



# The Four Essential Questions

*Is your Family Enterprise ready for a Transition?*

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What Policies  
&  
Agreements  
do you  
need?

What  
Processes  
should you  
implement?

What is the  
right  
Ownership  
Structure?

What is the  
right  
Governance  
Structure?

## INTRODUCTION

Many business founders in Asia today are struggling with the questions surrounding who will succeed them in the future to continue running the family enterprise that they have built. Common goals include a desire to see the family enterprise continue to prosper and provide a source of income and wealth for the family, to see the family remain united, supportive of the business and able to speak with one voice. Family harmony is an important value.

The business founder might be thinking about whether they should appoint one of their children as the next chairman and/or chief executive officer, whether the next generation have what it takes to operate as a successful sibling partnership, whether there should be an increased role for non-family professionals and whether a family trust should be set up to own the shares in the business.

The business founder may be worried whether his choice of successor will be respected by the rest of the family, how to ensure the successor has adequate control, and whether his children will continue to get along together when he is no longer around. And who can he rely on to step in and settle any disputes that may arise in the future?

These are extremely difficult and complex questions and statistically the odds of getting it wrong are very high. We have all heard of the saying that “wealth does not survive three generations”. The reality is that family firms around the world are very complex organisms (or “systems”) and that the complexity only keeps increasing in quantum leaps as the business has to face the transition from first to second generation and then from second to third.

Doesn't the business founder – and their adult family members - need some kind of framework that they can use that will help them organize the important issues, manage some of the complexity and provide a process they can work through together to develop the answers to their questions and concerns?

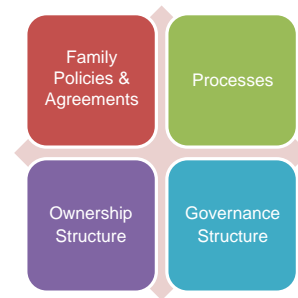
By looking at best global practices for family firms there are four basic, but essential, questions that the founder & their family should consider that can help them to get organized, and over time, develop the answers that will work for them and allow their family to achieve their goals of succession, continuity and harmony.

The four essential questions are:

1. What is the right Ownership Structure to own the family business?
2. What is the right Governance Structure for the family and for the business?
3. What Policies should the family have in relation to the business?
4. What Processes will the family need to put into practice to bring the family and the business Governance system to life?

## Question 1: What is the right Ownership Structure to own the family business?

The first question to consider is what is the right kind of Ownership Structure that should be formed to secure the long term protection of the family business?



### ***The Family Shareholders Agreement***

The most basic option is to leave the members of the family directly owning or directly inheriting shares in the family business and to rely on a family shareholders agreement (or buy-sell agreement) to regulate dealings among shareholders and to ensure that ownership stays within the family. These kinds of legal agreements can be very helpful in allowing for the family tree to be pruned from time to time.

### ***The Family Trust***

The approach which is perhaps the most common in Asia is to set up a family trust structure to own the shares in the family business. For example in Hong Kong, many of the family controlled listed companies have a trust as the Ownership Structure that is used to hold the controlling family's stake. This kind of trust structure can provide asset protection benefits for the family and importantly prevents the share ownership from fragmenting over time.

### ***A Company with Voting and Non-Voting Shares***

An approach that is not common in Asia is to have two classes of shares created, voting and nonvoting shares, so that the economic interest, including the right to receive dividends, can be separated from the voting control. With this approach the voting shares might be given only to those family members who work in the management of the business, while the non-voting shares which carry the right to receive dividends etc. can be given to all of the family members, even those who do not work in the business.

### ***Other Options***

There are other forms of Ownership Structure that can be adopted depending on the goals of the business founder and the circumstances, including holding company structures, partnership structures and even charitable foundations.

