



**IFB** Research  
Foundation

FAMILY BUSINESS CHALLENGES

No. 6

# **BUILDING FAMILY GOVERNANCE**

Practical guidance for family business owners and managers

SECOND EDITION

## No.6 Building Family Governance

### Section 1. INTRODUCTION

**Successful family business owners learn to manage two facets of governance.** Corporate governance, covering the direction for business operations and strategy, and secondly, family governance, providing a framework of rules that define family members' roles and responsibilities, and how the family interacts with their business (see Exhibits 1 and 2).

#### Exhibit 1: Defining family governance

"The focus of family governance should be to find consensus on matters where owners' wishes matter most, as well as to provide family members with a shared sense of identity and mission that transcends their individual interests in the business. While every family business is unique, embracing systematic governance processes can help any family business achieve goals shared by virtually all: orderly decision making, peaceful continuity, and the freedom to make decisions based on the highest and best purposes of both the business and the family."  
*Source: Craig E. Aronoff and John L. Ward (2011) Family Business Governance: Maximizing Family and Business Potential, Palgrave Macmillan, p.84.*

#### Exhibit 2: The challenge of building family governance

Family governance requires establishment and maintenance of a number of values and practices:

1. A culture and structure of open family communication.
2. Valuing overall family above individual or family branch needs.

3. The importance of demonstrated competence in assigning responsibilities.

4. An effective generational succession plan for the continuity of the family firm.

5. The creation of family conflict management processes.

6. The creation and maintenance of an effective family governance plan.

*Source: Adapted from Harry F. Martin (2001) "Is Family Governance an Oxymoron?", Family Business Review, XIV (2), pp.91-96.*

**Separating family and business decision-making is the goal.** But this is complicated because in most family firms individuals often have dual roles. It's not possible – or indeed desirable – to eliminate all personal interests or conflicts of interest, but family governance procedures make it easier to identify and address them with reasonable objectivity.

**Family governance needs to evolve to take account of predictable developments.** Family firms become more complex over time as the business expands, the family grows and ownership dilutes. What used to work for a founder or entrepreneur and their nuclear family – usually informal governance based on understandings and assumptions – is less likely to serve the interests of a group of second-generation siblings. A generational transition to a business owned by cousins will raise yet more issues (see Exhibit 3 on family governance and large family ownership groups).

### Exhibit 3: Creating effective family governance

“Good family governance can take many forms, but its key function is to promote effective ownership communication and deliberation. Large family ownership groups need to be educated about the business, its history, and its current challenges. They need to understand the values, vision, and goals of the business and the family, and how these are related and support each other. Good family governance, however, needs to do more than provide information. It must enable ownership discussion and feedback. The family itself must make decisions, including fundamental decisions about how it will govern both itself and the business.”

Source: John L. Ward. (2005), “The Value of Hands-on Ownership”, in John L. Ward (ed.) *Unconventional Wisdom: Counterintuitive Insights for Family Business Success*, John Wiley & Sons, pp. 203-220; p.224.

**Informality giving way to rules, procedures and structures.** It makes sense to organise governance early when the family enterprise is young and the family group relatively small (see Exhibit 4). During this period, family relations are often harmonious, while big issues like succession remain a distant prospect.

### Exhibit 4: Degrees of formality

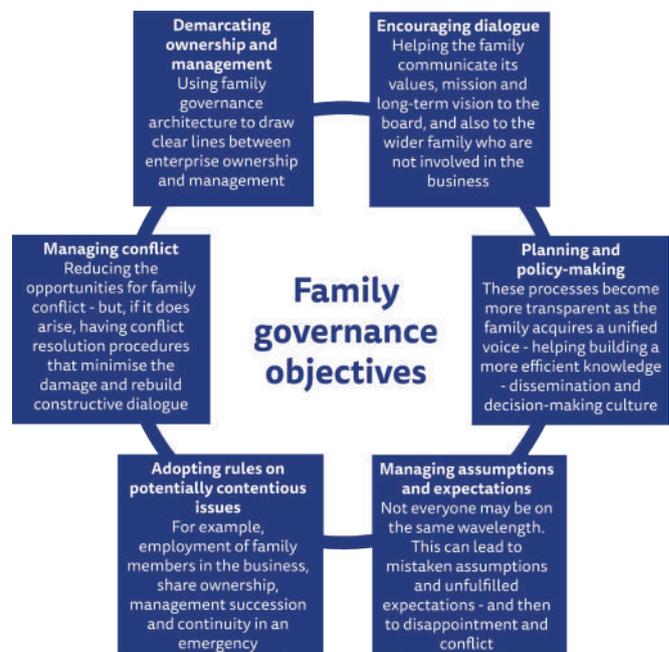
“Family governance lies on a continuum, along which there are gradations of formality. For some families, particularly in the first and second generations, it might take the form of family meetings held on a regular basis, or even ad-hoc meetings. For other families (often larger groups) family governance might be achieved through a representative body of that group, often called a family council (some families have other labels such as a family steering group, family stewardship committee or family board). Whatever the name, this body serves by creating a small group of representatives that can act on behalf of the entire family.”

