



Morgan Stanley

Family Governance: Managing Conflict, Fostering Continuity

As families flourish and achieve success, it's not uncommon for them to reflect on what accounts for their success, particularly when one of their goals is to help the family continue to flourish and achieve. The result of such reflection often centers on an examination of what makes the family special and what matters to them most, and this examination often results in a renewed appreciation for the bonds of family, whether those ties are expressed exclusively in intangible ways, or when the intangible expression is also made manifest in some common family enterprise.

Having identified the critical importance of those bonds, it's natural for ultra high net worth families to ask themselves how to perpetuate them. Particularly in the case of an ultra high net worth family engaged in a common enterprise, such as running a family business, guiding a charitable foundation, operating a family office or simply investing together as a family, it's extremely important to have a sound framework within which to make decisions—in other words, a family governance system. Without such a system, families often are ill-equipped to deal with certain areas of conflict when they inevitably arise.

In our experience, the families that need governance systems the most usually have an inadequate system or, more commonly, no system at all. Unfortunately, with the exception of a small minority of process-oriented families, most families either never address their governance needs or wait until they are in the midst of a crisis—picking up the pieces afterwards—before they finally get serious about creating and implementing a robust family governance system.

Because families tend to grow more complex with the passage of time, the need for family governance tends not only to be a lasting one, but indeed may grow as the family itself grows and achieves still greater success. Moreover, it's given that issues, such as changing direction, hiring family members, acquiring a significant asset or exiting a collective venture may be driven by the family's need to confront a particular challenge, and decisions made during challenging times may very well be especially contentious and subject to special scrutiny. It is especially at times like these when family governance is paramount.

We hope this paper will encourage families to consider their own situations, to think deeply about the value of a governance framework and to use the insights and information presented in this paper to start the process of creating and implementing their own governance systems. Our experience teaches that a family governance system will help you deal with whatever curves both life and family throw at you.

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Parsing Family Governance

It's difficult to define "family governance," because the term means different things to different people. Sometimes, it is used interchangeably with "family office"—a central administrative function that manages certain aspects of the family's affairs, such as its investments—but we believe the two are not synonymous. In academic circles, "family governance" is commonly defined as a process to help make better, more-informed decisions.

We posit that it's impossible to design a process that helps families make better decisions when there is no way to determine—or effectively measure—what a good decision is for a particular family. As we conceive of it, family governance is a system that helps families make decisions in such a way that the decisions are more likely to be respected over time. We believe that eliminating family conflict is impossible, but that the principal goal of a family governance system is to manage the potential for devastating family conflict by making it more likely that decisions will not be challenged.

A sound family governance system often comprises both structures and documents. Each of these two categories has a number of possible components that we describe briefly in the table on the next page.

The concept of family governance is forward-looking and optimistic by nature—it has to be rooted in the notion that there's something worth governing, perpetuating and developing. It also can be helpful not to burden yourself and other family members with the unnecessary expectation that the governance system you create has to be perfect from the outset and set in stone for centuries to come. Rather, any system you create should offer the opportunity to revise and reconfigure in the face of change.

Because each family's needs are different, there is no real standard or template to follow in terms of creating and implementing a family governance system—families have tremendous flexibility to create one that fits them. To be most effective, however, whatever system that is ultimately developed should facilitate three essential functions:

- Articulate shared values
- Effectuate normative decision-making
- Set expectations

ARTICULATING SHARED VALUES: The process of creating governance-related documents, such as a family constitution or a mission statement, is what's truly valuable, not the piece of paper itself. If a family can come together and engage in the collaborative process necessary to produce such documents, there's a good chance it will emerge with a set of principles that reflect what's important to the family, what it would like to accomplish and how it sees itself. Revisiting these principles on a regular basis—by reading them aloud at the annual family assembly, for example—and holding the family to them at all times can help family members stay connected to each other and to their collective goals.

NORMATIVE DECISION-MAKING: While articulating shared values is a necessary step in establishing a robust family governance system, it doesn't create a framework within which a family can actually make decisions. Enter the family council, a structure that is typically the chief decision-making body. The reason a strong council structure—bolstered by documentary components such as a family constitution and family bylaws—is so crucial boils down to one element: the process by which it makes decisions.

