

INL No. A0416

Project FBN

Description Perspective book

 www.inl-agency.com



FAMILY BUSINESSES

Perspectives on Responsible Ownership

PREFACE	XX
INTRODUCTION	XX
OWNING A BUSINESS: SOME BASIC CONCEPTS	XX
The "spirit of ownership"	xx
FAMILY BUSINESS OWNERS: A SPECIAL CASE	XX
STRESSES AND STRAINS OF FAMILY BUSINESS OWNERSHIP	XX
Proliferating ownership	xx
Becoming an owner – problem areas	xx
Staying an owner – more problem areas	xx
Role confusion	xx
Inadequate ownership education	xx
Family branch complications	xx
"Insiders" versus "outsiders": Disparate interests	xx
Trust ownership	xx
HALLMARKS OF RESPONSIBLE OWNERSHIP	XX
Responsible ownership behaviours	xx
Responsible ownership attitudes	xx
Other characteristics of responsible ownership	xx
Multiple stakeholders	xx
Active and visible commitment	xx
"Enterprising stewardship"	xx
Defining responsible ownership	xx
THE "BUILDING BLOCKS" OF RESPONSIBLE OWNERSHIP	XX
Articulating a clear and powerful vision for the family and the firm	xx
Planning ownership	xx
An ownership education programme	xx
Preparing the next generation for ownership	xx
The role of governance structures in unifying family ownership	xx
A defined succession plan	xx
Transfer methods	xx
Transfer timing	xx
Financing the transfer	xx
Retirement funding	xx
Responsible ownership and succession: Some conclusions	xx
Shareholder agreements	xx
A "graceful exit"	xx
CONCLUSIONS	XX
NOTES AND BIBLIOGRAPHY	XX

PREFACE



As part of our mission to support the success and sustainability of family firms, FBN International aims to encourage the development of research and the formation of new ideas to help family businesses find and stay on the path to continuing growth and development. At the heart of stewardship, which spans generations, lies the concept of "responsible ownership" along with the burden that this places on our shoulders, and the great opportunities that we can grasp.

The aim of this publication has been to collect and consolidate research commissioned by FBN and its chapters with other source materials into a digestible review of the topic. In consequence, current thinking is presented in a less academic way than in the research publications, and with a more practical emphasis. I commend this short booklet to your families.

Hans-Jacob Bonnier

Chairman, FBN International

INTRODUCTION FROM THE EDITOR

This is not a "how-to" guide for family business owners. Rather, the booklet is designed as a review of current thinking and best practice aimed at helping family shareholders (and family members expecting one day to become shareholders) to achieve a more effective and successful approach to the ownership of their business.

The message is that while owners have the ultimate power in a family business, they also have large-scale responsibilities, in particular to ensure the long-term sustainability and prosperity of their enterprise. Owners need to show leadership as they play an active role in building effective ownership structures and in developing a consistently applied ownership vision and strategy.

We begin with some reflections on basic ownership concepts, and then move on to illustrating how these ideas are modified in the case of family businesses. The main stresses and strains of family business ownership are examined, as are some thoughts about particular attitudes and behaviours that are associated with "responsible ownership". Finally, we look at key aspects of family governance that we describe as "the building blocks of responsible ownership" – practical steps that will help promote a more unified, constructive and productive approach to owning shares in a family business.

Grant Gordon

Director General, Institute for Family Business (UK)

London, August 2007

OWNING A BUSINESS: SOME BASIC CONCEPTS

Business ownership can be seen as a package of rights and responsibilities. Arguably, the chief responsibility of business owners is to provide capital to the firm. In most countries, in exchange for capital, shareholders are given rights, such as to attend and vote at meetings, to receive dividends, and to elect a board of directors, which has the primary duty of managing the business.

The extent of owners' legal responsibility depends on the company form. When a business is structured as a partnership, for example, some partners may have unlimited personal liability for the debts of the partnership, while the responsibilities of owners in limited liability companies are – as the name implies – less extensive. (In this text, for simplicity we will treat partners as shareholders.)

It's clear from these opening remarks that when we think about the ownership of a business, we tend to focus on the

concept in a narrow, legal sense. We usually concentrate on how ownership can be bought and sold; how ownership gives control over what the business does; and how owners get to benefit from the revenues it generates and are responsible to varying degrees for its debts. But business ownership, properly defined, amounts to much more than a technical set of legal rights and obligations.

In looking at this broader dimension to ownership, a useful starting point is the idea that while ownership may be the

ultimate source of capital for the business, that capital should not be viewed solely in financial terms. A good definition of "capital" also includes fundamentals about what the business is for and what it is trying to achieve. This begins with the personality of the founder, but as the enterprise develops it will turn into constructs like "values" and "culture" which, in private businesses, will be rooted in and dependent on the owners. This is very different from the experience of share ownership in widely owned quoted companies, where for shareholders – whether institutional or private – the motivation is financial and the role is one of investor rather than owner.¹

This distinction between investors and owners is just one of a number of possible ways to analyse and categorise ownership. Professors Aronoff and Ward have drawn up a list of six types of owner that throws useful light on our subject (see Exhibit 1).² A given shareholder can fit into more than one of the categories.

Exhibit 1: SIX TYPES OF OWNER



Source: Adapted from Craig E. Aronoff & John L. Ward (2002) Family Business Ownership: How To Be an Effective Shareholder. Marietta, GA: Family Enterprise Publishers.

“When we recognize and accept a definition of responsibility that goes beyond the requirements of the law, we are expressing the ‘spirit of ownership’. One of the special advantages of family-owned businesses is that the spirit of ownership can pervade all those family members who are connected with the business.”

Roy O. Williams (1992) “Successful Ownership in Family Businesses”, *Family Business Review*, 5(2), 161–172, at p.162.

THE “SPIRIT OF OWNERSHIP”

With these distinctions in mind, and with capital in a business seen as embracing not just money but also the values and vision underpinning private business ownership, we are able to modify the legal and technical focus on ownership with which we began this guide. It’s a short step to understanding that effective, constructive ownership encompasses bigger ideas like integrity, knowledge, conscientiousness, mutual consideration and trust; and an even

shorter step to appreciating that family businesses are in a unique position to take advantage of this richer definition – a perspective we will refer to as “responsible ownership” and that some writers expand into the idea of the “spirit of ownership”.³

But what exactly does responsible ownership signify, and, more specifically, what are the types of behaviours that this represents? Is it regular attendance at shareholder meetings, willingness to invest

for the long term, or is it something else, something more? Later on in this guide we try to categorise responsible ownership attitudes and behaviours (distinct from management activity) that could apply to a broad group of family enterprises, aiming to identify concrete activities that other family owners could learn to emulate. First, however, we need to look at why these family business owners are different from shareholders in other types of business.

FAMILY BUSINESS OWNERS: A SPECIAL CASE

Owners of family businesses constitute a group of investors with a special set of responsibilities. The family-owned firm often represents not only a key part of a family’s overall monetary wealth but also of that family’s tradition and legacy. Owners often perceive their participation as a heritage on loan, which they need to cherish, sustain and help to develop.