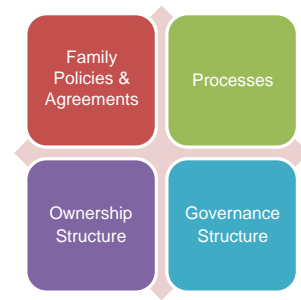
## How do you select the right Ownership Structure?

When you go into more detail, important & fundamental questions to consider when choosing the right Ownership Structure for your business include:

- Whether the Ownership Structure will be a good fit with the family relationships and dynamics?
- Whether (given the legal complexities of many of the common forms of Ownership Structure) your family members have the capacity to actually make the Ownership Structure work?
- How to balance doing things “together” as a unified family, while on the other hand allowing individual family members (and family branches) a degree of autonomy and independence?
- If the Ownership Structure is a family trust, how would a family member “exit” from the trust?

Best practices point to the significant importance of having family meetings to explain the terms of the family trusts or other Ownership Structures to the family members while the founder is still alive and healthy so that there will be no surprises for the family in the future and so that the next generation family members will know how to properly work within the framework of the Ownership Structure when the time comes.

## Question 2: What is the right Governance Structure for the family and for the business?



The Ownership Structure is one thing, but it is not sufficient by itself. So the second essential question that must be addressed is “What Governance Structure would best suit the goals and objectives of the founder and his family?”

The trust or other Ownership Structure is like the computer hardware. Governance (and in particular “family governance”) is the software that the computer needs to function. You need both hardware and software.

Global best practices for successful family businesses offer the following list of “building blocks” to consider for the design of a Family Governance & Business Governance Structure:

### ***The Family Assembly***

A Family Assembly comprised of all of the family members. It would normally include spouses and even teenage children. The Family Assembly meets once a year on average. A key purpose is to foster family connections, harmony and unity, as well as sharing information and updates on the business and to gather the views of the whole family.

### ***The Family Council***

A Family Council comprised of a smaller representative group of family members. These could be the representatives of the different branches of the family or perhaps the representatives appointed by the Family Assembly. The Family Council is not limited to family members who work in the business although membership might be restricted to blood descendants of the founder. The Family Council is the family executive body. It might meet quarterly or on a more frequent basis. The Family Council is firstly a family forum and a core purpose is to decide upon the relationship between the family and the business.

### ***The Shareholders Council***

In larger more complex families, the Family Council is established to deal with family matters while a separate Shareholders Council is created to specifically address the issues concerning the owners and future owners of the business. In a less complex family this function might be incorporated into the Family Council.

### ***Sub Committees of the Family Council***

One approach is for the Family Council to create one or more standing committees to address specific topics. For example there might be an Education and Development Committee, a family Philanthropy Committee, a family Investment Committee and a Family Constitution Committee. Alternatively these topics can be addressed on a more ad hoc basis or by the Family Council as a whole.

### ***A Family Office***

If the family have created a dedicated Family Office to help them administer their family affairs and investments (separate and distinct from the business operations) the Family Council can be the Governance Structure that is responsible for overseeing the Family Office. An important role for the Family Office will be to provide support for the family governance activities of the family, which might include helping to arrange regular family meetings.

### ***One extra piece - A Council of Family Elders***

Another important element of the Governance Structure that is recommended is a Council of Elders or Elders Council. Initially this might be the parents (or even better, a trusted “uncle” or “auntie”) and over time each branch of the family can nominate an Elder. The role of the Family Elders is to ensure that the family values are respected in the future, family stories are told, the Family Constitution is being complied with and with their wisdom, family disputes are mediated. Respect for elders is a key part of Asian culture, so this additional element should be a very good fit with an Asian family.

### ***Board of Directors***

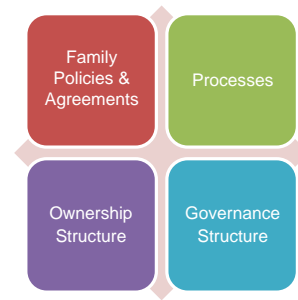
The seat of corporate governance for the business is the Board of Directors (the “Board”). When designing the overall Governance Structure for the family and its business this is also an opportunity to consider questions such as what is the current role of the Board, what is the ideal Board composition, should the Chairman role be kept within the family, should there be more non-family, non-executive directors, and what is the right “job description” for a director?

