

GOVERNANCE IN FAMILY BUSINESSES

Evidence and Implications

By Carole Howorth and Martin Kemp



UNIVERSITY
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IFB Research
Foundation

GOVERNANCE IN FAMILY BUSINESSES: EVIDENCE AND IMPLICATIONS

Report by the IFB Research Foundation

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ABOUT THE IFB RESEARCH FOUNDATION

The IFB Research Foundation is a charity (no. 1134085) established to foster greater knowledge and understanding of family firms and their contribution to the economy and society, as well as the key challenges and opportunities that they face.

The Foundation's vision is to be the UK's centre of excellence for family business research, and to this end its publications are designed to create a better understanding of family business for the benefit of all stakeholders.

Alongside Family Business Research and White Papers, providing thought leadership on key family business characteristics and issues, its work covers a broad range of publications, including:

- Family Business Sector Report – benchmarking the size and importance of the sector.
- Family Business Challenges – offering practical guidance for family business owners on a broad range of topics, including family business dynamics, governance, performance, succession and wealth management.
- Family Business Case Studies – showcasing family business exemplars.

The Foundation disseminates knowledge and best practice guidance through printed publications, online media accessible via the IFB website and other activities.

ifb.org.uk/research

ABOUT THE IFB

The Foundation is independent of, but works closely with the Institute for Family Business (IFB), the UK family business organisation.

The IFB's mission is to help family businesses remain successful across the generations.

The IFB provides a safe space where family businesses can share their challenges and successes openly.

Family businesses are the backbone of our economy and communities, and the IFB works closely with them championing their contribution and voicing their needs.

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FOREWORD

A message from the Chair of the IFB Research Foundation



In recent years, around the world there have been many attempts to codify best practice in family business governance. This comprehensive review by Carole Howorth (University of York) and Martin Kemp (IFB Research Foundation) seeks to survey the evidence and guidance on governance in family firms and draw out some common themes in this diverse and complex area.

This report highlights how the governance requirements of family firms depends on their longevity and stage of development, with generational maturity requiring different solutions. Whilst each family has different dynamics, structures and interpersonal relationships, identifying best practice in family governance can help to ensure the smooth transition of businesses through generations of a family. My own family business (Bibby Line Group Limited) is in the process of making the transition from being a family-run enterprise to having no family in the executive. At the same time, we are setting up governance for a cousin consortium to take over from a sibling partnership. This report has helped me understand the best structures and rules that we need to put in place in our family business, and I hope it will also assist you in not only improving the governance structures in your own family businesses, but also in planning for the future.

Sir Michael Bibby
Chairman, IFB Research Foundation

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EXECUTIVE SUMMARY

This report presents a review of academic studies, national guidance and codes relating to governance of family businesses. Practical implications of research and insights for governance practices in family firms are provided. The report will be of interest to owners of family businesses, family business researchers, family business advisers, as well as those working in the field of corporate governance more broadly.

Evidence from over 200 studies on family business governance is synthesised to identify recurring themes, reliable evidence and gaps in knowledge. Studies from around the world provide helpful insights. Very few studies have examined governance of UK family firms specifically.

REVIEW FINDINGS

Effective governance can add value. Family-owned businesses face additional governance challenges because they negotiate family relationships intertwined with business imperatives. Good governance processes and structures clarify relationships, rights and responsibilities to ensure that businesses are managed professionally and responsibly, regardless of whether managers are family or non-family members.

Family business governance should recognise the complexity of family relationships, which increases with multiple generations. Family relationships can bring love, commitment and passion for the business, but can also drive nepotism, intense rivalries and unhealthy power dynamics. Governance for family businesses encompasses family governance as well as corporate governance.

The underlying (agency) theory of corporate governance assumes a separation of ownership and control, and individuals who are self-serving, assumptions that do not necessarily apply to family businesses. Family managers and owners may act as stewards, doing what they believe is best for the firm, rather than themselves. Long-term perspectives, psychological ownership and high levels of altruism might influence governance approaches and requirements.

Family businesses are more heterogeneous than publicly-listed companies. Governance recommendations need to be flexible enough to take account of variations in circumstances, ownership models and context. In some family-owned businesses, attitudes of trust, love and commitment may engender positive stewardship behaviours and reduce the need for formal controls. Tensions can arise if strong controls stimulate perceptions of not being trusted, leading to self-serving behaviours and a downward spiral of trust.

Corporate governance for family businesses should focus on establishing clarity of roles, an effective board, and a logical organisational structure. The board of directors contributes human capital (experience, expertise, knowledge, skills, reputation) and social capital (networks, contacts, trust relationships) to the firm. In addition to providing oversight and controlling stakeholder interests, boards of directors add value to the firm through their strategic input.

IMPACT OF GOVERNANCE ON PERFORMANCE

Evidence of the impact of governance on performance is inconclusive. Family businesses may stress a wider range of performance objectives than non-family businesses. Governance mechanisms that improve performance for non-family firms may not have the same effect in family firms. UK family businesses' ability to survive better than non-family businesses is believed to be associated with the stability and strength of their governance structures. Lower bankruptcy risk is associated with board size, age and experience of directors, gender diversity, director (co)location, and directors' networks.

Overall, there is little evidence that the appointment of external (non-family) directors per se improves the performance of family firms. The ability of directors to provide unfettered opinion can be restricted by power dynamics, homophily and a lack of true independence of directors. Family businesses need to work harder to ensure diversity on their boards, due to the shared ethnicity of families.

Family governance structures exist in a minority of family businesses. Rigorous academic research on family governance is very limited, although there are many prescriptive texts arising from the experience of family business advisers.

Family governance enables family business owners to manage both their family business asset and the relationship between the family and the business. Well-functioning family governance could mitigate or avoid potentially destructive conflicts, manipulation by powerful family members, resentment, animosity and jealousies. Family relationships can be strengthened and the next generations nurtured. Effective family governance reduces the number of voices attempting to influence the business.

Family constitutions, meetings, assemblies, councils and offices all have different functions. Family governance needs to be appropriate for the size, complexity and context of the business family.

WHAT DON'T WE KNOW?

Research into family business governance is hampered by a lack of longitudinal studies and limited access to governance functioning. Longitudinal studies are required to establish causality, enabling clear distinction for example, between whether a particular mechanism improves performance or whether better performing firms install that mechanism. Only a handful of studies have looked at the functioning of the board of directors, the roles of directors, or processes in the selection of directors. Available studies tend to explain why particular structures and mechanisms exist, rather than 'what works' and under what circumstances; there are few studies of family councils and other family governance mechanisms. Further research is needed in order that any codes or guidance are based on evidence rather than untested assumptions.

Other evidence gaps include:

- power relations and how these affect governance practices;

- determination of dividend policies and directors' remuneration and their impact;
- the relationship between active and non-active shareholders in family firms;
- how intermediary governance structures such as family councils and trustees affect the success of the business;
- how value systems affect family-business governance.

CODES OF GOVERNANCE FOR FAMILY BUSINESSES

The UK does not yet have a governance code or national guidance specifically for family-owned businesses. The governance codes and guidance developed for publicly-owned companies might not be applicable to family-owned businesses. Codes aimed at private companies focus on corporate governance, particularly the board of directors, with little reference to family firms and their specific governance needs.

Some countries (chiefly European) have developed codes and national practice guidance specifically for family-owned and family-run businesses. Codes or national guidance developed specifically for family firms in six countries (Spain, Germany, Switzerland, Netherlands, Italy, and the Gulf countries) were systematically analysed to identify common features, differences, and examples of best practice.

The guidance and codes were compiled between 2003 and 2018, in most cases by national family business associations or networks. Most state that their aim is business improvement and recognise

that codes need the ability to tailor recommendations to a firm's specific circumstances (for example, its stage of development or size). Most guidance includes a conceptual element, where general principles and definitions are specified, followed by practical recommendations on family and corporate governance (tailored to family firms).

All the reviewed codes and guidance provide recommendations for the board of directors and typically provide detailed guidance on family governance structures and mechanisms such as family councils, family charters, and the relationship between the family and the company.

The codes/guidance vary considerably in the extent to which they address ownership and shareholders, management, the external environment and corporate social responsibility. Recommendations relating to business management receive much less attention overall, compared to family and corporate governance. Most codes pay little attention to guidance relating to the external environment, stakeholder engagement and corporate social responsibility, perhaps with the exception of the Swiss Code G.

Codes and guidance are shaped by the country context, particularly by legal and regulatory systems. The legal, regulatory, and cultural context in which businesses operate needs to be considered when interpreting each set of guidance or when seeking to compare countries.

SHOULD A CODE FOR PRIVATE FAMILY FIRMS IN THE UK BE DEVELOPED?

It should be: tailored to firms of different sizes and stages of development; provide recommendations tailored to different stakeholders; balance family and corporate governance; provide guidance on implementation, and take into account the specific country context (legal, regulatory, and cultural). The guidance should also be grounded in a coherent conceptual or theoretical framework, and any assumptions should be supported by evidence.

There is clearly scope for anchoring governance guidance more firmly in research, evidence and empirical examples of best practice. The recommendations and advice presented in these codes are mostly unsupported by evidence, and the use of empirical examples to illustrate key principles is rare.

The report concludes with practical governance advice for family firms.



1. INTRODUCTION

Effective governance plays an important role in the long-term success of families in business. The effective governance of a family business can create value, whilst poor governance can constrain the business or even destroy value. This review synthesises existing evidence on governance in family firms and provides recommendations for effective governance underpinned by sound principles. Family-owned businesses face more complexity than other models of business ownership because they must negotiate family and business relationships, including intergenerational expectations, alongside business imperatives. Good governance processes and structures clarify relationships, rights and responsibilities to ensure that businesses are managed professionally, whether managers are family or non-family members.¹

Governments and industry associations in a range of countries have developed codes of practice - and in some instances legislation - to try and ensure effective corporate governance. In light of increasing attention being paid to the governance of family and privately-owned businesses, the IFB Research Foundation commissioned this report to provide a review of academic studies and codes of practice to provide insights for policy and practice. Research by the IFB Research Foundation indicates that family businesses in the UK employ over 13 million people and generate a quarter of the country's GDP.² It

is therefore vitally important to ensure that family businesses are governed effectively. The *G20/OECD Principles of Corporate Governance* summarise the need for good governance thus:

*'Good corporate governance is not an end in itself. It is a means to support economic efficiency, sustainable growth and financial stability. It facilitates companies' access to capital for long-term investment and helps ensure that shareholders and other stakeholders who contribute to the success of the corporation are treated fairly.'*³

Effective governance can provide structures and processes to manage the competing demands and interests of the key stakeholders in the business. For family business owners, there are two distinct but intersecting areas of governance: their business and their family in business. As a group of interconnected shareholders, family business owners need to ensure effective governance of their family's relationships and interactions with their businesses, as well as the businesses themselves; these are referred to as family governance and corporate governance respectively.

The need for family and corporate governance to have effective structures and processes is well recognised, but it is also important to understand the influence of underlying attitudes and motivations, including values, trust and integrity. Donald Johnston, Secretary General of the OECD in 2004, emphasised the importance of developing

*'a culture of values for professional and ethical behaviour on which well-functioning markets depend. Trust and integrity play an essential role in economic life and for the sake of business and future prosperity we have to make sure that they are properly rewarded.'*⁴

This report synthesises over 200 studies that have examined various aspects of family business governance, as well as guidance and governance codes developed specifically for large family firms around the world. The aim is to capture evidence, inform decision-making and provide recommendations for families in business and policymakers.

The roles and relevance of governance structures as they apply to family firms are explained, including boards of directors, family councils, family constitutions, and family offices. Explanation of the specific challenges and risks for family businesses provides useful insights into the family business context. We explain theories and concepts that enable families in business to identify what is relevant to their situation. In this way, governance practices are informed by theory and evidence. The report draws on international studies because very few studies have examined governance of UK family firms specifically.⁵ Note that while families throughout the world share many issues, variations in culture, regulations and legal frameworks need to be considered in interpreting specific findings. Evidence from a range of sources reduces the risk of sweeping generalisations and misconceptions about family businesses.

The need for family and corporate governance to have effective structures and processes is well recognised, but it is also important to understand the influence of underlying attitudes and motivations, including values, trust and integrity.

2. GOVERNANCE CHALLENGES AND RISKS FOR FAMILY BUSINESSES

Governance challenges for families in business arise from the intertwining of family and business issues. Family businesses are associated with emotional attachments. Psychological ownership, love, resentment, attachments to the past, promises made and expectations of the future all have a bearing on family businesses. Governance structures aim to separate family issues from business decisions⁶ but many issues overlap, such as employment of family members, successor selection and process, retirement, length of tenure, family share ownership, inheritance and trading of shares, next generation education and development.

In the following section, we explain the issues and challenges for family-owned businesses that highlight the need for effective governance to avoid negative implications for employees, businesses, families and the wider society.

2.1 COMPLEXITY OF FAMILY RELATIONSHIPS

Family can be a force for good and provide a positive influence on the business, encouraging commitment, loyalty, long-term perspectives and good relations internally and outside the business. Family members' networks and expertise can be drawn upon to enhance the business. The business can

provide an unrivalled learning experience for the next generation, which good governance can foster. The best families in business are creative, innovative and drive their businesses to excel. Many are altruistic, trustworthy and held up in society as providing a positive influence in their communities.⁷ Many use their wealth and influence to benefit others, such that some have called them 'natural philanthropists'.⁸

On the other hand, families can be a melting pot of conflict, embroiled in past hurts and entrenched rivalries, made worse by nepotism, free riding and destructive self-interest. If such behaviours are brought into the family business, the consequences can be disastrous. The unconditional love associated with families can lead to shirking and free riding. Family members may shy away from tackling bad behaviours by other family members. Particular family members might be favoured in ongoing nepotism, which could lead to resentment elsewhere in the family or firm. Sibling rivalries can bubble up and destroy a company.⁹ Nepotism can be reduced by having an agreed policy for the education and employment of family members. The impact of sibling rivalries can be reduced by having a forum such as a family council, where issues can be aired outside of the business before they become destructive.