SETTING EXPECTATIONS: A common complaint within families that don't have a rule-guided, transparent system in place is that most decisions are made, or appear to be made, ad hoc. The problem with such a decision is that it is susceptible to challenge on one or several grounds:

- It was not consultative
- It was not deliberative
- It was motivated by personal animus

By contrast, if a decision is made pursuant to a rule-directed and transparent process, it will be—by definition—deliberative and consultative. Moreover, it's much more difficult to attack a decision that results from such a process as being motivated by personal animus.

Families that have created a family council often find that each time the council issues a decision that the family ultimately accepts, the respect for the decision-making process itself grows. And with each favorable outcome, the system acquires increasing moral and persuasive force. Ideally, at some point it becomes violative of the family culture to challenge a decision made by the family council. If the family can get to this point, the authoritative impact of a decision rendered by the council becomes almost unquestioned.

One particularly delicate area wherein having a normative way of making decisions could help avoid devastation is when family members have significant responsibilities in the family office. The hiring and firing of these family members involve decisions fraught with the potential for trouble. However, if the family can create a set of rules and procedures in advance, and then seek to apply them neutrally to situations as they arise, it's more likely that the decision will be a principled one. Such a decision is then likely to have greater moral and persuasive force.

STRUCTURES	WHAT IS IT?	WHAT IS ITS PURPOSE?
Family Assembly	Typically, the largest set of family members, and the body from which all powers delegated to entities such as a family council emanate. It can also be thought of as a periodic forum or gathering that includes all adult family members (children may attend starting at a certain age, pursuant to family policy).	The group to which all decision-making family entities ultimately report; may be responsible for selecting family decision-makers. Provides a forum to educate family members on the family business, family philanthropy or other family undertakings; to provide updates on important events and milestones; and to reinforce the family constitution or mission statement. Provides a framework for the family culture.
Family Council	An entity composed of family members to address family issues, business issues and the intersection of the two.	Provides an organized forum within which to make decisions; to articulate the family's values and vision; to educate family members about the history of the family and business, along with the responsibilities and obligations tied to both; and to be the vehicle within which to anticipate, air and resolve family conflict.
Advisory Board/Outside Advisory Board	Usually composed of some nonfamily representatives (and separate from any trustees), this structure helps identify and prioritize issues objectively, and then recommends resources to address them. Often the makeup includes at least one family member to help consider the family view.	Leverages the expertise of its various members to tackle complex and sensitive challenges such as investment policy and succession plans. Outsiders can often raise sensitive and important issues without the emotions and burdens of family baggage.
Trustees	Individuals who are legally bound to hold and manage property on behalf of the trust beneficiaries.	Focuses on issues directly related to trust beneficiaries, such as when to make distributions.
STRUCTURES	WHAT IS IT?	WHAT IS ITS PURPOSE?
Family Mission Statement	An aspirational document that reflects a family's articulation of its shared values and collective sense of history and legacy. Grounded in a family's past, this document looks toward the family's future.	Sets out a road map—in broad, aspirational terms—of what's important to the family and the direction it wants the family to take as a whole.
Family Constitution	More administrative or operational in nature, this document expresses how the family puts the broad, aspirational principles contained in its mission statement into place in certain important segments of their lives (such as the use of family wealth or the extent to which the family supports charity); may also delegate powers to committees consisting of individual family members formed to address particular family opportunities or challenges.	Creates the normative, transparent and rule-bound system by which the family governs itself.
Family Bylaws	A more precise set of guidelines and regulations by which the family agrees to govern itself.	Augments and enforces certain general expressions of the constitution.
Succession Plan	A documented and communicated plan that governs succession upon the death, incapacity or resignation of a key leader. Must address matters of transfer, ownership, control and taxation, as well as operational or managerial succession.	The roadmap for the continuity of joint family enterprise—business, philanthropic or investment.



THE BAD ACTOR

At some point, virtually every family has to deal with an agitator or “bad actor” who tries to throw a wrench into the spokes and pit family members against each other. In fact, in the new global world with multiple easy-to-access communications vehicles, the ability of the bad actor to inflict reputational and financial damage is greatly enhanced.

While no system can protect completely against bad actors, a carefully considered and implemented family governance structure can isolate and reduce their influence. Having a normative process for making decisions, for example, gets issues out in the open that may have otherwise been discussed in the bedroom or another cloistered setting. When these issues are openly debated, there’s an opportunity for other members of the family to discredit a particular idea—an opportunity that otherwise would not have existed.

