GenSpring
SunTrust Private Wealth

The Essentials of Family Governance

At GenSpring, we firmly believe family governance is essential to the successful transfer of multi-generational wealth. This belief has been confirmed through decades of work and research by leaders in the family wealth space. Our primary objective in this paper is to inform our readers on the topic of family governance. In addition, we present an approach to creating a system of family governance that not only aligns with industry best practices, but also has proven successful for many of our client families.

Growth in families can be exponential – potentially leading to a breakdown in communication that results in decision-making paralysis and increased frustration and conflict. During the wealth creation process, generation one, the patriarch and matriarch, is responsible for all decisions made on behalf of the family. Assuming each family branch has three children, the number of households will triple with every successive generation. In a scenario where generations two, three, and four are all living stakeholders in the family enterprise, there could be as many as 39 households having to make decisions together. As the family continues to expand, there will come a point when the family members need to determine whether or not to stay together for purposes of governing the family enterprise. To the extent family members see the many benefits of working together, including sustaining the family's financial capital, a governance structure becomes vital.

Although industry leaders espouse the benefits of adopting a family governance system, it has been our experience families constantly struggle with the question of whether to take the time and effort to implement a formal system of governance and how the structure will directly benefit them today and in the future. Generally, they feel it may be too rigid, unnecessary, and intrusive. One of the true thought leaders in the area of family wealth, Jay Hughes, breaks it down to the most basic level. Hughes states that a family is, by definition, two or more people. In order to navigate the necessities of daily life, a family must make joint decisions on a myriad of topics, from where to live to what to eat. Family governance, at its core, is nothing more than joint decision making. In its simplest form, families are practicing informal governance every day.

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MISSION STATEMENTS

When working with families that share the common goal of sustaining wealth across generations, we are often asked, "What is the best way to start working on family governance?" GenSpring's answer is simple: Start by creating a family mission statement. A mission statement can set direction for a family and provide a useful tool to guide decision making. Additionally, it helps a family articulate its purpose and establish shared goals that will support pursuit of long-term success. A mission statement is generally recognized as the first concrete step towards developing an effective system of governance.

While there are a number of ways to craft a mission statement, we believe the mission statement should strongly reflect the family's shared values. If the mission statement is not aligned with the beliefs of the family, it will not resonate with family members, nor will it double as a compass should there come a time when the path to sustainability grows unclear. One client we work with put it very simply, "We need to find our north and head in that direction!" Once family members gather to explore their intrinsic values and engage in the process of developing a mission statement, they begin to see the need to implement family governance. The rich and thoughtful discussion about who they are as a family and what they want their wealth to do for them is essential to the process. Active and enthusiastic participation is key to a family's ability to achieve its goals.

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Another very important benefit of crafting a family mission statement is the opportunity it provides the family to better understand each individual's vision for the family, as well as for his or her own life. Family Member Well-Being is one of our recommended best practices and the mission statement process provides a window into the thoughts and dreams of each person. Industry leaders advise families to ensure their collective goals do not limit their individual family members from pursuing their own passion and achieving their own goals.

FAMILY GOVERNANCE STRUCTURES

Although the end result is well worth the upfront effort, working toward establishing effective governance is a challenging exercise and not for the weak of heart! One of the first challenges is deciding: Who is family? It sounds like an easy question: Family consists of lineal descendants and spouses. However, Jay Hughes thinks about it more broadly. Hughes talks about the idea of a "family of affinity." This is a family that "sees itself as linked by affinity and a common mission rather than simply by genetic lineage." As families begin to think through the types of decisions and information the "family" would be involved in and exposed to through their governance framework, they might begin to change their thinking about who is family.

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When it comes to full disclosure of the family financials, it is the rare family that is all-inclusive. Industry leaders advocate inclusiveness for a number of reasons, all of which we agree with, but we also understand one size does not fit all. Each situation requires a careful consideration of the constellation of the particular family, including what the family members hope their family governance will do for them, what decisions will be made under the umbrella of governance, and the best options given each unique set of circumstances. Seeing how communication is critical, the family needs to have a structure or structures through which family members communicate.

Because families are complex, a number of family governance structures have evolved. These structures include, but are not limited to, the Family Council, Executive Committee, Family Assembly, and Family Board. The range of an enterprising family's complicated issues and decisions can vary from where to have the next family meeting to whether to start a foundation to determining how to meet the mounting liquidity needs of its shareholders. As a result, a single entity typically will not suffice. It is important the whole family be educated on the many different structures and led through a process of determining which would work best based on specific needs. Even the smallest of families might end up choosing three different structures, once they have thoroughly explored the “who is family” question in the context of what they want their family governance system to do for them.