To protect this heritage, and to continue building its wealth, family owners generally want (and are expected) to do more than the typical investor. They have a personal and emotional involvement in the business in which they are investing. They act as stewards of the family wealth, both to guard their investment and to assist in its growth, either through patient capital or more active means. With many such families, success is to leave to the next generation more than they had inherited. This notion of stewardship is one aspect of “responsible ownership”, which we might define as ownership behaviours that contribute to the interests of the collective group of owners, as opposed to behaviours that selectively serve the shareholder’s own interests.

Ownership is a complex concept for many families because it involves a number of layers. If an owner’s motivation is purely financial, while most of the other

shareholders are focusing on non-financial objectives, that shareholder is out of alignment with co-owners, and this can lead to conflict and damage. As we saw in Exhibit 1, there are operating owners, governing owners, passive owners and so forth, all playing different roles within the family and the governance system (and, to make matters even more complicated, some owners can fit into more than one category and thus play multiple roles). So, while all family members have critical roles as relatives within the family and as stakeholders in the family enterprise, some owners have day-to-day decision-making control, or are overseers, or have a junior managerial position, or none of these extra responsibilities. Conflict and damage are not inevitable results of these different perspectives, but, like many family business issues, they will definitely lead to problems if they are not understood and actively

managed as part of a comprehensive ownership strategy.

Another intriguing aspect of studying family businesses is the discovery that we are never very far away from a paradox. In this guide we aim to review and promote the virtues of thoughtful, committed, aligned and responsible ownership of family firms, but what is our starting point? It is the distinctly unhelpful reality that most family business shareholders do not become owners by choice! Unless they started the business or bought their shares, most will have become a shareholder as a result of inheritance or a gift. Also, owning shares in a family firm (as we will see in the next section) leads to all sorts of stresses and strains that are not encountered in other types of business investment. This means that to make the most of being a family business owner – and thereby transforming sterile legal concepts of ownership into a force that unifies the family and helps the business prosper – heirs need to effectively turn themselves into volunteers. In the words of Professors Aronoff and Ward,⁴ inheritors “become deserving of ownership and turn it into a voluntary act by stepping up to their responsibilities”, learning how to become successful owners, and looking after not just their own interests but also embracing those of the wider family and the business.

STRESSES AND STRAINS OF FAMILY BUSINESS OWNERSHIP

Being an owner of a family business should be a fulfilling, satisfying and profitable experience, but for many it falls short of this, in large part due to the range of dynamics and tensions that uniquely impact shareholders in a family enterprise. In this section we highlight some of these challenges that get in the way of achieving responsible ownership, because understanding these complications and obstacles – many of which overlap with each other – helps frame and inform our later discussion of responsible ownership strategies, behaviours and attitudes. Problem areas considered are:

PROLIFERATING OWNERSHIP

As family business ownership evolves and becomes more complex, it tends to migrate to family members who are increasingly remote from the operations of the business.

TRUST OWNERSHIP

Where family company shares are held in trust, the beneficiaries are one step removed from full ownership.

ROLE CONFUSION

Family shareholders do not manage the business, but many think they do.

INADEQUATE OWNERSHIP EDUCATION

Education for ownership – both for individual owners and owners as a group – is frequently neglected.

BECOMING AN OWNER – PROBLEM AREAS

In older family businesses, owners tend to be "conscripts" rather than volunteers. Also, awkward questions arise like should in-laws and non-family managers be allowed to become owners?

"INSIDERS" VERSUS "OUTSIDERS"

Every family business has "insiders" and "outsiders", and the different perspectives of these groups can lead to mistrust and conflict.

FAMILY BRANCH COMPLICATIONS

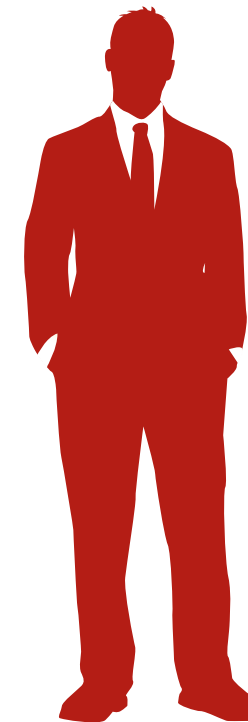
Branch politics can undermine the unity and effectiveness of family business ownership.

STAYING AN OWNER – MORE PROBLEM AREAS

Uncommitted owners can find themselves "locked in" because there is no market in the company's shares.

Exhibit 2: FAMILY BUSINESS LIFE-CYCLE

Owner-managed businesses in which ownership and management of the company are in the hands of just one person.



Sibling partnerships where ownership has been divided more or less equally among a group of siblings, some or all of whom work in the business.



Cousin companies (third generation firms and older) in which ownership has been spread across a group of shareholders, a significant proportion of whom take no part in the day-to-day management of the business.



PROLIFERATING OWNERSHIP

Ownership of family businesses tends to progress through a sequence, reflecting ageing and expansion of the owning family – namely owner-managed businesses, sibling partnerships and cousin companies (see Exhibit 2).⁵

There are exceptions to this progression. Not all owner-managed family firms are first generation businesses. There are examples of family businesses where the single-owner model is recycled, and the company is passed on to just one owner

(usually from father to son) in the succeeding generation: this distinctive type of succession is often found, for example, in farming businesses where families do not want to split land holdings among siblings. Also, buyouts at family firms can lead to the re-establishment of either an owner-managed business or a sibling partnership, where one branch of the family buys out the others and takes control.

As family businesses evolve and their owning families become more complex, a migration takes place towards ownership

by family members who are increasingly remote from the operations of the business. The other important point here is that when families and companies grow larger, the group of shareholders tends to grow larger as well, and a number of family considerations can lie behind this. For example, the family tenet of parents treating their children equally will probably have been applied, with the result that shareholdings in the organisation have been divided up equally among children (regardless of their talents or wishes).

A large group of shareholders may provide the benefit of greater financial muscle and thus a more solid foundation for the company, but the other side of the coin is that commitment and unity of vision among the ownership group may well come under threat. For instance, with most shareholders not employed in the family business, over time they often come to feel they are receiving less and less direct information about it. Without vigilant preventive action, later generation ownership becomes depersonalised.

BECOMING AN OWNER – PROBLEM AREAS

Mention has already been made of the likelihood that in more mature family enterprises a significant number of the family members who directly or indirectly own interests in the business may not be owners by choice – they made no positive decision to invest – but rather they owe their position to being gifted shares or to acquiring them via inheritance. These owners have no “calling” when it comes to enterprise ownership and governance in the sense possessed by investors who have chosen that status. In many cases, such owners are even less conscious that they are owners because their interests are held through trusts (discussed below). In addition, heirs can feel unworthy or undeserving of ownership because they have not earned it. No matter how well-intentioned a family may be when it comes to educating for ownership, good intentions may not be enough to overcome feelings of

apathy, denial or anxiety (or simply competing visions and goals) of a significant group of owners who did not volunteer.

The innocuous-sounding question “Who should become a business owner?” raises contentious and divisive issues for family businesses. We’ve already mentioned how families feel they must treat heirs “equally”, and how most owners are unwilling to even contemplate what they see as preferential treatment of one child at the expense of the others, even though business principles suggest that shares should be passed down (only or mainly) to those members of the next generation who have the required competence and keenness. But there is also the matter of in-laws. New in-laws among the ownership group are frequently seen as a threat to the status quo. Their arrival on the scene forces the family to examine how they are likely to fit in and whether they should eventually have any claim to ownership in the business. The increasing incidence of divorce and therefore of families with children from more than one marriage, further complicates the determination of who is “in” and who is “out”.

