NEWSLETTER

Aspen Family Business Group

fall 2002

The Aspen Family Business Group—David Bork, Leslie Dashew, Dennis T. Jaffe, Ph.D., Sam H. Lane, Ph.D., Joe Paul—serves as a resource to help families create an environment in which members are open and willing to learn and grow. It is in such a setting that families are able to envision and achieve the positive possibilities of their business as well as maximize enjoyment of their family life. Our goal is for the family to develop harmonious, healthy, constructive, interpersonal relationships and to maximize the success of their family-owned enterprise.

Current Perspectives on Governance in Family Businesses

This issue of the Aspen Family Business Group Newsletter is focused on governance and boards of directors for family-owned businesses in particular. In an era when corporate governance is being examined in great depth, we believe that family and closely-held businesses can benefit greatly from a well-run board of directors. Each of the contributors offers thoughts about the value of the board, practices which support effective use of the board as well as the importance of other family organizations (e.g. family council) to the management of boundaries between the family and the business.

The challenge to boards of directors in a family business is that the role of family member, owner and employee often blur.

In an era when corporate governance is being examined in great depth, we believe that family and closely-held businesses can benefit greatly from a well-run board of directors.

A family member who serves as a director may overstep the limit and get involved in operational issues. Conflicts within the family may put board members or key (non-family) executives in awkward positions. However, when run effectively the board can help with many family and business issues. Dennis Jaffe describes principles he has found help boards work well for family businesses. Sam Lane provides guidance on how families can provide clarity of direction to the board through the process of gaining consensus and documenting their purpose, vision and values. Joe Paul examines the tasks and traits of board members and Leslie Dashew emphasizes the importance of independent directors to the success of the board.

A family member who serves as a director may overstep the limit and get involved in operational issues.

We hope the ideas presented herein will further your thinking about the importance of a board of directors and strategies to manage a board effectively.

looking ahead

November 7, 2002
Dennis Jaffe presents:
"Creating a Family Council"
Family Business Program
University of San Francisco

December 10, 2002
Dennis Jaffe presents:
"Governance Structures for Multi-Generational Family Wealth"
Multi-Family Office Conference
New York City
(February 26, 2003 in San Francisco)

January 30, 2003
Dennis Jaffe presents:
"Governance in Family Business"
Family Business forum
University of the Pacific, Stockton, CA

March 6–9, 2003
Leslie Dashew presents:
Women in Family Business Retreat
Miraval Resort in Tucson

July 31–August 3, 2003
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Balancing Family Desires with Effective Business Practices

by Dennis Jaffe, Ph.D.

Over time the business evolves to have more family and non-family owners. The Board then serves as the focus for family influence, while balancing the rights of non-family owners. In looking at families who have been able to manage the boundary between family and board in growing businesses, and conglomerations of businesses, there are six key principles for effective performance:

PRINCIPLE 1:
Business Trumps Family

The family is used to seeing the business as part of the family, but as it grows, the Board must steer the business, while providing reasonable returns to family and non-family owners. This may involve challenging certain elements in the family. The ownership concerns of family members for liquidity or diversity creates a continual tension between prudent investment, and the legacy attachment of the family to their company. If prudent business practice, does not bring the desired returns to family members, there must be an orderly exit process for family members. Some demands by family members must be kept out of the business and Board deliberations. The family may face a situation where family and business interests diverge such that the family sells their shares of the business, and diversifies into other areas.

PRINCIPLE 2:
Create an Open System

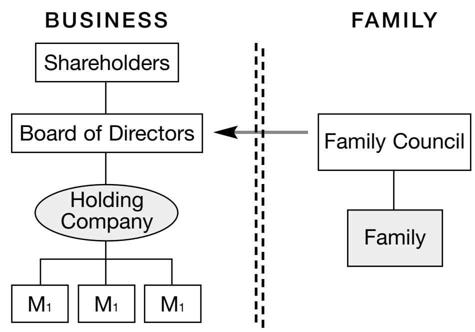
Family isolation and lack of feedback or oversight has led to disaster for some families. They may be so concerned with pleasing family members, or offering family perks, that they neglect employees and competitors. A closely-held business can be as private and insular as a family, or it can be open to input of outside directors and professional leaders.

Family isolation and lack of feedback or oversight has led to disaster for some families.

