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FAMILY GOVERNANCE
WHITE PAPER

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# **Family Governance:**
# How Leading Families Manage the Challenges of Wealth

# CONTENTS

# EXECUTIVE SUMMARY

Effective governance empowers leaders of wealthy families and/or families in business to make the most of the unique strength of a family enterprise: the synergy between a strong, unified owning family and a well-run family enterprise or family office.

This White Paper explains why so many families fail to govern the family-business relationship and the impact this has on their enterprises and wealth; what best practices successful families in business and affluent families are deploying to build enterprises and wealth that last;

- how succession and the transfer of wealth across generations are likely to fail without governance-building initiatives by the incumbent generation;
- how to use a board;
- how to use a family council;
- how to make the family council the finance and stewardship education campus for next generation members;
- how to overcome common pitfalls in the use of governance structures;
- how to determine primary responsibilities of the board, the family council, and the family office;
- how outside directors can help;
- how to set family policies, like family constitutions, that govern key areas of family concern;
- how to encourage trans-generational entrepreneurial activity and preserve the continued spirit of enterprise;
- how to counteract *affluenza* and feelings of entitlement in the family;
- how to nurture stewardship and the family's service and philanthropic initiatives;
- how to govern the family with a sense of purpose after a wealth creation event such as a company sale or an initial public offering (IPO).

*Family Governance: How Leading Families Manage the Challenges of Wealth* illuminates and challenges, but also illustrates, with several cases of enterprising families that are successfully applying governance best practices in Latin America, Europe, Asia and the United States. While every family is unique, adopting professional governance practices can help any enterprising family achieve its dreams and the higher goals it has for its wealth and enterprise.

# INTRODUCTION AND WELCOME

Dear Reader,

We are pleased to present our most recent White Paper: Family Governance: How Leading Families Manage the Challenges of Wealth. Since 1856 Credit Suisse has been in the privileged position of advisors to the world's wealthiest families. Over that time we have gained considerable knowledge of how families can make the most of the unique strength of a family enterprise.

As a part of a series of White Papers with external research institutes, universities and Professors, this Family Governance White Paper aims to illuminate and challenge, but also illustrate, with several cases of enterprising families that are successfully applying governance best practices in Latin America, Europe, Asia and the United States. While every family is unique, adopting professional governance practices can help any enterprising family achieve its dreams and the higher goals it has for its wealth and enterprise. Specifically, the paper examines:

- Challenges faced by families
- The "three generation rule"
- Tools of effective family governance: family assemblies, councils and constitutions
- Best practices: cases that show what can go wrong and what works

The White Paper was written by Ernesto J. Poza, Professor of Global Family Enterprise at Thunderbird School of Global Management. Professor Poza's research interests are family business continuity, new venture creation and growth, global opportunities, family business governance, leadership of change and family entrepreneurship.

Although there is no magical formula to achieve family unity and preservation of wealth, effective family governance is pivotal in preservation and growth of family wealth and family values.

We hope you will find this White Paper and research inspirational as you continue or begin to install family governance systems and tools.

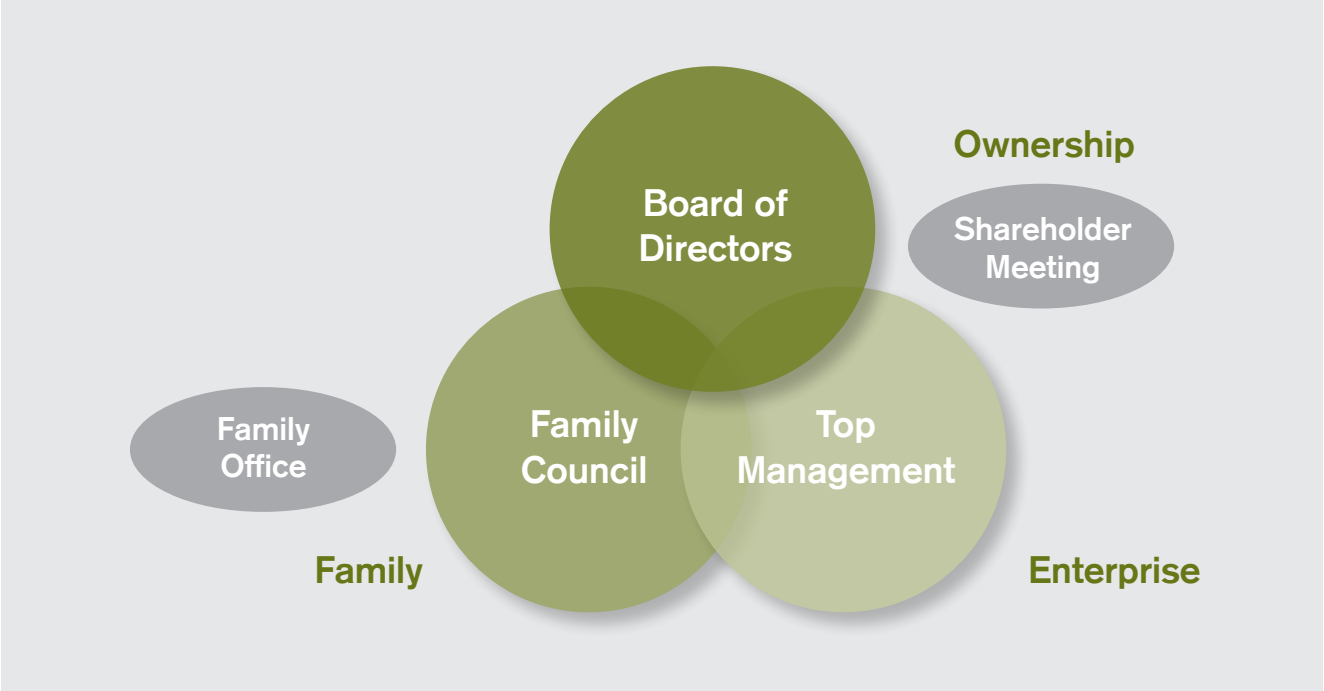
**Hans-Ulrich Meister**
CEO of Private Banking
Credit Suisse AG

# WHAT IS FAMILY GOVERNANCE?

**Family governance is a system of joint decision-making, most often by a board of directors and a family council, which helps the owner family govern its relationship with its wealth and enterprises. It is often assisted in this mission by a family constitution capturing the family's vision and important family values, a family employment policy setting the requirements for the employment of family members in the firm or family office, an ownership structure that allows for corporate control, and capable non-family managers that set a standard for the professional management of the family enterprise (see Figure 1). The desired outcome is rational economic and family welfare decisions that are not overwhelmed by traditional family dynamics.**

**Figure 1. Family Governance Structures**

Adapted from Family Business, Ernesto Poza, 2010




In many wealthy families, the family council delegates much of its day-to-day work to a family office. For some, often as a result of an initial public offering or a wealth creating event, the family office becomes the family enterprise itself, or at least a significant part of it.

In *Family Governance: How Leading Families Manage the Challenges of Wealth* we refer to family businesses and family offices interchangeably (family's enterprise and a family's wealth). While we recognize the very different nature of these entities for purposes of their management, we argue that for the purpose of governing the all-important owning family-enterprise relationship, the challenges and opportunities are quite similar.

The cases at the end of this White Paper all represent a unique opportunity for an intimate look at the real-life experiences of families wrestling with achieving the right balance: one that will promote family unity and a continuing spirit of enterprise. Their stories, as told in richly narrated detail, may serve as guideposts for creating a tailored step-by-step approach to developing a family strategy, improving communication, and fostering family unity and family trust: the raw materials of patient family capital. And because these are the real stories of families who value their privacy, their names and the names of their enterprises have been changed.

What follows should be very relevant and practical information for a family of wealth, whether its wealth is being managed by a family office, by key managers in family enterprises, or both.

# Family Anchors and the Challenges of Wealth to Family Governance

**Loss of family identity and values** — Family values, family legacy and the renewed sense of purpose brought on by a multigenerational family vision are the anchors of an enterprising family's continuity plan. But these often erode as families grow in number and wealth.

While some members of the family are busy leading successful family enterprises, others can serve the family well by stewarding its continued engagement with the original values of the founder and the founding family, and adapting them as needed. Spouses and in-laws of those actively managing the day-to-day activities in the enterprise or the family office can play a significant role in engaging the next generation in re-discovering the nonfinancial legacy of the family and facilitating its re-adoption for the future.

**Family conflicts** — Speed is one of the competitive advantages inherent in entrepreneurial firms resulting from the overlap of ownership and management. But in later generations, a family that is paralyzed because of conflicting views across generations or across branches of the extended family can become inward-looking and fertile ground for turf wars. In the process, a family enterprise can forget its most basic comparative advantage in relation to often larger, more global, and bureaucratic corporations–its nimbleness.

As Sir Adrian Cadbury, former Chairman of Cadbury Schweppes, the large British chocolate and beverage maker, observed, perhaps reflecting on his own family's experience,

> *"Paradoxically, the less important some established family benefits are, the more trouble they can cause. I was once involved in a dispute in a family firm over the produce from a vegetable garden. The family home, factory and garden were all on the same site and the garden was cultivated for the benefit of those members of the family who lived on the spot. When this apparently modest benefit came to be costed out, it was clear that it was a totally uneconomic way of keeping some members of the family in fresh fruit and vegetables. Any change in the traditional arrangement was, however, seen by those who benefited from it as an attack on the established order and the beginning of the end of the family firm."*[1]

**Current leader's inability to let go** — The critical and urgent need to build institutions of family governance is often lost on the family CEO. In a study conducted by the author, the most statistically significant finding was that CEOs of family businesses perceive both the enterprise and the family much more favorably than do the rest of the family and non-family managers. The findings further indicate that CEO/parents perceive the business in a significantly more positive light than do other family members along the dimensions of business planning, succession planning, communication, growth orientation, career opportunities, and the effectiveness of their boards. In the absence of expressed dissatisfaction with the status quo, the CEO/parent may be the last to recognize the importance of engaging in still one final leadership responsibility—creating the institutions that will effectively govern the family-enterprise and family-wealth relationship in their absence.[2]

1 Cadbury, A. (2000). *Family Firms and their Governance: Creating Tomorrow's Company from Today's.* London: Egon Zehnder International.

2 Poza, E., Alfred, T. & Maheshwari, A. (1997). *Stakeholder Perceptions of Culture and Management Practices in Family and Family Firms. Family Business Review,* 10(2), pp.135-155.

**Affluenza** — Another significant challenge from wealth to multigenerational families is the entitlement culture, a symptom of *affluenza,* which can be defined as an unsustainable culture of acquisition for acquisition's sake. Warren Buffett is credited with a principle that aims to curtail its harmful effects on families: *"Give each child enough money so that they can do anything, but not so much that they can afford to do nothing."* Families that develop a list of principles that guide their relationship to wealth and enterprise and capture them in a family constitution (see a sample family constitution in Appendix 1) are also proactively governing the family and leading it towards responsible stewardship of its wealth and enterprises.

**Dilution of wealth** — Besides the erosion that may result from unnecessary expenses, taxes and a culture of entitlement, distributions and the break-up of the enterprises or the pool of family capital can negatively affect the family's access to new investments and to the financial resources needed to take advantage of these opportunities. A smaller capital base is presented with fewer investment opportunities. Distributions motivated by needs for current consumption and the break-up of business interests fueled by family conflict — as happened with Reliance Industries in India — prevent families of wealth from reaping the benefits of patient family capital; that is, capital that stays together.

**Lack of transparency** — Neither boards of directors nor professional managers can make their value-adding contributions to family enterprises without good metrics and clear scorecards. Shareholders themselves can seldom act as responsible shareholders in the absence of financial knowledge and financial controls. While entrepreneurial cultures often resist the call for greater transparency, after all the founding entrepreneurs stayed on top of everything, next generation leaders are well served by investing in the pulse of the enterprise in real-time terms. Lack of transparency can also give rise to an absence of caring for the enterprise within the extended family. Absent caring, continuity is threatened.

**Lack of oversight and keeping it in the family** — Publicly traded firms, through their capacity to create a market for corporate control, hold management accountable. The market for corporate control makes top management accountable to all shareholders. The absence of the equity markets' influence prevents this disciplining function in privately held family firms. Even family enterprises that are publicly traded, by definition, have an overriding measure of family control. Lack of oversight often breeds complacency and resistance to change. It may also lead to self-dealing and giving some shareholder's interests priority over those of all shareholders, as in the case of Adelphia Communications in the U.S. and Gome Electrical Appliances Holdings in China. (See the Gome Electrical Appliances case on page 34).

*Family Governance*, then, is an essential discipline for the long-term well-being of the family enterprise and the family's wealth. It refers to a family's ability to optimally discipline and control the nature of the relationship between family members, shareholders, and professional managers in such a way that the enterprise prospers and the family promotes and protects its unity and its financial, human and social capital — as much for the family's sake as for the company's. After all, a family's unity and its human and social capital are the source of long-term comparative advantages of the family enterprise form. Patient family capital, reputation, and influential knowledge and networks represent unique resources that family enterprises can translate into competitive advantage.

The current CEO or president of a family office can hardly leave a finer legacy and contribution to family-business continuity and continued family wealth across generations than the creation of an effective governance structure.

# Three Generation Rule

In Spain and throughout Spanish-speaking Latin America, the challenge of preserving wealth and the spirit of enterprise across generations is captured in popular wisdom in the expression: "Padre bodeguero, hijo caballero, nieto pordiosero" (or Father-merchant, son-gentleman, grandson-beggar). In Brazil, the three generation rule goes like this: "Pai rico, filho nobre, neto pobre" (or Rich father, noble son, poor grandson). In North America the most common expression on the subject is: "From shirtsleeves to shirtsleeves in three generations." In China, the expression "Fu bu guo san dai" states unequivocally that wealth is not supposed to survive three generations. And in other countries around the world, similar folklore points to the significant challenge that family business and family wealth continuity represent.

Family members play a unique role in the strategy of family-controlled companies. Top management and the ownership group of any family enterprise must not lose sight of its primary objective—creating value for its customers. Only in this way can a business create value for itself and for its shareholders. This ongoing process of creating customer value will generally result in healthy profit margins and cash flows, which will then lead to an increase in shareholder value. This is easier said than done, particularly after a generation or two of great success and the understandable attitude that it creates: why change?

