

# FAMILY GOVERNANCE: MANAGING THE CHALLENGES OF WEALTH

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# How Can We Help Successful Families Stay That Way?

- ▶ Recognize the challenges families face in transferring wealth.
- ▶ Understand how you can help them prepare and succeed through generations.

# A Parent's Worries

- ▶ Affluent clients worry about how wealth will impact their heirs:

65%	“Too much emphasis on material things”
55%	“Naïve about the value of money”
52%	“Spend beyond their means”
50%	“Initiative could be ruined by affluence”
49%	“Won't do as well financially”
42%	“Hard time taking financial responsibility”

U.S. Trust Survey of Affluent Americans, XIX

# And Their Worries Are Well-Grounded

The three generation rule:

U.S.

“From shirtsleeves to shirtsleeves in three generations”

Spain & Latin America

“Father-merchant, son-gentleman, grandson-beggar”

Brazil

“Rich father, noble son, poor grandson”

# Avoiding Failed Wealth Transfers

Research indicates 70% of wealth transfers fail due to loss of:

- a. Assets
- b. Control
- c. Family Harmony

Institute for Preparing Heirs  
(based on 20 years of field research  
with 3,000 wealthy families)

# Why the High Failure Rate?

- ▶ Focusing on non-threatening, relatively mechanical aspects of planning, such as taxes and asset management.
- ▶ Avoiding or fumbling the preparation of heirs.
- ▶ Lack of trust and communication.

# The Key Challenge

Managing family  
dynamics in advance  
of wealth transfer

# Challenges of Wealth for the Entrepreneurial Family

Wealth builder's inability to let go:

- ▶ Lack of transparency
- ▶ Next generation's insecurity
- ▶ At worst, control games



# Unprepared Children

- ▶ Timing of wealth transfer unknown.
- ▶ No family plan for it.
- ▶ No practice within defined roles/cooperation.
- ▶ Unpredictable environment on death of parent.

Not a recipe for success!

# Family Conflicts

- ▶ Conflicting views and family paralysis
- ▶ Turf wars
- ▶ Divisive relationships

# Affluenza

Clients struggle with how much to leave children.

“Enough to do anything but not enough they can afford to do nothing.”

-- (Warren Buffett)

- ▶ Managing children’s expectations.
- ▶ Preparing them for personal responsibility and productivity.

# Loss of Capital/Dilution of Wealth

- ▶ Expenses
- ▶ Taxes
- ▶ Sense of entitlement
- ▶ Distributions
- ▶ Growth in number of family members

# Inability to Keep It in the Family

- ▶ Lack of oversight and accountability.
- ▶ Lack of clear leadership succession.
- ▶ Resistance to change and lack of visionary leader who is nimble in responding to changing markets.

# How Successful Families Sustain Wealth and Family Harmony

- ▶ Effective communication
- ▶ Shared values
- ▶ Ability to make decisions together
- ▶ Conflict resolution skills
- ▶ Sense of purpose

# Successful Families

- ▶ Allow for diversity of views
- ▶ Mentor and train in financial competency
- ▶ Manage expectations
- ▶ Provide a structure for leadership and governance across generations
- ▶ Stress the non-financial legacy of the family

# What Clients Want From Advisors

- ▶ It's not about the money.
- ▶ Broader definition of family wealth
- ▶ Family values, heritage and traditions
- ▶ Family unity
- ▶ Increase in human intellectual and social capital for future generations



# Human Capital

- ▶ Parenting/Grand-parenting
- ▶ Communication
- ▶ Values/Morals/Ethics
- ▶ Collaborative decision making
- ▶ Conflict resolution skills
- ▶ Leadership training
- ▶ Team building

# Intellectual Capital

- ▶ Education
- ▶ Career choices
- ▶ Mentoring/Coaching
- ▶ Governance
- ▶ Rights and responsibilities of trustees and beneficiaries

# Financial Capital

- ▶ Earning money
- ▶ Managing/Investing Money
- ▶ Wealth transfer strategies
- ▶ Family business
- ▶ Financial parenting
- ▶ The psychology of money

# Social Capital

Philanthropic initiative of the family:

- ▶ Checkbook
- ▶ Donor-advised funds
- ▶ Family foundation
- ▶ Support organization
- ▶ Operating foundation
- ▶ Volunteer service

# The Nurturing Family

- ▶ Has a plan
- ▶ Uses a family constitution to establish governance and processes
- ▶ Has family meetings
- ▶ Allocates resources, creates opportunity, rewards wealth and manages expectations

# Family Meetings

Key cause of wealth transmission failure: **lack of trust and communication**

Regular meetings allow the wealthy family to:

- ▶ Air and resolve conflicts
- ▶ Be inclusive and transparent
- ▶ Develop a succession plan
- ▶ Manage expectations
- ▶ Encourage entrepreneurship and work ethic
- ▶ Identify and perpetuate core values

# Family Constitution

Create an effective governance structure to:

