

Corporate Governance Handbooks

The Business Family Governance

**Basic Concepts, Challenges,
and Recommendations**



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**Basic Concepts, Challenges,
and Recommendations**

IBGC | Instituto Brasileiro de
Governança Corporativa

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● ● ● ● Brazilian Institute of Corporate Governance

Founded on November 27, 1995, the Brazilian Institute of Corporate Governance (IBGC), a civil organization, is the Brazilian reference and one among the main reference organizations for corporate governance worldwide. Its purpose is to generate and disseminate knowledge on the best corporate governance practices and influence the most diverse agents in its adoption, contributing to the sustainable development of organizations and, consequently, to a better society.

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Presentation



Since 1999, with the launch of the first *Code of Best Practices of Corporate Governance*, IBGC has been publishing specific documents within the scope of good practices in corporate governance.

This publication, *Corporate Governance: Basic Concepts, Challenges, and Recommendations*, integrates the series of publications called *Corporate Governance Handbooks*. IBGC's *Governance Handbooks* are edited according to their content, in three series: Legal Documents on Governance, Documents on Governance Structures and Processes, and Special Governance Themes. They bring contributions, suggestions, and recommendations elaborated by IBGC members who are part of its several working committees.

This publication, which is part of the Special Governance Themes, presents concepts and recommendations for the composition of a timely and efficient structure of business family governance. Family-owned companies have various particular challenges, and this handbook offers the first tools and guidelines to help overcome difficulties that may hinder these organizations' success.

IBGC hopes this work can contribute with Brazilian family companies, helping their managers and partners implement good governance practices and continue the founders' work in the search for success and longevity.

Introduction

“Governance” is a word that is becoming more and more known and, above all, practiced by the day. The growth, evolution, and complexity of a business, as well as the demands of the contemporary world, lead almost naturally to a need to better define roles, rules, and processes, whether the company is public or private, small, medium or large, family-owned or not.

Good governance practices apply to any organization, regardless of size, legal nature or type of control, and its pillars of transparency, equity, accountability, and corporate responsibility¹ are the same for any company.

In the case of family or multifamily controlled companies², however, there are issues that go beyond corporate governance and concern only the business families³, their evolution, interpersonal relations, natural expansion, and interaction with the business. To approach such issues in a productive and conscious way, family companies should implement not only corporate governance, but family governance. These two types of governance are independent, but they complement each other, being, each of them, endowed with immense intangible value and unable to survive without the other.

The number of Brazilian family-owned companies of great size that already practice family governance is growing. It is important that medium or small family businesses can do the same, thus winning the challenge of longevity.

Seeking to collaborate in this process, this handbook was prepared by IBGC. It is the result of internal discussions of the Commission of Family-Owned Companies and reports of real experiences, with the participation of external guests. It is a practical and quick document for those who wish to evolve in this field. It is not a manual, but a guide, written in accessible language. Its goal

1. *For more details on the basic principles of governance, see IBGC's Code of Best Practices of Corporate Governance, currently in its fifth edition, published in 2015.*
2. *Defined as organizations of defined control (exercised by a partner or group of partners, governed by a shareholders agreement or under common control, which owns over 50% of the quotas with a right to vote in the organization) or diffuse control (exercised by a partner or group of partners which are not governed by a shareholders agreement, under control or representing common interest, owner of a relevant share of the organization's voting capital, but less than 50%) in which one or more families have the power of control, based on the fourth edition of IBGC's Code of Best Practices of Corporate Governance, p. 18.*
3. *Understood here as all the family members who are or can become partners and their aggregates.*

is to explain what family governance is and how it can help overcome relevant challenges in family businesses. It also discusses the most common governance structures involving the business family and a series of successful practices, adapted to the reality of this kind of company, reinforcing that its application must be adapted to the size and complexity of each business.

For family-owned companies which are further along on the process, we recommend the vast national and international literature specialized on the subject—including the ones we used, listed to the end of this handbook.

Hoping to have achieved our goals, we wish you a good reading!

What Is Family Governance



1. What Is Family Governance

To define what family governance is, it is best to start with what it is not: family governance is not corporate governance. The latter acts within the business to ensure sustainability and protection of assets, the company's image, its reputation, and its relationship with stakeholders. Family governance operates within the family, addressing the family's relationship with its individual members, with ownership, with the company and its stakeholders.⁴ To this end, it uses an integrated set of guiding principles, forums, rules, and services aimed at putting family members on the same page, fostering more harmony and more actions geared toward a long-term vision and the perpetuation of the legacy of values and social-economic heritage.

It is also worth noting that, often, the business family is comprised of two subgroups: that of the family as a whole and, within this, that of family members who are partners. In the initial stages—first and second family generations—there is a natural overlap between the two groups. Over time, however, this overlap tends to diminish, requiring the creation of separate forums to deal with issues within the family or the group of partners. As a result, there are different governance goals: the main goal of the family governance involving the whole family unit is to maintain the family union in relation to certain objectives and prepare its members to be contributory individuals in relation to the system. The family governance restricted to the business sphere, in turn, in the scope of the partners, addresses exclusively corporate issues, such as nominations for the board of directors, general direction of business, distribution of dividends, carrying out large operations, and so on. This publication deals with the first subgroup, that is, family governance that deals with every aspect of the business family—although, inevitably, aspects of the business sphere are also mentioned. More specific recommendations in relation to corporate governance can be explored by reading the *Code of Best Practices of Corporate Governance*, the *Handbook of Good Practices of Corporate Governance for Privately-Owned Companies*, and other IBGC publications, as well as the texts suggested in this document's bibliographical references.

But what, after all, is family governance?

To put it simply, we can say it is the system according to which the family develops its relationships and business activities, based on its identity (family values, purpose, principles, and mission) and in the establishment of rules, agreements, and roles. Family governance takes place, in practice, through formal structures and processes. Its goal is to obtain safer and more quality information in decision-making, help mitigate or eliminate conflicts of interest, overcome challenges, and fostering business longevity.

You don't need to be big to practice family governance. Business families of any size, maturity or area of expertise can only gain from implementing it.

4. Any person, entity or system which affects or is affected by an organization's activities.

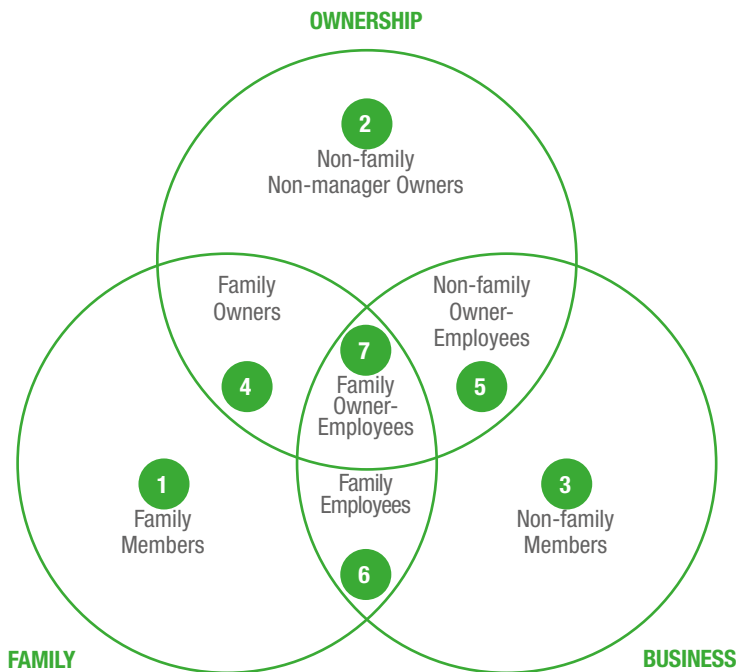
The Dynamic of Family Companies



2. The Dynamic of Family Companies

In order to evaluate the importance of governance and take the first steps towards its implementation, we recommend a synthesized review of the basic dynamic in family-owned companies. Several researchers had been studying, practicing, and producing materials on the subject. One of the best known is professor John Davis, who, along with his colleagues at Harvard University, created the “three circle model”⁵. This model describes the family business system as three independent but superposed, subsystems—company, family, and ownership—and is represented below.

