

Shareholders Have to Earn Their Wings, Too

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BY IVAN LANSBERG

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THE distinction between ownership and management, so critical for the effective running of modern enterprises, is poorly understood by many family companies. If ever there was an issue that validates the old maxim "Something you don't know can hurt you," this one is it.

The rights of owners have become increasingly defined in the courts (see "Giving Minority Shareholders Their Due," Winter 1994), but the perpetuation and health of the company depends not just on respect for legal rights. It turns to a great extent upon a proper understanding by family members of the roles and responsibilities of owners and managers.

Too often, family members in senior management positions look upon shareholders as greedy nuisances, and on paying dividends as charity rather than a management obligation. Frequently, male prejudice has something to do with this, since many women who inherit stock end up as non-participating shareholders. Sometimes, though, there are good reasons for managers' attitudes—when, say, aunts and uncles who take little interest in business insist on serving as directors. Shareholders have to realize that they have obligations as well as rights.

Let's look first, however, at what owners are entitled to insist upon from management. First and foremost, they have a right to expect a certain economic return from their investment. If the business is not generating sustained profits and benefits for them, they have a legitimate gripe.

This does not mean, of course, that shareholder needs alone should dictate the company's dividend policy. Obviously, the growth and renewal needs of the business have a big claim on the company's available resources. And the tax implications of disbursing dividends must also

be considered. The crucial point is that the company should have an explicit policy that strikes a balance between these competing demands.

Owners are also justified in insisting that the business be run in accord with the fundamental values of the family. The case of an insurance company I once studied which was owned by a Jewish family illustrates how those values sometimes clash with the financial objectives of management. Back in the 1980s, the company had an opportunity to re-insure a shipment of arms from Europe to the headquarters of a militant group affiliated with the Palestine Liberation Organization. The deal was perfectly legal and would have been very profitable to the company. Nevertheless, it violated the family's long-standing commitment to Israel, and for that reason the board of directors rejected it.

Do emissions from the company's plant pollute a local water supply? Does the business employ too few women or members of minorities in top management? Should it be cutting corners on taxes? These are the kinds of difficult ethical issues on which family shareholders have a right, even a duty, to speak out. By developing a mission statement, they can hold management's feet to the fire on preserving family values.

Shareholders should also have some say in the degree of risk that management undertakes with their assets. For example, they should be asked their opinion on the amount of debt that will be taken on to finance expansion of the business. With the help of the board, the shareholders may even want to establish an explicit debt-equity ratio beyond which management cannot go without first getting their consent.

Similarly, they have a right to express their views on whether those managing the company are competent to do so. Not only do shareholders stand to lose their investment if the company is mismanaged, in a privately held company they may themselves be liable for any damages that managers inflict on others or the environment.

Now let's look at the responsibilities of owners. To begin with, owners of a family business should regard themselves, in the words of my colleague John Ward, as "stewards of capital"—meaning that they are committed to the long-range development and perpetuation of the business. In this view, family shareholders who retain their stock—and do not seek to be bought out—commit themselves to leaving their children a larger and more successful enterprise than they inherited. Family business stewardship thus challenges the commonly understood definition of property. Instead of viewing stock as a mere asset to be milked for personal gain as long as it lasts, shareholders see themselves as temporary custodians of the family's patrimony and legacy.

This does not mean that the business grandfather built must never be sold. Sometimes, at a given juncture, family members may decide that other, more entrepreneurial ventures hold a brighter future, and that it is necessary to sell the business in order to revitalize the family legacy. But it does mean that in assessing the costs and benefits of all such ventures, the overall needs of the family take priority over the potential gains to specific individuals.

To adequately fulfill their duties to the company, non-participating shareholders have an obligation to educate themselves about business in general and their company in particular. Unfortunately, too many people who inherit stock in family companies believe that this automatically qualifies them to look after their own economic interests as well as those of the business. Worse still, some even think it is enough of a credential to be effective members of the board of directors.

In this country I am often asked: "How do those multigenerational European businesses with large numbers of cousins/shareholders manage to survive so long as family companies?" There's no big secret here. These com-

panies, which are usually three or four generations old (or more!) invest considerable effort in educating various stakeholders—and particularly non-participating shareholders—in their rights and responsibilities. They establish governance structures that set ground rules and help regulate relationships among family, managers, and shareholders.

Non-participating family members who wish to continue to hold stock in these companies may be asked to attend quarterly meetings at which senior managers make presentations on their operations. The company may pay for them to attend short courses at INSEAD in Paris or IMD in Lausanne, may bring in career counselors to talk with younger family members, or business school professors to acquaint stockholders with accounting methods and how to read a balance sheet.

As family companies grow and develop in the U.S., they face ever more complex issues. It is time to dispel the wide spread notion that shareholders are born with enough knowledge to fulfill their responsibilities. Ownership requires training, and even nonparticipants must have a basic minimum of business literacy. Above all, they must understand and respect management's role in directing the enterprise toward its goals. ■

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