# The Difference Between Family Governance and Business Governance

Governance may be the least understood or most misunderstood concept when applied to family businesses. Governance is commonly associated with boards of directors as if understanding what a board of directors does means you also understand governance. More recently, governance is associated with a family, suggesting that what a board does also applies to the family or that some group must interact with the family in a manner similar to a board of directors. Some have even suggested that each of the primary groups involved with every family business (that is, family, owners, and managers) requires governance.

This article provides a functional definition of governance for private businesses (as opposed to public companies) and distinguishes the roles and responsibilities of governance from the roles and responsibilities of the family, ownership, and management.

Governance Defined. The dictionary does not provide much help. There are challenges to identify a working and practical definition of governance. To do this, let's start by looking at the most simple case. That is, a successful family business in which the founder is actively involved in all of the key decisions.

Dan founded Mobair Technologies 15 years ago to market some innovative telecommunication software he created while serving in the Army's signal corp. Dan's proprietary software gave him a foothold with several large, innovative telecommunication companies, with a strong personal relationship he established with key decision makers in these companies. Plus his ability to modify his technology to support the innovations created by his customers helped Mobair Technologies grow to $80 Million in annual revenue and 165 employees.

Pete is the sole owner and President of Bedford Electronics which he founded 12 years ago. Bedford's annual revenue exceeds $10 Million and employs more than 40 people. Pete believes in paying his people market wages and sharing the company's profits with them. As a result, he has an incentive plan that allocates half of the company's profit among its employees based on seniority and productivity factors. Faced with ever continuing competitive factors, however, Pete finds himself determining how much of the profits of his company he should reinvest in research and development, expansion, and employee leadership and development training vs. payments to himself and bonuses to his employees. An opportunity to acquire two new products from a competitor going out of business brought this issue to a head.

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If governance exists in every business, it must be evidenced in the simplest business structure consisting of a single person who owns the business and is a single employee. Further, references to governance would suggest that it is different than ownership and management. If that is the case, then what governance functions does a sole owner of a corporation employing that sole owner as his only employee perform? And how is that governance function different than what that person does as an owner and as a manager of the business? Everyone who owns a business has at least one reason for doing so. Usually, one reason is to make money. Perhaps not all of the money the person can make and perhaps making money is not the first of among many reasons, but some level of financial return is a reason for business ownership. Further, every manager of a business realizes that the business requires investment in time and money to grow and make money. In good times, the investment made in a business provides enough profit to meet the financial return desired by the owner. In not so good times, the financial needs of the business may exceed what the business can provide to the owner. When that happens, the owner decides to live with less or as a manager, nurture the business with less to provide the owner with more. Success in these more difficult times depends on how the financial needs of the owner and those of the business are balanced.

In the simplest form, the act of balancing the interests of the owners and the interests of the business is governance. This balancing exists in every business. Defined in this way, balancing is also different than ownership and management. The owner determines the reasons he or she owns the business, identifying his financial and non-financial reasons for continued ownership. As the manager, he or she identifies the needs of the business and works to provide those needs and to meet the expectations he or she has as the owner. This person regularly evaluates whether his/her interests as an owner and the interests of the business are aligned. If they are not, he/she makes adjustments with respect to the business, his/her expectations as an owner, or both in order to somehow and in some way balance his/her personal interests and the interests of the business so as to provide what each needs.

Governance therefore requires an understanding of what the owners want and what the business needs, the ability to evaluate whether the interests of the owners and those of the business are the same or different, and the ability to work with either the owners or management or both groups to adjust their respective interests so the interests of the owners are aligned with the interests of the business.

Someone is doing this balancing in every business. In a business that continues to involve the founder, the founder usually is the person that continues to do the balancing even though there may be multiple owners and others helping the founder manage the operations. The founder continues to make the key decisions relative to ownership and management, and to ensure that the interests of those two groups are balanced.

The succession of a family business involves transitioning the founder's role in management and the founder's ownership. It also, however, involves transitioning the founder's role and responsibility of acting as the balancing point. Founders often begin to transition their involvement with the business by transitioning the responsibility in management. They begin hiring other managers and delegate more and more responsibilities for operations. Eventually, they look for opportunities to involve themselves differently in management. Some may want to work less, deciding to take time off, vacationing during the winter months, or travel. Others may want to continue working, but some want to focus on what attracted them to begin the business in the first place. Those activities might involve focusing on sales, customer relations, or research and development. At some time, transition turns to ownership. Addressing estate tax concerns is the primary driver for the transition of ownership from the founder to descendants using trusts or other vehicles. Additional motivation can be found in allocating assets among descendants in a fair and equitable manner, providing a way to allocate company profit to family members who are not working in the business, or rewarding employees for their loyalty, commitment and productivity.

Rarely do transition plans involve transitioning the balance point. Yet this seems to be the function that founders want to retain for as long as they can. Intuitively, they know that making sure that the interests of the owners and managers are aligned or in balance is a critical component to a successful company. Acting as a balance point keeps the founder in the role of being able to direct the owners and the managers to fulfill the dual purpose of meeting the needs of the owners within the capabilities of the business and seeing that adjustments are made as needed as circumstances change the ability of the company to satisfy the owners or the owners to modify their interests. There are only three choices a founder has to transition the balance point relating to the business. The founder can either transition the balance point to the owners, to management, or to a board of directors. If the balance point is transitioned to the owners, the owners have the authority to reconcile any differences that might exist between their interests and those of management. If the balance point is transitioned to management, the managers are able to reconcile any differences between the owners and the business. If the balance point is transitioned to the board, the board can be given the responsibility to either balance the interests between the owners and management or to require the owners or managers to adjust their plans so the interests of the two groups are aligned.

The balancing concept of governance is much different than the way governance is commonly viewed with public companies. Read most books on governance, and they will describe the responsibilities of the board as setting strategy, overseeing management, providing oversight, making distribution decisions, hiring, compensating, and evaluating the President and other top managers, and making policies. Very little attention is given to the role owners have relative to the governance function.

This is largely because with public companies, owners have an available market to sell their shares so owners themselves can decide whether they want to continue owning an interest in the company or not. This, of course, is not true with family businesses. Very few family businesses have an established market that allows an owner to readily sell his or her shares without impacting the profitability of the business. Further, and perhaps most importantly, owners of a family business usually do not want to sell their interests because of their desire to continue the legacy and to participate in the activity shared by the extended family. As a result, the role of an owner in a private business is much more evident and prominent and requires a system to take into account the interests of the owners not to the extent where the owners manage the business. This is not to say that owners always get their way. This is also not to say that owners manage the business or that the board should always give owners what they want. It does however, say that the interests of the owners are important and require a meaningful and deliberate response. It requires people to identify the interests of the owners, to understand it, and to provide and deliver it, and a meaningful response.

The responsibilities of the board are most always focused on management. One result of this is a board increasingly becoming involved in managing the company. While the role of the board historically may have been to manage the business, the law clearly now provides that boards have the choice to either manage the company or to oversee management. Most boards desire to oversee management, rather than actually manage the company. However, the duty to oversee management often becomes management itself without some guidance or perimeters or standard by which the board provides as oversight function. In other words, if five directors are charged with overseeing management's proposal, all five of those directors will most likely bring to the table a different viewpoint as to what is or is not appropriate. Who sets that standard? Is the standard set by management? By the directors? By the owners?

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