To get the full benefit that a Board can provide an enterprising family, the Board should be bringing an objective perspective to issues that is different from the perspective that you would get from an operating or executive committee. In the time of the founder, the Board is there for him to sound ideas off against. In later generations, the Board can help to act as an important buffer between the owners (who appoint the directors) and the CEO and management. In a family business, the Board always serves at the discretion of the family owners.

### ***An Advisory Board***

One further element that can be added is an Advisory Board. The Advisory Board is there to give advice on the business to the founder or the CEO and to the Board. Best practices point to the great value of having non-family, non-executive directors on the Board. However if this is too big a step for the founder to take immediately, then an Advisory Board is a possible solution. Members of the Advisory Board are not appointed as directors, so the founder (and the Board of Directors), have no legal obligation to follow their advice. The members of the Advisory Board should not have the legal liability and fiduciary duties that would come from being appointed as an actual director (as long as they do not become “shadow directors”) which might make it easier to find experienced and respected business men who are willing to give their advice and third party perspective.

### Question 3: What Policies should the family have in relation to the business?



The majority of family businesses around the world fail because of family conflicts, including conflicts between family members who are “inside the business” and those who are “outside the business”.

The good news is that the majority of family business conflicts are predictable conflicts and many are due to either:

1. Role confusion, given the complexity of the family business system, or
2. Relate to a failure to make a distinction between the rules and messages of the family system and sound business practices.

Having written Policies is a way to prevent these predictable conflicts. Family Policies help to reduce role confusion and to create a clear boundary between family matters and business matters.

#### ***The Family Employment Policy***

One example of a very important Policy is the family employment policy. This Policy will spell out matters such as whether family members are encouraged to join the business, what qualifications they will need, what the application procedure should be, whether they first need to have outside work experience, and what kind and how much.

It is very predictable in an Asian family business that siblings will start to fall out over the issue of which of their children (i.e. the third generation) are competent and should be allowed to work in the business.

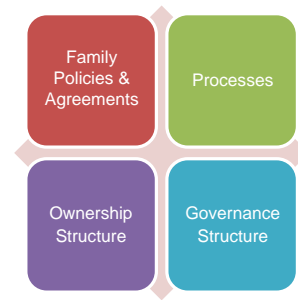
#### ***Three more helpful Policies***

Three other examples of important Policies for a family business are a Compensation Policy, a Dividend Policy and a Conflicts of Interest Policy:

- Depending on the values of the family, a Compensation Policy can be used to make it clear that compensation for work is based on merit and performance and the role, and is different from any benefit or allowance that you might be entitled to simply because you are a family member or an owner.
- A Dividend Policy helps to provide clarity for family member shareholders as to what they can expect in terms of a return on their shares.
- A Dividend Policy might also point to alternative forms of liquidity for shareholders during periods when it would not make business sense for the company to declare a dividend.
- A Conflicts of Interest Policy is relevant to ensure that decisions are made in a conflicts free manner, and can also be very helpful in terms of establishing a clear boundary between the family and the business.



## Question 4: What Processes will the family need to put into practice to bring the family and the business Governance system to life?



### ***A Common Scenario***

Consider the following example. A business founder sets up a family trust to own the shares in the family business. The trust is structured such that the founder controls all of the voting rights on the shares in the business. The trust provides that if the founder dies or becomes incapacitated, control of the voting rights on the shares will pass to his surviving spouse.

- However what if the spouse does not know anything about being a controlling shareholder in the business?
- What if the spouse does not understand the trust structure and her potential role in it?
- What if there is an active Board but the spouse does not understand its role, that the members of the Board could be her representatives in the future and that she has the power to change them?
- What if the spouse does not understand the strategy of the business?
- What if the spouse does not understand (or does not like) the risk profile of the business?