Ignacio Osborne – the Spanish/U.S. USD 332 million maker of premium wine, sherry and brandy – in 1993. His father and uncle had led Osborne in the fifth generation. Now as the sixth generation took over (Ignacio as its CEO, Tomás, Ignacio's cousin, as the chairman of the board), competitive conditions had changed. Casa Osborne may not have needed a revolution, but it certainly needed to change its culture and its strategy to respond to its increasingly successful competitors.

The wake-up call for the change was quite personal for the family. As Ignacio Osborne revealed, "*Up until the fifth generation, at least some of the Osborne family members could live from the dividends generated by the company. In the sixth generation, none of us could live from the dividends. I know this is not very romantic or very family-business oriented, but in practical terms, this was very important."* The resulting business renaissance of this wake-up call led to higher revenues and increased profits, and prevented Casa Osborne from meeting the fate of the three-generation-rule in its sixth generation.

The inability of a family company to generate sufficient dividend income to maintain the living standards of a family that generally grows with each succeeding generation has served as a wake-up call for other families as well. For example, the McIlhenny family, known in the United States for their Tabasco products, did not gun the engines of growth through new products as a result of grand strategic planning exercises led by outsiders or famous consulting companies. Instead, it adopted a new strategy and promoted growth opportunities as a result of its CEO putting the choice to family shareholders in stark terms during a family retreat in its homestead on Avery Island, not far from New Orleans. The choice: invest in growth so as to expand the profit-generating capacity of the firm or invest in psychologist fees through a family assistance program aimed at helping family members adjust to their new, less affluent, reality. The family chose to move the challenge to the strategy level, to try to find a solution to their quandary, and supported reinvestment in growth. New products and product-line extensions were created. The company grew successfully and the shareholders benefited.

# Magic of Family Enterprise

While the challenges posed by a growing company, a growing list of shareholders, a developing sense of entitlement, the paradox of success and the ever popular global folklore of the three-generation-rule all represent a warning of the unique difficulties faced by affluent families, new research also points to the tremendous opportunity that family enterprise represents worldwide. Here are some highlights:

- Worldwide, family enterprises represent anywhere from 80% of all businesses in developed economies to 98% of all businesses in emerging economies. (They account for about 90% throughout Latin America, depending on the country.) They are responsible for anywhere from 64% of the GDP to 75% of the GDP of individual countries, achieve anywhere between 6.65% and 16% higher annual returns on assets and shareholder equity than other businesses, and have created most of the jobs in the last decade.[3] In the U.S., family-controlled companies enjoyed 6.65% greater return on assets on an annual basis between 1992 and 2001; family-controlled firms also reinvested more than non-family firms.[4]
- In the EU, family-controlled firms (min. 50% family stake) outperformed the Morgan Stanley Capital International Europe index by 16% annually from 2001 to 2006.[5] Family-controlled firms (min. 10% family stake and USD 1 billion in market capitalization) outperformed the pan-European Dow Jones STOXX 600 Index by 8% a year from the end of 1996 to the end of 2006.[6]
- In Chile, a study of 175 firms traded on the Bolsa de Comercio, or Chilean Stock Exchange, found the 10 year performance of the 100 family firms in the sample (1994-2003) significantly higher in ROA and ROE terms. Tobin's Q – proxy for market value created – was higher also.[7]
- In Japan, a 2008 study of listed but family-controlled firms found higher returns on assets, returns on equity and returns on invested capital by family enterprises when compared to non-family firms.[8] In Taiwan, a study of 228 firms listed in the Taiwan Stock Exchange, found family control not impacting financial performance.[9] But two more recent ones have found family involvement to positively impact the financial performance of the firm.[10]
- In almost every industrial sector researched worldwide – information technology, consumer staples, consumer discretionary and industrial – family-controlled firms produced higher total returns to shareholders between 1997 and 2009. The only exceptions were the health care and financial services industry.[11] (In health care the state's role in most countries probably accounts for the finding, whereas in the financial services industry, the business model requires the use of other people's money to make money, which might explain family business not outperforming in this industry, notwithstanding the positive "family effect" seen elsewhere.)

3 Poza, E. (2010). *Family Business,* 3rd edition. Mason: South-Western Cengage.
4 Anderson, R. & Reeb, D. (2003). Founding Family Ownership and Firm Performance: Evidence from the S&P 500. *The Journal of Finance,* 58(3), pp. 1301-1328; and Weber, et al., *Business Week,* November 2003.
5 Poza, E., op. cit.
6 Credit Suisse *Family Holdings Outperform Competitors.* Press Release, Zurich, January 30.
7 Martinez, J. & Stohr, B. (2010). Family Ownership and Firm Performance: Evidence from Public Companies in Chile, Family Business Review.
8 Allouche, J., Amann, B., Jaussaud, J., & Kurashina, T. The impact of family control on the performance and financial characteristics of family versus non-family businesses in Japan: A matched-pair investigation. Family Business Review, 21, 2008, pp. 315-329.
9 Filatochev, I., Lien, Y. Ch., & Piesse, J. Corporate governance and performance in publicly listed, family-controlled firms; Evidence from Taiwan. Asia Pacific Journal of Management, 22, 2005, pp.257-283.
10 Chu, W. The influence of family ownership on SME performance: Evidence from public firms in Taiwan, Small Business Economics, 33, 2009, pp. 353-373; and Chu, W. Family ownership and firm performance: Influence of family management, family control and firm size. Asia Pacific Journal of Management, in press 2012, doi:10.1007/s10490-009-9180-1.
11 Thomson Reuters Data Stream, McKinsey's Corporate Performance Tool (CPAT), McKinsey Analysis, 2010.

**Figure 2. Family Businesses as a Percentage of Total Listed Companies above USD 50 Million Market Capitalization[12]**

| SOUTH ASIA | |
|---|---|
| India | 67% |
| Philippines | 66% |
| Thailand | 66% |
| Singapore | 63% |
| Malaysia | 62% |
| Indonesia | 61% |

| NORTH ASIA | |
|---|---|
| Hong Kong | 62% |
| South Korea | 58% |
| Taiwan | 35% |
| China | 13% |

A 2011 study conducted by Credit Suisse Research Institute of 3,568 publicly listed family businesses in 10 Asian markets with market capitalization of over USD 50 million finds that family businesses are the backbone of the Asian economies, as they represent about 50% of all listed companies in the study universe. See the table on the left. They have a relatively short equity market history compared with their peers in Europe and the USA. Thirty-eight percent or 1,371 of the family businesses reviewed were listed only after 2000. This should be largely attributable to the much more early stage of their life-cycles and the less-developed capital markets in the Asian region. In Asia, many family businesses are first generation businesses, in contrast with many family businesses in Europe and the USA, which are already in their fourth or even fifth generation.

Between 2000 and 2010, family businesses outperformed their local benchmarks in seven out of the 10 Asian markets, among which family businesses in China, Malaysia, Singapore and South Korea achieved the strongest relative outperformance against their local benchmarks in terms of compound annual growth rate in total return. Throughout the last decade, Asian family businesses also delivered a higher average dividend yield spread of 22 basis points over the market average over the past decade, except in 2002 during the internet bubble crisis.

See Figure 3 for examples of great family business brands. These, along with premium names like Prada, Hermès, Salvatore Ferragamo, Grupo Femsa's Dos Equis, The New York Times, The Wall Street Journal, Copa Airlines and Bacardi, all highlight the significant potential that families have to build great reputations and continue the spirit of enterprise.

**Figure 3. Great Family Business Brands**


12 Source: Credit Suisse Asian Family Businesses Report 2011, published in 2011, research conducted by Credit Suisse AG

# STRATEGY AND STRUCTURE OF FAMILY GOVERNANCE

A study in contrast illuminates the significant contribution of good governance to families of wealth and family enterprises. On the eve of the 2007 shareholder vote for the USD 60 per share offer for Dow Jones, publishers of the *Wall Street Journal,* Crawford Hill, one of the young Bancroft family members, sent an email to family members from Spain, where he was residing. In it he stated:

> *"With all due respect, it is time for a reality check. What is missing from this discussion about Dow Jones and the Bancrofts is a sense of historical perspective […] Neither grandmother, the "family matriarch" and to whom many of us owe "the legacy" nor my mom ever spoke of the legacy of Dow Jones, much less the possibility of working there or what it meant to be a steward of the business […] There was no effort at educating the next generation whatsoever […] we talked about everything under the sun […] but never Dow Jones […] We never had, by the way, conversations that the Sulzbergers (New York Times Company), the Grahams (Washington Post Company), and yes, the Murdochs (News Corp.), had every day! There has absolutely never existed any kind of family-wide/cross branch culture of teaching what it means to be an active, engaged owner and more crucially, a family director."*

He concluded his email with his recommendation that the Bancroft family accept what he considered a generous USD 60 per share offer by the Murdoch family of News Corp.

In sharp contrast, Don Graham, Chairman of the Washington Post Company, and fourth member of the family to lead the company, followed in the footsteps of his mother and former Chairwoman, Katherine Graham. Mr. Graham is committed to continued family control of its enterprises and invests in governance best practices such as a family council, a board with significant independent outsider influence, top-notch professional non-family management (including a non-family CEO), estate planning to preserve wealth and agility, much communication and education within the family and two classes of stock that give the family control while allowing it to raise capital in public equity markets. Having gone public in 1971, the Graham family retains control of the company that publishes the newspaper, operates cable TV and broadcasting companies and owns Kaplan Testing and Kaplan Higher Education. And to further consolidate its patient family capital advantage, the Graham family got long-term investor Warren Buffett's Berkshire Hathaway to purchase 20% of its Class B publicly-traded shares. Notwithstanding the digital media-induced turbulence in the newspaper industry, the Washington Post Company continues to be profitable and highly regarded; it has received 47 Pulitzers in its history, including six in 2008, the most by any single newspaper in one year.[13]

Globally, leading families are pointing the way on approaches and best practices when it comes to governing the all-important family-enterprise or family-wealth relationship. While the strategy has to be tailored to each particular family, boards with independent advisors, family councils, family offices, family constitutions, estate and ownership control planning and committees of the family (e.g., investment, strategic planning, and philanthropy committees) are all part of the structure.

The latest research points to the particularly significant role that boards of directors play in providing for effective family governance. Since our intent is to provide actionable ways to lead family governance efforts, we begin the practical information section of this White Paper with the subject of boards and the value of independent advisors serving on them.

13 See the *Wall Street Journal,* July 27, 2007, p. B12. Also see *The Washington Post,* "The Post Wins 6 Pulitzer Prizes, April 8, 2008" and *Hoover's Company Profiles,* The Washington Post Company, April 18, 2011.

# Financial Performance of the Firm

For most of the 20th century, the financial performance of corporations had not been conclusively proven to be related to the presence of independent outsiders on the governing board.[14] This held true until groundbreaking research on board composition in family-controlled firms in the S&P 500 found that companies where independent directors balanced the influence of founding families on the board performed better and created greater shareholder value. On the other hand, firms that retained founding-family ownership and had relatively few independent directors on the board performed significantly worse than non-family or management-controlled firms. Return on assets was higher for family firms with greater board independence (75% with independent directors) than for family firms with insider-dominated boards (25% with independent directors).[15] This same study found that as affiliate directors (i.e., lawyers, bankers, or accountants with a preexisting relationship with the firm) assume a greater proportion of total board seats, the performance of the family firm deteriorates. Affiliate directors do not seem to bring to board deliberations the same high level of contention, diversity of perspective, objectivity, and healthy influence that independent directors bring. Similarly, when family control of the board exceeded that of independent directors, the firm's performance was significantly poorer, and when family control was less than that of independent directors, company performance was better.[16] (See box on following page).

14 Dalton, D., Daily, C., Ellstrand, A., & Johnson J. (1998). Board Composition, Leadership Structure, and Financial Performance: Meta-Analytic Reviews and Research Agenda, *Strategic Management Journal,* pp. 269–291.

15 Anderson, R. & Reeb, D. (2004). Board Composition: Balancing Family Influence in S&P 500 Firms, *Administrative Science Quarterly,* 49, pp. 209–237.

16 Same as footnote 15.

## Family-Controlled Firms Outperform Management-Controlled Firms Worldwide

- In the U.S., family-controlled firms (which constitute 34% of the S&P 500) achieved a 6.65% greater annual return on assets and equity than their management-controlled counterparts (which account for the other 66% of the S&P 500) for the decade studied (1992-2001.)
- Similar results in *Business Week* replication of Anderson and Reeb (1992-2001).
- Study has now been replicated for the EU as a whole and for individual members like Germany, France, and Spain. Study more recently done in Chile, Japan and Poland. All studies are long-term studies of financial performance since they look at 5 and 10 year returns.
- Family-controlled firms have consistently outperformed management-controlled firms. Worldwide outperformance runs between 6.65% and 16% annually in ROE terms.[1]
- A year after the first U.S. study, the same researchers revisited their analysis and controlled for board composition. This time, their study of board composition in family-controlled firms in the S&P 500 found that where independent directors balanced the influence of founding families on the board, companies performed better and created greater shareholder value.
- Firms in which founding family ownership remained dominant (and relatively few independent directors served on the board) performed significantly worse than non-family firms.[2]
- The findings of this research support earlier findings that pointed to effective governance requiring both active, caring oversight by shareholders and significant influence by independent directors.[3]

1 Anderson, R. & Reeb, D. (2003). Founding Family Ownership and Firm Performance. *Journal of Finance,* July 2003; Weber, et al., *Business Week,* November 2003. Others.
2 Anderson, R. & Reeb, D. (2004). Board Composition: Balancing Family Influence in S&P 500 Firms, *Administrative Science Quarterly,* 49, pp. 209-237.
3 Zajac, E. & Westphal, J. (1996). Director Reputation, CEO-Board Power, and the Dynamics of Board Interlocks, *Administrative Science Quarterly,* 41, pp. 64-91; and Chatterjee, S. (2005).

