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‘We the people...to form a more perfect union’

Who needs a family constitution? The future harmony of your family and continuity of your business may well depend on going to the trouble of writing one.

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Families like to see themselves as informal and free-form, so their usual first response to the suggestion that they create a family constitution is that it seems utterly pointless. "Who needs it?" they say. "We know each other well enough. We can sit down and work things out when they come up." And the parent-owner, if he or she is honest, will add: "My family knows where they stand and what to expect. I make the rules. Why put things in writing?"

In many cases informality works fine. However, some owners are finding that as their family grows and their business becomes more complicated, one of the most important gifts they can bequeath to future generations is a formal, written family constitution.

There is nothing more painful in a family business than a disagreement which exposes old wounds and misunderstandings in the family, with the deeply held and seemingly inflexible beliefs of one faction running head on into the equally immovable beliefs of another. The business is often a bystander and a hostage. As family business consultants, we are too often asked to help at the end-stage of this long-developing process, after everyone is so personally invested in winning that simple resolutions are impossible. If only we could turn back the clock.

Most family conflicts in business can be anticipated. They are as predictable as a market downturn: Although we don't know when it will happen, we know it will happen. The clashes that commonly occur fall into set areas, such as: Whose offspring will get jobs in the company? Who will receive what benefits from the family assets? Who will have control? How can I separate myself from the family? What am I entitled to as a shareholder who doesn't work in the business?

If families can anticipate these sorts of issues, and create clear guidelines for dealing with them that everyone supports, they increase the odds of avoiding the pain of conflict and poor decisions. That is what a family constitution strives to do. It functions as a kind of insurance policy against future problems. By creating binding agreements on governance, it sets up the playing field for orderly succession, provides clear criteria for decisions, and establishes mechanisms to help resolve conflicts and disagreements before they have ruinous effects.

Perhaps the best way to explain how and why a family constitution is created is to explore some recent examples. We'll examine a family constitution adopted by the three Hibbard brothers, who own one of the largest ranches in Montana, as well as one created by the large, extended Kelley family, owners and operators of the Outrigger hotel chain in Hawaii. But first let's look more closely at the nature of constitutions, the function they serve, and their components.

Family government

Constitutions are instruments of governance. They establish a framework and a forum for a group of equals to deliberate issues, create policies and procedures, clearly define rights and obligations of participants, and make decisions about the important issues they share. As a family grows through generations, and its branches have more people who are less connected, they need a government that sets up structures to regulate the family members' shared financial and business dealings and ensure each member receives predictable and fair treatment.

To explore why a family constitution is important, we might begin with the U.S. Constitution, still regarded in many countries as a model for representative democracy. The 13 sovereign states wanted to institutionalize their relationships to reduce conflicts and create a single, more powerful entity. Yet they feared this larger entity might encroach on their independence and rights. The Constitution emerged as a masterfully constructed document that balanced the competing interests of the individual states and the whole, and defined the common values that would guide the new country's stance in the world.

A family constitution expresses the will of the family for future generations. Most important, it creates a foundation for maintaining trust within the family and for guiding the distribution of resources. The document helps to clarify everyone's expectations, so that family members do not have to read the tea leaves to understand what Mom or Dad or Uncle Harry has in mind for them. It gives family members the basic security of knowing what they can expect from the business, as well as how they can participate in it and continue to earn rewards from it. While it leaves many uncertainties, such as who will be allowed to enter the business and who will lead it, the document sets out guidelines for making such decisions.

The basic components of the U.S. Constitution are similar to those of a family constitution. First, there is the mission statement. "We the people of the United States, in order to create a more perfect union, establish justice, provide domestic tranquility...." Likewise, the family mission statement expresses the values, goals, and purposes that will guide the members' actions as a group.

Many families have mission statements. While these are the cornerstones of a constitution, they aren't enough. Missions are statements of intention. They say nothing about how to get there, or the rules of the game. A constitution is more comprehensive, and defines the major ways that the family will work together, including specific agreements about employment, compensation, stock ownership and inheritance, sale of family assets, buy-sell agreements, and so forth.