- ▶ Promote and protect family unity
- ▶ Optimize use of family's financial, human and social capital

# Family Constitution

- ▶ Develop it by consensus
- ▶ With input from advisors
- ▶ To promote family cohesion through rules, processes, and shared goals and values



# Family Business: Components of a Family Constitution

1. Mission/Vision
2. Values
3. Brand/Reputation
4. Family Employment Policy
5. Development of Next Generation
6. Ownership, Voting and Transfer Policies

# Family Business: Components of a Family Constitution (continued)

7. Family Bank
8. Dividends and Family Benefits Policies
9. Liquidity Policy
10. Governance
11. Family or Family Council Role
12. Shareholder Meetings

# 1. Mission and Vision

Statement of family's vision and commitment to the business and its continuity.

## 2. Family Values

Description of values that have made the business successful in dealing with employees, customers, suppliers, competitors, partners and the community.

# 3. Brand and Reputation

- ▶ Guidance for firm visibility: relations with media/use of family name
- ▶ Protection of reputation of both the family and the business
- ▶ Expectations for family members in management

# 4. Family Employment Policy

- ▶ Enumeration of educational and other requirements for employment of family members by the company
  - ▶ Internships
  - ▶ Lower Level Positions
  - ▶ Management
- ▶ Are spouses eligible?
- ▶ What prior work experience elsewhere is desirable?

# 5. Development of Next Generations

- ▶ Commitment to and policies and procedures for education and professional development
- ▶ Availability of funds for college and graduate education and performance expectations
- ▶ Resources for financial literacy and management training

## 6. Ownership, Voting Power and Restrictions on Transfer

- ▶ Stock ownership and classes of stock
- ▶ Transfer policies, including buy-sell agreements and separate property requirements
- ▶ Business valuation processes
- ▶ Representation on the board/voting rights
- ▶ List of governing and other pertinent legal documents



# 7. Family Bank

Availability of funds to develop new initiatives and ventures and terms of use for those funds.

# 8. Dividends and Family Benefits

Educational guidance for shareholders about:

- ▶ Expectations for returns on capital
- ▶ Reinvestment requirements
- ▶ Risk and risk management policy
- ▶ Acceptable company debt levels
- ▶ Distributions

# 9. Liquidity Policy

- ▶ Business valuation
- ▶ Buy-sell Agreements/Shareholders' Agreements

# 10. Governance

- ▶ Primary functions and operating procedures of the board
- ▶ Board composition, standing, authority
- ▶ Relationship of board to shareholders, management and other family entities

# 11. Family Council Role

- ▶ Membership, standing and operating procedures
- ▶ Purpose and functions in relation to board and shareholders

# 12. Shareholder Meetings

- ▶ Role of shareholders, including authority and legal standing
- ▶ Relationship of shareholders to the family council and the board

# Goals of Family Meetings

1. Transparency
2. Productive, timely communication
3. Education and updates about the business
4. Education about estate plan/wealth transfer plans
5. Rules for participation in the business
6. Support for younger family members
7. Mechanisms for problem solving and dispute resolution
8. Collaboration to promote continued wealth and opportunity

# When?

- ▶ Not in time of crisis, urgent need or conflict
- ▶ In time to address hard issues
  - ▶ Create common ground
  - ▶ Ameliorate conflicts due to
    - ▶ Misunderstandings
    - ▶ Misinformation
    - ▶ Budding Ill-Will



# Starting the Conversation

- ▶ What is the purpose of my wealth?
- ▶ How can it be used to increase human, intellectual and social capital for future generations?
- ▶ How do I avoid feelings of entitlement/engender healthy gratitude?

# What Is It Appropriate to Provide Children and Grandchildren?

- ▶ Birth to college
- ▶ College and grad school
- ▶ The launch
- ▶ Marriage/first house
- ▶ Incentives
- ▶ Lifestyle

# Family Philanthropy

- ▶ Sense of broader value
- ▶ Gratitude and empathy
- ▶ Family bonding
- ▶ Family values
- ▶ Accountability
- ▶ Importance of mission
- ▶ Support of community
- ▶ Not about money!

# Family Philanthropy Meetings

- ▶ Share in family mission
- ▶ Promote communication and trust
- ▶ Teach
  - ▶ Responsible leadership
  - ▶ Financial literacy
  - ▶ Impact analysis and assessment
  - ▶ Negotiation and accountability
  - ▶ Decision making process
- ▶ Shared sense of responsibility

# Key to Success

Engage children and grandchildren:

- ▶ Early
- ▶ Concretely
- ▶ Often
- ▶ In age appropriate ways
- ▶ In a spirit of sharing, cooperation and common values

# Taking an “It’s not just about the money” approach:

- ▶ Lets advisors engage the whole family
- ▶ Create cohesion
  - ▶ Develop relationships with younger generations (90% now currently change advisors after inheritance)
  - ▶ Facilitate family mission and harmony



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