All businesses require good governance, but family relationships bring extra complexity to the governance of family businesses. Business-owning families are advised to

consider the implications of divorce, the rights of stepchildren, spouses and co-habiting partners. Some family business owners prefer a family CEO or chairperson, in which case the process for appointment and selection might become a family issue as well as a business one. Families are advised to clarify inheritance rights, including their tax implications, which have been the death knell of some families in business.¹⁰

Family governance provides structures and mechanisms to manage the relationship between the business-owning family and the business, and to discuss and make decisions relevant to the owning family. It is important, therefore, that family governance is considered carefully in addition to corporate governance. Our review of governance codes (below) shows little emphasis on family governance.

2.2 INCREASING COMPLEXITY OF MULTIPLE GENERATIONS

Family issues tend to have a greater impact as the family business moves through the generations. With each additional generation the number of potential family shareholders can expand: some family businesses have hundreds of family owners in a complex array of cousins, aunts, uncles, parents, grandparents and siblings. Family owners who are more distant may have less emotional attachment to the business and are more likely to focus on their own self-interest and financial returns than the long-term strategic objectives of the company. Combined with the illiquid nature of shares in many family businesses, this leads to greater attention on dividends when ownership is dispersed. An expanding group of shareholders can also lead to factions developing - for example, between different branches of the family, or between executive and non-employed family owners.¹¹

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2.3 POWER AND DOMINANCE

Family businesses are often founded by dynamic, entrepreneurial individuals with strong personalities. The drive and dominance that gave them success in the early days can sometimes become a constraint as the business develops. Senior family members might hold a powerful position over other family members, dominate decision making and constrain the contribution of other executives. Many cultures deem it unacceptable to question or challenge more senior family members. Dominance by one or more senior family members has the potential to hamper business performance and create family conflict or resentment. There is a risk of intra-generational factions developing. Younger family members and talented executives might vote with their feet and leave the family business. Innovation can be stifled by not enabling a diversity of ideas, views and perspectives to be shared. The presence of powerful or dominant executives can result in management entrenchment, where self-preservation by executives favours strategies that fit their own skills and interests, for example not investing in innovation or developments that render existing technologies or favoured product lines obsolete.¹² Good governance can temper the power of dominant family members, providing a control mechanism but also, on the positive side, ensuring that the business benefits from a broad range of contributions, skills and experience.¹³

Majority family shareholders may also exert significant power in family businesses, particularly where they also occupy the CEO or chair position. Concentration of ownership has been linked to weak corporate

governance, where minority shareholders are not considered.¹⁴ In publicly-listed firms, financial markets provide an oversight that mitigates potential for self-serving behaviours of powerful shareholders but privately-held firms are not subject to such controls.

Shareholder expropriation concerns the ability of majority owner managers to extract private benefits to the disadvantage of minority owners. Examples from Thailand show how powerful family business groups can use 'extensive corporate pyramids to systematically exploit wealth from minority shareholders'.¹⁵ Ownership concentration has also been associated with inefficient investment, excessive diversification and risk taking. Pyramidal and cross-shareholding ownership structures have been criticised by the World Bank.¹⁶ Large blockholders can mitigate a controlling owner's power, but where blockholders are members of the same family this might be reduced.¹⁷

2.4 UNDERSTANDING RIGHTS AND RESPONSIBILITIES

The intertwining of family and business can lead to lack of clarity around rights and responsibilities. Family members may attempt to interfere in areas and decisions outside their remit. Younger family members may inherit shares directly or through a trust, not understanding what their rights and responsibilities are.¹⁸ Executives from a plc background may expect more control than family owners are used to giving. Family owners could attempt to access the company's assets in ways that might be inappropriate. Good governance can provide clarity around rights and responsibilities, control and monitor behaviour, and install the mechanisms for communication and learning about rights and responsibilities.



3. GOVERNANCE FOR FAMILY BUSINESSES

This section reviews research providing insights into how governance has been approached in family businesses. It highlights that governance solutions need to consider context and that there is not one solution that will suit all family businesses.

3.1 DIVERSITY OF FAMILY BUSINESSES

Extant studies agree that family businesses are more heterogeneous than publicly-owned firms, and their heterogeneity partially explains why corporate governance codes developed for plcs may not be relevant for private family-owned firms. Family firms can be any size, and they vary in their objectives as well as in the level of family ownership and management.¹⁹ Different types of family firms have been identified, varying in whether ownership is closely-held or dispersed, totally family-held or not; and whether management is dominated by family, shared with non-family or devolved to non-family.²⁰ Family ownership in one business might be enhancing and in another constraining. Individual family firms also change over time, and governance structures that work for one generation may need revisiting following succession.²¹ Country

contexts, cultures and legal frameworks also vary. Governance recommendations in the USA and UK tend to be market-based models, whereas in Latin America, Asia, and some parts of Europe, governance is control-based.

Therefore, it is important not to generalise and not to assume that one governance model is best for all.²² Instead, any governance guidance designed for family businesses should consider business size, sector, stage of development and specific context. Klein states:

*'Family businesses are more heterogeneous than are corporations listed on the stock exchange, and therefore they need specific and well-tailored governance, respective of the situation.'*²³

3.2 FORMAL OR INFORMAL GOVERNANCE

Governance can be formal or informal, i.e. contractual or relational. Where there is strong family cohesion, a collectivist attitude and alignment of interests, governance may be relational, with fewer formal structures.²⁴ In some contexts, formal governance structures and contracts may be counter-cultural. Most European and North American countries have strong institutional frameworks where contractual and formal structures are the norm. In developing economies, legal mechanisms to enforce contracts may be less prevalent, and therefore informal governance may predominate. Many of the recommendations of 'good governance' are based on assumptions underpinning agency theory (explained below) that ignore social forces and relationships. Some would argue that strong emotional and relational ties can be more effective than formal governance mechanisms.²⁵

Formal governance structures aim to have policies and structures in place before there is a crisis, avoiding decisions made in the heat of the moment; for example, considering who will be the next successor in the middle of grieving over the unexpected death of an incumbent.

Formalisation of governance tends to occur in waves, often triggered by changes in ownership or management.²⁶ Sir Adrian Cadbury suggested that there are three essential requirements for family firms to achieve success once they have moved beyond the stage of being owned and managed by one or more founders.²⁷ The first is clarity of roles, which relates particularly to the relationship between business and family and the intertwining of family and business objectives and needs. Cadbury suggests that all family members, be they executives, owners or an incoming generation, should be clear about their role in the family firm. Governance structures and processes allow roles to be clearly defined. Second, family firms need to have an effective board. It is often argued that families need to bring in external directors to provide objectivity and broaden the perspective. However, families who recruit external directors in their own image or among a close group of trusted family friends could negate the benefits of external directors. It is important to examine what makes a board effective. The third requirement is to have a logical organisational structure. Cadbury argues that the structure of the family firm should be aligned to its purpose. Chains of command and decision-making processes need to be clear to avoid arguments within the family about fairness and responsibilities.

3.3 GOVERNANCE STRUCTURES

The governance structures of family firms relate to three spheres of influence: the family, ownership and business systems.²⁸ These spheres overlap, as illustrated in Figure 1. Legislators and policy makers emphasise the business system, or corporate governance, because it impacts employees, the economy and society. However, in family firms, the family and ownership systems are intertwined with the business, and can also

therefore indirectly impact stakeholders, the economy and society. It has been suggested that the family system is most important for the success of a family business²⁹ because it can have such a significant positive or detrimental effect. Our review identified less attention paid to the ownership system, which is frequently subsumed under family governance, despite larger family firms often having non-family shareholders in addition to family owners.

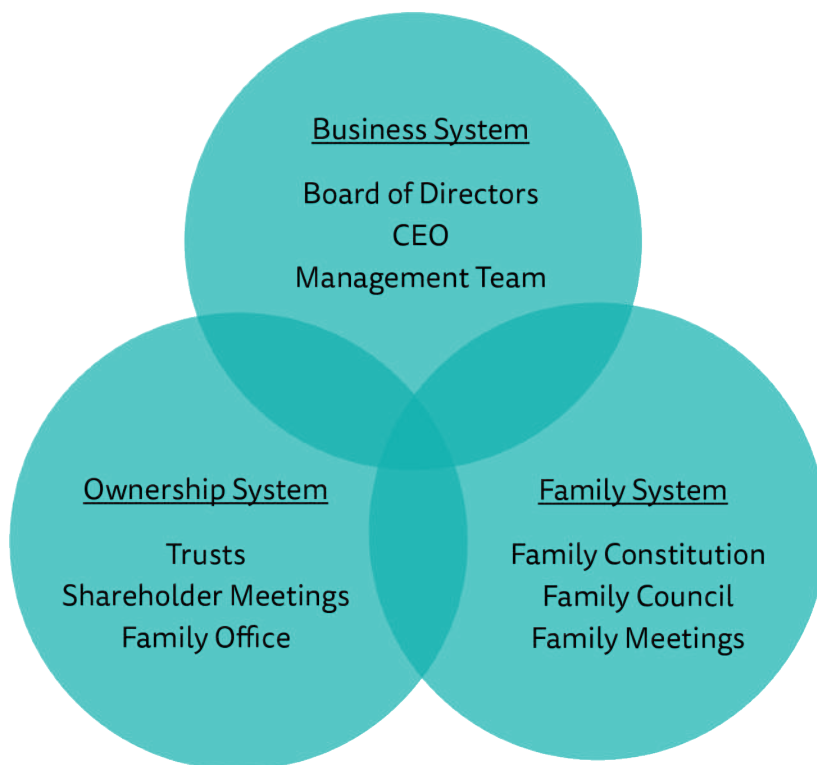


Figure 1: Family Business Governance Systems

4. THEORETICAL INSIGHTS

Theories help us to understand why things happen as they do and there is 'nothing so practical as good theory'.³⁰ In this section, we explain the theory that underpins corporate governance and highlight why corporate governance codes based on agency theory may be less applicable to family businesses.

4.1 OWNERS AND AGENTS

Corporate governance mechanisms tend to be based on assumptions that do not necessarily apply to family businesses. The underlying theory of corporate governance assumes a separation of ownership and control and is named agency theory, because those in control of the business (i.e. managers) act as agents for the owners. Agency theory assumes that individuals always act in their own best interest. Owners' and managers' interests are likely to differ, therefore governance mechanisms are needed to bring them into alignment. In a small, closely-held firm, this is irrelevant because the owners and managers are likely to be the same people. As a firm grows and employs managers to act for the owners, the problem arises of how to motivate or control the managers so that their interests are aligned with those of the owners. This problem is compounded by 'information asymmetries,' which means that information is not equally available to both parties.

Usually, executives have a fuller picture of the firm than owners. Thus, performance-related pay, share options schemes and control mechanisms might be introduced to align managers' interests to owners'.³¹

Information asymmetries might occur in other relationships, giving rise to agency problems: for example, controlling family shareholders versus non-controlling shareholders; shareholders versus creditors; family shareholders versus family at large.³² Governance mechanisms that might control agency problems include: ownership concentration, boards of directors, executive compensation, reduction of free cash flow through debt or dividends, corporate takeovers, dual-class unifications, and legal (or regulatory) investor protection. Schulze and colleagues suggest that family firms are subject to alternative agency costs: firstly through altruism that might lead to free-riding and shirking by offspring, and second through management entrenchment and shareholder expropriation.³³ Parental altruism might motivate owner/managers to favour their employed children to the detriment of the business. Alternative views have suggested that family altruism is a positive influence, bringing love, security, ethical clarity, socialisation and self-esteem that benefit the business and society.³⁴

Agency theory also assumes short-term orientation and motivations that can be monetised, which has led to questioning its applicability to family businesses, where individuals have more long-term

perspectives and varying non-financial motivations.³⁵ The governance challenge for family businesses is that most of the existing models, codes and recommendations are based on agency theoretical assumptions, summarised as self-interest, short-term orientation and financially quantifiable motivations.

4.2 STEWARDSHIP AND GOVERNANCE

Governance mechanisms based on agency theory have been critiqued for assuming that managers will behave in ways that are 'opportunistic, self-serving, guileful and lazy'.³⁶ Stewardship theory recognises that people can be organisation-serving and have higher-order motives than personal financial gain or utility.³⁷ Family managers and owners may seek to protect the assets of the family and act as stewards by doing what they believe is best for the firm, rather than themselves. Orientation may be towards a long-term perspective. Stewardship theory is most relevant where owners', managers' and

employees' agendas are in line with those of the organisation. Strong psychological ownership³⁸ and high levels of altruism might also be expected. Stewardship theory assumes a relationship-based system that focuses on non-financial objectives and is therefore particularly relevant to family businesses.

Tensions can arise if governance mechanisms are implemented in line with agency theory in a context that is characterised by stewardship. Individual financial incentives are anathema to a stewardship culture and could change behaviour to become more self-serving; strong controls could stimulate perceptions of not being trusted, leading to self-serving behaviours and a downward spiral of trust; executives appointed externally from a plc culture could introduce a short-term orientation.

This theoretical insight highlights that the wider implications of specific governance mechanisms need to be thought through and that one size is unlikely to fit all.

Stewardship theory recognises that people can be organisation-serving and have higher-order motives than personal financial gain or utility.

5. CORPORATE GOVERNANCE AND BOARD EFFECTIVENESS IN FAMILY FIRMS

This section reviews evidence that specifically examines corporate governance. We start by presenting definitions and an overview of studies, and then examine different aspects of the board of directors.

