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Creating Family Governance Systems in Different Cultures

By [Isaret](#) on May 5, 2009 9:05 PM | [Permalink](#) | [Comments \(0\)](#) | [TrackBacks \(0\)](#)

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What makes a culture? What makes one culture different from another culture? ²In one sense, each family is its own small culture. In a broader sense, families in France see themselves as quite different, culturally, from families in Japan. As do families in the Kingdom of Saudi Arabia, who have a Shariah law overlay. How does an advisor adjust for the different cultures? The answer comes from an approach that assists families in creating their own tailored governance system.

The first question, however, for all private client advisors, is why is it important for families to create their own governance systems? The second question is what is a family governance system and how does it address the first question? The third question is who should be creating a family governance system for their family? Finally, the last question is how does an advisor help a family create its own effective governance system, in whatever culture the family lives?

I. Why create a family governance system?

Families tend to have disagreements and conflicts. Large amounts of wealth tend to increase and intensify the occurrence of disagreements and conflicts. If (and this is an important preliminary condition) the family wants to prevent (or minimized) the disruption and hostilities that result from their intra-family conflicts--the best solution is to create an effective family governance system.

Statistics and proverbs both confirm the difficulty of preventing the loss of family wealth across several generations. The accepted statistics are grim: less than ten percent of family-owned businesses survive to the third generation³. As the Economist put it: "Few family businesses manage to survive beyond the third generation. A failure to develop the founder's business, together with disputes over dividing up the spoils, usually does in most family firms."⁴ The parallel proverb for large family wealth is "shirtsleeves to shirtsleeves in three generations."⁵ The general issue seems to be how to motivate a generation that has grown up in a wealthy household. Numerous programs exist on "next generation" training. This is a global issue. The Chairman of Almoayyed & Sons (Bahrain) said "I think it's very difficult to motivate the third generation...I would say about 50% are not really motivated. This is basically the problem we have and I don't know what the solutions are."⁶

What causes the ruination of the fortunes? The single most lethal cause, in the author's opinion, is intra-family conflict⁷. How does a family minimize the occurrence and the severity of their intra-family conflict? The single best practice, in the author's opinion, is to create an effective family governance system.

Looking at the seeds of conflict, we can begin with a focus on wealth and its inheritance. It is the link of money with affection and approval, even with "success", that breeds discontent in the second generation. When the parents are able to make transfers of wealth, during lifetime or at death, that are unequal among their children, conflict is inevitable.

In some legal systems an unequal division is more possible than in other legal systems. In the United States, and other common law jurisdictions⁸, parents have almost unfettered freedom to dispose of their assets unequally among their children, or, indeed, to omit a child from any inheritance at all. In France, and other European civil law countries⁹ this is not possible. Instead, children have rights to inherit that are fixed at birth.¹⁰ The fixed rights remove the entire (often contentious) subject of how to allocate an inheritance among children--who inevitably differ from

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each other in their abilities, needs, marriages, professions and emotional closeness to the parents--in a manner that is not based on equality but rather is based on a presumed sense of fairness (at least to the parents and their advisors). But even when children live in a jurisdiction of parental freedom for children's inheritances the children often develop a sense of entitlement¹¹. It is when that sense of entitlement is disregarded that serious conflicts and legal court claims arise.

Traditional solutions include increasingly sophisticated legal documents. Lawyers can create tightly drafted dynasty trusts, incentive trusts, asset protection trusts, family wealth preservation trusts, etc¹². However, it remains true that unhappy family members can and do find ways to attack even the best drafted plans. Usually the family members who are the most likely to raise complaints are the ones who are least likely to have been included in the planning process¹³. Being left out of any meaningful participation often has the unpleasant result of exacerbating their dissatisfaction.

If the conflicts arise from a lack of participation in the inheritance planning process, it seems logical that the advisor's focus would be more effective if time and attention were spent on the group of family members as a unit, and to help ensure that they are able to voice their concerns and to have felt a sense of participation. If there is meaningful inclusion, all family members are more likely to abide by the results of the participatory process. The best practice of this participatory process, in the author's opinion, is the development of a formal family governance system.