This does not mean that family directors do not also play an important value-adding role on the board. The findings of this research agree with earlier findings that pointed to effective governance requiring active, caring oversight in addition to independence. And, indeed, the value of caring control has been evident recently in the initial public offerings (IPOs) of Google, LinkedIn and Facebook, where the founding entrepreneurs have insisted on two classes of stock, notwithstanding Wall Street's aversion to it, in order to ensure their continued caring, and independent owner control. (Mark Zuckerberg, Facebook Inc.'s CEO, owns 28% of Facebook's stock but controls 57% of its voting rights.)[17]

Because of the unavailability of public records on privately held companies, studies similar to the ones just discussed have not been done on the extent to which this applies to private companies. At this point we can only speculate that the rationale for the findings above, given the incentives present, applies to private family companies too. In fact, given that private firms receive less scrutiny (from analysts, bankers, government, and the media) we would argue that complementing family directors with independent directors plays an even more important role in the success of these companies.

17 Zajac, E., & Westphal, J. (1996). Director Reputation, CEO-Board Power, and the Dynamics of Board Interlocks, *Administrative Science Quarterly,* 41, pp. 64–91; and Chatterjee, S. (2005). Board Composition: Active, Independent Oversight Is Not Enough, unpublished research paper. Also see *The Wall Street Journal,* "In Facebook Deal, Board Was All But Out of Picture", April 18. 2012, p. A1.

# Board of Directors

***What Tomás, my cousin, and I did to create the needed fundamental change was to present very early in our leadership of the company a series of alternatives to the board describing how challenged the company was. The contrast between our vision and the then unsuccessful situation made the task clear for the board and the company. We also described to the board how our generation of owners thought the company had to be managed in order for it to have a future.***

— **Ignacio Osborne,** 6th generation CEO, Casa Osborne, Cádiz, Spain, personal conversation with the author.

The primary responsibilities of a board of directors include the following:

- Review the financial status of the firm
- Deliberate on the strategy of the company
- Look out for the interests of shareholders
- Promote and protect the owning family's unity and long-term commitment to the enterprise
- Mitigate potential conflicts between shareholders, including majority and minority shareholders, and between branches of the family
- Ensure the ethical management of the business and the application of adequate internal controls
- Review the performance of the CEO and hold him or the president of the family office and top management accountable for performance and good shareholder returns

Most boards of directors emphasize their responsibility to monitor management, with their mission guided by the implications of agency theory — that agents or managers have different objectives than principals or owners and, unless monitored, will not run the firm in the best interest of shareholders. The emphasis on monitoring is reflected on most boards in the publicly traded and management-controlled universe of companies and some of the larger family-controlled but publicly traded companies. When it comes to most family firms, however, particularly if they are privately held, boards are more likely to function in an advisory and value-adding capacity. This stands to reason, since there is evidence that family-owned and family-controlled firms benefit from lower agency costs and fewer agency risks, [i.e., costs and risks associated with owners delegating the management of the firm to agents, usually professional non-family managers.[18]]

Note though, in the absence of family unity, or if the agendas of majority and minority shareholders or different branches of the family begin to diverge, as is often the case in later generations, boards may be required to carry out much-needed monitoring and oversight.[19]

18 Chrisman, J., Chua, J. & Litz, R. (2004). Comparing the Agency Costs of Family and Non-Family Firms: Conceptual Issues and Exploratory Evidence, *Entrepreneurship Theory and Practice,* Summer, pp. 335–354.

19 Westphal, J. (1999). Collaboration in the Board-room: Behavioral and Performance Consequences of CEO-Board Social Ties, *Academy of Management Journal,* 42, pp. 7–24.

# Family Members on the Board

The board of a for-profit enterprise is meant to be a working board. Unlike its not-for-profit equivalent, it does not exist to facilitate fund-raising activities and so does not require representation from an exhaustive group of stakeholders who have the capacity to be potential donors. Because the mission of a family board is to work with and advise the CEO of the company or president of the family office—not represent constituencies—it is better kept small. Most group dynamics research argues that board size should be limited to between five and nine members in order for it to remain a working board. The majority of those members should be independent outsiders, such as peer CEOs, business-school professors, and/or professional service providers who derive no revenues from their relationship with the company except through board service fees. Ideally, the individuals chosen are not friends of the family, as friends tend to turn the board into a rubber-stamp board, devoid of independent and respectful but challenging thinking.

Fourth generation Richard and Tim Smucker run the now 115-year-old J. M. Smucker Co. (SJM): famous for its jams, jellies and peanut butter. Their family, with fifth-generation Mark Smucker and Paul Smucker Wagstaff now in the management ranks, avoids the squabbles that mark many business dynasties. Tim and Richard Smucker have quintupled sales by buying up iconic, but underdeveloped, brands such as Crisco, Jif, and Pillsbury, along with winners like Folgers and Dunkin' Donuts coffee, making the Smucker Company a branded food products giant. Their stock, at about USD 80 a share, was close to an all-time high in 2012 (closing stock price on April 18), and company revenues exceeded USD 5 billion.

Chief executive Richard Smucker, 64, says their business formula is: Strategy + Implementation + Culture = Success, with the added responsibility of needing to manage the family dynamic because of their being a family enterprise. "At Smucker's being a family member helps get the first job but performance measurement then is the same for all employees. Family members must remember that their actions are scrutinized more closely than those of others, by fellow employees. A good family business is like a good marriage, at times you have to 'work on it,' he says. (It is worth noting that Tim and Richard Smucker served as co-CEOs for several years. This was a rather unusual structure that has, since the summer of 2011, been replaced by the more traditional single chairman and CEO posts.)

The J. M. Smucker Co. has an independent board, which, Richard Smucker says, shows that you're willing to listen. But he adds that their board members understand the unique company culture, much of which is family-infused with values such as quality, personal and business ethics and independence, and support their unique culture. A couple of the independent directors have also been involved in their own family businesses but serve on the company's board with an independent perspective. Smucker's has been a public company since 1959 and the family has never treated family shareholders differently than any other shareholders, producing share-holder returns that have exceeded the industry's and total market returns by anywhere from 30 to 50% over the long term.[20]

20 Richard Smucker, CEO, J. M Smucker Company, personal conversation with the author, April 21, 2012.

# Board's Role in Setting Family Office and Family Enterprise Strategy

***The contribution of the outside directors of Cadbury Schweppes was to ask the right questions. These questions were sometimes uncomfortable, like whether parts of the business should be sold to put more resources behind those that were to be retained, and they were not questions we would necessarily have raised from within the business. It was up to the executives to provide the answers, but from this board dialogue between insiders and outsiders a bolder and ultimately more successful strategy was hammered out than had we not had the benefit of that external view of the firm and its prospects.***

— **Sir Adrian Cadbury**, Chairman of Cadbury Schweppes[21]

Customer-oriented businesses are always changing, always adapting to customer-induced changes in competitive dynamics. These businesses recognize the need to change in order to remain competitive. Families, by their very nature, are about stability, consistency, enduring values, love, and caring, all of which support individual development and family harmony. They tend to focus on legacy and continuity, not change. As a result, family companies often have difficulty dealing with conflict rooted in different visions of the future. And yet, quite naturally, the visions of successive generations are likely to be very different. Some owning families seek out psychologists and family therapists in the hope of resolving conflict. Others decide to gun the engines of growth so that conflicts may be seen more dispassionately in the context of an enterprise growing in resources and opportunities. Still other families decide to talk extensively across generations, aided by their boards and advisors, until a new direction can be supported by all of the generations involved.

Adaptation is not easy. If it were, the average lifespan of a U.S. corporation (family and non-family) would not have shrunk to a mere 10 years; nor would 2/3 of all first generation family-owned businesses fail to survive in the founding family's hands to a second generation.[22] The conflict between the old and the new in a family enterprise is more often than not a personal conflict between a parent and his or her child. It cannot get more subjective than that. This creates an opportunity for board members to mediate, facilitate, cajole, illuminate, provoke, and ultimately get the two generations to jointly create something they both can support. After all, it takes two generations to supply the two critical ingredients for sound adaptation in a family enterprise: (1) the wisdom to know what has made the company successful thus far and (2) the passion to seize today's opportunities, embrace change, and thrive in the decades ahead.

Sir John Harvey-Jones, former CEO and Chairman of Imperial Chemical Industries, once commented that the job of the board is to create momentum, improvement and direction and that precisely because of the failure of boards to create tomorrow's company out of today's, famous names in industry continue to disappear.[23]

21 Cadbury, A. (2000). *Family Firms and Their Governance: Creating Tomorrow's Company from Today's.* London: Egon Zehnder International.

22 Zook, C. (2007) Unstoppable: Finding hidden assets to renew the core and fuel profitable growth, Harvard Business School Press, Boston, MA; and Ward, J. (1987). *Keeping the Family Business Healthy.* San Francisco: Jossey-Bass.

23 Harvey-Jones, J. (1988). *Reflections on Leadership.* New York: HarperCollins.

# THE FOUNDER EXITS, A FAMILY OFFICE IS BORN

After the wealth-creating sale of an EU technology company in 2000, the founder and father of three siblings decided to launch a family office. Its primary mission: preserve the family's wealth. Three years later, and still imbued with the spirit of enterprise, the family revisited the family office's mission and agreed with the investment committee's recommendation to invest some of their money in new ventures, acting as venture capitalists, some with private equity partners and some in income-producing and wealth-preserving commercial real estate. It bears revealing that in the three years preceding the creation of this new family enterprise, the family office, members of this leading family wrote and signed a family constitution prescribing the nature of the desired family-wealth-enterprise relation going forward. The founder restructured the family council to include three independent outsiders so that the family council could act as a family board, when in session about business, ownership and investment matters. He then hired a key non-family professional to replace the interim family member director of the family office and, with his assistance and the assistance of several investment advisors and family business consultants, created a sophisticated family governance structure. The family office was tasked with wealth management, risk management, client services, tax planning, administration, and investment services. The family office reports to the family council/family board through its non-family director/CEO. (See Figure 4 on page 21 for a diagram of a family governance structure similar to the one described above.)

# Family Office

A growing number of second- and later-generation family firms are creating family offices to assist shareholders in their owner duties and responsibilities. Although the services offered vary, family offices can shoulder primary responsibility for:

- Joint family investments
- Family philanthropy
- Family private equity and venture capital investments
- Tax and legal advice to shareholders, tax-return preparation
- The filing of required legal documents on behalf of the shareholder
- Shareholder education
- The planning and execution of family-council meetings, shareholder meetings and family assemblies
- Administration of shared assets or properties—for example, a family vacation property, farm, or ranch

With roots in Rockefeller's Room 56 (so named because the family office originally operated out of Rockefeller Plaza's suite 5600 on the 56th floor) and in the family office at Cargill, the largest private corporation in the world, many leading families today rely on their own family office or a shared service family office, a multifamily office. The latter, usually housed in the family office of a larger family, represents a way to outsource the administration of a family office, with its corresponding cost savings.

Family offices assist family members with their ownership and wealth responsibilities, and help make the owner/company or family/wealth relationship a more positive and disciplined one.

# Family Council

Family councils, in conjunction with family business boards, constitute the best forum for achieving and maintaining an optimal balance of ownership, family, and management, one that fosters a positive family/enterprise interaction. The family council is a governance body that focuses on family matters. It is to the family what the board of directors is to the enterprise. Family councils primarily promote communication, provide a safe harbor for the resolution of family conflicts, and support the education of next generation family members in family dynamics, and financial and ownership issues. The list below defines important family council tasks:

- Serve as a vehicle for transparency and for good, timely communication
- Provide an opportunity to update family members not active in the business about the state of the business such as financial results, management, strategy, and the competitive dynamics of the industry
- Educate family members about the difference between ownership, management, and family membership
- Engage family members in responsible ownership
- Inform and educate family members on the estate plan and on the management of inherited wealth
- Allow for policy making, e.g., family employment policy, ownership transfers, and other similar matters
- Present a time for problem-solving and conflict resolution
- Provide a forum for celebration and introspection
- Create a safe harbor for planning the family's future involvement in the business

A great deal of anecdotal evidence suggests that restrictive trusts, ostensibly crafted to maintain business continuity and family unity, usually fail to prevent next generation members from doing with the company as they see fit. While these instruments often do protect and preserve the asset-based legacy for a time, family estrangement and asset sales will result unless a way is found to rediscover the intangible, value-based legacy of the founder and earlier generations.

Rediscovering the values and the legacy takes time and conversation. It takes family history projects, and candid discussions regarding the strategies and growth opportunities sought by the different generations. It takes making history come alive again. For example, at one start-up of a family council, a second-generation sibling kicked off the initial meeting not with the usual discussion of goals and expectations for the meeting but rather by reading a fictional letter from her deceased father. Her father supposedly wrote this letter after finding out that his widowed spouse, five second-generation heirs and their spouses, 18 grandchildren, and seven of the grandchildren's spouses would be meeting together. Its purpose was to convey to all family members in attendance a sense of history, a sense of priorities, the founder's commitment to a few essential principles, and his tremendous appreciation for the job done by his three successors in the management of the business.

This family's first family council meeting was launched with a tremendous sense of history and a personal challenge to the next generation to do the right thing as the family and the business moved forward. They formed a family council in order to preserve the momentum created by the first family meeting. The five siblings along with five members of the next generation continued their work on behalf of the entire family. No amount of legal expertise or foresight in the drafting of legal documents can match the goodwill and personal responsibility that next generation members begin to assume when the importance and relevance of both family and enterprise are stated so eloquently. This example offers a compelling argument for creating family councils in multigenerational family-controlled companies. Only the shareholders who are engaged by the founder's and successors' shared dreams and vision will choose to be stewards of the legacy. The rest will put their individual interests and agendas before anything else and are likely to exhibit the behaviors of rich but ungrateful heirs.