Source: Kelly LeCouvie and Jennifer Pendergast (2014) *Family Business Succession: Your Roadmap to Continuity*, Palgrave Macmillan, p.135.

**The importance of shared values and vision.** A strong sense of shared purpose among owners and the wider family is a source of competitive advantage for family businesses. Each family needs to work through how this sense of belonging and teamwork will be reflected in their family governance rules, processes and procedures.

**Helping families “speak with one voice”.** The formal framework and written rules of governance make it less likely that personality issues will divide the family and interfere in the business. Through the mechanisms of family governance, families aim to build trust, ensure clarity and manage stakeholder expectations (see Exhibit 5).

### Exhibit 5: The goals of family governance



**Family ownership governance issues for large family businesses.** Family ownership control in these firms can be exercised via a variety of structures and mechanisms, including:

- **Board of directors.** Research on governance implications in this area focuses on board characteristics – especially the number and type of directors and the make-up of board committees (see the “Professionalising the Board” Challenge in this series).

- **Ownership concentration.** The concentration of ownership in the hands of individuals and voting blocks is a central characteristic of family-controlled firms and can, if not managed well, represent a threat to effective governance, including board oversight.

- **Board chair / CEO duality.** “Duality” refers to the situation when the CEO also holds the position of chair of the board. Duality in family firms, broadly reflects the balance between streamlined decision-making versus accompanying loss of board oversight and management accountability.

- **Trusts and other wealth transfer mechanisms.** Trust and estate planning structures have important governance implications for family-controlled enterprises, mainly relating to the impact they can have on business strategy, owner engagement and financial structure.

**Implementing family governance – protocols, structures and procedures.** No two families or businesses are alike, and family governance systems work best when they are tailor-made – shaped by the age, size and culture of the business, the family’s degree of involvement and the personal dynamics among family members. The more important components include:

- **A family constitution or protocol,** documenting:
  - o the family’s long-term vision and values for the business;
  - o key policies – e.g. relating to family members’ employment, management succession, and the ownership and transfer of shares;
  - o a code of conduct governing how family members should treat each other;
  - o the role of family governance bodies and their relationship with the business, including the board of directors.

A family constitution should be considered a living document, open to change and updated from time to time.

- **Shareholder agreements** are contracts between the family owners. They often codify provisions of the family constitution, such as defining the types of decisions that owners are entitled to make (as opposed to the board), rules on share transfers and how shares are valued. (See also the “Enhancing Communication with the Board” Challenge in this series)

- **A family assembly** is a forum for both family shareholders and other family members to learn about the family business and its activities. They are particularly valuable in larger family businesses, helping families to manage diversity of interests and demands, and letting the voices of family members be heard.

- **A family council** is formed of representatives of the family (normally chosen or elected). Its purpose is to provide a decision-making forum in which family members can participate in the development of their vision and values and in policy-making, laying down ground rules governing their ownership of, and involvement in, the family business. The family council can act as the conduit between the family and the board of directors.

- **Family council committees** work to foster family education (particularly among the next generation, and in relation to sustainability), to strengthen family consensus and cohesion, to limit family conflicts and to support succession planning.

- **A family office** provides wealth management services to the family, acting as an investment, liquidity management and administrative resource.

**Think of family governance as “applied fair process”.** Because family members relate to the business in a variety of ways – some are shareholders, some are employed by the firm, some are both, some neither – it’s very rare for everyone to agree on the fairness of outcomes. But what you can do is make sure that the family’s governance model supports and protects decision-making arrived at by fair process. If a family member believes the process to be fair, they can usually accept a decision they do not personally agree with.

## Section 2. ACTIONS TO CONSIDER

- Have we explored whether there's a consensus across the family about the importance of the family business and how to maximise its success?
- What's the purpose of the business, including the family's view on sustainability?
- Have we looked at ways to set up separate governance processes for the business and the family?
- Do we have regular meetings to discuss the family's relationship with the business?