II. What is a family governance system?

All governance is a system of allocating power. In John Locke's social contract, an individual member must believe that he or she will be better off by relinquishing some individual freedom for the benefit of belonging to a group. Returning to "culture" again another element of group formation is to share an identity, which seems to be a core human need.

Governance takes many forms. In the Platonic benevolent dictator system, one wise leader takes care of the group. In other versions of the dictator system, however, the one leader may be motivated by self-interest, and not by the goal of caring for all of the members. Families are microcosms of the same allocations of power.

The critical study is to analyze which systems have worked well in the sense of keeping the groups together, in a productive mode, over time. The systems (e.g. French royalty) that resulted in destructive revolutions are not models of success. Neither are the systems that professed to share all power and all resources (e.g. classical communism) when the result was non-productive economies and stifled individual creativity.

What are the benefits an individual will value by being a member of a group? First might be physical safety, especially historically. In modern times the safety might be just as important but be of a psychological nature. For example, an advisor who asks an individual about the role of the family might hear that the importance of the family is that it is a place where the individual feels "safe". That sense of safety might mean a refuge of caring and comfort. It might also mean a solid base from which to exercise freedom and creativity. In either sense, a core element is security, a form of safety.

A final comment on governance relates to the geo-political standard known as the "rule of law". This phrase refers to countries that do (or do not) have a governance system that is based on the principle that whatever laws have been established...will apply to everyone. This was the hallmark of the Magna Carta¹⁴ in 1215: for the first time the English monarch agreed to be subject to the same laws as everyone else. Benefits of the rule of law include the ability to know what the rules are and to be assured that one will be treated in the same manner as will the others. This "rule of law" applies equally well in a family setting.

In discussing a family governance system we must address not only the nature of "governance" as above, we also need to address the definition of "family". Who exactly is the family? It turns out that this initial question, which is in many ways one of the most serious and lasting questions, is the question of which individuals should be included in the family, for family governance purposes? Should the "family" include only the natural parents and their adult children¹⁵? Even that simple format becomes complex if there are multiple wives. If there are multiple divorces, the selection is also complex. A very sensitive question is the inclusion of spouses of the adult children. In some cultures, such as Japan¹⁶ and Muslim cultures, the daughters may be treated as belonging more to their husband's family than they do to their original family¹⁷. Next is usually the question of the minimum age of a child for inclusion. In some cases, such as where the married daughters are considered to belong more to their husband's family, their children may also be considered to belong more to their father's family.

Having addressed, albeit briefly, the words "governance" and "family" we need to consider the broader concept of a "system" of family governance. A family governance system refers to the method by which a family makes decisions (the way in which the group's power has been allocated). As John Ward, author of several treatises on family business continuation, used to mention, any way in which a family does make decisions is that family's governance system, even if it is that they will toss a dice for any decision. The point is that all families already have a family governance system; even a system in which the patriarch makes every decision is a family governance system. The question is whether or not the existing family governance system is "effective." That means "effective" in accomplishing what goal?

We are focused on the goal of preserving family continuity, family harmony and family wealth-- across the generations and against the odds.

III. Which families should create family governance systems?

Any family that is concerned about keeping the family together¹⁸ would improve their odds of success by creating a family governance system.

In an earlier article on the basics of family governance, I said that although the most obvious families who need family governance are those who share assets and therefore need to make group decisions, this does not address a deeper need to be together as a family:

Another thread in the fabric of family governance, which is often not made as explicit but may be the most important, is a generational desire to be part of a family continuum. This involves keeping the past alive and planning now for the future. This instinctive urge is nothing less than a wish for immortality. A sense that the family lives on can be most reassuring, especially in the face of the unwelcome inevitability of personal death. In ancient Roman times, the reason that a man needed to have a son before he died was clearly tied to immortality. It was the son who would have the obligation of *sacra* after the father's death, an obligation to continue honoring the family ancestors. If he did not have a son, he would adopt one. In legal terms the son "became" the persona of the father, inheriting his position as *paterfamilias*, head of the family. Property was not thought of as owned by various individuals, but as owned by the family itself, in communal form¹⁹.

