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The value of family governance

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1. **Family enterprises**

Behind every family business and family office is an enterprising family whose lives are connected through the ownership and enjoyment of various assets and activities. Hence the terms ‘family enterprise’ and ‘enterprising family’ are used in this chapter to refer to both a family business and a family office.

2. **Family governance**

Family enterprise governance is everything that maintains a functional balance of interests among three groups of stakeholders: (i) the people who work in the enterprise; (ii) the current owners (including any beneficial owners); and (iii) relatives of the owners who we will call ‘family’. Effective governance helps these stakeholders to perform their respective roles satisfactorily and to participate in a network of relationships in the family and the enterprise.

Family governance is always part of this overall governance for several reasons, such as:

- the enterprise could be the source of the family’s financial security, so family members who are neither owners nor employees have a vested interest in its performance;
- some family members might view the enterprise as a future career opportunity;
- the conduct of the enterprise could affect the family’s social status and sense of self-worth, and, equally, the behaviour of family members could affect the enterprise’s reputation; and
- how the enterprise deals with its stakeholders and accounts for its impact on the environment and society could all be based on the beliefs and aspirations of the founding family as well as commercial considerations.

2.1 **Discovering family governance**

Some family enterprises are attracted to formal family governance, such as a having written family constitution and policies that govern potentially sensitive areas like employing family members. Some of them create formal

structures with rules of engagement and participation, like a family assembly or family council. However, it is important to grasp that all family enterprises have family governance and not just those with an appetite for formality.

The family governance that always exists is in the form of customs and conventions, assumptions, expectations and understandings, which we will call 'natural family governance'. This governance initially emerges spontaneously from innumerable interactions among stakeholders, and from decisions that are made to cope with whatever life throws at the family and their enterprise. It is sustained by a successful family enterprise having the good sense to continue governance practices that have worked well for them in the past, while also seeking to avoid repeating their previous mistakes – that is, learning from experience.

An absence of formal family governance should never be mistaken for an absence of governance. The mere fact that natural family governance has not been written down does not mean it does not exist – it just means it has not been written down. When advisers become involved, the first task is to discover and describe the natural family governance that already exists, then perhaps to modify some aspects of it or fill any gaps that become apparent.

There is a very practical reason for adopting this discovery approach. Successful family enterprises naturally resist making radical changes to existing governance practices that have helped them become successful. Change can easily be perceived as a threat to the existing order, and so will be accepted only when the need for it is clear. This attitude to change is sometimes described as a preference for evolution over revolution, and it means that family enterprises tend to move forward by adapting their existing governance so that it can remain functional.

This makes it essential for advisers to understand existing governance before making suggestions that might result in change. Suggesting changes while choosing to remain deliberately ignorant of existing governance risks arousing the innate resistance to change in a family enterprise, which once mobilised can easily overwhelm the desire or even the need for change.

The task of discovering and describing natural family governance can involve:

- articulating existing norms in relation to family governance;
- identifying the overall purpose of the family enterprise and the governance practices that serve this purpose; and
- identifying who is eligible for important governance roles.

3. Every enterprising family is normal

Every family enterprise has unwritten rules that determine what is acceptable, or normal, behaviour. These norms will be based on the history and culture of the family, and sometimes a world view that is shaped by their religious faith,

political ideology or other belief system. Norms will also have absorbed influences from education, travel, other social groups and the media.

Norms are different from values. Norms identify behaviours that are currently accepted as normal, whereas values are principles that express what a family enterprise aspires to become. Accordingly, the process of discovering family governance involves discovering existing norms of behaviour rather than creating a statement of values.

Norms can be discovered wherever the curious observer cares to explore. The simplest enquiry would be “What normally happens in relation to ...?”, followed by the subject of enquiry. This could be applied to the following areas of governance that are often important.

Table 1: Enquiries about norms

Norm	<i>“What normally happens in relation to ...”</i>
Communication	... sharing information about the enterprise with the wider family?
Conflict	... dealing with disagreements or conflicts among family members, including any that involve the enterprise?
Conflict of interest	... family members working for, investing in, or buying products or services from the family enterprise’s competitors?
Cultural attitudes	... attitudes about work, wealth, financial and other types of risk, philanthropy, gender roles and the status of different generations?
Cultural beliefs	... any belief system that shapes relationships in the family and/or the enterprise’s strategy, such as a religious faith or political ideology?
Decision making	... making decisions in the family? Is any family member who is not an owner, director or employee normally involved in or able to influence decisions about the enterprise?
Education	... educating the family about the enterprise, including its history, ownership and current operations?
Family glue	... family events or rituals that help to maintain family cohesion, for example, a regular family gathering or event?

Enquiring into the unique version of normality in a family enterprise will reveal a lot of information about family governance. This can then be enhanced by the other approaches described below.

4. Purpose

The owners of a family enterprise will be striving to achieve a version of success that matters to them, which becomes the purpose of their enterprise. Governance, including family governance, will be what it must be to achieve this purpose because that is what all governance does – it serves a purpose. Good governance supports the purpose and bad governance gets in the way.

The accepted view is that to discover the purpose of a family enterprise, it is necessary to identify the financial objectives and any non-financial returns on investment to which the owners attribute value. The value generated by non-financial returns is referred to as socio-emotional wealth, which describes a range of positive emotional responses to a family enterprise that create a powerful sense of psychological ownership among various stakeholders.

These could include feelings of joy or pride that are connected to the family enterprise and its operations, or to its success and its brand. It could be a sense of identity, status or self-worth that derives from being part of a family enterprise. The feelings might also relate to the impact the enterprise has on a geographical community, an economic sector or the physical environment.

There are some family enterprises for whom the idea of a non-financial objective would be a good definition of ‘non-sense’. However, the pursuit of socio-emotional wealth is common enough among family enterprises to make it worthy of enquiry.

This is an extract from the chapter ‘The value of family governance’ by Ken McCracken in *Business Families and Family Businesses: A STEP Handbook for Advisers, Third Edition*, published by Globe Law and Business.

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