- Do we have rules about who can work in the business, who will be on the board, who can own shares?
- How should we as owners organise constructive communications with the board of directors?
- Does the family have a code of conduct to strengthen interpersonal relationships and communication skills?
- How should we educate the next generation about the business, ownership and governance?

### CASE STUDY: Clarks Shoes



In 1993, sixth generation Clarks Shoes – one of the UK's oldest independent family-owned businesses – came within a whisker of being sold because the perceptions and aspirations of family shareholders had become disconnected from those of company management. Also, there were disagreements among the family around ownership and strategy.

The crisis was followed by a period of renewal including radical changes in business strategy and systems, plus a focus on building new ways for the owners to engage with their business. A family shareholder council and a strengthened board were at the core of new governance structures designed to improve communications, shareholder involvement and strategic clarity on business issues.

The family shareholder council remains the pivotal governance structure:

- It represents virtually all 350 of the family shareholders, who together own around 80% of Clarks.
- A "Governance Code" has been agreed, laying down guidelines about the division of responsibilities between management and ownership, and setting out clearly the objectives of the family council.

- The council comprises 16 council members drawn from family shareholders and elected by them for four-year terms.
- To be eligible for election, council members must have the backing of a fixed, identifiable percentage of the share capital, so each family shareholder knows who their family council representative is.
- The council meets four times a year, with meetings attended by the company chairman, CEO and finance director, who make presentations and discuss business strategy and performance. Meeting summaries are distributed to family shareholders via the ClarksNet website.
- Family issues also feed into company board discussions via the council's right to nominate two family non-executive directors.
- Between family shareholder council meetings, the council chair has regular meetings with the company chairman to ensure a continuous two-way flow of information.

Having worked for more than two decades on building this system, family members are under no illusions that their task is now complete. Across recent years the family shareholder council has conducted a full review of its governance code and constitution to ensure it is fit for purpose. It has also formally articulated its ownership vision and values. Families and companies constantly change, and at Clarks regular reviews and appraisals with consultants help to ensure that their hard-won governance system continues to foster long-term ownership and strategic engagement with the board and the company.

## Section 3. RESOURCES

### Articles and reports

#### The Three Components of Family Governance

John Davis (2001), Working Knowledge, Harvard Business School (available at: [hbswk.hbs.edu/item/the-three-components-of-family-governance](https://hbswk.hbs.edu/item/the-three-components-of-family-governance)).

In a crisp summary of the topic, the author highlights periodic family assemblies, family council meetings and a family constitution as the three main (and often sufficient) ingredients of family governance for family businesses. “The rare family in business may have a more elaborate family governance structure,” the author explains, “but I prefer the simplest structure that does the job, and the three components above are all most families in business need.”

#### Family Firms and Their Governance: Creating Tomorrow's Company from Today's

Sir Adrian Cadbury (2000), published by Egon Zehnder International (available at: [www.ecseonline.com/PDF/Cadbury%20-%20Family%20Firms%20and%20their%20Governance.pdf](http://www.ecseonline.com/PDF/Cadbury%20-%20Family%20Firms%20and%20their%20Governance.pdf)).

Authored by Sir Adrian Cadbury, an expert in the field, this monograph highlights the governance implications of the special status of family businesses. Sir Adrian argues that family firms have to strive to be as well managed as the best of their competitors, but that the need for a professional business approach is in fact greater in a family than in a non-family firm.

#### The IFC Family Business Governance Handbook

Published by International Finance Corporation (2008), World Bank Group.

This is a readable and practical description of the main family business governance components, plus suggested approaches to resolving common family business governance dilemmas. The handbook is divided into five sections: family member roles in the governance of their business; family governance; board of directors in a family business; senior management in a family business; and family businesses going public.

#### Representing Family Constituencies: The Role of the Family Council

Sylvia Shepard (2014), FFI Practitioner: Family

and Business Interface, Models and Structures, 20 August 2014 (available at: [ffipractitioner.org/representing-family-constituencies-the-role-of-the-family-council](https://ffipractitioner.org/representing-family-constituencies-the-role-of-the-family-council)).

Written by a fifth generation owner and family council chair of a 165-year-old US manufacturing business, this article provides valuable insights on ensuring a family council represents diverse perspectives in a mature family business. With 135 family shareholders and 85 non-shareholding family members, the author describes balancing multiple overlapping constituencies – including family branches, women, different generations, minority shareholders, and family members employed and not employed in the business.