5.1 DEFINITIONS

A commonly adopted definition of corporate governance is that given by the Organisation for Economic Cooperation and Development (OECD):

*'Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.'*³⁹

The division of responsibilities is generally perceived as follows:⁴⁰

- shareholders are responsible for long-term vision, setting expectations about risk and reward;
- boards of directors are responsible for ensuring fair and objective treatment for all shareholders, aligning business strategy with shareholders' interests and holding the management team to account;

- the management team are responsible for the implementation of strategy and business operations, and are accountable to the board.
- In addition, family business shareholders frequently determine the values that they expect to underpin the business.

Cadbury defined corporate governance simply as: 'the system by which companies are directed and controlled'.⁴¹ Corporate governance operates within a framework that includes legal and regulatory requirements, expectations of shareholders, employees, and other stakeholders and public opinion. Cadbury later stated:

*'Companies have to be alert to changes in the terms on which their communities expect them to carry on their businesses... It is the board of directors which has to determine where a company stands... they have to balance the demands of the various interests which their company seeks to serve. Corporate governance therefore focuses on the role of the board.'*⁴²

Corporate governance relates to performance, broadly defined, and accountability. Monks and Minow suggested that accountability should be to the wider community:

*'Corporations determine far more than any other institution the air we breathe, the water we drink, even where we live. Yet they are not accountable to anyone.'*⁴³

5.2 OVERVIEW OF STUDIES

The majority of research on corporate governance in family businesses focuses on internal governance mechanisms, such as composition, size and structure of the board of directors, with emphasis on the ratio of family to non-family directors, the appointment of non-executive or external directors and the separation of CEO and chair functions. Elements of corporate governance that are common to all types of firms and not specific to family businesses tend not to have been examined specifically in a family business context, for example the functioning of remuneration or audit committees.

Most studies assume that objectivity and independence are key to good governance.⁴⁴ A small number of studies provide critical perspectives and examine the importance of values, relationships and trust. Studies emphasise 'balance' and 'clarity' as in, 'balance of power' 'balancing family and business interests'; clear roles; clear responsibilities; clear boundaries. For example, 'Corporate governance requires operating systematically with a strong balanced power base... the stockholders have to define clear individual component roles and responsibilities.'⁴⁵

Improved firm performance across a range of measures is associated with family firms that balance family and business objectives, rather than emphasising one or the other.⁴⁶

5.3 BOARD OF DIRECTORS

The board of directors is an asset where directors contribute human capital (experience, expertise, knowledge, skills, reputation) and social capital (networks, contacts, trust relationships) to the firm. Whilst increasing concerns about corporate governance have led to inquiries and legislation for boards of directors, it is important to note that effective boards add value to the firm through their strategic input and are not just a means to control stakeholder interests.⁴⁷ Pendergast, Ward and Brun de Pontet suggest that

*'A well-functioning board of directors can play an essential role in providing insight and oversight to help businesses succeed – yet many family businesses do not make use of this valuable resource.'*⁴⁸

Whilst UK law requires companies to establish a board of directors, there is considerable variability in how effective or active boards of directors are. A board's legal duties are to appoint (and remove) executive directors, set executive remuneration, determine dividends and ensure that the company is fulfilling its statutory obligations. In addition, many boards review and approve budgets, strategic plans, major policies and significant capital expenditure, and oversee the audit processes.

Cadbury argues strongly that a board's effectiveness is not purely down to its composition but depends on the quality of the directors and their ability and willingness to work as a team.⁴⁹ Nevertheless, research and evidence about board effectiveness tends to focus on measurable or observable characteristics such as the composition and independence of directors, which relate to avoiding groupthink, bringing challenge and a diversity of ideas and perspectives.⁵⁰

Some commentators have attempted to prescribe the frequency of meetings or composition of boards.⁵¹ However, board size and composition need to reflect the firm context and stage of development; for example, the boards of large firms will tend to be larger and need to meet much more frequently. Smaller family firms, if they have any external directors, are more likely to have only one or two.⁵² The Institute of Directors emphasises that governance recommendations need to be appropriate to the size and type of firm⁵³ (see Codes below).

5.4 BOARD COMPOSITION

A key question for board composition in family-owned businesses is the inclusion of family versus non-family directors, as well as the balance of executive directors to non-executives. In the USA, the Sarbanes Oxley Act (2002), aiming to prevent fraud and bankruptcy risk, emphasises the need for directors to be independent, with no links to the organisation on appointment.⁵⁴ In contrast, in Latin America, over 90% of companies are family-controlled, with boards consisting only of family members.⁵⁵ Of the largest 200 UK family firms, 46% have no family directors on the board and 70% have no shareholders as directors.⁵⁶ Smaller firms tend to have relatively higher percentages of each.⁵⁷

Family directors (i.e. directors from the shareholding family) can provide a strong connection to family values, strengthening stewardship perspectives and ensuring that the family business preserves the strategic objectives of the family owners, as well as shielding the business from any dysfunctional family effects - like sibling rivalries - that might be detrimental to

the firm. However, a predominance of family directors could potentially lead to over-emphasis on family priorities to the detriment of the business, and family issues could spill over into the boardroom.

Many family business boards include family owners who are not employed in the firm (i.e. non-executive family directors). Family non-executive directors can be personally very influential through their (usually senior) position in the family. When they work well, the combination of family owners' commitment and insights with external directors' objectivity and experience can add substantial value to family firms' boards of directors. A high-trust relationship with family directors can enable external directors to provide a challenging, objective perspective - for example, restraining any tendency to over-emphasise family agendas or challenging entrenched positions and escalating commitments. External directors might also be more able to take the heat out of emotionally-charged situations than a family director.

Westhead and Howorth examined UK family firms to determine if there were any associations between particular board structures and the performance of the firm.⁵⁸ Their findings indicate that family firms do not gain advantages purely from the appointment of particular permutations of directors, for example the ratio of non-family to family directors, but that variations exist in the effectiveness of boards of directors. Theoretically, the appointment of external, non-executive directors should enhance the performance of a company, extending the social capital, expertise and resources available, as well as bringing challenge and new ideas to the boardroom. However, Westhead and Howorth, along with numerous other studies, have found no general association between family firm performance and the appointment of non-executive directors.

There are various reasons why performance on average is not improved by the appointment of an external non-executive director. Some families in business appoint close friends and longstanding business associates as non-executive directors, whilst in other cases non-executive directors are inactive or compliant. Powerful owners or directors (or other stakeholders) may drive the appointment of nominees to represent vested interests. Non-executive directors may be appointed without the systems and processes to support and include them. Powerful family shareholders or executives, deliberately or unwittingly, can induce the appointment of non-executives in their own image. Independence of directors is difficult to maintain. Interlocking directorships, intermediate relationships and tacit dependencies are common among family business directors.⁵⁹ In Mexico, for instance, most board members are related to others through family ties, friendship, business relationships or employment contracts, and 53% have other directorships within the group.⁶⁰ The pattern is similar in some other countries.⁶¹ Lack of independence, homophily⁶² and weak systems can all limit the value of external non-executive directors' influence.

Research by Brenes et al. found that non-active family shareholders in Latin American family businesses welcome non-family directors, perceiving increased transparency and greater confidence in company management.⁶³ Family shareholders perceived that their businesses would do better if non-family board members were more committed and demanding of management, instead of being 'friends of the family and unwilling to offend them.'⁶⁴ In another study, Lane and colleagues suggest that it is not the independence of the directors that is key, but their ability to provide unfettered opinion.⁶⁵ Bettinelli sampled 90 family firm directors in Italy and found that external directors affected the culture of the board and improved their effectiveness, through increased effort and cohesion.⁶⁶

The role of external directors will vary with the size and context of the family business. Founder-led family businesses may be less embroiled in family agendas and are likely to value the external director's mentoring role, whereas later generation, more complex businesses are more likely to require independent, monitoring expertise from external directors. Thus, the selection of external directors is important in matching them to the expected role; family businesses should analyse exactly what they need from external directors. For small family firms who are not yet ready to include external directors on their board, an advisory board can provide a useful transition stage, providing mentoring and external perspectives.

5.5 BOARD DIVERSITY

Evidence suggests that a more diverse board in family firms is associated with increased innovation, stronger entrepreneurial orientation and reduced bankruptcy risk.⁶⁷ Family firms in the UK⁶⁸ have low diversity on their boards, which could be constraining their potential. In relation to gender, the majority of the largest family firms in the UK have no women on their board, but on average, across all sizes of UK companies, family firms tend to have a higher ratio and incidence of women directors than non-family firms. In relation to age, members of boards of UK family firms are on average older than non-family firms: the average age on boards in large UK family firms is 54 years. Little research has been conducted on ethnic diversity in relation to boards of family businesses, but the shared ethnicity of families would indicate that family businesses have to work harder to achieve diversity in this area.



5.6 CEO AND CHAIR ROLES

Corporate governance models question the appointment of a Chair of the Board who is also CEO of the company, i.e. CEO/chair duality.⁶⁹ In Mexico, the president (chair) is usually the main stockholder and CEO, and there is little independence of directors.⁷⁰ Eight percent of large UK firms have a CEO who is also the board chair.⁷¹

A particular issue for family businesses is whether there is any advantage or disadvantage to either one or both of the CEO and chair being a family member. In the UK, 23% of large firms have a CEO who is a member of the owning family, rising to 88% for smaller family firms.⁷² Similar patterns are found elsewhere in Europe.⁷³ Where the CEO is a member of the owning family, and particularly where they own a majority of shares, power is very concentrated, and the CEO could potentially undermine board decisions, dominate recruitment and the selection of directors, and even undermine business performance for family or lifestyle reasons. This is exacerbated if a family CEO is also Chair of the Board. Restricting recruitment of the CEO to family members may exclude more experienced and qualified candidates. However, rigorous empirical tests of associations between family firm performance and the appointment of a family CEO show - on average - no negative association with performance.⁷⁴ Family CEOs and/or chairs might have stronger commitment to the long-term success of the business, rather than short-term gains that enhance their own career or financial returns.

5.7 BOARD FUNCTIONING

Few studies provide insights into the functioning of the board of directors, the roles of directors, or processes in the selection of directors among family firms. Little is known about important topics such as setting authority limits, attitudes to risk and division of responsibilities. Johannisson and Huse are one exception in their examination of the recruitment of directors into smaller family businesses.⁷⁵ They highlighted that within any organisation, multiple ideologies are at play, but one will usually dominate and determine the selection and influence of new (external) directors. The three main ideologies they identify in smaller family firms are 'paternalism', 'managerialism' and 'entrepreneurialism'. They suggest that entrepreneurial firms avoid having outside directors, managerial firms welcome outside directors and paternalistically-run family firms are likely to be ambivalent. Selekler-Goksen and Oktem examined the largest Turkish family business groups from 2002 to 2006 in the context of increasing institutional pressure to appoint independent outside directors. They identified no significant changes in the number of independent directors, and that avoidance, defiance and manipulation were employed to avoid appointing further independent directors.⁷⁶

Very few studies have examined board processes or tasks in family firms because researchers have little access to board functioning. Therefore, we do not know under which circumstances informal or formal processes are most effective, nor how particular functions and processes affect firm performance. A notable exception is Zattoni et al.'s examination of Norwegian SMEs: they found that family involvement in the business increased the board's effort norms and use of knowledge and skills but restricted the openness of debate.⁷⁷ Further research is needed to understand board functioning in family businesses.

5.8 PROFESSIONALISATION PROCESS

Most businesses introduce corporate governance mechanisms in a process of professionalisation that might take many years. Until recently, professionalisation has been conceptualised as a binary variable, firms being either professionalised or not professionalised.⁷⁸ Family managers have been contrasted with non-family 'professional' managers, terminology which implies that family managers are not considered to be professional. Such sweeping generalisations are incorrect and not helpful. Many family managers are highly educated and skilled, particularly those from later generations, where the firm's success has provided the family with resources to invest in the next generation's development.⁷⁹

The characteristics associated with 'professionals' (e.g. solicitors, doctors, lawyers, professors) are related to high levels of integrity, specialised expertise, high morals, capability and, notably, not increased bureaucracy.⁸⁰ Howorth et al. demonstrate that professionalisation occurs in waves, with the highest level being 'mastery' - characterised by reflexive management, high levels of skill and integrity.⁸¹ Howorth et al. argue that once basic controls are in place, as businesses adopt more sophisticated governance, they need to provide space for family business professionals to develop mastery and not constrain their efforts with excessive bureaucracy, monitoring and controls.

6. FAMILY GOVERNANCE

Most studies of governance in family businesses focus on corporate governance, and there are fewer studies analysing family governance. Family governance is concerned with the relationship between the owning family and the business, as well as issues internal to the business-owning family. This section reviews evidence in relation to family governance and explains various family governance mechanisms. There are many guidance texts that make prescriptions and recommendations on family governance: for example, how to establish a family council or design a family constitution/charter. Most of these are written by individuals or organisations whose major role is in family business consultancy, and tend to be based on experience rather than rigorous academic research. In this section, we place more focus on evidence from academic studies.

6.1 REASONS FOR FAMILY GOVERNANCE

Family business owners have two concerns: first, the management of the family/company relationship; second, the mechanisms and processes that enable them to control their company asset. Evidence indicates that while a majority of family firms have a board of directors, only a minority have family governance structures.⁸²

Families are relationship-based systems, often underpinned by strong emotional ties between family members. For loving families with high levels of trust, the idea of implementing a formal family governance structure might be anathema. Good family relationships increase trust and trustworthy behaviour. Trust operates as a spiral, so that if you feel you are trusted you are more likely to act in a trustworthy way, then you are more trusted etc.; in reverse, if feel you are not trusted you are less inclined to go all out to show you are trustworthy and trust declines. Excessive control mechanisms are a signal of low trust; therefore, good relationships could be more effective than control mechanisms.⁸³ However, many families have found that formalising family governance enables them to address issues before they become problems. Family governance can clarify the rewards and responsibilities of family participation in the business, channel opportunities for family involvement in the business, improve communication and information flows, so that trust is increased and, importantly, foster a sense of belonging to the business.⁸⁴ Unlike some corporate governance mechanisms, family governance mechanisms are entirely voluntary and usually have the aim of strengthening and governing relations between the owning family and the business and between members of the business family. Family governance mechanisms can therefore be custom designed to suit a particular business family's circumstances, interests and values.

