



Family Office Association Q&A

Angelo J. Robles on
**Guiding
Governance:**
Clarifying the Practice
of Family Enterprise
Governance

with
James Grubman, Ph.D.
and Dennis T. Jaffe, Ph.D.



OVERVIEW

- Q:** What mechanisms should a large family of wealth have in place on making inclusive decisions?
- Q:** What are the problems that can happen when this is not the case and just one person makes the decisions?
- Q:** How does a family governance plan help the family make effective decisions and how often should this be reviewed and adjusted annually?
- Q:** This all comes down to family governance issues, how does a family start to formulate a family governance plan?
- Q:** How do families involve through marriage or adoption non-blood line family members into the process?
- Q:** Tell us about a family constitution.
- Q:** How do families incorporate a family council into the governance plan?
- Q:** How early do you recommend engaging the younger family members into this process and how?
- Q:** How do families preserve their history and culture yet also adjust to changing conditions and social norms over generations?



AJR: What mechanisms should a large family of wealth have in place on making inclusive decisions?

Family Office Association Q&A **GUIDING GOVERNANCE:** *Clarifying the Practice of Family Enterprise Governance*

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JG & DJ: A wealthy family cannot function truly as a democracy since certain family members may need to be responsible for some decisions as owners, fiduciaries or elders. Yet there are serious long-term risks in one person holding all the reins of power. Finding the best middle-ground for decision-making in the family requires setting up healthy mechanisms to balance the twin goals of inclusiveness and leadership.

The main components needed in family governance follow the journalistic “who, what, why, when, where, and how” bullet points. The Why is codified by the family’s **mission statement**, designed after extensive discussion about their core values. A mission statement is like a lighthouse beacon that helps the family keep to a path, avoid getting lost in the stresses of life, and illuminates the way back home when the family may be off track. A mission statement alone, however, is a noble set of ideals without the practical implementation of knowing How, What, Who and When the family will govern itself and make decisions. That’s what the **family constitution** is for. A constitution doesn’t have to be overly complex, but it does have to identify mechanisms such as the family council, whether the family will also have a family assembly, the description of how the council and/or assembly are to function, how many members will constitute the family council, where these members will be drawn from, the minimum age or other requirements for being on the council, the frequency of meetings, whether members must be family bloodline, and a multitude of other specifications. The constitution will specify in broad terms the scope of the family’s decision making, making sure these do not override or conflict with other important governance mechanisms the family may have in place, such as the board of directors of the family operating company or provisions in ownership agreements or trust documents. Finally, supporting the general terms of the family mission statement and constitution need to be the various **policies** developed and managed by the family council in running the day-to-day operations of the family enterprise.

Through the mission statement, mechanisms described in the family constitution, and supporting policies and procedures, the family is able to communicate and listen to each other, avoid conflicts due to misunderstanding, and anticipate disagreements before they grow into deep rifts.



AJR: What are the problems that can happen when this is not the case and just one person makes the decisions?

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JG & DJ: In high school civics we learn that the fundamental process in good government is the principle of checks and balances. Families need this as well. Having one person making all the decisions may be simple and convenient, but ultimately the family is at risk due to the absence of checks and balances. With a lone decision-maker, decisions can be overly *person-based* rather than *policy-based*, leading inevitably to conflicts. Families can become frustrated because there is a lack of consistency over time by the patriarch or matriarch for decisions addressing different people that seem to have the same elements. One time the answer may be yes, while two years later with similar facts the decision may be no. Siblings are particularly attuned to what they believe is “fair” and they tend to have long memories. Such feelings especially surface when family members affected by these decisions are not consulted or their views about the outcome aren’t taken into account. This lack of consistency and perceived unfairness undermines trust and eventually can lead to deterioration in communication and support for even reasonable decisions that patriarch might make. When heirs are not included in decisions they do not understand or agree with, unintended negative outcomes can result.

There are other problems with an autocratic model of decision-making. A sole leader may at times lack essential knowledge or skill to handle certain decisions and contingencies that arise for the family. Being the family business leader does not necessarily lead to being a legitimate or the most effective leader in family relationships. Having more than one decision maker provides greater breadth of wisdom and experience to handle the multitude of issues that come up. Finally, having a sole decision-maker represents a risk to the family system in case of disability or death of that person. Being able to distribute decision-making ensures greater continuity as crises occur inevitably with aging.



