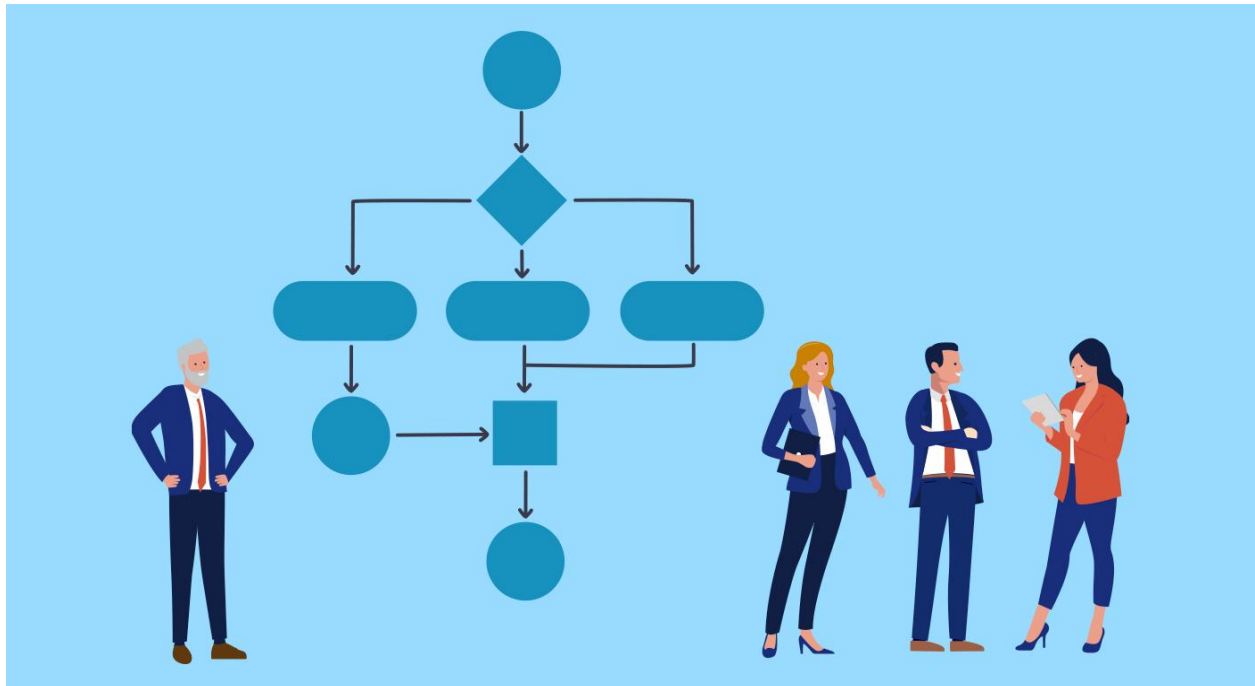
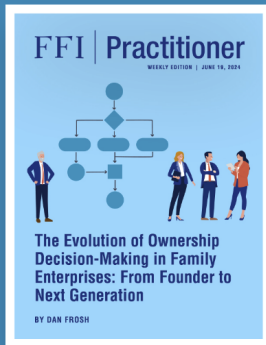


GOVERNANCE

The Evolution of Ownership Decision-Making in Family Enterprises: From Founder to Next Generation

WEEKLY EDITION • JUNE 19, 2024





From FFI Practitioner

For family enterprises, passing ownership from the founder to the next generation represents a critical transition that requires careful planning to help the family prepare for increasingly complex decision-making processes. Thank you to this week's contributor and FFI Fellow Dan Frosh for his article that explores key considerations and strategies for advisors to help their clients manage this transition effectively.

In family enterprises, the transition of ownership and decision-making from the founding generation to the next is a critical juncture.

This evolution involves a shift from centralized, founder-led control to a more distributed form of ownership and governance. Family enterprise advisors play a vital role in guiding families through this complex transition process.

