

FAMILY BUSINESS GOVERNANCE 101



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Family business governance is the formalization of your family business – some or all the following components may apply, or better yet, you will want to update or add, to governing your family business. Many family businesses are started on an idea, heavy involvement by the founder and an immense amount of sweat equity. Time and energy are initially spent on product/service-related matters that will ensure longevity and success of the business. Very few founders will rank formality, structure and/or governance in their top 5 priorities in getting a business off the ground. However, when it comes time to transition or sell the business, a lack of formality can actually decrease the value of your business.

1. ADVISORY BOARD

An Advisory Board is a useful way to help manage the family patrimony (trusts, investment, foundation, operating assets, etc.),

1.1 Definition

An advisory board is a select group of “independent” people who provide advice and support to the owners/ shareholders/directors of a business or other entity. They provide non-binding strategic advice to organizations and hence are informal in nature. This gives greater flexibility in how they are structured and managed, when compared to a board of directors. Whereas formal boards of directors have legally defined responsibilities, advisory boards are not regulated under any “Corporations Act” or corporate governance codes. Advisory boards advise. However, calling a board that has a governance function an ‘advisory board’ will not preclude its members from their legal and fiduciary duties.

1.2 Purpose

An advisory board:

- Provides an independent source of information and advice to the owners/directors on strategic issues or risks confronting the business or wealth management
- Creates a “learning forum” for future involvement in family financial activities, including but not limited to:
 - Business succession
 - Foundation involvement and succession
 - Future family trustees or executors
 - Future advisory board participation
 - Policy-making

The advisory board is not supposed to be a decision-making forum, **however**, each family will need to determine the roles and responsibilities of its advisory board to best suit its particular circumstances and needs.

Suggested roles and responsibilities for advisory board members include:

- Developing an understanding of the investments (operating businesses, real estate holdings/operations, market and industry trends, etc.)
- Providing “wise counsel” on issues raised by the:
 - owners/directors/management of operating assets
 - Foundation board of trustees, and
 - Family trust beneficiaries
- Providing insights and ideas which can only come with distance from the day-to-day operations and the Family
- Encouraging and supporting the exploration of new business ideas, investments, etc.
 - Acting as a resource in your area of specialty
 - Encouraging the development of a governance framework that enables continued growth, while not stifling the spirit or vision of the founders and/or family members
- Monitoring business performance and challenging management to consider options to improve results of:
 - Investment portfolios
 - Operating assets
 - Etc.

There are a number of matters that must be addressed before moving forward with an Advisory Board:

1.3 Mandate

This important document must be in writing and communicated to those we are responsible of:

- Overall reach and involvement of the Advisory Board?
 - Big picture only?
 - Involvement in Management and operations of the family assets (OPco ABC, real estate, investment portfolios, foundation, etc.)
- Focus of the Advisory Board?

1.4 Governance

- How should things be run?
 - Expectations
 - Reasonable results – setting the bar
- Objectives of the family – short and long-term

