The great governance transformation

When ownership of a family company passes from a sibling partnership to a cousin collaboration, important decisions must be made concerning design and leadership of the board.

BY JOHN L. WARD

IMAGINE A TYPICAL family-owned business, started by a husband and wife who, through hard work and sharp wits, built the enterprise and proudly passed it on to their children. The siblings then grew the business through its second generation. Governance? No problem. The owners all worked for the family business, so they were the decision-makers who charted its course.

But let's assume that the business continues to grow and prosper, ultimately arriving at the third stage of its life cycle, in which ownership passes from a small number of siblings to a significantly larger group of relatives, most of whom do not actually work for the firm. Those of us who study family businesses call this important moment in the growth of a family-owned company the transition from a "sibling partnership" to a "cousin collaboration."

This shift poses important governance issues. At the cousin stage, a family business's governance system is likely to go through a substantial, radical change. The ownership group will have important decisions to make that will shape the way the business is managed—well into the future.

Succession is often misunderstood. Most think of it as simply the passing of a leadership position from one person to another. While that may be true when the business is young, it badly underestimates the extent and complex nature of succession from the sibling to the cousin stage. At this point in the life of the family-owned business, the entire governance system should be preparing for continuity. There is an opportunity to make decisions about the design of the board of directors and the leadership of the board. The succession process should take into account the chair of the board's responsibility and the process through which decisions in the family-owned business are made.

Rather than being an event that takes place in the time it takes to change the nameplate on an office door, succession is a dynamic, ongoing process, and should be started sooner rather than later.

The nature of change

As ownership moves from a smaller group of siblings to a larger group of cousins, the basic assumptions about governance change dramatically. A few examples are given in the table below.

	Sibling Partnership	Cousin Collaboration
Positions	Partitioned among family members so each has his or her own turf	Open for any qualified person
Involvement	Everyone has a role; all senior positions held by family members	Not everyone is interested or qualified; some positions held by non-family members
Preparation	On the job, after the fact	A program run by family council prepares a person for governance roles
Evaluation	If any, very informal	Formal system based on merit and results
Compensation	Presumed equal. Variations based on negotiations among siblings	Merit system based on external market data
Family Leadership	Ill-defined and informal	Defined positions and formal selection
Decision-Making	Consensus	Democracy, including non-family outsiders

A dramatic shift in business operations

It is easy to see why so many family-owned businesses are sold at this stage of their life cycle. The extent of change that is needed can be intimidating. Those in a position to take over the business may not care as deeply about its future and may choose to sell.

The system converts from an informal one, led by a team of owner-operators, to a formal one led by family governors. Because the shift is so foreign to the incumbents, it will likely require an external change agent and perhaps a task force of disinterested people to educate the family on the nature of the change and to overcome the expected resistance. The members of the task force may include, for example, a consultant, an independent director or two, a member of the organization such as the human resources director, and two or three family members with no expected role in the new governance system.

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The family owners and the succession task force must make many fundamental decisions about the design of the new governance system. Here are some typical questions they might face.

- **Encourage or restrict family participation?** Is the family more worried that there will be too few family members taking on roles or too many who are not qualified?
- **Separate or combined governance roles?** This discussion is guided in part by the perception of family members who are interested in serving the business and qualified to do so. It is also influenced by views on separating the CEO and chairman roles in the business, as well as the "chairman" role in the family vs. chairman role in the business.
- **Elect or select positions?** Should candidates be slated so there is only one choice proposed, or is it better to choose among multiple candidates?
- **Professional or volunteer?** Should governance positions receive compensation, or perks, or no extra remuneration?
- **Rotation or stability?** Should roles rotate among family members, or should effective incumbents remain in their positions for a long time?
- **Larger or smaller board?** A large board allows more participation, while a smaller board improves group effectiveness.
- **Insiders or outsiders?** The mix of family and nonfamily board members is a decision that has enormous implications for the direct involvement of family members over time.
- **Pre-qualified capabilities or on-the-job training?** Should people prove themselves before they serve on the board, or should they have the opportunity to learn on the job? The family can also consider subsidiary boards, family committee participation, and junior (shadow) boards for development.

The evolution of family business governance

At certain stages—and the transition of ownership from siblings to cousins is the most important—business or family growth will become exponential. All family businesses eventually face this reality.

Change in the size of the family is one of the most important factors driving the evolution of family business governance. As a company grows, it becomes increasingly complex, creating its own demands for a more formal organizational structure. Adapting governance practice to the emerging needs of families and businesses as they grow can be a very complex and challenging job. It is also unavoidable.

There are governance assumptions a family must face and decisions it must make as it moves from an informal sibling governance system to a more formal cousin collaboration. Recognizing that these issues exist and launching a careful exploration of them when the time is right can be an important step in ensuring a successful future for a family-owned business. FB

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