Part II: Governance in the evolving business family

In the last issue, Kelin Gersick described the differences between the 'pyramid' view, emphasising the generational expansion of one family, and the 'network' view, focusing on the complex relationships among the multiple units of an extended family. Part II of this article explores the implications of that developmental model for the critical tasks of governance and continuity

By Kelin Gersick

EACH STAGE IN A BUSINESS family's development presents challenges of survival and effectiveness. The 'nuclear family stage' begins with a marriage of the founders and continues through the couple's early years. It covers the years of childbirth and childrearing, coming to a close as the younger generation moves from adolescence into adulthood. The second stage, called the 'multi-generational stage', covers the years of the sons' and daughters' transition into independent lives and careers. The offspring in this stage are typically between 18 and 30 years old, as the two generations address both separation and working together. Finally, the family moves into the 'network of families stage', as the second generation marries and begins families of their own. This final stage, in its complexity of multiple relationships, becomes the structure for all the generations to come.

Governance in the nuclear family stage

In the nuclear family stage, the couple set the foundation of their "marital enterprise" and their basic approach to parenting. The marital enterprise is the contract, explicit and implicit, that guides a couple's relationship: what they expect from each other, what they are willing to give to each other and how they will work together to manage their family. Few couples actually sit down and negotiate their marital enterprise; it emerges over time as they deal with the routine details of daily life and the unusual challenges that occasionally arise. But in some way they reach an understanding on fundamental questions:

- How will we divide authority?
- How will we relate to our extended families?
- What is it OK (and not OK) to talk about?
- How will we each balance family and work?
- Will we have children? How many? When? How do we each imagine ourselves as parents?

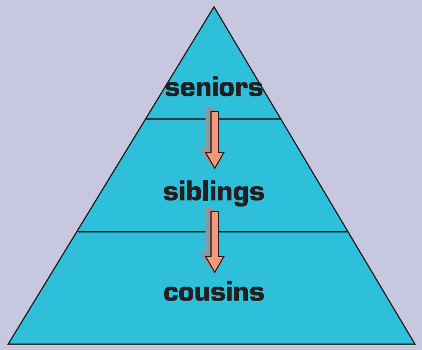
In business families at this early stage, the governance issues are straightforward. The ownership, management and family participation in the business are all expressed through the same individual or small group. However, choices made here will echo throughout the years and the generations to come, shaping the expectations of all family members about how to relate to each other and to the business. In this stage it helps if you:

'Each stage in a business family's development presents challenges of survival and effectiveness'

Talk with your spouse about governance. At this stage, couples often see the business as either a checkbook or a demanding taskmaster, or both; they rarely think ahead about the responsibility of governing the enterprise over the long run. The spouse in the business is reluctant to talk much about long-term demands because he/she is trying to protect a boundary between family and work. The spouse not in the business is reluctant to ask questions for fear of appearing intrusive or greedy. However, issues such as the career demands that go with working in the family business, the opportunities available to the next generation, the timetable for withdrawal of the seniors, the specific expectations for the spouse's behaviour inside the family and in the community – all benefit from open discussion as the marriage establishes its patterns.

Introduce your children to the world of the business from an early age. Remember that children see more, understand more, worry more and can process more than their parents think. A realistic picture of the family company and what it means to the parents is the best insurance against the kinds of distortions that children can

Figure 1 – The multi-generational stage



develop. The key word is "realistic" – neither oversold nor undersold.

Governance in the multi-generational family stage

There is one overriding task in the multi-generational family stage: launching, without losing, the second generation. This is no simple task. Providing a balance between separation and connection for sons and daughters as they move into adulthood is one of the most difficult challenges that any family faces at any point in its development. As we discussed in Part I, the family "pyramid" (see Fig. 1) governs the view of both generations at this stage: the family is an expanding unit, transmitting its values and resources down through the generations, distributing rewards but demanding service and commitment.

> 'For a family business to survive as a family enterprise it requires the commitment and collaboration of an ever-expanding network of relatives'

This dilemma is more complicated in business families than in families in general. In most families, parents expect that their offspring will eventually go their own ways in their work and financial affairs. That is not to deny the financial help that parents provide to their children as they start out, or the ultimate financial connection of inheritance. But most families assume that the younger generation will find work through their education or their own work experience, separate from the careers of the parents. The ties that bind will be social.

