

What is different about family governance? V2

What is the purpose of this article?

- 1) Enable the family to discuss their overall governance structure, including the purpose of the family and family governance.
- 2) The article identifies potential components of family governance.
- 3) This article is focused on what to do, not how to do it. There is no advice on how to structure governance for your specific family situation.

What are the critical learnings in this article?

- 1) Wealth management is only a small part of family governance.
- 2) Purpose, legacy, values, morals, and ethics are the foundation of family governance.

What is family governance?

Family governance involves a set of relationships among: family members, family components such as family holding company, the family office, and other family ecosystem components. Family governance also provides the structure through which: the shared values and objectives of the family are set, the objectives of the family components are set, and the means of attaining those objectives and monitoring performance are determined.

Based on the above definition, there are four aspects to corporate governance:

- 1) Relationships. The focus is on relationships among different people and groups of people,
- 2) Setting values and objectives. People determine values and set objectives. People have different interests and personal values and objectives. The conflicts of interest need to be understood and managed to agree upon some shared values and objectives.
- 3) Determining how to achieve values and objectives. People have to develop plans which reflect what they will do to achieve the values and objectives.
- 4) Monitoring performance. The performance of people is monitored. Everyone needs to understand the personal consequences of not achieving values and objectives.

What is the purpose of governance?

Governance is the mechanism by which the purpose, values, and objectives of the family are achieved.

A critical challenge of family governance is understanding and managing the broad range of conflicts of interest.

What are the components comprising family governance?

#1 What is the purpose of the family?

Why does the family exist? Is it to provide a certain lifestyle for certain family members? Is to enable wealth transfer to future generations? What benefit to communities and society, if any, should the family provide? What constraints or negative impact to communities and society should the family be committed to, if any? The purpose of the family is intimately tied to the values, morals, and ethics of the family.

What is the definition of a family member? Who may, or may not, be a family member? This can become complex, as people marry, divorce, have common-law relationship, have children outside of any formal relationship, as children are adopted, etc.

The greatest legacy for the founder(s) is to be able to see that memory, legacy and values will carry on through a family which remains joined. Family governance is critical to this.

#2 What is the purpose of the Family Constitution document?

The family constitution includes:

- 1) The values, morals, and ethics of the founder(s).
- 2) Other values.
- 3) What the family members can expect from the family businesses and investments.
- 4) Employment policy regarding family members in family businesses.
- 5) The overall family governance structure, e.g. family assembly, family council, etc.
- 6) Who is a family member and who attends the Family Assembly i.e. spouses and partner or only direct descendants. At what age do children start to attend and participate in the Family Assembly.

There can be additional policy documents, approved by the family council, but not part of the constitution e.g. investment policy, philanthropy guidelines.

The family constitution should be signed by each family member.

#3 What is the Family Council

- 1) It is the family council that helps bind the family across generations, by emotional bonding. Trusts and other legal documents alone will not be successful in keeping the family together.
- 2) The family council: engages the family; resolves issues (there can be angry and passionate disputes); celebrates the family; starts the education of future generations; and enables blunt discussion about the future and the policies embedded in the family constitution.
- 3) Articulating and gaining commitment to a common understanding of the legacy, shared vision, identity, values, and purpose.
- 4) Managing the transition from controlling founder(s) to subsequent generations. Ideally the new governance is in place in time for the founder(s) to see that it is working, and to be comfortable that the family will continue to be bound together in future.
- 5) Resolving family differences, which are often emotional and based on different perceptions.
- 6) The family council may enable a once-a-year family assembly where all members of the family come together. There, the family council provides an update as well as learns the views and preferences of the entire family. This can be an opportunity to build (or destroy) trust between the council and the family, as well as among the family.
- 7) The family council may represent different branches of the family.
- 8) The family council provides the legacy, emotional, and policy context for family philanthropic activities, including family foundation(s).
- 9) The family office provides the support required, and daily management of family council activities.

#4 What is the Family Investment Committee

- 1) The family investment committee recommends the investment policies which direct the investment activities of all the entities falling within the family governance structure. The investment policy is approved by the Family Council.
- 2) The investment policy is designed knowing that there can be swings in asset valuations and asset liquidity.
- 3) The investment policy also needs to consider the degree to which different family members depend upon income from the family assets.

#5 What is the purpose of a Family Holding Company (or companies)?

- 1) Having a wide range of family assets under a single governance structure, with a single board of directors.
- 2) Decisions regarding asset management reflect the overall direction of the family, rather than individual family members.
- 3) Enabling generational wealth transfer.