Family governance becomes more important as the number of shareholders grows and the percentage of non-active shareholders increases. With a larger number of shareholders, there may be less emotional attachment to the business and shareholders may place more emphasis on the financial returns they might gain, including potentially selling their shares, which could lead to a loss of family control in the long term.⁸⁵ Earlier, we highlighted that family businesses can be a site of conflict. Well-functioning family governance could mitigate or avoid issues such as potentially destructive family conflicts, manipulation by powerful family members, resentment and animosity among family members, and jealousy over the appointment or promotion of family members.⁸⁶ The family might specify mechanisms for conflict resolution. Family relationships can also be strengthened through effective governance, sustaining the family as a social entity. From the business' point of view, effective family governance reduces the number of voices attempting to influence the business and the potential for family shareholders to interfere beyond their remit.

As with corporate governance, family governance structures and processes need to be appropriate to the size, development and complexity of a business. Studies have shown over many decades that organisations frequently morph into similar structures and ways of working through three types of pressure: force (i.e. coercive pressure such as legislation), imitation (i.e. mimetic pressure to be like another) and conforming to perceived norms (i.e. normative pressure).⁸⁷ As reviewed below in Section 9, various countries and associations have produced codes or guidance for family governance. Even where there is no coercion, family business owners who are involved in family business associations may experience mimetic and normative pressures to conform to a particular model of governance.⁸⁸ Less complex family businesses with a small number of owners may find that a simple system of regular family meetings may be sufficient for their needs.

Box 1 summarises some of the reasons why families in business might seek to put family governance mechanisms in place. The following sections review the most frequently used methods of family governance.

Box 1: Some Reasons For Family Governance

1. Provide a forum outside the business for family issues to be addressed.
2. Facilitate a collective view so shareholders speak with one voice.
3. Gain input from all generations, and avoid older generations claiming superiority in terms of experience and younger generations thinking their parents or grandparents are 'past it'.
4. Clarify roles, rights and responsibilities of family members.
5. Manage family shareholder relations, increasing transparency and understanding of the business.
6. Invest in the education of the next generation.
7. Avoid or address conflict.

Source: Howorth and Robinson (2020)

6.2 FAMILY CONSTITUTION

A family constitution, also known as a family charter or family protocol, is an agreement by family members that sets out the principles by which they will manage their relationship with the business and specifies the family's commitment and responsibilities to each other.⁸⁹ The agreement is usually developed collectively and written up as a document that is revisited at specified regular intervals. The family constitution is specific to a particular family and so can include anything that the family deems relevant, but often specifies the basis on which the family council will operate. Families can have a family constitution without establishing a family council, particularly where families have smaller and less complex businesses. Some possible elements of a family constitution are listed in Box 2.

The process of agreeing a family constitution provides a helpful forum for family members to air and discuss issues that they consider pertinent to their relationship with the business, before they become contentious. The process allows family members to interrogate time-honoured customs and practices. By having agreed principles and processes, the family constitution provides mechanisms for family members to air issues and try to resolve them, but it cannot negate conflict or disagreements.

A family constitution becomes more relevant as complexity increases. Additional generations may bring new attitudes, while increasing numbers of family members with ownership rights are likely to generate greater divergence of interests and motivations. A thoughtfully developed set of principles and processes for governing the family's relationship with their businesses provides stability and clarity for long-term business sustainability and ensures that family business owners are not caught in the ebb and flow of different opinions.

Box 2: Possible Content of a Family Constitution

1. Definition of the business family (who is included and who is not).
2. Strategic objectives, family values and aspirations: why we are in business.
3. Family involvement in business: principles, employment, roles, responsibilities.
4. Next generation involvement, education, rights.
5. How the family meets and is represented, possibly including family council.
6. Relationship between family council, board of directors and family members.
7. Membership of family council (or other structure), roles and responsibilities.
8. Finance – compensation, expenses, budget.
9. Process for amending the agreement.
10. Anything else the family deems relevant and appropriate.

Source: Howorth and Robinson (2020)

6.3 FAMILY MEETINGS

Family meetings enable the family to discuss their interaction with the business outside of the formal business structure. Small family businesses with simple structures may find that family meetings are sufficient for their needs. Some families may rely on only ad hoc family meetings for specific purposes, e.g. to discuss succession planning or to respond to a crisis; other families may install a regular pattern of meetings that more closely resembles a family council. Membership may be open to all (over a particular age), or specific to a sub-set of family members. For family meetings to work well, the family needs to establish clarity of purpose, roles and decision-making. Families may find that family meetings are a good means of integrating new spouses into the family business, increasing interaction and engagement between family owners and the business, building entrepreneurial learning, improving communication and developing decision-making skills among family members.⁹⁰

6.4 FAMILY ASSEMBLY

A family assembly is an inclusive forum for all family members, usually with a minimum age limit. Each business family can determine who is to be included in their family assembly. Larger families may hold retreats or away days with a structured programme of activities and meetings appropriate to different groups, e.g. small children, next generation, shareholders.

The purpose of a family assembly could include education, communication, relationship building between distant family members, as well as governance and contributing to business development. Family assemblies tend to incorporate social activities, and many families suggest that they are an important element of ensuring

they have fun together. Through social activities and the interactions within a family assembly, dispersed family members can build stronger relationships that might help reduce conflict and increase the understanding of varying points of view.

6.5 FAMILY COUNCIL

A family council is a formal governance mechanism that provides a forum specifically for family members to meet outside of the business and discuss issues relevant to the family's relationship with their businesses. Gersick et al. define the family council as:

*'A group who periodically come together to discuss issues arising from their family's involvement with a business. The fundamental purpose of a family council is to provide a forum in which family members can articulate their values, needs and expectations vis-à-vis the company and develop policies that safeguard the long-term interests of the family.'*⁹¹

In larger business families, the family council will usually consist of representatives from constituent groups within the business-owning family. Owning families influence their business in a variety of ways and therefore family is a legitimate concern of the business; from a business point of view, the implementation of a formal family council can be a positive step in managing the interaction of family and business. Family councils have been found helpful for non-family CEOs, as they provide family members with a space to share without directly involving the non-family CEO in family issues, and they reduce the inclination for family interference in daily operations.⁹²

Formal family councils are more appropriate for larger, more complex, family ownership groups.⁹³ Case study evidence indicates that families who have a family council find it an extremely useful means to manage the interaction of the family and the business.

Family councils mitigate the potential for conflicts, align different beliefs, support succession planning and enable the individual preferences of family members to be formed into a set of communicable objectives, thus aiding decision-making and commitment to decisions.⁹⁴ Very few studies examine family councils from the inside. One exception, in Australia, identified that the main discussion topics in family council meetings were succession planning, investment strategy, dividend policy, philanthropy, capturing the family history and integration with the board of directors.⁹⁵

While there is plenty of evidence suggesting the benefits of family councils, there is little research that systematically evaluates their effectiveness in relation to performance indicators or provides evidence on the effects of different models for family councils.⁹⁶ Box 3 provides a summary of the purposes of a family council.

Box 3: Some Purposes of a Family Council

A Family Council can promote the following:

1. Family mission and meaning
 - a. Shared values
 - b. Understanding the family's history
 - c. Stewardship of all the family's enterprises
 - d. Share philanthropic pursuits
2. Understanding of the family's enterprises
 - a. Review status, strategy and performance
 - b. Discuss opportunities and challenges
 - c. Explore new visions
3. Communication and mutual understanding
 - a. Exchange information
 - b. Strengthen friendships and share good times
 - c. Recognize, appreciate and learn from each other
4. Problem solving
 - a. Address family grievances
 - b. Make decisions on family matters
 - c. Address common problems
5. Family education
 - a. Learn about business and about the family business
 - b. Understand rights, responsibilities and implications of ownership and wealth
 - c. Enhance interpersonal skills
 - d. Study family dynamics
6. Family and ownership continuity and succession
 - a. Develop and review the family's constitution [charter]
 - b. Initiate and develop the next generation

(Source: Eckrich and McClure, 2012: 79-81)

6.6 FAMILY OFFICE

The term 'family office' covers a wide range of service centres and wealth management functions that support business-owning families. Larger families in business may adopt a family office, either purely for their own benefit or in collaboration with other families. The key role of the family office is to manage family wealth centrally, but many family offices provide additional services, such as insurance and financial services brokerage, legal advice, tax management, real estate and asset management. In addition, the family office might organise activities such as education and mentoring of younger family members or a family newsletter, which might otherwise sit within the family council; or professional services such as physical security and concierge services for family members. Some family offices manage philanthropic services for family members.

The family office provides a process and means to diversify the family's wealth. Families in business need to consider the risk of retaining nearly all their assets within one business. Some wealthy families use the family office to invest in other businesses and in assets unrelated to business in order to diversify their risk.

There are three types of family office: first, a not-for-profit family office controlled by one or more family owners, providing services exclusively for the family; second, a for-profit family office controlled by family owners, providing services for other clients in addition to their own family; third, a for-profit family office owned by professionals or consultants who provide wealth management and other services to various families. When a family decides they wish to set up a family office, the decision on which

type depends on the amount of their wealth, the willingness and ability of family members to take on roles within the family office and the level of trust between groups of family owners and professionals. Family offices might be organised as a separate company with a board of directors and paid managers, depending on the resources available.⁹⁷

Some advantages of setting up a family office include the sense of unity and belonging it provides for family members, generating a centripetal force to counteract the natural centrifugal force that occurs as the family expands through generations. A family office can increase the professionalisation and education of family owners and future family owners. However, it is suggested that family offices do not provide the same attachment as governing an operating company.⁹⁸ As with other aspects of family governance, the literature focuses on advice giving and case examples. There is little systematic research on the effectiveness of family offices.

To summarise, individual families can determine the remit of any aspect of their family governance, therefore the exact role and structure might vary. For example, philanthropic activities might be considered within a family council and/or a family office.

7. FAMILY AND CORPORATE GOVERNANCE: ASSOCIATION WITH PERFORMANCE

This section examines evidence testing whether there are associations between family and corporate governance and the performance of the firm. We note that causality is not proven and that relationships with different aspects of governance are complex and context-specific. An inappropriately complex governance system will negatively impact on performance by introducing unnecessary costs, whereas the benefits of an appropriate governance system should outweigh its costs. Interestingly, some studies provide evidence that governance has a different relationship with performance for family firms, as compared to non-family firms.⁹⁹ The studies reviewed below also show that performance effects vary with country.

7.1 APPROPRIATE PERFORMANCE MEASURES

All performance measures have limitations. Market value relative to book value is the most frequently employed measure of performance, reflecting the predominance of studies of publicly-listed family businesses. Studies might also examine return on assets or return on equity. Such measures are dependent on accounting practices and

the difficulties of obtaining reliable market and asset valuations. Measures of financial performance do not capture alternative objectives that might be important to specific families or firms, e.g. growth, sustainability, providing employment, societal contribution. A small number of studies use a 'Weighted Average Performance' (WAP) variable, which is a composite of various performance measures weighted by the importance placed on them by senior management, and is viewed as appropriate for family businesses that might have a range of financial and non-financial objectives. Westhead and Howorth empirically demonstrate that WAP is a reliable, comprehensive performance measure.¹⁰⁰

7.2 PERFORMANCE IN UK FAMILY FIRMS

Wilson, Wright and Scholes' comparison of 700,000 family and non-family UK firms demonstrated that family firms are less likely to fail than non-family firms. Their tests indicated that the higher survival rate of family firms is associated with board characteristics that are unique to family firms, providing them with additional human capital and social capital, as well as the stable ownership that allows family firms to build non-tradeable assets in the form of reputation and long-standing trading, financing and other business relationships.

Wilson et al. summarise:

*'Family firms have a significantly lower failure rate... a result that is robust to alternative definitions of family firms and in the presence of a large range of other variables. We... find evidence that family firms put together stronger boards... The attributes of the board that are related to lower bankruptcy risk are board size, the age and experience of directors, gender diversity, director (co)location, and networks (multiple directorships). Associated with higher bankruptcy risk is board instability, previous failure experiences, and, albeit weakly, the ratio of independent directors.'*¹⁰¹

Westhead and Howorth's studies of small UK family firms¹⁰² demonstrated that performance did not improve with the implementation of a particular structure such as the introduction of outside managers or directors. Their analyses show the importance of the objectives and approach of the firm. The worst performing family firms were characterised as 'entrenched', focusing strongly on family objectives. Of firms with the same structure of ownership and management, those which had a balance of family and non-family (business) objectives had better performance. Neither performance improvement nor worsening performance were associated with the employment of non-executive directors.

Studies¹⁰³ indicate that the advantages of family members occupying senior management roles include their strong commitment and ties to the firm, together with significant training and education provided by long lead times to appointment. The disadvantages include a risk of demotivating senior non-family staff who may see no potential to take the top jobs, as well as selection from a small pool of family talent. No positive or negative association was detected between firm performance and the appointment of family members as managers or CEOs in UK firms. This suggests that, on average, the positive and negative influences of family ownership can balance out.



