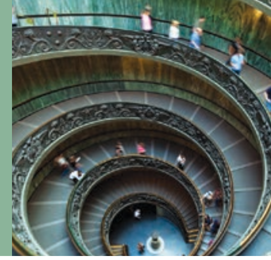

By **Patricia M. Angus**

Governance for Business-Owning Families: Part I

An often overlooked challenge

Families who own businesses face a challenge they often overlook, that is, "governing" all that they do together inside, and outside, of the business. Admittedly, governance itself is fraught with connotations that range from the highest aspirations to something far at the other end of the spectrum, so it takes some work to figure out what this means and how it might make a difference. To some, governance itself is a "necessary evil;" to others, it's a "dirty word" best left unsaid and undone. The reality, however, is that all business-owning families already have governance, in fact on multiple levels, but it's often overlooked. And, how they address it impacts all stakeholders—family, business and communities. This article is the first in a two-part series looking at governance for business-owning families. It proposes some steps to take so that business-owning families can get a better handle on governing and governance not just for their own sake but also for all those they impact.

Crossing the Line Into Governance

Imagine that George and Martha, an entrepreneurial couple, come up with an idea for a new product that has potential commercial appeal. Perhaps it's a new machine that dramatically increases the efficiency of their farming operations. It works so well on their own farm that they decide to go into business to sell it to others. So, they go to their corporate lawyer, Ben, and he recommends that they set up a limited liability company (LLC), "Farming LLC," so they can minimize their personal liability just in case the machine malfunctions. The LLC has the added benefit of being a pass-through entity for income tax purposes. They like the idea, and Ben drafts some documents for them. In Farming LLC, they're both named as "members," sharing their ownership in percentages that they agree on between themselves. Martha agrees to be "manager" so she can sign documents. George has no formal title, but they agree that he'll be in charge of day-to-day business operations. Like most entrepreneurs, they don't think much about the legal documents and are happy to quickly return to getting the business off the ground.

Even if they might not realize it, George and Martha already have crossed the line into formal governance with a whole new set of rights, responsibilities and opportunities (by law, and in theory, at least, if not in practice). The LLC agreement also redefines their relationship with each other and under the law.

More Governance Requirements

Well, things go well for Martha and George, and not only is their business extraordinarily successful, but also, their two children, Betsy and Abe, are chips off the old block. They share their parents' entrepreneurial spirit and actively join the business just as soon as they're able. Martha and George are thrilled to work alongside their capable children, and, on the recommendation of their estate-planning lawyer, James, they decide to set up some trusts and a family limited partnership (FLP). Again, on the recommendation of their lawyer, they begin to make gifts of membership interests in the LLC to or for the benefit of their children. They understand that this gifting is good for tax purposes and sign the paperwork that's handed to them. All this is done without giving a thought to the fact they've now dramatically expanded the governance requirements in their lives. This pattern

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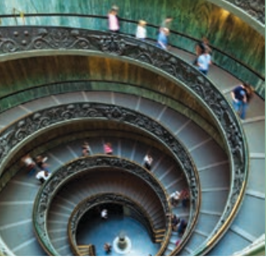


proceeds for a long time. As more documents get signed, and more entities created, this business-owning family unwittingly creates its own little government—or at least its own governance system. Let's stop here in the story to explore how and why.

To understand what it means to say that George and Martha have created a governance system, it's necessary to step back and think about what governance "is" and how that applies here. The term "governance" comes from the Latin verb, "gobernare," which means to guide or steer. Over time, this term has evolved beyond its original meaning, and there are now a variety of definitions, especially in the family business and wealth context, that make it more than a little confusing. However, for the sake of this article, and for the sake of business-owning families, this original definition should be their guidepost (pun intended). Just as every ship must be headed in some direction, every business needs to know where it's going, and how it will get there. And someone—or more likely, several people—must guide it that way. This is the work of governance. It's not just about managing the business for profits, or merely making sure that owners get their fair share. Further, in the family business context, it's not simply helping them all get along better. It's about overseeing the business, making sure that it's headed in the right direction, doesn't get off course, and yes, is accountable to its owners. And, at a more basic level, any entity created comes with its own set of rules that are defined by law and/or in its governing documents.

Each new corporation or LLC document should be accompanied by guidance on governance activities that are required and also recommended.

