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Pruning the Family Tree: When Is it Necessary?

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Abstract The longevity that characterizes many family businesses is explained, to a large extent, by the continuous effort that is made within them to ensure their own governance over the years. To this end, it is important that the structures and regulations developed in the various decision-making areas (such as the General Meeting, the Board of Directors, the Family Council or the Management Committee) are the appropriate ones, as well as the fact that the people who lead them (owners, directors or managers) are active and competent to initiate processes sufficiently in advance. Based on the experience of the authors, this document proposes possible decisions to be taken in favour of governance, developed based on the existence of unity within the family and the degree of balance between the levels of *potestas* and *auctoritas* of the people involved in the decision-making process, as well as in relation to the size of both the business and of the family. In addition, and due to the crucial importance of the process itself, different factors are proposed to make this possible and favour it. The analysis of the various elements included in the article aim to provide suggestions for reflection, to professionals and academics in the field of family business, in order to advance upon our mutual understanding of the implications that *caring for the family tree* has on its own governance.

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PALABRAS CLAVE
Empresa familiar, Equilibrio empresa-familia, Árbol familiar, Voluntad familiar, Gobernabilidad, Liderazgo.

Podar o no podar el árbol familiar

Resumen Pese a la longevidad que caracteriza a muchas empresas familiares, el continuo esfuerzo que en estas se debe realizar para asegurar su propia gobernabilidad a lo largo de los años es una cuestión indudable. A ello contribuye tanto el que las estructuras y los reglamentos desarrollados en los diversos ámbitos de decisión (tales como la Junta General, el Consejo de Administración, el Consejo de Familia o el Comité de Dirección) sean los adecuados, como que las personas que lideran los mismos (propietarios, consejeros o directivos) sean lo suficientemente activos y competentes para iniciar procesos, con la anticipación suficiente, que contribuyan a alcanzar dicho objetivo. En base a la experiencia de los autores, el presente documento propone posibles decisiones a tomar en pro de dicha gobernabilidad, desarrolladas en función de la existencia de unidad en la familia y del grado de equilibrio entre los niveles de *potestas* y *auctoritas* de las personas implicadas en el proceso de decisión, así como en relación al mayor o menor tamaño tanto del negocio como de la familia propietaria. Además, y por la crucial importancia que tiene el proceso en sí, se proponen diferentes factores que lo posibilitan y favorecen. El análisis de los diversos elementos incluidos en el artículo, pretenden proporcionar sugerencias de reflexión, a profesionales y académicos del campo de la empresa familiar, para avanzar en nuestro mutuo conocimiento sobre las implicaciones que el *cuidado del árbol familiar* tiene sobre su propia gobernabilidad.

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1. Ensuring Governance

Longevity in family businesses can be explained by the depth with which they analyse the different situations they encounter, and they agree upon the most appropriate decisions for each of these situations. In order to reach this, it is assumed that it is necessary to develop, in parallel, a planning process for the governance of both the business and the family. If this process is implemented adequately, it will facilitate the evolution in equilibrium of the needs of the company to be competitive, and the expectations of the family members; both of which need to be aligned (Carlock & Ward, 2010).

Based on the solid values that characterize them, such as innovation, entrepreneurship, social responsibility, professionalism, or effort (Gallo, 2011), these excellent families have known how to preserve and transfer to new generations, a shared vision that permeates the businesses they own. To this end, they have developed the appropriate decision-making structures and regulations in each area -such as the Board of Directors and the Family Council- in which they define the objectives and necessary actions related to the business strategy and their heritage, based on a deep reflection on what type of family business they want to be (Gallo, 2004).

Despite this, it is difficult to ensure the governance of the business group over time: this usually occurs as a result of an imbalance in the growth of the family with regards to the size of the business, or due to a crisis within the family. Therefore, it is common for it to be increasingly difficult to have an adequate number of active and committed owners or directors, given that:

- owners who are not linked to executive positions in the company distance themselves from the needs for growth or reinvestment in the business, and tend to demand levels of dividends that are not in line with the company's reality, or
- the owners who do hold management positions in the company have different and irreconcilable points of view on the development of the business model, and tend to paralyze strategic decision-making; and this ends up disuniting the owners, or
- as the generations advance, the number of owners increases, so it will normally be necessary to create coalitions in order to govern (syndication of votes, or creation of intermediate companies that represent the different family branches), which slows down decision-making in governance, or produces tied votes, or
- the so-called "*sense of belonging to your family branch*" prevails over the commitment given to the global family project.