7.3 INTERNATIONAL COMPARISONS ON THE PERFORMANCE OF FAMILY FIRMS

Contrary to their predicted hypothesis, Anderson and Reeb found that publicly-listed family firms in the S&P 500 perform better than non-family firms, while family firms with a family CEO outperform those with a non-family CEO.¹⁰⁴ It is suggested that family members on the board make a valuable contribution to performance through transmission of the family's culture and values, sharing long-held firm-specific knowledge and social capital.¹⁰⁵ In tests across 18 countries, on average, family governance mechanisms are associated with improved financial performance.¹⁰⁶ In Norwegian SMEs, improved financial performance was associated with family involvement on the board and an increased

emphasis on the board's strategic role, but there was no association between performance and the board's control role.¹⁰⁷

Tests of performance, however, do not establish the direction of causality, e.g. whether better-performing family firms are more likely to have family governance mechanisms or vice versa. Moreover, the relationship between company performance and particular ownership structures or governance mechanisms varies from one country to another.¹⁰⁸ For example, concentration of voting power has a negative effect on family firm value in the USA and Sweden but not in Canada.¹⁰⁹ Board independence is positively associated with

performance for US firms but negatively associated with performance in a study of Canadian firms.¹¹⁰

Amran and Ahmad compared 896 family and non-family firms listed on the Malaysia Bursa from 2000 to 2003.¹¹¹ Their results indicate that family and non-family firms have different corporate governance requirements. Using a performance measure of market value to book value (similar to Tobin's Q), with controls for size, industry and age of firm, they showed that improved performance was associated with smaller board size, but only for non-family firms.¹¹² Separation of chair and CEO roles was associated with improved performance, but only for family firms. There was no association between numbers of independent directors and performance.

Similarly, Martin-Reyna and Duran-Encalada found that governance mechanisms have opposite effects on performance for family and non-family firms. They tested associations between corporate governance and performance on a small sample of 64 family and 26 non-family firms listed on the Mexican stock exchange. Concentrated ownership is associated with improved performance for family firms. The presence of outside directors is positively associated with performance in non-family firms but negatively so in family firms. This could potentially be capturing the lack of independence of outside directors in Mexican family firms. They also found that high debt is negatively associated with performance in family firms in their Mexican sample and positively associated with performance of non-family firms.

The implementation of a family constitution has been shown¹¹³ to improve performance in Spanish firms and implementation of family governance practices has led to a more effective dividend policy in Belgian firms, where intra-family conflict was shown to be associated with higher dividend payouts. In the USA, no economic performance difference was found between family businesses that utilise family meetings and others that do not. However, family businesses with more inclusive meetings had higher revenues and longer survival than those with restricted meeting membership. In Thailand, family business groups with closely-held ownership and management and mainly family directors were more likely to take on excessive debt and fail in financial crises. Moreover, family business groups with more non-family directors and managers appeared more able to survive financial crises.

Overall, studies of the impact of governance measures on firm performance highlight that performance is influenced by a range of factors and there are no simple solutions to implement. Some governance mechanisms that improve performance for non-family firms may be ineffective in family firms. For family businesses, balancing the benefits and offsetting the dangers of family involvement appears to be important.

8. NATIONAL GUIDANCE AND CODES OF GOVERNANCE FOR FAMILY BUSINESS

Having reviewed the academic research on corporate and family governance, we turn our attention to codes of governance and guidance that have been implemented in a range of countries. Corporate scandals and failures have been linked to an over-emphasis on short-term financial returns and inadequate corporate governance. Governance codes aim to improve trust in businesses, increase transparency and accountability, alongside or in addition to legal and regulatory requirements, which vary across countries. Corporate governance codes¹¹⁴ should improve standards of board accountability and effectiveness by strengthening the position of investors and strengthening the influence of boards over the companies they direct, ensuring boards are neither 'somnolent' nor 'confused'.¹¹⁵ Very few codes are statutory; most operate on a 'comply or explain' principle. Two principles underpin such codes: the need for adequate disclosure and for governance structures to include appropriate checks and balances.

The UK's first governance code for listed companies, the Cadbury Report, was published in 1992, focusing on financial aspects of corporate governance. In 2018, the Financial Reporting Council (FRC) published the 2018 UK Corporate Governance Code, covering a wider remit. Cadbury stated the need for corporate governance thus:

*'The country's economy depends on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharge their responsibilities determines Britain's competitive position. They must be free to drive their companies forward, but exercise that freedom within a framework of effective accountability. This is the essence of any system of good corporate governance.'*¹¹⁶

In response to very high-profile scandals, including those associated with the financial crisis of 2008, many countries have adopted codes for corporate governance, most often aimed at publicly-listed companies. Codes vary cross-nationally because the institutional contexts vary and the drivers of codes are different groups in different countries.¹¹⁷ Codes were driven by the financial sector in the UK, businesses in France and India, accountants in Hong Kong, the government in Spain, and investors in the Netherlands.¹¹⁸ An international benchmark is recognised in the OECD Principles of Corporate Governance, first issued in 1999 and re-issued in 2004 and 2015.

8.1 CODES FOR PRIVATELY-HELD AND FAMILY COMPANIES

Most codes of practice and corporate governance legislation are aimed at plcs, and are based on a market model that expects companies to have a widely dispersed shareholder base and a majority of independent outside board members. The typical family business has a concentrated group of shareholders and family owners who are active in management and on the board.¹¹⁹ Family firms are also more heterogeneous than publicly-owned firms, so that corporate governance codes developed for plcs may be less relevant for private family-owned firms. Financial markets provide an external governance mechanism but many family firms are not subject to their rigour, due to their ownership or financial structure. Some family firms are noted for their avoidance of debt, possibly due to avoidance of external monitoring or concerns about dilution of control.¹²⁰ However, as we noted above, on average, family firms' governance structures and financial preferences are associated with increased survivability. Codes and guidance need to recognise and build on the strengths of family firms.

The IoD notes that:

*'[For privately-held companies] copying the widely-recognised principles of best practice for listed companies is... not a viable solution, as the corporate governance challenges of listed companies are distinct from those of unlisted companies.'*¹²¹

Moreover, the governance codes and guidance developed for publicly-owned companies might not be applicable to family-owned businesses. Some commentators such as Lane et al. have argued that they could be 'detrimental' and that:

*'...many of these recommendations may harm family unity or might be too complex for private firms, and many are applicable only to very large, public companies with dispersed ownership. As a result of these differences, many... laws and recommendations may actually be harmful to family-owned businesses.'*¹²²

Some countries have developed codes and national level guidance for family-owned businesses, but not yet the UK. In the following sections, we first discuss codes developed for unlisted firms and then codes developed specifically for family firms, drawing out common themes and issues. We follow the wisdom of Cadbury when he says,

*'...there is no single right corporate governance model... the best approach is to start from whatever system is in place and to seek ways of improving it. In this search for improvement, every country can learn from the experience of others.'*¹²³

8.2 GUIDANCE AND CODES FOR THE GOVERNANCE OF PRIVATE COMPANIES

Codes aimed at private companies focus on corporate governance, and particularly the role of the board of directors. The principles emphasised by governance codes include: impartiality; transparency; trust; probity; fairness and equity; representation, and accountability.

Our review identified that codes specifically for private companies were first developed in a European context and then adopted in the UK.

In Belgium, *Code Buyse II*¹²⁴ was developed specifically for non-listed enterprises registered under Belgian law. In 2010, the European Confederation of Directors' Associations (ecoDa) developed governance guidance for unlisted European firms. It was subsequently published in the UK by the IoD to provide unlisted firms in the UK with voluntary guidance and best practice principles.¹²⁵ Whilst they do not cover family governance in as much depth as the guidance specifically designed for family firms, these guidance documents nonetheless acknowledge the particular governance requirements of family firms and include principles relating to family governance.

In the UK context, since 2019, all companies meeting a minimum size criterion (more than 2,000 employees or £200m turnover) must report which corporate governance code they have applied and how they have applied it. Alongside this statutory requirement, a coalition group of government and business representatives developed the Wates

Corporate Governance Principles for Large Private Companies¹²⁶ to provide a code of governance more applicable to privately owned companies. The six Wates Principles (Box 4) all relate to the role of the board of directors and are intended to provide a flexible approach to corporate governance for large private firms 'without being unduly prescriptive'.¹²⁷

Guidance designed for unlisted or private firms does not include recommendations and best practice advice on family governance or the particular governance challenges faced by family firms. The guidance also has very little to say on ownership rights and responsibilities. Next, we look specifically at guidance for family firms.

Box 4: The Wates Principles (2018)

1. Purpose

An effective board promotes the purpose of the company and ensures that its values, strategy and culture align with that purpose.

2. Composition

Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.

3. Responsibilities

A board should have a clear understanding of its accountability and terms of reference. Its policies and procedures should support effective decision-making and independent challenge.

4. Opportunity and Risk

A board should promote the long-term success of the company by identifying opportunities to create and preserve value, and establishing oversight for the identification and mitigation of risks.

5. Remuneration

A board should promote executive remuneration structures aligned to the sustainable long-term success of a company, taking into account pay and conditions elsewhere in the company.

6. Stakeholders

A board has a responsibility to oversee meaningful engagement with material stakeholders, including the workforce, and have regard to that discussion when taking decisions. The board has a responsibility to foster good stakeholder relationships based on the company's purpose.

Further details from www.frc.org.uk

In the UK context, since 2019, all companies meeting a minimum size criterion (more than 2,000 employees or £200m turnover) must report which corporate governance code they have applied and how they have applied it.

9. AN ANALYSIS OF NATIONAL GUIDANCE AND GOVERNANCE CODES FOR FAMILY FIRMS

Sir Adrian Cadbury followed the 1992 report with guidance specifically for family businesses.¹²⁸ However, the UK does not currently have a code of governance specifically tailored to family businesses. This section reviews some examples of codes or national guidance developed in other (chiefly European) countries. Governance codes or national guidance developed specifically for family firms were identified for eight countries.¹²⁹ Of these, six have produced guidance specifically for family firms that are available in English translation (Spain, Germany, Switzerland, Netherlands, Italy, the Gulf countries). Two other countries (Morocco and Columbia) have produced codes or national guidance for family firms which are publicly available, but not in English translation, so they were not included in the analysis reported here (see Annex 1 for information concerning each of the codes and national guidance included in this review).

The six national guidance documents and codes reviewed here were all compiled between 2003 and 2018 by national family business associations or networks, many of which are the local chapters of the largest global family business organisation, the Family Business Network (FBN).¹³⁰ For example,

- FBNed, the Dutch association of family firms, worked with FBN to produce the governance guidance for family firms in the Netherlands.

- A team of academics from Bocconi University worked with AIDAF, the Italian association of family businesses, to produce the code for family firms in Italy.

- El Instituto de la Empresa Familiar (IEF) produced the guidance for Spanish family companies.

- The code produced for families and their businesses in Germany was a joint initiative of INTES (the Academy for Family Businesses), FBN, and Die Familienunternehmer (ASU).

- The guidance for Gulf countries was produced by The Family Business Council – Gulf (FBCG), which represents family firms in Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Bahrain, and Oman.

Unlike the guidance documents listed above, the code for Swiss firms (Code G) was produced by a working group of family business advisers and legal experts from Continuum AG and Prager Dreifuss.

9.1 PURPOSE AND AUDIENCE

Four of the six guidance documents call themselves 'codes', whilst the remaining two are framed as guidance on practice. They all cover family and corporate governance and have been developed specifically for family-owned or controlled companies in their respective countries. However, there is some variation in audience, purpose and scope. The codes and guidance are aimed specifically at large or medium-sized family firms (Germany; Italy; Switzerland) or family firms of any size (Netherlands; Spain; Gulf countries). The Swiss code (Code G) is directed towards all family firms irrespective of their legal form, and in particular, family members and business officers working in medium-sized and large firms. The codes developed for family firms in Germany and the Gulf countries are aimed at the owners of family firms. The Netherlands guidance usefully indicates in the margin of the text which stakeholder each recommendation(s) is relevant to: family members (senior or junior), executives, board members, or shareholders. This enables the different stakeholders to easily identify advice and recommendations relevant to their role in the family-business system.

Most of the codes state that their aim is business improvement. The Swiss Code, Code G, describes itself as a 'regulatory framework for governance', consisting of a codified set of best practice principles. The advice is intended to help 'determine the power, management and control structure for the family (family governance), the company (corporate governance), and their conduct towards external stakeholders (public governance)'.¹³¹ The German code seeks to offer 'family-owned companies and their environment (stakeholders) a

reliable framework for the assessment and optimisation of their individual governance structures'.¹³² The Netherlands guidance provides recommendations that seek to promote a 'healthy and vital family business'. The code for the Gulf countries seeks to codify best governance practice and provide 'a common compass to help family businesses navigate through their own process'.¹³³

The ability to tailor recommendations to specific circumstances is recognised in most codes and national guidance. The German code¹³⁴ states that guidance should be 'tailored to the situation specific to the business and the family involved'. The Spanish guidance seeks to offer 'practical instruments to family businesses which help to answer a series of challenges which cannot be dealt with through laws or self-regulation'.¹³⁵ It describes a 'set of mechanisms' to assist family firms achieve both family and business objectives. The guidance details 'a set of principles and actions which [...] may contribute to improving the long-term feasibility of family businesses, independently of their size, sector or origin'. The code for the Gulf countries emphasises variation among family firms and provides a series of questions to consider. The Netherlands guidance acknowledges variation within the family business sector, and links its advice to the governance challenges faced by different types of family business (owner-managed; family-managed; family-controlled). The Italian code sets out principles and guidelines for evaluating and improving governance practices and systems and then invites companies 'to report the (even partial) adoption of the recommendations and behaviours set out in the Code in its Annual Report or in any other similar document'.¹³⁶

9.2 STRUCTURE AND CONTENT OF GUIDANCE AND CODES

Most guidance includes a conceptual element, where general principles and definitions are set out, followed by specific practical recommendations on family governance and corporate governance (in family firms). Texts vary in their accessibility, readability, and ease of navigation, varying in length between 30 and 40 pages. Whilst they all cover family and corporate governance, they vary considerably in the amount of attention they devote to ownership and shareholders, management, the external environment and corporate social responsibility.