In practice this is often a very common scenario. The trust structure in this example may be a good Ownership Structure and it may help the founder to keep control and to pass legal control to his spouse. There may be an ownership succession plan.

However you can see that this trust structure is not by itself going to teach the spouse how to be a good owner and steward of the business in the future. It does not teach the spouse anything about how the business is governed or about the strategy for the business. It is easy to see you cannot rely on the trust structure alone to guarantee future success.

In this common scenario, Processes should be established while the founder is alive and healthy, to educate the rest of his family, including his spouse, both on the trust structure and on how to be effective owners of the business.

### ***The Family Meeting***

The main vehicle for this kind of family education Process would be for the family to hold periodic, ongoing, Family Meetings, where they learn about the ownership (not the management) of the business and they discuss and plan for the future.

## **Examples of Ongoing Processes**

The kinds of ongoing Processes that business owning families implement can include Processes for:

- Ongoing strategic planning.
- Ongoing planning for the involvement of the family members in various business and family governance roles.
- Education and development of owners (whether that ownership is direct, or indirect through a trust).
- Ensuring a flow of information to concerned stakeholders.
- Ensuring appropriate transparency and confidentiality.
- Career planning and developing the next generation of family managers and leaders.
- Encouraging the development of entrepreneurial talent in the next generation.
- Performance reviews and salary reviews for family member managers.
- Regular meetings of the various governance bodies, i.e. the Family Assembly and Family Council meetings, Committee meetings, Board meetings.
- Ongoing investment oversight by the Family Office and family investment committee.
- Carrying out & assessing progress towards achieving the various objectives of the family.

## **Other Processes**

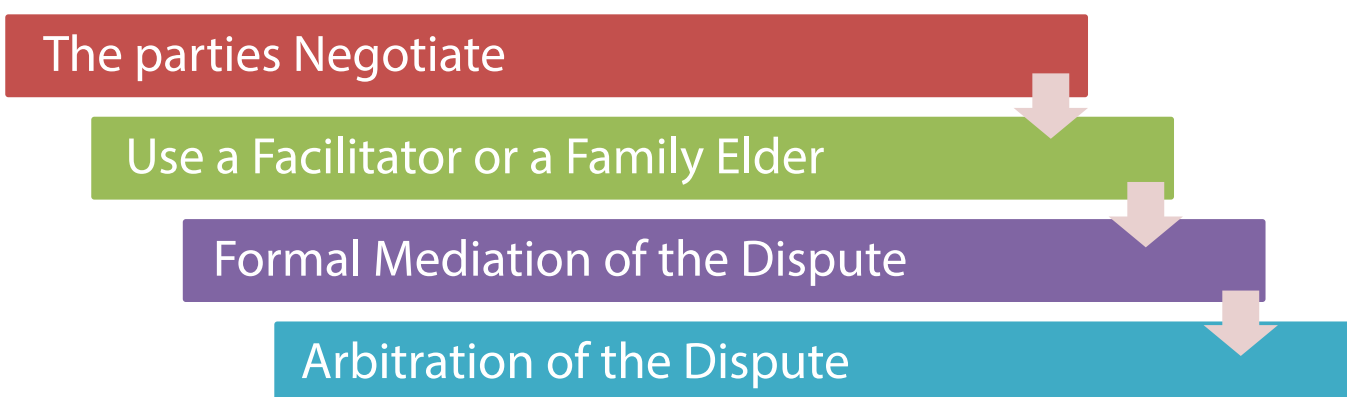
Two other highly important processes that should be agreed upon by the family, and clearly documented, are the following, even though these events might not be part of the regular annual schedule of events:

- A process for conflict resolution, and
- A process for selecting the successor to the business leadership role.