IV. How should families and their advisors create effective family governance systems in different cultures?

One of the first questions is whether a family can create its own governance system, without the assistance of an outside advisor. The general advice, given by families themselves, is that an outside facilitator is essential during the creation of the family governance system, a process that usually takes one to three years. Each family member needs to be free to participate, is one reason. Another reason is that during the creation process it is important to suspend the family's normal decision-making patterns. For example, to have a patriarch who makes all the decisions also act as the leader of the family meetings to create a governance system is unlikely to achieve a participatory result, however well-intentioned the patriarch may be.

What then is the role of the facilitator? The first task should be to spend separate time with each family member, listening to each person's perspective. Several useful open-ended questions are "What is your role in the family?" "What does it mean to you to be part of this family?" and "What are some issues that you think should be discussed by your family?" The replies should give the facilitator a good sense of the family and its most critical issues. This is also where the family's particular culture will surface as relevant²⁰.

So, the first crucial step is to work hard to truly understand the individual family. Listening with a goal of understanding any family is not easy; one might think that trying to understand a family in a culture quite different from that of the facilitator would be much more difficult. However, it can actually be easier to understand a very different culture--because there is no assumption that one already understands it, meaning that the listening is much more open-minded. Any culture-specific elements will surface at this stage.

The next stage is to convene the family for a formal family meeting. The facilitator leads the meeting. The goal is to decide upon the family's rules of procedure and to choose several issues to be discussed at future meetings (based on the issues shared during the interview process).

In the author's experience, even the rules of procedure are developed best when they originate with the family. This will also highlight any differences in the family's culture. As stated in "International Family Governance: Beyond Basics"²¹ :

Although many of the core issues are similar, such as those that are embedded in human nature (jealousy, mistrust, dominance, etc.), a particular family has its own history that has shaped it. It has its own culture in which it lives. It has its own collection of hopes and aspirations.

At the first formal family meeting, an initial issue raised by someone in the family is likely to be the question of deciding which family members should be included in the meetings. The family can decide how they wish to answer that, and also which areas they want to cover by some rules. They can then decide together what those rules should be. In the author's experience and perhaps surprisingly, families do not raise the issue of voting rights but proceed by general consensus.

As part of ensuring that everyone does participate, it can be useful to assign small groups to prepare the chosen topics to present at the next meeting. This can model cooperative behavior across the generations and among family members who do not otherwise work on joint projects.

It is the process itself that adds the value, not any particular written documents. When a family struggles with issues in creating its own family governance, when the family members go slowly and digress often, the family learns how to make its own way in this tricky area. The best solutions are those arrived at by the family, following its own process.

In other words, what is important and gives value to the family is not the production of written documents that could include a Constitution, By-Laws, Protocol, Mission Statement, Value Statement, Shareholders Agreement or Family Council. What gives value to the family is their acquired skill in listening to each other, learning to make accommodations and then arriving at a decision-making process that all will honor. When conflicts arise, as they will, the family will not need to resort to lawyers and threatened litigation. They will instead have a time and place of their own to address those difficult issues in a respectful manner, applying their own "rule of law."

As may be obvious this emphasis on process means that the family may progress slowly, which may be a hallmark of ongoing success. As George Washington said (in a letter to John Washington): "To form a new government requires infinite care and unbounded attention; for if the foundation is badly laid, the superstructure must be bad. Too much time, therefore, cannot be bestowed in weighing and digesting matters well."

As a final comment, it is very important to keep the process flexible, and to allow future generations to adapt it as they see necessary. A good governance system is one that provides fairly for its members and adapts well to changing circumstances. Each member feels consulted, respected, and treated fairly. The pride in the family can then be passed on to future generations, who will be able to participate in the same flexible process.

If this approach is followed, of simply facilitating the family's formation of its own governance system, then like Socrates the wise advisor will be extracting the system that the family knows will work for them. It will be their own family governance system, whatever their culture.

1

This is a preview summary of the arguments treated with more detail in the author's current draft of a guidebook for families and their advisors on creating effective family governance systems in different cultures.

