Family Governance: Who, What, and How

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Family governance is a hot topic. With generational transitions looming and market pressures focusing on "right now"—those two forces clash. One comes from tradition and continuity; the other disregards both history and long-term futures. Just as with countries, the families who can weather the short-term crises are those based on strong internal governance structures. Families do not achieve this by accident.

This article will address three questions. First, who are the families for whom governance is an issue (and who "counts" as members of those families)? Second, what does "governance" mean in the family context? Third, how can a family deliberately establish an internal governance structure to achieve its goals?

WHO?

The first question is which families need to be concerned with family governance.

Need for Group Decisions

Contrary to a common assumption, it is not only the very wealthiest families who are and should be concerned with family governance issues. Similarly, it is not automatic that all wealthy families need to be concerned with family governance issues.

Which families, then, have a need for family governance? If we think of governance as a system of decision-making, then it is families who need to make decisions, as families, who need to address family governance issues. Which families need to make decisions as families? Is this a matter of deciding whose home will be the host home for a celebration? It could be. Is this a matter of deciding which child will receive which family heirloom? It could be. It could be about where to spend a family vacation. It could be about whether to buy a new home, or to move.

Shared assets. Family governance has become a "hot" topic, though, in terms of managing vast resources that in some sense are "shared" by the family. In some cases this includes the family's operating business. In many other cases there is no longer an operating business, but the size and nature of the family wealth itself functions much like a business. The assumption is that by pooling the financial investment funds each individual can benefit from lower fees and higher returns than any one of them could individually.

Almost more difficult than investment funds are the shared "amenities": the lodge (or cabin or large estate), homes in other countries, the private jet (to be used by whom and when), the yacht, and so on. In many cases, another "shared" asset is the family office staff (again, who should be able to use how much of those services, and who pays for them). Finally, there is the family foundation which by its definition is perceived in the community as representing "the family" as it makes its annual contributions.

A family without significant shared hard assets and without a particular interest in combining financial investments may not think it needs to develop family governance structures. But all families who feel that carrying on their own traditions and values is important will need to pay attention to family governance. On a day-to-day operating basis every family has need of some decision-making process, designed to address the inevitable conflicts that arise within families ("Whose turn is it to do X?" "I want to stay out later." "Why can't I have a car now?"). With myriad decisions needing to be made, how will they be made?

Legacy commitment. Another thread in the fabric of family governance, which is often not made as explicit but may be the most important, is a generational desire to be part of a family continuum. This involves keeping the past alive and planning now for the future. This instinctive urge is nothing less than a wish for immortality. A sense that the family lives on can be most reassuring, especially in the face of the unwelcome inevitability of personal death.

In ancient Roman times, the reason that a man needed to have a son before he died was clearly tied to immortality. It was the son who would have the obligation of *sacra* after the father's death, an obligation to continue honoring the family ancestors. If he did not have a son, he would adopt one. In legal terms the son "became" the *persona* of the father, inheriting his position as *paterfamilias*, head of the family. Property was not thought of as owned by various individuals, but as owned by the family itself, in communal form (albeit with the management given to the *paterfamilias*). As the learned jurist Oliver Wendell Holmes noted (in his book *The Common Law*):

> If the family was the owner of the property administered by a *paterfamilias*, its rights remained unaffected by the death of its temporary head. The family continued, although the head died.

We are not as explicit about it now, but we do speak of "having his father's wit" or "having her mother's smile." Children are often named after another relative, and so become that person's "namesake." The continued preference for sons demonstrates itself in the practice of giving the son the name of the father, the son to be known as "Junior," and if continued then as "II" and then he may name his own son "III." When daughters change their "family" name on marriage, their father may be concerned that the family name (his name) may "die" out.

When inherited wealth is involved, the continuation of the "family" becomes tied to the passing on of the wealth from one generation to another. Edmund Burke (in his *Reflections on the Revolution in France*) wrote:

> The power of perpetuating our property in our families is one of the most valuable and interesting circumstances belonging to it, and that which tends the most to the perpetuation of society itself.

