



Institute for
Family Business
with UCG

Family Business Challenges

Building Family Governance



The *Family Business Challenges* series

This guide is part of the *Family Business Challenges* series commissioned by the IFB Research Foundation. The series offers practical guidance for family business owners seeking to manage the unique challenges and opportunities they encounter.

The series provides concise information on a broad range of topics – covering family business dynamics, governance, performance, succession and family business wealth.

Each guide, which is illustrated by a real-world case study, is divided into three sections:

1. **Defining the challenge** – clarifying the issues and summarising expert thinking.
2. **Actions to consider** – ideas and strategies to help family business people meet the challenge.
3. **Resources** – annotated further reading.

The publisher

About the IFB Research Foundation with UCG

The IFB Research Foundation with UCG is a charity (no. 1134086) established to foster greater knowledge and understanding of family firms and their contribution to the economy and society, as well as the key challenges and opportunities that they face.

The Foundation's vision is to be the UK's centre of excellence for family business research, and to this end its publications are designed to create a better understanding of family business for the benefit of all stakeholders. Alongside *Family Business Challenges*, its work covers a broad range of publications, including:

- *Family Business Sector Report* – benchmarking the size and importance of the sector.

- *Family Business Research and White Papers* – thought leadership on key family business characteristics and issues.
- *Family Business Case Studies* – showcasing family business exemplars.

The Foundation disseminates knowledge and best practice guidance through printed publications, online media accessible via the IFB website and other activities, including the IFB Research Foundation Annual Lecture.

About the IFB

The Foundation works closely with its sister organisation, the Institute for Family Business, which is a membership association representing the UK's family business sector. The IFB is a member of FBN International, the global network for family businesses.

www.ifb.org.uk

Building Family Governance

1 Defining the challenge

Successful family business owners learn to manage two facets of governance.

(a) Corporate governance, covering the direction for business operations and strategy, and (b) family governance, providing a framework of rules that define family members' roles and responsibilities, and how the family interacts with their business. (See the definition of family governance in Exhibit 1.)

Exhibit 1: Defining family governance

“The focus of family governance should be to find consensus on matters where owners' wishes matter most, as well as to provide family members with a shared sense of identity and mission that transcends their individual interests in the business...

While every family business is unique, embracing systematic governance processes can help any family business achieve goals shared by virtually all: orderly decision making, peaceful continuity, and the freedom to make decisions based on the highest and best purposes of both the business and the family.”

Source: Craig E. Aronoff and John L. Ward, *Family Business Governance: Maximizing Family and Business Potential*, published by Palgrave Macmillan, 2011, p.84.

Separating family and business decision-making is the goal. But this is complicated because in most family firms individuals often have dual roles. It's not possible – or indeed desirable – to eliminate all personal interests or conflicts of interest, but family governance procedures make it easier to identify and address them with reasonable objectivity.

Family governance needs to evolve to take account of predictable developments.

Family firms become more complex over time as the business expands, the family grows and

ownership dilutes. What used to work for a founder or entrepreneur and their nuclear family – i.e. informal governance based on understandings and assumptions – is less likely to serve the interests of a group of second generation siblings (and their spouses). A subsequent generational transition to a business owned by cousins will raise yet more issues. (See Exhibit 2 on family governance and large family ownership groups.)

Exhibit 2: Creating effective family governance

“Good family governance can take many forms, but its key function is to promote effective ownership communication and deliberation. Large family ownership groups need to be educated about the business, its history, and its current challenges. They need to understand the values, vision, and goals of the business and the family, and how these are related and support each other. Good family governance, however, needs to do more than provide information. It must enable ownership discussion and feedback. The family itself must make decisions, including fundamental decisions about how it will govern both itself and the business.”

Source: John L. Ward (editor), *Unconventional Wisdom: Counterintuitive Insights for Family Business Success*, published by Wiley, p.224.

Informality giving way to rules, procedures and structures. It makes sense to organise governance early when the family enterprise is young and the family group relatively small – and at a time when family relations are harmonious, while big issues like succession remain a distant prospect.

The importance of shared values and vision. A strong sense of shared purpose among owners and the wider family is a source of competitive advantage for family businesses. Each family needs to work through how this

sense of belonging and teamwork will be reflected in their family governance procedures.

