

# Family Governance

*Maintaining Family Connectivity, Collaboration, and Continuity*

**Prepared by:**

Michael C. Morrone  
*Associate Director,  
Relationship Management*

Patricia M. Armstrong  
*Managing Director,  
Family Dynamics*

**In This White Paper:**

|   |   |
|---|---|
| Introduction                              | 1 |
| Family Governance Defined                 | 1 |
| A Comprehensive View of Family Governance | 1 |
| Conclusion                                | 4 |
| Appendix                                  | 5 |

# Family Governance

## *Maintaining Family Connectivity, Collaboration, and Continuity*

*A family governance system can help your family navigate the challenges of family, business, financial and legacy continuity. A structure that is inclusive enough to serve the current generation and flexible enough for the needs of future generations can position your family to thrive, now and in the future.*

### Introduction

As families grow, the development of a family governance system becomes a critical component of the family's plan for managing its wealth for the succeeding generations. Without effective family governance, many families are unable to preserve their wealth beyond the third generation. This unraveling of a family legacy tends to follow a familiar path: the first generation creates the wealth; the second generation preserves the wealth; and the third generation spends the wealth.<sup>1</sup>

Size and complex family dynamics are key risk factors that can lead to a breakdown in communication, ineffective decision making and ultimately, the kind of frustration and conflict that may lead to a desire to dissolve the family enterprise. Family governance provides a blueprint for navigating these complexities through the application of agreed-on principles, policies, and practices. In essence, family governance describes the process of joint decision making that a family chooses to adopt based on their unique needs and characteristics.

### Family Governance Defined

Family governance can serve your family as a system, a process and a tool. As a system, it can manage family members' competing and interrelated interests, defining roles and boundaries and supporting the family's collective vision. As a process, it can help your family make decisions based on a shared sense of values, mission and vision. As a tool, it can help your family recognize and manage specific family, wealth and enterprise dynamics.

In a family governance context, your family is more than a group of biologically related people. A family might include both immediate and extended family, in-laws, individuals separated by divorce, adopted children, domestic partners and trusted family advisors.<sup>2</sup> The right family governance structure balances the dynamic interests of your uniquely blended family unit and its businesses and other holdings.

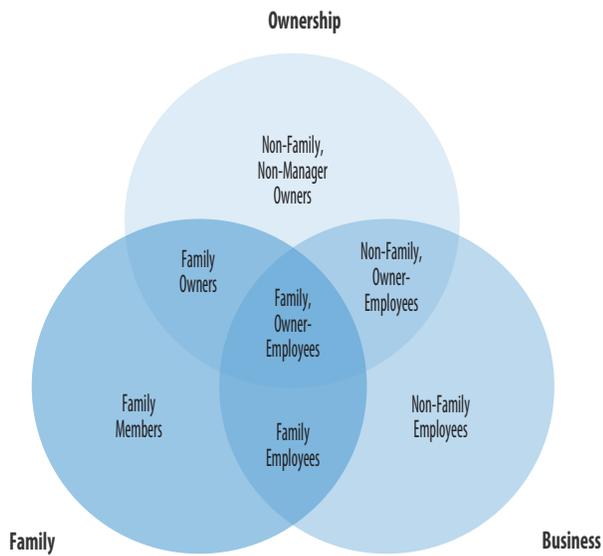
Family governance can help your family address and manage the following issues:

- How will we preserve our family and its wealth?
- How will we address family and wealth dynamics?
- How will we make decisions together?
- How, what and to whom will we communicate?
- How will we encourage stewardship and discourage entitlement?
- How will we develop future leaders?
- How will we transition control of our wealth from one generation to the next?
- How will we develop our human and intellectual capital?
- How will individual family members interact with the family enterprise?
- How will we determine the appropriate boundaries between family and family enterprise owners?

### A Comprehensive View of Family Governance

Every family contains smaller groups that have both overlapping and competing interests. Effective family governance systems serve, manage and balance those interests. Figure 1 depicts these overlapping groups. As you build a family governance system, be aware of each group's roles, objectives and concerns. Individuals and groups feel included when you consider their needs.

**Figure 1: Micro Constituent Groups**



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### ***Foundations of a Family Governance System***

Human and intellectual capital is just as important as financial capital to a family's success over time. Consider implementing programs to:

- Satisfy each family member's basic human needs.
- Ensure that each family member understands the governance system and his or her roles within it.
- Emphasize the value of work in realizing individual happiness.