Most families carry on certain "traditions," principles, or belief systems. These can be as minor as opening Christmas presents on Christmas Eve or as serious as being "required" to enter certain professions or even certain religions. The sentiment in passing on physical heirlooms is symbolic of continuing the visible family continuity. The deliberate agreement to manage family assets for the welfare of future generations leads into the maze of family governance issues.

Membership in the Group

Interestingly enough, the initial issue is who is to be included in the definition of family. One senior family member responsible for managing the family wealth saw nothing odd about stating, "Membership in our family is voluntary. If you choose not to follow our rules, it means you are choosing not to be a member of our family." The connection with passing on inheritances of wealth is embedded in the threat "Do X, or else I will disown you." To speak of "owning" or not "owning" a family member does hint at unexpressed family "inclusion" requirements.

Inclusion of ancestors. In Japan a business owner may begin each day by spending quiet time in the "room of the ancestors" in his home, to absorb their spirits and teaching and to honor them. In the United States we admire the "self-made" man, which shows slight regard for ancestors. In fact there is a puzzling practice in the family business industry to label all generations in relation to the one who created the wealth. The "wealth creator" is called the first generation (or "G-1"), his children are known as G-2, and so on. It is amazing that G-1 has no ancestors worth including. Diane Roskies, of Mahoney Cohen Family Office Services, knows one family who published a family history book which included a family tree, photos, memoirs, maps, and histories of family members in an era before there was much wealth in the family. This book was given to every family member at Christmas.

Current family members. Apart from the issue of ancestor inclusion, discussed above, we turn to a few issues involving the various living members of families. In family governance structures, the basic issue is whether or not they should have a vote or attend meetings.

Spouses/partners. Although the issue of including spouses continues to be discussed ("Are we in-laws or outlaws?"), the so-called best practices seem to have settled on a determination that, all things considered, it is better to include spouses. Sometimes. They are not usually given a full legal vote, and seldom are given outright ownership of family business stock or significant assets. But they are usually allowed to attend most meetings. The more discreet issues are whether a fiancé should be included, or a cohabitant, or a same-sex partner. When should each of these be included as a member of the family?

Ex-spouses/ex-partners. Unfortunately members of a family who marry into the family may later leave. It is unusual to include them in family meetings. If they had children, however, it becomes very awkward to include the children and not the parent.

Children. In terms of children, the only issue is at what age should they be invited to attend which meetings, and when should they have a vote. Parents vary considerably on this issue. Age 21 is often used, but others feel that a younger age, such as age 14 or even 12, is more appropriate. One family uses a "junior" version of their family foundation to include children as young as eight years old. As Lord Denning said, "Children are like trees: they grow stronger with firm roots."

Future generations. Looking ahead, many families who work on family governance structures assume that what they are creating will be followed in the future. Just as the Greek proverb explains for countries and societies— "A society grows great when old men plant trees whose shade they know they shall never sit in"—working on family governance structures can be done with the future in mind. The interesting distinction is whether the families who are "planting the trees" intend to "require" the family to follow those rules, or whether they see the structure as one that can be changed (even rejected) by each generation.

Forced legacy. The appeal of "ruling from the grave" (the so-called graphic image of a "dead hand") is a fairly obvious attempt to continue one's life after death. From a legal point of view this can be done. The popularity of dynasty trusts (trusts in jurisdictions that do not have a limit on how long a trust may last) is due to the wish to establish control that will "live on" forever. This is a family legacy that has been written in stone, and handed down unilaterally. Sadly, it is unlikely to survive and is apt to cause resentment and lack of gratitude.

Adaptable legacy. Children by their nature tend to resent rules that are imposed without their participation. This should not be a surprise to the parents. Our own country was founded in rebellion from "taxation without representation." A more lasting model is likely to be one with a fair amount of elasticity, so that future generations may each adopt and shape the family precepts in a way that is acceptable to them at that future time.

WHAT?

All governance has certain common elements. First there is a group to be governed. Next there are decisions to be made by and/or for the group. We can think more analytically about family governance if we consider other more common forms of governance.