Similar issues arise in relation to talented non-family executives and managers, who often have fears about how effective they will be in the job and whether they’ll be given a fair chance. Key non-family managers are sometimes unwilling to remain with the company unless they are given financial incentives, possibly including shares or share options. As share ownership is generally jealously guarded by the family, this can result in an impasse if alternative reward schemes are not established.

STAYING AN OWNER – MORE PROBLEM AREAS

The potential problem of owners who did not volunteer for the role is compounded when such shareholders have their wealth locked into a private family company that has no liquid market in its shares. Not surprisingly, this is often experienced as suffocating, particularly when no dividend is being distributed. In the event that the personal ambitions and needs of a shareholder take a different direction and he or she needs the capital, or when the chemistry among family members is lost, inability to exit is clearly very bad news. In the long term it is harmful to the company to be forced to derive its capital from frustrated, uncommitted, “imprisoned” shareholders.

ROLE CONFUSION

It is important for shareholders to understand the role of an effective, responsible owner, particularly in relation to ownership versus management control. The situation often arises in smaller firms where owners and managers are owner-managers, and get confused in business meetings about whether they are taking decisions as shareholders or as managers. Even in more mature family businesses, family members sometimes continue to confuse these two concepts, believing that because they own shares they are also entitled to exercise day-to-day management control of the company. Often there is basic misunderstanding as family

“A metaphor helps explain the difference between owners and managers. Imagine the family business is a Boeing 737. Owners have a right to choose what the plane is used for – e.g. passengers or cargo – and they might decide on different risk profiles (like whether to heap up debt in order to expand the fleet). But owners stay out of the cockpit, they do not serve drinks or collect garbage. They let the pilot and the crew do their jobs. The trouble is inherited shares don’t come with a user manual, and one of the toughest challenges families in business face is in educating their members about ownership, and defining their rights, roles and responsibilities.”

Dr Ivan Lansberg (2005) “Governance Structure for a Complex Family Enterprise”, paper delivered at IFB Master Class 6: Professionalising Governance in the Family Firm, London, 29 September.

members fail to recognise that they are part of a team consisting of owners, managers and the board of directors – a pyramid structure, in which owners are at the top choosing who will sit on the board of directors, with the board, in turn, selecting and overseeing management. Owners become liabilities when, for example, they make business decisions based on a personal agenda or lobby individual board members, or make ill-considered comments that managers can misinterpret as commands.

Owners’ role confusion can also impact senior managers working for the family business in another way. If family members do not understand their roles and responsibilities as owners of the enterprise, how can non-family executives manage the enterprise successfully given that they are directly responsible to, and working for owners who, in this case, are intellectually absent? If family owners are not playing an active and constructive role in the governance of the enterprise, management effectiveness is placed in jeopardy.

INADEQUATE OWNERSHIP EDUCATION

We saw in the “Role confusion” section that family members working in the business can be confused about whether they are taking decisions wearing their shareholder’s hat or their manager’s hat, or they make unacceptable and inappropriate demands of the board of directors. The need for education can also be highlighted as regards family owners who are not employed in the business.

Shareholders do not manage the company, and nor do they – when a board of directors has been appointed – supervise the company’s governance. Nevertheless, shareholders can have a lively interest in how the company is doing and feel strong ties with it. Moreover, beneficial ownership of the company brings specific controlling rights, such as approving/adopting the annual accounts, appointing and dismissing directors, voting on the dividend to be distributed, as well as possibly approving “big-ticket” decisions affecting expected

return on investment, the risk and operational profile of the business, and indeed its identity and continuity.

Shareholders must be able to exercise these controlling rights in a knowledgeable, accountable and consistent manner. But in mature family companies, shares can be owned by spouses, children, siblings, retired parents, cousins, in-laws, and numerous other relatives who may not have any idea about the operation of the business, or about business matters in general. Even in family firms with management development programmes, training programmes in responsible ownership – either for individual owners or for the ownership group – are often non-existent. Similarly, even in families that, in a general sense, value education very highly – from serious discussion of school reports to unqualified support through university – a well-structured education agenda on managing wealth and being a responsible owner is uncommon.

Exhibit 3: INSIDERS AND OUTSIDERS – HOW PERSPECTIVES CAN DIFFER



FAMILY BRANCH COMPLICATIONS

A further example of a set of ownership issues that are unique to family firms concerns what tends to happen when shares in the business are passed down from generation to generation within branches of the family. By the cousin company stage, issues arise because some branches may have one child, while others have many offspring, producing significant branch imbalances when it comes to individual ownership interests in the business.

Another common scenario is that, by generation three, management control of the business has often been assumed by one particular branch of the now multi-branch founding family. Any skill shortages of the branch and how its members exercise their authority can generate tensions and resentment among the wider ownership group (for example, if there is branch favouritism in recruitment or remuneration).⁶ By this stage also, another branch (generally not itself involved in management, and possibly motivated by some historical grievance – real or imagined) commonly takes on the role of critic and challenger of ruling branch policies, and sets out to campaign and seek support for its opposition from elsewhere in the family.

"INSIDERS" VERSUS "OUTSIDERS": DISPARATE INTERESTS

Over time, the needs, expectations and ambitions of owners running the business

can become very different from those of owners who are not employed by the firm. The latter, for example, relying on dividend income to maintain lifestyle expectations, may oppose any reduction in dividends, even if that money is to be reinvested for future growth of the business. In contrast, the spouses of share-owning relatives working in the business may feel that their partners are being under-rewarded and their business prospects and careers undermined by the regular payout of dividends to shareholders not involved in day-to-day operations.⁷ These differing perspectives and needs of "insiders" and "outsiders" can be a significant source of intra-family conflict and, sometimes, outright warfare. It is not possible to overestimate the emotional turmoil that a disgruntled section of the ownership group can introduce into a family.

We've highlighted here just one aspect of the "inside" / "outside" divide – i.e. owners who work in the business and owners who do not (see Exhibit 3) – but family businesses can have various other groups of "insiders" and "outsiders": majority shareholders and minority shareholders; family members who own shares and those who do not; owners who hold their shares directly and those whose interests are held in trust; and married couples where one spouse is an owner and the other is not. The perceptions of each faction about the other can breed resentment that serves both to damage personal family relationships and to

undermine the cohesion and effectiveness of the ownership group as a whole.

TRUST OWNERSHIP

Shares in a family business may be placed in trust for the benefit of an individual or group of individuals known as beneficiaries. Control of the trust is in the hands of a person (or institution) designated as the trustee. In other words, trusts allow the separation of the control of shares from their ownership and, as such, they enable firms to be passed down to the next generation within a structure that supports continuity while retaining flexibility.

However, criticism is sometimes levelled against the use of trusts in a family business context, precisely because of the disconnection that results between control and ownership. At a time when family business success is being understood more and more as a product of shared vision and values, a long-term perspective and concentrated ownership, some families are reluctant to follow the trust route because of the emotional perspective they have about ownership. Trust beneficiaries, it is argued, do not have the same feeling of a bond with the family that comes from share ownership; their indirect ownership means they may feel distanced from the responsibilities that are required to help ensure effective ownership of high-performing, long-lasting family businesses.

