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### “Corporate Governance in Family Business”

What is this thing called, “Corporate Governance?”

If you search the Internet you will find a variety of descriptions that speak of a system by which companies are directed and controlled. Some describe it as a process, a collection of customs and policies that affect the way a corporation is administered or controlled, while others describe it as the relationships among the stakeholders, shareholders, Executives, Board of Directors, employees and customers.

None of these descriptions include, “Ask you mother, your grandfather or Uncle Ahmet,” or “Because I said so,” yet that can be, and often is the control mechanism in family businesses. Someone in authority commands or decrees that it be so

In family business, there is a *clearly defined but invisible* control mechanism or governance structure called the “family system.” Some might call it the psychology of the family. What is clear is that one can craft an elegant business solution to business problems but in family business, the keys to implementation are *ALWAYS* locked up in the psychology of the family. Failure to pay attention to creation of the right solution and to the family psychology and nothing happens. Thus, it is useful to understand family systems theory, another name for the family psychology and the behavioral messages in your family system.

#### FAMILY SYSTEMS THEORY

Murray Bowen, M.D., a psychiatrist, studied at the internationally re-known Menninger Clinic in Topeka, Kansas and then at Georgetown University. He first studied schizophrenics and found that when he worked with them on an individual basis, he could get them to function more effectively but when they returned to their families of origin, they reverted to the less functional, schizophrenic behavior. This was Bowen’s “Ah ha!” moment for it caused him to recognize that there were forces in the family that precipitated this behavior. Here is a simple description of his family systems theory:

1. **A family is a system.** There are clear boundaries of who is a family member in the system and who is NOT a family member. There is a line drawn that determines family – on one side you are in the family and on the other side, you are something else but **“Not one of us.”**
2. **The family system contains rules or strong messages for behavior.** The rules can determine who is in charge, who makes what kinds of decisions, who will go to university, gender roles, how money is used or distributed, who gets favored or special opportunities...it is an unlimited list of rules for everything. To understand this better, take time to jot down in the margin, a list of decisions in your family and how they are made. Are you on the “inner circle” for decisions or is there someone who is always favored? You might find that when major financial decisions are made, the real decision maker is not who you might expect it to be. This will be the beginning of your understanding your family system and what *really* governs your family.
3. **We can and we do learn other behavioral messages than those of our family.** This means that one can go to university and achieve advanced degrees in business, then work effectively for years in business, using the knowledge, skill and experience we have acquired. Some of the behavioral messages of our family of origin contradict the things we learn outside the family and we learn to set those contradictory family patterns aside. Further, we are working with people from other families who have different family patterns so, as a group

of colleagues; we focus on and use International Best Practices for Business, not the individual family pattern.

4. **When we as individuals or as a family are under stress, we are at risk of reverting to the pattern of our family, UNLESS we learn to recognize the ineffective family pattern and actively avoid reverting to that pattern.** This is the key to understanding the family systems theory and how it comes into play in family businesses. You may have a collection of family members, all of whom are well schooled, trained and experienced in business and function well independently. Then, when they all get together and are under stress, the entire group is at risk of reverting to the less effective family pattern rather than use the “International Best Practice” that they know so well.

An example might be the family pattern of upward delegation to father or mother. “You will have to ask your father,” is an example of upward delegation. International Best Practice tells us that decisions must be delegated downward in the organizational structure to the lowest possible level. Put the decision at the level where it must be addressed; with the people who must solve the problem.

When a family has the “upward delegation” pattern, and they revert to using it, a bottleneck is created in the decision structure. This means that decisions are often delayed, don’t get made or are made without full knowledge and command of the facts. The business ends up with a poor decision. Why? Because the family members reverted to the family pattern and did not use International Best Practices for Family Business they must settle for a less than optimum outcome. They did it to themselves!

Some family system messages actually compliment or enhance the business operation. This could be a family pattern of expecting members to work hard, do the job expeditiously and do it correctly. These are behaviors every employer wants in an employee. On the other hand, the family message that says you only do something if and when you want to do it is the total opposite of what any employer wants in an employee. In fact, such behavior will get you fired in most businesses!

#### **International Best Practices in Family Business and Corporate Governance -**

The family businesses that have been sustained over the generations have an internal governance structure that parallels the structures found in leading businesses around the world. Such structures provide an internal discipline on how family and non-family members will function within the business. The role of family business professionals is to assist in professionalizing the way the family business operates. This starts with proper corporate governance that includes the following:

**Board of Directors** – The Board must be populated with persons of genuine business relevance to the corporate purpose who have proven competence to function in the role. It is generally a mistake to put on the Board a professional whose services you would normally pay to have. Thus, it is not recommended to put the corporate lawyer or accountant on the Board. Buy their expertise when required but don’t let them occupy a seat on the Board. Further, cronies have no place on the Board, no matter how close the friendship or important they might be. The ultimate criteria for the Board must be their ability to make quality contributions to the decision-making that pertains to the business itself and to the fiscal stability of the company.

The Board sets the policy and direction of the company and is responsible for the selection, hire/fire and setting the compensation of the President/CEO. The Board reviews and approves the President’s over all strategy for achieving corporate goals.

There should be a number of robust, highly functioning committees within the Board. At a minimum, these include:

- Nominating Committee.
- Compensation Committee, with specific responsibility for setting President's compensation and evaluation of President's performance.
- Audit, Finance and Risk Management Committee.
- Strategy Committee.

**Chairman of the Board** – In family business this position is filled by the shareholders, which are all or predominately family members. The Chairman is responsible in leading the Board of Directors in the execution of their responsibilities. Some progressive families select a chairman who is not a family member but has a profile of special skills to serve in this capacity.

**President or Chief Executive Officer** – Is selected by and accountable to the Board of Directors. President, with his team of executives creates a corporate strategy for achieving corporate goals and ROI – return on investment, or ROMA – return on managed assets, or other measurable performance criteria. The President is accountable to the Board, who assess his/her performance and effectiveness in achieving corporate goals. The President is responsible for assembling a team of professionals that can implement the strategy.

**Chief Financial Officer** – is responsible and accountable to the President/CEO. CFO directs and oversees all financial activities of the corporation including preparation of current financial reports, cash management as well as summaries and forecasts for future business growth and general economic outlook.

**The Family Business Council** – Many families find it effective to create a forum where business can be discussed, where family members can be educated about business matters. Whether called a council or forum, it is clear that this is neither a place for discussion of operation of the business nor a place where decisions about the business are made. Some families use this structure to improve communication within the family, to build on and enhance the family values that are the glue for the family as well as to teach specific things such as finance, charitable giving, personal money management and other issues relevant to raising responsible adults.

Each of the roles described in the Corporate Governance carries clear job descriptions, with very specific authority, responsibility and accountability. In the forum/council family members learn that they must observe and respect the corporate governance.

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