Family owners have the ultimate responsibility for guiding the future of their enterprise and are empowered to make important decisions to grow its *value*—be it economic, social, reputational, or relational value. Among the most important decisions that owners must excel at making to grow the value of the enterprise include:

1. Setting the **Strategic Vision** for the enterprise, including defining what the family wants to achieve and collectively own.
2. Making prudent bets on **Capital Investments**, including when to get out of bad bets and how best to allocate capital across the portfolio of jointly held assets and opportunities.
3. Making good bets on **Key People and Talent**, as well as knowing when to move on from an ineffective hire, which can be especially difficult for family businesses.
4. Setting, protecting, and adjusting the **Culture** so that it reflects the family's values, fosters innovation, and contributes to the family's reputation and legacy.
5. Designing the right family enterprise **Governance** structures, practices, and policies to foster effective decision-making and clarify roles, responsibilities, and rights for the key stakeholders.¹

To successfully keep pace with the accelerated rate of changes in today's turbulent world and to stay ahead of the curve when making these critical decisions for the future of the enterprise, designing an effective and efficient ownership decision-making process is a requisite. When authority resides in a unitary founder, this decision-making process is often straightforward. However, this imperative ownership function can become much more complicated when this authority passes to multiple owners in the next generation.

This article explores key considerations and strategies for advisors to help their clients to manage this transition effectively, helping to ensure the longevity and success of their family enterprises.



“FAMILY OWNERS HAVE THE ULTIMATE RESPONSIBILITY FOR GUIDING THE FUTURE OF THEIR ENTERPRISE AND ARE EMPOWERED TO MAKE IMPORTANT DECISIONS TO GROW ITS VALUE—BE IT ECONOMIC, SOCIAL, REPUTATIONAL, OR RELATIONAL VALUE.”

Distributed Ownership and the Need for Collaborative Decision-Making

The founding generation often experiences unitary ownership control of the family business, with a single individual or spousal couple responsible for making significant ownership decisions. As ownership of the business transitions to the next generation, it often gets distributed among multiple siblings in the second generation. This shift in ownership dynamics can lead to new challenges, including the need to align diverse interests and maintain effective communication to achieve a collaborative process.

Involving multiple owners in decision-making requires creating processes that foster appropriate collaboration and inclusivity of potentially diverse perspectives. To help achieve this collaborative environment, advisors can help their family clients to develop a cohesive team of future sibling owners prior to the transition of ownership. This can potentially be accomplished through the development of a collective owners' vision for the future of the enterprise that is based on the family's core values. Additionally, providing opportunities for future next-generation owners to work together on meaningful projects can also help teach a team of siblings how to work and communicate effectively with each other.



"Future-Ready Shareholders Agreements to Help Family Enterprises Navigate Turbulent Times"

FFI Practitioner
By: Dan Frosh

In today's turbulent world, family enterprise owners must become more agile to keep up with increasing rate of change. Implementing future-ready shareholders agreements can help family enterprise clients by providing better flexibility and protections for family owners. This article explores the benefits of family enterprise shareholders agreements and provides several suggestions to discuss with your clients.

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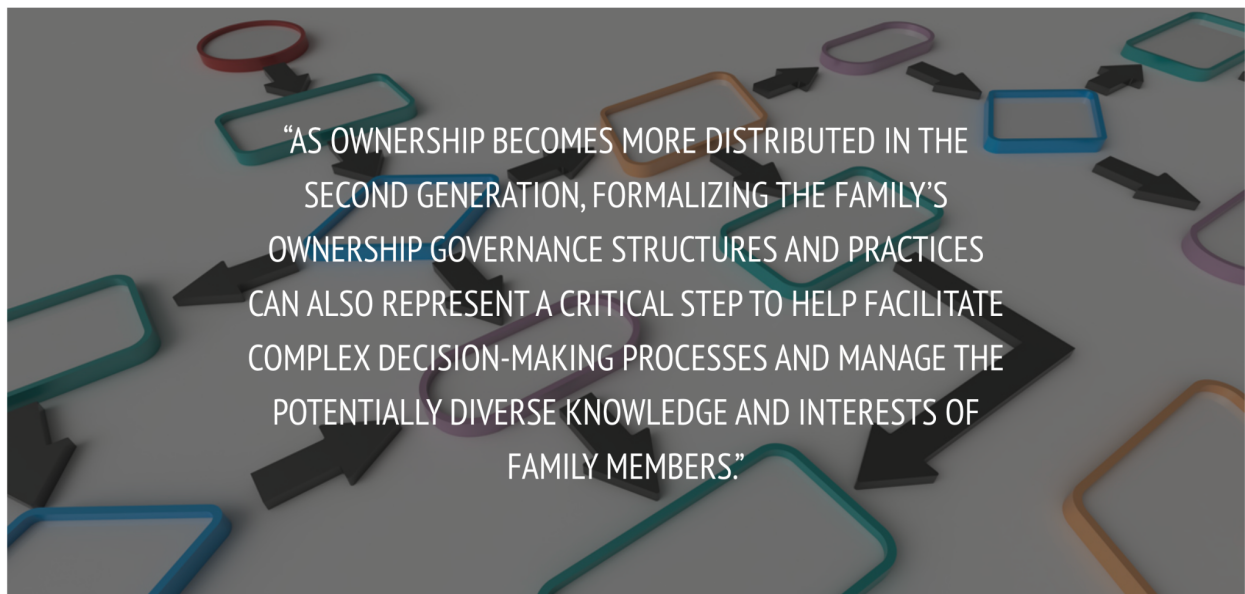
Involving Family Members Not Active in the Business