Source: Adapted from Craig E. Aronoff & John L. Ward (2002) Family Business Ownership: How To Be an Effective Shareholder. Marietta, GA: Family Enterprise Publishers.

HALLMARKS OF RESPONSIBLE OWNERSHIP

Earlier we tentatively defined "responsible ownership" as ownership behaviours that contribute to the interests of the collective group of owners, as opposed to behaviours that selectively serve the owner's own interests. But what are the types of behaviours involved in responsible ownership and what attitudes are associated with it?

In this section we examine recent research studies designed to throw light on this subject in ways that are applicable and important to a wide range of family-owned businesses.⁸ The main focus of this research effort was the identification of responsible ownership behaviours, and their links with responsible ownership attitudes, family governance practices, the financial performance of firms and changes in family wealth.

RESPONSIBLE OWNERSHIP BEHAVIOURS

The research identified the three most critical categories of responsible ownership behaviours to be:

- **Serving as a resource to the family enterprise** through "patient capital" (i.e. the tendency of owners to keep their investment in the business as long as needed), willingness to delay dividends to facilitate capital improvements, and, more generally, owners making themselves available to the family enterprise.
- **Acting professionally towards the family enterprise**, which includes respect for lines of authority in the family enterprise, discussion of long-term goals with management, being clear about current and future intentions regarding investments – i.e. plans to hold, sell or buy shares – and being careful not to interfere with internal affairs in the firm unless this is part of formal duties.
- **Working proactively for the family enterprise**, which includes making outside contacts, monitoring the work of management, and putting in considerable effort beyond what is expected in order to make the family enterprise successful.

Other behaviours considered important were:

- **Keeping informed about the family enterprise** through activities such as attending shareholder meetings and reading annual reports.
- **Enhancing interpersonal relationships** by listening to other owners' opinions, treating other owners and employees with respect, and fostering team spirit among owners.
- **Acting according to agreements**, such as shareholder agreements or the terms of the family constitution.

RESPONSIBLE OWNERSHIP ATTITUDES

In addition to examining behaviours, these studies identified a number of responsible ownership attitudes – that is, feelings, thoughts and values owners found to be associated with responsible ownership actions or behaviours. The main categories of attitudes identified were:

- **A long-term view of the family enterprise**, including interest in its strategy as well as a long-term view of investments and returns.
- **Psychological ownership**, measured by a variety of factors reflecting care, emotional attachment, personal interest, strong commitment, enthusiasm, personal meaning and identification with the values of the family enterprise.
- **A common vision of the family enterprise**, as well as agreement about its long-term objectives.
- **A commitment to growing the family's wealth** versus preserving or harvesting it.
- **Social responsibility**, in the form of a feeling of responsibility to society, wanting to give something back, as well as the possibility of sharing norms and values with those outside the family.

The research results indicated responsible ownership attitudes and behaviours to be strongly and positively linked.

"Ownership of a family firm rests on two fundamental axes – economic value and emotional value. Economic ownership refers to the number of shares and their actual monetary value and voting power. Emotional ownership refers to the identity and attachment associated with the family firm and the value that each individual assigns to it, regardless of legal ownership rights. These two components make for a powerful combination, and it is therefore crucial that family ownership relies on trust and recognised mutual dependence for it to be responsible."

Nigel Nicholson & Åsa Björnberg (2005) Family Business Leadership Inquiry, London: Institute for Family Business (UK).

OTHER CHARACTERISTICS OF RESPONSIBLE OWNERSHIP

These studies, and the research literature more generally, raise a number of other interesting themes and perspectives that help us to turn "responsible ownership" from an abstract notion into a useful, working concept. Three of these issues deserve special mention:

- Multiple stakeholders
- Active and visible commitment
- Enterprising stewardship.

Multiple stakeholders

When asked to define the role, most family business people agree that the responsible owner must address the needs of multiple

stakeholders – the company, the family, other owners, employees, customers and society at large. This theme of multiple constituencies is echoed in many of the definitions of responsible ownership.⁹

Coupled with the notion of the responsible owner serving multiple constituencies is the need to balance those demands. The idea of balance, however, not only addresses balance as between the needs of stakeholders, but also between rights and duties. Thus, one study defines responsible ownership as "balancing the rights and privileges of ownership, such as wealth, power, joy, source of motivation and other rewards, with associated duties and risks of ownership, including the proper concern

for welfare of the firm and accountability for the firm's success".¹⁰

Active and visible commitment

The notion of "commitment" also pervades the research literature. Owner responsibility to the company includes a commitment to company continuity and development, and acceptance that the company is separate from the family. Emphasis is laid on the importance of ownership to the family, including commitment to assuring preservation and growth of family wealth, and assuring the smooth transition of ownership to the next generation.

Commitment comes in many guises. Perhaps one of the most valuable is the way united and committed family shareholders

are willing to be more patient and to temper their expectations of financial return. As a result, their family business enjoys a lower cost of capital.

It's clear from the points made so far that definitions of responsible ownership of a family business need to focus on the owner as active participant, not just as a passive investor. If owners do not contribute directly to the generation of economic returns by their family business, but instead simply supply financial resources that are generic, non-specialised and easy to substitute, then the owners are replaceable.¹¹ In a family business the owner is identifiable, and this underpins responsibility and acts as a motivator.

"Enterprising stewardship"

Commentators agree that effective owners who understand their responsibilities and use their power and influence in a timely and well-informed manner (when this is

considerable understanding of governance and discipline on the part of owners.¹²

Making such demands on how shareholders exercise ownership implies that systematic, timely and specific action is taken within the family circle to foster and form responsible owners, who understand their four-fold role:

1. To assure the identity and promote the continuation of the enterprise.
2. To stimulate and facilitate sound entrepreneurship.
3. To supervise the proper employment of capital.
4. To ensure that the business has capable directors who add value.

This can mean, among other things, that while owners make sure they continue to hold a controlling interest in the enterprise, they are open to the option of attracting external resources (capital, talent, strategic partners) and are prepared to share power.

Because the notion of stewardship is

cultural values, family and social values, and symbolic values (often stemming from being part of an organisation that has stood the test of time).

DEFINING RESPONSIBLE OWNERSHIP

A variety of "hallmarks" of the responsible family business owner have been reviewed in this section. For example, the responsible owner is active towards the business, is associated visibly with the company's actions and decisions, has multiple ownership goals (e.g. transgenerational ownership, responsibility for culture and traditions, formulating and implementing the long-term strategic direction), understands when to bring in outsiders, and is able to balance the needs of the family, the business and the other stakeholders. These qualities enable us to broaden the working definition of responsible ownership with which we began this section into the following proposition: "Responsible ownership can be defined as an active and long-term commitment to the family, the business and the community, and balancing these commitments with each other."

A family business will only fully develop its real potential if it has a group of capable and responsible owners – in the enlarged sense of our definition – who assume the collective leadership of the family enterprise. This leadership must stem from a coherent, powerful vision and a well thought-out ownership strategy, and putting together such a strategy is the subject of the next section of this guide.