In business families this launching is different. For at least some of the offspring, there will be a lifelong intimate connection between the parents' and the children's work. For all of them the business will be a part of their identity and their lifestyle. Parents may "pre-select" which children are well suited for leadership in the family business, and discourage or exclude others. They may pressure some or all of the second generation to enter the company. Their tax planning may lead to a structure of trusts and holding companies that require close contact throughout their lives. If the business is a large one, and especially if it carries the family name, its public visibility will shape the expectations that others have of the younger generation and affect their relationships with acquaintances, friends and intimates. Becoming an adult – the exploration of work, lifestyle and relationships that is the main task of the years between 18 and 30 – is special in business families.

Governance of the business also needs to take a step into maturity at this stage. The simple system of parental owner/management must begin to evolve into family governance. This is the moment when families often consider creating the basic governance structures: boards of directors and family councils. In keeping with the "pyramid" the purpose is still to facilitate the flow of information, values, traditions and responsibility downward, from seniors to juniors. But broadening the base and including the second generation has a profound effect on the system as a whole. For the first time it is becoming a family business. Therefore, it is important to:

Carefully design the entry of younger generation offspring into the business. Too often families underestimate the importance of the first summer job, an internship or a first job after college. In the eyes of the late teen or early adult, these are not just "experience" or a way to earn spending money, but rather a reality test about what a career would be like in the family business. As far as possible, match jobs to the particular interests of the individual, without going outside the standard human resource policies and organisational structure. Most importantly, make sure that supervisors have a clear idea of how to handle the family member. This means giving everyone the message that the family has a special interest in the career development of its younger members, but within the company they are subject to the same rules, expectations, policies, supervisory obligations and compensation as other employees.

> 'The simple system of parental owner/management must begin to evolve into family governance'

Prepare the younger generation for responsible ownership. In most cases, by the end of the multi-generational stage the family's primary connection to the company is shifting from the few family owner/managers to the much larger group of family shareholders. Too often families focus all of their continuity preparation on those who may enter the company as their career. They neglect the development of responsible, knowledgeable, skilled shareholders who can make a real contribution to governance. Families who understand and anticipate this issue invest in shareholder education, financial literacy discussions about family values and company strategy, and director development. They encourage appropriate contact between young adult family members and the business leaders. They discuss the connections between the family enterprise and the careers of all their children, not just the ones in the business.

Governance in the network of families stage

In this stage, the second generation are living independently and raising their own families (see Fig. 2). The key challenge now, particularly for the senior generation, is to realise that the network exists at all and that clinging to the pyramid view of the family is not productive. Too often, the parents' preoccupation with continuity and legacy make it hard for them to acknowledge the conflicting demands of marriage, in-law relationships, parenting and career on their offspring. When adult children consider moving away to further a spouse's career or to achieve a different lifestyle, it is seen as an abandonment of the family. Parents are badly hurt (and often the spouse is blamed) if children are unavailable for family meetings, board or trustee service, or even traditional group vacations and holidays. The senior generation is shocked by new financial questions from children who are beneficiaries or shareholders. Even in very sophisticated families with strong, caring relationships between the generations, it is difficult for parents to accept that their married offspring may want to devote only a small slice of their attention and resources to the "pyramid" family and its enterprise. In this stage it helps if you:

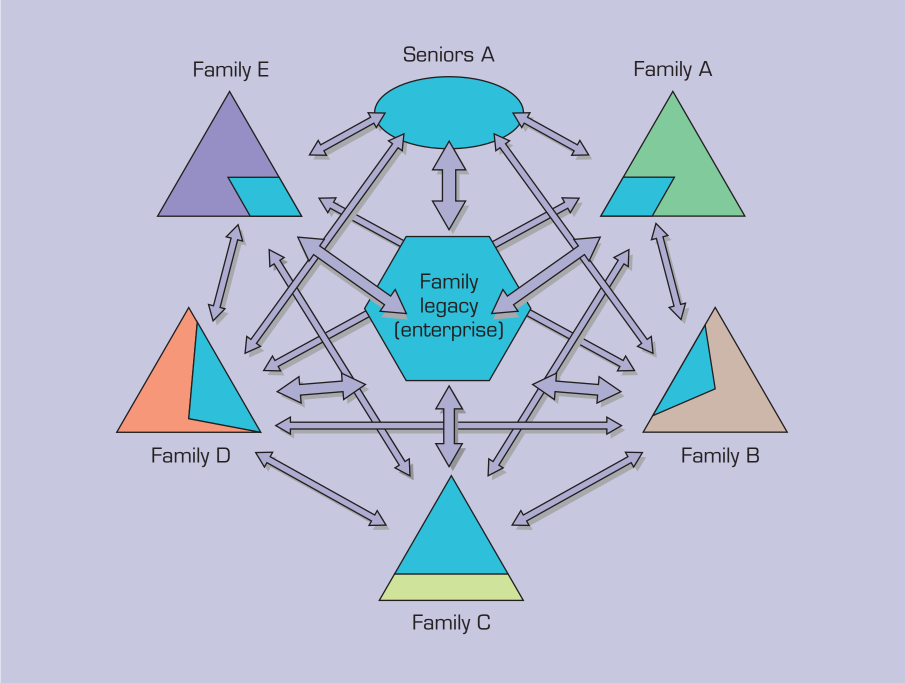
Recognise the conflicting demands on all the satellite families. Families who understand this issue select family directors, trustees, committee members and foundation directors with careful attention to realistic expectations of service. They provide flexibility for offspring to move in and out of governance roles as life situations change. They are respectful of the terms of each child's "marriage enterprise". They move away from expecting primary loyalty to the family branch and encourage other alliances, based on common interests and geography. And they make the nurturance of the network the prime agenda of an active family council.

> 'The fundamental truth about family enterprise is that more than anything, continuity depends on viable family relationships'

Build explicit governance policies. In this stage of family development, the governance network replaces the authority structure of the business as the critical infrastructure of the family. The best way to recognise the network is to create policies for enterprise governance that are uniform and preemptive. This includes shareholder agreements, policies on prenuptial and postnuptial agreements, criteria for employment in the company at all levels, qualifications for board service, rules about the roles that spouses can and cannot play in all of parts of the enterprise, and policies for the fourth generation.

Provide honourable exits from the enterprise. Captive owners are poison in the system. The network of families, sooner or later, requires exit options; some of the individual families are best served by staying in the pool and others are not. The families who handle this issue well create fair and honourable paths to liquidity. That includes non-punitive shareholder agreements, good valuation procedures and policies that protect the legitimate rights of all shareholders and the tax and capital needs of the company. More importantly, those families initiate a dialogue about liquidity between family shareholders who are active in the business and shareholders who are not.

Figure 2 – The network of families stage



Nurture the family. Families that remain strong in this network stage pay attention to the family as a system in its own right, not only in relation to an operating company. They actively consider other components of a complex enterprise: a family office, a philanthropic foundation, a venture fund for younger generation entrepreneurs, or a family presence in religious, cultural or governmental spheres. They support and honour the careers and contributions of family members far removed from the business. They celebrate family milestones in meaningful ways. They give particular attention to vacations with the extended family when the cousins are young children, time to interact at family events, special events (camps, excursions, projects sponsored by a family foundation or family office), all of which help the younger generations be more than strangers to each other. In all these ways, they nurture the "human capital" of their family. This provides the vitality and sense of belonging that sustains the collective enterprise through ups and downs of the business.

Conclusion

Understanding the evolution of families from the nuclear unit through the multigenerational pyramid to the network of families helps guide our governance decisions about the family business. It underscores the fundamental truth about family enterprise: more than anything, continuity depends on viable family relationships. Strategy, finance, management, marketing, production and operations all help make family businesses strong. But for them to survive as family enterprises requires the commitment and collaboration of an ever-expanding network of ever-more-distant relatives. Inspired leaders recognise this inevitable evolution. They plan for it. They are guided by the realisation that the single-leader family and the pyramid each have their time, and then must give way to the governance network that becomes the true family enterprise of their future. ■

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