The Swiss code (Code G) tailors its recommendations to three key groups in the family business system: the family, 'business players', and external stakeholders. The German code begins by discussing the role of family firm owners, their rights and obligations, and then goes on to define the role of the [supervisory] board,¹³⁷ followed by advice on management, wealth and ownership, family governance. It also provides a useful glossary with definitions of key terms and concepts.

The Italian code identifies the behaviours or governance practices believed to characterise a well-functioning governance system. The style is more legalistic and is organised around 20 principles and 10 articles. Its scope and the key concepts underpinning the code are well defined. Topics include the 'management of the ownership structure, succession plans, involvement of non-family managers, and balance between company and family interests',¹³⁸ reflecting the emphasis on entrepreneurial families.

The Netherlands guidance is particularly schematic and is organised at the highest level around the familiar tripartite model (family, business, and ownership), the 'three pillars' of a 'healthy and vital family business'. It is underpinned by a detailed analysis of what constitutes good governance in a family business context. The Netherlands guidance is atypical in that it usefully distinguishes between advice with different levels of prescription: recommended; advisable; or to be considered.

The Spanish guidance adopts a more theoretical approach, and employs systems theory to take into account the complexity of family firms in the guidance provided. Like some of the other guidance discussed here, its recommendations are organised around the tripartite family-business-ownership system, with an emphasis on the relationships within that system (e.g. between business and family, shareholders and board).

The code developed for the Gulf countries is unusual among those reviewed here in that corporate governance receives less attention than family governance. The code provides 'questions to consider' on ownership governance - legal structure, governing policies (such as shareholder agreements) and governing bodies (shareholder council, shareholder assembly). There are also sections on wealth governance, public engagement and succession planning. Finally, the code includes guidance on implementation in the form of a standardised checklist (this checklist can be found in Annex 3 of this report).

9.3 CORPORATE GOVERNANCE

All the codes and guidance discussed here cover corporate governance and provide recommendations relating to the activities of the board: for example, defining corporate governance and the rationale for it. Across countries, guidance is provided on the duties, size, composition and operation of the board, the chair's role and the role of independent directors - their selection and remuneration. This advice varies in two main ways: first, the level of attention given to the relationship between corporate and family governance; and, second, the coverage of other aspects of corporate governance, apart from the board and its directors.

The Swiss guidance on corporate governance in family firms is mainly targeted towards management and includes recommendations and advice on: vision and strategic orientation; the structure of the business; the board of directors (board composition, chair, duties); shareholders (relationship with board, engagement); management (decision-making, duties, reporting, remuneration, compliance); corporate culture and motivation; and managing generational change and succession planning.

The German guidance discusses the role of the supervisory board, its purpose, and responsibilities. It also provides recommendations on reporting remuneration, composition of the supervisory board, and the selection of board members (including family membership).

The Spanish guidance considers the role of the board in the context of the 'family business system of governance' and provides advice on board regulations; board structure and function; size and composition; directors' competences, duties, and remuneration.

The guidance developed for the Gulf countries emphasises the importance of understanding the relationship between the family and the business. It presents a definition of corporate governance and identifies the elements of good corporate governance: vision; legal structures and governing bodies; the board of directors and their responsibilities; board composition; the role of committees, etc. The code also recommends that the board should include 'well-qualified family' members and that at least one-third of the board should be independent. Finally, it points to the benefits of having a board that is entirely external.

The Italian code focuses on corporate governance and business management, and pays less attention to family governance. The makes the case for adopting a corporate governance system where

*'powers are balanced and the interests of the company in respect to all interests, both proprietary and not, are represented, are aimed at ensuring continuity and growth, thus characterizing a modern concept of sound and responsible entrepreneurship.'*¹³⁹

The code identifies two main objectives of the corporate governance of family-controlled firms:

*'a well-functioning system of governance has to favour the dynamic achievement of two objectives: (i) the ability of the owner family to express a clear vision of the future of the company/subsidiary group; (ii) the possibility of (family or non-family) management to implement said vision using the best available resources on the market.'*¹⁴⁰

9.4 FAMILY GOVERNANCE

Those codes and national guidance designed specifically for family-owned firms place more emphasis on family governance when compared with codes designed for unlisted companies (for example, the codes produced by the IoD or *Code Buysse II*). They typically provide guidance on family governance structures and mechanisms such as family councils, family charters, and the relationship between the family and the company. Some also include guidance on succession and business handover, how to handle family appointments and employment, communication, and ways of preventing and managing conflict.

The Swiss guidance (Code G) stresses the importance of control mechanisms within the family, and that the need for such mechanisms depends on how much influence the family has on the business. A key reason for introducing a system of family governance is to ensure business stability and to protect the firm from issues arising within the owning family. This might include, for example: defining family goals and values and expressing these in a family charter; organizing family reunions and establishing a family council; formulating a communication policy; and developing a wealth strategy and succession planning.

According to the code for German firms, family governance has two main goals: first, 'to strengthen and foster long-term consolidation of the feeling of cohesion on the part of the owner family and their identification with the company – in the sense of a common project'; and, second, 'to avoid potential conflicts or help resolve them'.¹⁴¹ There is a chapter dedicated to the principles and activities for achieving 'solid family governance'.

The guidance for firms in the Netherlands includes recommendations on good family governance intended to achieve a 'functional entrepreneurial family'; it recommends, for example, producing an historical narrative of the family business and working with family members to define the family's mission and its vision for the business. This is followed by detailed guidance on ways of encouraging good communication and consensus among family members – holding family meetings, establishing a family council or family association, drafting a family charter. The guidance also includes recommendations on: family leadership; succession and engaging the next generation; involving family members in the business; and preventing and managing family conflict.

After setting out the purpose of family governance, the guidance developed for Spanish family firms provides detailed advice relating to the family council and family assembly, and the relationship between them. Given the systems approach underpinning this guidance, it emphasises the family-business relationship and the relationship between family and corporate governance structures – how the board and family council should interact. The family protocol is a formal document that can help clarify and manage this relationship and the governance arrangements of both.

Unlike the other guidance considered here, family governance is not separately covered in the Italian code. Nonetheless, the guidance it provides on corporate governance is tailored towards unlisted family-controlled firms and to their special circumstances.

9.5 MANAGEMENT

Within the six sets of guidance reviewed, recommendations relating to business management receive much less attention overall, compared with family and corporate governance. The advice given typically covers: recruitment and remuneration; the role of executives in governance; and the involvement of family members in running the business.

The Swiss guidance (Code G) includes a chapter focusing on business management, with recommendations on strategy, the structure of the business, decision-making, reporting, compliance, remuneration, and corporate culture. It also recommends paying heed to professional qualifications when recruiting for key roles, rather than concentrating on family membership. The guidance for German firms also includes a chapter dedicated to management that starts by defining the responsibilities and duties of company management and provides advice on composition, remuneration, family involvement and employment in the firm. The guidance for firms in the Netherlands also includes advice on business operations, particularly where they come into conflict with 'family traditions and values' or the priorities of individual family members.¹⁴² It provides guidance on developing a 'professionally-managed business' that remains 'sufficiently entrepreneurial and innovative.' Some of the particular challenges that family firms face are flagged up, for example where family ownership can potentially have implications for the way the business operates. In particular, they caution against conservatism and continuing with business activities that are not profitable and which may be motivated by 'family pride'. They further observe that 'this conservative attitude can be a grave handicap in business terms' and 'sticking to the closed character of the family business can have important negative consequences for its own development.'¹⁴³

9.6 EXTERNAL ENVIRONMENT

Guidance relating to the external environment, stakeholder engagement and corporate social responsibility do not figure strongly in most of these codes, with the exception perhaps of the guidance for family firms in Switzerland (Code G). The latter includes advice on public governance and emphasises the importance of effective cooperation with external stakeholders¹⁴⁴ for the good governance and management of the company, a key consideration here being to preserve and promote the company's public reputation. Code G advises that the 'company must demonstrate an active concern for the public and the environment' and provides recommendations on reporting, the treatment of employees, the mitigation of negative environmental impacts, effective management of resources, philanthropy and community engagement. The guidance advocates the reporting and the communication of environmental and social goals and activities, noting that 'information and reporting on economic, social and ecological performance can boost long-term success and the reputation of the company.'¹⁴⁵

As for the other guidance considered here, there is a small section on transparency and corporate responsibility in the Spanish guidance that covers reporting, annual accounts, and relationships with non-family members, corporate social and environmental responsibility. The code for the Gulf countries includes a section on 'engaging the public', highlighting the value and importance of philanthropy.

9.7 GUIDANCE AND IMPLEMENTATION

Some of the codes/guidance supplement their recommendations with further guidance on how to implement them and sometimes provide resources to help with this. For example, Code G (Switzerland) includes a section on how to implement the recommendations, together with a comprehensive checklist to assist family firms apply the recommendations for good governance. Similarly, the guidance for the Gulf countries includes a useful checklist (included in Annex 3 of this report), setting out the steps needed to achieve an effective governance system and to facilitate implementation of the principles.

9.8 LEGAL AND COUNTRY CONTEXT

The country context shapes the codes and guidance provided, particularly the legal and regulatory features of each country. The political, legal, regulatory, and cultural context of each set of guidance needs to be considered when interpreting them or generalising any of their recommendations to other countries. For example, whilst many of the recommendations included in Code G are likely to be relevant to family firms in the UK, the code was compiled by a working group of Swiss corporate and legal experts and so therefore represents a Swiss perspective on how to achieve good governance in family firms. Some of the recommendations in the Netherlands guidance cite Dutch company law. Similarly, the Italian is situated within a broader system of best practice aimed at improving business governance, referring to the Italian Civil Code.

Some of the guidance reviewed recognises the variation that exists among family firms and particularly firms' governance needs at different stages of their development. For example, the guidance for family firms in the Netherlands provides specific guidance on the governance challenges faced by different types of family business according to their phase of development (owner-managed; family-managed; family-controlled firms), and links the guidance provided to these challenges.

9.9 EVIDENCE AND RESEARCH

Cadbury¹⁴⁶ highlighted the dearth of evidence on the effectiveness of governance mechanisms or the links between governance and performance. He emphasised that quantitative measures, for example on the composition of boards, do not capture how effective or competent directors are, nor do they give insights into effectiveness or processes. Occasionally, the guidance reviewed here draws on evidence to support the claims presented but typically they do not; the recommendations and advice in these codes are mostly unsupported by evidence and the use of empirical examples to illustrate key principles is rare. The guidance provided is mostly normative and prescriptive (what firms and business families should or ought to be doing, rather than what they are doing). Moreover, as the authors of the

Spanish guidance indicate, there is a lack of research evidence on governance in unlisted and family businesses. The authors point out that the focus of research has been on governance in listed companies, and they highlight the need for more research in this area, recommending 'in-depth studies of the relationship between effective management of these structures and the ability of family businesses to achieve their development objectives.'¹⁴⁷

In this area, evidence-based policy making is recommended to ensure that guidance is based on a thorough understanding of what works in particular circumstances. There is clearly scope for anchoring the guidance more firmly in research, evidence and empirical examples of best practice.

Information and reporting on economic, social and ecological performance can boost long-term success and the reputation of the company.

10. IMPLICATIONS FOR FAMILIES IN BUSINESS

Family firms, unlike non-family firms, have to consider governance of the family's relationship with the business, as well as corporate governance relating to business issues. While good governance is required for all businesses, family businesses have the added complexity brought about by the intertwining of business and family relationships and imperatives. The best family businesses are responsible, well-managed and trustworthy. However, the negative aspects of family relationships can have disastrous consequences if brought into the family business. The evidence and guidance reviewed in this report indicates that families in business can mitigate the risk of such consequences through appropriate governance.

Good governance needs to comply with statutory responsibilities and be effective for the firm and the family. Professionalisation will take time and tends to occur in waves, stimulated by changes in management or ownership and contingent on the specific context of each firm. A significant challenge for some family businesses is balancing trust and control. Trust may be higher in family firms with concentrated ownership; recognition of the intertwining of family and business wealth may incentivise stewardship behaviours. Where fewer controls are in place, people are more likely to behave in a trustworthy manner because they value the trust that is placed in them, and vice versa. Businesses might implement more formal controls and systems as they professionalise, up to a point where they have sufficient structures and can increase flexibility. Whilst firms might satisfy checklists in

terms of board and committee structures, effectiveness may not be enhanced by this. The ability of a board member to contribute fully and provide an unfettered opinion is more important than their status as an insider or an outsider. Directors may be constrained by interlocking directorships, social and emotional ties, and power relationships. Many family businesses have close relationships with other family businesses that may lead to interlocking relationships and commitments.

Suggestions for family governance are not prescriptive, but options to consider within a specific context and circumstances. Family firms might find it helpful to examine codes designed in other countries to identify which is most applicable for them to follow. Many family firms have found that implementing robust family governance structures allowed them to tackle issues before they became damaging. Formal family governance mechanisms also provide a means for families in business to strengthen relationships and improve understanding of the business. Family governance becomes more important as family businesses move through generations and become more complex.

Openness to external advice and scrutiny are key elements of good governance. Privately-owned family businesses are at risk if dominant family executives resist external advice and controls; on occasion this has led to the downfall of companies. Policy makers in various countries are therefore increasingly interested in implementing governance codes of practice for businesses.

11. IMPLICATIONS FOR NEW UK GOVERNANCE GUIDANCE FOR FAMILY FIRMS

Our review of governance codes for family firms highlights many of the ways that family firms in the UK might improve how they are governed, and what should be included in any code tailored specifically to the needs of family firms. Any governance code specifically designed for family firms needs to be based on clear evidence of how different elements of governance influence specific aspects of performance. Many recommendations appear to be based on assumptions, experience, and expertise, and there is limited systematic research evidence that helps family businesses to understand how the implementation of particular governance systems will affect their business performance. Therefore, as of yet, the evidence is insufficient, but indications are that, on average, family involvement improves firm performance and the board's strategic role has a greater impact on performance than its control role.