To develop your family's intellectual capital, consider a governance system that:<sup>3</sup>

- Creates channels to collect and share information efficiently and appropriately.
- Provides leadership incentives.
- Helps develop younger generations into family leaders.
- Relays your family's history and values.
- Sparks and develops interest in your family's history and goals.
- Mentors family members through life experiences and helps forge bonds among family members.
- Promotes intellectual diversity.

A family that enhances its human capital is better positioned to identify family members' individual strengths and use its financial capital to develop these resources. Families get a double return on investment: individuals add to the family's wealth, rather than simply extracting it, and

individuals gain the resources to achieve their own goals independently of the family.

A governance system based on these foundations helps your family interact efficiently, equitably and cordially. It discourages entitlement and consumption by teaching family members to create their own wealth. When new generations have independent resources, your family is more likely to both perpetuate its wealth and value the education and other experiences that help younger family members grow toward economic independence.

### ***Constructing a Family Governance System***

Your family's governance system should be customized to meet its objectives. It requires voluntary buy-in from family participants. The construction process is ideally both a short- and long-term process that involves compromise, open dialog, frequent analysis and ongoing education. Your family governance system should be a living entity, one that builds on family tradition but can be amended as your family evolves.

Abbot Downing's comprehensive wealth planning process helps families understand and develop effective governance systems.

The first phase of this process is designed to map out your family's complete architectural design, encompassing its individuals, entities and sources of wealth. Presenting the current architectural framework enables your family, as well as your trusted advisors, to have a clear understanding of the entire landscape. Once defined, your family has a baseline from which to work to build upon areas of strength and address areas of weakness. Performing this exercise entails producing the following deliverables:

- Goal discovery and data gathering
- Family organization
- Estimated net worth statement with supporting financial summaries
- Estate flow diagrams
- Legal document highlights
- Illustration of family entity ownership
- Values clarification
- Preliminary observations

Abbot Downing, in conjunction with a family and its advisors, typically creates a family tree and diagrams of your family's legal and financial architecture.

- **Family tree.** The family tree illustrates the lineal descent and shows the members of each generation including spouses, ex-spouses and their respective children. The family tree can be expanded to include information such as shared values; strengths of each family member; and wealth dynamics such as which

family members are wealth stewards, beneficiaries, employees of the family business, and contributors to decisions that affect the family's wealth. This information can help your family select trustees, appoint board members of family entities, determine membership on family governance bodies, identify family leaders and stewards, manage expectations, and deal with intra-family conflict.

- **Family legal architecture diagram.** A family's legal architecture consists of various legal entities, such as partnerships, corporations and trusts. A legal architecture diagram can help your family understand how the various family entities fit together and affect one another. Your advisors can use this diagram to find potential gaps and determine how family governance programs can best operate in conjunction with legal entities.
- **Family financial architecture diagram.** By identifying assets within each legal entity, your family gains further insight into its current financial affairs. Your advisors can then offer cash flow analysis, estate disposition and global asset allocation to help you determine the best ways to deploy financial resources to develop human and intellectual capital.

In the next phase, we educate families on the purpose of family governance. We hope to:

- Spark conversation.
- Generate a sense of inclusion.
- Solicit feedback from family members.
- Allow individuals to become comfortable with the idea of governance.
- Help your family assess its leadership needs and determine future family leaders.
- Assess family governance needs and work with you to devise the most appropriate system.

This process helps your family and advisors prioritize your family's governance needs, determine the most appropriate programs and then implement successful governance.

### *Components of a Family Governance System*

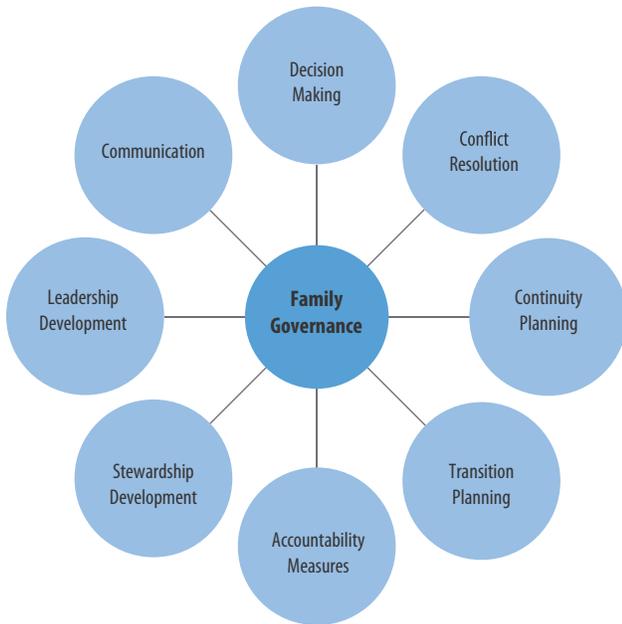
A family governance system relies on programs designed to achieve specific outcomes. These programs operate as a family's strategic roadmap and include principles, agreements, policies, plans and entities.<sup>4</sup>