One family we work with initially decided a Family Council would best suit its needs and expressed a wish to “keep things simple.” One entity was all the family members thought they needed. By utilizing a Family Council the family could achieve its goals of fostering more effective communication, exploring family values, preserving the family legacy, and engaging in shared philanthropy, family learning, succession planning and designing future family events. However, as the conversation ensued, family members acknowledged their needs for privacy around financial matters and their wish to preserve that right for lineal descendants of an appropriate age. Upon further discussion, they realized the additional formation of an Executive Committee would be an ideal solution. An Executive Committee is often the perfect structure for a family that wants to preserve the rights of lineal descendants as the leading decision makers in situations where the decisions being made are not of a fiduciary nature. Executive Committees are not typically legally empowered. The Executive Committee is generally composed of a smaller, select group that can share and act on confidential financial matters with agility. By adopting two governance structures, the family was able to accomplish its goal of including all family members in the Family Council for broader decision making while reserving the decisions regarding the family’s financial enterprise and the information needed to make those decisions to the Executive Committee.

At this point you may be wondering, “What about the next-generation members of the family?” As many of our families do, this family decided to also create a Family Assembly. A Family Assembly is an all-inclusive entity where the family’s younger set can begin, at an early age and through active involvement, to learn the family’s history, its value system, and the richness of being a member of a multi-generational family of wealth. Family Assemblies provide an inclusive forum where all family members can work toward raising happy, healthy, responsible, and motivated next-generation stewards of the family’s wealth.

It is important to note that while the three aforementioned structures worked well for this very small family, these same structures are often the solution for a much larger family as well. However, as generational mathematics come into play and families transition from second to third and third to fourth generations, families may decide to move from individual to branch representation within their family governance. So, at the Family Council level, each branch might elect a member of the branch to represent their interests in decisions facing the family, leaving the Family Assembly as the main body for all family members to gather.

If a family’s ownership structures include legal entities such as LLCs, FLPs, corporations, etc., it is important to understand the governance of each entity and make certain it aligns with the family governance. Complex ownership structures may dictate a need for a Family Board wherein the members have a fiduciary responsibility when making financial decisions with regard to the family’s shared assets. For example, charitable family foundations often have their own governing Board of Directors, which is obligated to operate in a fiduciary capacity. Another example of where a Family Board might be appropriate would be a family whose shared financial capital involves the management of a closely held business, pooled investment vehicle, real estate, and/or trust(s).

At GenSpring we agree with Dennis Jaffe, a recognized leader in family governance, who believes that when contemplating the appropriate system of governance, families need to learn to separate the business of family from the family business. The business of family includes planning family meetings, promoting shared values, creating mission statements, promoting and supporting educational opportunities, establishing family policies, and more often than not, engaging in shared philanthropy. This is done within the Family Council and/or Family Assembly. The family business focuses on managing the shared financial capital and can include liquid investments, private equity, real estate, trust administration, and the closely-held business. This entails a fiduciary responsibility and is done within the Family Board or Executive Committee.

As we said earlier, family governance is not a one-size-fits-all model. With regard to any structure, the hardest decisions remain the most important: Who is family and how and by whom will decisions be made?

FAMILY POLICIES

It has been our experience that educating families on family governance, and helping them determine which structures would best suit their individual circumstances, warms them up for the even more challenging decisions that lie ahead. Within a family governance framework we often suggest families consider establishing policies to guide family members' interactions and documenting them in a Family Constitution or, as some may call it, a Family Charter. While at first it sounds a bit formal, once families begin to learn about the types of policies families craft and why, they are quickly able to identify policies that would help them. After all, family members know where they have had difficulty communicating in the past and where the challenges will be in the future. The discussions family members undertake when crafting family policies are rich, robust conversations that, when properly facilitated, offer each family member the opportunity to have a voice in the process.

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Based on our experience and interaction with industry leaders, GenSpring often advises that one of the very first policies families should create is a Decision-Making Policy. After all, without one how would they continue to resolve the important issues that need to be addressed? We have found most families would prefer to make decisions unanimously. While that desire is a good indicator of families' desires to work together peacefully, it is rare that families unanimously agree on anything. If unanimity is not possible, the next most common suggestion is to make decisions by consensus. Consensus usually requires participants to exercise some level of flexibility in order to reach agreement.