This reality has been analysed in the field of family firms for decades: each family is different (Dyer, 2021), and its complexity (Gallo, 2011; Gimeno-Sandig et al., 2006; Jaffe & Lane, 2004) increases as time passes and with each of the generational transfers.

In this scenario, it may be considered appropriate to regroup ownership, or reconfigure governance and management responsibilities. But... is it opportune to propose it when the management of the family vs. company relationship has been based, almost exclusively, on mechanisms that guarantee *social peace*?; Is it feasible to raise the issue when the members of the family identify themselves, emotionally and socially, as part of the family business; do they understand it as consubstantial to their own *vital project*?; Is it possible to feel part of the family when you stop being the owner of the company?; Is it convenient to make decisions of this nature without extraordinary anticipation? When the degree of complexity of the family business is high, governance can be ensured if the family is united around a process of reflection, initiated by a leader: he or she will know if it is the right decision to propose the *pruning of the family tree*.

2. Looking after the Family Tree

We can understand *taking care of the family tree* as a process of dialogue, negotiation and consensus on the adequacy between the size and complexity of the family and the company, with the aim of achieving an efficient governance of the family's business project.

This process must be supported by actions that can simultaneously:

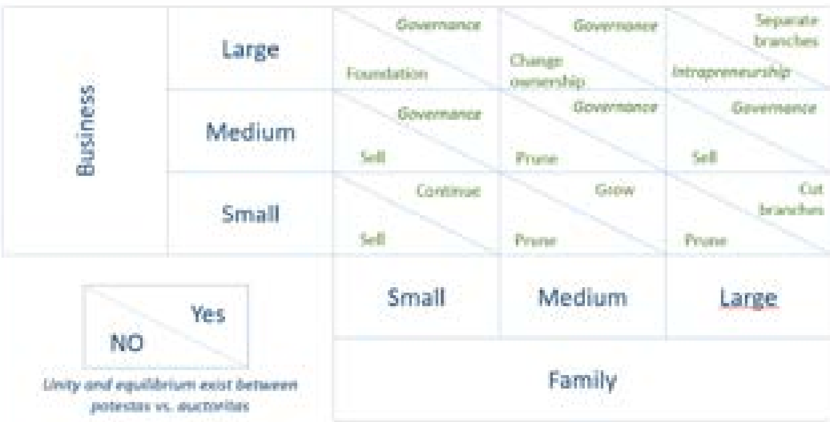
Promote unitedness, for as long as possible, avoiding the presence of family members -as owners, members of the board or managers-, who do not promote it in a sincere and committed manner, and

Guarantee adequate levels of *potestas* and *auctoritas* among family members (Gallo, 2021; Gallo & Pereira-Otero, 2018), making it possible for those who are, or want to be, competent to fulfil the corresponding responsibilities (Davis, 2019), or are able to undertake this responsibility with the necessary power, to become shareholders, directors, or managers.

As we know, it is often considered that, in order to achieve such governance, it is necessary to reduce the number of family owners, or to separate business units, or to minimize the number of family members with management responsibilities (Lambrecht & Lievens, 2008). However, in recent years we are witnessing a drastic reduction in the number of people that make up each family unit[1]. This fact has a direct impact, but in the opposite direction, on the continuity of the family project. In this context, it would therefore be necessary to propose other options -such as the creation of a foundation, which would be the holding company englobing the family group, responsible for managing the whole family group-; or the incorporation of external professionals at the highest levels of responsibility.

For this reason, we consider that the different decisions that are taken, must be based on the fact that each family business is always unique and different; It would therefore be irresponsible to assume that a *pruning process* is always the best option. The idea underlying this statement is the need to consider other possible and more appropriate paths. And these, in our consulting projects, arise from a double analysis: on the family unit and the levels of *potestas* and *auctoritas* among different generations and/or branches of family members, and on the balance between the size of the company and of the family.