The family assembly and family council are the most popular family governance entities. For smaller families or families that are new to forming a governance system, these two entities may be the same.

- **Family assembly.** The family assembly can involve all family members, key members only, or members who are old enough to understand and participate in the governance process. The family assembly typically operates as the legislative branch of the governance system, initiating governance programs and discussing policy and procedure.<sup>5</sup> If the family also creates a family council, the assembly serves as the ongoing candidate pool.
- **Family council.** As a multigenerational family of wealth expands, an elected family council may become the most efficient governance entity. The family council manages family business, developing future generations, regulating family members' involvement with the family's business ventures, and aligning the business with the family's goals and objectives.<sup>6</sup> It operates as an executive and legislative hybrid entity, devising, managing and executing various protocols to achieve long-term success.<sup>7</sup>
- **Judicial entity.** Your family may also use a judicial entity to resolve family conflicts and offer advice that reflects the family's shared goals and values.<sup>8</sup> Families often create a judicial entity comprised of either family elders or key family members who enjoy general family respect. They work to resolve family conflicts that cannot be addressed by the governance system's established conflict resolution programs, and their decisions are final.
- **Subcommittees.** Some families create subcommittees to focus on specific areas of interest and importance, such as development of the next generation or the design of family retreats. Subcommittees typically fall under the family council's jurisdiction. These forums develop and harness the family's human and intellectual capital by focusing on individual family members' interests. By expanding the overall system's reach, subcommittees can help family members feel a sense of inclusion, purpose, excitement, engagement and accessibility in their relations with the family.

The model illustrated in Figure 2 may help your family develop its governance system. The model is designed to be both comprehensive and dynamic so as to address the needs of all families.

**Figure 2: Family Governance Model**



## Conclusion

A family governance system is a key part of a comprehensive plan for managing wealth within families. A successful governance system can be instrumental in equipping your family to navigate the challenges of family, business, financial and legacy continuity. Creating a structure that is inclusive enough to serve the current generation, yet flexible enough to be embraced by future generations is a crucial task for multigenerational families who hope to sustain and preserve wealth for generations to come.

## Endnotes

- <sup>1</sup> Hughes, James E., Jr., *Family Wealth—Keeping It in the Family: How Family Members and Their Advisers Preserve Human, Intellectual, and Financial Assets for Generations*, New York: Bloomberg Press, 2004, p. 3.
- <sup>2</sup> Angus, Patricia, *Family Governance: A Primer for Philanthropic Families*, National Center for Family Philanthropy, p. 2.
- <sup>3</sup> *Ibid.*, p. 37.
- <sup>4</sup> *Ibid.*, p. 3.
- <sup>5</sup> Hughes, James E., Jr., *Family Wealth—Keeping It in the Family: How Family Members and Their Advisers Preserve Human, Intellectual, and Financial Assets for Generations*, New York: Bloomberg Press, 2004, p. 173.
- <sup>6</sup> Jaffe, Dennis T., “Strategic Planning for the Family in Business,” *Journal of Financial Planning*, March 2005, pp. 2-3.
- <sup>7</sup> Hughes, James E., Jr., *Family Wealth—Keeping It in the Family: How Family Members and Their Advisers Preserve Human, Intellectual, and Financial Assets for Generations*, New York: Bloomberg Press, 2004, p. 174.
- <sup>8</sup> *Ibid.*, pp. 174-175