Next in the U.S. Constitution, comes the articles that set out the key governance structures—the legislative, executive, and judicial branches, and their various checks and balances. A family constitution may provide for a council of the family members as well as a board of directors for the business, along with various links between the two. It specifies the responsibilities and basic operations of each forum, the criteria for membership and selection of leaders, basic rules of behavior, and procedures to be followed in meetings.

The Bill of Rights, added only after the U.S. Constitution was adopted, was designed to prevent the majority from running roughshod over the rights of the individual and the minority. Similarly, a description of the rights of the various family stakeholders is one of the most important and precise areas of a family constitution. But the constitution must show the other side of the equation, too—the obligations and responsibilities of those who wish to enjoy the benefits.

Like the U.S. Constitution, a family constitution sets high standards that may not always be followed in practice. Sometimes behavior falls short of expectations, and a sense of entitlement overwhelms notions of duty and stewardship of the business. What happens then? Unlike state governments, most families do not have a good judicial system to mediate disputes. A constitution can help by defining the values and goals to be considered in resolving disputes.

The Hibbards: Laws to save a ranch

A constitution is not just a tool for a large, multigenerational family with many branches. The three Hibbard brothers co-own the Sieben Live Stock Co., a ranch founded by their great-grandfather, Henry Sieben, in 1868. Chase Hibbard, 50, is the manager of the ranch and the only brother who works full-time on it. The other two, Scott and Whitney, both 47, are twins who live nearby. Scott is a consultant to family ranches, and Whitney is a publisher currently working on a doctorate in psychology.

The ranch has been run continuously by family heirs for four generations. Henry had two daughters—and two ranches—so two large family ranches were created in the next generation. The Hibbard side runs one of them. They are lucky in one respect: A succession of only-child families on their side has kept ownership to just the three brothers. Their mother is still active on the ranch but does not share in the ownership. Other families are finding it increasingly difficult to continue to own and operate such a ranch. Their increasing numbers, the difficulty of making a ranch work as a business, and pressures from the estate tax all make sale of the land economically attractive.

The brothers were in their early 20s when tragedy struck. Their father, Henry Sieben Hibbard, was killed in an air crash on the ranch. Chase, who was working in a bank in California, decided to return to Montana to run the ranch. Whitney and Scott, in college, helped out as much as they could and, later, settled in the area. The three brothers were determined to avoid what was happening to other ranch families. As Chase recalled: "It is unusual for siblings to successfully work together in managing family ranches. Sometimes they can work it out, but often the ranches are divided up to meet different needs or accommodate different management philosophies. Many of the large successful ranches in Montana have become smaller and smaller or sold entirely as successive generations take over. Folklore tells us that ranches can survive brothers and sisters, but seldom cousins."

The ranch prospered under Chase's management, but a few years ago it faced another crisis. The brothers' attorney told them it was doubtful they could keep the ranch in the family after their deaths. Scott and Chase each have two teenage sons, and while the four have not yet decided whether they want to work on the ranch, the senior Hibbards are hoping they will—or at least want them to have the option. The estate taxes their heirs would have to pay would likely force a sale, however, unless they took strong measures to protect their future.

The brothers began to talk about what was important to them. They came upon a clear theme—that of stewardship. This meant that their primary goal was to preserve the land as well as its natural resources, and to pass the ranch as a whole down to the next generation. Scott explains: "One thing that differentiates us from other family businesses is the connection to the land. Our whole business is about life, directing and managing the life of herds, crops, and wildlife—not dealing with inanimate objects. As an ecosystem, the ranch evolves every generation, as we add to it and improve it. There's a history and a story to every part of the ranch, because you are working with the land and the environment is always different."

After several talks and drafts written separately by each brother, Whitney sat down and wrote what became the Sieben Family Constitution. The seven-page document has several noteworthy features. First, it takes a lot of time to articulate why the mission is important to the family:

It is the desire of the current senior owners to formulate a family constitution and mission statement to help insure the integrity and longevity of the ranch through successive generations. The realization that it becomes more difficult for family ranches to survive with each succeeding generation prompts us to voluntarily and willfully draft this mission statement and constitution. Since the time of its founding, each generation has made certain deliberate sacrifices in the interests of the greater entity. It is our intention and belief that future generations should do the same.