Family council meetings can educate family members on estate and estate-tax issues and guide next generation members in the management of inherited wealth. They may also allow for policy making on issues such as: (1) family member participation in the business, whether through employment, consulting, board service, or the conduct of family philanthropy; (2) family strategy vis-à-vis the business, determining the right mix of growth/reinvestment and higher dividends/current returns; (3) liquidity for individuals or branches of the family who would like to diversify their assets using buy–sell agreements between shareholders; and (4) the rationale for having different classes of stock and trusts in the interest of corporate control, company agility, and the family's economic well-being. The benefits of family council meetings are outlined below and include:

- Understanding the family values and traditions that underlie the business and the family's commitment to the business across generations of owners.
- Appreciating more deeply the history of the family and its role in the business and in the successful competitive strategy pursued over the years.
- Understanding the estate plan, ownership-transfer plans, and the need for corporate control and agility.
- Defining, over time, the nature of family member participation in the business. This is especially important for next generation members who choose not to work full-time in the business, but want to contribute to it in some meaningful way. Opportunities for participation—in family philanthropy, community service, and industry association leadership—may be identified that add value to the enterprise and support the family's role in society.
- Providing support to family members. Family council meetings can be a significant reference and support group—for example, by financially supporting the education of grandchildren and providing emotional backing to family members with special needs.
- Providing ongoing family problem-solving and conflict-resolution mechanisms. These mechanisms allow families to constructively address feelings of alienation and anger over perceived favoritism or unequal distribution of money, love, influence, or opportunity.
- Reviewing the returns on the family's investment in the business and legitimizing any concerns that shareholders may have about the management of the firm.
- Making the priorities and preferences of family members known to the board of directors, which has the ultimate responsibility to mesh, or at least align, family priorities with the priorities and strategic imperatives of the business.
- Professionalizing the business by inviting key non-family managers to attend family meetings as resources, teachers, and mentors. By their skills and abilities, these non-family managers convey to shareholders the tremendous value that professional management adds to the family-owned, family-controlled company.

The existence of ongoing family meetings or a family council as a forum for family members reduces the likelihood that family concerns will be ignored or inappropriately exported to a board of directors or a top-management team of a family enterprise. Attendance at these meetings represents a deposit in the family's emotional bank account—an investment in increasing trust and respect for all working on behalf of continued family wealth and opportunity while reducing the family's likelihood of becoming a zero-sum entity.

Renewing the family's commitment to the business, a natural outgrowth of family meetings, builds a stronger business. Family council meetings represent an investment by an ownership group in the competitive advantage created by patient family capital. It is an investment that increases the chances that shareholders will support the firm being managed for the long run.[24] Loyal shareholders who are patient capitalists in a family enterprise can provide it with a unique ability to deploy longer-term strategies, allowing the enterprise to enjoy sustainable competitive advantages that public or management-dominated operating or investment firms can ill afford.

As family councils develop their experience and mature, their ability to address conflict improves. Therefore, while they should not be started during periods of conflict or when the needs of the family are urgent—as, for example, when a decision to sell or continue the business under family control presents itself—over the long run, family council meetings are an excellent vehicle for addressing issues that are hard to manage otherwise. These may include the ones just mentioned along with frustration over dividend policies and lack of liquidity, as well as anger over real or perceived unfairness of family employment practices, compensation, promotions, family benefits, and other opportunities enjoyed by some but not by others.

All of these problems are addressed and resolved to the best of the family's ability by families with experience in family council meetings. Because some of the problems are based on feelings rooted in different perceptions, the educational mission of family council meetings can go a long way to create common ground and ameliorate conflicts rooted in misinformation, misunderstandings, or budding ill-will.[25]

A family council is often given responsibility for the family's philanthropic initiatives and for the creation of family offices to oversee trusts and other financial matters of the owning family. Because it gives family members a voice in the business, a family council relieves some of the pressure to appoint only family members to the board. Indeed, family councils often select one or two at-large members to sit on the board of directors in order to represent the family's interest in board deliberations.

Figure 4 illustrates the boundaries that should exist between family councils and boards of directors. Although family councils and boards have different missions, they are also well served by some degree of integration. Having two members of the family council serve as at-large representatives of the family on the board, for example, will help to ensure that family strategy and family preferences are appropriately considered by the board. Non-family, independent directors can also be added to the family council in order to enable it to go into *family board* session as a separate part of its family council meeting. When in session as a family board, this family body takes up ownership, business, investment, and wealth issues across all of its enterprises including operating companies and family office investments and activities.

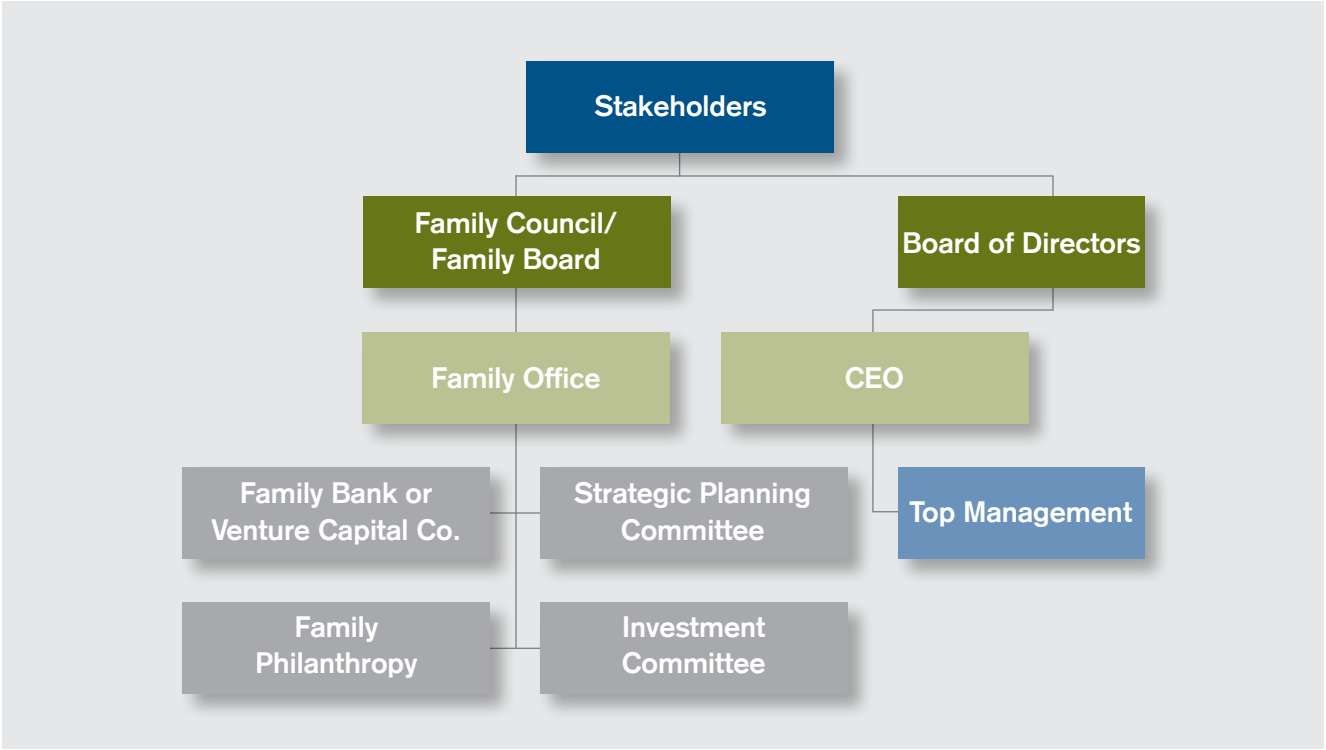
Family council membership should not exceed 12 to 15 members. While the educational and informational tasks of a family council can accommodate larger numbers of participants, family members experience difficulty working in such a large group in policy-making and decision-making tasks, particularly when in session as a family board. Participation in later generation family councils then relies on representatives from each branch of the family and each generation involved, with an eye to not exceed the 12 to 15 member recommended maximum.

24 Poza, E., Hanlon, S., & Kishida, R. (2004). Does the Family Business Interaction Factor Represent a Resource or a Cost? *Family Business Review,* 17(2), pp. 99–118.

25 Habbershon, T. & Astrachan, J. (1997). Perceptions Are Reality: How Family Meetings Lead to Collective Action, *Family Business Review,* 10(1), pp. 37-52.

**Figure 4. Contributions of Board and Council**

Adapted from Family Business, Ernesto Poza, 2010




## Family Assembly

Since not all members of a large multigenerational family can work together as members of a family council, because of the size constraint just discussed, larger families sometimes create an annual family assembly. The assembly operates in conjunction with the family council. Family assemblies are another vehicle for education, communication, and the renewal of family bonds among a larger number of family members. Family assemblies create participation opportunities for all family members at least once a year. The smaller group that makes up the family council can work on behalf of the assembly during its three or four meetings per year and then report on its progress, inform the family on a variety of timely subjects and consult the larger family about their views and preferences on an annual basis.

# Family Policy and the Family Constitution

To govern the relationship between family members, managers, and shareholders, some family enterprises write family constitutions. The family constitution makes explicit some of the policies and guidelines that shareholders will follow in their relations with each other, other family members, and family office/family company managers. While family constitutions are more prevalent in larger multigenerational families, they represent an important asset to family unity and the culture of patient family capital starting with second-generation family enterprises.

The family constitution usually has no legal standing with regard to the issues covered but it does have a bearing on the legal documents, including articles of incorporation, buy–sell agreements, and so on, that support the family's intentions and goodwill as set out in its family constitution. The principal articles contained in family constitutions typically deal with the following topics:

**I. Mission and vision.**
The family's vision and the nature of its commitment to the firm and its continuity are presented in the first article.

**II. Values.**
The family values that have successfully guided the firm in its relations with customers, employees, suppliers, partners, competitors, and the community are detailed.

**III. Family brand.**
This article guides family members in its owner–firm visibility, the use of the family name, relations with the government, traditional and social media. The desired behavior of the family toward its enterprises and their management is spelled out—what behavior is expected of family members who are in management and what family members need to be aware of in order to protect the company's and the family's reputation.

**IV. Employment policy.**
The requirements family members need to meet in order to be considered for employment are enumerated. These are often segmented into requirements for employment in management posts, requirements for internships, and requirements for lower-level positions. Requirements for management posts often include an undergraduate degree plus five years of work experience outside the family business or three years plus an MBA. This policy may also spell out whether in-laws qualify for employment or are prohibited from becoming company employees.

**V. Next generation family-member development.**
This policy sets out the commitment and procedures guiding the education and professional development of next generation members. It often also defines the level of financial support available for the college and graduate education of next generation family members.

**VI. Ownership policy.**
Stock ownership, classes of stock, and ownership transfer policies are defined. Business-valuation processes are often spelled out. Buy–sell agreements in existence are discussed. Voting and shareholder representation on the board and other entities may be acknowledged. Legal documents governing transactions of any kind are listed and their authority is recognized.

**VII. Family bank and/or family venture capital fund.**
Special funds allocated to sponsor the development of new ventures or new initiatives by members of the family are discussed and the overall terms of use of these funds are explained.

**VIII. Dividends and family benefits policy.**
This section of the constitution educates and guides shareholders on the expectations for returns on invested capital. It discloses reinvestment requirements. It may also, if the family has agreed to it, set a ratio of reinvestment to distribution of shareholder returns. Policies related to risk and risk management, including debt-to-capital ratios, may also be discussed here.

**IX. Liquidity policy.**
This article discusses business valuation, buy–sell agreements in force, redemption funds, if any, and their use in wealth-creating events.

**X. The board of directors or advisory board.**
Its make-up, standing, authority, and relation to management, shareholders, and other entities are discussed. Its primary functions and operating procedures are disclosed.

**XI. Family council meetings.**
Their purpose, primary functions and relation to the board and shareholder meetings are discussed. Membership and its standing and operating procedures are discussed.

**XII. Shareholder meetings.**
Their role is discussed, as are their authority and legal standing. Their relation to the board and the family council is also discussed.

If a family office has already been created, the constitution would also list and define the role of a family office and its relationship to shareholders, the family council, the board, and management of the family's other enterprises. (See a sample family constitution in Appendix I.)

# Trans-Generational Entrepreneurship — Keeping the Spirit of Enterprise Alive

Trans-generational entrepreneurship, or *interpreneurship,* a term coined over 20 years ago by the author of this White Paper,[26] is nothing more than entrepreneurial activity across generations driven by new products, product line extensions, new markets for existing products, joint ventures, or private equity and partnership investments in new ventures. The McIlhenny family, discussed earlier, engaged in *interpreneurship* when they decided, in the fourth generation, to extend their product line by bringing out new sauces and condiments for Cajun cooking.

Business families engage in trans-generational entrepreneurship through their family council or family office out of recognition that each generation has to bring its own vision for the future or risk economic decline and the loss of the family's spirit of enterprise. Without a sense of opportunity, families, like societies, become fertile ground for zero-sum or win-lose dynamics.

Family enterprises today seldom need a next generation that just serves as a placeholder. More often than not, family businesses need a younger generation that wants to be entrepreneurial in some way, whether as a company entrepreneur internal to the existing business, or as a stand-alone entrepreneur launching her/his own venture. And since children are seldom carbon copies of their parents, it stands to reason that many next generation members with an entrepreneurial orientation might like to launch a business with little if any relation to the original family business.

What enterprising families can do to nurture this very healthy development is design an application and approval process through which next generation members can get their new venture funded by the family bank.

Below are five steps that leading edge families are following to make trans-generational entrepreneurship a reality.

1. The family develops a vision for the new business on the board and in family council deliberations.
2. The family council assigns the next generation member as strategic planning quarterback.
3. The *interpreneur* develops, writes, and presents a formal business plan for the new venture.
4. The family's venture review board evaluates the business plan (see details below).
5. If approved, the family bank or a family venture capital company funds the venture. The next generation member becomes president of the new venture, a job that allows for plenty of feedback and learning from the responsibility for profit and loss.

The venture review board usually comprises between three and five members (an odd number is better). Board membership should preferably include two to four people who know the industry, the competitors and/or key disciplines like marketing, finance and technology, and one or two family members to ensure that the family's interests are well represented in all deliberations. The venture review board, after reviewing the venture's business plan, makes a recommendation to the family council, the family office, or the holding company board to fund the new venture, or not, and under what terms. Funding may be in the form of an interest-bearing loan or in exchange for stock in the venture, with a provision for the *interpreneur* to buy back the stock on an installment basis. If financing is in the form of equity, best practice is to ensure that the new venture leader retains majority control (e.g., 51% or more of the stock) in order to align the incentives in favor of the risk-taking family member.

26 Poza, E. (1989 & 1995). *Smart Growth: Critical Choices for Family Business Continuity.* Cleveland: University Publishers.

