

# FAIR PROCESS AND FAMILY BUSINESS GOVERNANCE

When family members do not trust that their relatives are considering their shared interests in making decisions, their psychological commitment and even cooperation is significantly reduced. Says Sir Adrian Cadbury: "At the heart of management of relationships in a family business lies the concept of fairness. Division and ructions within the family can be caused only too easily through suspicion that some family members are benefiting at the expenses of others, or that the contribution which some are making to the firm is not being properly recognised. The problem is to separate family judgments from business judgements. This is where independent, outside counsel is invaluable."

What Sir Adrian is suggesting is that a relationship exists between fairness and how decisions (judgements) are made. The judgments that he describes as objective family and business decision-making processes are what is generally referred to as governance. All firms need to make business decisions about where and how to compete to create future value for their stakeholders. Family controlled firms face the additional challenge of ensuring that decisions affecting the family or business are seen as fair to motivate entrepreneurial creativity, ensure patient capital and encourage personal commitment.

## ARE FAMILY BUSINESSES FAIR?

Some individuals from business families would answer a resounding 'no'. When we interviewed family members we found that, besides those satisfied, some shared a sense of disappointment in the lack of fairness around decisions regarding ownership, board membership, career opportunities, job responsibilities and promotions, rewards and recognition and accountability. Our research also showed that these dissatisfied family members often had a strong desire to contribute and be valued as part of the family but the sense of unfairness made this difficult, if not impossible. The family's perceived unfairness in decision-making was creating resistance and blocking the potential contribution of many family members.

We use the legal concept of justice to operationalise fairness as three different human behaviours: distributive (who gets what and how much), retributive (how do we correct past injustices) and procedural (how do we make decisions that are deemed fair).

We have adopted the procedural approach, known as fair process, because the complexities of the family business systems make this the only workable solution. Families by definition can hardly achieve distributive fairness because of intervening factors such as genetics, birth order, branch membership and family dynamics. Moreover, distributive fairness is hard to assess in a complex system where family, business, and ownership spheres overlap, each with different criteria of distributive fairness.

## GOVERNANCE FOSTERS FAIRNESS

If we accept that how decisions are made is a critical factor in determining a sense of fairness in the family business then we must ask ourselves what a family can do to improve its decision-making process. We would argue that strengthening the family's decision-making processes is best accomplished by formalising family and business governance. Governance is the best approach to improve fairness because no activity is more central in shaping decisions about careers, ownership, control and business strategy. The next logical step is learning how to apply fair process thinking in family and business governance.

## THE MORE COMPLEX THE ISSUES... THE MORE SOPHISTICATED THE GOVERNANCE PROCESS

Governance institutions, such as boards of directors, should reflect the needs and demands of the business, family and other key stakeholders. For example, factors such as size of the family and business (sales, number of employees and number of family members), ownership and financial structure (private, public and bank debt), life cycle (start-up versus fifth generation), and statutory requirements (types of board, responsibilities) all shape the type and sophistication of the governance structures required. Generally speaking the more complex the issues the family and business must address the more sophisticated the governance processes.

## FAMILY POLICIES

Fair process calls for clarity of rules, so that all family members can be treated consistently. Legal systems are based on agreed laws and family policies serve the same purpose: they create a shared set of

## FAIR PROCESS PRINCIPLES IN FAMILY BUSINESS

- **Communication and voice.** Giving those concerned with a decision a voice, so that they can have their views heard.
- **Clarity.** Clarifying viewpoints, decisions, and "rules of the game".
- **Consistency.** Treating all in the same way, (same rules and consistently)
- **Changeability.** Adapting to changing business conditions, new information, or new generations.
- **Commitment to fairness.** Seeking to continuously improve processes, and to listen and to speak sincerely.

expectations so family members know how to behave and how they will be treated.

The policies can vary considerably from family to family and country to country. If we take the example of employment policies for family members, we find some families that have a clear policy that no family member is employed in the business and others go to the other extreme and expect all family members to work in the business. The specific policy is not as important as the fact that it is known (clarity) to all family members and applied consistently.

Some families in their zeal to create more structure engage consultants to help them formalise their policies. It is important that families and consultants keep in mind the necessity to use a Fair Process in considering and developing their family business policies. Policies will be more accepted – and supported – if all family members participate in a Fair Process using the five principles described in the box on the previous page. Family business advisers and consultants, being outsiders and, it is hoped, more objective, can serve a useful role in collecting the opinions of family members, making sure that all are heard in the process, and facilitating meaningful dialogues within the family.

While family policies increase clarity and consistency, families must also be sensitive to the demands of the external world and new generations of family members and allow the possibility of change or amendments to the policies. As conditions and circumstances change, the family's policies must adapt to accommodate the changes.

#### SHAREHOLDER AND FAMILY MEETINGS

Meetings can be a great opportunity to engage family members. Unfortunately, shareholder meetings are not always held in privately owned firms. A well-planned shareholder meeting is an important first step in building more fairness into the system. One two-hour shareholders meeting can be the foundation of a new style of family relationships and a series of family meetings can be used as a catalyst for starting a family dialogue where family members' opinions are explored, plans proposed and eventually decisions made.

#### BOARD OF DIRECTORS

Boards of directors are the formal decision-making body for the businesses. Most family firms have some type of board but often the board's contribution to strategic planning, effective decision-making and accountability is limited by a lack of Fair Process in how the board functions. A board created with consideration for Fair Process strives to treat all family members consistently. It can play an important role in ensuring that family and business policies and decisions meet the needs of the family and demands of the business.

One recurrent issue is the nomination of family members to the board. Some families insist that equality amongst branches should be the norm so that each branch or given ownership stake has a representative on the board, others use merit as the only criteria selecting senior family members with extensive business experience. Both equality and merit are possible criteria to exercise distributive justice – and we see once more the difficulty of assessing distributive fairness.

#### EXPERIENCING FAIR PROGRESS IN FAMILY MEETINGS

Some family meetings trigger negative reactions: "Oh no, uncle Eduardo is organising this meeting again and will lecture us for two hours" In other cases: "Why am I coming since all the decisions are taken by those working in the business?" However, family meetings can be a wonderful occasion to encourage fair process, to experience it. Suggestions to develop fair process in family meetings include:

- Seek family members' input on the meeting agenda before the meeting
- Establish a code of conduct for the meeting
- Have a moderator
- Use moderation tools to allow all to express themselves
- Develop transparent decision-making processes
- Engage family members in family projects
- Review the meeting: what worked? What should be changed next time?
- Write and send minutes

Solutions combining both criteria can be found: in some families, the holding board represents branches and ownership, while only competence prevails in the business board; in other families, branches are represented at the level of the family council; in others, branch, ownership and competence criteria are combined in the selection of business board members. We have no evidence that there is one best solution but the process is important: criteria and decision-making must be clear, communicated, and applied consistently. Processes typically used can include a board committee, an outside human resource consultant, rotations on the board and evaluation by 'the elders' or the non-family board members. Non-family board members can increase Fair Process by encouraging clarity, consistency and change.

Finally, a good example of Fair Process in board meetings is the evaluation of the board and of the board members. By evaluating itself, the board ensures that it continuously improves its functioning. The chairman, or an outside consultant debriefs each board member and, if necessary, works on an improvement plan.

We believe there are several good reasons for Fair Process in business families: it improves the quality of business performance; it ensures that family members not favoured by a specific decision will better accept it, because they participated in a process and perceived it to be fair; and it supports a family legacy. In the words of an anonymous poet: "Live so that when your children think of fairness and integrity they think of you." ■

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