After presenting the history of the ranch, the brothers outline their core values:

We hold the importance and uniqueness of our family legacy and Montana pioneer heritage to be paramount. The ranch is the basis of our identity as a family and as individuals. Without it, we are just average, or at least we are not set apart, and we are certainly not positioned to do something special. It is our power base. On a personal subjective level, we feel a strong sense of ancestry, family and ranch tradition, heritage, honor, and a desire to continue what our ancestors started and passed down to us.

Next comes their statement of purpose:

We have been charged with a sacred trust. To violate that would certainly bring financial reward, but it would do so at the expense of intangibles which have much to do with the growth of our souls. This assumes that the ranch is financially healthy (so we do not have to sell assets out of financial duress), and that we acknowledge and choose to honor our legacy and love of the land.

We were raised with an unwritten code that the ranch is inviolate, that as an entity it is greater than any of its owner -stewards, and that it is not to be used as a money tree for personal interests. The ranch does not exist for the financial gain of its owners. The ranch is more than just a business. It is a home, a lifestyle, an identity, an ethos, and a cherished heritage. To sell or divide it would violate an ancestral and familial bond. It would rupture our sense of place, our deep -seated spiritual union, and responsibility to the land.

That is where family mission statements usually end—with deep feeling but no clear guidelines for how to achieve and maintain the values expressed. The Hibbard constitution goes further, describing, first, the responsibilities of the owners, and then their rights. The document outlines the rights of the three owning families to use the ranch, but also spells out their obligation to select and oversee its management. It indicates what financial benefits the owners will be entitled to, but makes clear that funds are to be used first to develop and maintain the ranch, before being distributed to the owners.

Nine articles cover everything from ranch management to what specifically will be expected of heirs and how the family will operate. To ensure that members of the next generation understand their legacy and values, they are required to learn the history of the ranch, to work there for several summers, and finally, before age 25, to spend one full year—a whole ranch cycle—working there. This provision is meant to instill an understanding of the ranch and what it means to be an owner before the next generation receives stock.

The constitution also mandates annual family meetings at the ranch, as well as regular extended family gatherings. The document points out how choices are to be made between competing priorities, for example, between prudent management and financial return to the owners (management comes first), and the future of the business—it will remain intact, even if that is not the most profitable course.

The three brothers, who signed the family constitution in 1997, consider it a living document. Like the land, it will evolve and change. The next step will be to present it to the four sons in the next generation. Chase has shown it to his oldest son, but Scott has yet to present it to his sons. The brothers agree that the family constitution cannot be imposed on the next generation. Each son will have to make his own decision about whether to commit himself to the agreement.

The Kelley’s collaborative effort

If you have visited Hawaii, you may well have stayed at a hotel owned by the Outrigger Group, a family business owned and managed by three generations of the Kelley family, with a fourth generation waiting in the wings. Richard Kelley, a physician who returned to run his family's business, is chairman; David Carey, a third-generation member by marriage, is CEO; and Bitsy, Richard's daughter, is a member of the executive team. The Kelley’s are very much public figures in Hawaii, and the family has carefully guarded its unity and its privacy, as it thoughtfully guides its hotels into the next generation.

The essence of a constitution is that it is established collaboratively, not handed down by the business and family leader. That means that in drafting it, the family leader, who as business owner can pull many strings in the family, has to hang back and work with other family members, inside and outside of the core business. The Kelley’s constitution was drafted in a half-dozen family meetings that took place over the course of a year. Two generations took part in the creation of what they call their Charter and Mission Statement: Richard Kelley and his two sisters, one of whom also works in the business; and the nine adults among their 11 third-generation offspring, ranging in age from the 20s to 40.

All direct descendants of founder Roy Kelley, Richard's father, are entitled to be shareholders in the family businesses, which include hotels and other ventures from Florida to Palau. As the family and business grew, the Kelley’s decided they needed to anticipate and manage their future. In addition to a substantial inheritance, the third generation would be looking for possible employment at the many ventures. The family also felt some pressure to set standards for behavior of family members, and to provide for the future health of the business and the family legacy.