#6 What is the purpose of Family Trust?

- 1) Shielding assets from creditor claims.
- 2) Avoiding the probate process.
- 3) Avoiding legal challenges to asset dispersal.
- 4) Enabling generational wealth transfer.

#7 What is the purpose of the family foundation (or foundations)

- 1) It helps bind family members, providing continuity of family values, and illustrating there is more to the family than growing and sharing wealth.
- 2) Family members on the foundation board(s) can actively participate, and make a contribution to the family. The guidelines and policies guiding the foundation(s) are set by the family council.

#6 What is the purpose of a Family Bank (or other family controlled financial institutions?)

- 1) Provide finance and financial tools for family members and family controlled assets.

#8 What is the purpose of the family office

- 1) Supports the family members and family components with the day-to-day administration and management of the family's affairs.
- 2) The services provided by a family office may include: asset management (this may include homes around the world, planes, yachts), cash management, risk management, financial planning, tax, accounting, travel arrangements, school arrangements, insurance, personal and property security, data security, vetting of

employees and contractors, hostage & ransom negotiation, etc. The family office will depend upon third party service providers.

#9 What is the purpose of the Family Assembly?

- 1) Create emotional bonds between family members who may not otherwise meet frequently.
- 2) Provide non-binding feedback to the Family Council.
- 3) Provide training and education e.g. estate planning, taxes, etc.
- 4) Identify future leaders e.g. potential Family Council members.

What are the biggest challenges faced by family governance?

- 1) The family losing its understanding and commitment to long-term vision, identity, values, and purpose. This is a challenge as the family grows in size over the generations. The family council and family office are key to helping new family members understand and commit to the non-financial legacy.
- 2) Gradually revising the shared vision, identity, values, and purpose over the generations. What was appropriate 50 years ago may not be appropriate 50 years from now. Managing the desire for continuity with the need for change, which can result in passionate disagreements. The legacy is not forgotten but actually evolves.
- 3) Family conflicts can easily arise, especially with multiple branches and multiple generations. A key issue can be the decisions around growing the family's wealth vs distributing the family's wealth.
- 4) The leaders find it hard to "let go". The founder(s) may have built their wealth, based on being the decision-maker(s). But to have a successful legacy, the founder(s) should transition to, and see, a new governance model in place. The same challenges apply to the CEO of the family office (who should be a non-family member), as well as chair of the family council. Thus, the succession planning for these two roles is critical and different from what one would see in traditional corporate governance.
- 5) The family wealth could suffer dilution or shrinkage due to high expenses, poor tax planning, or distributions to the current generation of family members. It can be difficult for individuals to defer immediate spending in order for wealth to be available for the next generation. It is key to build in the concept of "stewardship" – that the wealth is being passed onto the current generation, who must ensure that wealth is also passed onto the next generation. The stewardship also applies to all the non-financial aspects which have been identified.
- 6) Entitlement is often an issue. Young family members may grow up with wealth and feel entitled as they become adults. The family constitution should have principles around this. As Warren Buffet said "*Give each child enough money so that they can do anything, but not so much that they can do nothing*". This approach to guidance as to how parents raise their children, can be a source of family conflict.
- 7) Intense and transparent communication with the family. If the family does not know what is happening, the family will not care. And without the emotional commitment arising from caring, the family will dissolve.
- 8) The subsequent generations attempt to run the family and business the same way the founder did (i.e. the family makes many investment and business decisions). The founder(s) have been successful this way. The facts show that family businesses with majority of independent directors outperform the average public company (except in health care and financial services). This can be a source of family conflict when subsequent generations believe they are just as competent, if not more competent, than the founder(s).

What are your next steps:

- 1) Determine which components of family governance apply to your situation, taking the amount of your wealth into consideration.
- 2) Perhaps all that is appropriate is have a will and powers of attorney and discussed those with your heirs and trustees. Even in this case, you'll need to consider whether step-children and step-grandchildren should be heirs.
- 3) Perhaps there are more components of family governance you need to execute, but you'll do it yourself.
- 4) Perhaps you need third parties to manage your wealth and the related financial management e.g. tax planning
- 5) Perhaps you need to execute all components of family governance, given the size of your wealth, as well as your legacy wishes. This will require third party help to create and manage your multi-generational governance structure.

What further reading should you do?

Why are values, morals, and ethics important?

<http://koorandassociates.org/values-morals-and-ethics/why-are-values-morals-and-ethics-important/>