Political Governance

Countries by definition consist of a group of people, and a country will need to have decisions made that will apply to its group. The built-in tension is between the desires of an individual as a free individual and the freedoms that are voluntarily circumscribed "for the common good." John Locke's social compact describes a deliberate contract to exchange certain individual liberties for the purpose of being better off individually as a result of the strength given to the group as a whole. As Edmund Burke said (in his speech on conciliation with America):

> All government, indeed every human benefit and enjoyment, every virtue, and every prudent act, is founded on compromise and barter.

This same exchange occurs in families. Thinking of families, let us visit a few of the common types of political governance and how they would apply in the family setting.

Dictator. The first classic prototype is a dictatorship. One ruler makes all the decisions. At its best this describes the "philosopher king" from Plato's time, a ruler who really does have the wisdom needed to do this job well and alone. At its worst this model includes delusional tyrants driven by greed and human destruction agendas. With this model there is unlikely to be a governing document, such as a constitution. Think of Louis XIV's view that nothing else was needed, since "*L'état, c'est moi.*"("The state, it is I."). The dangers to the group result from the maxim that "Power corrupts and absolute power corrupts absolutely." The powerful dictator would like to rule forever. One ruler who became obsessed with staying in office forever was the founder of the Chinese Qin dynasty, of whom it is written:

> To begin with, he hated if anyone mentioned anything about death. He became obsessed with it. He wanted his Dynasty to last forever, preferably with himself at the head of it. He sent his ministers to the four corners of the empire to discover the secrets of immortality…. After being told by Master Lu, a native of Yan whom the Emperor had sent on a quest of the secret of immortality, that "When you are in the palace, do not let others know where you are. Once that is done, I believe the herbs of immortality can be obtained." Heeding his advice, Shi Huangdi turned his various palaces into mazes of secret corridors, walkways, and towers. If someone revealed where he was at any time they were put to death. (From www.illuminatedlantern.com.)

Most (but not all) successful entrepreneurs assume the dictator role in the family. They have, after all, created the wealth or are recognized as the head of the family by gender. Think of the saying "A man's home is his castle" (and he is the king of that country). Think of the popular television show in the 1950s "Father Knows Best." As Pascal said (in his *Pensées*): "Tyranny is the desire of universal rule outside its sphere." With countries there is eventually an insurrection, a wish to reverse the power structure, a revolution. The powerless do revolt sooner or later. Within the family that revolt can range from murder to abandonment. Vicious family revolts also make the headlines, especially if large fortunes are involved.

Communism/consensus. The next stage of political rule, after the removal of a dictator (assuming that another dictator is not chosen), is usually a stage of "communism" in the sense that power stratifications and delegations are feared. All decisions, no matter how trivial, must be made by the group as a whole. Each individual may have one vote, but not even a majority vote may "rule." Think of the popular "communes" of the 1960s as a recent example of a recurring wish for a "utopia" where all are equal and all are included in every decision. Consensus is the goal, and is given a priority over attributes such as efficiency. This may work in an isolated setting but not when that country is "competing" with other countries with more efficient political decision-making processes. East Germany may have had a communal governance system, but it is now being governed according to the West German model.

In a communal setting there is often little respect for personal privacy. On a family level the lack of individual privacy has led some family members to say that there must be "boundaries" where the individual is left alone to make his or her own decisions without examination, input, and approval (or not) by the whole group.

Representative democracy. Finally, we have the stage of a "representative" democracy. At the level of the general *populus* there is a general right to vote. As far back as Aristotle, this has been seen to be the most "fair" of all systems. As Aristotle wrote (in *Politics*, Book IV):

> If liberty and equality, as is thought by some, are chiefly to be found in democracy, they will be best attained when all persons alike share in the government to the utmost.

The votes are usually used to elect the representatives, who are given decision-making authority on behalf of the larger group. The representatives must be reelected on a regular basis, and can be removed from office during the term if there is enough dissatisfaction with their performance. On some of the more important questions there can also be general referenda, turning back to the *populus* to vote on that matter. The quality of the elected representatives is crucial to the success of the governance. Great care went into the formation of the political structure in the United States. As George Washington said (in a letter to John Washington):

> To form a new government requires infinite care and unbounded attention; for if the foundation is badly laid, the superstructure must be bad. Too much time, therefore, cannot be bestowed in weighing and digesting matters well.