AJR: How does a family governance plan help the family make effective decisions and how often should this be reviewed and adjusted annually?

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JG & DJ: Governance refers to policies and procedures agreed upon by all members of the family. A family governance plan organizes methods of sharing information, making decisions, and insuring family members will be treated fairly. It balances the divergent needs of individuals and groups, including their business and financial affairs. As the family grows and becomes more complex, decision-making must become more formalized and explicit in how policies are formulated and implemented. Good governance creates healthy processes that can handle situations which come up over time rather than having each decision made in an arbitrary or piecemeal fashion. Also, the more people who are involved, the greater the capacity to implement these processes effectively and to foster trust and fairness within the family. Governance processes and structures endure across time and situations, whereas individuals may not.

Regarding how often governance plans should be reviewed and adjusted, much depends on whether good groundwork is laid on the front end for long term success. Families that take the time to truly understand their options and their values don't rush. Work on building cohesion at the leadership level tends to create better governance plans that stand the test of time. It is helpful to review governance, structures and processes periodically, perhaps every three to five years, with more major assessments during major generational transitions. Good governance plans help the family enterprise navigate generational transitions. But over time the world changes, the family changes, and the family enterprise must adapt, requiring review and realignment of the governance plan. What worked for a previous generation may not work for the next one.



AJR: This all comes down to family governance issues, how does a family start to formulate a family governance plan?

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JG & DJ: The initiative to formulate a family governance plan can happen from three directions: a) the family's current decision maker; b) the rest of the family, particularly the next generation; or c) the family's trusted advisors.

If the current leader has good foresight, wisdom, and willingness to consider succession planning, he or she may propose to the family a desire to begin the process of developing family governance. One of the highest responsibilities of a family's leadership is to understand the risks involved in not developing a governance plan for broader and deeper family involvement and preparing the next generation. Unfortunately this pro-action is not as common as it should be, as wealth-creating patriarchs and matriarchs tend to hold onto the reins as long as possible.

The initiative can also arise from the next generation or sometimes from supportive family members such as the wife of the patriarch. They may have learned about family governance from another family, or at a conference or workshop. As children reach adulthood, develop their own skills for managing the family enterprise, and perhaps learn about governance strategies, they approach the patriarch to 'make their case' in a reasoned and mature manner. Making this initiative successful requires sensitivity to the current leader's position. Outside advisors or consultants working with the family can help assess the readiness of the family and the current leader to develop a governance plan. Sometimes having the idea broached by a seemingly neutral yet credible third party can get around some sticky family dynamics. We advocate that these kinds of "crucial conversations" are part of their role and can be immensely helpful in moving a family forward.

Once the initiative is taken, the family then embarks on a series of family meetings to clarify their values and come up with written policies that everyone understands and can agree on. Through (sometimes intensive) meetings, family members work together to decide best policies around distribution of wealth, how to treat everyone fairly, representation on family councils or boards, and how to develop the capabilities of the next generation. Family members can work in small groups, but they must take care to get input and communicate with the whole family as they do their work. The family ultimately gradually crafts mechanisms for managing two domains: financial and business matters, and development of the family's human capital. Although the process can often be difficult, in the end the family is in much stronger shape to face the future.



AJR: How do families involve through marriage (or adoption) non blood line family members into the process?

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JG & DJ: This can be one of the thorniest issues due to the natural sense of mistrust many family enterprises have about non bloodline family members. Yet exclusion of non blood line members can be a risk factor that undermines the long term success of the family. Capable in-laws may provide valuable input that keeps the family enterprise that successful. They add to the family's skill set and human capital. Failure to involve capable in-laws can leave them feeling disenfranchised, can set up unnecessary rifts and conflicts within branches of families, and can eventually lead to the downfall of the family enterprise. The best way to view bloodline vs. non bloodline members is to consider it just one issue in the families risk management. Non bloodline members potentially pose some risk but taking a general stance of excluding them because of this risk can backfire. Best practices with multi generational family enterprises usually include some mechanism for evaluating and involving any family member, whether bloodline or non bloodline, to make sure that those who are involved in leadership of the family have the capabilities needed, are trustworthy, aligned with the family values and goals, and rewarded appropriately for taking on leadership responsibilities. Governance policies also can provide for the removal or replacement of family members who are not exercising their responsibilities appropriately for the benefit of the family. Finally it's important to understand the interrelationship of family, ownership, and business management of any enterprise activities (as in the 3 circle model) since involvement in family governance is only one part of the entire system. Allowing non bloodline family members to participate in family governance can also have safeguards in other areas such as buy sell, ownership, and executive compensation agreements.