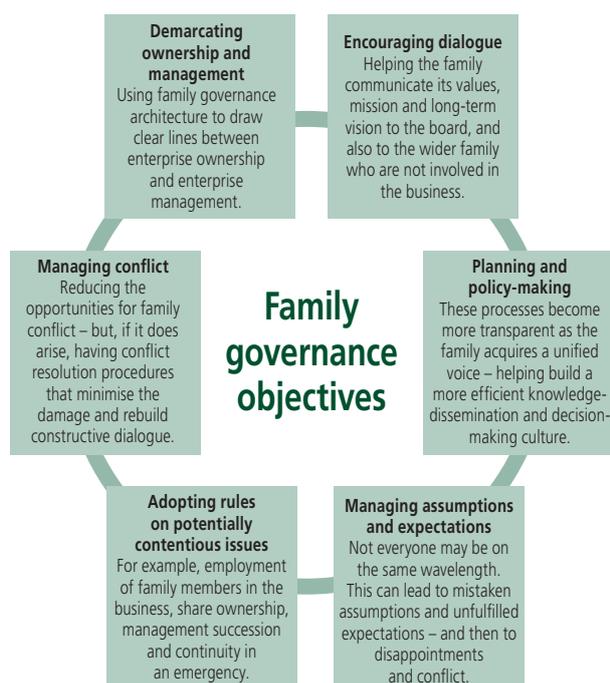
There are no “one size fits all” solutions.

No two families or businesses are alike, and family governance systems work best when they are tailor-made – shaped by the age, size and culture of the business, the family’s degree of involvement and the personal dynamics among family members.

Helping families “speak with one voice”.

The formal framework and written rules of governance make it less likely that personality issues will divide the family and interfere in the business. Through the mechanisms of family governance, families aim to build trust, ensure clarity and manage stakeholder expectations. (See Exhibit 3 on “Family governance objectives”.)

Exhibit 3: Family governance objectives



Family governance documents and structures.

There are no templates, but here’s a summary of the more important ingredients:

- A family constitution or protocol, documenting:
 - the family’s vision and values for the business;

- key policies – e.g. relating to family members’ employment, management succession, and the ownership and transfer of shares;
- a code of conduct governing how family members should treat each other;
- the role of family governance bodies and their relationship with the business, including the board of directors.
- A shareholder agreement (i.e. a contract between the owners) often codifying certain provisions of the family constitution, such as listing the types of decisions that owners are entitled to make (as opposed to the board), rules on share transfers and how shares are to be valued.
- Family governance bodies – including a family assembly, open to all family members, and a family council, formed of chosen representatives of the family. The family council sets policies to balance family and business, and acts as the conduit between the family and the board of directors. These bodies provide family members with forums for discussion and help them develop a coordinated family approach.
- Family council committees, working to foster family education, information, communications and social cohesion.
- A family office providing centralised wealth management services to the family, acting as an investment, liquidity management and administrative resource.

Think of family governance as “applied fair process”.

Because family members relate to the business in a variety of ways – some are shareholders, some are employed by the firm, some are both, some neither – it’s very rare for everyone to agree on the fairness of outcomes. But what you can do is make sure that the family’s governance model supports and protects decision-making arrived at by fair process.

2 Actions to consider

- Explore whether there's a consensus across the family about the importance of the family business – how to make it sustainable and maximise its success.
- Do we have regular meetings to discuss the family's relationship with the business?
- Do we have rules about who can work in the business, who will be on the board, who can own shares?
- Have we looked at ways to set up separate governance processes for the business and the family?
- How should we as owners organise constructive communications with the board of directors?
- Does the family have a code of conduct to strengthen interpersonal relationships and communication skills?

Case study: Clarks Shoes

In 1993, sixth generation Clarks Shoes – one of the UK's oldest independent family-owned businesses – came within a whisker of being sold because the perceptions and aspirations of family shareholders had become disconnected from those of company management. Also, there were disagreements amongst the family around ownership and strategy.

The crisis was followed by a period of renewal including radical changes in business strategy and systems, plus a focus on building new ways for the owners to engage with their business. A family shareholder council and a strengthened board were at the core of new governance structures designed to improve communications, shareholder involvement and strategic clarity on business issues.