# The Unifying Power of Family Philanthropy

Family philanthropy is quite extensive the world over. It is often a reflection of the values of the enterprising family. These values may have been made explicit in a family constitution or may have been transmitted via the oral history of the family. It is also a great catalyst for a family's dream of continuity, and a great elixir for the prevention of *affluenza* and the development of an entitlement culture in the wealthy family. In the United States, more than 50% of all foundations and more than 56% of all philanthropic giving comes from family foundations, resulting in more than USD 18.5 billion in charitable grants each year.[27] Some analysts argue that the United States is unusual in this respect. However, many wealthy families, e.g. in Latin America, Switzerland and Europe are as every bit as engaged in this mission as are traditional religious or charitable organizations.

According to a yearly research paper (published by Centre of Philanthropy Studies University Basel, University Zurich and Swiss Foundations), the positive trend in creating new charitable foundations is catching up in Switzerland. Regarding to the hurdles of transnational giving, the European Union is envisaging of creating a European Foundation (Fundación Européa) which will allow in the future the philanthropic activities within various European countries without losing the tax privileges of the donor's country.

The comparatively high levels of charitable giving by family foundations in the United States are attributed to a generous national culture and one that prefers direct giving to giving through a third party, such as the government, in the form of taxes. It is also likely the result of tax laws that, in the U.S., make contributions to family foundations by family members tax deductible. This form of independent philanthropy represents a large social investment in the development of ideas, the discovery of new medical treatments, the support of music and the arts, and improvements in health care, education, housing and the environment.

There is much anecdotal evidence that family foundations are much more focused in their giving, and more intent on significant and measurable impact, than non-family foundations. This parallels research showing that entrepreneurial and family businesses, in general, are more focused in their business strategies, aiming for niches and more differentiated market segments, while their management-controlled counterparts deploy more diversified strategies.[28] In fact, the latest thinking in philanthropy is referred to as impact philanthropy, defined as a belief that a focused, targeted deployment of higher levels of philanthropic dollars for shorter periods of time will have a greater impact than fewer dollars over a longer time horizon. This high impact philanthropic model forces donors to behave like social entrepreneurs; philanthropists want their gifts to make meaningful contributions short term, while the high dollar infusion gives recipients the incentive to more quickly become self-sustaining. A good example of high impact philanthropy is the Bill and Melinda Gates Foundation, which, intentionally or not, is clearly a family company. The foundation has an enormous endowment but maintains a laser-like philanthropic focus on global health issues, with an expectation of quickly seeing dramatic reductions in childhood diseases responsible for early death in many parts of the world.

27 NCFP, Family Philanthropy: Current Practices. (2009). National Center for Family Philanthropy Special Report.

28 Gomez-Mejia, Makri & Kintana. (2010). Diversification Decision in Family-controlled Firms. *Journal of Management Studies,* 47(2), 223-252.

Family philanthropy is also capable of providing wealthy families with a mission of service to others. This mission often brings the family together and forces it to organize itself to do something larger and more transcendental than minding the financial well-being of its members. Much as in the Bill and Melinda Gates Foundation, family philanthropy often becomes the purpose that keeps bringing a family together, to work together. The Harris family, owners of the Display Company, ultimately decided to sell the family business. But they continued to meet as a family, in a family council, to do the work of the Harris Family Foundation. (See the Display Company case study on page 40.)

This brings us to the way in which many enterprising families organize themselves to further their philanthropic objectives. Usually, philanthropy is an important subject in family council meetings. Here guidelines for giving, criteria for selecting gift recipients and policies for evaluating the effectiveness of the giving are developed. Gift decisions are then made. And the management of the work of the philanthropy is delegated either to a family member or to a foundation professional, depending on the size of the philanthropy and the complexity of its portfolio of charities. In many cases, families also launch a separate foundation board to oversee the work of the foundation and to reap the rewards of engaging, through the foundation, those family members who may be the least likely to be attracted to business matters.

Family philanthropy and family foundations, then, are part of the arsenal of governance mechanisms available to families in business, and to wealthy families in general. Not only do they help achieve important social goals that may be totally unrelated to the economic function of the family's enterprise, but they also help nurture family unity by recognizing that non-economic goals also have a place at the family table. Family unity, after all, is good both for the family and for a family enterprise that thrives on patient family capital.

**Family philanthropy and family foundations, then, are part of the arsenal of governance mechanisms available to families in business, and to wealthy families in general.**

# Managing the Challenges of Succession

For a CEO parent, the need to pick one, and only one, descendant to lead the family company is not an easy task. It is avoidance of this extremely difficult decision that motivates many CEO parents, who deeply doubt the viability of a sibling partnership, to turn the succession question over to the board. Regardless of how compelling the arguments may be in favor of a particular successor, choosing one offspring over another for the top job can be extremely difficult and emotionally distressing for the CEO parent.

While a board of directors may rely on many different sources of information when exercising its due diligence in evaluating successor candidates from among siblings, it should always be able to rely on its independent outsider members to review the facts and render objective opinions and recommendations. For this reason, a board is in the unique position of being able to enhance the perception of the quality and fairness of the succession decision by shifting responsibility away from family members. This third-party stamp of approval significantly increases receptivity to the new company leader on the part of both key non-family management and family members.

An example of how this works follows. A hospitality company with USD 150 million in annual revenues owned and operated several restaurant and hotel concepts. It had been working on its succession process for approximately five years. The company was now being managed and operated by three brothers, who already owned a significant portion of the company stock. The second-generation CEO remained chairman of the board. The owner-managers met periodically with a family-business consultant and had initiated a family council to air and address issues pertaining to the family and its control of the business.

This firm and its owners were not short of advisors and consultants, yet they depended heavily on the board when it came to succession planning. In fact, while all the other consulting was going on, the issue of how the company was going to be managed—whether by a single owner-manager and CEO of the next generation to whom his siblings would report, or by a sibling team operating as an office of the president—was being deliberated by the board.

Sibling teams often do not work. So the board, after hearing recommendations made by the family business consultant, agreed to a trial period on the sibling team concept. During this trial period all three siblings, running two separate business units and the corporate finance function, would operate as a top team and report directly to the board. After a year of tracking the performance of the company, meeting with the siblings individually, consulting with key managers of the various properties and talking to the parent/chairman of the board, the board recommended a single CEO structure and chose one of the siblings as the best candidate to fill that position. The chairman and father agreed with, and implemented, the board's recommendation. Ultimately two of the three siblings continued in their jobs while the other moved to a related venture as its general manager, and after the initial hard feelings subsided, all three remained co-owners and best of friends.

# The Erosion of the Entrepreneurial Culture

The entrepreneurial stage is widely recognized as one that endows the organization with the capacity to be nimble, largely because at that formative stage owners know that the essence of being successful is making the sale.

But it does not take long for successful family businesses to be expected to comply with standard accounting principles that promote greater transparency — and the accompanying paperwork — and to have to comply with a growing number of industry standards and government-initiated requirements. Increased regulation and the expanding need for coordination create the impetus for more meetings, more memos and more e-mail that make the business of the family naturally become more bureaucratic. Collectively, these multiplying requirements may contribute to the family enterprise or family office experiencing time delays that the founder's business never experienced during its entrepreneurial phase.

More importantly, there is the possibility that the family itself may have become an important source of inward-focused time-wasters (like who gets to use the company plane or the country home for the holidays, both administered by a non-family staff member), in which case, the family begins to represent a cost to the enterprise rather than the resource that a family member in a combined owner-manager role represented during the entrepreneurial stage.[29] And, more importantly, by focusing inward, it can lose its ability to keep an eye on new competitive dynamics, the ever-changing marketplace, and the financial landscape.

Ignacio Osborne, reflecting on this very development, commented:

> *"The biggest source of resistance to any change may have been that the family name is on every product label. So we had to try to explain to family members who have been managing the company that in business today you have to focus on the customer and you have to forget a little bit about the vineyards, the countryside and the craftsmanship in production and look more into the market and what is going on in the world. I think that was the biggest resistance. After all the company has been very successful with the original business model for many years, so why change?"*

For a number of companies with entrepreneurial cultures the costs of losing this competitive advantage only become evident when their leadership transfers to later generations of the owning family. Ownership-transfer policies motivated by a founder's desire to love and treat all heirs equally or, from the next generation's perspective, expectations by family members of equal treatment, are likely to promote an impasse, to the detriment of continued agility and competitiveness. Distributing voting shares equally among a growing list of shareholders often erodes a next generation owner-manager's ability to lead. Stock ownership by complicated trusts can also create difficulties for successor generation leaders. Unless ownership and management have been sufficiently differentiated through the presence of non-family managers with a great amount of influence in the top management team, trustees, too, can second-guess a firm's management into paralysis. Successors need to be able to manage the company with agility, flexibility, and speed, and have ample leeway, including freedom from family constraints such as those mentioned above, to sustain the entrepreneurial culture of the first generation.

Multigenerational family-controlled businesses, even those with some exposure to public markets, are largely illiquid enterprises. This lack of liquidity and need for selfless interest can be a burden for family members operating in a society that tends to focus on the short term, the last quarter, the day trade. They will bear this responsibility willingly only if opportunities to acquire information, to be educated, and to engage with important family values of stewardship are plentiful. Inclusion, affection, and mutual influence across generations and between active and inactive shareholders are an absolute necessity. Investing sweat equity in disseminating information to family members and encouraging multiple avenues of participation gives rise to trust, a spirit of service, and a sense that everyone is in the same boat on the same long journey.

29 Zahra, S., Hayton, J. & Salvato, C. (2004). Entrepreneurship in Family vs. Non-Family Firms: A Resource-Based Analysis of the Effect of Organizational Culture. *Entrepreneurship Theory and Practice,* Summer, pp. 363-381.

# IN CONCLUSION

Family governance is the result of leadership by boards of directors, family councils, family offices, and professionalized top-management teams. The primary responsibilities of a board of directors include reviewing the financial status of the firm, deliberating on company strategy, looking out for shareholders' interests, ensuring the ethical management of the business, being a respectful critic of management, reviewing CEO performance and holding top management accountable to the family.

The family council is a governance body that focuses on family matters, frequently developing family policies in a family constitution. A family constitution is a collection of family policies guiding the family–ownership–management relationship. It represents a great investment in governing the relationship between ownership, management and family membership and addressing liquidity issues and estate planning. In larger families, a family assembly creates participation opportunities for all members by meeting at least once a year. In third and fourth generation families it is a great venue for the inclusion and engagement of spouses who, because of sheer numbers, may not be included in the family council. Family meetings are a significant contributor to the unique resource that family firms enjoy: family unity. Family unity and commitment to continuity can be the source of strategies—such as managing for the long run—that differentiate family enterprises from others and endow them with unique competitive advantages.

A family office's primary duties are to provide and organize a series of services for family shareholders, including legal and financial assistance with estate and tax issues, management of the investment portfolios of the family, promoting transparency by providing information of relevance to shareholders through meetings, e-mails, and newsletters, and fairly and equitably making family or shareholder benefits available to family members.

Key non-family managers in the top-management team help set high standards for work ethic, accountability, dedication, and expertise. By doing so they too help govern the family–business relationship in a family enterprise and family office.

Finally, trans-generational entrepreneurial activity and philanthropy are great elixirs for the prevention of *affluenza* and an entitlement culture in the family of wealth. They also often promote a leading family's legacy and its continued spirit of enterprise.

The incumbent generation's leadership and very concrete steps to promote family governance through the approaches and best practices presented, and the family cases from around the world discussed in this White Paper, are meant to inspire you to fulfill this final test of leadership greatness.

Despite the popularity of Thomas Friedman's well-known book title, the world is not flat when it comes to family enterprises. Many of the challenges to family governance are global indeed. But regional and national cultures, and their influence on family dynamics, make custom-tailored implementation of family governance best practices essential.

In family-first countries, in Latin America, parts of Asia, Spain and Italy, for example, a systematic approach like the one suggested by drafting a family constitution and having a professional family office and a board of directors that includes unaffiliated independents is critically important. The systematic approach to family governance provides a discipline that may be absent in cultural environments where family obligations supersede a business-first focus.

In business-first countries on the other hand, these may include the United States, Germany and Switzerland, for example, nurturing the heart of the family in business through family meetings, family assemblies, much communication and trust-building, promotes the engagement of next generation members that otherwise would be threatened by the loss of family values. The demise of the non-economic legacy often precedes the ultimate loss of wealth and the spirit of enterprise in these cultural contexts, making it vital for family businesses to embrace governance practices that strengthen family bonds.

Trusted advisors and their network of knowledge resources can help tailor a unique approach to the universal challenges posed by wealth to family governance. The need for family enterprises to consult with their advisors on good governance practices should not be underestimated.

## These questions will help organize the family governance leadership effort:

1. Do you have a board of directors for the enterprise or the family office that meets regularly? Is it composed of several independent directors who complement family board members and hold management accountable to all shareholders?
2. Do you have a family council that meets regularly? Or do you follow a disciplined schedule of family meetings to provide information, education and engagement of family members least involved in the enterprise or family office?
3. Is the CEO spouse, another family member or a third party playing a leadership role in nurturing a healthy family-wealth relationship, promoting ample communication and problem-solving and creating trust among family members?
4. Do you have a family constitution guiding the relationship between the family and its wealth with specific policies on the employment of family members, values you want to share with next generation members and provisions for managing conflict?
5. Are you contemplating adapting the ownership structure so that the next generation can lead the enterprise and the family with agility, as if with majority control?
6. Do you have shareholder agreements and buy-sell agreements that provide liquidity for those who want to exit and continued control for those committed to continuity?
7. Do you have professional top management assisting family members in their leadership of the enterprises and the management of family wealth?
8. Are outside advisors being used to help plan the estate, manage tax liabilities and assist in governing the family-enterprise relationship?

# Case Studies

These cases were prepared by Professor Ernesto J. Poza as the basis for discussion rather than to illustrate effective or ineffective handling of a family governance situation. The Display Company Case was prepared with the assistance of Dr. Tracey Messer. For permission to publish the cases, grateful acknowledgement is made to the chairpersons and chief executive officers of the various enterprises. Note that while the cases are factually accurate, the names have been changed to protect the privacy of the families.