As a business grows, it can outgrow the collective capabilities of even its family management team. The challenge is to arrange a process where the family gets feedback and sustains processes for innovation and leadership. This includes performance evaluation for key family and non-family executives, and performance measures about operations and financial targets. They solicit regular feedback from executives and outside directors to make up for deficiencies in family ability. But the outsiders need authority to have their voice heard. In several recent cases, the counsel of outside board and executives did not deter the family from taking self-defeating steps.

PRINCIPLE 3:
Heed the Voice of the Family

To the outside world, the family patriarch may embody the family, but internally, the family has many voices, particularly the voice of the next generation, and several often-differing family branches. They need to handle their differences internally. Since family passions are deep and personal, the family can erupt in a divisive, public feud. Effective families create councils and other groups to channel the family voice and make policy. The family makes their voice known to the Board and management. If the family contains several branches, they need to form councils for individual families, then integrate key policies and concerns in a representative Shareholder Assembly that reports to the Board.



PRINCIPLE 4:
Continually Clarify Roles and Boundaries

An effective board is like the court of a complex kingdom, where different factions and constituencies must balance, for clarity of direction and focus for the company. There is always a tension between family and company interests, and the board must be active and creative in balancing them. First, it must represent family owners, by input from the family council, and by appointing family representatives. Outside directors take on roles as mentor, advisor/resource, friend, steward, politician, or market influence. The Board must recruit and evaluate the performance of key executives; if they are family members this can be difficult.

Effective families create councils and other groups to channel the family voice and make policy.

The Board must exercise its authority, while realizing the limits of its role, not to micro-manage. Family members must understand that their roles may differ, and

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Balancing Family Desires

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must respect their roles and not intrude in other areas.

PRINCIPLE 5:
Develop Family Leadership

Whether family members are on the Board, in the family council, or executives, if a large company is involved, the family needs several forms of leadership. The family must establish clear paths to develop, temper and encourage family leaders to take on these roles. Family leaders must be accountable to the whole family, so unlike the archetypal patriarch, they must be collaborative and communicative.

Family members must understand that their roles may differ, and must respect their roles and not intrude in other areas.

An effective family utilizes processes like internships, family finance seminars, expectations of professional education and employment, and real opportunities for young leaders to develop and exercise their capability.

PRINCIPLE 6:
Respect Non-Family Leadership

The question of succession is especially tricky, because there are family and non-family candidates for CEO. By differentiating and making clear the criteria for leadership, and having creative roles for family-members on the board, the company can create effective teamwork without being crippled by internal focus on family politics. But respect for non-family talent is more than giving them a shot at the top; there must be fair compensation, evaluation of performance, and policies that insure that family members do not exercise improper influence over management. If the company is not fair and respectful to non-family managers, there will be periodic brain drains, when a key talent leaves to a competitor. ♦

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assessments

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D) Family Business, Risky Business
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   by Dennis Jaffe
4. **Family Boards: How to Make Them Work**
   by Sam H. Lane
5. **Joining the Family Business**
   by Leslie Dashew
6. **The Challenge of Families Who Work Together**
   by Leslie Dashew
7. **Transferring Authority in Family Business**
   by Joe Paul
8. **The Challenges of Downsizing a Family Business**
   by Sam H. Lane
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   by Sam H. Lane
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Being a Values Driven Company

by Sam H. Lane, Ph.D.

The Governance Structure in a Family Business links the family owners to the Board and Managers who are responsible for the enterprise. In a non-family business, the shareholders are typically larger in number, more diverse and not as readily identifiable. Boards of these companies can only surmise the individual and aggregate's wishes of the people they represent. Since the ownership group in a family business is more circumscribed, it is possible for them to organize their thinking and make their wishes known.

For many, the business is an extension of values and ethics the family holds dear.

It is important for a family to be conscientious and thoughtful about the purposes of their business and what they want it to stand for. For many, the business is an extension of values and ethics the family holds dear. For some, these values promote increasing shareholder value as one of the main thrusts of the business. For others this goal is low on the list. In multi-generational businesses, transferring the legacy created in the past is also a strong concern. This usually positive quest can become problematic if the drive to preserve the past obstructs and clouds the need for the business to innovate and make the changes necessary to maintain its viability.

A lot has been written about how being a "values driven" organization is an important ingredient for long-term success. Values driven companies achieve consistency of excellence by identifying and adhering to a set of principles or values in the midst of changing products, times and market conditions.