Figure 1. Governance Structures in the Family Business System.



According to this, any family member can be put in any of the sectors formed by the circles and their juxtaposition. Even people from outside the family (executives) are in these sectors. This model was largely accepted as a useful tool to understanding the challenges, dilemmas, priorities, and limits of the family business. A family cannot be treated as a company or vice-versa. Thus, each circle must be managed according to its own nature, guidelines, and

5. J. A. Davis and R. Tagiuri, “Bivalent Attributes of the Family Firm”, 1982.

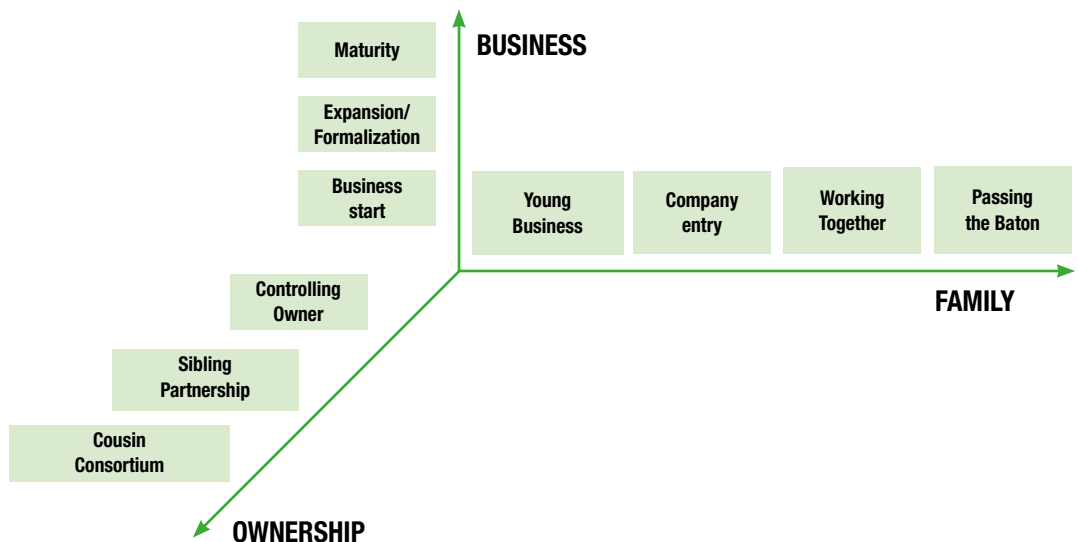
base documents: the ownership circle, according to the shareholders agreement; the family circle, according to the family protocol or constitution, or the family governance system; the business circle, according to the strategic planning and the governance system—documents which we will talk about in more detail.

The fact that the circles represent distinct universes notwithstanding, they are interconnected and, thus, can or must have a common goal: the success of the business and the business family. However, their juxtaposition makes the system more complex, since changes in one of the systems may affect the others.

With this in mind, two considerations are important: (1) it is essential to understand each circle's content and the impacts of their intersection; and (2) people in or outside the family (executives) can be included in more than one circle at the same time. This overlap also helps understand why the same people end up wearing “multiple hats” in the system: a family member may at the same time be an owner, family leader, company CEO or board chairman. But though he has the three hats, he must recognize each has its own function and attributions, wearing them appropriately, that is, in the correct forum with appropriate considerations. That means his decisions must be made in light of the authority conferred by the “hat” he has own at the moment.⁶

The Harvard group later came up with a tridimensional model which shows the temporal development of the business family throughout the time, explaining, in evolutionary stages, the changes in each of the three circles,⁷ as represented in the diagram below.

Figure 2. The Three-Dimensional Model of Family Business Development.



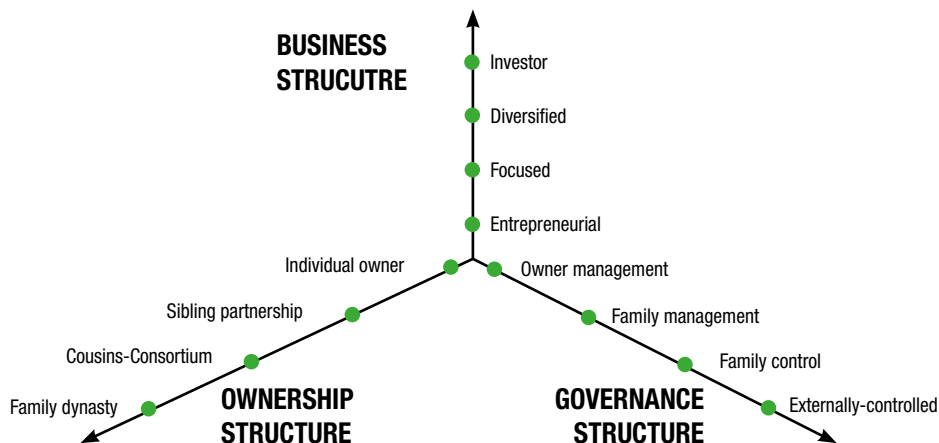
6. For more information on the circles' intersection, see IBGC, Caderno de Boas Práticas de Governança Corporativa para Empresas de Capital Fechado, 2014 [in Portuguese].

7. K. Gersick et al., Generation to Generation: Life Cycles of the Family Business, 1997.

Each stage of the three axes presents different challenges, which must be addressed specifically. The founder's challenges are different from those that will be faced later, in the same company, by the cousin consortium, just like the challenges of a company in its early stages won't be the same when it is developed, and so on.

We can also mention the approach researcher Peter May⁸ recently developed in Germany, where there are lots of long-lasting family businesses. May's model contemplates three axes. The first is related to the business structure. In it, starting with the founder, usually with entrepreneurial characteristics, the family businesses can be classified as "focused" (when they are dedicated to only one business), "diversified" (when they have a business portfolio) or "investors" (when they manage their investments in a business portfolio). In the ownership structure axis, the business families evolve from the individual owner to the sibling partnership, then to the cousin consortium and, if they are long-lasting, to a family dynasty of many generations. The third axis, related to the governance structure, evolves from the owner management to the family management (when the CEO or directors are family members), then to family control (when family members are part of the board of directors or, in the last instance, only of the partners meetings). In practice, there are companies with the most varied combinations. There can be, for instance, a diversified family-controlled company already in its fifth generation, that is, a dynasty with dozens or hundreds of partners; or a diversified family-managed business which is a sibling partnership. For each situation, there are strengths and challenges of various natures. For instance, in a company managed by the owner, there usually is a reliance in decisions, centralization, and succession issues. In the sibling partnership there can be issues with rivalry or conflict of interest in management. In turn, in family companies, the most challenging aspect is to maintain the emotional value, the member's connection to both the family and the business. It is important to note that, in every case, governance contributes to a contemporary, sustainable management.

