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VOLUME 01

Governance: Risk Management for the Family Business

Taking steps now to ensure
that your family business will
last for generations



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Governance: Risk Management for the Family Business

A family business is the embodiment of a family's values and culture

The family, once a tight knit group who worked side-by-side in the business Dad started, is sitting around a conference table. Father, mother, two sons, and a daughter who clings to the arm of her son-in-law husband. They each have an attorney present. The family is not speaking. In fact, they haven't spoken since the suits were filed. And the business they worked so hard to build? It's in a downward spiral and will never recover. All those years of hard work: if you asked the father why, he would have said, "It's all for the family." Irony at its cruelest.

This story is fiction, but it is one we all recognize. It happens far too often with tragic results – shattered families and broken businesses. Historically, 65% of family-owned businesses fail to survive to the second generation and 85% fail to survive to the third. Fortunately, there are some easy lessons to learn from the minority of families who have gotten it right, one of which is the importance of good governance. What follows are seven essential steps (written from the perspective of a large and diverse family, but applicable to any) that will help you implement a thoughtful system of governance so your business can survive and thrive from generation to generation.

All businesses are governed – some on purpose and some by accident. The question is not "if," it is "how and to what ends." To answer those questions, a family must first know its values and culture.

Embrace the intangibles

A family business is the embodiment of a family's values and culture. These are the intangibles that make a family business unique. They don't show up on the balance sheet, but they are probably your most valuable asset and deserve fitting attention. Capturing and communicating these intangibles is the first step towards good governance.

First, identify your family's values. Talk as a family. What is important to you about the business? What impact has being part of a family business had on you? What role does the business play in your lives? In the lives of your employees? In the community? Are you there to serve the business or is it there to serve you? There are no right answers. Honesty is what's important.

Interview older generations about the business history. What were the motivations of the founders? The sacrifices? What

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pearls of wisdom have already been passed from one generation to the next, but never written down?

Now, craft this information into a family mission statement or a documented history of the company and share it with all your stakeholders. Going forward, everyone in the business will have a better understanding of the family, and everyone in the family will have a better understanding of the business.

Split personalities

In most businesses the roles – owners, directors, employees – are clearly defined. Not so in the family-owned business, where these roles are blurred and board meetings take place nightly around the dinner table. Many family businesses run into trouble because they afford the benefits of ownership – high compensation and control – to family employees who are hired on an ad-hoc basis driven more by circumstance than strategy. Likewise, ownership stakes are often awarded haphazardly and inconsistently while the true benefits of ownership – the right to the earnings of the company – are diminished by excessive compensation of the employed family. Lack of planning and poor precedents in these areas are a major cause of family business strife.

Smart families understand that you can work in the business and not be an owner, and you can be an owner and not work in the business. Each role has different rights, responsibilities, and benefits, and it is up to each family (according to their culture and values; see step one) to decide what those are. This is the second step to good family business governance: separating the roles of employee and owner, providing clarity and consistency to each, and ensuring that each is accountable to the other.

Consider a board

When a family or business is large enough, a separate board may be appropriate. An ideal board would have seats for family members who are owners, family members who are managers, non-family management, and qualified outside advisors. Not every owner has to be a board member and not every board member has to be an owner. The board should be responsible for strategic direction of the company, major decisions, and hiring and compensation of top management. Taking these potentially emotional charged decisions and creating a framework to deal with them fairly, rationally and openly is the third step to good family business governance. (For a copy of a white paper from Loyola University on best practices in family business boards, please contact me.)

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Earn your voice

Now that you've established the proper governance infrastructure for your family business, it's time to think about qualifications. Each role – owner, board, employee – requires qualifications beyond the common spelling of your last name. It is important to separate membership in the family, a birthright, with involvement in the family business, which needs to be earned.

It's your family and your business, so you can define what the qualifications are and how one earns their voice in the business. What are the education requirements? The life experience? What level of responsibility and maturity must be displayed? How? These are your choices to make, but making them proactively and clearly communicating them levels the playing field among siblings and in-laws and makes for smoother generational transitions. This is step number four in good family business governance.