Figure 1. Decisions for efficient governance in a family business



Thus, in the majority of small- and medium-enterprises in which it is not possible to reach any agreement due to the lack of unity in the family, or because it is impossible for those with *auctoritas* but not *potestas* to lead the necessary process to work on the governance , the following decisions are usually considered: either the sale of all or part of the company, or to carry out *maintenance pruning* -that is, to reduce the number of owners, or to reach agreements that limit the dispersion of the property in the future-, which guarantee the balance both between the size of the family and the business, and that those that head the companies have the necessary commitment, power and skills. Notwithstanding the foregoing, when the size of the company is large, the alternatives that arise may be different: if the family is small, it is feasible to propose the creation of a foundation that governs the company for a certain time, headed by an external professional -waiting for the family members of later generations to be in a position to run it responsibly (Poza-Valle, 2021). If the family is of medium size, we propose asking the family members, who do not wish to participate in the business project, to become owners of other assets - changing the proprietorship of various assets that make up the family patrimony, such as fixed assets, investment portfolios, etc. Lastly, if there are more family members, we consider it is necessary to provide the family project with maximum liquidity and investment capacity, in order to be able to develop entrepreneurship projects whose future ownership may correspond to the different family branches.

When the family is united around recognized and respected leaders, and there are adequate levels of *potestas* and *auctoritas* both in the government and in the management of the company, the analysis and decision processes in which we participate tend to define different actions. In most of them, and with the aim of maintaining both the competitiveness of medium

1. Currently, the size of families in Europe is as follows: 49.4% of them have only one child - 13% of them being single-parents-, 38.6% of families have 2 descendants, 12% are considered large families with three or more children (Eurostat, 2023).

and large-sized businesses, as well as the growth of the family's wealth, it is customary to take measures aimed at strengthening the governance of the property (incorporating external and independent directors in the Board of Directors, appointing Chief Executive Officers favouring the active participation of minority shareholders in General Meetings, etc.), of the family (creating a Family Council), as well as of the executive structure of the company (attracting external professionals to top-level management positions). Faced with a large company, owned by a large family, in addition to active governance structures, it is usually necessary for a senior leader, with a long-term vision, to enable the balanced development of the different strategic units so that, if it were necessary, the group could be divided into different branches in the future. This last option should be understood as something positive, as an opportunity; we therefore encourage a change of paradigm that could be summarised in the following statement: *"we have everything so well prepared, that we could even separate into different branches of family owners, and continue united as a family"* (Gallo, 2017). Finally, when the family business is small, the following actions are usually considered, related to the smaller or larger size of the family: continue with a successful niche business, transmitting the necessary knowledge and expertise to the next generation, managing at the same time their expectations and their emotional property (Björnberg & Nicholson, 2012); promote strategic orientation and the creation of a competent management team to enable the growth of the business, or cut certain branches of the family if they weigh too much on a small business -in this case, the commitment as a member of the family will be to facilitate the process of separating the business, in order to preserve family unity.

We have verified in our advisory practice, that each of the above measures are difficult to propose within the family but also to agree upon by the relevant decision-making body, needing to be carried out with a lot of anticipation. However, it is also true that most of the documents[2] that we help to prepare within the decision-making structures of family firms -such as the Board of Directors, Family Council, or Family Office, etc.-, must bear in mind that it needs to be feasible to undertake this type of processes, if necessary and desired.

The previous apparent contradiction raises the following question: what is the real reason behind it being common for many families to reach *dead ends*, -disunity, lawsuits, business bankruptcy, etc., when what they initially wanted was to endow a more effective governance for their business project? From our point of view, one of the main causes is to not consider the process itself as important as the result sought by it. The only way to obtain their commitment is for family members to understand that each proposal put on the table is, in itself, fair and equitable (Carlock & Ward, 2010; Van der Hayden et al., 2005) and for each phase to be defined by clear and agreed upon rules of the game (Lambrecht & Lievens, 2008). It will only be possible to preserve family unity by paying the maximum attention to the process, and its protagonists.

3. Initiating the Reflection Process

When the common objective is both the preservation of the family unit, as well as the competitiveness and growth of the business and the patrimony, we find that it is convenient to work on strengthening the governance of the business group, even when trust has been lost, and coexistence might seem impossible to achieve (Gallo, 2019). Although this convenience is unequivocal, the objective of unity will only be achievable if the family understand that the definition, organization and control of the process that can make it possible, is in itself crucial.