THE "BUILDING BLOCKS" OF RESPONSIBLE OWNERSHIP

Family members seeking unity in their commitment to the family business and its future must plan in order to promote ownership group effectiveness. Stable, committed, active and involved ownership of the family business is the goal, and in this section we discuss issues that are relevant in developing a strategy to help achieve this.

The research studies reviewed in the previous section link a range of family governance practices with responsible ownership behaviours, and these provide an excellent framework for developing an ownership strategy. The key strategic elements – called here the "building blocks" of responsible ownership – are:

- Articulating a clear and powerful vision for the family and the firm
- Planning ownership
- An ownership education programme
- Preparing the next generation for ownership
- The role of governance structures in unifying family ownership
- A defined succession plan
- Other agreements and arrangements.

Exhibit 4: FIVE SIGNS OF GOOD OWNERS

- 1 View themselves as stewards of the business.
- 2 Consider the welfare of others – the business, the family, other owners, employees, customers and society at large – as well as their own.
- 3 Educate themselves about business ownership.
- 4 Understand that ownership is a privilege.
- 5 Try to add value to the business.

Source: Adapted from Craig E. Aronoff & John L. Ward (2002) Family Business Ownership: How To Be an Effective Shareholder. Marietta, GA: Family Enterprise Publishers.

necessary) must have an entrepreneurial mentality, be capable, and hold consistent views regarding the development of the enterprise and the family. On the other hand, owners must not get under the feet of executive management. This requires a

another factor underlying the complicated concept of responsible ownership, it is also important that owners are aware of the "meaning" of the family heritage that has been passed on and entrusted to them, combining economic and financial values,

ARTICULATING A CLEAR AND POWERFUL VISION FOR THE FAMILY AND THE FIRM

Values are what a family and its business stand for, while vision is a shared sense of where both constituencies are headed. Successful families learn to build a shared vision by aligning individual and family values and goals, and that vision becomes a guide for planning, decision making and action.

On ownership, a good starting point for family members is to address key questions like "What is our business for?" and "Why and how do we want to be shareholders?" Developing an honest consensus on such basic issues helps the family improve its chances of success when family members move on to establish ground rules for other aspects of their relationship with the business. Important examples of an entrepreneurial family's values are to be found in their views on the significance of family ties, the preservation of harmony, mutual obligations and conduct, as well as in the philosophical convictions and beliefs that may underlie their entrepreneurship – integrity, honesty, ethics, meritocracy and openness to others' ideas. What are their views on the balance between "business first" and "family first"? What does "socially responsible entrepreneurship" or "corporate social responsibility" mean to them?

Some of these values are fundamental – deeply embedded in the family's collective subconscious – while others are largely determined by situational and generational factors and must therefore be reconsidered from time to time, in particular when

ownership passes to a new generation. Aspects of the family's value system can be reinterpreted by succeeding generations, helping to reinvigorate the sense of connection between family shareholders and the organisational mission. Also, a reassessment of the values of the entrepreneurial family between the outgoing and the incoming generation can help make the process of transfer pass smoothly.

It is important to identify these values, to articulate them and make them explicit. This is a responsibility of the entire extended family, not just of the shareholding members, although these values have a special significance for the shareholders because they bear ultimate responsibility for what is happening in and around the enterprise and for safeguarding its identity.

Values feed into the vision a family develops about its own future and that of its business. These perspectives lead to the conclusion that the essential mission of the owners of a family business should include fostering the continuation and independence of the enterprise, deciding on the optimal employment of capital invested and built up in the firm, making sure that in running the business the fundamental family values are adhered to, and contributing to the development of the entrepreneurial family.

PLANNING OWNERSHIP

A clear impression of the extent to which a family business operates on the basis of an ownership strategy can be obtained from the answers to questions such as:

- Has it been established who can and cannot belong to the entrepreneurial family, and are there specific criteria for establishing eligibility for ownership?
- Are there rules to be followed when allocating shares to the next generation?
- Has the family considered whether or not to admit non-family members to ownership, and if so with what rights?
- Does the company have a clear and understandable dividend policy?

These are all component questions of a much larger question – "How do we want to own the business?" – involving strategic choices on many dimensions. The perspectives and needs of different types of owners (Exhibit 1) must be taken into account, and an ongoing dialogue entered into with shareholders so that communications do not arise only when there is a need for change.

It is not feasible here to do more than highlight a few of the planning issues that will require attention. Broad ownership choices will centre on issues like:

- Are we committed to private ownership no matter what pressure the business is under?
- Are we determined to maintain 100 per cent family ownership of the business?
- Would we consider going public or adding non-family owners in some circumstances, and if so what are those circumstances? For example, to grow the business, make it more profitable, or to buy out family shareholders who no longer wish to be involved.
- In what circumstances, if any, would we consider selling the family business?



Exhibit 5: THE PROS AND CONS OF TRUST OWNERSHIP

REASONS FOR

- Separates ownership from control
- Estate and tax planning – and can make divorce easier to resolve
- Facilitates ownership if there is a large group of shareholders
- Avoids family members claiming executive rights

REASONS AGAINST

- Can be rigid and lack flexibility
- Inherent conflicts of interest arise – different trustees
- Undermines the recognised family business strength of a shared ownership bond
- Can bind incompatible family members together

Source: Adapted from Nigel Nicholson & Åsa Björnberg (2005) *Family Business Leadership Inquiry*, London: Institute for Family Business (UK).

Narrower family ownership choices concern how the family sees ownership going forward. For example, should allocation of shares to the next generation be based on:

- Maximum distribution – i.e. all shares distributed equally regardless of whether or not family members work in the business.
- Maximum concentration – only family employed in the business can be owners, or just one or two family members have voting control for the entire business.
- Selective allocation – the choice to individual owners of family branches.

Trusts are often used in family businesses as a method of concentrating voting control, involving the need for yet more choices. For instance, should there be just one trustee (i.e. a single ultimate voter), or one trustee per branch, or a small group of trustees selected because of their company

knowledge, or perhaps only family members employed in the enterprise can be trustees? We looked at some of the criticisms levelled at trust ownership in the earlier section on "Stresses and strains of family business ownership", and it is clear that the merits and risks of this form of family ownership need to be carefully weighed (see Exhibit 5).

Another way to concentrate (or, more accurately, reconcentrate) ownership of the business is by "pruning the family tree" – i.e. to reduce the number of individual shareholders – as a way of seeking greater alignment among the owners. Buying back shares is the main possibility here (although we also look at other exit opportunities later in the section about shareholder agreements). In the long term this policy tends to concentrate ownership of the company in the hands of the people who

are running it. Distant cousins who are small shareholders in a family business can be problematic, and the business may be better off if they are bought out. There's a counter-argument, however, that shareholdings can be widely dispersed and disconnected from management provided there are mechanisms that link the two together in a robust way. So, for example, it may be a healthier outlook for family ownership if the company can find a way to increase dividend payments, thus encouraging continuing family ownership as opposed to family sale. Like so many of these issues, the point very much depends on the ethos of the family and their vision for the future.