On a related note (pun intended), it’s important to remember that bad actors are not always people who have joined the family through marriage—there are just as many disgruntled lineal descendants out there. Therefore, it can be a mistake to overlook or discount the contributions an in-law can make to a family council, for example. An in-law often brings a fresh perspective to the table—one that is appreciated by other family members and can add value to the discussion of the issue at hand.

Family Council—A Critical

Framework: As suggested previously, a family council is the single most important structure an ultra high net worth family can put in place to help address and resolve—in a systematic and normative way—issues such as:

- Conforming the strategic and tactical plans of the business to the family’s core values.
- Dealing with the potential for inequality of income and wealth.
- Identifying and rewarding contributions to the family ethos made by family members not in the business.
- Clarifying the appropriate relationship between family and nonfamily managers and employees.
- Establishing whether outside business experience is required to join the family business.
- Integrating in-laws and the next generation.

Depending on the nature of the family and its concerns, the council can also address investment issues, issues relating to the effective management of trusts, philanthropic issues and everything in between.

The family council can be an extremely powerful part of a family’s strategic plan for the preservation of its legacy and culture, and for managing conflict. Indeed, many of the country’s best-known families attribute much of their success to a robust and vigorous family council.

Creating a Council: When creating and structuring a family council, one of the most critical questions that must be resolved is, who will be members of the council? In addition to this question, numerous others also will need to be addressed, including:

- Will spouses participate on the family council?

- If spouses are to be members of the family council, do they cease being members entirely upon divorce or death of a lineal descendant, or continue in some (perhaps limited) function?
- At what age do younger-generation family members participate in the deliberations of the council?
- At what age do family members become enfranchised to vote?
- Will all members have a vote on matters before the council?
- Will the council structure be representative (i.e., family members vote to elect representatives to the council, but only the representatives vote on matters before the council) or democratic (i.e., one vote per family member?)
- If representative, how are representatives determined?
- If democratic, are all votes equal?
- Is there a role for outside advisors and other nonfamily members? (If so, what provisions should be made for removal and succession?)
- How will decisions be made—by consensus (whereby every family member must agree or no action can be taken) or by majority?

There are no wrong answers to any of the questions listed above. In terms of spousal participation, for example, some families might conclude that the family council should reflect the fact that all members have a stake in the resolution of family issues—and therefore should include spouses as full members. Other families may wish to create some separateness by allowing spouses to participate in some but not all deliberations. (They might be excluded from the discussion of business matters, for instance.)

Another key question in the list above is how decisions will be made—and whether the actions of the family council

will be determined by the affirmative vote of a majority of its members or whether it must act by consensus. While consensus decision-making is difficult, it can be a powerful and effective way for families to make decisions, as majority decision-making necessarily creates winners and losers on any particular issue.

Part of the challenge is to find the answers that are best for the family—that's why it is helpful to have as many family members as possible at the table initially to talk through them. Once these questions have been thoroughly discussed and a consensus has been reached, many families will create a document that officially establishes and empowers the family council, and delineates its role and functions.

Roadblocks to Good Governance:

There are numerous obstacles that can hamper family governance discussions and the implementation of an effective system.

DENIAL. One classic roadblock is the presence of a first-generation wealth creator who refuses to engage in the governance-development process because it involves both giving up control and facing mortality—two very tough things to do for many business owners and entrepreneurs. In some cases, this avoidance or denial can be overcome by reminding the patriarch or matriarch that one day control will be taken away from them whether they like it or not—and they might conclude that it's valuable to begin creating a system now that bears their imprint and that will take over when they are no longer able to call the shots.

INERTIA. This roadblock can present itself when the wealth creator attempts to implement his or her vision of a family governance structure, including provisions such as 100-year plans and elaborate tests that each heir must pass before

receiving an inheritance. More often than not, this kind of overzealous approach creates a legal quagmire and stalls itself in the process, so nothing ends up getting resolved or implemented. Sheer abundance of choices and possibilities can also contribute to a “paralysis of perfection.”

NAIVETÉ. The qualities that brought an entrepreneur to great success are often not the same qualities that can help smoothly transition his or her wealth and sense of purpose to the next generation. Also, the values an entrepreneur had in terms of the uses of wealth are often set aside once he or she is dealing with children—many don't want to see their kids struggle the same way they did. As a result, the governance system ends up lacking structure when it comes to teaching the next generation to use common sense or instilling a sense of confidence in them.

Other roadblocks can arise when a governance system is set up and then ignored, or when the governance system is difficult—if not impossible—to amend to reflect changing family needs.