A defining characteristic of the founder generation is that the controlling owner is often deeply involved in the day-to-day management and operations of the business. However, by the second generation, it can be common for some of the founder's children not to be as actively engaged in the operations of the business—either due to increasingly siloed roles inside the business or due to their pursuit of career paths outside the family business.

Family members who are not actively involved in the business can form a distinct group within the sibling cohort, often with significantly less knowledge about daily operations or the challenges confronting the business. Effective information-sharing processes and forums for discussing high-priority matters become increasingly necessary and advisors can have an important role in helping family clients to design effective methods of sharing easily digestible information. One option may be for an advisor to help the family to design an owners' dashboard—a comprehensive, visual tool designed to provide family owners with a clear, real-time overview of key performance metrics and critical information about the business. It serves as an effective communication and decision-making aid, helping family members—especially those not actively involved in day-to-day operations—stay informed about the health and performance of the business.

Formalizing Ownership Governance

As ownership becomes more distributed in the second generation, formalizing the family's ownership governance structures and practices can also represent a critical step to help facilitate complex decision-making processes and manage the potentially diverse knowledge and interests of family members. Introducing new governance forums, such as an owners council, can serve as a forum for the family owners to discuss and debate important ownership matters as well as to receive regular updates about the performance of the business or other collectively owned investment activities.



Additionally, family enterprise advisors should encourage their clients to update their ownership agreements to ensure they effectively address the increased complexity among the sibling partners, including establishing clear decision-making criteria to guide the sibling owners. This involves developing an agreed-upon set of rules and procedures for making major decisions, such as defining approval thresholds, consensus-building processes, and creating a clear delegation of authority between the owners, the board of directors, and management.

With multiple owners involved, the potential for conflicts increases. Ownership agreements often need to be updated to include effective conflict resolution mechanisms and deadlock provisions, which can be essential to maintaining harmony and avoiding litigation. Mediation, arbitration, and structured conflict resolution processes can provide frameworks for resolving disputes amicably. Advisors should work with families (and their attorneys) to update their ownership agreements as part of their preparation for the eventual generational transition.

Conclusion

The evolution of ownership decision-making from a founder to the next generation in a family enterprise is a complex process that requires careful planning and strategic guidance. Family enterprise advisors play a crucial role in helping families navigate this transition by promoting collaborative decision-making, formalizing governance structures, clarifying roles and responsibilities, and implementing effective conflict resolution mechanisms. By addressing these key considerations, advisors can help ensure that family businesses thrive across generations, maintaining their legacy and achieving long-term success.

References

¹ Davis, John A. n.d. "Families Today Must Think Like Owners." *Cambridge Family Enterprise Group*. Accessed June 12, 2024.
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About the Contributor



Dan Frosh, FFI Fellow, is an attorney and senior advisor with Cambridge Family Enterprise Group. His areas of focus include developing effective governance practices and structures, holistic estate planning, succession planning, and the ownership dimension of family companies. He speaks and teaches on family business topics at conferences and academic institutions and serves as a facilitator in the family enterprise programs at the MIT Sloan School of Management. He is a current member of the FFI board of directors and serves as the managing editor for *FFI Practitioner*. He can be reached at dfrosh@cfeg.com.

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