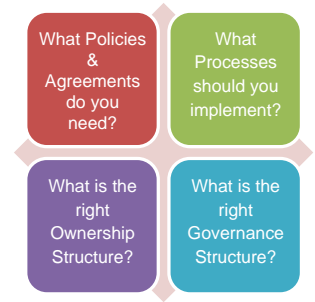
## **A Family Conflict Resolution Process**

Destructive family conflict is the number one risk for any family business. Families that take the time to develop a process that they perceive as a fair one for resolving future conflicts have a significantly higher chance of successfully resolving conflicts when they do arise than a family that does not have this. A conflict resolution process is a critical, must have, for any family owned business.

## **An example of a Conflict Resolution Process**



# WHY?



## ***Why do you need an Ownership Structure?***

- A key reason is to keep ownership consolidated and prevent fragmentation.
- Ownership Structures are about allocating the benefits of ownership and they are also about determining who has control.
- The Ownership Structure should provide an ownership transition plan for the business.
- The right Ownership Structure can also help to protect the shares in the business from creditor claims and from divorce and claims from illegitimate heirs.
- It can provide confidentiality.
- An Ownership Structure such as a trust can make provision for the shares in the business to be owned by the family for multiple generations.

## ***Why do you need a Governance Structure?***

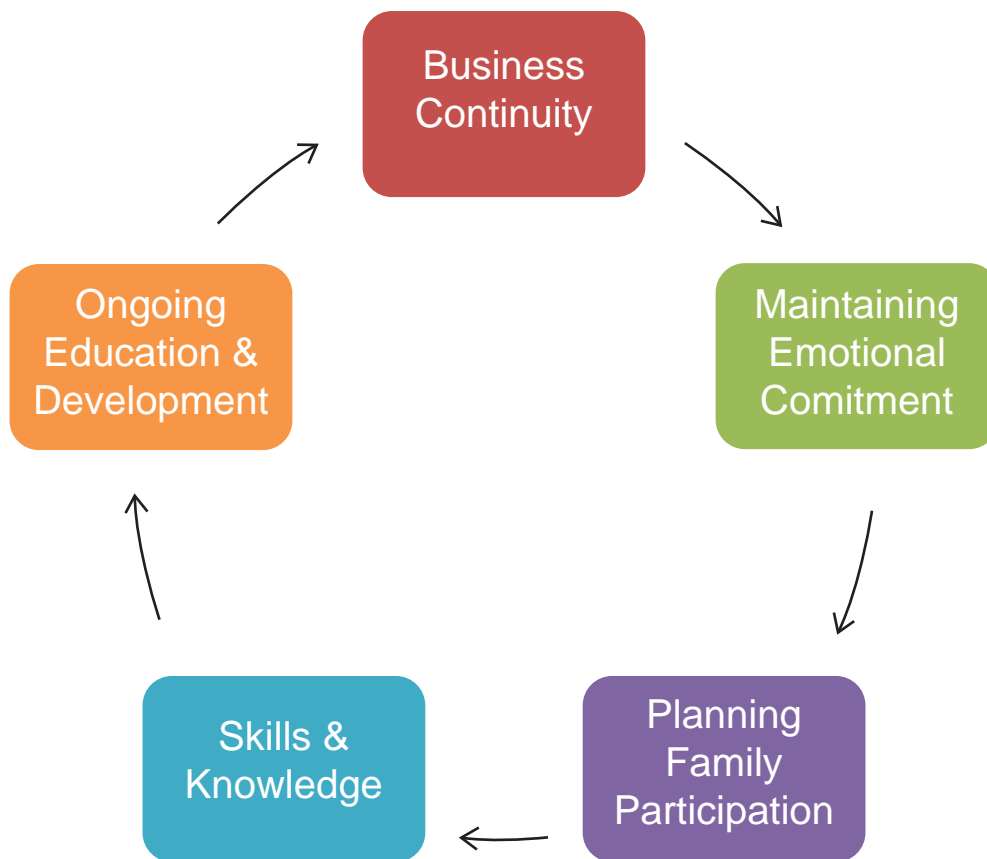
- In a family owned business you need to have structures for both the business as well as for the owning family.
- Structure helps support the ongoing Processes.
- Governance Structures are about providing leadership and direction for the family and its business.
- Governance Structures help ensure continued family support and commitment to the business.
- They help ensure family harmony and that the family members both have a voice and can speak with one voice, because they have worked out their differences behind closed doors.
- Governance structures also ensure that family issues and ownership issues do not come out in the Board room or in management meetings and disrupt the business.
- Finally, if the goal of the founder and the family is to continue the business for generations, there needs to be an organized structure and processes for the family member owners to make joint decisions together.