The evidence to date indicates that governance codes developed for listed companies might not be applicable for private family businesses and could even be detrimental in some circumstances because codes tend to assume separation of ownership and control, self-interested individuals and utility-maximising behaviours. In contrast, family businesses often have concentrated ownership, close relationships between owners and managers and longevity of shareholding, making agency-theoretic governance codes irrelevant or inappropriate.

If a governance code for private family firms in the UK were to be developed, then it should seek to:

- strike a balance between corporate governance and family governance;
- provide clear guidance on the responsibilities of owners, in addition to directors;
- be underpinned by a coherent theoretical framework. The Spanish guidance is underpinned by a systems approach and provides an example of good practice here;
- be organised around a well-defined set of principles and concepts. The Wates Principles provide a sound basis for this;
- be informed and supported by empirical research evidence that tests assumptions about family firms and the impact of governance recommendations;
- be consistent with UK regulation and legislation regarding the reporting requirements of private companies;
- include practical guidance on implementation;
- cover social responsibility, engagement with stakeholders and relationship of firms with the external environment;
- provide recommendations tailored to firms

of different sizes and stages of development (not just large firms). The Dutch guidance by FBNed provides an example of good practice here.

Governance codes and family businesses should consider what it means to have 'meaningful engagement with material stakeholders' (Wates Principle 6). The push towards greater employee engagement on boards and 'accountable capitalism' represents a challenge to family businesses that continue to be paternalistic, with uni-directional communications and assumptions that they know what is in employees' best interests. In the USA, Senator Warren's 'Accountable Capitalism Act' would require 40% of board members to be elected by the employees. Governance codes need to consider the trend towards employee directors, workforce advisory councils or dedicated directors representing employees. Further research could examine family business responsibilities or accountability to society or groups other than the family.

Family involvement improves firm performance and the board's strategic role has a greater impact on performance than its control role.

12. IMPLICATIONS FOR RESEARCH

Further studies of governance of family businesses in a UK context are needed. There is a dearth of longitudinal studies, which are necessary to establish causality, particularly the relationship between various governance structures and performance. Well-designed longitudinal research could evaluate the impact on performance of the introduction of national guidance, codes or specific governance mechanisms. Despite many prescriptions for family governance mechanisms, there is very little systematic evidence of what works best in what circumstances.

Further research should avoid uncritical comparisons between family directors or managers relative to 'professionals', i.e. externally appointed non-family directors or managers. The implication that family directors and managers are 'unprofessional' is outdated and should be avoided.

Only a few studies provide evaluation or insights into the functioning of the board of directors, the roles of directors, or processes in the selection of directors. The finding that non-executive directors do not on average positively influence performance might be surprising to some and further research is needed to identify under what circumstances non-executive directors influence performance, positively and negatively. Moreover, few studies evaluate the functioning of family councils and there is a lack of basic performance metrics against which the effectiveness of family councils can be measured. Studies should consider carefully which performance measures would be most appropriate for family

businesses and perhaps identify specific intermediary performance measures for particular governance mechanisms.

Additional gaps in knowledge include

- implications of different governance mechanisms for alternative performance measures in addition to firm value, e.g. innovation, growth, productivity;
- use and impact of family governance mechanisms;
- determination and impact of dividend policies and directors' remuneration;
- the relationship between active and non-active shareholders;
- intermediary structures, specifically whether family councils and trustees create double agency costs and the extent to which they impact the success of the business;
- power relationships, in board of directors and within family governance;
- value systems and their influence on governance.

Studies should take account of the variation in definitions of family business. Varying definitions make it more challenging to build a body of evidence and compare studies. Variations in context highlight the role of legal and market institutions, particularly relating to investor protection, that determine whether family control is 'good, bad or irrelevant'.¹⁴⁸

13. CONCLUSION

Family businesses' ability to survive better than non-family firms is attributed to their board characteristics and stable ownership. Effective governance needs to balance the positive and negative aspects of family ownership. Good governance for family business requires:

- clarity of roles - particularly clarifying the roles, rights and responsibilities of family members;
- an effective board – as outlined in The Wates Principles; and
- a logical organisational structure – with appropriate corporate and family governance mechanisms.

Governance needs to be appropriate to the context. Many of the recommendations of 'good governance' are based on assumptions derived from agency theory, which ignore social forces and relationships. The emphasis tends to be on formal rather than informal governance mechanisms. Formal governance puts policies and structures in place before there is a crisis, so avoiding making decisions when disaster strikes or in the heat of the moment. Family businesses should not underestimate the power of emotional and relational ties, which in some contexts may be more effective than formal governance mechanisms. Any governance code needs to be tailored to different sizes and stages of development of family-owned businesses, and be flexible enough to take account of context.

- ¹ It is argued that we should not separate family businesses into 'professionally-managed' and 'family-managed' businesses because many family-managed businesses are managed extremely professionally (Hall and Nordqvist, 2008; Stewart and Hitt; 2012; Howorth et al., 2016a).
- ² IFB (2019). The State of the Nation. www.ifb.org.uk/media/3995/ifb_rf_report_2019_lr.pdf
- ³ G20/OECD Principles of Corporate Governance www.oecd.org/corporate/principles-corporate-governance.htm
- ⁴ Johnson, D. J. 2004. Available at www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf
- ⁵ Scholes and Howorth, 2018
- ⁶ Cadbury, 2000b
- ⁷ Edelman (2019) reported that in most countries people trust family businesses more than other types of business. Employees of family businesses also trust their organisation more than employees of non-family businesses.
- ⁸ Breeze, B. (2009). Title of report reporting on Family Business Philanthropy and Social Responsibility.
- ⁹ See for example, Gordon and Nicholson (2008). Family Wars.
- ¹⁰ File and Prince, 1996; Carney et al., 2014
- ¹¹ Gordon and Nicholson (2008) provide some extreme examples.
- ¹² Shleifer, A. and Vishny, R. (1989) Management entrenchment: the case of manager specific investments. *Journal of Financial Economics* Volume 25, Issue 1, November 1989, Pages 123-139
- ¹³ See Westhead and Howorth, 2006b
- ¹⁴ Pindado and Requejo, 2015
- ¹⁵ Suehiro and Wailerdsak, 2004: p.81
- ¹⁶ For example, Claessens et al., 2000, in Suehiro and Wailerdsak, 2004
- ¹⁷ Jara-Bertin et al., 2008
- ¹⁸ Howorth et al., 2016a; Scholes and Wilson, 2014
- ¹⁹ Westhead and Howorth, 2007; Jaskiewicz and Klein, 2007; Basco and Perez, 2009
- ²⁰ Hall and Nordqvist, 2008; Westhead and Howorth, 2007; Suehiro and Wailerdsak, 2004
- ²¹ Klein, 2010
- ²² Suehiro and Wailerdsak, 2004; Klein, 2010
- ²³ Klein, 2010: p.1
- ²⁴ Pieper et al., 2008
- ²⁵ Lane et al., 2006; Howorth et al., 2004
- ²⁶ Howorth et al., 2016b
- ²⁷ Cadbury 2000b
- ²⁸ Halyk, 2012; Aronoff and Ward, 2011
- ²⁹ Olson et al., 2003
- ³⁰ Lewin, 1943
- ³¹ Mallin, 2018
- ³² Villalonga, Amit, Trujillo and Guzmán, 2015
- ³³ Schultze et al., 2001
- ³⁴ Lubatkin et al., 2007
- ³⁵ Howorth et al., 2004; Klein, 2010
- ³⁶ Quote from Donaldson, 1990: p.379
- ³⁷ Davis, Schoorman and Donaldson, 1997 provide the basis for stewardship theory
- ³⁸ Psychological ownership is the feeling that something belongs to you, regardless of legal ownership. For example, an employee may feel they have rights over an office or piece of equipment, and family members who have no ownership stake may talk about the business as 'ours.'
- ³⁹ OECD (2015), 'About the Principles' (p.9) G20/OECD Principles of Corporate Governance, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264236882-en>
- ⁴⁰ Summarised in Brenes et al., 2011
- ⁴¹ Cadbury, 1992: p.15
- ⁴² Cadbury, 2000a: p.8
- ⁴³ Monks and Minow, 1991: p.1
- ⁴⁴ Shleifer and Vishny, 1997; Morck, 2005; Voordeckers et al., 2007; Siebels and zu Knyphausen-Aufseß 2012; Suess, 2014; Zellweger and Kammerlander, 2015; Mallin, 2018
- ⁴⁵ Brenes et al., 2011: p.281 is just one example among many that emphasise balance and clarity.
- ⁴⁶ Westhead and Howorth, 2006a
- ⁴⁷ Cadbury, 2000b; Zattoni et al., 2015
- ⁴⁸ Pendergast, Ward and Brun de Pontet, 2011: foreword.
- ⁴⁹ Cadbury, 2000a
- ⁵⁰ Anderson and Reeb, 2004; Ryan et al., 2004; Morck, 2005; Westhead and Howorth, 2006b; Usdiken and Oktem-Yildirim, 2008; Cuadrado-Ballesteros et al., 2015; Kotlar et al., 2019
- ⁵¹ For example, Pendergast et al (2011) suggest that an effective board of directors is one that meets at least three times per year and includes at least three independent, external directors.
- ⁵² Westhead and Howorth, 2006b
- ⁵³ IoD, 2010
- ⁵⁴ The Sarbanes Oxley Act (2002) is a US Federal law that brought in sweeping changes following financial scandals involving Enron, WorldCom and Global Crossing.
- ⁵⁵ Brenes et al., 2011
- ⁵⁶ Kotlar et al., 2019
- ⁵⁷ Westhead and Howorth, 2006b
- ⁵⁸ Westhead and Howorth, 2006b
- ⁵⁹ Martin-Reyna and Duran-Encalada, 2012
- ⁶⁰ Babatz 1997; Husted and Serrano, 2001
- ⁶¹ For example, Suehiro and Wailerdsak, 2004, report similar patterns in Thailand; Üsdiken and Öktem, 2008 in Turkey; Johannisson and Huse, 2008 in Scandinavia

⁶² Homophily is the tendency for individuals to associate with people who are similar to themselves.

⁶³ Brenes et al., 2011

⁶⁴ Quote from Brenes et al, 2011: p283

⁶⁵ Lane et al., 2006

⁶⁶ Bettinelli, 2011

⁶⁷ Wilson, Wright, and Scholes, 2013;

Campopiano et al., 2017; Arzubiaga et al., 2018

⁶⁸ Statistics in this section are from Wilson, Wright and Scholes, 2013 and Kotlar et al., 2019

⁶⁹ See Krause et al., 2014 for a review of CEO duality

⁷⁰ Martin-Reyna and Duran-Encalada, 2012

⁷¹ Kotlar et al., 2019

⁷² See Kotlar et al., 2019 for large UK firms and Westhead and Howorth, 2006b, for small UK firms.

⁷³ Corbetta and Salvato 2012 provide an overview of European family firms. They report that 31% of large Italian firms have a family CEO; in Cyprus, 77% and in Slovakia, 66% of family businesses have only family members in managerial positions.

⁷⁴ Westhead and Howorth, 2006b

⁷⁵ Johannisson and Huse, 2000

⁷⁶ Selekler-Goksen and Oktem, 2009

⁷⁷ Zattoni et al., 2015

⁷⁸ Daily and Dalton, 1992, suggest that professionalization is a once and for all 'threshold', whereas Dekker et al., 2015, and Howorth et al., 2016b, indicate that it is a process. Gedajlovic et al., 2004 emphasise the learning and resources needed to professionalise.

⁷⁹ Hall and Nordqvist, 2008, and Stewart and Hitt, 2012, provide interesting critiques of the assumption that family managers are not professional.

⁸⁰ Stewart and Hitt, 2012

⁸¹ Howorth, Wright, Westhead and Allcock, 2016a

⁸² Westhead and Howorth, 2006b; Hartman, Schierstedt and Gudmundson, 2011

⁸³ Lane et al., 2006; Howorth et al., 2004

⁸⁴ Gallo & Kenyon Rouvinez, 2005; Pieper & Astrachan, 2008; Labaki, 2011; Gersick & Felieu, 2014; Suess-Reyes, 2017

⁸⁵ Suess, 2014

⁸⁶ Gordon and Nicholson, 2008; Gersick et al., 1997; Martin, 2001

⁸⁷ DiMaggio and Powell's, classic article in 1983 highlighted and conceptualised these isomorphic pressures.

⁸⁸ Parada et al., 2010

⁸⁹ The IFB Family Business Challenges series provides short introductory guides to different aspects of governance, including family governance, communication, the relationship between owners and the board, and professionalising the board. The series also provides guidance on topics such as stewardship, engaging the next generation, planning succession, responsible ownership, and family governance. The guides can be accessed here: www.ifb.org.uk/research/family-business-challenges/. The IFB blog provides further insights including why families might need a family constitution. See <https://www.ifb.org.uk/advice/for-next-generation/why-you-should-think-about-developing-a-family-constitution/>

⁹⁰ Eckrich and McClure, 2012

⁹¹ Gersick et al., 1997: p.237

⁹² Blumentritt et al., 2007; Chittoor and Das, 2007; Jaffe and Lane, 2004; Peterson & Distelberg, 2011

⁹³ Suare and Santana-Martin, 2004; Brenes et al., 2011; Mustakallio et al., 2002; Jaffe and Lane, 2004

⁹⁴ Chittoor and Das, 2007; Craig and Moores, 2002; Brenes et al., 2011; Gilding, 2000, Mustakallio et al., 2002

⁹⁵ Craig and Moores, 2002

⁹⁶ Gersick and Felieu, 2014

⁹⁷ Corbetta and Salvato, 2012, provide a comprehensive examination of family offices in Europe

⁹⁸ Gersick and Felieu, 2014

⁹⁹ Amran and Ahmad, 2009; Martin-Reyna and Duran-Encalada, 2012

¹⁰⁰ Westhead and Howorth, 2006a

¹⁰¹ Wilson, Wright and Scholes, 2013, quote from page 1383.