CASE STUDY 1

# The Vega Food Company

## When Family Members Become Shareholders

**The Valle family's first family council meeting began to re-establish the trust that had existed while the founder was alive and re-engaged the shareholding family in shareholder responsibilities toward the enterprise.**

The Vega Food Company was a Spanish meat-processing business that produced hams, sausages, and other delicacies for domestic and export markets. The USD 104 million company, owned and managed by its founder, Francisco Valle, had a great reputation for quality products in the marketplace. Francisco Jr., 45, had worked with his father for 16 years and became president when his 72-year-old father was killed in an automobile accident.

Francisco Valle, Jr., held the first family council meeting in the family's history three years after his father's death. Many in the family had been calling for this meeting for two to three years. While he liked the concept of a family council as a forum for family issues, he was most concerned about the problems he was having with his sister, Mari.

Mari, the youngest, was concerned about her future and the financial security of her own young family in the absence of her father, whom she trusted completely. As for Francisco, well, she was not so sure. Neither were her sisters, some of whom no longer lived in Spain, knew little about the business, but considered Francisco an ambitious man with extravagant tastes.

Except for brief stints, none of the Valle daughters had worked in the business prior to their father's death. But soon after he died, Teresa, middle daughter, was encouraged by Francisco Jr. to return from Latin America and join the top management team.

**First Family Council Meeting**

Francisco took the initiative in sponsoring this first family meeting. It followed a day-long shareholders' meeting, where financial information and the state of the business were discussed with shareholders. The news for shareholders was not great. Although company sales had continued to increase (to USD 84 million), profits had plummeted in the last couple of years to less than USD 2 million, and dividend distributions had been cut.

With Teresa's help, Francisco had interviewed and selected the family business advisor who facilitated the family council meeting. The consultant had conducted a private meeting with every member of the family. A few days prior to the meeting, Mari told the family business consultant:

> *"It is important that each of us know what we have, what we don't, and what we can and cannot do as shareholders. We have to speak clearly about these things. Right now, bringing up the subject is taboo. We need more transparency in all of this. We need to recognize that we are all siblings here."*

Teresa observed, in her meeting with the advisor:

> *"The reason for these meetings is that we need Industrias La Vega to continue as a family business. In order for that to happen, Francisco needs to be supervised. There has to be more balance between Francisco and the sisters. Those inside the company have to live by corporate rules, manage with transparency, and meet the needs of the inactive shareholders. There has been too much centralization by Francisco. Financial information about the company has to be sent out regularly and explained in such a way that all*

*shareholders understand it. Without this education, there will be no sense of justice. But don't get me wrong; we love each other a lot. We have grown in family unity. My mother, Isabel, is a very strong woman and a very steadying influence."*

Isabel expressed her own expectations of the meeting this way:

*"In the interests of the family and the business, everything has to come out well defined and organized. Things have to be clear for everybody, after some discussion and reflection, so that there is no second-guessing later."*

The meeting started with the setting of meeting goals and behavioral norms for constructive problem solving and conflict resolution. Feedback from the conversations with the family business consultant was provided for family members to discuss, clarify, and then use to build an agenda that responded to the identified needs, problems, and opportunities. Selected as the top two priority items on the agenda were (1) the lack of clarity and organization in the ownership structure, estate plan, and financial reporting mechanisms for shareholders and (2) the lack of a well-organized family council and board of directors.

Board meetings existed only on paper, and only family members were on the board. While a mini-family business presentation made by the consultant early in the meeting may have influenced the selection of topics, both Teresa and Francisco had attended a family business course for next generation members at a renowned business school in the U.S. and had been convinced of the need for both of these governance bodies. For this reason, their opinions had significant influence in the larger shareholder group.

Other topics selected for discussion included the need to define the responsibilities of shareholders toward the business and of managers toward shareholders, the need to define the rules guiding relations between members of the family acting as suppliers or subcontractors to the company, and the third-generation scholarship fund.

By the end of this first family council meeting, an action plan had been drafted that directed various family members to review the ownership structure and the possession of stock certificates, retain a valuation expert to perform a company valuation, review and account for the family benefits that individual members had been granted by the founder prior to his death, in order to make appropriate decisions regarding family benefits in the next shareholder meeting, and continue to schedule open conversations about what shareholders wanted from the business—things like higher dividends, more reinvestment for long-term growth, and liquidity of shareholdings via buy–sell agreements.

An agreement was reached among family members that the company hierarchy would be respected, and any shareholder questions regarding the company and its finances would be directed to Francisco, the president, and not to accounting department personnel. Francisco, in return, agreed to respond to such requests in a timely manner. Shareholders also reached other agreements regarding the expectations they had of management and what management could rightfully expect of shareholders.

Finally, a discussion on family business boards produced a consensus on the desirability of a board with independent outsiders and a list of board responsibilities. These responsibilities were to promote the continuity of the business, review the strategy of the business, review and approve financial reports and budgets, review the compensation of key executives, and provide oversight on large capital investment decisions. The criteria for selecting board members were to be developed by a task force made up of Francisco, Teresa, and another sister. The selection of independent board members themselves and the holding of the first board meeting were deemed to be the responsibilities of Francisco, though shareholders naturally wanted to be consulted.

The Valle family's first family council meeting began to re-establish the trust that had existed while the founder was alive and re-engaged the shareholding family (prior to Francisco Sr.'s death no family members owned any stock, but in the absence of a trust and following Sr.'s desires, all family members now owned shares) in shareholder responsibilities toward the enterprise. Notably, five years later, sales exceeded USD 120 million, profits were significantly higher and the value of the enterprise had grown five-fold.

CASE STUDY 2

# Gome Electrical Appliances Holding Limited

## In the Absence of Family Governance

**Mr. Huang had not, as chairman and CEO, built an infrastructure of family governance. In what experts consider the rather unique legal and market context of Chinese enterprises, one where both the legal system and the capital markets for control rights are underdeveloped, only Mr. Huang's social capital and high profile identity represented a foundation for continued success.**

Gome Electrical Appliances Holding chairman Huang Guangyu was removed as chairman and an acting chairman was appointed on December 23, 2008. Huang Guangyu's spouse, Ms. Du Juan, resigned from her position as director the very same day. Mr. Huang had been at the helm of the largest appliance retailer in China (more than 800 stores) since he founded it in 1987. He is currently serving 14 years in prison, accused of stock manipulation through unwarranted stock repurchases carried out by him and his spouse. The stock, trading in the Hong Kong Stock Exchange, was halted from trading between November 2008 and the end of June 2009.

Intent on fighting the allegations, Mr. Huang submitted a series of board proposals, fought the sale of new stock which was advocated by the acting chairman and top management to deal with the liquidity crisis created by the scandal (it would have diluted his 34% voting control) and only resigned as director and chairman of the board on January 16, 2009.

Unless there was criminal intent all along, something experts doubt, this situation could have been avoided and a proud entrepreneur could have maintained a proud family enterprise. If only Mr. Huang had done what the acting chairman and the restructured board of directors, with the help of management, ultimately did to turn around from the crisis.

What were the very specific family governance steps taken starting in August of 2009?

- The board of directors was restructured to achieve greater balance in safeguarding the interests of all shareholders, not just the majority family shareholders. Three nonexecutive directors and three independent nonexecutive directors were appointed along with five executive directors.
- An independent audit committee was formed. The three independent nonexecutive directors and two of the non-executive directors were elected to this committee of the board.
- Bain Capital came in as a strategic outside investor with voting rights, after exercising its conversion rights under the Bain Convertible Bonds agreement, and appointed three directors to the board.
- Ernst & Young conducted an internal control review and an internal audit, and provided much needed transparency to the company's financials.
- Top management actively engaged with suppliers and key accounts to restore confidence and repair the damage done to the company's identity, reputation and brand equity.
- Top management also sought assistance with best management and governance practices and the drafting of a five-year strategic plan from its new core outside investor, Bain Capital.

Mr. Huang had not, as chairman and CEO, built the infrastructure of family governance. In what experts consider the rather unique legal and market context of Chinese enterprises, one where both the legal system and the capital markets for control rights are underdeveloped, only Mr. Huang's social capital and high profile identity represented a foundation for continued success. In his fall from grace, value destruction was sudden and dramatic. (While in more developed capital markets, competition for control could have actually buoyed the price of the stock, in this case, the shares lost most of their value and Huang family wealth vanished.)

Management was distracted by the legal and negative publicity, and in the short term the innovation and competitive drive that had been part of Gome Electrical Appliances Holding's culture of success disappeared.

The turnaround in the past two years has been dramatic, with company profits, share price and market share all having recovered in 2011 and 2012 from the depths of the crisis. The self-dealing and expropriation of rights from other shareholders, workers and the communities in which Gome operated did not have to happen and would have been prevented by proactively governing the founding family's relation to the enterprise. And in a classic example of win-win, with best practices in family governance in place, family wealth too would have been protected.[30]

30 Gome Electrical Appliances Holding Limited corporate documents. Available at www.gome.com.hk/ Retrieved on April 18, 2012. The facts of the case have been published (in the media and the company website) and the information is therefore public domain.

CASE STUDY 3

# The Miró Media Group

## Family Governance, Trans-Generational Entrepreneurship, a USD 200 Million Wealth Creating Event, and a Fourth Generation Starts a Family Office

**Carlos Miró successfully transferred power to the fourth generation at the end of the eight-year generational transition period much as he had planned. He credits family unity, the most important resource available to family enterprises in his opinion, with his ability to do so successfully.**

In 2003, the Miró family began to meet regularly as a family to discuss family and business issues. Collectively, over the next several years, they developed a family constitution, a document that guided their succession-planning discussions. In it, they established guidelines for the involvement of family members and the eventual transition across generations. The family constitution included a statement of family values; criteria for employing family members and restricting the employment of in-laws; behavioral expectations of next generation members involved in the company; principles regarding the relations between family and non-family managers; guidelines for decision making, including the CEO/father's tie-breaking role during the next five to seven years; policies for the performance reviews of next generation members; and a commitment to the professional management of the family-owned enterprise by both family members and key non-family executives.

Family council meetings, which were held monthly, were given top priority in the busy schedules of all the owner-managers. These half-day meetings included discussions about the business, investments, the succession process, conflicts between the siblings or between family and non-family managers, relationships between family members, and stress management. Any emerging conflicts were addressed. Discussion of individual aspirations was encouraged.

According to one in-law, family dynamics improved as a result of the meetings: "I am a lot more confident and optimistic since these family meetings started and the brothers and sisters started communicating more and more regularly. It takes time to express and listen to other opinions and understand the different perspectives. Without it, and without accommodating others' ideas, all you are doing is competing." Family unity was given the utmost priority in these meetings, and through much communication, listening, and compromising, trust was built.

In 2005, the first family weekend retreat was held. It included the spouses of next generation members. Spouses were briefed on the state of the business (financial results, strategy of the various business units, and new developments) with the intention of leveling the playing field for all participants. Later in the retreat, the family reflected on its legacy and recommitted to several core values that it wanted to pass on to the next generation. Subsequently, the family developed a mission statement for its principal holding, the newspaper *El Diario*, and for the Miró family. The family mission statement acknowledged the important role of spouses in a supportive role vis-à-vis the family members who worked in the family enterprise. Several spouses had demanding careers of their own in other fields.

Over the next several years, these annual retreats continued to update spouses on the family enterprise, promote analysis and discussion of family business cases with relevance to the family's current situation, nurture candid discussion about the unique skills and career aspirations of various next generation members, and review the dynamic vision for the family and the firm. Preliminary designs for the holding company, which was to become the Grupo Miró, were also drafted at these meetings.

In 2010, one of the legacy family enterprises that was not part of its now core media industry holdings was sold to a strategic buyer. This created a USD 200 million windfall for the family to re-deploy as a family enterprise.

Carlos Miró successfully transferred power to the fourth generation at the end of the eight-year generational transition period much as he had planned. He credits family unity, the most important resource available to family enterprises in his opinion, with his ability to do so successfully. The most direct contributors to family unity in the eight-year plan, besides the very large reservoir of love and goodwill with which he and his wife had endowed the family, were his family council/family retreats and the entrepreneurial spirit of that next generation.

After the fourth generation took over management and ownership control of the family enterprises, they decided that they needed a family office to assist them in the combined mission of creating and preserving wealth. The family office was initially staffed with key finance and administration staff from the existing family enterprise. It did not take the fourth generation long to realize that they needed fully dedicated staff and advisors to run the family office. Soon thereafter, key staff was moved to a separate building and a professional non-family director of the family office was hired. Investment advisors to the family were retained, a multi-family office was charged with providing additional investment and administrative services and a separate board of directors for the family office was established.

CASE STUDY 4

# The Construction Materials Company

## The Board Provides Continuity in the Face of the Founder's Death

**Families are great at accomplishing family functions like protection, transfer of values, love, even forgiveness, but not so good, especially after the children are adults (some would argue after they become teenagers), at holding their members accountable for results, the ultimate discipline and prerequisite of a successful business.**

John, the founding entrepreneur, was 64 when he died of a heart attack. John had worked hard and had continually reinvested in the company's growth since the mid-sixties. Expanding it from his home state of Michigan, he opened up operations in Indiana, Ohio, Pennsylvania, and finally Arizona. He saw significant growth potential and geographic diversification in this move to the southwestern United States. What John did not exactly foresee was how quickly two of his children, his daughter, 32, and his son, 27, were developing into capable and highly motivated next generation leaders of the family business.

Barely five years before his untimely death, John sought the help of a family business consultant. It was not his idea, rather, it was that of his wife, Ellen. She was convinced that John would have trouble letting go of his power to the next generation and convinced him to start seeking outside advice.

The family business consultant worked with John on several urgent issues: executive compensation of non-family management (talent retention was an issue), a development plan for his daughter and son in the business, a simpler organizational structure, and a preliminary estate and ownership transfer plan. In the process of doing this work, the consultant became more and more convinced that the only way to make the improvement that had begun sustainable was to launch a board with independent outsiders that would hold John, the president, accountable for progress in every one of these and many other fronts. The family business advisor could only do so much of that, the current board was a family-only board, and Ellen and her children, ages 32, 30, 27 and 25, were in no position to hold John accountable for anything on business matters.