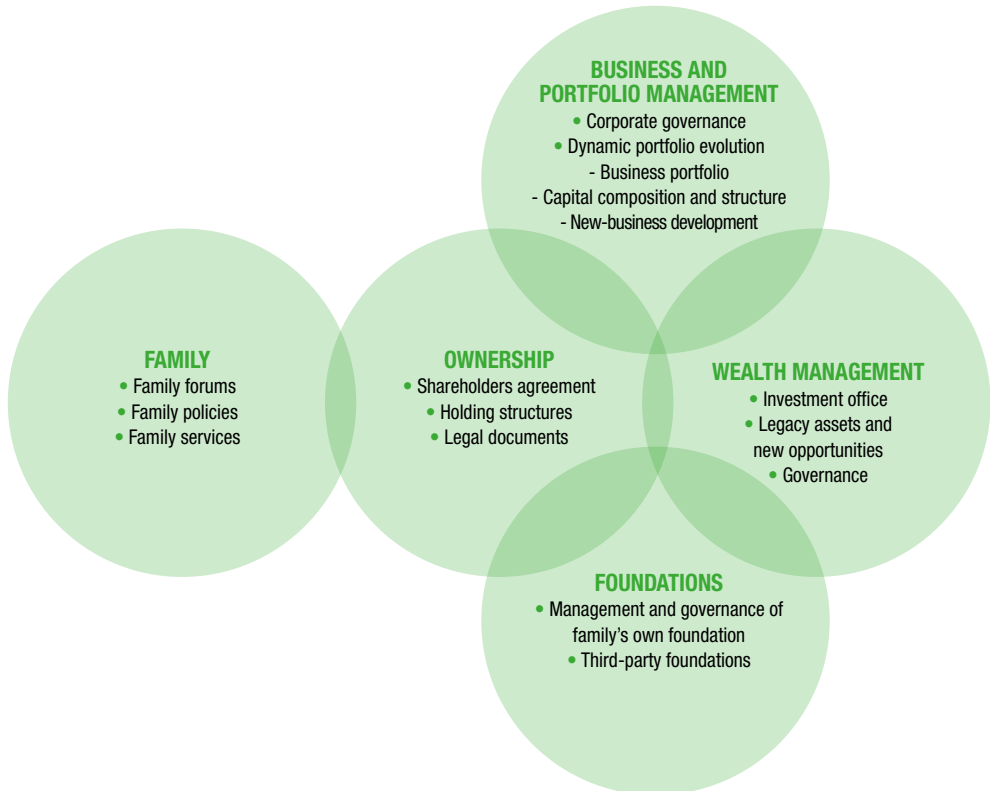
Figure 3. INTES-PwC Three-Dimensional Model, developed by Peter May.



8. See C. Mendonça, "A Boa Governança nas Empresas Familiares Alemãs", 2015.

Other specialists in the area suggest other approaches. Equally respected researcher Heinz-Peter Elstrod and his colleagues at McKinsey advocate for a model with five circles of power, which includes, as well as family, ownership, and business, the circles of wealth management and social actions. Also, the group says the business focus and decision-making processes change over time, according to the family's growth and the business's development⁹.

Figure 4. The Five Circles of Power Model.



This work's goal is not to get deep in the theory nor to encompass, in just a few lines, every existing theory about the dynamic of family-controlled companies. For that, it is ideal to read the originals (indicated in our bibliography). Suffice it to say that, though it is the most known, the Davis model is not the only one. Every model, however, converge in one point: family-controlled companies face specific challenges which require specific solutions. In Brazil, we see a growing number of companies interested in preparing themselves to deal adequately with these issues. So, we see a growth in the number of family-controlled companies which see family governance as an essential ingredient for the success of its management processes and its businesses.

9. See H.-P. Elstrod, C. Caspar and A. K. Dias, "The Five Attributes of Enduring Family Businesses."

Main Characteristics of the Family Business



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3. The Strength of Purposes and Values

● ● ● ● 3.1. The Strength of Purposes and Values

The backbone of the business family has two pillars. The first is related to the family purposes and its relationship to the business. It defines its reason for being as a family and a company. The second pillar is about family values, that is, the principles and beliefs that guide individual conduct and establish group relations.

The alignment of purposes and the daily experience of values are the most precious asset in a business company. It is what inspires the future and, at the same time, plays a key role in establishing governance parameters, functioning as a ruler to define processes of succession, family roles, conflict resolution, educational principles, and so on.

Purposes, values, education, and love of work are essential items of heritage that one generation can pass on to another, because they represent the strength of a legacy capable of impelling new generations to new achievements, looking to the past with pride and to the future with confidence.

● ● ● ● 3.2. The Importance of Family History

The family history, from the founder or founders' exemplary model of entrepreneurship, is the "glue" that agglutinates, strengthens the bonds between family members, and serves as a reference to define family identity. It should be seen as a basic subject in the education of new generations and disseminated to all in a continuously and systematically. The registration and sharing of historical data is the foundation where the "feeling of belonging" to the family and the commitment to the legacy between generations are cultivated.

Family history can be disseminated in diverse, simultaneous ways, appropriate to each family member's age group: virtual platforms, small "museums," books, photo albums, films, videos, family trees, genograms, social networks, role-plays, comics or whatever else technology, new media, and creativity are capable of producing and conveying.

● ● ● ● 3.3. Long-Term View

Other characteristics of the family business result from the commitment to the legacy: long-term vision; emphasis on stable relationships and perpetuation of the company, based on trust, respect, commitment, and involvement; attachment to the business; pride in belonging; dedication to the company and attention to aspects such as sustainability, among others.

One of the most positive consequences of this ability to plan and invest in the long term is the so-called “patient capital” (i.e. which has the “patience” to obtain a return), which does not cling only to monthly or annual results, but promotes stability and long-term vision, making it possible to face circumstantial turbulences with greater serenity. It is worth pointing out that, generally, family businesses aim at the longevity of both the business and their family. However, businesses and families evolve in a dynamic way and can: (1) due to strategic interest, allow the entry of new partners or the partial or total sale of the business; and (2) due to interest and need of the corporate family, experience be a succession process in the company and/or management (this subject will be addressed later in item “4.8. Succession Process”).

It is important to remember, however, that having a long-term vision does not mean “closing your eyes” to the opportunities that arise in the short term, but taking advantage of these opportunities with a focus on the business longevity.

● ● ● ● 3.4. Social Commitment and Sustainability¹⁰

Family-controlled companies have historically been very close to its surrounding community, in addition to being more involved with social investments. The origin of this, it is believed, is the fact that these companies have a greater desire to maintain their legacy of citizenship and family identity, in addition to generally being more aware of the impact of their businesses on the communities where they are inserted and of the mutual and fruitful dependence of a good relationship and coexistence. This often implies a more consistent long-term vision and extrapolation of organizational values, which also tend to permeate the relationship with external stakeholders.

Social commitment is generally a shared value, encouraged in family-controlled companies. Besides contributing to a more equal, fair society, it promotes the economic development of the community and the company itself. Educational actions, for instance, result in increased productivity for the local worker and reduced labor migration costs, which translates into social sustainability and gains for everyone. It is important to emphasize, however, that such projects must always be aligned with the values and strategy of both the family and the organization. The dissociation between social commitment and the company’s vision and mission may represent a risk to its longevity.

Environmental issues may also contribute to the creation of long-term projects by preserving the environment’s integrity for current and future generations.

This approach—which equally considers economic, social, and environmental aspects and is aligned to one of the basic governance principles, corporate responsibility—allows

10. *We understand sustainability, according to IBGC’s Guide of Sustainability for Companies, p. 15, we as “an innovative approach to doing business, in the sense of supporting the businesses economic-financial viability, and, at the same time, preserving environmental integrity for current and future generations, as well as building more harmonious relationships in society, resulting in a positive, solid reputation.”*

us to better identify risks and opportunities, offering a greater probability of continuity for the business and simultaneously contributing for the sustainable development. In this context, we also recommend the establishment of a broad compliance program,¹¹ with continuous monitoring, giving real-time quality information for appropriate decision-making.