In the earlier "Stresses and strains" section we raised another ownership issue that needs to be planned for – whether in-laws and non-family (such as managers or joint venturers) should be allowed to

become shareholders? Choices need to be made about how to manage the role and influence of in-laws in relation to the family business, and approaches to the issue vary. At one end of the spectrum (common in some Latin countries), in-laws are fully accepted and effectively enjoy family member status in relation to the business. At the other extreme, in-laws are excluded, not just from share ownership (via rules laid down in the articles of association and in pre-nuptial and other compulsory legal agreements) but also from any involvement in the business or its family governance architecture. There are also compromise positions available between the two extremes – for example, the articles of association can provide family bloodline members with first refusal on the transfer of shares before they can be offered to non-bloodline family members. Whichever viewpoint, or compromise, is adopted, achieving a family consensus on rules that are understood is likely to be a delicate exercise. But it is not an issue that can be left to chance. The role and voice of in-laws need to be actively managed through the mechanisms of family governance, with the family proactively managing expectations by codifying its rules on ownership.¹³

As regards admitting non-family shareholders, the majority of family businesses prefer to maintain 100 per cent private family ownership. A common view is that as soon as non-family members are allowed to become shareholders this changes underlying dynamics, making governance of the family business more difficult. As a compromise, some family

enterprises do issue equity to executives under incentive schemes, but these are special shares that carry restrictions – for example limited voting rights and/or limitations on transferability.

AN OWNERSHIP EDUCATION PROGRAMME

We discussed earlier how responsible owners see themselves as stewards of the family business. They try to add value to the enterprise, and they understand that ownership is a privilege. Responsible ownership and stewardship require a full understanding of the roles and responsibilities that accompany a shareholding, and the best way for this to be achieved is through education. Most importantly, owners – especially those not employed by the family firm – have two main challenges: understanding shareholder responsibilities and ensuring they are knowledgeable about the business.

Here is a five-point framework under which families can encourage responsible and enlightened ownership:

1. Building an education programme that teaches family virtues, values and history. This includes knowledge of the family business, its strengths and weaknesses, family history, core family values and how they relate to the family enterprise, together with ownership philosophy and corporate culture. Family shareholders should have enough specific knowledge about the business to underpin informed decisions.

2. Learning about commerce and economics. It is important that owners have basic financial fluency – the ability to read profit and loss/income statements and balance sheets, and knowledge of saving, investing and making good decisions on critical financial issues. Not all owners need have the same skills, but there should be a minimum level of knowledge so that different owners can share their expertise. Beyond basic financial fluency, in family enterprises it is often challenging to maintain the entrepreneurial competitive edge necessary for the enterprise to compete successfully with enterprises formed by risk-taking investors. Family owners must therefore also be educated to act as engaged investors, with competence, skill and energy.

3. Understanding the legal duties imposed on owners. Family members should agree to study and accept the responsibilities contained in the statutory documents that empower them as owners. This does not mean earning a law degree, but it does mean achieving a basic understanding sufficient for owners to comprehend their legal rights and fulfil their legal obligations. An important example concerns the right of owners to elect the board of directors, which then serves as the governing body of the business. In effect, shareholders exert their control through their choice of directors, but education plays an important role here because the owners must be diligent in seeking, attracting and electing the best

directors they can find – directors who will help the owners achieve their goals. Education in this area will also help address role confusion issues (the dividing lines between ownership and management) discussed earlier in the “Stresses and strains” section.

4. Learning how to make competent decisions in tandem with representatives and financial advisers. Part of the definition of being a responsible owner involves the ability to make competent decisions regarding the stewardship of family business assets when requested to do so by the people the family has asked to represent them in connection with those assets. In this role, the educated owner becomes a partner with his or her representatives. In addition, owners need to develop interpersonal skills,

including an ability to communicate and to help build consensus. Relations with the board of directors once again provide a good example of the point. As we have seen, the board is charged with fiduciary responsibility for the company, representing the owners in providing direction and oversight to the business, but it is the owners who take what can be called the “big-ticket” policy decisions. Thus it is the owners who define and explain (with one voice) to the board the values and vision that are to underpin the way the board runs the business, and they also work with the board to set goals for the business on the key areas of growth, risk profile, profitability and liquidity.

5. Participating in family meetings related to their ownership role. Family members should actively

participate in family meetings, annual shareholder meetings, beneficiary/trustee meetings and so forth, bringing knowledge and understanding that enables them to contribute to shareholder decision making.

The family business will gain in the long run from well-informed, capable and educated shareholders who feel responsible for their role and are willing to invest time in learning to carry it out to the best of their ability. But education for the responsibilities of ownership is a process and a mindset, not an event. Owners meeting once or twice a year without a sustained, coherent vision about learning goals and clear outcomes is not sufficient. Also, developing a good working ownership structure requires a joint effort from the board and the shareholders.

“There is no enlightened ownership unless the family keeps itself informed on the progress and strategy of the business. How else can the owners vote responsibly (at the annual general meeting) on matters that, by law or custom, must be approved by the shareholders? How else can they pass judgement on the board’s and the CEO’s performance, not only in business terms but also in terms of whether or not the family’s values are being respected as the board and top management go about their governance tasks?”

Fred Neubauer & Alden G. Lank (1998) *The Family Business: Its Governance for Sustainability*, Basingstoke: Macmillan Business.

PREPARING THE NEXT GENERATION FOR OWNERSHIP

Responsible business owning families are aware that the availability of capable, motivated successors in the family is not self-evident, so, in addition to current owners, ownership education is also relevant to next generation family members who may be future owners of the business. The hope and wish of an entrepreneurial family to sustain their family business into the next generation can only be realised if parents take steps to encourage the children to be enthusiastic and to prepare them for their future ownership responsibilities. From the time children are small until they become young adults, the more they can acquire and share business and financial knowledge

the more likely it is that they will become effective owners.

Sometimes the older generation is afraid that they influence the next generation too much. They feel their children should make their own choices. However, this may be a dangerous strategy that risks the next generation feeling alienated and distanced from the company.¹⁴ The wise course is probably to bring the children into contact with both the ups and downs of the family business from childhood in a natural, imaginative and varied way. Care is required to avoid turning an expectation that a child will join the family business into forcing the choice upon them. For this reason it is recommended that young adult children, after completing their education, gain their first work experience outside the family business.

Some researchers draw a distinction between general and financial upbringing. As part of general upbringing, parents can emphasise the versatility of the family's business-based wealth – i.e. stressing wealth as spiritual capital (family values and harmony), human capital (skills, knowledge and character), structural capital (governance structures) and social capital (obligations to the wider community). This emphasis, it is argued, is the best guarantee for the retention of financial capital.¹⁵ A healthy financial upbringing, on the other hand, entails open dialogue with young heirs about the family's wealth, contacts with financial and legal advisers, learning to be prudent with money and so forth. As wealth adviser James Hughes puts it: "A family without educated human capital can receive the most timely financial information but be unable to do anything with it."¹⁶

Financial education can be based on a developmental plan to help ensure that skills are mastered at appropriate ages and in an appropriate sequence. The list in Exhibit 6 provides a starting point, which may be adapted to suit particular families' needs.

Owners who grow up with family business leaders as role models and solid financial security clearly have opportunities not available to other young people. But along with these advantages come responsibilities, including preserving the family heritage and enhancing the family reputation. Learning how to contribute in constructive ways is a key challenge for many young owners.