The hotels had a mission statement that governed their purpose and guiding values, but the family needed to link those values and aspirations with the behavior expected of family members. Richard Kelley notes that when he was CEO, he could informally talk to each of his kids about summer jobs and their relationship to the business. But the family needed to be direct and clear about issues like "How do you get a job at the hotel?" and "How do we act as family employees?" While there were implicit rules of behavior within the family, Kelley says, "by putting them down on a piece of paper, you focus on it and people take it seriously."

The Kelley's constitution begins with the Charter and Mission Statement:

We are a family committed to our members and descendants being responsible, productive, well -educated citizens who practice the work ethic and make constructive contributions in the local community and the world at large. Each member is encouraged to develop and use self-supporting, marketable skills that contribute to the enhancement of their own self-esteem and independence. We urge family members to adopt lifestyles that are healthy, personally satisfying, and at such a profile as to preserve the maximum level of family privacy, given the public nature of our business.

We urge the continuation of the orientation of prudent, careful investing with a long -term view of outcomes so all descendants of Roy and Estelle may enjoy the benefits of the foundation they built.

We believe clear, constructive communications are at the core of our long-term success as a family. We encourage all efforts to further harmony, develop humor and perspective on life, balance long -term concerns while enjoying the present, and to enhance communications, caring, and amicable relationships among family members.

The charter is accompanied by concrete guidelines for family employment and for the creation of a family business advisory board. The Kelley's all signed off on it, even though Richard was clearly in charge at the time as CEO and controlling owner. Now he has handed the leadership to David Carey, who is married to his daughter Kathy.

The agreements then contain two central documents that regulate the family's participation and relationship to their business. The Kelley Family Employment Policy is designed to "further the professionalization of the relationship between Outrigger Hotels Hawaii and affiliated Companies and members of the Kelley family." As they move from a generation of siblings (Kelley and his sisters) who can informally work out jobs and responsibilities, to first and then second cousins who might want to work in the business, families must make job and career expectations, rules of entry, and methods of compensation explicit. Kelley notes: "In a family there are often so many unwritten, even unstated, expectations that there are certain to be differences. It becomes increasingly important to get agreement on the rules so that everyone is working from the same sheet of music."

The second feature of the Kelley's charter deals with the often vague border in complex family businesses between the board and management, on the one hand, and the inactive shareholders, on the other. A provision in the corporation's bylaws provides for an advisory board of directors and a formal board of directors. The charter goes into detail on the role of the advisory board, which is viewed as the official pathway for family shareholders who are not members of the formal board to learn about and influence the business, and to deal with their concerns and differences.

The advisory board functions as a version of a family council. While family members are represented with six seats on the board of directors (there are four outsiders on it), the advisory board is open to all family members who inherit shares and wish to serve. Two of Richard's seven children are still teenagers, and they attend meetings, as do the teenage members of the next (fourth) generation.

The advisory board meets quarterly, and has a large annual meeting at a resort area for several days. The meetings are designed to be informative, educational, and fun. But the board enacts policy and makes decisions on any issue that comes up in relation to the family's stewardship of the business. Meetings may include educational briefings by experts on such topics as estate planning, or shared learning experiences such as building a house together.

Family shareholders are encouraged to participate, and the advisory board's recommendations flow up to the formal board immediately for consideration. The advisory board's bylaws are explicit about membership, removal of members, notices of meetings, appointment of the chairperson, quorum and voting, fees, and amendment. Each bylaw has been adopted after extensive family discussion and the forging of consensus.

By making their family council part of the formal, legal business structure—and paying members for their participation—the Kelley's senior leaders show they take ownership and the rights of shareholders seriously. The advisory board takes care of another important element of family business, too: It separates family learning about the business from traditional board processes. It gives young family members who do not yet have the experience, sense of responsibility, or commitment to be on the board of director's opportunities to learn and grow through participation.

The Kelley's constitution separates the family's governance from the governance of the business by clarifying the nature of the overlap between the two systems. The theme of their experience is that a constitution must be created collaboratively by the family, and must be actively pursued by all of the members.