## ***Why do you need Policies?***

- Family business Policies help to avoid predictable family business conflicts.
- Family Policies help to establish boundaries between family matters and business matters.
- Policies help make things clear and explicit, so that everyone knows the way things are to be done, so that everyone in the family is on the same page together.
- The process of creating Policies, if done correctly, also fosters buy in and commitment to the Policies, and to the business.
- They help ensure family harmony and that the family members both have a voice and can speak with one voice, because they have worked out their differences behind closed doors.
- Governance structures also ensure that family issues and ownership issues do not come out in the Board room or in management meetings and disrupt the business.
- Finally, if the goal of the founder and the family is to continue the business for generations, there needs to be an organized structure and processes for the family member owners to make joint decisions together.

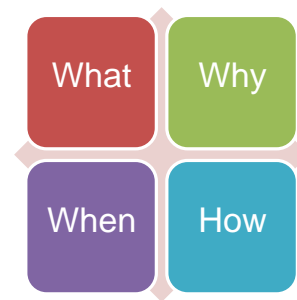
### **Why do you need Processes for the family business?**

- To ensure proper sharing of ownership information.
- To ensure the family understand the business performance.
- To ensure proper accountability and stewardship.
- To teach and pass on family values, including the value of entrepreneurialism.
- To teach the next generation of shareholders how to work together.
- To ensure there are Processes in place to resolve conflicts and misunderstandings.
- To ensure there is “fair process” in decision making.
- To educate family stakeholders so that they are competent and able to play a role in the ownership of the family business and family governance system and so that they will continue to support and be committed to the business.



- A final reason is to ensure there are Processes put in place to intentionally develop the next generation of family leaders.
  - The next generation of leaders will need skills in important matters such as communication and conflict resolution, strategic planning and leadership, skills that should not be left to chance.

# HOW?



## ***How do you go about creating an Ownership Structure, a Governance Structure, Policies and Processes?***

The process for creating the Ownership Structure, Governance Structure, Policies and Processes is very important and should be grounded in the vision, values, principles and goals of the founder and the rest of the family.

### ***How do you create an Ownership Structure?***

Often in practice the Ownership Structure is the starting point.

The traditional approach to selecting and setting up an Ownership Structure for the family business has been to work only with the business founder (and perhaps his spouse). There are some cases where the Ownership Structure that has been set up is not fully revealed to the rest of the family members until the founder has died or become incapacitated! However there is nothing like secrets and surprises to trigger an adverse emotional reaction from the family.

As a trust structure is the most common form of Ownership Structure chosen in Asia, the work on this step is often focused around selecting:

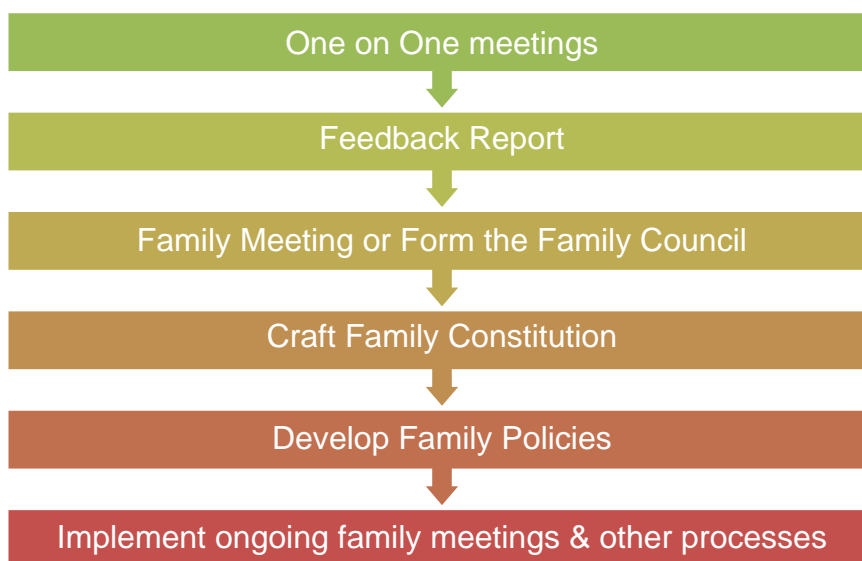
- The right kind of trust structure (there are many options here);
- The right jurisdiction;
- The right trustee (again there are several common options); and
- The drafting of the terms of the trust deed and the non-legally binding “letter of wishes”.

### ***How do you establish a Governance Structure, Policies, & Processes?***

In practice a very different kind of process is used to design the right Governance Structure, Policies, & Processes. For these three steps the most common approach is to either form a family task force which might consider options and give proposals to the founder, or alternatively to institute a series of family meetings, which include the founder and his spouse and adult children, which then discuss and design their own Governance Structure etc. The founder is still very much in control but by involving his spouse and his children, they can get a clear understanding of his goals objectives, wishes and thoughts and they can work together to develop an approach that has family buy in and support. For the majority of families it is also advisable to work with an outside facilitator, to make sure that all the key family stakeholders have a voice in the process. Having a voice in the process leads to support for the process.

The most common approach is to document the agreed upon Governance Structure, Policies and Processes into a written document called a “Family Constitution” or a “Family Charter”. These can be made into legally binding agreements, but often they are not. A key concept to keep in mind with a Family Constitution is that its value and its effectiveness come from the process of the family members working on it together, considering alternatives, and coming up with their own shared understandings of how things should be done. The process is more important than the product.

## ***A common process for creating a Family Constitution, Family Policies, & Processes***



### ***What about combining the Processes?***

As noted above, traditionally work on an Ownership Structure involves working solely with the founder (and perhaps his spouse) while work on creating the Governance Structure, Policies and Processes is done by involving the spouse and the adult children of the founder in a series of family meetings with an external facilitator, i.e. the later is a “family project”.

It is recommended that if the Ownership Structure is also handled in the same way, i.e. as part of the “family project” then there will be the same benefits of increased family buy in and understanding and the ability to get immediate feedback on the basic question of whether the proposed Ownership Structure will be workable or not when the founder is no longer around. This alternative approach would ensure that there are no surprises later on.

### ***Rethinking the best place to start***

It was also noted above that in practice the Ownership Structure usually comes first. However if starting from a blank piece of paper it might actually be advisable to start first with the second question of what is the right Governance Structure, so that the Ownership Structure comes after that. In this way the Ownership Structure can be designed to support and provide alignment for the family’s Governance Structure.

### ***How do you make Policies that impact on the business?***

A final note on the process for creating Policies for a family business. A common approach is for the Family Council to have the task of developing the terms of the family Policies. However the Family Council should not make policies or decisions concerning the management or operation of the business. As such, where a Policy would impact on the business management or operations, the Family Council can develop and propose the Policy to the Board of Directors, but the Board should approve the Policy.

