

KEY POINTS

What is the issue?

Practitioners advising family enterprises should consider the role of a legal structure in cultivating family resilience, which is the greatest predictor of family success against external crises.

What does it mean for me?

Taking the time to consider resilience in the context of legal drafting is a worthwhile and value-added activity; savvy practitioners embed components of resilience into family governance work, which can inform appropriate structures.

What can I take away?

An understanding that legal documents can achieve succession goals for tax and inheritance purposes and help to achieve long-term family resilience.

It takes a village... again

CARLY E DOSHI, WILLIAM J KAMBAS AND MICHAEL S SCHWARTZ LOOK AT APPLYING A MODERN LEGAL PERSPECTIVE WITH A VIEW TO ENHANCING RESILIENCE IN FAMILY ENTERPRISES



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Crisis management strategies are essential for the stability of any enterprise. Leadership, management and organisational structures succeed when there is clarity on goals, objectives and process.

Change is inevitable, however. Increasing global uncertainty, including political and social unrest, market volatility, global pandemics and an ageing population of family business owner-operators, only adds to the unpredictable situations family enterprises face. Although it may seem daunting, research has shown that a family enterprise's ability to overcome crises lies in its resilience.¹

However, trust and estate practitioners frequently shy away from discussions of family resilience with their clients. As the architects of large family enterprises, advisors may focus purely on tax efficiency, but at what cost? Below, we suggest that advisors should consider the resilience of the family systems they build and take pains to cultivate it. We provide suggestions for this practice, including components of a legal advisory framework that may help your clients, and the advice you give them, stand the test of time.

FRAMING THE ISSUE: WHAT IS RESILIENCE?

Resilience, in the broadest sense, is the capacity to recover quickly from difficulties. In psychology, developing resilience focuses on its three component parts: beliefs, organisation and communication.² Further research has shown that these concepts apply to both individuals and families. In one example, psychologists studying victims of Hurricane Katrina found a relationship between a family's resilient response to the disaster and its reported feelings of hope, family hardiness and spirituality.³

Although resilience is a trait that may be innate for some, all humans have

the capacity to learn resilience and it can be developed and nurtured through practice. For families seeking to cultivate resilience as a unit, the trait and its parts are developed through roles, attitudes and interactions over time.

RECOGNISING THE PARTICIPANTS: WHO IS IN THE VILLAGE?

The first step in cultivating family resilience requires an understanding of the current state: the individuals involved, existing structures and systems, how individuals communicate with one another, feelings and perceptions of individual participants, and how those roles and feelings may change over time. This is best illustrated by the Three Circle Model (see Figure 1).⁴

Natural governance, based largely on personalities, is often the initial (or default) system.⁵ It may be resilient to changes and therefore stable in the face of adversity, but it lacks permanence or long-term stability. Further, governance based only on participation in an operating business exposes the entire system to conflict when profitability wanes, as some excluded family members may question the decisions impacting them.

A better approach is to develop thoughtful, intentional governance with the Three Circle Model in mind and resilience

'For families seeking to cultivate resilience as a unit, the trait and its parts are developed through roles, attitudes and interactions over time'



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as a goal. Taking the three component parts of resilience in turn, a template emerges for development of family governance.

BELIEFS

Working together to articulate a succinct set of values is often a favourite exercise of families working through their governance and is frequently an early step for the savvy practitioner focused on family governance. Helping clients home in on their values is critical, as values serve as the core from which the entire system will then be built. They are also the foundation on which a family will rely when crisis hits, thus serving as the backbone of resilience.

ORGANISATION

While unpredictability breeds uncertainty, clear organisation enables efficient and effective decision-making. For family enterprises, this involves developing systems for sound management. Which individuals should be involved in key decisions? Do the relevant persons include those with both formal and informal roles within a business? How does a group convene, vote and effectuate its decisions?

A tax-efficient structure that does not contemplate these issues will inevitably lead to problems, and a family mired in bureaucracy will succumb to inaction during a crisis. It is better for a family to

consider this early on, when no such crisis exists, and proactively include their desired organisation in their structure.

COMMUNICATION

Finally, family resilience demands clear communication with a spirit of collaboration. Family member roles may differ and, in a complex enterprise, there may be individuals occupying all seven quadrants of the Three Circle Model. However, the importance of feeling included and informed cannot be overstated. Failing to communicate with key parties, even those who lack current authority but whose future interests are nonetheless at stake, is the surest path to family discord and potential litigation. For the practitioner building the system, this means building into the plan opportunities for participants to collaborate and communicate as a matter of course, while stakes are low.

