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Effective governance for a family enterprise

BY DOUG BAUMOEL

Once a family enterprise reaches a certain level of complexity – beyond the 'mom and pop' stage or lifestyle business – decision-making and planning often become exceedingly difficult or fraught with conflict. For these firms, crafting effective governance structures for both the corporation and the family can provide a path for reliable business performance and family harmony.

While most people think of family firms as small and privately held, in actuality 20 percent of S&P 500 firms are family controlled. Family owned and managed companies, both public and private, comprise approximately 60 percent of GDP in the US and over 80 percent of the country's employment base. These figures are even stronger in other countries in Asia, Latin America and Europe. Therefore, drilling down to find what works for family businesses is of crucial importance to the world economy and, from this perspective, the issue of governance for family enterprise is central.

Family businesses, large or small, public or private, can be best understood as 'controlled' companies, similar in many ways to venture capital or private equity-backed companies. When ownership is concentrated in the hands of a few powerful shareholding groups, individual or factional interests often drive director selection and board processes. This can compromise a director's ability to adhere to their fundamental charge of advancing the interests of all shareholders.

Beyond the complication of factional interests at the board level – common to all controlled companies – the often-complex interests of family can transcend simple economic concerns. When your name is on the building, the values by which the company comports itself are often a reflection of, and concern to, its owners. When a business has been in the family for generations, there may be embedded long-term relationships with distributors or vendors that are important to owners. And, when family members grow up in a business, they are often raised to have, or grow to have, an interest in employment and possibly a leadership position in the business. These characteristics have broad implications on the strategy and organisational structure of the firm.

Caring deeply about long-term performance, rather than a focus on quarterly results, often provides a competitive advantage for family firms. In addition, family business leaders are more likely to dig in when the going gets tough, rather than look for another job. This combination of commitment, long-term outlook and a focus on values can be a powerful differentiator.

But, too often family business stakeholders fall victim to conflicts among

owners, the complexities of managing family employees, and unaligned visions for their enterprise among family branches and across generations. These are the stories that make headlines and serve to advance the false narrative that a family-controlled enterprise is a second-class business model. Many studies, business articles and organisations, such as the Family Firm Institute, however, report that family enterprises can actually outperform their non-family-controlled counterparts.

So, how do successful family businesses manage the inherent conflict and complexity that is woven into the fabric of family enterprise? Well-designed governance for both the family and the business is key.

Public company boards are held to strict fiduciary standards in the US and throughout much of the world, with high standards of transparency mandated. In general, public, non-family controlled companies operate with a relatively level playing field for shareholders.

The situation is much different with family-controlled firms – especially when privately held. Without mandated and enforced disclosure to shareholders, as well as clear policies for governance structure and process, a family business boardroom can become a cauldron of conflict and discontent. As such, family businesses should consider developing their governance process and structure in accordance with standards that exist for public companies.

The problem of factions

For effective governance to exist, directors must believe they serve the interests of all shareholders – not just the branch that nominated them. This can be challenging when directors chosen by a faction feel a fiduciary duty to that faction.

When trustees with a fiduciary duty to a group of shareholders (i.e., beneficiaries of the trust) are put on a board, these trustees encounter a structural conflict of interest. Say an issue comes before the board that might be good for the company and for most of the shareholders, but not necessarily good for the trustee's beneficiary group, what is the trustee to do? Where does the trustee's loyalty fall?

Another common problem arises when shareholders select their attorney for 'their' board seat. Their attorney has a fiduciary obligation to serve the interests of their client first and foremost; and, their employment relationship could prove an economic conflict of interest as well.

Some conflicts can be managed through agreement. For example, by developing an agreement whereby a trustee is considered to be acting in the best interest of the beneficiaries by prioritising the broad interests of the company over the narrower interests of the beneficiaries he or she serves. However, though providing legal cover for the trustee, ultimately it might be difficult for the trustee to be perceived as unbiased.

Adding to the problem of factionalism on the board is the nominating and voting process itself. Shareholder agreements and bylaws may actually guarantee factionalism on the board by providing each family branch or voting bloc with a 'board seat'. Families sometimes go to great lengths, fighting for their seat without understanding how counterproductive this can be. So where possible, a consensus-building process for nomination and selection of board members should be pursued, perhaps requiring a change to a shareholder's agreement or corporate bylaws, that needs unanimous consent of the shareholders.

Board processes might also be reviewed for the purpose of minimising factionalism. Board chair rotation among factions might help reduce 'branchism', by ensuring that each faction has the opportunity, and responsibility, to lead the board at some time. Additionally, adding an outside board facilitator or independent lead director might be considered.

Managing conflict

The boardroom is no place for family disharmony. Shareholders holding divergent visions for what they are trying to accomplish with their shared enterprise simply should not own an enterprise together. When shareholders are fundamentally unaligned in their vision for the company, an equitable exit path should be provided so they can gracefully resign.

Assuming all shareholders are aligned in their vision for the company, it is appropriate to hash out disagreements on strategy, distribution policy, family employment issues and other issues in the boardroom, especially as family stakeholders often cannot help bringing family 'baggage' with them.

Family business consultants, in this regard, can be extremely useful, understanding as they do both family dynamics and related substantive issues, including the fact that family business conflicts rarely involve simply the particular dispute at hand. When stakeholders have grown up in a family business and see their role in it as an integral part of who they are and their place in the world, they often go to great lengths to advance their personal interests. So helping stakeholders deal with such unique types of conflict is a specialised skill. Not just any outside consultant will do.

Managing non-economic interests
In a family-controlled business, the boardroom is certainly the place to discuss shareholder interests that go beyond corporate performance and distribution policy. Family employment policy, corporate values and other issues important to the family need to be addressed and considered, as well as brought to the board in an organised manner with assurance that the family is aligned around these issues.

Forging alignment around these non-economic interests is the job of the family council, a place where all stakeholders – not just shareholders – will have a voice. Next-generation leaders, for example, who one day will become significant shareholders, can find a voice in a family council, as will all other family stakeholders affected by the company. The family council thus provides an organised and productive way of channelling feedback to company leadership. Without such a communication conduit, stakeholders can become disgruntled and adopt less productive means of being heard.

Developing the corporate vision
Corporate vision should emanate from company owners. Family shareholders are often not experts in their company's industry and may not even be experienced in business. The company board can provide guidance and information but decisions about what the company should be are the owners' responsibility. If a board disagrees with the vision of its shareholders, the shareholders would likely select new board members.

Therefore, an organised way for owners and their board to communicate about options and information is required. Thoughtful shareholder communication and meetings are useful, as is a process for ownership to clearly articulate what it wants from the shared enterprise. For large shareholder groups, owner's councils can be an excellent vehicle for discussing and communicating corporate vision to the board after consensus has been reached.

This is a notably different process than for a non-family controlled company. When there are many independent shareholders, as in a public company, vision is typically set by the board and management together. And, because shareholding is fluid, shareholders can opt-in or opt-out of that vision by buying or selling their stock. But because family business shares are less fungible, owners must find this alignment within their group in order to select and direct the right board that will help them achieve their vision.

Summary
Robust corporate governance, operating in concert with well-crafted family governance structures, can enable a family enterprise to leverage the benefits of family control and leadership. Truly successful family companies have engaged owners that understand their roles and the structures that connect them, understanding that their 'stakeholder' group is broader than their 'shareholder' group and that their voices also matter. Most importantly, such companies understand that family business systems have a high potential for conflict 'built in' so they must avail themselves of all needed resources that will enable them to manage conflicts well and thus succeed as an enterprise. ■

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