Families are great at accomplishing family functions like protection, transfer of values, love, even forgiveness, but not so good, especially after the children are adults (some would argue after they become teenagers), at holding their members accountable for results, the ultimate discipline and prerequisite of a successful business. Some families try anyway, and when the challenge is great, often face the prospect of failure at achieving both the objectives set and the overriding objective of preserving family unity. So why charge family members with a task that they are not well equipped to do? That's where John and Ellen thought the new board could be of real assistance.

John launched the new board with three independent outsiders: the president of an investment firm who was a very savvy financial professional, a highly regarded industry attorney with no prior relationship with the family or the business, and a business school professor who served on other family business boards. The board's top priority became financial transparency; without it, they realized, they could not do their job as board members. And it was not that John was hiding anything; quite the contrary, the complexity of the operations and the maze of corporations created for liability and risk protection (important in the construction industry) were bewildering even for John.

The board succeeded, after insisting on replacing the accounting/audit firm, firing the company controller, and hiring a new CFO, in bringing much financial clarity to the business. It also met on several occasions with an estate planning attorney and helped create a blueprint for a tax-advantaged multi-year ownership transfer plan and a contingency plan in case of an emergency. Neither John nor the board had any way of knowing how prescient this would turn out to be. Within 18 months of launching the new board, John passed away. Sad as the news was for everybody involved, board members collectively understood that while difficult days lay ahead, their planning and the changes they had made would help them manage the business through a successful generational transition and transfer of power. The board, in this case at least, would make all the difference in the world; the difference between a forced liquidation in the absence of leadership and an estate plan and owner-manager continuity to a second generation.

Indeed, the business grew profitably and significantly, to over USD 110 million in annual revenues, under the leadership of the next generation until 2007, when the global financial crisis hit. In 2008, the construction industry faced the devastating power of a depression-era-style contraction. Less than a decade after John's death, his daughter, the CEO, and son, general manager of the Ohio operations, would again have to rely on the board to help them do what families are least equipped to do; hold the CEO and top management accountable for results in the interest of company survival and shareholder wealth preservation.

The conversations at the quarterly board meetings and during in-between regularly scheduled meeting conference calls were very difficult ones. The Ohio market had been hit particularly hard; and for a sister, even an older sister, to hold her sibling, the general manager, accountable for a turnaround was difficult. But with the presence of a competent board of independent advisors, aided by a world-class CFO, the company moved forward by drafting a series of improvement plans addressing cash flows, net income, administrative expenses, sales forecasts, and raw material and finished goods inventories.

In 2011, the company began to see improvements in cash flows from operations, successfully renegotiated its debt and by year-end had seen the most concrete evidence yet of the power of a board to serve the interests of a family in business.

CASE STUDY 5

# The Display Company and Jim Harris' Wealth Creating Exit

## The Role of the Board, Family Council and Family Philanthropy[31]

**At 68, Harris felt that this was more risk than he wanted to assume. An even more pressing concern was his son and heir apparent's recent announcement that he did not want to become Display Co.'s next president and instead planned to leave the company.**

In December 1999, James Harris, known by everyone as Jim, faced the toughest decision of his 37 years as an entrepreneur. Something had to be done about the long-term future of the Display Company, the business he had founded in 1962. The company had been extremely successful, with sales doubling every five years since the 1980s, and the market for the company's point-of-purchase display products was still growing. Within the past two years, the company had begun to expand from an enormously successful catalogue company into a full-service provider to global retail chains.

With no dominant players in Display Co.'s niche, Harris saw nothing but opportunity ahead. Still, he was concerned. The company had been debt-free from the start, but feeding its continuing growth would require an infusion of cash. At 68, Harris felt that this was more risk than he wanted to assume. An even more pressing concern was his son and heir apparent's recent announcement that he did not want to become Display Co.'s next president and instead planned to leave the company. None of his other children were interested in becoming part of the leadership team. Harris mused,

> *"I am a good entrepreneur, but I am not managerial in nature and I don't like that part of the business. I have a good manager here in John Collins [the non-family company president]. It is time to move on. Until a year ago, I couldn't decide what to do because I was ambivalent, but now I have reached a point where I want to make a transition."*

This decision would affect the future of his family, his business, and its employees. Should he sell the company, appoint a non-family CEO, or persuade another family member to come into the business?

31 Poza, E. & Messer, T. (2010). Fasteners for Retail, A&B. In Poza, E., *Family Business,* 3rd edition, Mason: South-Western Cengage.

**The Founder**

Jim Harris was the classic American entrepreneur—visionary, charismatic, driven, impatient, and independent. Born in Chicago in 1931, Harris was the ninth of 13 children. He loved the retail environment, was strongly independent, and had a deep appreciation of people.

Harris' point-of-purchase display products included the signs, devices, and structures used to merchandise services or products in retail stores. The industry was estimated to be a USD 13.1 billion sector. Display Co.'s segment was estimated to be approximately USD 600 million. While the broader point-of-purchase market was expected to grow at 4% annually, Display Co. and its competitors experienced much higher growth rates. Display Co., for example, had grown 19.6% annually since 1984.

In the early 1990s, Jim Harris and his wife, Julie, joined their local university's family business program. Through the program and conversation with other business owners, Harris began to see the need for different points of view regarding the business, and he decided to establish a board with independent advisors:

*"One of the things that sprang from the family business program was that we set up a board. The board consisted of four independent current and former company CEOs. It included my brother and my son, Richard, who ran his own non-profit organization. Preparing for these meetings was a great discipline. The Board challenged me through a review process and an implied evaluation of my performance. These men had all managed their own businesses. From their advice, I learned that entrepreneurship alone isn't enough to generate continued growth. Management and systems become essential once a business grows."*

Family council meetings were a high point for Julie:

*"From the family business program, we learned about family meetings. We had an outside facilitator at the first meeting, and it was marvellous—he had experiential learning games for us to play and different ways to communicate. By the third meeting, different family members were taking responsibility for planning activities for the meetings. The focus for the meetings shifted to the business of family from family business. Everyone in the family looked forward to the family council meetings. They were a chance for us all to be together as a family. We talked about business and caught up with each other as family."*

The family council meetings were important to Jim as well:

*"Before we had family meetings, I kept pretty much everything to myself. I was not that open. One of the things I learned was the importance of communication. At the first meeting, there was a critical point where I had to remind my family that while this was a family business, I had to make the final operating decisions."*

As part of their estate planning, Jim and Julie created a trust and transferred the majority of their Display Co. shares to their children. However, Jim retained voting rights. Family council meetings began around this time and proved to be a useful way for the new owners, particularly those not active in managing the business, to learn more about the business and the estate.

At the same time that youngest son, George, decided that he did not want to continue his career at Display Co., the company's senior management finalized its strategic plan. The plan made a strong case for developing fulfillment and manufacturing capabilities, expanding sales internationally, and increasing the sales force. Jim recalled:

*"It was apparent from the strategic plan that the management team saw many opportunities for growth. I didn't want to make the size of investment that was needed to broaden the product line and increase sales growth. I wanted to hand over the company and there was no one in the second generation who was interested in it. Their career goals led them in different directions."*

A joint meeting of the family owners and board of directors was held to discuss the future of Display Co. The board had significant experience in valuing and selling private firms. The broad experience of the board supported discussion of a wide array of options as the Harris family considered the future of Display Co. The Harris children were the largest shareholders, but only Julie and Jim held voting shares in the company. One son recalled the meeting:

*"The agenda question was — Do we want to continue the business without a family member running it? — From the start, George and James, Jr. believed that selling the business was the best course of action. Initially I felt a strong desire to keep Display Co. as a family business, as did Kirk. My thinking was partially sentimental — the company had been part of our lives for so long. The board of advisors helped us consider all our options. After reviewing the options it became apparent that a sale was the best course of action."*

During the meeting, the Board also encouraged Jim to define his objectives. In his words:

*I wanted to keep the company in Chicago because I wanted my employees to be able to continue to work for Display Co. Staying in Chicago meant that we would be looking for a financial buyer. While we could get more money from a strategic buyer, there was a strong likelihood that a strategic buyer would move the company out of the area. Selling to a financial buyer served the shareholders and the key employees whose efforts helped build the company.*

Five groups participated in the bidding process. Eight months after the owners made the decision to sell, the company was sold to a local investment firm. The transition to new ownership was very smooth. Senior management remained in place after the sale and Display Co.'s revenues continued to grow. The new owners provided an infusion of capital that enabled Display Co. to make several company and product acquisitions, improve systems capabilities, and hire new personnel. The transition for the Harris children was uneventful, though some family routines were temporarily disrupted.

Since selling Display Co., Jim has enjoyed a more relaxed pace. The Harris family increased its involvement in the Harris Family Foundation, a family philanthropy initially focused on mental health issues.

In Jim's words:

*"We sold most of the company to a local investment firm, but kept some shares. My brother and I remained on the Board and I remained Chairman for a few more years. I continued to work on new products, though I spent more time with community activities, family involvement, traveling and playing sports.*

*Before this experience, I would not have said that selling the family business was a good outcome, but it was for us. After the sale we continued to have family council meetings and got together regularly to talk about our shared interests, like the family foundation."*

For the past 10 years, next generation family members have been busily launching new businesses, entering new professions and taking over greater financial responsibility for the family's wealth and the running of its Harris family foundation. The Harris family council continues to meet to this day. Its primary mission is to continue the work of the family foundation. Today the foundation actively supports educational, health and environmental initiatives around the globe. Next generation Harris family members consider the foundation's work both their personal mission and a public trust; a great way to both celebrate a proud past and invest in a better future for many of the communities they live in.

# APPENDIX 1.
# SAMPLE FAMILY CONSTITUTION

## The Gary W. Smith Family Constitution

# 1 Introduction

## 1.1 Objective

This Family Constitution has been established to serve as a reference point for relationships between family members and the business during the next 10 to 15 years, a period in which we foresee the change from the second to the third generation taking place. We, the members of the Smith Family, recognize our common bonds and assume the responsibility for carrying on the legacy, through ABC Manufacturing, into the next generation.

## 1.2 Mission

It is necessary to bear in mind that the Family Constitution

- Clarifies what ABC Manufacturing and the Smith Family want to be and thus outlines the form and content of the main points of the relationships between the business and the family.
- Highlights ways of increasing unity and commitment, essential components of the family enterprise.
- Can never be contrary to what is stated in the laws governing the corporation or in the company bylaws.

## 1.3 Approval and Modification of the Family Constitution

The Family Board is the competent body for the approval and, when necessary, the modification of the present Constitution.

# 2 Guiding Principles of the Family Constitution

## 2.1 About the Founders

## 2.2 Values to Be Passed On

In the same way, we members of the second generation wish to pass on other values that form the basis of the work done during these years.

2.2.1 *Work ethic and a sense of accountability.* These are the best vehicles for the continuation of the entrepreneurial idea of the founders. Hard work reflected in products that are highest in relative quality is the reason for our success.

2.2.2 *Understanding, unity, harmony, and a bond among the shareholders.* These have played fundamental roles in the continuity of the company. They also continue to play a key role in the life of the extended Smith Family.

2.2.3 *Stewardship of the brand.* As stockholders, we must always keep in mind the consequences that our actions may have for the Company, the rest of the shareholders, and our family's reputation.

2.2.4 *Ethical conduct.* As evidenced by discretion, honesty, and humility, it works in favor of the common good.

2.2.5 *Dedication and commitment to the attainment of company objectives.*

2.2.6 *Confidence in the governing bodies of the company,* including respect for the people who today carry out the managerial, family and family wealth responsibilities and those who may do so in the future.

2.2.7 *Partnerships with customers and suppliers.* Continuously working on enhancing the value of the relationship for the partners in the supply chain.

2.2.8 *Love and concern for family and the family enterprise.* As a result of his/her ownership role, the family shareholder or board member should not enjoy any special treatment in his/her professional career within ABC Manufacturing by the mere fact that he/she is a member of the family. In this sense, family members who are active in management will have the same rights and responsibilities that the rest of the non-family employees have (salary, working days, promotions, vacations, etc.).

2.2.9 *Philanthropy.* Tithing and other community and cause-based gifting will continue to be carried out by the Smith Family through its family foundation, with oversight by the Family Board.

**2.3 Other Values**

The members of the first generation dedicate themselves to ensuring that the following values become gradually known and appreciated by the second generation.

2.3.1 *A balance between dedication to work and dedication to family,* in order that, over time, the healthy development of the next generation, unity and an appropriate commitment of service to the company may be maintained.

2.3.2 *Focused differentiation in niches and custom solutions.* Always seeking opportunities to compete based on unique capabilities, customization and novel ways of doing business. These shield us from commoditization and price competition.

2.3.3 *A sense of history that informs family members of their legacy* and firmly positions the family and the business for a promising future.

2.3.4 *The hope to form part of an important business* that should continue to be able to compete advantageously. A family member's motivation should be found in the opportunity offered to him/her to be able to collaborate and contribute to the growth and continuity of the family business.

2.3.5 *Respect for all people: family, employees, customers, suppliers, competitors.*

2.3.6 *An understanding of the obligations and responsibilities of the shareholders* of a family business, among which stand out the need to seek out the best resources for the company and to collaborate positively for the good of the other shareholders.

2.3.7 *An understanding that participation as a shareholder of the family business is a privilege bequeathed by our ancestors,* and as part of our legacy, we must use the capital responsibly to increase it, insofar as it is possible, and to pass it on to the following generation.

2.3.8 *The hope to pass on to future generations a company whose brand and customer service capability stands out in its field.*

2.3.9 *A commitment to search for solutions for liquidity and peaceful separation* (in agreement with the established procedures) with shareholders who don't want to continue participating in the business as patient capitalists or who don't share the aforementioned values.

2.3.10 *A commitment to wealth and opportunity creation for family members and employees alike.*

## 3 The Type of Company We Want to Be

**3.1** *A business in which the families,* as represented on the Family Board and the Board of Directors, *retain controlling ownership.*

**3.2** *A company that is among the leaders in its field* and among the best in the industry.

**3.3** *A business that is a leader in technology, forward-looking and technology driven.* Always seeking process improvements and product innovations that will keep OEMs considering ABC Manufacturing a preferred partner.