11. The compliance program's aim is to ensure that legal and regulatory norms are followed. It also strives to ensure the adequation, strengthening, and functioning of the organization's internal controls.

The Family Company Challenges



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4. The Family Company Challenges

The challenges of family businesses are, in many ways, the same as those faced by any type of company. Strategy, planning, management, and corporate governance are as important for family companies as for non-family ones. One of the differences is that the latter, if badly managed, can immediately replace their managers. In family businesses, substitutions tend to be more complex when management positions are occupied by family members (or by people close to them). Hence the need to analyze the challenges of family businesses in their different dimensions (family, company, and ownership), always seeking harmony at the top, alignment, and joint leadership preparation.

It is worth remembering that, if the focus of this document was the business aspect of family governance, several challenges would deserve to be highlighted, because, if not properly equated, they can contaminate and damage the company and the family harmony itself. Some of these challenges are: paternalism and protectionism, undue interference, centralization and difficulties sharing decision-making power, emotional decisions, confusion of assets and of financial order, among others. About them, information and guidance can be found in the works cited in the bibliographical references of this handbook. At the business family governance's core, which is this handbook's focus, emphasis is given to some other subjects that deserve special attention. They reflect the family's challenge to reinforce its identity in relation to the company (and not only in relation to the family itself) and to remain aware of its importance for the business and vice-versa. It is this interdependence that characterizes the business family and its enterprises.

● ● ● ● 4.1. Perpetuating the Family Identity

A clear, solid family identity strengthens the family member's union and the family's relationship with the business, solidifying the shared DNA.

Defining family identity is the first step in perpetuating it. This is usually done based on items like mission, vision, values, and alignment of purposes and behavioral, emotional, and communication patterns between family members. This process may or may not have the help of a specialized external view.

But as important as defining family identity is to practice daily, reinforce it and pass it on to all family members, especially new generations. How can you do that? In many simultaneous ways, starting with the example of daily experience and including research and dissemination of family stories and achievements. Family members' engagement and awareness that everyone is part of this construction process are key to strengthening the family identity.

Continuous, structured communication of the family identity makes abstract concepts more tangible and must, therefore, be a constant focus for the business family.

● ● ● ● 4.2. Liquidity Strategy

Liquidity necessities usually happen at times in times of corporate restructuring, for instance, in the succession among generations; when there are personal needs from family members or the business; or in case of partner conflicts. The family must consider this possibility in their planning and be ready for that moment.

As the business family grows and spreads out, the chances of having partners looking for liquidity also grow, and this must be faced naturally. Since addressing possible liquidity necessities is an issue to be resolved in the shareholders agreement and the company's internal regulation, using the specific technical means, such as drag/tag along clauses,¹² criteria for business evaluation, and so on.

Since mobilizing resources requires time, it is necessary, once again, to have a solid planning and to establish minimum deadlines, in such a way as to not harm the business in the face of eventual urgencies of liquidity.

● ● ● ● 4.3. Family Union

The union around common goals is key for the perpetuation of the company. Harmony among family members makes the group stronger and the decisions easier, and contributes to the business's success.

Differences of opinion are not negative events and, as long as they are debated in a positive manner, can even help improve the decision-making process. But the emotional nature of family issues and the desire to preserve harmony often indefinitely delay the debate of more sensitive issues. When these finally surface, it may be too late, and reactions may be even more exaggerated and difficult to control, reinforcing the belief that they should not be addressed and starting a vicious circle that may have serious consequences in the future. In cases of extreme difficulty and rigid disagreement, outside help from a professional or specialized team can be of great value, bringing an outside view and an analytical mediation process to the problem or conflict. In this case, in addition to mechanisms such as protocols and agreements, also mentioned below, codes of conduct and regulation mechanisms may be helpful.

Many experts in family governance consider it better to learn how to manage conflicts than to try to get to their roots to resolve them. Others advocate the opposite: conflicts can be viewed positively and should be made explicit and resolved through dialogue. Views may vary, but prevention is easier than control. In this sense, protocols, agreements, and other forms of formal regulations of family relations play an important role.

12. *Drag along: an insurance mechanism for the majority shareholder, establishing the obligation for minority shareholders to sell their shares in case there is a change in control.*

Tag along: a mechanism of protection for the minority shareholder, obliging the control acquirer to make a public offer of acquisition to all shareholders, thus guaranteeing their right to take part in the transaction.

To create rules that prevent or minimize family conflicts, one can start by identifying the most frequent causes of disagreement. Among them will certainly be issues such as dividend payouts, strategies and management of family assets, family members' professional careers in the company and others (see examples of rules in the chapter "Recommended Practices").

Of course, having rules is not always enough. Conflicts happen in all interpersonal relationships and, sometimes, the solution is to resort to a reliable process of negotiation, mediation, and arbitration, preferably external and without emotional involvement with the case.

● ● ● ● 4.4. Relationship Dynamics

The dynamics of the internal relations in the family business must be treated with special zeal and attention. In a family company, the emotional aspect, guided by kinship and intimacy, is a constant challenge. Keeping it under control is, therefore, essential and becomes easier when family members have the ability to relate to their peers and to understand the business—competences that aren't always native, but can be developed or acquired. Self-knowledge, clarity of roles, emotional intelligence, ability to work as a team, respect for differences, transparency, and communication are important elements to make relationships more fruitful.

Some recurring issues can be minimized by governance protocols. For example, succession processes; family members without qualification for the desired position; attempts by members who do not work in management to influence business decisions; ambiguity of partners when wearing the family or business "hat;" generational differences of goals; and many others.

Deeper emotional aspects can also affect the business. A frequent situation is for the founder to display a dominant personality which in the past (controlling-owner stage) made it possible for the company to be created, but can now represent an obstacle to the development of successors and the business. In the same category are unspoken desires and motivations, old rivalries, individual agendas inconsistent with business goals, conflicts with aggregates, and similar situations.

To identify and address these issues, there is nothing better than to seek transparency, practice and stimulate communication, establish relationship rules, and, if needed, seek a specialized mediator. Trying to reach a common understanding among the interlocutors is essential for an efficient dynamic in the relationship among family members.

● ● ● ● 4.5. Retention of Talents from Outside the Family

Attracting and retaining external talent should be a constant concern of family businesses. Whether it is true or not—since no two family companies are the same—, many times non-family senior executives run into the idea that there are limitations to evolve within a family company. This perception can hinder the already complex task of motivating and

maintaining external talents, which are, after all, essential for the diversification, evolution, and innovation of any company.

Once again, the systems and processes of family governance are indispensable, because they make clear and established, since the beginning of the partnership, what are the parameters, rules, limits, levels, opportunities, and expectations related to the non-family professional, avoiding future surprises for both sides. Explicit rules, communication, transparency, and meritocracy are good family and business governance practices that benefit not only the relationship between family members, but also between them and non-family executives. The demonstration of an environment of trust generated by formal and material processes of corporate and family governance, producing predictability and respect, not only retains but also attracts talent, something increasingly needed by organizations.

A good measure when recruiting external executives is to prioritize professionals with a philosophy, culture, principles, and values compatible with those of the company in question, instead of focusing only on their performance capacity. It is equally important to offer real opportunities for evolution within the company and maintain them over time.

● ● ● ● 4.6. Renewal

Renewal and entrepreneurship mark the creation process of all family businesses. Though the capacity for renewal is vital for the longevity of any business, it is traditionally seen as one of the great challenges of family businesses, especially those under the command of the third or fourth generation. Many factors come into play, and, faced with the responsibility of maintaining the business's success, successors often tend to opt for safer, traditional, already tested strategies instead of undertaking innovation. Additionally, the need for consensus to make decisions and the large number of family members who become dependent on dividends increase managers' responsibility and, therefore, the potential aversion to the risk of renewal—as well as the possibility of forgetting that the real risk is that the company becomes complacent and uncompetitive.