2

The fifth meaning of the word "culture" in Merriam-Webster's Dictionary is: "**5 a:** the integrated pattern of human knowledge, belief, and behavior that depends upon the capacity for learning and transmitting knowledge to succeeding generations **b:** the customary beliefs, social forms, and material traits of a racial, religious, or social group."

3

See, e.g., Center for Family Business, College of Business Administration, Northeastern University, Dedham, MA, Volume 12, No. 4. at p. 2, viewed at <http://209.85.129.104/search?q=cache:qcnVi-7CGv4J:www.cba.neu.edu/documents/Fall02.pdf+%22family+business%22+survival+%22third+generation%22&hl=en&ct=clnk&cd=3> (It is widely known that fewer than one out of ten family enterprises survive through a third generation.)

4

Economist, Oct 12, 2006.

5

The classic work in this area is James E. Hughes, Jr., *Family Wealth: Keeping it in the Family*.

6

Farouk Almoayyed, Chairman, Almoayyed & Sons, Bahrain, in "Succession: the view from the Middle East" Sept/Oct 2007 Families in Business, p. 56.

7

The author also believes that the global acceptance of the three-generation proverb itself causes the expected failure. For a different approach, encouraging the model of an indefinite cycle, see Barbara R. Hauser, "The Four Seasons of Sustainable Wealth," Journal of Wealth Management, Fall 2007.

8

The United States inherited its common law legal system from England, as did Canada, Australia and other former members of the British Empire. See generally: Robert C. Lawrence, *International Tax and Estate Planning: A Practical Guide for Multinational Investors*, Practising Law Institute (Third Edition); Professor Jeffrey Schoenblum, *Multistate and Multinational Estate Planning*, CCH; and Barbara R. Hauser, *International Estate Planning: A Reference Guide*, Juris Publishing (www.jurispub.com).

9

Most of the European countries have adopted a civil code that is based directly or indirectly on the Napoleonic Code of 1804. (Interestingly even Japan adopted a form of the German Civil Code which itself was based on the French Code Civil).

10

These rights can vary considerably in different countries: there may be a "claw back" that applies to lifetime gifts, the percentages may vary, the ability for the heirs to agree to a different plan might exist, etc.

11

See, e.g., Barbara R. Hauser, "A Child's 'Station in Life': Inheritance Rights and Expectations," Journal of Wealth Management, Fall 2001.

12

In addition, there are increasingly creative roles in addition to the role of the trustee: Protectors, Investment Advisors, Art Advisors, etc. For proposals of ways in which to involve the beneficiaries more, see Barbara R. Hauser, "Beyond Protectors", STEP Journal, January 2009.

13

See, e.g., Barbara R. Hauser, "Appreciating Beneficiaries," Trusts and Estates, June 2007.

14

The Magna Carta is in many ways the central document in English democracy, as England has no written constitution.

15

The joke with so much truth in it is the one asked about the spouses of children: are they in-laws or out-laws?

16

According to Mark McLelland's review of Wim Lunsing's *Beyond Common Sense: Sexuality and Gender in Contemporary Japan*, "Statistically speaking it is still overwhelmingly the bride who enters the register of her husband's family, although in families where there are no sons to inherit it is possible to adopt a son-in-law and bring him into the wife's family register (*muko yōshi kekkon*) in which case he adopts his wife's family name." (http://intersections.anu.edu.au/issue10/mclelland_review1.html)

17

One could say that even in countries like the United States, the practice of a married woman's changing her "family name" to that of her husband is an indication of which family has the stronger claim to her (and then to her children as well). One's name is an important part of one's identity, both as an individual and as a family member.

18

"Together" includes the scenario where the family may agree to separate and make decisions as individuals about various assets that were originally group family assets, as long as they have agreed to separate for those purposes but have at the same time agreed to stay "together" emotionally, with close enduring and respectful relationships with each other.

19

Barbara R. Hauser, "Family Governance: Who, What and How", Journal of Wealth Management, Fall 2002.

20

For example, a traditional Muslim family may have younger members who want to discuss the family's role in selecting a spouse.

21

By Barbara R. Hauser, STEP Journal, April 2009.

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