THE ROLE OF GOVERNANCE STRUCTURES IN UNIFYING FAMILY OWNERSHIP

A key component of active, involved ownership is to ensure that an effective system of family governance is in place and functioning. As we have seen, the complexity of family businesses, especially once they have reached the cousin company stage, is reflected in (a) the increasing complexity of the family as it grows through marriages and childbirth, and (b) the complexity of ownership as shares pass down the generations in different proportions and at different times, creating a variety of shareholder situations.

Managing this complexity requires introducing "structure" in the form of rules, policies and procedures that help the family develop a cohesive approach to its involvement in the business. Setting up such a governance system means establishing forums like family assemblies and family councils, and adopting a written family constitution that records the family's agreed policies towards the business and other issues. This is not the place for a detailed discussion of family governance architecture,¹⁷ aside from emphasising the point that such governance structures are designed to support consensus decisions, coordinate family actions and provide leadership. Rather we focus on examples of how formal shareholder involvement in governance helps address issues highlighted earlier in the "Stresses and strains of family business ownership" section.

Family councils are the ideal forum for

discussing core questions concerning the family's long-term plans for ownership of the business. When they are functioning effectively, family councils enable the more sensitive personality and relation-based issues to be brought out into the open, and high on the list here are "insider-outsider" dilemmas highlighted in Exhibit 3. We saw the situation where family owners who have decision power can benefit from information that is not known to non-managing owners. Also, non-active family shareholders may sometimes be less committed to the business, placing greater emphasis on financial returns than active family owners and be more reluctant to reinvest profits in the business. This situation often leads to intense conflicts over strategic direction of the family business. In larger family businesses, informal gatherings can be insufficient in addressing these problems, and formal governance mechanisms become necessary in order to maintain balanced family relationships.

But this should not imply that there are easy answers, because there are not. "Inside owners" should make efforts in areas like accepting all owners, being open and accountable for their actions, providing comprehensive information in a form outsiders can understand, being sensitive about power and status, and striving to create pride in the company, helping outsiders to see that that the business they own is precious. Similarly, "outside owners" should understand and respect the challenges of management, educate themselves so as to become more knowledgeable about the business

(including about the competition for funds) and find ways to get involved (perhaps as a representative on the family council).¹⁸ Ultimately, however, what bridges the gap between insiders and outsiders is trust. Governance structures provide an objective framework for communication on sensitive topics, which helps build family trust, and once governance systems have been created it is important to trust those systems to work.

In the "Stresses and strains" section we also discussed inter-branch complications like numerical imbalances between branches of the founding family and the political manoeuvring that can take place between branches. These issues provide another example of sensitive problems that can most effectively be discussed and tackled within the rule-based formality of a family governance system. Decisions can be taken on what policies should apply to inter-branch decision making, and how should differences (and possible deadlock) be dealt with. Should there, for example, be branch representation on the board of directors?

We mentioned above that informal family gatherings may not be adequate in addressing serious issues like those that can develop between "insiders" and "outsiders", but this is not meant to devalue the vital role played by less formal family communications in bolstering shareholder unity. While clarity of vision and formal governance processes are critically important in the family's ability to maintain ownership continuity from generation to generation, the commitment of the owners themselves is the most important single

Exhibit 6: TEN SKILLS CONTRIBUTING TO NEXT-GENERATION FINANCIAL LITERACY

- 1 How to keep track of money
- 2 How to save
- 3 How to get paid what you are worth
- 4 How to spend wisely
- 5 How to discuss money
- 6 How to live on a budget
- 7 How to invest
- 8 How to develop an entrepreneurial mentality
- 9 How to handle credit
- 10 How to use money for philanthropic causes

Source: Adapted from J. Godfrey (2003) Raising Financially Fit Kids. Berkeley, CA: Ten Speed Press.

long-term determinant of family success. Indeed, the literature and research reviewed in this guide have shown that informal gatherings are more predictive of family harmony than are formal family governance structures.¹⁹ Consequently, family business shareholders should focus on maintaining and promoting communication and good family relationships as part of responsible ownership. Ideas for setting up good verbal and written communication among family members include organising family retreats, a family website or newsletter that connects family members between meetings, and perhaps a family code of conduct that facilitates open discussion of difficult issues. Successful families are those that spend time with one another and learn to communicate openly.

A DEFINED SUCCESSION PLAN

Issues affecting how ownership should be organised in the next generation – that is, the type of ownership structure that best supports the shared family vision for the business – were considered under “Ownership planning” above. Here the focus is on a responsible approach to the more detailed concerns surrounding the transfer of ownership of a family business (which often coincides with management succession), including some important estate planning considerations.

Transfer methods

How the transfer is effected – gift, purchase and sale, or inheritance – depends on numerous business, taxation and emotional

considerations. Gift and sale are appropriate if parents intend to make the children owners or co-owners while they are still alive. This is often considered important, in particular for children who start working in the business, and it also expresses the idea that for a certain period two successive generations will manage the enterprise as a team. Inheritance, on the other hand, probably best reflects the idea of “family heritage”. The choice between transferring shares by gift or by purchase and sale (the latter usually accompanied by a loan from the parents to the children) rests mainly on financial and tax considerations. When next generation members are asked to fund a significant part of the purchase price themselves (perhaps via a loan secured on the assets of the business), this provides an early test of the extent of their commitment to the family business, and at the same time helps crystallise their own views about career options. In some cases the family opts for a combination of transfer methods.

Transfer timing

The timing and phasing of the transfer can also involve a variety of procedures. Ownership and control may not be transferred until the next generation have joined the business and amply proved their suitability. Also, the outgoing generation can retain ultimate control way beyond the time that management of the business is transferred. Factors at work in this decision sometimes include a lack of confidence in the capacities and intentions of successors, the parents' own psychological inability to let go, or a need to remain involved because

the parents' pension provision depends on the performance of the enterprise. Prolonged postponement of a full transfer can lead to differences of opinion on business strategy and management style, and all too easily can generate conflict between the two generations.

Financing the transfer

Under normal circumstances, owners of family firms rarely ask themselves “What is this business worth?”, although they often have an idea – a subjective and sometimes incorrect one. Determining the value more objectively and realistically usually does not come into play until a possible sale is considered, or when the time comes to transfer ownership to the next generation. Various methods are used for valuing the business, and it is vital to consult experts to help arrive at a negotiated consensus.

If the intention is to carry on the enterprise as a family business, a sound “financing plan” for the transfer will be needed. This must cover issues like any supplemental pension benefits that may be required for the outgoing generation (see the next section), reasonable remuneration for the incoming generation, tax payments due in connection with the transfer and – not to be overlooked – the financing needs of the enterprise. Additional funding may be needed to compensate children who will not become shareholders, or sometimes also to buy out other shareholders.

Retirement funding

Estate plans are a critical component in the responsible ownership of family businesses

because they must balance the financial needs of the outgoing senior generation with the ability of the business to remain financially viable and competitive.

The starting point is the current owners' needs. Family business owners will often have become accustomed to a substantial salary and benefits package, but if they continue to own the business after retirement their financial situation is likely to alter abruptly. The amount of money they can draw from the business will be limited by its capacity to pay a salary to both the outgoing and incoming generations (and, in a number of countries, by rules that limit tax deductibility). Other senior generation financial “needs” may include funds for philanthropy and assets to share with heirs, including distributing some assets to children who have decided not to participate in the family business.