On the other hand, the accelerated pace of transformation the world is experiencing and the arrival of new technologies and new competitors bring to the new generations who come to power the need and opportunity to review their portfolio. It is up to them to reflect whether the current pattern of competitiveness is sustainable over time or whether it is time for a change, whether that is only incremental or transformational—both require distinct levels of innovation and organizational and family readiness.

The safest way to ensure that renewal is part of the corporate and family culture is to encourage periodic strategic planning or reflection processes. Both should include consistent benchmarking and sector analysis, so that both current and future generations understand the context and position themselves on their business portfolio and ways of competing and sustaining competitive advantages over time.

Developing a culture of renewal is therefore crucial for both the company and the partner family. To do so, there is nothing better than developing and hiring talent, empowering them, and opening internal spaces for the debate of new ideas.

● ● ● ● 4.7. Instructing the Next Generation

The next generations' education is ultimately what will ensure that the business remains in the hands of the family. Family governance must therefore seek to ensure the individual fulfillment of each family member, giving full awareness of their rights and, above all, their duties. This will facilitate the process of preserving the family's main asset: the business. The awareness of this process should preferably start early, with education transmitted from parents to children through examples and guidelines.

An important challenge for family governance in this regard is to awaken and maintain the new generations' interest in the business. How to do this is a challenge upon which each business family should think, but some tips can help: include the new generations from an early age in family meetings, practicing activities in accordance with the age group and field of interest; provide young people with internship and trainee programs, inside or outside the family business

It is also the responsibility of family governance to provide support to all heirs, both professionally and personally, seeking to train qualified and productive individuals who have a good relationship with their peers, based on the same principles and values. A good family governance structure allows you to identify talents, guide and follow the education of leaders and potential successors. But as important as supporting those who will get directly involved with the business is to accompany those who will follow other paths and qualify them for a successful professional life.

Spouses have a key role in the whole context, and it is also up to them to contribute to the education of family partners who are aware and ready to play their parts, as well as to organize qualified forums of information, analysis, and decision making.

All these aspects—of the educational formation, personal and professional orientation of the family members—must be included in the family's protocols and constitution.

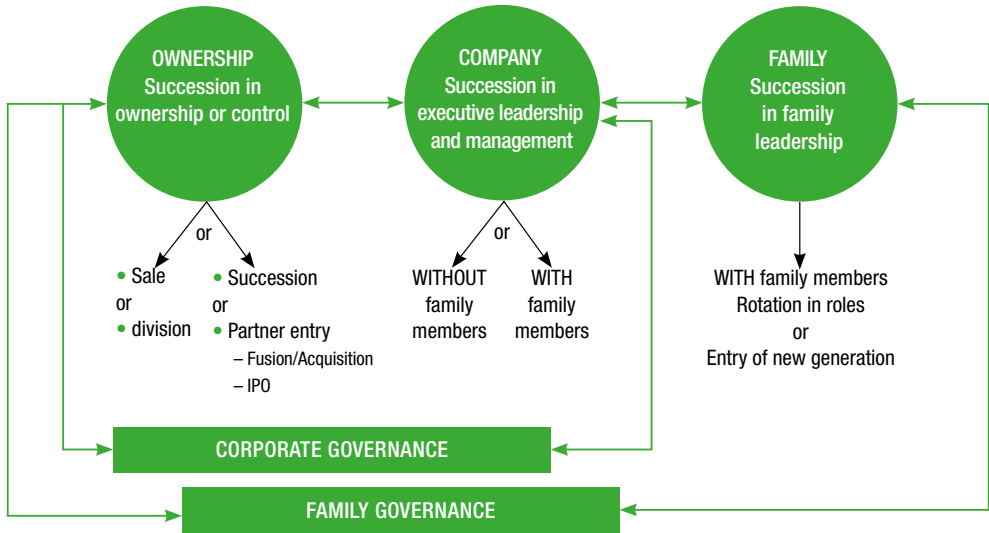
● ● ● ● 4.8. Succession Process¹³

The succession process of family companies is continuous and occurs on the three circles: family, ownership, and management¹⁴ (see figure 1). In the strict family sphere, on which we will focus here, values and common vision of future are the basis to ensure harmony during the process. The guiding rule is governance. It is also a determining characteristic of the company and the controlling family, such as type of culture, maturity of the business, stage of ownership, stage of the business family, and the environment in which it operates.

13. *More on the subject on IBGC, Guia de orientação para planejamento de sucessão, avaliação e remuneração de conselho de administração e diretor-presidente, 2011.*

14. *For more information on succession planning on the context of ownership and management, see IBGC, Caderno de boas práticas de governança corporativa para empresas de capital fechado, 2014.*

Figure 5. Key events in the succession process



In any case, succession is one of the most determining and complex processes of family-owned companies. It is the moment when the business family sees itself face to face with its ambiguities, having to deal, on the one hand, with financial aspects and legal structures; on the other, with emotional factors, bonds and family culture.

During the processes of change, crisis, and succession, the socio-emotional component takes on a relevant dimension, since positions as well as roles will be reviewed, and the movement in the family can generate the most diverse emotions. Successful ones will have to face the feeling of losing the ability to lead the business, losing control of a successful enterprise, absence of new abilities, fear of not having the same importance to the family group and society anymore. On the other hand, the successors will have their skills in running the enterprise tested. It will be necessary to include everyone involved in a new psychological and emotional space, and the type of environment will facilitate or restrict the new agreements. Everyone will need to use relationship resources for the service of the family group and the good of the business, so that the family/company whole acquires a new and better configuration.

Like with any change, the transition can offer opportunities for growth, but also cause discomfort. To meet these challenges, both the top management and the family must prepare and align themselves according to established governance models. A well-planned and well-executed succession process contributes to the longevity of the business, the sustainable growth of the company, and the continuity of the family legacy. It therefore requires attention to the preparation of family members and the criteria for identifying who has the profile, interest and qualification to hold positions. Seen this with tranquility contributes to the succession, as a process that can deepen relationships, integrating family and business not as a one-time occurrence. By preparing for succession proactively, family members grow together and learn to interact constructively to pass the business on to the next generation.

One succession process is never the same as another and there is no universal recipe. The only certainty is the positive contribution of governance structures, which seeks to ensure that all agreements are already defined, that the long-term vision is aligned, that management structures are in place, that values and rules are instituted and accepted, and that the family group is attentive to its socio-emotional aspects.

In the sphere of family governance, both the generation that holds power and the one that will take it on must prepare for the change, which will happen sooner or later. The preparation of successors must begin early, in the training and education of new generations. It is equally important to think of those who will withdraw and include in the planning items to ensure the financial, physical, and psychological security of those involved. For the senior generation, it is time to think about reformulating habits and paving the way for young people.

Nor should those family members who do not work in the company or do not participate directly in the process, but can impact its development, be left aside. In fact, the whole family should be approached. The more inclusive and consensual the succession process is, the better. The more information, training, and interaction among family members, the better. The more everyone knows their peers, rights and duties, assets, goals, and strategies of the common business, the smoother the transition. Hence the importance of communication and interaction promoted by family governance. The institution of seminars in family meetings, with the goal of acculturation on the various aspects of governance and business moments and operations, are of great value for this process

It is worth noting that leadership succession within management often involves one or more family members—which can be a great solution, as long as the family member has the appropriate profile, competence, and skills, in equal or superior conditions to a non-family professional.