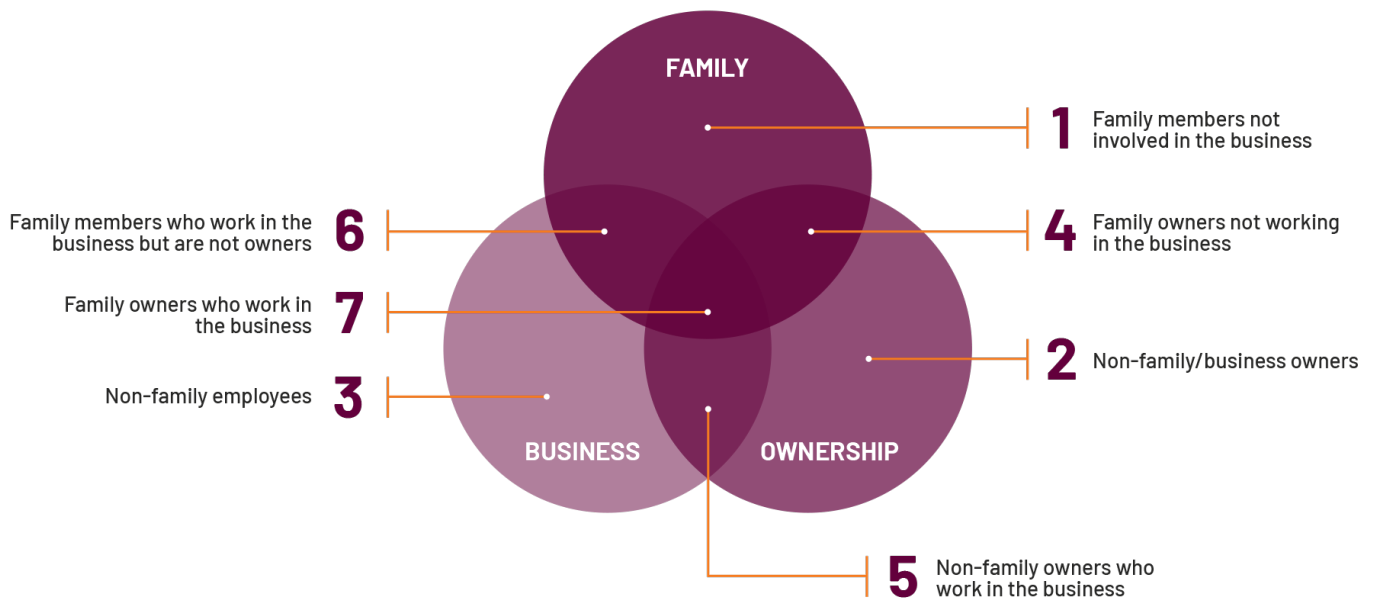


1.5 Accountability

- Who is the Advisory Board responsible to? Entire Family? Etc.
- What are their limitations?
- Etc.

Below you will find information that should be taken into account as you answer the above questions. You have previously been responsible to the family, but not in a formal way. Now is the time to have the family understand your roles, limitations, powers, etc. to protect current family patriarch...and the Board.

THE FAMILY BUSINESS SYSTEM



Source: The Newport Institute

One of the hardest factors to determine in consulting within the Family Business environment is determining where to place each member of the family, i.e., identifying the role of each person involved in the intricate web of:

- Family (the family emotional system)
- Business (the business system)
- Ownership (the ownership system)

Some rather sensitive questions need to be addressed:

1. Are family members (especially children of the founding generation) entitled to ownership on transition due to:
 - a. Birthright, or
 - b. on active involvement in the family business
 - i. Define active involvement – janitor vs VP?
2. Who gets a salary from the family business, and at what rate?
3. Who should work in the business – only those qualified, or do you find a place for everyone, no matter what their talent and skill level?
4. Who is, in fact, the family?
 - a. Direct (blood) descendants?
 - b. Adopted children?
 - c. Spouses? In-laws? Etc.
5. When and how to get rid of an underperforming family member in the business, known as ‘pruning the family tree’
6. Should children and grandchildren be encouraged to attend university before contemplating joining the family business?
7. Should children work elsewhere BEFORE joining the family business?
8. Should there always be a non-family member in a key management position?
9. What family member should be groomed (trained) for what aspect of the family management team?
10. Should there be a Family Counsel “chaired” by a non-family member?
11. Do you have a “Family Business Constitution”?



2. FAMILY COUNCIL (“COUNCIL”)

A family council is also known as a:

- Family Supervisory Board
- Inner Council and
- Family Executive Committee

It is a working governing body that is elected by the family assembly among its members to deliberate on family business issues.

It is created to facilitate family assembly to have meaningful discussions and make prompt and qualified decisions.

The family council is established as a representative governance body for the family assembly in coordinating the interests of the family members in their business. The composition, structure and functioning of family councils differ from one family business to another.

2.1 Purpose

Duties of a typical family council would include:

- Being the primary link between the family, the board, and senior management.
- Suggesting and discussing names of candidates for board membership.
- Drafting and revising family position papers on its vision, mission, and values.
- Drafting and revising family policies such as family employment, compensation, and family shareholding policies.
- Dealing with other important matters to the family

3. FAMILY BUSINESS CONSTITUTION (FBC)

Unlike a Family Counsel, whose objective is to provide a sounding board for family members and to assist in conflict resolution and/or arbitration, the Family Business Constitution is a written document that serves as a roadmap for business continuity **and** family harmony.

A family constitution is a blueprint that clearly states the family vision, mission, values, and policies regulating family members’ relationship with the business.

The FBC is a living document that evolves as the family, its investments and its businesses continue to evolve. As a consequence, it is necessary to regularly update the constitution in order to reflect any changes in the family and/or the business.

The difference between the FBC and a shareholders’ agreement are the signatories. **All family members are party to the FBC, not just owners.**



3.1 Components

The form and content of family constitutions differ from one family business to another depending on the size of the family, its stage of development, and the degree of involvement of family members in the business. However, a typical family constitution will cover the following elements:

- Family values, mission statement, and vision.
- Family institutions, including the family assembly, the family council, the education committee, the family office, etc.
- Board of directors (and board of advisors if one exists).
- Senior management
- Authority, responsibility, and relationship among the family, the board, and the senior management.
- Policies regarding important family issues such as family members' employment, transfer of shares, CEO succession, future trustees, future "head" of the family, etc.
- Defining the family dreams, goals and vision for integrating the family business into family life. A balancing of commercial interests against:
 - Family preferences
 - Paternal attitudes towards:
 - Employees (family conduct towards family & non-family employees),
 - Pensioners (how to treat retired or retiring family business members),
 - Tenants of family-owned building (commercial, residential, etc.)
 - local residents vs family members living out of town
 - Communication structure between family members on:
 - Business & Non-business matters
 - Family issues
 - Conflict resolution mechanisms
 - Informal process, or
 - Formal process – Family Counsel
 - Family employment/personnel policies
 - Compensation guidelines
 - Frequently encountered and predictable problems
 - Family governance
 - Family policy and guidelines for acceptable behavior
 - Emergency planning