The family shareholder council remains the pivotal governance structure:

- It represents virtually all 350 of the family shareholders, who together own around 80% of Clarks.
- A "Governance Code" has been agreed, laying down guidelines about the division of responsibilities between management and ownership, and setting out clearly the objectives of the family council.
- The council comprises 16 council members drawn from family shareholders and elected by them for four-year terms.
- To be eligible for election, council

members must have the backing of a fixed, identifiable percentage of the share capital, so each family shareholder knows who their family council representative is.

- The council meets four times a year, with meetings attended by the company chairman, CEO and finance director, who make presentations and discuss business strategy and performance. Meeting summaries are distributed to family shareholders via the ClarksNet website.
- Family issues also feed into company board discussions via the council's right to nominate two family non-executive directors.
- Between family council meetings, the council chair has regular meetings with the company chairman to ensure a continuous two-way flow of information.

Having worked for more than two decades on building this system, family members are under no illusions that their task is now complete. Families and companies constantly change, and at Clarks there are regular reviews and appraisals with consultants to help ensure that their hard-won governance system continues to foster long-term ownership and strategic engagement with the company.

The Clarks logo is written in a stylized, green, cursive font.

3 Resources

Articles and reports

The Three Components of Family Governance

John Davis, Harvard Business School
(available at: <http://hbswk.hbs.edu>).

In a crisp summary of the topic, the author highlights periodic family assemblies, family council meetings and a family constitution as the three main (and often sufficient) ingredients of family governance for family businesses.

Family Firms and Their Governance: Creating Tomorrow's Company from Today's

Sir Adrian Cadbury, published by Egon Zehnder International.

Authored by Sir Adrian Cadbury, one of the most prominent experts in the field, this monograph highlights the governance implications of the special status of family businesses, supported by a series of case studies.

The IFC Family Business Governance Handbook

Published by International Finance Corporation, World Bank Group.

Available in the form of individual articles or the complete study, this is a readable and practical description of family business governance components, plus suggested approaches to resolving common family business governance dilemmas.

Fair Process: Striving for Justice in Family Business

Ludo Van der Heyden, Christine Blondel and Randel S. Carlock (available at: <http://econ.upf.edu>).

A thorough and readable review of the concept of fair process, with suggestions for improving fair process practices in family businesses.

Books

Family Business Governance: Maximizing Family and Business Potential

Craig E. Aronoff and John L. Ward, published by Palgrave Macmillan (2011).

In one of the few books devoted to this topic, the authors explain the governance processes for organising the family and the business, focusing on the distinct functions of these two domains and the areas in which they overlap.

Family Councils

Peter Leach, published by the IFB Research Foundation (2012).

The first comprehensive guide to family councils and their role in governance. The book explains the strategic goals and objectives of family councils, and provides practical guidance to ensure their efficiency and effectiveness.

Understanding Family Business: A Practical Guide for the Next Generation

Andrew Drake, published by the IFB Research Foundation (2009).

Written with younger family members in mind, this guide discusses the rights, duties and responsibilities of working in a family company, and includes a section on governance plus definitions of the main structures and systems.

Unconventional Wisdom: Counterintuitive Insights for Family Business Success

Edited by John Ward and published by Wiley (2005).

See pages 219–226 where the author presents a clear-sighted review of how family governance tends to develop and evolve in family businesses, and goes on to offer practical guidance on how to organise family ownership effectively.

Family Business Challenges

The *Family Business Challenges* series of guides offer practical guidance for family business owners. Each guide identifies issues commonly faced in a particular topic area, suggesting strategies for managing the tensions and competing demands that arise. Titles include:

Family business dynamics

- Understanding Family Business
- Maintaining Family Values
- Developing Stewardship
- Promoting Sustainability

Family governance

- Managing Differences
- Building Family Governance
- Strengthening Family Communication
- Fostering Responsible Ownership
- Managing Communication:
Owners and the Board

Family business performance

- Fostering Entrepreneurship
- Professionalising the Board
- Maximising People Capital
- Employing Advisers

Family business succession

- Engaging the Next Generation
- Planning Succession

Family business wealth

- Selling the Family Business

Growing successful enterprises
for generations to come

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