In the absence of a family successor who fulfills the established requirements or if it is in the group's interest to bring an external professional to the company, the business family may seek a non-family manager. In this case, a good measure is to define parameters, goals, and, mainly, the decision scope of this professional, as well as to elaborate a document with the description of his/her attributions, before starting the selection process. It is worth remembering that, besides capacity and performance, factors such as values, principles, temperament, and philosophy of life may define the relationship of the executive with the business family.

The non-family manager can be recruited within the company itself or in the market, depending on the moment and the goals of the business family. In any case, some attributes must be valued: ability to bring people together and unite them; good level of self-esteem and self-confidence; maturity and clarity to define the role and exercise his or her decision-making power with the partners and the company; principles and values that are compatible with those of the business family; balance, leadership, and maturity to deal with family issues that can affect business decisions.

To preserve harmony between the partners and the non-family manager, there is nothing like defining limits in a transparent way from the beginning of the partnership and reviewing these parameters from time to time. Just as the family can't disrespect the autonomy spheres of the manager and the limits of governance, the manager must also understand his position and respect the agreed-upon boundaries.

Family Governance and Its Structures



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5. Family Governance and Its Structures

The implementation of formal governance practices is never the same in every family and can follow different paths. The installation of processes and structures can take months or years, be simple or complex, depending on the family characteristics and maturity of the company. But there is a common denominator: governance is a continuous and constantly evolving process, which delimits spaces and roles and makes family life easier. It should not imprison the family members, who can (and should) always make use of creativity and entrepreneurial mechanisms that have a certain degree of informality and intuition. Corporate, partner, and family governance should be formalized in its structures, rules, regulations, devices, and procedures, in order to establish its institutional framework. But it must also provide mechanisms for its materialization through the real and effective practice of its essence and form, in a cycle of continuous improvement, permeating the whole organization, agents involved, and interested parties with its programs.

To implement family governance, one of the initial steps may be the formation of a council of family members and partners, of an informative and advisory nature only. Then, the process of separating the subjects inserted in the three circles of power (company, family, ownership) begins and each one requires the establishment of its respective structures, processes, and councils (board of directors, family council, and shareholders assembly).

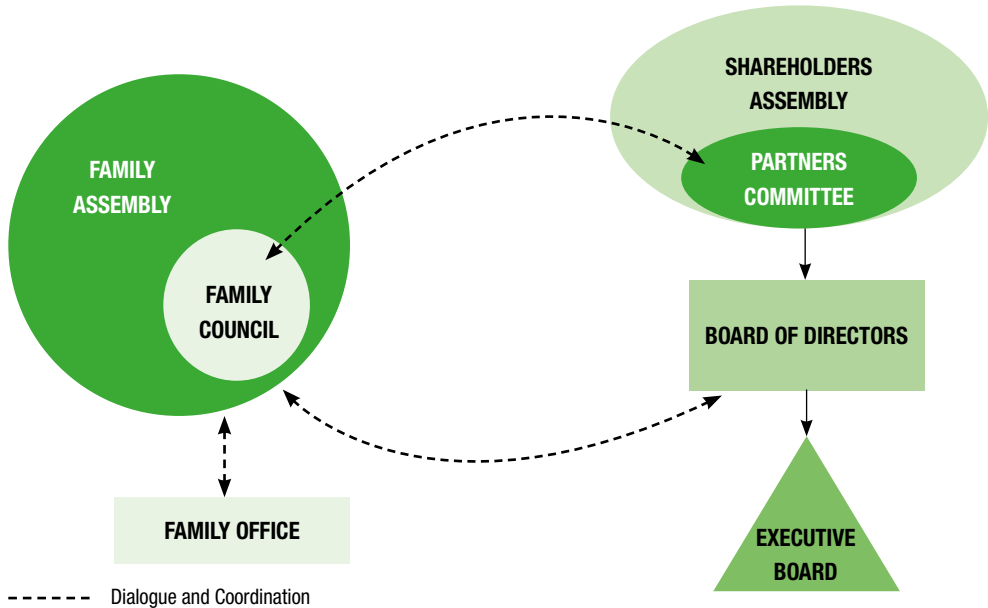
In general terms, the board of directors is responsible for the strategic direction and the election and supervision of the business management; the family council, for family policies; and the shareholders assembly, for electing the members of the board of directors (or the company's own managers, if it does not have a board of directors) and making more significant business decisions. The three instances should work in a coordinated manner. The family council should have a good communication and goals that are consistent with those of the partners or, when there is one, with the partners committee (a body without a deliberative role that discusses corporate issues and makes recommendations to the assembly); and, at the same time, work in line with the board of directors in business matters.

Working together does not mean just discussing decisions, but having complementary agendas. For example, the family council recommends the policy to hire family members in the company, but this recommendation needs to be discussed and approved by the board of directors to become a business policy; the board of directors suggests how family members should act in business roles, but this suggestion needs to be approved by the family council to become a family policy.

In order to be implemented and evolve, family governance needs financial support. There are several ways to fund family governance structures: for example, expenses can come out of the distribution of dividends or be paid by each family member, depending on the business's size and maturity. This is an issue to be agreed upon by each family and company.

Figure 6 presents the structures and dimensions of family governance and its relationships with other circles of power. It is a general diagram, and each family must adapt it to its own reality. The structures mentioned may vary according to the size of the group, the diversity or the complexity of the family, and the group of members.

Figure 6. Family Governance Structures.



Source: Cambridge Family Enterprise Group, 2015

● ● ● ● 5.1. Family Meeting and/or Assembly

It is a broad forum of informative, guiding, and/or deliberative nature, where family alignment and positioning are debated, in which all family members participate, according to previously agreed rules regarding age group, participation of spouses and aggregates, among others. There are various models, which reflect the profile of the business family in question, but generally the family assembly is a celebration of family coexistence and has a more strategic scope.

Thus, its main goal is to promote contact, integration, and communication among family members, in addition to sharing visions and aspirations. After a good meeting, the participants should feel not only united around a common ideal, but certain of having received relevant information about the other participants and the company.

The family assembly generally meets once or twice a year to hear and ratify the family council's recommendations. Typical activities include:

- Update about the activities developed throughout the year;
- Annual rendering of accounts (budgeted x fulfilled);

- Statements about the company, ownership, and other family activities;
- Evaluation of the activities of the various family governance structures;
- Debate and definition of guidelines, plans, and family policies;
- Election of the family council.

For the family assembly to attract and motivate the younger members, a good choice is to offer specific activities adequate to their age or include them as listeners on some debates.

● ● ● ● 5.2. Family Council

Made up of a group of family members elected by the family assembly to represent them, the family council is responsible for the interface with other governance organs. It is up to it (and its eventual committees) to propose and monitor the family's activity scope.

A good way of starting the work in a family council is to define, preferably in writing, the principles, the mission, the vision, the goals, and the values shared by the family, as well as some basic rules to guide intrafamily relationships and the relations of family with company and society at large.

The family council should get together at least with the same frequency of the family assembly. To preside it, we recommend someone who can balance reason and emotion, and has the respect of all family members. It can even be the same person who presides the family assembly.

Some common activities of the family council are:

- To stimulate family integration and union;
- To define the family assembly's agenda;
- To promote communication among family members and between the family and other organs;
- To elaborate and update the "Family Constitution", including: family values and mission; rules and guidelines protocol (relationship between family members and between family and family company or other enterprises); and, occasionally, important elements of the shareholders agreement (governance, share transferal, inheritance, and others);
- To support and accompany preparation and education of the family members for the role of partners and/or members of other governance forums;
- To contribute to the career planning of family members, inside or outside the family company;
- To organize, preserve, and disseminate the family's memory and legacy;
- To establish social responsibility guidelines and philosophy, as well as to follow its development;
- To mediate conflicts;
- To coordinate the succession process;
- To lead the family office, if there is one.