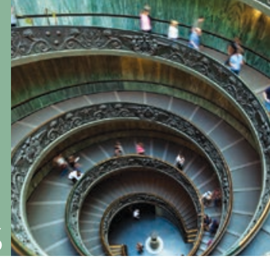
First Level of Governance

For business-owning families, the first level of governance that they create is in the companies that are used to organize their business operations. These entities include corporations, LLCs and LPs, to name a few. In each of these cases, there's governance, and there are multiple stakeholders. The primary stakeholders are the owners of the business, who have the right to benefit from its success, but also need to ensure that it's being governed well. In a corporation, this function is served by the board of directors. In LLCs, it falls somewhere between the manager and the owners (members) themselves. Either way, someone has to be in the governance seats. In those seats, they must spend time on the long-term vision for the company and have conversations about how company assets will be used, or not used. Discussions among owners about their respective personal objectives and joint objectives for the company must take place. And, each of these seats comes with fiduciary duties toward the business and its owners. These "govern-ors" must ask, again and again, the kinds of questions that any partners need to discuss before launching a joint venture.[1] This all seems so obvious as to feel insulting to have to write—or read—it. But the fact is, in family-owned businesses, active governance is very often the exception, not the norm.

Provide Help in the Start-Up Phase

Of course, the ultimate responsibility falls on the family itself—or, at a minimum, those who own the business and/or have been appointed to positions of authority and responsibility in it—to step up to the plate and "govern" their businesses. At the same time, it's pretty clear that lawyers, accountants and financial advisors have often fallen short both in the set-up phase and on an ongoing basis for their clients. Professionals who excel at planning might not even see these issues as being in their purview; governance work takes place after clients have left their advisors' offices. And, even for advisors who try to help clients establish or maintain governance best practices, it's not unusual to get more than a little pushback. Put mildly, entrepreneurial types are usually not excited about following *Robert's Rules of Order.* They're excited about getting things done, yesterday. But, governance requires thinking about tomorrow, and beyond, today. This is done in meetings, with other people, even ones who might not agree. It's no wonder that it doesn't get done.

To make it worse, Martha and George, like so many



families in business, on recommendation of counsel, also create holding structures including FLPs and trusts—for their own estate-planning purposes. Again, these create a level of governance, this time including indirect beneficial owners (in the trusts) in addition to direct legal ones. Betsy and Abe start acquiring rights and responsibilities, possibly in their own names but more likely in trusts created for their benefit. So many business-owning families today have created multiple levels of structures, it's nearly impossible to assess the extent of governance that is—well simply, not being done.

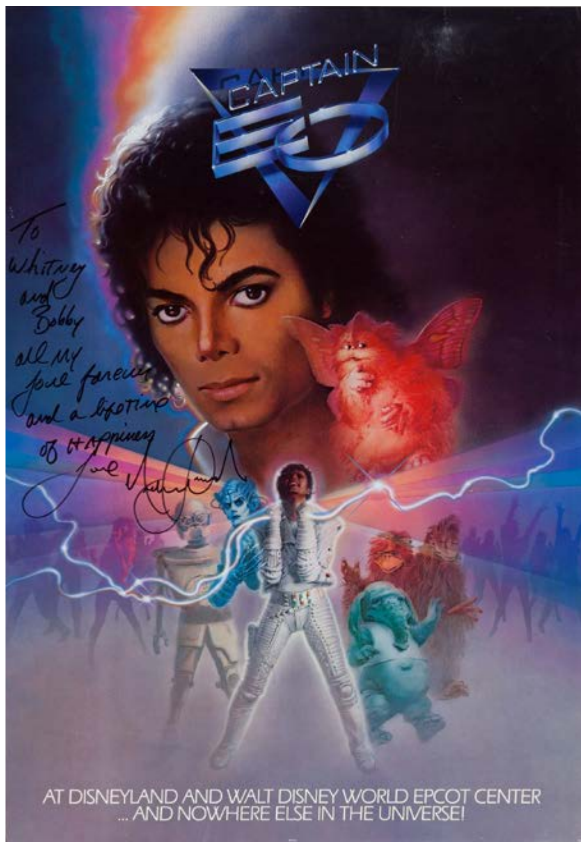
This is an unfortunate state of affairs. Not only does it limit the potential success for family businesses, but also, it's often the forum for some of the most important battles that bring many a family business down in the end. This harms not just the family itself, but also the business employees, customers and other stakeholders. The Boston-based Market Basket story of the past decade is a telling tale of the scope of people who can be harmed in a family business conflict.[2]

It doesn't have to be this way, and in fact many family business consultants wind up working on remedial ownership and governance education and best practices to help family businesses that never knew what they were missing. That's often too late, and it would be best if lawyers, accountants and other advisors working with business-owning families addressed these issues from the start and along the way.