# WHEN?



## ***When should you establish an Ownership Structure?***

- In practice, one would expect that there would be a holding company structure for any business of any value.
- If the business is of sufficient value, then ownership by one or more trusts can be considered even when the children of the founder are very young, which will help to provide for the unexpected death or incapacity of the founder.
- It is often a good idea to establish the ownership structure that is intended to operate following death or incapacity of the founder, while the founder is still alive and healthy.
  - If the ownership structure is going to involve one or more trusts, if those trusts can be revocable trusts, establishing them during his lifetime will give the founder a good feel for how things are likely to work when he is not around anymore, and the power to revoke will give the founder the ability to make any changes that are necessary as time goes by.

## ***When do you need a Governance Structure?***

- In practice when the founder is still very much in control of ownership and management and the next generation are young:
  - the focus of corporate governance is likely to be having a Board that the founder can use for advice and as a sounding board for his ideas; and
  - the focus of family governance might be on educating and developing the founder's spouse and the next generation, and providing the next generation with opportunities to learn how to work together collaboratively.
- In practice, once the founder starts to become concerned about succession and continuity, then this will be a good time to formalise the family governance arrangements for the family.
- The complexity of the governance structure that a family need will evolve over time.

## ***When do you need Policies?***

- Policies should be made before they are need.
- If Policies will impact on the Next Generation, then it's good to have those policies in place by the time they are finishing school, so they know what to expect.
- Policies help to “manage expectations”.

## ***When do you need Processes?***

- If you have Governance Structure then you have to have Processes to bring the structure to life.
- Even if you only have an Ownership Structure, then there should still be ongoing Processes:
  - to review that Ownership Structure from time to time, and
  - from time to time there should be family meetings (assuming the Next Generation are adults) to talk about the Ownership Structure.

## ABOUT THE AUTHOR



Originally a tax and trust lawyer from South Australia, Christian Stewart moved to Hong Kong in 1994. In July 2008, he formed Family Legacy Asia to provide independent advice to Asian families on family governance. In this role he acts as a process consultant to help family businesses in Asia work together, through facilitating family meetings and helping the family to prepare their own family policies and family constitution. He also advises several Asian Family Offices on trust and succession matters. He acts as an advisor on several Private Trust Company structures.

Prior to founding Family Legacy Asia Christian was a Managing Director and the Head of Wealth Advisory in Asia for JPMorgan Private Bank for 6 years. In that capacity he was responsible for representing JPMorgan's trust business in Asia.

Prior to joining JPMorgan, Christian was with PricewaterhouseCoopers in Hong Kong for 7 ½ years. At PwC he became a Partner in their Tax Practice specializing in Hong Kong estate duty planning and trust structuring, and he ran their Trust & Private Client team.

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### NOTE CONCERNING GENDER

In this paper, to avoid repetition, the term “founder” has been used in the masculine. However, the term “founder” and any reference to “his” or “him” should also be read as including a reference to the feminine.

### DISCLAIMER

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## **ABOUT FAMILY LEGACY ASIA**

We work with successful Asian families to help them establish communication platforms and decision making structures for both the family and the family enterprise.

We facilitate family meetings to help the family talk about their vision and values and the relationship between the family and the family enterprise. We help them to create the “rules of the road” so that family members know what to expect in the future.

We believe that the key to passing on a successful family enterprise that will flourish for at least five generations comes down to the way in which the family members make joint decisions together, and this is called family governance.

While our approach is tailored for every family, we often use the process of creating a family council and family constitution to help build the “family team”, to strengthen family unity, and to help the family resolve the specific issues that they have been unable to resolve on their own.

The process of creating family governance is a problem solving process.

Our process can help simplify the challenges of planning for family succession.

One of the benefits of our process is that it helps to build a bridge between the older generation of the family and the next generation.

Another benefit is that we help create tools for the family to balance doing what is good for the family with doing what is good for the business.

In many family controlled enterprises, family conflicts arise because of confusion between family roles and values on the one hand, and business roles and values on the other hand. We help families avoid these kinds of conflicts.







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