● ● ● ● 5.3. Family Office

Increasingly widespread, the family office is the structure that supports family governance and provides services to family members. There are several family office formats practiced by families, which range from simple concierge services¹⁵ to asset management or philanthropy management. The structure and size of the family office is also dependent on the size of the work to be done and there are no general rules valid for all models.

However, it is usually subordinated to the family council, has a more tactical-operational role, based on the family's proposals, principles, and values. It may or may not include family members. Some examples of activities are:

- To manage the structures of asset protection;
- To implement the plans defined by the family council;
- To interact with other family structure organs;
- To manage financial and property assets for the family members;
- To serve or attend to the needs of family members and their companies (for instance, doing and paying taxes, solving legal issues regarding the family);
- To create and execute development and educational programs for family members;
- To research, organize, and disseminate family history;
- To promote in various ways the preservation of family values;
- To support the process of property succession, led by the family council;
- To support the family council, looking after the daily practice of the shareholders agreement.

● ● ● ● 5.4. Partners Committee

There is an obvious interweaving between family governance and the partners' actions, which is why a structure has been included here that concerns these two spheres: the partners' committee. At the ownership level, the two basic structures are the shareholders assembly and the partners committee or meeting. In situations where there are few partners, the two structures overlap. When there are too many partners, including non-family members, a partners committee can be established for a temporary period to address specific issues. It is a body without a deliberating role, in which the controlling group discusses, through its representatives, matters typically corporate or that exclusively concern the members. The committee's recommendations are taken to the partners' meeting (of the holding or the main company), which approves and formalizes them. In this way, the body has the role of preparing and guiding the performance at the company's general meeting. For example, it may deal with the entry or exit of large businesses, dividend distribution policy and transactions above a certain level (defined based on a percentage of the group's assets).

15. This services include booking trips, supervising household chores, and shopping for various items, among other attributions.

The committee may also have the task of developing or updating the controlling group (family) partner agreement, offering recommendations to the group of partners that will be signatories of the document.

● ● ● ● 5.5. Coordination of Corporate and Family Governance

The coordination between family and company should take place through the board of directors, the family council, and/or partners committee, once each one's mission and role has been defined. In practice, this happens in several ways: through structured systems of communication, relationship protocols, informative reports, and/or occasional interaction of participating committee members.

Recommended Practices



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6. Recommended Practices

● ● ● ● 6.1. Communication and Transparency

Good communication helps to qualify governance, as well as strengthening family ties and the notion that they are all part of a group. As the family grows, however, it becomes increasingly difficult, if not impossible, to sit around the table to exchange information or discuss common issues. On the other hand, there is an increasing amount of electronic equipment, tools, and means available for accessing information at a distance, sharing experiences, and connecting family members: computers, laptops, tablets, smartphones, applications, websites, social networks, digital platforms, and so on.

Each family must adopt forms of communication according to the characteristics of the family, the nature and confidentiality of information, etc. In any case, the technological evolution of communication mechanisms and new forms of interactivity do not replace the strength of face-to-face meetings, but offer alternative environments for family members to receive information and express opinions and expectations, in an interactive process.

Not all information needs to be widely disseminated or is the responsibility of all family members. But there are items that can and should be shared periodically in order to keep the group integrated and updated about the business: institutional information, strategic guidelines, results update, financial reports, business positioning in the market, work agendas, relevant internal and external news, clippings and institutional or business-related news, besides other items that are mandatory by law or regulation. News about acquisitions or diversification of individual businesses should also be communicated in a clear and transparent manner, as a demonstration of respect to partners.

To promote family integration and stimulate the relationship, it is also important to share, preferably interactively, personal news: achievements, conquests, awards of any kind, birthdays, celebrations, photos, and news.

The challenges in communication are numerous and diverse, but practicing helps improve performance. A clear, strong, structured, and fair communication, based on the family's principles and values, promotes closeness and trust among family members. It is no wonder that specialists recommend that communication channels are always open, with updated, frequent contents, managed by professionals or dedicated structures.

● ● ● ● 6.2. Meritocracy

The more the business family grows, the bigger the need to establish clear rules to formalize the entry and professional growth of family members in the company.

Current demands are complex and the competition is intense. Market vision and pressure for results demand high qualification of family members, either compatible or higher than market average.

The first step in managing these issues is to establish clear rules for entering the family company. Many of these today demand technical training or highly-qualified formal education; others establish as a pre-requisite that the family member accumulates professional experience outside the family company. Some forbid the creation of jobs for family members and, when one naturally opens up, the aspiring person's qualifications must fit the desired profile, like with any other candidate.

Criteria for promotions, raises, termination, and other professional events must always be in the rules, following the same commandments that are valid for the whole company.

Some topics worth being defined:

- When and how the company can hire family member and/or their spouses;
- What is the obligatory qualification and for which positions.
- What is the expectation for the participation of family members in the company;
- How will the hiring process be and who will be responsible;
- How and who will follow and judge the performance of the family executive;
- How and who will lead the compensation, benefits, and promotion policy;
- If a family member can or cannot report immediately to another family member;
- What are the criteria for an eventual termination from the company;
- How will the career plan be conducted.
- How, when, and who will select future leaders;
- How to prepare and motivate young members to join the family company;
- Age and conditions of exit from the company.

● ● ● ● 6.3. Social Responsibility

Besides contributing to generate a good image of the family and deepening its ties with the community, social responsibility reinforces the commitment and unity of family members. Social projects are especially stimulating for new generations: they awaken and solidify values and help develop professional skills.

It is important, therefore, to include in the agenda of discussions what will be the family's activities in this area and how they will be implemented, making sure they are aligned with the family structure of values. Some family businesses create foundations; others allow members to invest part of their personal budget in activities of their particular interest; in many of these social projects, family members participate in the board of directors or as staff—as long as they have the necessary skills and technical abilities—or act directly in the projects, as volunteers or not. The family can also position itself in the area independently of the company, if so agreed in a joint decision. In any case, if the financing of these projects comes from a collective fund or from the company, care must be taken not to transform social projects into personal projects.

Organizational and operational issues inherent to these activities should not be underestimated and can be solved internally or through partnerships. Knowing how to act with

professionalism is essential. As with any enterprise, success depends on having qualified personnel, managing operational costs, investing in strategy, planning, goals, and carrying out later evaluation of achieved goals in relation to results.

● ● ● ● 6.4. Legal Protection of the Family

Legal instruments such as wills, prenuptial agreements, donation with usufruct, and other civil legal documents, besides the creation of family holdings, are only some examples so that the family can rely on a minimum structure of legal protection and stability, both in the scope of tax planning and in family longevity guided by the principle of kinship, generation by generation.

Openly talking about legal instruments that prevent conflicts is key in the family circle. Establishing rules, pacts, and agreements in advance helps to avoid wear and tear, hard feelings, distrust, and misunderstandings, strengthening harmony.

However, even if the family circle is organized, the intertwining of family circles with the business and ownership circles should not be overlooked. In family businesses it is very important to take care of tax, labor, anti-corruption, and environmental liabilities. These can cause profound problems to assets, partnerships, and the family if not treated with due care and attention.

For example, in several cases provided for by law, the Brazilian justice may disregard the legal personality of the company and advance on family assets of individuals who are signatories from society. In this sense, the responsibility of family managers is even greater, and they should seek deep knowledge on the subject.

Family partners must be aware of their responsibility in the sphere of the patrimonial society, after the signature of the social contract, because they will assume a series of obligations among themselves and before the community, as indicated by Article 1,001 of the Brazilian Civil Code.