Instill Better Governance Practices

Here are some ways that an advisor could help a family business instill better governance practices:

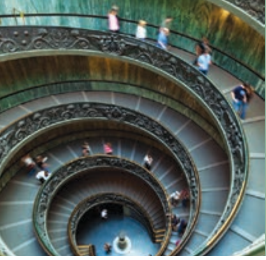
1. **Provide guidance.** Each new corporation or LLC document should be accompanied by guidance on governance activities that are required and recommended. In the family business context, this may be as simple as outlining whether a board of directors must be appointed, and how. Or, even if a board of directors isn't legally required, outline some of the benefits of having one. For example, studies have shown that a family business with independent board members may have a better chance of succeeding across generations.[3] If an entrepreneur is made aware of this sooner, rather than later, resistance to the idea might be kept in check.
2. **Outline required and recommended procedures.** How often should meetings be held? How are directors and officers to be elected and removed? By making clients aware of the default provisions, it becomes possible to spark conversations about how they actually would want things to run so they can tailor it to their own style.
3. **Recommend additional resources.** There are more than enough books and related resources about corporate boards, shareholder relations and corporate best practices. Rarely are these shared with family businesses until a conflict arises. And, that's when the



SPOT LIGHT

Electric

This Michael Jackson signed and inscribed "Captain EO" color poster, circa 1992, was addressed to Whitney Houston and her husband, Bobby Brown. Tragically, Jackson and Houston, who were good friends, suffered the same fate three years apart—untimely deaths stemming from drug intoxication.



underlying governance—whatever it is—will become apparent as one source of the problem. General resources would be helpful.

4. **Conduct check ins.** Make it a regular practice to have "check ins" with clients, on at least an annual basis, to review ongoing issues including governance.
5. **Develop inter-disciplinary teams that are appropriate for each stage of a family business.** For some, an outside facilitator might be needed to get meetings off the ground. For others, sharing educational resources on an ongoing basis might help clients carry through with best practices.[4]
6. **Compare with other family businesses.** Identify practices that have helped or hindered other families in similar situations.[5]

Of course, these steps are just a start and are just focused on the governance of the company and family entities. The family behind the business will have challenges and opportunities of its own that could use at least a little guiding and steering. George and Martha, along with Betsy and Abe, probably have a few challenges that could be exacerbated by the business they own together. Those issues—falling under "family governance"—will be the subject of Part II.

Endnotes

1. *See* David Gage, *The Partnership Charter: How To Start Out Right With Your New Business Partnership (Or Fix The One You're In)* (2008).
2. *See* *www.bu.edu/adminsc/files/2015/02/Howard-Williams_Market-Basket-Case-Study_2014-2015.pdf*; Daniel Korschun and Grant Welker, *We Are Market Basket: The Story of the Unlikely Grass-roots Movement that Saved a Beloved Business* (2015).
3. *See* John L. Ward, *Perpetuating the Family Business*, *www.untag-smd.ac.id/files/Perpustakaan_Digital_1/FAMILY%20BUSIBESS%20Perpetuating%20the%20Family%20Business.pdf*; Jennifer M. Pendergast, John L. Ward and Stephanie Brun de Pontet, *Building a Successful Family Business Board: A Guide for Leaders, Directors, and Families* (2011).
4. *See* Kelin E. Gersick, John A. Davis, Marion McCollom Hampton and Ivan Lansberg, *Generation to Generation: Life Cycles of the Family Business* (1997). *See also* Ivan Lansberg, *Succeeding Generations: Realizing the Dream of Families in Business* (1999).
5. *See, e.g.*, Fred Neubauer and Alden G. Lank, *The Family Business: Its Governance for Sustainability* (first edition 1998) (2014); Patricia M. Angus, "The Family Governance Pyramid: From Principles to Practice," *Journal of Wealth Management, Institutional Investor* (Spring 2005).