework and a forum for a group of equals to deliberate issues, create policies and procedures, clearly define rights and obligations of participants, and make decisions about the important issues they share.

The function of governance in Families who share assets and/or businesses include:

- Clarification of purpose
- Reduction of conflict
- Creation of a more powerful entity
- Articulation of family will
- Creation of a foundation of trust in relationships
- Clarification of expectations
- Definition of structures
- Delineation of consequences

Generally this kind of governance defines boundaries of the family business system in a way that is far more conscious and intentional than is normally necessary in family relationships. This level of intent is necessary because families in business differ from other families in two important ways:

The web of relationships in which they live is more complex for two reasons

- The demands of more constituencies (employees, suppliers, advisors, customers, competitors, etc.) and,
- The multiple internal roles for family members (ownership, management and family roles)

The greater frequency and consequences of the decisions that must be made within the context of that web of relationships.

Family Council

Purpose: Family Councils serve as a legitimate forum for dialogue concerning the interests of the family in family business; particularly dealing with the interface between family and business.

1. Family Councils can become the place to discuss a range of issues

- A "private" place to resolve business/family issues and concerns.
- Topics may include the purpose of the family (Family Mission); philosophy of the family (values, fairness); roles and responsibilities; beliefs about asset management, etc.

2. The council can serve as a policy making board

- For such issues as family employment and compensation, values to be manifested in the business and in the community, use of shared assets, etc.

3. A place for education Regarding the family business as well as business in general, finance and investments, estate planning, interpersonal skills, etc. 4. Provide a vehicle for Planning for the future of the family and its assets

- The Vision Statement is one method to help the family with its planning.

5. Reporting on family sponsored activities

- Provides a vehicle to keep family members not employed in the business aware of what is going on and feel included.

6. The Council can also represent family members who are or are not shareholders and provide a communication channel among members, to the board of directors and/or with management.

7. Can formalize the role of the family in the community, via service, philanthropy, establishment of a foundation, etc.

8. Finally, the Council can provide an opportunity to strengthen the family no matter how their other assets are invested.

Success Factors for Family Councils

1. Clear Mission And Purpose To Which The Family Is Committed
2. A Shared Vision For The Future Of The Family, Its Assets And The Role Of The Council
3. Specific Objectives And A Plan To Achieve Them
4. Shared Responsibility For The Council Among All Members
5. Guidelines Or Ground Rules For Membership And Participation
6. Good Teamwork (Including Good Communication, Shared Leadership, Etc.);
7. Documentation And Communication Of Agreements, Schedules, Agendas And Minutes
8. Calendar Of Events
9. Method Of Regular Communication

Board Governance and Legal Responsibilities

Difference Between Governance And Management

Governance implies a system of oversight, while management has accountability for implementation. So a board must represent the shareholders in assuring that the business is being managed effectively, ethically and in the best interests of its owners. One of the challenges is managing the boundary between oversight and management. Often family members feel entitled as owners to make operational decisions, bypassing the board and/or management. But family members need to understand the boundary between owning and governing a business and the day-to-day management of the business. The board delegates authority to the management of the company (President, CEO/COO) for the operations of the business and each entity must understand its responsibility and limits. The National Association of Corporate Directors calls this the "NIFO Principle:" Nose in, Fingers out!

Purpose of Board of Directors in a family Business

The fundamental responsibility of directors is to represent the interests of the shareholders as a group, as the owners of the enterprise, in directing the business and affairs of the corporation within the law. Directors are also required to adopt or change corporate bylaws; approve amendments to the articles of incorporation; approve mergers, acquisitions, and changes in capital structure; declare dividends; and elect corporate officers.

Individual directors also have important legal obligations regarding the quality of their service, including attention to the duties of care, loyalty, and attention. Directors are assigned broad

responsibility for protecting the assets of the corporation, reviewing corporate objectives and policies, monitoring corporate performance, and ensuring competent management.

- Overseeing the operation of the business:
- Reviewing corporate objectives
- Monitoring the performance of the enterprise
- Approving major acquisitions and divestitures of businesses
- Approving the strategic plan and operating budgets
- Advising the CEO and his/her management team
- Approving debt/equity ratios
- Guiding succession planning
- Assuring that the values, ethics and priorities of the family owners guide the operations of the business

Legal Responsibilities

Duty of Care

- "Directors must act with the care that a reasonably prudent person in a similar position would use under similar circumstances."
- Show up regularly at meetings; pay attention; act in good faith
- In the best interest of the organization
- You are responsible for decisions made by the board whether you are in attendance at the meeting or not.

Duty of Loyalty

- Sole purpose doctrine (to assure good return to shareholders)
- Avoidance of conflict of interest
- The best interest of the corporation and shareholders must take precedence over the personal interests of the director

Duty of Obedience

- In accordance with applicable statutes and the company charter

Duty of Oversight

- Presence of reasonable controls in place in the organization
- That the board has full and necessary information to be fully informed
- The responsibility to be pro-active in seeking information and asking questions (why/why not something is done);

The Business Judgment Rule

This is the guiding principle and protection for all directors.

This presumes that board decisions are made by

- disinterested directors
- acting on an informed basis
- in good faith and
- in the honest belief that their actions serve the corporations best interests.
E.g. if a board decision proves unwise, directors are free from liability as long as they acted in good faith.

Family Foundations

What is a Family Foundation? "Family foundation" is not a legal term and therefore it has no precise definition. Yet, approximately two-thirds of the estimated 40,000 private foundations in this country are believed to be family managed. The Council on Foundations defines a family foundation as one in which the donor or the donor's relatives play a significant role in governing and/or managing the foundation. Members decide themselves if they wish to categorize their private foundations as family or independent foundations.

Foundations are an important tool through which a family can collectively channel philanthropic desires. The Board of the Foundation can be structured in a way, which gives family members an opportunity to learn to make decisions together and consider shared values and goals.

Family Offices

Family Offices are organizations, which provide support to one or more families. These offices are typically organized to provide shared financial services, insurance management, concierge services and administrative assistance to families who may have cashed out of active businesses and need a location and staff to organize their assets and activities.

All of these structures exist to help people organize their efforts in a manner that accomplish goals, promote good stewardship, provide clarity about who is accountable for what outcomes and how decisions get made. They are tools to help families manage interactions that have been informal by "nature" become more structured in the management of shared assets and legacies.