¹⁰² Westhead and Howorth, 2006a and 2006b

¹⁰³ Suehiro and Wailerdsak, 2004; Carney, 2005; Westhead and Howorth, 2006b; Hall and Nordqvist, 2008; Bammens et al., 2011; Corbetta and Salvato, 2012

¹⁰⁴ Anderson and Reeb, 2003. Performance measures are Tobin's Q (market value of assets to replacement value of assets) and ROA (return on assets).

¹⁰⁵ Arregle et al., 2007; Carney, 2005; Zattoni et al., 2015

¹⁰⁶ Berent-Braun and Uhlener, 2012

¹⁰⁷ Zattoni et al., 2015

¹⁰⁸ Based on a comprehensive review of empirical research on family business performance, Pindado and Requejo (2015) argue that the role of legal and market institutions in varying countries, particularly

relating to investor protection, determine whether family control is 'good, bad or irrelevant' (p.288).

¹⁰⁹ For the USA, see Villalonga and Amit, 2009; Bigelli and Mengoli 2011; for Sweden, Cronqvist and Nilsson 2003; for Canada, Ben-Amar and André 2006 and Jog et al. 2010.

¹¹⁰ For USA, see Anderson and Reeb, 2004; for Canada, see Klein et al., 2005.

¹¹¹ Amran and Ahmad, 2009

¹¹² Martin-Reyna and Duran-Encalada, 2012

¹¹³ For Spain, see Arteaga and Menéndez-Requejo, 2017; for Belgium, Michiels et al., 2015; for the USA, Tower et al., 2007; for Thailand, Suehiro and Wailersak, 2004

¹¹⁴ Cuomo et al., 2016; Mallin 2018

¹¹⁵ Cadbury, 2000a: p.9

¹¹⁶ Cadbury, 1992: p.10

¹¹⁷ Autorité des Marchés Financiers report on corporate governance annually. In 2016 they conducted a comparative study of corporate governance codes across ten European countries, including the UK (AMF, 2016). The study examined how each of the codes work and compared each code's' provisions across several areas of corporate governance – for example, the role of CEO and chair, board member independence, board gender diversity, remuneration, caps on severance pay.

¹¹⁸ See Cadbury, 2000a, for developments following the 1992 Cadbury report. Also Cuomo et al., 2016, for a review of corporate governance codes.

¹¹⁹ Westhead and Howorth, 2007

¹²⁰ Tappeiner, Howorth et al., 2012; Shyu and Lee, 2009; Croci et al., 2011

¹²¹ IoD, 2010: p.9

¹²² Lane et al., 2006: p.147

¹²³ Cadbury, 2000a: p.7

¹²⁴ Buysse, 2005; 2009

¹²⁵ IoD, 2010: p.9

¹²⁶ The Wates Corporate Governance Principles for Large Private Companies. published in December 2018 <https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf>

¹²⁷ FRC, 2018: p.5

¹²⁸ Cadbury, 2000b

¹²⁹ The European Corporate Governance Institute maintains a searchable database of national codes. Full texts of corporate governance codes and principles of corporate governance can be accessed here: ecgi.global/content/codes

¹³⁰ www.fbn-i.org

¹³¹ Continuum and Prager Dreifuss, 2008: p.3

¹³² INTES, FBN and die Familienunternehmer – ASU, 2015: Prelim.

¹³³ FBCG, 2016: p.3

¹³⁴ INTES, FBN and die Familienunternehmer – ASU, 2015: p.8

¹³⁵ Casado et al., 2005: p.16

¹³⁶ AIDAF, 2017: p.6

¹³⁷ German companies typically have a dual board system, comprising a supervisory and management board.

¹³⁸ AIDAF, 2017: p.7

¹³⁹ AIDAF, 2017: p.7

¹⁴⁰ AIDAF, 2017: p.4

¹⁴¹ INTES, FBN and die Familienunternehmer – ASU, 2015: p.31

¹⁴² FBNeD, 2003: pp.24-25

¹⁴³ FBNeD, 2003: pp.24-25

¹⁴⁴ External stakeholders include, for instance, customers, employees, investors, partners, the general public, government and professional organisations.

¹⁴⁵ Continuum and Prager Dreifuss, 2008: p.29

¹⁴⁶ Cadbury, 2000a

¹⁴⁷ Casado et al., 2005: p.11

¹⁴⁸ Pindado and Requejo, 2015: p.288

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ANNEX 1: GOVERNANCE GUIDANCE AND CODES FOR FAMILY FIRMS

Country	Author(s), contributors, committee members, partners	Year	Title	Type of document	Target audience
Unlisted/non-listed companies					
Belgium	Code Buysse was produced by a committee of company CEOs, lawyers/legal advisers, accountants and other stakeholders and chaired by Baron Buysse.	2005; updated 2009	Corporate Governance Recommendations for Non-Listed Enterprises – Code Buysse II. Belgium	Code	
UK/EU countries	Institute of Directors/ European Confederation of Directors' Associations	2010	Corporate Governance Guidance and Principles for Unlisted Companies in the UK	Best practice guidance and principles	Unlisted companies in the UK, including founder and family-owned businesses
Private firms					
UK	Financial Reporting Council (FRC)	2018	The Wates Corporate Governance Principles for Large Private Companies	Set of principles	Large private firms in the UK
Family owned firms					
Netherlands	FBNed. The Dutch Association of Family Firms (The FBNed Committee for Good Governance in Family Businesses)	2003	The Family Business Governance Report: Practices and Recommendations. FBNed (The FBNed Committee for Good Governance in Family Businesses); Tilburg, Netherlands.	Practice guidance	Family firms in the Netherlands
Germany	P. May, INTES; K-E. W Haub, FBN; and L. Goebel, die Familienunternehmer - ASU	2015	Good Governance in the Family Business: Guidelines for the responsible management of family businesses and business-owner families	Code	Family owned companies and business families in Germany
Spain	F. Casado, A. Olcese, P. Nueno and J. Roure. Instituto de la Empresa Familiar, IESE, University of Navarra and Fundacion de Estudios Financieros	2005	Good Governance in the Family Business/Buen Gobierno en la Empresa Familiar	Practice guidance	Family businesses in Spain

Switzerland	Continuum AG and Prager Dreifuss; Compiled by a working group (Swiss corporate and legal experts)	2008	Code G Family: Business: Environment: Governance Guide for Families and their Businesses	Code	Family members and 'business officers' of medium sized and large companies run by private shareholders
Italy	AIDAF (The Italian Association of Family Businesses) and Università Bocconi Marchetti, P., Corbetta, G., Minichillia, A. and Passador, M.L	2017	Principi per il Governo della Società Non Quotate a Controlla Familiare: Codice di Autodiscipling (Corporate Governance Principles for Unlisted Family-Controlled Companies: Code of Corporate Governance	Code	Unlisted Family-Controlled Companies – Specifically entrepreneurial families who control large family companies
Gulf countries (GCC)	The Family Business Council-Gulf (FBCG)	2016	The GCC Governance Code: Guidance for Family Businesses	Code/practice guidance	Family firms in Gulf countries
Columbia	Comité Interinstitucional liderado por la Superintendencia de Sociedades, la Cámara de Comercio de Bogotá y Confecámaras (Colombian Confederation of Chambers of Commerce)	2009	Colombian Guide of Corporate Governance for Closed Societies and Family Firms	Practice guidance	
Morocco	Commission Nationale de la Gouvernance d'Entreprise (CNGE)	2008	Code spécifique de bonnes pratiques de gouvernance des PME et Entreprises familiales	Code	

ANNEX 2: GLOSSARY OF KEY TERMS

Agency Theory: the main theory underpinning many governance mechanisms in business. Assumes that individuals are self-serving and utility maximising. Complementary to stewardship theory.

Board of Directors: the formal governing body of a business, with legal obligations and responsibility for directing the operations of the business.

Corporate Governance: structures, processes and mechanisms to manage 'relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.' (OECD, 2015 Definition)

Executive Director: a member of the board of directors who also has an employed role within the business.

External Director: a member of the board of directors who is not a member of the owning family and not an employee of the business.

Family Assembly: a gathering of family members that could include those who own shares and relatives who do not own shares in the family business.

Family Charter: see family constitution.

Family Constitution: an agreement drawn up by family members that sets out how they will manage their relationship with each other and with the business.

Family Council: a connected organisation that deals with family issues associated with the family business.

Family Director: a member of the board of directors who is also a member of the family that owns shares in the business.

Family Governance: structures and mechanisms that a business-owning family employ to manage the relationship with their family business and the issues relevant to them as a business owning family.

Family Member: any person related to the business-owning family through kinship or marriage.

Family Office: an independent organisation set up to manage the assets of one or more families.

FRC: Financial Reporting Council. Governance Code: a set of standards of good practice for governance of businesses.

Independent Director: a member of the board of directors who has no connection with the business, shareholders or associated interests.

Non-executive Director: a member of the board of directors who is not employed by the company in an executive role.

Shareholder: an owner of the firm who may or may not be a member of the dominant ownership family.

Stewardship: a theory originating from ancient religious texts but currently employed to capture the collective management of an organisation in the organisation's best long-term interests, regardless of any individual's personal interests. Complementary to agency theory.

ANNEX 3: THE GCC GOVERNANCE CODE

GOVERNANCE GUIDELINES FOR FAMILY BUSINESSES - CHECKLIST



CHECKLIST

The checklist is provided as a guiding tool to assist family businesses in their journey of governance. As previously highlighted, each family business has its own unique properties and requirements, and should, accordingly, identify the specific factors that require its attention and work on implementing the mechanisms necessary. The checklist acknowledges that governance implementation is a journey; it lists the different stages your business might be at, providing you a clear direction on what is left to accomplish.

Governance Type	Not Addressed	Planning Phase	Application Phase	Completed (under testing & revision)
FAMILY GOVERNANCE				
Vision, Values, and Goals <ul style="list-style-type: none"> Family members are aligned on the vision and core values, values are embedded in goals, governance and policies. 	⊙	○	○	○
Family Communication <ul style="list-style-type: none"> Regular family reports to document what was planned, send updates, and report achievements. Regular family meetings where family and business issues are discussed. 	⊙ ⊙	○ ○	○ ○	○ ○
Governing Bodies <ul style="list-style-type: none"> A family assembly that acts as a forum for communication between all family members. A family council that acts on behalf of the family assembly to manage family affairs. 	⊙ ⊙	○ ○	○ ○	○ ○
Family Policies <ul style="list-style-type: none"> A family charter/ constitution that identifies and enables shareholders to understand the main elements of the family and the business. Clear and fair policies that regulate matters of importance to the family and any processes pertaining to them. Example: family employment policy and family new venture non-compete policy) 	⊙ ⊙	○ ○	○ ○	○ ○
Conflict Resolution <ul style="list-style-type: none"> A clear conflict resolution strategy that sets out the means and processes for resolving conflict among family members, and between family members and the company. 	⊙	○	○	○
Family Members <ul style="list-style-type: none"> Family members with entrepreneurial spirits are identified and roles in the business are assigned. Family members' performance is regularly assessed and acted upon by an assigned party. Female family members are involved in the business, gender parity is minimized/ overcome. The next generation is prepared to join the business, equipped with adequate skills and knowledge. 	⊙ ⊙ ⊙ ⊙	○ ○ ○ ○	○ ○ ○ ○	○ ○ ○ ○
OWNERSHIP GOVERNANCE				
Legal Structure <ul style="list-style-type: none"> A coherent legal structure is in place with the necessary legal firewalls to protect the business and family. 	⊙	○	○	○
Governing Policy <ul style="list-style-type: none"> A shareholder agreement that summarizes the will of the shareholders, and sets forth their rights and responsibilities and regulates family matters. 	⊙	○	○	○

Governance Type	Not Addressed	Planning Phase	Application Phase	Completed (under testing & revision)
Governing Bodies				
• A shareholder assembly that comprises of all shareholders and plays a role in business decisions by governing and assists the shareholder council.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• A shareholder council that comprises of a smaller number of shareholders and represents the shareholder assembly in respective business matters.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
CORPORATE GOVERNANCE				
The Family and the Business				
• The relationship between the family and the business is assessed and properly identified.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Corporate Vision				
• A corporate vision that outlines the business's key values and sets out its primary goals.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Legal Structure and Governing Bodies				
• Separation of ownership from management.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• A clear distinction between the roles of shareholders, board members, managers and employees.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• The creation of different committees that assist the board of directors.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Corporate Policies				
• Clear policies that regulate important business matters and processes pertaining to them.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Plans for Non-Family Employees				
• A fair treatment to non-family employees in terms of appointment, assessment and development.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
WEALTH GOVERNANCE				
Wealth Management Strategy				
• A robust strategy that allocates wealth to different fields of investment and sets out independent policies for each.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Family Offices				
• A family Office that supervises and manages the family business's private wealth through a separate operation	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• Family engagement in the activity and periodical reporting to the family board on activity and performance	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Investment Planning and Solutions				
• A clear set of investment objectives aligned aligned with the vision, goals and wealth strategy.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• A clear set of investing rules that regulate family business's investments and ensures that they are	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
ENGAGING THE PUBLIC				
Philanthropy				
• A commitment towards philanthropy and an engagement in philanthropic activities.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• Setup of family foundations for large charitable causes.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• Creation of a family philanthropy committee to manage philanthropic activities.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Identity and Business Reputation				
• A clear and consistent business identity is established and maintained.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
• A positive coherent business image is showcased.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
SUCCESSION PLANNING				
Succession Plan				
• A clear carefully designed succession plan to facilitate the transfer of the family business from one generation to another.	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

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