Most successful family businesses are built on a similar set of values propositions. Of the many statements of values I have read, few put "making money" near the top of the list (if it was on the list at all). Not having an all-consuming profit motive decreases the pressures to do everything possible to make next quarter's earnings estimate. It is hard for a high-flying company to sustain growth quarter after quarter. The temptation to cut corners can be overwhelming in the face of these stresses; Ethics suffer. A family business is not driven the same way, which allows it to be more long-term oriented.

Values driven companies achieve consistency of excellence by identifying and adhering to a set of principles or values in the midst of changing products, times and market conditions.

The family has a number of ways to communicate the values they want their business to represent. A **Family Mission Statement** describes the purposes of the family and how they relate to the business. A **Statement of Family Values** enumerates the principles the family has agreed to live by that extend to the business. A **Vision Statement** talks about how the family and the business will evolve into the future and what they want to become. Family businesses occupy a range from having a, clearly understood by all, set of values; to others, where their values seem to have little or no guiding influence.

We think it strongly behooves a family to articulate and communicate its values to the company and hold it accountable for making them paramount guideposts in its dealings. A well-organized governance structure facilitates this communication and accountability.

While ethical lapses can occur at values driven companies, they seem to be rare. When they do occur, it is on a wide scale and are due to the fundamental dishonesty of one or more family members.

We think it strongly behooves a family to articulate and communicate its values to the company and hold it accountable for making them paramount guideposts in its dealings.

Several years ago Stew Leonard was caught skimming cash (lots of it) from his very successful dairy market and is now in jail. Prior to being caught, he and his family were recognized as one of the most successful and innovative family businesses in America. More recently, several members of the Rigas family were indicted for using their company—Adelphia—as a "personal piggy bank."

It is important for a family to recognize the importance of the governance structure as an ethics and values expression conduit from itself to the people who make day-to-day decisions in the business. It is good for the business and good for the family. ♦

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The Purpose of Boards

by Joe Paul

The major difference between families in business and other families is an intellectual one. Families that are in business must analyze, deliberate and plan strategically in ways that most other families never need consider. In the early entrepreneurial stages of a family business, a normally functioning board is often seen as unnecessary because the most important intellectual assets of the company are in the brain of the company leader. But, success of the company often means that it outgrows its dependency on one leader. Eventually, more sophisticated systems must be put in place to manage the growing complexity of operations. Boards of Directors are a major resource in this kind of organizational transformation.

But, success of the company often means that it outgrows its dependency on one leader.

THE PURPOSE OF A BOARD OF DIRECTORS

A company's Board of Directors is the brain trust of the organization. It is a place where smart people are meant to be working on the company instead of in it. The Board is supposed to ensure that plans are made and implemented, and that resources of the company (both tangible and intangible) are managed effectively. In the end, it is responsible for the long-term viability of the company and the assurance that owners receive an adequate return on their investment.

A seat on the Board of Directors is <u>not</u> a place to teach someone about the business. Placing unqualified family members on a Board to teach them about the company is a mistake that many family business owners make as they are planning for succession. The seats on the Board need to be filled by people who are there because of what they know, or who they know; not to whom they are related.

It is a place where smart people are meant to be working on the company instead of in it.

MAJOR RESPONSIBILITIES OF BOARD OF DIRECTORS

Board members may have defined responsibilities based on the unique challenges of the company's market niche, or as defined in the Bylaws of the organization. Generally, board members:

- Regularly attend board meetings and adequately prepare for issues on the agenda
- Determine the organization's mission and purpose
- Select, support, evaluate; and, when necessary, dismiss the CEO
- Oversee long-term strategic planning
- Oversee the management of the tangible and intangible assets
- Insure compliance with governmental standards
- Oversee the company management systems, products and services
- Manage the company's image in the community
- Evaluate Board performance

Some traits of effective Family Business Board members are:

- Honesty
- Willingness to say "no" to the CEO
- Open-mindedness
- Interest in the company and enthusiasm for its mission
- Expertise that is relevant to the company
- Able to see several sides of an issue
- Willingness to collaborate with peers
- Able to deal with intellectually complex issues
- Able to speak and write clearly
- Willing to be tough minded when necessary
- Able to ethically balance self-interest, the needs of the organization and the laws of the land
- Keen sensitivity to conflicts of interest

In family businesses, there are many varieties of boards. They range along a developmental continuum from those that exist in name only, to meet legal requirements; to boards populated by "yes men" and compliant children of the founder; to boards that are made up of strong, gifted and wise people.