The other side of the equation, of course, concerns the financial resources of the family business, and its ability to meet the “needs” calculation of the senior generation. If most of the outgoing generation's assets are tied up in the company (as is the case for many family business owners), their retirement income will be dependent on there being sufficient accumulated liquid assets, or on the ability of the next generation to manage the business successfully. Broadly, financial peace of mind in retirement can either be achieved by business owners continuously taking money out of the business during their period of tenure, or leaving this money to build in the balance sheet so that, on retirement, a restructuring can be arranged to transfer

personal wealth to the departing owner. Both strategies have pros and cons.

Responsible ownership and succession: Some conclusions

Transferring the ownership (and often, at the same time, the management) of a family business from one generation to the next is not simply a question of pulling a switch. Usually it is a process lasting for several years, during which the two generations work together in a gradually shifting division of roles. This may work smoothly, but the process may also come to a halt and end in disaster. It is therefore important:

- That the issue of whether or not to carry on the business is placed on the “family agenda” at an early stage – meaning many years in advance. It must be a recurrent theme in the communication between parents and children, gradually leading to concrete questions being asked and clear answers being given.
- That, once the succession process is under

way, mutual ownership expectations and concerns are clearly and openly expressed between the outgoing and incoming ownership generations, and also between next generation members themselves.

- That a crystal-clear transfer scenario is outlined by the two generations in mutual consultation and that the arrangements are laid down in writing.
- That the senior generation's estate plan addresses retirement income, distributing assets among the family, minimising estate taxes, and providing adequate funding for taxes payable and philanthropy, while balancing any funding needs of the business.
- That qualified professionals are called in to advise on all the technical ins and outs of the transfer, and maybe also the assistance of a trusted all-round adviser who can guide the family and help keep the process moving in the right direction.



SHAREHOLDER AGREEMENTS

We have already discussed how successfully managing family enterprise complexity requires introducing "structure" in the form of rules, policies and procedures that help owning families develop a cohesive approach to their involvement in the business. Families can benefit from a number of arrangements and agreements specifically tailored to meet their needs. We referred earlier, for example, to the family constitution, by which a family lays down the norms and values it considers important in running the business, together with rules governing interaction between the family and the business. Usually the family constitution is not legally enforceable, but rather has the nature of a declaration of intent or a moral agreement. More technical arrangements between owners can be set down in shareholder agreements, which do have the force of law.

Although many families instinctively favour basing the joint continuation of the family business on trust, respect and loyalty, in certain areas it is wise to make provisions very clear (and ultimately enforceable) in case things go differently than family members may have expected or wished. For example, the firm may run into difficulties, personal circumstances may change or personal relations may become problematic.

Owners frequently enter into shareholder agreements containing clauses on, for example, exercising controlling rights (such as the nomination of directors) and on

resolving conflicts and disputes among shareholders, should they occur. Such contractual arrangements are especially relevant when the situation involves a limited number of parties each representing substantial individual or branch interests.

Another area covered by shareholder agreements – and one that is particularly important and valuable – concerns share transactions. A shareholder agreement can stipulate, for example, that inactive members are required to sell their shares to the active members. Potential disagreements between owners about the value of shares can be avoided if the agreement includes a clear formula for price calculation.

A "graceful exit"

As well the key rights and duties that shareholders have towards each other when they enter the agreement, it is recommended that rules should also be laid down to help ensure a smooth parting of ways. We saw in the "Stresses and strains" section that, except for business founders, most family business owners do not choose to become owners because that status comes to them via inheritance or a gift. To help promote the effectiveness of an active and responsible ownership group, however, it is critically important that remaining an owner be a matter of choice, and business-owning families are therefore encouraged to provide shareholders with the opportunity to make a "graceful exit":²⁰

To make such an exit possible (and

thereby ensuring that ownership is truly voluntary), two things need to be done. First, clearly defined procedures must be agreed regarding share offering, price setting and terms – in effect the establishment of an internal share market. Secondly, it is advisable to provide for a reserve inside or outside the company to facilitate buying out exiting shareholders. The shareholder agreement should require a reasonable time period between a shareholder indicating a desire to sell and the transaction taking place (too long and the shareholder's wishes may become frustrated, too short and the continuity of the business could be threatened), and the price-setting procedure should be clearly defined. Sometimes the existence of an exit route stops owners seeking to cash in their shares.²¹

Shareholder agreements can also provide solutions to a number of other sensitive ownership issues. As we've seen, some family companies restrict share ownership to bloodline family members, and enforce this through agreements that give the family first refusal before shareholdings may be transferred or sold. Similarly, a family member's involvement in divorce proceedings can be made to trigger a compulsory offer of their shares to the family. Share purchase agreements, therefore, can provide an effective method of limiting both the number and character of owners, and limiting the opportunities for outside, potentially hostile investors to purchase an interest in the company.

"Families in business must reconcile the classic paradox of needing both stability and change. Inevitably, both the family and the business face change, and their changes can compound one another. Without a strong, stabilizing influence, the natural tendency of the system is to pull apart. Committed family ownership is the stabilizing core of a family business... Ownership commitment is not cast in stone and must be constantly renewed in order to simultaneously maintain stability and pursue adaptive change."

Professor John Ward (2005) *Unconventional Wisdom: Counterintuitive Insights into Family Business Success*, at p.228. Chichester: John Wiley & Sons Limited.

CONCLUSIONS

From the legal perspective, being a shareholder represents a package of rights and duties, both financial and as regards control. In family businesses, however, ownership is more: ownership also represents cultural values, family and social values, and symbolic values. The shares acquired by gift, purchase or inheritance are often seen as a family heritage that must be preserved and expanded, to be passed on again later to a younger generation, and in this sense the owner of a family business can be seen as an "enterprising steward".

Owners have the ultimate power, but

chiefly they bear great responsibility – responsibility for the further growth and prosperity of their family business – and effective ownership demands a conscious and active interpretation of this dual role. Not staying passively on the sidelines, but pursuing active involvement in the development of the enterprise; acquiring skills if needed; being a good communicator and listener; intervening and providing management with the support it needs, but knowing when not to intervene; preparing the next generation for ownership, but not forcing the process; pursuing a planned ownership strategy and applying it consistently. Also, owners should be conscious of the leadership they are

expected to display, carrying out their role in a stable, recognisable and visible manner – visible both to the enterprise and to the extended family.

Pursuing a strategy aimed at achieving responsible, effective and stable ownership offers rich opportunities for debate and discussion and – as successful families have found – such exploration helps unite family members in their commitment to the business and its future. In turn, unified family ownership helps family enterprises to make the most of their unique competitive edge, enjoying a corporate culture grounded in family values, which provides them with the potential to outperform and to outlast other businesses.

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Published by the Family Business Network UK/ Institute for Family Business

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Family Business Network International

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British Library Cataloging in Publication Data available

ISBN 978-0-9551898-2-1

Editorial and content management: Simon Perry/Grant Gordon
Project management by Olivier de Richoufftz
Design by inl-agency.com. Printed and bound by image-viscom.co.uk

The Publication of this report has been made possible
thanks to the generous support of

JPMorgan 
Private Bank