Thus, compliance and risk management programs should guide the three circles of family businesses to the control of good governance practices, legally protecting the company, the ownership, and the family members.

● ● ● ● 6.5. Rules and Protocols

Rules are essential to ensure the alignment and transparency of relations inside the family and of the family with the company. This is why they must be created in such a way as to be lasting—which doesn't mean that they shouldn't be revised from time to time. To be effective, the rules must be clear and written in the form of a statute, constitution or similar document. If very well debated, defined, and accepted by all involved, they will naturally be respected. There is also no point in establishing rules if there is no real willingness, desire to share and harmony at the top. Understanding that it is not always possible to win is the basis for achieving a harmonious coexistence and building something greater.

One of the means to establish good rules is to ask good questions about each structure or process. We list below some suggestions related to the family, some encompassing different instances and circles of governance:

Family assembly – Who can participate? What is considered family when it comes to participating in the assembly? How to elect the family council president? What about the partners committee, in case there is one? What is the frequency, duration, and theme of the meetings? Who can take part in the assembly to give information and collaborate on topics such as education and qualification?

Family council – What is the most adequate composition to generate cohesion and credibility with the family? What is its scope of action, mandate, and sphere of competence? What is its role regarding education, communication, and support for family members? What is its power over the family and the business? Are the members going to be compensated?

Board of directors – Who can participate? What are their roles and scope to make decisions? What is its size and structure? Will all members be compensated? How will this be determined? What are the required qualification and profile of the members? How will the interaction with the family be? What is the duration of the mandate? How will it be evaluated? How can family members be prepared for future participation on the board? How and when will the board and board members be evaluated?

Work in the company – Can family members work in the company? If so, what are the pre-requisites and conditions (for instance, is there restrictions for spouses and non-blood related family)? What are the criteria for compensation, promotion, raises and other benefits, voluntary and involuntary termination?

Shareholders agreement and liquidity – What are the shareholders' rights and duties? Who can sell shares, when and for whom? How is the buying and selling price of shares determined and by whom? Is there a minimum to buy or sell? Who can vote? What is the duration of the agreement? What are the options to generate liquidity? To create an exit fund? Will shares be recorded with clauses for usufruct, incommunicability, and unseizability?

Dividends – How does the family see dividend distribution? What are the criteria for dividends distribution? What is the periodicity? What percentage of dividends should be reinvested in the company or retained for future needs?

Loans – Restrictions to publicly-traded companies aside, can the company loan resources for family members? It is worth remembering that this is not a good practice, but, if it can, how much and under what circumstances and rules? What can be given as collateral? Can shares of the company be given as collateral for third-party loans?

Communication – What type and channels of communication can be used between family members? What about between family members and management? What about between family members and the public? Are legal criteria about what is confidential and what needs to be communicated being obeyed? What are the limits and frontiers on topics to be approached?

Social investment and philanthropy – How do these subjects align to the family's values and goals? What is the family's and the business's position on these two modalities? Who decides about projects to be sponsored and how? Where will resources come from? If there are philanthropic

actions to be taken coordinately, must the person who manage and execute these actions be compensated for it? What is the best structure to manage these actions (consider whether by the creation of a foundation or institute, or by the company's own structure)?

Memory – Does the family value its memory? Are the family's and company's history being preserved and disseminated? Who is responsible for collecting, cataloguing, and storing documents and other materials in general? What purpose do these records serve? How are they being used?

Goods and services – What common goods and services can be offered to the family? How will they be charged and paid? What are the usage rules? How will they be managed?

Commercial transactions with related parties – What are the criteria for family members to acquire goods and services from the company itself? What are the rules to make transactions with the family company. What about to offer goods and services?

Conflicts of interest – What is the protocol for relationships with suppliers and clients? Can family members participate directly or indirectly in the competitors' businesses? What about offering services to the family company?

Family representation – Who represents the family in front of the public and the media? What rules and principles must this representative respect?

It is important to note that the above questions are only suggestions. Each company can and should formulate their own questions and find their own answers. For more references, see the Code of Best Practices of Corporate Governance, the handbook on privately-owned companies, and other IBGC publications.

Conclusion: Let's Get to Work



Family-owned companies play an extremely important role in the economy of both world and Brazil. According to analysts and scholars, this is due to several factors, among them, the founder's generally exceptional talent and dedication, as well as the legacy he leaves to his descendants, the positive reputation resulting from attributes such as long-term vision—following socioeconomic trends and models—, stable relationships with employees, lower propensity to debt, credibility, negotiation skills, solid corporate culture, and sharing of values.

The family companies that stand out the most—and are bravely reversing the myth that there can be no longevity after the third generation—are the ones that, besides the attributes above, have managed to understand that the interests of the family and of the business can diverge and succeed in evaluating and facing the typical challenges of this type of companies, mentioned above. To obtain alignment, they rely on processes and structures not only of corporate governance, but also of family governance. This goes along with the theory of Professor John Ward, expert in family governance, according to which, to achieve success and longevity, a family business must rely on both a healthy business and a healthy family. Caring for both is therefore essential. The two most important processes a family business can create are, in Ward's view, a governance system to guide each sphere of power—family, ownership, and business—and a proactive succession process.¹⁶

One of the great challenges currently facing family-owned companies is the so-called “professionalization” of the family, i.e., the training of family members to play their roles, to practice transparency, and to live following all the rules and protocols agreed upon. Many, especially the

16. D. Kenyon-Rouvinez and J. L. Ward, *Family Business: Key Issues*, 2005.

new generations, believe that only the professionalization of the family can generate the discipline necessary for its members to interact in a contributive, responsible way with each other and the common business. Professionalization is the basis for the family business to grow, innovate, retain talent, increase profitability, generate more value for the partners, ensure their future, and endure.

This basis, which is achieved through continuous learning, can only be practiced, developed, and stimulated when there are structures and processes of family and corporate governance.

Deploying a family governance system is not always a quick or easy process. After all, once started, it will be naturally deepened, reviewed, updated, and perfected on a daily basis. Where to start? It doesn't matter: the important thing is to start, usually with what is bothering you or where it is possible. You don't have to wait for a crisis to start—quite the contrary.

Who can or should start the process? Any family member has the right to raise questions, launch or lead the process of implementing family governance, regardless of generation, age or number of shares. It is worth pointing out here that the first generation is not always willing or able to start the process, but it can still be called upon to facilitate it or even lead it. In this sense, as important as practicing the principles of governance is to influence other family members to accept and practice them.

One thing is certain: the sooner the business family starts debating, planning, and implementing the principles of governance, the sooner it will be able to enjoy the benefits and positive results resulting from the process—in business, in the family, and in the country.

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Family companies are the oldest, most common type of company. Since people started working for themselves, they have relied on their family's help. Initially, production was an extension of homes, until the industrial revolution introduced the concept of factory plants to house large industrial equipment.

With the enlargement of these new industrial corporations, there came the need for a completely new management system. Their growth also resulted on an increase in the amount of investments demanded, which started to go above family's financial capacity. The capitalist world's answer to this was the development of the stock market. This imposed a separation between ownership and management within the company. Management science initially developed focused on serving these big publicly-traded corporations.

Family businesses are the economy's motor, responsible for great innovations, employment generation, and huge participation in the global GDP. So much so that, as a consequence, management science started studying business family management.

With this publication, we intend to make business families understand the need to create management rules before they are needed, as well as to professionalize and organize the family with the same attention granted to the business. Strategy, succession, and cohesion are three aspects of the highest relevance for family businesses.

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Get to know more at: pwc.com.br/pt/setores-atividade/empresas-familiares.html.



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