

# Morgan Stanley

PRIVATE WEALTH MANAGEMENT

## Family Governance: Managing Conflict, Fostering Continuity

If there is one silver lining to the 2007–2008 global financial crisis, it is that it has brought many families together to re-examine and re-emphasize what matters most to them. The result of such reflection is often 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, especially during turbulent and challenging times. 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 to be a lasting one. Moreover, it's a given that issues, such as hiring family members or exiting a collective venture, often come under greater scrutiny during times of challenge; therefore, family governance is also a particularly timely topic.

We hope this paper will encourage families to consider their own situation, 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 system. Our experience teaches that a family governance system will help you deal with whatever curves both life and family throw at you.

### **Glenn Kurlander**

Managing Director  
Morgan Stanley

### **Laird Pitcairn Pendleton**

Co-Founder and Principal,  
CCC Alliance LLC  
Chairman, Wharton Global Family  
Alliance Advisory Board

## FAMILY GOVERNANCE: MANAGING CONFLICT, FOSTERING CONTINUITY

### Parsing Family Governance

It's difficult to define "family governance," because the term means different things to different people. Sometimes, the term 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 it is more likely the decisions will 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 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:

1. Articulate shared values
2. Effectuate normative decision-making
3. 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 sys-

tem 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 are 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.

<b>STRUCTURES</b>	<b>WHAT IS IT?</b>	<b>WHAT IS ITS PURPOSE?</b>
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.
Family Assembly	A periodic gathering that includes all adult family members (children may attend starting at a certain age, pursuant to family policy).	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.

<b>STRUCTURES</b>	<b>WHAT IS IT?</b>	<b>WHAT IS ITS PURPOSE?</b>
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).	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 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.

## FAMILY GOVERNANCE: MANAGING CONFLICT, FOSTERING CONTINUITY



### 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. In-laws often bring 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 above, 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 also can 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, which 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 also can 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.



### 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 who ultimately succeed in weaving their mission statement into the fabric of their life as a family are the ones who 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.

## FAMILY GOVERNANCE: MANAGING CONFLICT, FOSTERING CONTINUITY

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, then someone will find a way to leave by invoking coercive measures—it’s just human nature.

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 its governance system to ensure it gets reviewed and revamped, if necessary.)

### **Monitoring Performance and Measuring Success**

We see tremendous value in doing a web-based satisfaction survey (Zoomerang, 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 each other’s company, then 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 multimonth 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.

## ABOUT THE AUTHORS

### **GLENN KURLANDER**

Glenn Kurlander, is the Managing Director of Family Governance and Dynamics at Morgan Stanley and has helped ultra high net worth clients address family governance and the family dynamics of intergenerational wealth for 25 years. Prior to joining Morgan Stanley Smith Barney, 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.

Glenn received his law degree, *cum laude*, from the Cornell University Law School in 1984, where he was an editor of the Cornell Law Review. He also holds an M.A. degree in English literature from Columbia University and is a *cum laude* and Phi Beta Kappa graduate of Franklin & Marshall College.

### **LAIRD PITCAIRN PENDLETON**

Laird Pitcairn Pendleton is the Co-Founder and Principal of the Cairnwood Cooperative Corporation, a family office that manages the affairs for a branch of the Pitcairn family, with offices in Boston and the Philadelphia area. The Pitcairn family founded the Pittsburgh Plate Glass Company in 1883 and is known as PPG Industries today. In 1995, Laird Co-Founded the CCC Alliance LLC, the country's leading private consortium of wealthy families. CCC Alliance has more than 100 member families from seven countries and 30 U.S. states. In 2004, Laird helped launch the Wharton Global Family Alliance, a joint venture between CCC Alliance and the Wharton School, where he serves as Chairman of the advisory board. He is active on various corporate and charitable boards and is president of The Glencairn Foundation, his family's charitable giving arm.

Laird is a graduate of Lehigh University and the Babson Graduate School of Business, where he was a Sorenson Merit Scholar.

## FAMILY GOVERNANCE: MANAGING CONFLICT, FOSTERING CONTINUITY

The views expressed herein are those of the authors and do not necessarily reflect the views of Morgan Stanley or its affiliates. All opinions are subject to change without notice. References to third parties should in no way be considered a solicitation by Morgan Stanley on their behalf or an endorsement by Morgan Stanley.

Morgan Stanley and Private Wealth Management personnel who hold law degrees are acting purely in a nonrepresentative capacity. Neither they nor any other Morgan Stanley employees or affiliates provide tax or legal advice to clients and are not "fiduciaries" (under ERISA, the Internal Revenue Code or otherwise) with respect to the services or activities described herein except as otherwise agreed to in writing by Morgan Stanley. Individuals are urged to consult their tax or legal advisors before establishing a retirement plan or to understand the tax, ERISA and related consequences of any investments made under such plan.