Corporate Governance

A corporation is a good example of a representative democracy. One could compare a dictator to an entrepreneur and a partnership to a communal form. The corporate form, usually for a larger group, has distinct legal roles for the shareholders, the board of directors, and the officers.

The shareholders are in the same position as the general *populus* is in a country. The shareholders vote to elect (and remove) the directors who are responsible for the general management of the corporation. In the corporate setting the law adds a fiduciary obligation on the directors who must act in the best interests of the shareholders, and not in their own best interests. It is the directors who hire (and replace) the operational executives of the corporation, for whose performance they are responsible. Certain major decisions (such as a merger or a sale of substantially all the assets, as two examples) may have to be submitted to the general shareholders for their vote.

What are examples of good corporate governance? Not Enron. In fact failures like the mismanagement of the Enron corporation resulted in a May 2002 *Business Week* cover issue on corporate governance, stating: "Directors who fail to direct and CEOs who fail at moral leadership are arguably the most serious challenge facing Corporate America today." One area that did not work was the shareholders' ability to elect (or interest in electing), good directors. The next area that did not work was the directors, who were accused of acting in their own short-term (stock options) interests (most of the directors' meetings were on compensation, for example). Under theories of justice and fairness, self-interest is often against the best interests of the group. A group of angry Vivendi shareholders recently requested the appointment of an expert to audit the company's corporate governance methods.

An editorial in the same May 6, 2002 *Business Week* issue warned:

> A new era of reform is dawning for Corporate America. Sparked by a popular revolt of the investor class and driven by a Republican Administration surprisingly intent on change, this movement aims to restore core American values of fairness, equity, and responsibility to the practice of big business in the U.S.

How do those core American values of fairness, equity, and responsibility translate into governance systems?

In his book *Theory of Justice*, John Rawls proposes that those responsible for creating a system do the creation work as they themselves sit behind a "veil of ignorance," meaning that they will not know which position they will occupy themselves. This is a more sophisticated version of the child's approach to dividing a pie fairly: "You cut it, and I'll have first choice." The cutter will try very hard to do a "fair" job! A well-run corporation would have knowledgeable, interested shareholders. They would elect directors who seemed likely to set aside any personal self-interest.

Family Governance

Is a family easier to "govern" than a country or a corporation? One might think so, since family members are assumed to love each other and to reach agreement more easily. One would be wrong. Professional conflict resolution experts who dealt regularly with countries busy killing each other's citizens have commented that that work is far easier than negotiating a governance structure for a family. Montaigne noted that governing a private family involves no less trouble that governing an entire kingdom.

Part of creating an appropriate family governance structure will depend on the "stage" in which the family finds itself. This is usually measured in terms of the relationship to the "founder." As discussed above, the creator of the wealth is referred to as G-1, the "first" generation.

Patriarch/founder. As with all adages, there is a lot of truth in the saying that "He who has the gold makes the rules." (And "He who pays the piper calls the tune.") This is usually (but not always) someone who is by nature reluctant to give up his power position. Looking again at the corporate setting, the May 31, 2002 *Business Week* commentary on "Choking Corporate America's Heir Supply" commented that despite promises of leaving, CEOs seem to hang on:

> But Weill [Sandy Weill, CEO of Citigroup], who refuses to discuss the issue publicly, says he has no plans to retire anytime soon. As one longtime peer quips: "Sandy will still be working two years after he's dead."
>
> For shareholders increasingly worried about corporate governance, poor succession planning is no joke. The question of who's in line to replace the chief has become a hot issue. At companies ranging from Tyco International to WorldCom, leaders once hailed as visionaries have been struggling to inspire confidence or deliver returns. More than a few who haven't left may soon be pressured to go.