BUILDING RESILIENCE INTO LEGAL DOCUMENTS

If resilience is the goal and family governance is the process that allows participants to create their own system, then the legal structure is codification of the chosen framework. Sound structure provides stability via a set of transparent, understood rules.

Key documents include by-laws, operating agreements, partnership agreements, trust instruments and letters of wishes, among others. In addition to achieving succession goals related to tax and inheritance, these documents memorialise one generation's desires for the future of the enterprise, set forth the formal arrangement between family members and dictate rules for engagement in times of calm as well as in crisis.

Although much could be written about the various legal structures and their role in facilitating family governance, some of the most pressing items to consider include the following.

Purpose clause

Why is a legal entity being established and what objectives should future decision-makers keep in mind? A practitioner must strike a balance between allowing for flexibility while also providing meaningful guidance to future participants. Depending on the context, it may make sense to have broader statements in certain documents that govern investments or other holdings that will change over time, with more refined objectives outlined in testamentary letters of wishes, which are non-binding and overarching.

Management provisions

Control, and the transition of it, is key to long-term family success. In general,

the granting and transition of these responsibilities should be clearly articulated and not left to interpretation. The process should also contemplate contingencies in the event that an heir apparent cannot be identified or does not want the role. An unqualified successor who finds themselves in a sudden position of power is not an ideal leader.

Decision-making rights of shareholders, partners and members

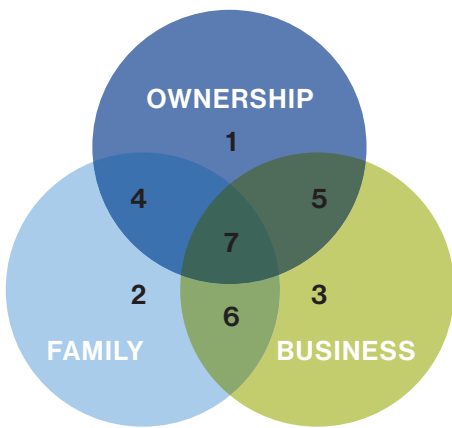
In general, the larger the system, the more likely it is that decision-making will be divided across multiple committees or advisory panels. Trustees may play a role where assets are owned by trusts, and independent fiduciaries or board members may provide additional needed expertise. With such complexity come key questions about frequency and depth of communication, as well as choices about voting rights. For simple administrative matters, a manager may be able to act alone, whereas other items may require a supermajority or unanimous consent before being executed.

Economic expectations of all parties: distributions, redemptions, exit

Whether it be in the governing documents themselves or in a separate letter of wishes, it is crucial to set expectations around disbursement of material benefits from the enterprise. The legal structure should contain a mechanism for clear understanding of what funds will be received and when. This may be as simple as incorporating such a statement into a letter of wishes, or more elaborate shareholder agreements and corporate documents governing dividends and the like.

As practitioners, it is often simpler to focus only on tax efficiency or maximisation of investment returns. However, the better practice is to help a family cultivate their own resilience. The key is in taking the time to identify the appropriate system for the family in furtherance of its goals and intentions, working on a stable framework and providing robust, flexible mechanisms that set forth a clear, articulable family vision while also allowing for change.

Figure 1: Three Circle Model



1	Non-family shareholder
2	Family non-shareholder, non-executive
3	Non-family executive
4	Family shareholder non-employee
5	Shareholder executive non-family
6	Family member employee
7	Family member, shareholder employee

#FAMILY BUSINESS AND FAMILY OFFICE #ESTATE PLANNING

1 HSBC Private Banking, *Essence of Enterprise* (2017)
 2 *Family Resilience: A Framework for Clinical Practice* (Wiley 2004), an abstract of which is available at bit.ly/3fo3pUz; see also F. W. Walsh, 'The Concept of Family Resilience: Crisis and Challenge' in *Family Process* (September 1996)
 3 Hackbarth, Pavkov, Wetchler and Flannery, 'Natural Disasters: An Assessment of Family Resiliency Following Hurricane Katrina', *Journal of Marital and Family Therapy* (19 April 2011)
 4 Tagiuri and Davis, Harvard Business School (1978)
 5 See Amelia Renkert-Thomas, *Engaged Ownership: A Guide for Owners of Family Businesses*, Chapter 5: The Legacy of the Past: Natural Governance, Family History, and Culture (Wiley, 2015) an abstract of which is available at bit.ly/3ZtTYL