The quality of a board of directors says important things about a company. What does the configuration of your board say about yours? ♦

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Importance of Independent Directors
by Leslie Dashew

Having truly independent directors serve on boards of private or public companies has always been considered a "best practice." In the recent months of governance scandals, the importance of independence has become even more evident. In this article, we will explore what it means to be "independent" and how it benefits family businesses.

Independence, when it comes to boards, allows a director to be objective and evaluate the performance and well-being of the company without any conflict of interest or the undue influence of interested parties. This includes:

INDEPENDENCE FROM MANAGEMENT

For instance, directors are not totally dependent on the company President or CEO for information. They "keep their ears to the ground" to get outside information and perspective.

Having truly independent directors serve on boards of private or public companies has always been considered a "best practice."

COMPENSATION

Board members do not accept compensation for anything other than board service (i.e. no consulting, professional services or other business dealings with the company as supplier, financiers or customer.) This prevents conflict of interest financially or biases based on those roles.

CONFLICT OF INTEREST

Board members are not affiliated with organizations or activities that would create a conflict of interest with the company on whose board he/she serves. On an ad hoc issue, (e.g. if the board is considering a partnership or alliance with an organization affiliated with a board member), a director can excuse himself if he feels there is a conflict.

Independence also comes from the character and values of the director. A director who is truly independent does so because of:

- Commitment to serve shareholders with due diligence and integrity
- Good judgment and common sense
- Sufficient self-esteem and confidence to stand up for an independent point of view

For a family business, independence is even more important.

Further, independence in the board as a whole can come from a diversity of perspective (as opposed to having many board members come from the same "club" or background).

A board with a majority of independent directors, can bring expertise and objectivity which:

- Assures owners that the company is being run legally, ethically, effectively and in the best interest of its owners
- And that they have "representatives" who are objective and have no "ax to grind"
- Who will look at issues with no vested interest or "hidden agendas."

Having a majority of independent directors (or at least a critical mass), allows outside directors to feel they have support in raising contrary points of view. Otherwise, it may be difficult for a single outside director to raise an issue that may be sensitive to the family or founder.

For a family business, independence is even more important. The independent director can help with issues where the family tends to lacks objectivity and independence such as:

- Hiring, firing, promoting, and compensating family members as well as determining succession plans;
- Bringing expertise and perspective to a business which is run on tradition and sentimental loyalty ("this is the way dad did it") rather than by current best business practices;
- Acting as a neutral bridge between family owners and non-family managers.

Attracting, fully utilizing, and retaining independent directors requires that the board be operated in a professional fashion. There are many talented, mature business people who enjoy serving on boards as a way to "give back," and to have a positive impact on another business. However, if their opinions are not given thoughtful consideration, if their time is wasted, or if the business is not run in a fashion that reflects the values of the outside board member, it is unlikely that effective director will continue to serve.

Attracting, fully utilizing, and retaining independent directors requires that the board be operated in a professional fashion.

A critical factor in attracting and retaining key outside directors is meeting management: i.e. running the board meetings in a professional manner. This

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Importance of Independent

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includes: having agendas and boardbooks sent out several weeks in advance to give busy people time to prepare; running the meetings efficiently and effectively, without regression into family squabbles around the board table; and, keeping the meetings focused on critical business (or family business) issues rather than administrative.

In conclusion, having a board that has a **majority** of independent members, that has directors who are neither members of the family, employees of the company, advisors, customers or suppliers, will add great value to a business and the family who owns it. Giving the board the authority, respect and support it requires to operate effectively will assure that value is realized. ♦

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the gathering. . . please join us

WHAT PARTICIPANTS HAD TO SAY ABOUT THE 2002 GATHERING

"The focus on concrete, real life examples is extremely valuable. Also, sharing of success stories, not just identifying problems."

"This program exceeded my expectations because it was NOT a lecture,but real, practical solutions for family businesses."

"I would highly recommend this program. The openness among the group was a true gift to all involved."

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"Diversity of perspectives in the group of consultants."

"As an outsider in the family business, I thought getting to discuss issues with the family, such as values, goals, and purpose was critical. It opened our eyes to a lot."

"The round-table style and open forum of the group. The mix between social and educational, which enabled the group to truly interact, and to learn from each other."

announcing our move

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The administrative offices of the Aspen Family Business Group will move, effective November 1, 2002.

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