AJR: Tell us about a family constitution. ▶

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JG & DJ: A family constitution represents the formal, explicit master agreement that defines the mission and values of the family and its enterprises, then defines the policies and practices that enable the family to achieve its mission. It functions as the **operating manual** for the family's decision making at the highest level. It puts legal agreements and policies into everyday language so the family can understand how things work and how they are done. It doesn't have to contain every single detail and provision of every decision; that's for the policy manuals which may be adapted from time to time by the family council.

Like any good government constitution, top-notch family constitutions strike a wise balance between stability and flexibility, a difficult thing to do. Imagine a large house built by the founding members of a family. A well-designed house has a solid foundation and a well-thought-through floor plan that will accommodate most situations in the family's life. Yet, as the family grows and the world changes, sometimes there need to be renovations, additions, or even removal of outmoded areas. A family constitution should be constructed well enough that there should be no need to alter the foundation or make major structural changes unless circumstances clearly require them. Yet it should not be so rigid that there is no capacity to make periodic updates equivalent to changing the wallpaper or moving a window here or there to accommodate new circumstances.

Families argue around how to balance of stability and flexibility. At times of crisis, some family members advocate for such substantial renovation that the original structure may no longer be recognizable, and it may not survive. Others never want to change even the smallest thing, saying the founding members in their wisdom "designed it this way" and nothing must be touched. Finding a way to rely on time-tested principles while providing for necessary adaptation requires thoughtful development of the family constitution in the first place and wise leadership thereafter.



AJR: How do families incorporate a family council into the governance plan?

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JG & DJ: The *family council* is the group of family members who guide the family in non business-related areas such as shared family activities, education and development of the next generation, managing family employment in family enterprises, and dealing with disagreements within the family. A council usually meets regularly (perhaps several times a year), solicits input from the whole family, and communicates its decisions after deliberating appropriately. The entire family may also meet from time to time (perhaps every year or so) as a *family assembly*.

A good place to start in developing a family council is to gather members who already are trusted but informal decision-makers. Depending on the size of the family, how many branches there are in the second or third generation, and who seems to have the capability to participate, the initial family council might consist of both G1 parents plus the bloodline heads of each branch in G2 and selected representatives from G3. Over time, the governance plan can specify who is allowed to participate in the family council, length of term, and what happens in case of disability, divorce, or death of a family council member. The council also needs to specify what voting model might be used and what the ground rules are during meetings.

The decision to form a family council is simply the beginning. It takes time for people (especially if they are family members with a difficult emotional history) to learn how to actually work together effectively. Many family members have little experience initially in exercising formal decision-making at this level. Council members need to learn to exercise power responsibly along with skills for communicating and collaborating. Making the family council function well together, particularly for difficult or stressful family decisions, can take years but is an important investment on the part of the family.



AJR: How early do you recommend engaging the younger family members into this process and how?

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JG & DJ: Family assemblies or council meetings can and should include activities for young people. From an early age, young people can be introduced to what it means to be a member of the family, what they can expect, and what they are expected to offer. Teenage family members as young as 14 can begin to sit in on parts of family council meetings if they are prepared to listen, ask questions, and participate in discussion in a reasonably mature manner. In this way, they get exposure to the issues of the family, watch how leaders deal with each other respectfully, follow the process of give-and-take in discussing positions, and understand how to draw discussion to a close in order to vote.

Younger family members also can be part of committees or task forces, as observers or even providing input about issues important to them and to the family which then are submitted for consideration to family council leaders. For example, young family members can provide valuable expertise in areas like social media where their elders are thoroughly confused. This helps the next generation build trust, learn the family's values, provide input, and achieve buy-in once decision are made. They learn that the family not only values but practices fairness in its dealings.

After a period of development such as this there can be policies that specify at what age a family member might be able to be a family council representative such as age 21, 25, or 30. However, the point at which a family member joins the family council should come after years after learning how the family governs itself. Younger family members also can be encouraged to learn leadership skills at school, in internships, or in jobs early in their adult lives. The family may respond by providing mentoring and career development that can help them learn and grow appropriate professional skills. Building leadership and collaboration skills elsewhere provides a foundation for bringing those skills into the family enterprise for the benefit of the family.