This is workable but only if there are no residual effects or resentments over the move to middle ground. All too often, a family member will move off his or her mark to achieve consensus but then reverse the decision post-meeting. Commitment to the process is critical to successful governance. Whether families choose unanimity, consensus, or both, they should also decide how they will make decisions if they reach an impasse. This usually involves a voting mechanism.

As the smooth execution of family governance can be complicated, families may wish to consider additional policies to help guide them in their ongoing work. A Code of Conduct is one of the most commonly used tools, as it addresses how family members will treat one another through their governance activities. A Code of Conduct can also address how family members talk about the family in public. This is an especially important issue and a powerful discussion for families that are visible – locally or globally. Protecting the family's reputation should be the collective responsibility of all family members.

One of the most sensitive challenges family leaders face is the inclusion of in-laws. While this is a very complicated issue and different in every family, a Confidentiality Policy and the conversation required to develop one can provide an invaluable opportunity to discuss one of the most critical factors to the success of a family enterprise. Best practices promote the inclusion of in-laws but the why, how, and when need to be determined one step at a time. Senior leaders of families, especially first-generation wealth creators, are often very leery of disclosing details of the family's wealth. It is hard enough for them to discuss the family wealth with their own children (and many never do), but concerns that confidential information about the family wealth might be disclosed outside the family by a loose-lipped in-law are enough to keep many a family leader from disclosing information to anyone. Engaging adult family members, including in-laws, in the drafting of a Confidentiality Policy can go a long way to soothe the privacy concerns of the leading generation. The beauty of effective family governance is that it invites participation of all family members in appropriate activities while gracefully allowing for participation of certain family members in other, more private aspects of the family business. As we often say, how will the senior leaders entice their lineal descendants to participate in the family enterprise if next-generation loyalties are divided by the inclusion of one parent and the exclusion of the other?

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Another area of growing concern is risk management. Developing a Risk Management Policy allows family members to discuss the many different ways shareholders might put one another at risk and typically opens up the opportunity for family learning. Families create policies across a variety of risk management topics, ranging from use of vacation homes, obtaining adequate liability insurance coverage, and executing appropriate estate plans to the role of pre-nuptial agreements in the family. Developing a Risk Management Policy that places an expectation on family members can go a long way to provide some method of checks and balances for family members to follow, even if the expectation calls for all family members to obtain a basic understanding of the topic in order to understand the implications of not having these protections in place.

DECISION-MAKING FRAMEWORKS

The many systems of decision making available to families are similar to the forms of government articulated as far back as Plato's *The Republic* and Aristotle's *The Politics*, including an aristocracy, an oligarchy, a republic, a democracy, and a tyranny.

In our experience, the type of decision-making framework families choose to employ is influenced by the number of family members and generations currently involved in the process. As a family grows, the typical autocratic structure with the wealth creator as the single decision maker may no longer be viable.

When a family evolves to the second and third generation, there may be several members vying for input to the decision-making process. At this point, a partnership style of governance may be the right solution. This is a key point in the life of any proposed governance structure as it involves the necessity of giving up control – an often hard pill to swallow. Jay Hughes believes the willingness to give up control can come only from a sense that the individual will receive greater freedom in return. As a result, in order for family members to give up control in a partnership format, they have to feel confident there is something to gain from shared decision making. The partnership style can initially relieve the stress caused by a power struggle over who will be the next family leader. There is a shared ownership and control that tends to make the family members comfortable. This is especially true with siblings who grew up together and have been making decisions together all their lives.

Governance is an evolutionary process and it is important that families recognize the benefits of embracing change.

When families expand beyond the second and third generation, the ties that bind become looser, and sheer numbers make it impossible for all parties to have a voice in the decision making. It is important to remember that whatever framework families embrace, it should be flexible and allow for reaffirmation. Governance is an evolutionary process, and it is important that families recognize the benefits of embracing change. Even our Founding Fathers understood the significance of flexibility and anticipated change when they built in the ability to make amendments to our Constitution.

CONCLUSION

The benefits to families that establish successful family governance and adhere to what they created can be invaluable and provide opportunities to enhance communication, reduce potential conflict, educate the next generation, preserve the family legacy, sustain the family capital, and build family leaders for the future. At GenSpring we could not wish more for our clients.

ADDITIONAL RESOURCES

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