Best Practices: We firmly believe that even for families stocked with talented and accomplished individuals, it is a mistake to attempt to develop and implement a family governance system without professional guidance and support. This process is a complex and nuanced one that calls for some independent vision and for someone who's done it before.

Another key best practice is to build “safety valves” or exit strategies into the governance system. Families that work too hard at keeping themselves together inevitably explode, and if there isn't a way to leave voluntarily, someone will find a way to leave by invoking coercive measures—it's just human nature.



MAKING A STATEMENT

A family mission statement is a family's articulation of how it sees itself, what it's trying to accomplish in life as a family and what kind of legacy it would like to pass on to future generations. It is aspirational in nature—think more “Declaration of Independence” than “U.S. Constitution.” The process of creating a mission statement and revisiting it on a regular basis can be an intensely unifying experience for the family.

When done well, the process of creating the family mission statement demands that family members collaborate meaningfully to create a statement that belongs to everyone collectively. But if this statement winds up in a desk drawer somewhere then an opportunity has been missed. The families that ultimately succeed in weaving their mission statement into the fabric of their life as a family are the ones that return to the statement periodically and ask themselves these questions:

- Do we still believe it, and does it still accurately reflect our values?
- If not, what do we have to do to change it to make it accurate again?
- If it is still an accurate expression of our values, vision and mission in life, have we lived our lives in accordance with it?
- If not, what do we need to do to get back on track?

The family mission statement not only becomes the ultimate destination, but it also can serve as a beacon to get the family back on track should it lose its way during the journey.

Other family governance best practices include:

- Involving multiple generations and outside advisors when creating the system.
- Making the system actionable.
- Reviewing the system annually and updating if necessary—there should always be a process for changing or amending it. (In fact, some families will include a sunset clause on some or all of their governance system to ensure it gets reviewed and revamped, if necessary).

Begin With the End in Mind¹: In planning and implementing their family governance system, or engaging together as a family in business, philanthropy or investing, families need to focus on the “end” in both its literal and figurative sense. And the literal “end,” because none of us gets out of this thing alive—that is, the need for a fully considered succession plan—is often difficult for families to address.

Indeed, in its 2021 Family Business Survey,² Pricewaterhouse Coopers reported that only 34% of the families it surveyed had a robust, documented and communicated family business succession

plan in place. Although PwC did not survey family offices separately, our experience suggests that family office succession is another area requiring much greater attention. While tax management often will be a significant feature of some of this planning, families who fail to take into account the more human elements of the planning often come to regret their oversight. Any form of joint family enterprise—family business, family office, family foundation—needs a robust, flexible, documented and communicated succession plan, including such practical, but often over-looked matters, such as passwords to computers and sites that access corporate and family financial information.

Monitoring Performance and Measuring Success:

We see tremendous value in doing a web-based satisfaction survey (SurveyMonkey, for example) with family members every year. This type of anonymous survey can be particularly helpful to uncover meaningful insights in families where people try to avoid conflict by not speaking their minds.

And while this is not exactly an empirical measure, if family members are able to stay out of the press and out of the

courts while still enjoying one another’s company, this is a strong indication that the family governance system is doing its job.

Like many other things in life, you’ll get out of a family governance system what you put into it. If you invest the time (it’s typically a multi month process) and some careful thought (we recommend using an expert to help guide this process), and include input from an array of voices (both family and nonfamily), there’s a good chance you’ll end up with a reliable way to make decisions that are more likely to be respected over time. As more time passes, the moral legitimacy of this system will be cemented, providing a solid foundation for your family to build upon its successes and its legacy.

¹ Stephen Covey, *The 7 Habits of Highly Effective People: Powerful Lessons In Personal Change* (2004).

² <https://www.pwc.com/us/en/services/trust-solutions/private-company-services/library/family-business-survey.html#content-free-1-1d64>



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Glenn Kurlander, J.D., is a Managing Director and Head of Morgan Stanley's Family Governance & Wealth Education unit. He's helped ultra high net worth clients address family governance and the family dynamics of inter generational wealth for over 35 years. Prior to joining Morgan Stanley, Glenn was a nationally recognized trusts and estates attorney, and headed up the trusts and estates group at Kirkland & Ellis. Glenn has written and lectured extensively on topics such as family governance, managing family conflict, the dynamics of family wealth, family offices, investment-enhanced wealth planning and the use of offshore trusts.

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