## Appendix

**Table 1: Model Detail**

| Topic                          | Objectives   | Governance Tools  |
|--------------------------------|--|---|
| <b>Communication</b>           | <ul style="list-style-type: none"> <li>■ Disseminate Information</li> <li>■ Educate and Inform</li> <li>■ Create Transparency</li> <li>■ Promote Unity</li> <li>■ Promote Inclusiveness</li> <li>■ Limit Conflict</li> </ul>   | <ul style="list-style-type: none"> <li>■ Meetings</li> <li>■ Retreats</li> <li>■ Family Website</li> <li>■ Family Assembly</li> <li>■ Disseminate Meeting Minutes</li> <li>■ Disseminate Meeting Agendas</li> <li>■ Family Newsletter</li> </ul>  |
| <b>Decision Making</b>         | <ul style="list-style-type: none"> <li>■ Promote Efficiency</li> <li>■ Spark Debate</li> <li>■ Educate and Inform</li> <li>■ Address Conflicts</li> <li>■ Defuse Intra-Family Politics</li> <li>■ Promote Equitable Results</li> <li>■ Facilitate Conflict Resolution</li> </ul>   | <ul style="list-style-type: none"> <li>■ Bylaws</li> <li>■ Family Constitution</li> <li>■ Meetings</li> <li>■ Family Council</li> <li>■ Family Assembly</li> </ul>  |
| <b>Conflict Resolution</b>     | <ul style="list-style-type: none"> <li>■ Resolve Control Issues</li> <li>■ Manage Rivalries</li> <li>■ Resolve Disputes</li> <li>■ Promote Efficiency</li> </ul>   | <ul style="list-style-type: none"> <li>■ Mediation</li> <li>■ Arbitration</li> <li>■ Judicial Entity/ Elders Council</li> <li>■ Family Constitution</li> <li>■ Bylaws</li> <li>■ Meetings</li> </ul>  |
| <b>Continuity Planning</b>     | <ul style="list-style-type: none"> <li>■ Preserve Values and Goals</li> <li>■ Preserve History and Traditions</li> <li>■ Develop Human Capital</li> <li>■ Develop Intellectual Capital</li> <li>■ Promote Stewardship</li> <li>■ Create 1st Generation Mentality</li> <li>■ Deter Consumption of Wealth</li> <li>■ Deter Sense of Entitlement</li> </ul> | <ul style="list-style-type: none"> <li>■ Continuity Plan</li> <li>■ Education Programs</li> <li>■ Family Retreats</li> <li>■ Family Constitution</li> <li>■ Mission Statement</li> <li>■ Vision Statement</li> <li>■ Chronicle History</li> </ul> |
| <b>Transition Planning</b>     | <ul style="list-style-type: none"> <li>■ Determine Leaders</li> <li>■ Deal with Transition</li> <li>■ Manage Relinquishing Control</li> <li>■ Deter Consumption of Wealth</li> <li>■ Deter Sense of Entitlement</li> </ul>   | <ul style="list-style-type: none"> <li>■ Transition Plan</li> <li>■ Education Programs</li> <li>■ Seat on Family Council</li> <li>■ Family Constitution</li> <li>■ Bylaws</li> <li>■ Employment Policies</li> </ul>                               |
| <b>Accountability Measures</b> | <ul style="list-style-type: none"> <li>■ Deter Sense of Entitlement</li> <li>■ Create 1st Generation Mentality</li> <li>■ Deter Consumption Mentality</li> </ul>   | <ul style="list-style-type: none"> <li>■ Education Programs</li> <li>■ Continuity Planning</li> </ul>   |
| <b>Stewardship Development</b> | <ul style="list-style-type: none"> <li>■ Promote Accountability</li> <li>■ Preserve History and Tradition</li> <li>■ Deter Sense of Entitlement</li> <li>■ Create 1st Generation Mentality</li> <li>■ Deter Consumption of Wealth</li> <li>■ Harness Human and Intellectual Capital</li> </ul>   | <ul style="list-style-type: none"> <li>■ Education Programs</li> <li>■ Mentor Programs</li> <li>■ Seat on Family Council</li> </ul>   |
| <b>Leadership Development</b>  | <ul style="list-style-type: none"> <li>■ Promote Accountability</li> <li>■ Facilitate Continuity Planning</li> <li>■ Facilitate Transition Planning</li> <li>■ Harness Human and Intellectual Capital</li> <li>■ Create 1st Generation Mentality</li> </ul>  | <ul style="list-style-type: none"> <li>■ Mentor Programs</li> <li>■ Internships</li> <li>■ Education Programs</li> <li>■ Employment Policies</li> <li>■ Governance Documents</li> <li>■ Seat on Family Council</li> </ul>                         |

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