Solve problems before they happen

Once your business has a strong foundation of participation and oversight, you can put it to use developing policies for the family and the business. Policies are the rails on which your increasingly efficient family business needs to run. Nobody likes policies – a bunch of pesky rules written to address what may or may not happen. But in the emotionally volatile environment of a family business, problems must be solved before they occur, and the rules of the game must be clearly defined. During a crisis, it is nearly impossible to make collective decisions that will be best for the family and the business. Therefore, it is imperative to do this heavy lifting while everyone is thinking clearly, acting rationally and willing to compromise.

Policies can cover a range of areas – ownership, employment, the board, management, in-laws, profit distributions, etc. They can be as detailed or as broad as the situation warrants. Some of the issues you are likely to address: Will there be a job for every family member that wants one? Will family members need a college degree or related outside work experience before coming into the business? Will they need to apply for an open position or can a position be created for them? Who gets to be an owner? How will profits be distributed? What voice do non-working owners have in the business? How will ownership be transitioned from generation to generation? Can the business have non-family management? Non-family owners? Can the business ever be sold? Under what terms? What role can in-laws play? What happens in the event of divorce? Who will evaluate

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the performance of family employees? What is the career track for the top job?

There are two types of companies – those in crisis and those approaching crisis. Rationally designed and agreed upon policies help a family weather the storms of crisis and come out the other side intact and ready to move forward. Establishing and communicating policies is the fifth step in good family business governance.

Honesty is a policy

As the family wrestles with these various questions, one thing must be clear: It serves neither the family, its members nor the business to sugarcoat the truth. Be honest with yourselves about the profitability and sustainability of the business, the competence and effectiveness of family members, and the levels and fairness of family compensation and benefits.

Be honest as well about the family's reluctance to address these important issues. This work is not easy. Lack of leadership or resistance to change can be stumbling blocks to an otherwise crucial agenda. Remember, "this is how we've always done things" is the rallying cry of a family willing to settle for an 85% chance that the business will not be around for the third generation. If you want to beat those odds, then you need admit that what may have worked in the past may not be good enough for the future. Address these and other issues openly and honestly and you will have taken the sixth step in good family business governance.

Keep the dialog going

You have the infrastructure in place, the policies defined, and the right mindset about the future. Now what? Develop a system of communication and accountability that ensures all this hard work has a lasting affect. Put structured communications in place – quarterly financial reports and an annual meeting – so owners get formal updates from managers (hopefully away from the dinner table). This is a two way street, however. Owners who are not active in the business have an obligation to be educated on the fundamentals of the business so they understand management's choices. Create a family mentorship program (aunts and uncles are ideal in this role) for new members of the family becoming active in the business so they understand the values, culture and history that makes the business the thriving enterprise it is today.

Thoughtful,
proactive
governance
is the key to
managing a
family
business for
long-term
success

Keep the dialog going through ongoing, consistent communication with all stakeholders and you will have taken the seventh step to good family business governance.

Conclusion

Family businesses are high risk/high reward activities in which you either hit the ball out of the park or wish you never played the game. Ask a fourth generation manager of a successful family business what keeps the family and the business rolling along. Or, ask the patriarch of a family whose business didn't last past the second generation what he would have done differently. They're likely to give the same answer: thoughtful, proactive governance. The steps laid out in this article could help you reduce the risk inherent in a family-owned businesses and pave the path to multi-generational prosperity by building that thoughtful, proactive system of family business governance.

About Century Wealth Management

Century Wealth Management is a multi-family office serving as advisor, facilitator, and investment manager to select clients who are driven to achieve their greater family vision and to ensure their legacy. We are dedicated to inspiring and empowering families to live at their highest potential.

Our family office model expands on traditional wealth management by offering a broader array of services in support of comprehensive long-term thinking. We offer integrated services in the areas of investment management, advanced financial strategies, lifestyle services, personal advancement and business development.



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