**3.4** *A business that continues to grow, providing a livelihood and opportunities for personal and professional growth.*

**3.5** *A business that continues,* from generation to generation, as a professionally managed *family-owned company* with members of the family on the Board of Directors and/or on the Executive Team. Because of this,

- Job positions cannot be indiscriminately offered to any family member.
- Family members working in the business should do so in leadership positions. Such positions, in order to be executed successfully, demand a person with a vision of unity, the ability to lead people, and advanced technical and managerial skills.
- Within the bounds of respect for personal freedom, the development of family members toward positions of company leadership is deemed a priority.

**3.6** *A business with an organizational structure designed to offer* both family and non-family managers *exciting career opportunities and the ability to act with autonomy,* supported by the latest in professional management.

## 4 What Can ABC Manufacturing Expect from its Shareholders

**4.1** *A long term investment* horizon that gives the family business the patient capital it needs to deploy unique competitive strategies.

**4.2** *Support for the development of intellectual capital in the business.*

**4.3** *Support for product development and new markets development.*

**4.4** *Significant industry and operations experience* from any owner who chooses to work in the business.

**4.5** *Commitment to family business continuity* across generations.

**4.6** *Respect for the very different roles and responsibilities of owners, managers and family members* that form part of this family business.

**4.7** *Ethical and responsible behavior* that enhances the reputation of ABC Manufacturing Industries.

## 5 What Can Shareholders Expect from Our Family Business

**5.1** *Growth in the size of operations,* notwithstanding existing competition and the evolution of markets.

**5.2** *Growth in the value of the estate,* increased shareholder value, by aiming for higher profitability and growth than the average in the industry. This will be accomplished via the following strategic commitments from top management:

- Gaining client loyalty by offering the best product and/or service value available.
- Developing new products and services.
- Entering promising new segments and markets and abandoning those that are less so.
- Achieving the lowest costs by economies of scale, integration, and continuing vigilance against bureaucracy.
- Reinvesting 30% or more of annual earnings in the business.
- Procuring and developing subsidiaries and joint ventures.
- Making acquisitions that ramp up the organic growth represented by the above approaches.

**5.3** *Growth that is balanced,* without taking undue risks, engaging in speculation or threatening the low debt to equity ratio that is essential to continued independence.

**5.4** *Growth financed primarily out of internal cash flows.* Only in cases where the opportunity is unusually compelling, should the company rely on external debt.

**5.5** *A market-sensitive dividend policy* that respects the company's needs for continued reinvestment and acknowledges shareholder needs and preferences.

**5.6** *Extensive factual information provided to shareholders* about the status of the business and its markets. Through periodic shareholder meetings and Family Board meetings, shareholders will be briefed on financials, competitive conditions and the overall state of the business.

**5.7** *The continued use of best practices and the selection and retention of best practitioners, family or non-family.*

**5.8** *First among equals for a top management job whenever a family member is deemed apt and capable* by the President or Board of Directors for a top management position that he/she desires. A qualified family member will be preferred for the job over a similarly qualified non-family candidate.

**5.9** *Professional advice on ownership transfer and succession,* so that the behavior and actions of individuals and the predictable challenges facing families in business do not create problems for the whole.

**5.10** *To have ABC Manufacturing be a continued source of pride for the Smith Family.*

## 6 Working in the Family Business: Family Employment Policy

It is important that family members be informed of the unique responsibilities and challenges of employment in ABC Manufacturing. They should be advised that in most cases they will be held to a higher standard of conduct and performance than other employees. We support an internship program to introduce future generations to the company.

### 6.1 General Conditions

6.1.1 Family members must meet the same criteria for hire/fire as non-family applicants.

6.1.2 Family members are subject to the same performance review as non-family members.

6.1.3 Compensation for family members will be at "fair market value" for the position held, the same as for non-family members.

6.1.4 Promotions and career opportunities for family members will be based on individual performance and company needs, the same as for non-family members.

6.1.5 Family members may be eligible for career-launching internships. This temporary employment will be limited to any one unit of employment for a predetermined time period. Family members may be encouraged to participate in internship programs with other companies with which ABC Manufacturing could reciprocate.

6.1.6 Family members will participate in summer employment opportunities when it represents a win-win for the family and the business.

6.1.7 No family member will be employed in a permanent internship or entry-level position; an entry-level position is defined as one requiring no previous experience or training outside ABC Manufacturing.

6.1.8 Family members seeking permanent employment must have at least three years' work experience outside ABC Manufacturing. During those three years with the employer, there must have been at least two positive reviews or promotions to rising levels of performance, competence, responsibility, and trust. It is our view that if a family member is not a valued employee elsewhere first, it is likely that that family member will be neither happy nor productive at ABC Manufacturing.

6.1.9 Graduate degrees in management, engineering, and other disciplines related to the knowledge base that is essential to the success of ABC Manufacturing are encouraged. A family career-development committee will be developed for the next generation's entry. It will be responsible for interviewing, coaching, and guiding interested family members to the HR Department and other appropriate company representatives, where the ultimate employment decisions will be made. This committee will comprise family top management team members and two independents.

6.1.10 No spouses will be considered for permanent employment at ABC Manufacturing.

## 7 Ownership of the Family Business

### 7.1 Ownership of the Shares

Direct descendants of Gary W. Smith should retain controlling ownership of the shares.

### 7.2 Recommendations for the Owners

While enjoying the most profound respect for their freedom and individual needs and aspirations, the owners should:

- Always consider the repercussions that decisions about passing on shares through estate planning will have on the business and the rest of the owners. In this sense, the desirable course of action would be always to look for ways that would most clearly facilitate the unity of the family business and the commitment of the shareholders to its continuity.
- In the most prudent fashion, make it possible for capable members of the third generation to attend, as informed and responsible shareholders, the Annual Shareholders' Meeting.

### 7.3 Shareholder Liquidity

In order to facilitate liquidity for the shareholders, the company will do everything in its power to pay dividends and also endow a Liquidity Fund. The object of the Fund will be to provide a buyer (namely, the family business) for the shares. The Liquidity Fund will complement the existing buy-sell agreement between shareholders. The intent is to guarantee liquidity in small quantities, following the spirit of the statutes and the Family Constitution. (The specifics of the Liquidity Fund and its tax implications need to be developed.)

Liquidity bylaw's key points:

- *The maximum amount* offered for purchase yearly will be up to 1% of the total shares of the company, depending on the funds available.
- *The value of the family business* will be calculated annually, in agreement with a formula proposed by valuation experts and approved by the Board of Directors. In the aforementioned formula, the different values of the totality of the shares, whether majority or minority, must be kept in mind. The values determined by the valuation process will be made known to the shareholders.
- *Purchase-sale:* In the situation in which a shareholder would want to sell and other shareholders would want to buy at a value higher than that offered by the Fund, or in the case that the Fund may not be able to buy, the Board of Directors will authorize the purchase-sale in accordance with the rules set forth in the Shareholder Buy–Sell Agreement.

## 8 Governing Bodies

In a family business that has the intent to strengthen the participation of the shareholders in the knowledge of the business, there are two types of governing bodies:

- Those responsible for the management of the company—that is to say, those established in the bylaws, the Annual Shareholders' Meeting and the Board of Directors. Others may be established by the Board of Directors and the Management Team, as necessary.
- The Family Board, responsible for shareholder education, communication, and developing and implementing the Family Constitution.

### 8.1 Annual Shareholders' Meeting

During the regular Annual Shareholders' Meeting, extensive information will be offered with the purpose of enabling the shareholders to be very familiar with the family business. Family members agree to refrain from using this information indiscriminately, given its confidential nature. One of the two Family Board meetings for the year will immediately follow this Annual Shareholders' Meeting.

### 8.2 The Board of Directors

The Board of Directors is the highest governing body of the company after the Annual Shareholders' Meeting. The Top Management Team is supervised and held accountable by the Board of Directors.

The functions of the Board, detailed in the corresponding bylaw, include:

- Reviewing and approving the business's strategy.
- Reviewing the financial performance of the company and holding top management accountable for such performance.
- Ensuring the ethical conduct of management and the corporation.
- Promoting the development of the managerial resources of the company.

### 8.3 Rules and Regulations for Board of Directors' Operations

- The election of board members is regulated by state laws and company statutes.
- There will always be a minimum of three high-influence independent outsiders serving on the Board of Directors.

There will be two at-large representatives of the Gary W. Smith family serving on the Board of Directors.

- Meetings should take place on a quarterly basis and be scheduled at least one year in advance.

### 8.4 Family Board

The main purpose of the Family Board is to foster a strong understanding of the business, the family, and the relationship between business and family among the family members/shareholders. Its responsibilities include:

- Informing and educating the family about the business.
- Facilitating the relationships of the family with the business.
- Educating the family about the legacy, disseminating the contents of the Family Constitution and keeping it a living document.
- Proposing to all family members those changes in the Family Constitution that, based on their judgment, can help foster a greater understanding among the family members/stockholders and better relationships between owners and managers of the company.

All family members over the age of 16 will be considered members of the Family Board until they are retired and have tendered their stock. As the family grows beyond 12 members, the Family Board will be made up of two members of each of the branches in that generation. Representative members are selected by the branches. One family member serving on the Board of Directors will also serve on the Family Board and represent a point of linkage between these two governing bodies. Total membership of the Family Board will therefore be limited to 12. Family Board meetings will sometimes be facilitated by an outside expert on family business.

### 8.5 Family Board's Problem-Solving and Conflict Resolution Committee

The primary mission of the Problem-Solving and Conflict Resolution Committee is on behalf of the Family Board, to prevent and ultimately resolve any conflict that may threaten the owning family's unity and commitment to the family's business. Its members will be selected by Family Board members and include family members and a minimum of two independent outsiders, at least one of which should be well versed in mediation and conflict resolution approaches. As a duly constituted committee it will be ready to meet only on an as needed basis after formulating its procedures and mode of operation. This Committee will also be responsible for proposing principles and approaches for the prevention of similar situations in the future.

### 8.6 Family Assembly

The Family Assembly, made up of all the blood members and their spouses, will meet once a year with the purpose of:

- Promoting greater knowledge and understanding of each other.
- Promoting greater knowledge and understanding of the business.
- Promoting greater knowledge and understanding of the estate and family trusts.
- Having fun and promoting extended family bonds.

# ABOUT THE CONTRIBUTORS

**Thunderbird School of Global Management's Walker Center for Global Entrepreneurship**

**Ernesto J. Poza**

Ernesto J. Poza (BS Yale University; MBA/MS, Sloan School of Management, Massachusetts Institute of Technology) is an internationally recognized, top-rated speaker and consultant to family-controlled and family-owned businesses. He is Professor of Global Entrepreneurship and Family Enterprise at Thunderbird's School of Global Management. As a speaker, consultant and board member he challenges business owners to revitalize mature businesses through strategic thinking, succession planning and change management. His work has been featured on CNN, NBC, and NPR, as well as in *The New York Times, The Wall Street Journal, Fortune Small Business, Business Week, Family Business Magazine, Inc., Industry Week, ABC, El Pais, Excelsior, El Norte, Expansion,* and *El Nuevo Día.* Poza is on the editorial board of the *Family Business Review* and the *Journal of Family Business Strategy,* and a contributing editor of *Family Business Magazine.*

Ernesto Poza has advised top managements of privately-held and Fortune 500 companies in strategic management, succession planning, growth and governance. Among the firms served in the U.S., Latin America and Spain are: Armstrong World, Caterpillar, Chevron, Chiquita Brands, Corn Products International, Donnelly Mirror, E. W. Scripps Company, Gonzalez Byass, S.A. (sherry and wine, Spain) and Catalana de Occidente (insurance, Spain), Grupo Alfa and Grupo Femsa (conglomerates, Mexico), James River Paper, El Nuevo Día (news media, Puerto Rico), Grupo Salcedo (food products, Ecuador), Huber & Co, Mars, Inc. and Simpson Investments. Poza has also consulted with substantial family offices and many smaller, yet equally wonderful, privately-held family firms in their efforts to keep the business successful and the family united during the often turbulent generational transition period.

In recognition of his contribution to the field of family business, the Family Firm Institute awarded him the third ever granted Richard Beckhard Practice Award in 1996 and its highly coveted International Award in 2010. His research interests are in the areas of family business continuity, new venture creation and growth, global opportunities, family business governance, leadership of change and family entrepreneurship. Poza is the author of *Family Business 3e* (2010, South-Western/Cengage Publishing) *Empresas Familiares* (2005, International Thomson Editores), *Family Business* (2004, South-Western-Thomson Publishing), and *Smart Growth: Critical Choices for Continuity and Prosperity* (1989, Jossey-Bass Publishers).

He is a founding member and Fellow of the Family Firm Institute and the creator of the very unique Thunderbird Global Family Enterprise program. He serves on the boards of several family-controlled corporations and as a consultant to private companies planning their continuity from generation to generation. He lives with his wife and daughter in Scottsdale, Arizona.

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Professor Hisrich received his BA from DePauw University, his MBA and Ph.D. degrees from the University of Cincinnati, and honorary doctorate degrees from Chuvash State University (Russia) and the University of Miskolc (Hungary). Prior to joining Thunderbird, Dr. Hisrich was the A. Malachi Mixon, III Chaired Professor of Entrepreneurial Studies at the Weatherhead School of Management, Case Western Reserve University.

He has authored or co-authored 28 books including: *Corporate Entrepreneurship* (2012), *International Entrepreneurship: Starting, Developing and Managing a Global Venture,* 2nd edition (2012), *Technology Entrepreneurship: Value Creation, Protection, and Capture* (2010), *Entrepreneurship: Starting, Developing, and Managing a New Enterprise* (2010 - translated into 13 languages and soon to be in its 9th edition).

**The Walker Center for Global Entrepreneurship**

Thunderbird's global entrepreneurship center is focused on the development of students, entrepreneurs and business leaders in the global marketplace. Strong academic curriculum and research in global entrepreneurship, corporate entrepreneurship, corporate venture funding, family enterprise, social entrepreneurship and innovation are complemented by a wide selection of non-academic offerings. The Walker Center's mission is to advance global entrepreneurship through comprehensive and relevant education, training, research and programming in the areas of enterprise capital, global entrepreneurship, global family enterprise, innovation and entrepreneurship in emerging markets.

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