Building continuity

Though every family constitution is unique, we have come to see that there are certain common features that must be in place for family to evolve and remain in control of the business. A family with a single branch of siblings, like the Hibbards, may need less detail than a family with several groups of cousins, or a large business with many parts, like that of the Kelley's.

Some constitutions are quite detailed when created, and others add new areas and greater specificity as the family grows. Some family businesses choose to create a brief, less comprehensive document on the first pass. Once set in motion, the document can be amended, but it remains in force for future generations of family members, who grow up comfortably aware of its boundaries and provisions. The first generation commits itself to the constitution by creating and signing it; subsequent generations are educated in its history and asked to subscribe to it when they become adults.

Family constitutions are still relatively new, and rare, although many families are creating clearer written agreements that contain the elements of a constitution. So far the only data we have on the usefulness and effectiveness of constitutions is the testimony of the families themselves. For example, two families who jointly own one business have had a constitution for more than a decade. They give the document credit for reducing conflicts that would otherwise have torn their partnership apart.

Of course, writing such a document is no guarantee of success. A constitution will be worthless if the signers don't take it seriously as the centerpiece of family governance. They have to come to meetings, honor the rules, and work with one another in the spirit embodied in the document's statements.

Families that devote the time and effort to developing such a document have taken a major step forward in governance. The process itself enhances their commitment to a shared future as well as the security and trust that they can work together. It provides a forum for family members to communicate and make decisions in times of pressure, disagreement, and tragedy. Finally, it allows conflict resolution to be contained within the family, instead of spilling out into the business or, worse, the courts.

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The articles of a family constitution

I. Mission and purpose

Explains why your family is in business, how you will use your wealth, and what you want to stand for, as well as a broad strategy for achieving your commitments.

II. Values, standards, and expectations

Sets standards for family "citizenship." Lays out guidelines for what is expected in return for enjoying the resources and support of the family. While some values have to do with business activities, they are set by the family, as founders and owners, and monitored by the family council.

A. Central values of the family

Describes values pertaining to how family members will treat each other and act in the world; values you'd like to see reflected in the business; how you will use your resources to benefit others; what the family will do to enrich society and each other's lives.

B. Ownership, inheritance, and succession

Provides guidelines on how the family will deal with issues of money and power, distribution of resources, and the allocation of jobs, position, and authority in the business.

C. Responsibilities of family members

Deals with the obligations of family citizens, including participation in decision-making, confidentiality in sharing information, treatment of employees, behavior in the community.

D. Support for personal development

Describes ways that the family's wealth can be used to support the education, aspirations, business ideas, and futures of its members.

III. Family council operating principles

Organizes the adult members into a clearly defined family council that has areas of focus and some limited decision-making authority. Describes the council's powers, its members, how its leader will be selected, how it makes decisions, how it will interact with the chief executive of the business.

While families often discuss topics of mutual concern informally, a council assures them of having regular meetings with established procedures for sharing information and reaching decisions on key issues. This is often done—inadequately—by the family patriarch or business leader, who assumes that his power generalizes to all family decisions having to do with the business. The intention of a constitution is to create some limits, even checks and balances, on the leaders.

IV. Family and business agreements

Defines the boundary between family and business and, as much as possible, builds a foundation for avoiding major conflicts between the two. Defines clearly the different functions of the family council and the board of directors, and how board members are selected. There are many areas of overlap, however, and some family members may be part of both groups.

In addition, some families adopt separate agreements having to do with how the family relates to the business. Typically, these agreements cover several areas:

A. Marriage and divorce

Guidelines for participation by spouses in family governance and the business, and for protecting the business in the event of divorce. May define opportunities for employment and ownership as well as rules of inheritance for in-laws.

B. Family employment policy

Defines who will be eligible to work in the business, the re quire ments for entry, the entry process, and how jobs will be offered to family members.

C. Compensation policy

Clearly defines the standards by which family members get paid for work in the various businesses, and for governance tasks, such as guiding the family council and sitting on the board.

D. Stock agreements

Provides guidance on how ownership passes among family members, how stock is bought and sold, how its value is determined, and the limits to ownership.