#### An Invigorated Family Council

Ken McCracken (2016), Advice and Insight, Institute for Family Business (available at: [www.ifb.org.uk/learn/advice-insight/an-invigorated-family-council](http://www.ifb.org.uk/learn/advice-insight/an-invigorated-family-council)).

The author offers advice on keeping a family council a vital and valuable component of family governance, by taking care (a) when drafting its terms of reference and objectives, and (b) when staffing the council, aiming to balance representation needs and volunteerism with ability, experience and competence.

#### Fair Process: Striving for Justice in Family Business

Ludo Van der Heyden, Christine Blondel and Randel S. Carlock (2005), Family Business Review, 18(1), pp.1–21 (available at: [https://flora.insead.edu/fichiersti\\_wp/inseadwp2001/2001-54.pdf](https://flora.insead.edu/fichiersti_wp/inseadwp2001/2001-54.pdf)).

A readable academic review of the concept of fair process, with suggestions for improving fair process practices in family businesses. The authors put forward a “Fair Process Framework” based on principles and characteristics that enable families to understand and use fair practices in a variety of family business settings. They describe fair process as deriving from five factors: communication; clarity; consistency; changeability; and commitment to fairness.

### Books

#### Family Business Governance: Maximizing Family and Business Potential

Craig E. Aronoff and John L. Ward, published by Palgrave Macmillan (2011).

In one of the few books devoted to this topic, the

authors explain the governance processes for organising the family and the business, focusing on the distinct functions of these two domains and the areas in which they overlap.

### Family Councils: A Practical Guide

Peter Leach, published by the IFB Research Foundation (2012).

The book discusses the strategic goals and objectives of family councils, and provides practical guidance to ensure their efficiency and effectiveness. The author explains that “whatever the agreed core strategic objectives, the family council provides an organised way for family members to achieve them,” and that the council’s long-term work of building cohesion and unity involves four major ingredients: maintaining shared values and strong vision; setting policies that balance family and business; guiding the firm’s important business decisions; and educating family members.

**The Family Council Handbook: How to Create, Run and Maintain a Successful Family Business Council**  
Chris Eckrich and Stephen McClure, published by Palgrave Macmillan (2012).

This is the first comprehensive guide to all aspects of family councils and their role in governance. Described by the authors as “an owners’ manual for family councils”, the handbook provides a reference for business families wanting to find answers to a specific question about how to start and maintain a family council, or how to enhance the performance of an existing one.

### Understanding Family Business: A Practical Guide for the Next Generation

Andrew Drake, published by the IFB Research Foundation (2009).

Written with younger family members in mind, this guide discusses the rights, duties and responsibilities of working in a family company, and includes a section on governance plus definitions of the main structures and systems.

### Unconventional Wisdom: Counterintuitive Insights for Family Business Success

Edited by John Ward and published by John Wiley & Son (2005).

See pages 219–226 where the Ward presents a clear-sighted review of how family governance tends to develop and evolve in family businesses, going on to offer practical guidance on how to organise family ownership effectively.

## Family Business Challenges

The Family Business Challenges second edition series includes 18 guides overing three areas:

### Family business dynamics

- No.1 Understanding Family Business
- No.2 Maintaining Family Values
- No.3 Developing Stewardship
- No.4 Engaging the Next Generation
- No.5 Planning Succession

### Family business governance

- No.6 Building Family Governance
- No.7 Managing Differences
- No.8 Fostering Responsible Ownership
- No.9 Strengthening Family Communication
- No.10 Professionalising the Board
- No.11 Enhancing Communication with the Board
- No.12 Employing Advisers

### Family business management

- No.13 Fostering Entrepreneurship
- No.14 Embedding Long-term Orientation
- No.15 Promoting Sustainability
- No.16 Maximising People Capital
- No.17 Branding the Family Business
- No.18 Selling the Family Business

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**Grant Gordon, Editor in Chief.** Grant is a trustee of the IFB Research Foundation and co-founder of the Institute for Family Business. He is co-author of *Family Wars* (Kogan Page, 2008), focusing on managing conflict in family firms.

**Simon Perry, Author.** Simon is a law graduate and trained as a barrister. He moved into publishing in the early 1990s. His work focuses on family businesses, writing academic and practitioner analyses and family enterprise histories.

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### **FAMILY BUSINESS CHALLENGES**

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