Bearing this premise as a guide, the first responsibility that needs to be taken on by one, or several leaders, with real power within the family firm, will be to find the right moment to raise a reflection of this nature within the family. In relation to this, and as a result of our experience in this type of processes, we offer a reflection on some of the elements that, we understand, enable and facilitate the beginning of this process - see Table 1.

In the event that the aspects that could favour a process of redefinition of governance do not exist -left column-, it will be necessary to develop them beforehand. At the same time, it is possible to work on some areas -right-hand column- that will make it easier for the family business to have what it takes to achieve the necessary level of governance, in the future.

2. Some examples of documents developed by family businesses: family constitutions, shareholder agreements, regulations for General Meetings and Boards of Directors, bylaws, wills, internal audits, due diligence, tax planning, senior management contracts, etc.

Table 1. Factors that enable and facilitate the beginning of a reflection process on governance

Factors that enable the process	Factors that facilitate the process
– Active governance structures in the business and in the family – Equilibrium between *auctoritas* and *potestas*. – Unanimously approved documents (bylaws, family constitution, shareholders agreement, marriage contracts, wills, audits). – Sufficient harmony between family members. – Agreement on a system to value the property. – Financial liquidity of the shareholders who wish to buy, or the existence of assets with which they can compensate. – Sufficiently shared values by the main decision-makers in the firm and in the family. – Tax planning objectives that enable change or transfer.	– Active participation between the different family branches. – Sufficient level of training on governance of the owners, directors, family managers, and in-laws. – Higher valuation of the property, than the psychological[3] or emotional property. – Developed and active communication structure within the family, with control of possible emotional dissonance. – *Family management* and *family government* types. – Family members with responsibilities in the company (shareholders, directors, or executives) with a high level of competence.

As the reader surely agrees, in order to move towards this objective, it is essential that, in addition to the owners, the key family members understand that this is one of their main responsibilities. In this sense, we propose that the leaders of the Board of Directors and/or the Family Council reflect upon the following: in the same way that the evaluation of the competitive advantages of a business model is unquestionable, or that it is mandatory to take decisions about the investment strategy in order to maintain or develop the family's patrimony, it is essential to have committed and competent family members, who understand and support the decisions regarding the type of family firm that they desire or need to be in the future.

Of course, each family project must define and apply what best suits the family, the business, and its owners (Widz & Leleux, 2018); that is to say, it is necessary that the people who hold the highest levels of *potestas* and *auctoritas* bravely value the degree of complexity of the current family project. Therefore, only through this sincere and courageous analysis, can it be determined if this is the appropriate moment to propose a process of the type like the one we are discussing (Gersick et al., 1990; Vandekerkhof et al., 2022) or, if on the contrary, it is necessary to previously work on the development and implementation of other types of measures. And, if these leaders do not want to assume the initiation of a process that they know, a priori, will be long and difficult but necessary; that is, if they take a position of *"after me, the deluge"* (Gallo, 2019) we invite them to undertake the responsibility of letting the family know.

It is true that "*it is preferable to prune the tree today than to inflict great harm on the family in the future*" (Gallo, 2019). It is also true that it is desirable that the leaders of the family business assume the responsibility of proposing a planning process for the governance, with the necessary anticipation (Gallo, 2021): this may enable both the unity of the family and the continuity of the project that the family shares.

4. Conclusion

In this article we have wanted to convey the need to advance in the understanding, not only about whether the decisions that are taken with regards to the governance of the family project are the correct ones, but also about whether the moment to start the process is the adequate one. In this sense, we encourage academics to analyse in greater depth how far in advance, and who, should promote the discussion on which are the best decisions for efficient governance, based on the size of the company and the family, to adapt them to the abilities and interests of family members from the next generation. We understand that it is also pertinent to improve the understanding of the relationships that must exist between the governance structures of family firms (Board of Directors and the Family Council), as well as the impact on the implementation of positive decisions for governance of the higher or lower levels of commitment and competence of the people who lead these firms.

3. We use the term *positive psychological ownership* to refer to that which increases commitment to the family legacy. In contrast, *negative psychological ownership* usually arises early on, as a right acquired by belonging to a family and not by a wish to freely train to become a future responsible owner.

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