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JG & DJ: In the first generation of wealth, family leaders typically establish the values, direction, and rules they expect their heirs to follow. Grateful for their inheritance, members of the next generation are likely to respect and admire this foundation of the family legacy. Like most families, the next generation may also find it difficult to change rules under which they have succeeded to such a high degree. Yet inside the family and outside in the economic environment, the family inevitably faces multiple forces of continual change.

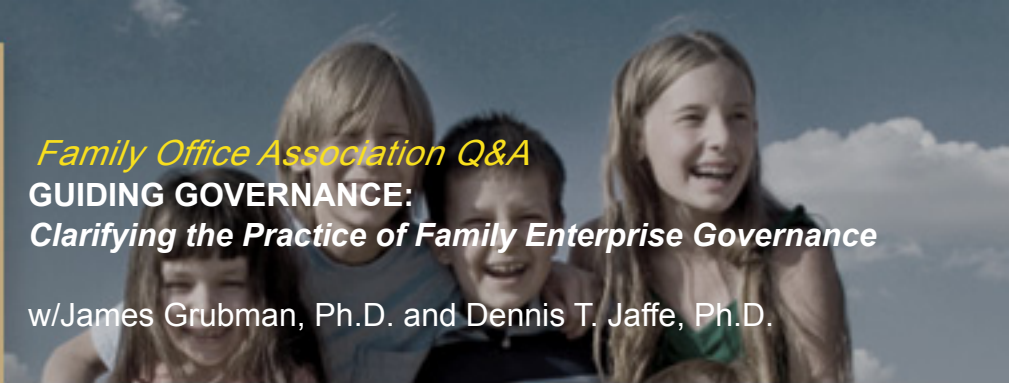
While continuing to celebrate the founding legacy mission and values, the family must gather periodically to look ahead at how the family membership and the outside environment are evolving. As noted for all investments, past success does not guarantee future performance. Old and new leaders in the family have a responsibility for adapting the original operating principles to modern-day realities. Inside the family, they have to listen to new viewpoints from the younger generation. The realities of the marketplace and the family goals also shift over time. The elders must remain open and actively listen to the voices of younger family members and to their advisors and employees. When older and younger generations communicate effectively about the changes that are emerging, the family's legacy and practices can evolve and adapt across generations so the family, its enterprises, and its wealth can endure.



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Angelo J. Robles is the Founder and CEO of the Family Office Association, a global membership organization of single family offices. Mr. Robles has written several books and numerous independently published articles, and has been quoted on family office topics for Bloomberg Radio & TV, Thompson Reuters, Institutional Investor, Registered Rep, HFM Week, Investment News, EurekaHedge, The Luxury Institute, The Greenwich Times and many others.

Mr. Robles had a successful career with positions at Arthur J. Gallagher & Co., UBS and New England Financial. He is the founder and past president of the New England chapter of the Hedge Fund Association, and was an Internet pioneer in retirement planning for Fortune 1000 executives with 401KRollover.com and IRARollovers.com, both of which he founded. Mr. Robles is a member of the Princeton Council on Family Offices and the NYU Stern Family Office Council.



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Jim Grubman PhD is a consultant to families of wealth, their advisors, and resources in the financial services industry. He works with ultra-high-net-worth families concerning succession, financial education, estate planning, and other transitions impacting family dynamics. He also provides intensive consultation and training to family offices about client relationship skills, family dynamics, and organizational functioning. He designed and taught the first graduate-level-only course in psychology and financial advising in the US, and he helped design and teach the family-dynamics and client-relationship-skills sections for the Certified Private Wealth Advisor certificate sponsored by IMCA and the University of Chicago Booth School of Business. A member of the Family Firm Institute, the Boston Estate Planning Council, and the Society of Trust and Estate Practitioners, Dr. Grubman has earned the Family Business Advising certificate. He is currently working on a new book, *Strangers in Paradise: How Families Adapt to Wealth Across Generations*, due out in 2013. His practice, FamilyWealth Consulting, is based in western Massachusetts. Email: jim@jamesgrubman.com Website: www.JamesGrubman.com

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