3.1.2. Possible Components Specific to Operating Companies

- Long-term goals of the family
- Business succession
- Retirement of family members – from the business and support of family members upon retirement



- Governance
- Family Involvement
- Commercial (non-family) management
- Training – new leaders from within the family – not just in the business, but in life matters and family matters
- Rectification of errors – what is the mechanism for rectifying incorrect decisions/choices? How are these errors identified?

Each objective or purpose gives rise to a range of specific issues that will need to be considered; a list of examples is outlined below:

OPERATING COMPANIES	
PURPOSE	POLICIES AND PROCEDURES TO BE CONSIDERED
The continued development of the business	<ul style="list-style-type: none"> ▪ Assessing the skills and frameworks required at board and management level to ensure the best resources are available to facilitate the continued development of the business ▪ Agreeing on ground rules for planning for the succession of the business’s leadership ▪ Documenting processes for clearly defining family and business governance issues
Facilitating the continued family ownership of the business	<ul style="list-style-type: none"> ▪ Policies for the inter-family transfer or sale of shares ▪ Dividend policies ▪ Policies in relation to the timing, participation and quantum of liquidity events ▪ Policies setting out the methods of communication of information to shareholders ▪ Policies in relation to the representation of shareholders at board and shareholder meetings ▪ Policies in relation to the nomination and assessment of directors Policies setting out the behaviours of and the relationship between shareholders ▪ Procedures for resolving conflicts
Bolstering the strength of the family	<ul style="list-style-type: none"> ▪ Processes to establish and review unifying family values and vision for the business ▪ Mechanisms for the family to get together and provide and receive information in relation to the business ▪ Policies for making resources and/or services available to the broader family ▪ Ground rules for selecting and assessing family members to join the business ▪ Rules delineating family and business issues



3.1.3. Possible Components Specific to Trusts and Foundations

- Long-term goals of the family
- Short-and long-term goals of the beneficiary of the specific trust
- Death, disability, etc. (already included in the Trust deeds?)
- Governance – how are the funds to be managed? Investment policies? Access to funds
- Beneficiary Involvement, if any
- Commercial (non-family) management (e.g., Morgan Stanley, etc.)
- Training – investment management? Fiscal management? Based on individual needs
- Rectification of errors – what is the mechanism for rectifying incorrect decisions/choices? How are these errors identified? Accountability?

Each objective or purpose gives rise to a range of specific issues that will need to be considered; a list of examples is outlined below:

TRUSTS	
PURPOSE	POLICIES AND PROCEDURES TO BE CONSIDERED
The continuity of the family wealth – as a group and at individual levels	<ul style="list-style-type: none"> ▪ Assessment of the skills and frameworks required at board and management level to ensure the best resources are available to facilitate the continued ▪ Agreement on ground rules for planning for the succession of Trusts’ wealth ▪ Processes for clearly defining governance issues
Managing the wealth, and family member cash flow requirements	<ul style="list-style-type: none"> ▪ Investment policies & reasonable returns ▪ Access to fund policies ▪ Dividend & Tax policies ▪ Policies in relation to the timing, participation and quantum of liquidity events of investments ▪ Policies setting out the methods of communication of information to beneficiaries ▪ Policies in relation to the nomination and assessment of directors, where needed ▪ Policies setting out the behaviours of, and the relationship between, family members who are managing affairs of others ▪ Procedures for resolving conflicts
Bolstering the strength of the family	<ul style="list-style-type: none"> ▪ Processes to establish and review unifying family values and vision for the long-term benefit of Family wealth ▪ Mechanisms for the family to get together and provide and receive information in relation to ‘shared investments’ ▪ Policies for making resources and/or services available to the broader family ▪ Ground rules for selecting and assessing family members to eventually join the Board ▪ Community involvement & Philanthropic desires of the family



Note: At some point, all of this will have to be communicated to the Family.

While none of the above is mandatory in running a family business, it will come is very handy when it is time for a change - in ownership, in management, in direction, or even a change of strategy. Most successful 1st generation entrepreneurs are long on energy, passion, commitment and "gut" feel, while short on structure, formalization and documentation. They have made huge successes of their creations by leveraging these qualities. However, passing these qualities along is not simple, and while governance is not the answer, it is, however, a way to highlight, encounter and address these items sooner than later... when it may be too late.