Any family governance instituted at this stage will work best if everyone is respectful of the intense difficulty many founders face in anticipating the end of their "reign." As with Emperor Sin, who forbade (and killed) those trying to live as long as he hoped to (that being "forever"), all seniors fear their departure.

Post-patriarch era. It should be possible to "collapse" the natural subsequent stage (the fear of letting any part of the group have disproportionate power) into the representative assembly mode. If however the numbers of adult family members are few enough, it may work to operate as a general partnership until the next younger generation begins to participate.

HOW?

Given the importance of establishing a family governance structure, how should it operate? There will need to be a method to call the entire family together, and then a way of structuring the political process to use.

Assembly

Calling the family together is a call for a family assembly. A family assembly is simply a more formal variant of the family meeting. Consultants have further elevated the concept to one of creating a family "council."

The full assembly of the family can be simply a gathering of the family or it can be organized into a "council" (not unlike our "Congress").

As described in a University of Nebraska extension course geared toward all families, a family council can be very worthwhile for decision-making in all families, and is:

- A meeting of everyone in the family at a designated time and place.
- A meeting that has a chairperson and a secretary (each family member takes a turn as chairperson, but only those who can read and write take turns being secretary).
- A meeting with fixed rules of procedures.
- A cooperative way of making decisions that affect all family members.

The extension course describes the process as well as any professional consultant:

> A meeting is called, the issues are faced, and all of the members have a chance to say what they think or feel. Everything is done to foresee the possible outcome of various solutions. The discussion continues with changes in attitudes, ideas, or opinions until "the solution" finally emerges that is acceptable to each family member. Being "acceptable" does not mean that each family member likes it. It only means they will try it for a period of time to see if it works. After the decision is made, each person is expected to abide by it and to work for its success.

As the course description notes: "Individuals are more willing to follow a policy or work for a solution if they have had a voice in making it instead of having it dictated to them" (www.ianr.unl.edu).

A more formal Family Council may work on preparing a family "constitution" (think of the political governance analogies) or at least a mission statement (think of the corporate governance analogies) or some statement of the family "values." As with all the counterparts, general language ("motherhood and apple pie") can be agreed upon, but specific concrete language is not so easy. Would the assembly begin with a statement of goals and operating rules? As one family member wryly commented: "It is not always easy to agree—in fact it is often a painful process."

Voting

A critical decision is who will be entitled to vote. If it is operated on the partnership model, each person will have an equal vote. If it is operated on a representative model, then there will be two levels of votes to be determined: those who vote for the representatives, and the votes to be held by those representatives.

Representatives

If a representative model is used, then the first decision to make is which portions of the group are to have representation. Often it is a division by "branches" of the family, which requires a starting point from which the branches will be counted. In legal terms this would be a *per stirpes* representation (the term actually means "by the roots"). It could also be a division by generations, each one given equal weight regardless of the branch divisions. It could also be a division by lineal descendants and spouses. What is most important is that no one feel left out of the process. Similar to our English expression of being left out "in the cold," most countries have a metaphor for that lonely, outcast feeling. In Japan it is *kaya no soto*, to be left outside the mosquito net. In Navajo, the expression is that one is *shee hoosnah*, forgotten by the others. It is well worth the effort to find a way to include everyone.

REFERENDA

Whichever method is used to divide the groups that will be represented, there will be major decisions where it seems fair (or necessary) to call for a general referendum. As with all representative democracies (including corporations), there will be certain issues that seem too fundamentally important to be decided by the representatives. For those issues the full assembly will be consulted.

With a corporation those would be decisions about major changes in strategic direction, a decision to sell all or most of the corporate assets or to merge with another company. In family terms it could include decisions about major changes in the family office staff or structure, combining with another family's family office, creating, dividing, or terminating a family foundation, creating a family trust company, and so on.

CONCLUSION

Family governance works in the same way as does any other form of governance. A good governance system is one that provides fairly for its members and adapts well to changing circumstances. Each member feels consulted, respected, and treated fairly. The pride in the family can then be passed on to future generations, who will be able to participate in the same flexible process. The shade from the trees that were planted long ago will protect the future generations.

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