2004 Kellogg Family Business Conference

Best Practices and New Ideas

May 18–19, 2004

2004 Kellogg Family Business Conference

Sponsored by **Kellogg School of Management**
Northern Trust Corporation
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KELLOGG CENTER FOR FAMILY ENTERPRISES

The Center for Family Enterprises was formed five years ago in response to a group of Kellogg M.B.A. students who wished to start a club and attend a class focused on the unique aspects of owning, governing and/or managing family businesses. The Center is deliberately concentrated on family *enterprises*, with a focus that includes family business, but also encompasses family foundations, family offices, family investment companies and family wealth management.

The Center's mission is to:

- Provide thought leadership to the field of family business
- Contribute to the body of knowledge through cases, research and publications
- Conduct public programs that are distinct and explore new and different topics not otherwise available
- Build a family business community among Kellogg students, faculty and alumni
- Stimulate awareness and research by other Kellogg faculty on the special issues and opportunities for family firms
- Develop a global network of successful business families who can learn from each other and connect with each other through Kellogg and its partnerships

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When the 200 invited Conference guests were asked what they felt is the biggest advantage of a family firm:

- Fifty-seven percent said it is the family passion for the business's mission and survival

- Twenty-two percent said it is a strong values-based culture

- Thirteen percent felt that enduring personal relationships with suppliers, customers and community is the biggest advantage

- Eight percent said it is independent leadership

When they were asked what they felt is the biggest disadvantage of a family firm:

- Thirty-six percent said it is psychodynamic conflicts among family members
- Thirty-two percent said it is conflicts of interest between family needs and business needs
- Sixteen percent felt the biggest disadvantage is lack of professional management
- Thirteen percent cited insufficient capital
- Four percent said the lack of a competent successor is the biggest disadvantage

Best Practices and New Ideas
May 18–19, 2004

GREETINGS

Dear Friends,
We are pleased, proud and excited to present the proceedings from Kellogg's 2004 Family Business Invitational Conference of May 18th and 19th. Each year, as part of our effort to enable and foster interaction and discourse within the family business community and to add to the growing body of knowledge concerning family business, the Kellogg Center for Family Enterprises brings together leading business families for two days of lecture, discussion and celebration. The purpose of this report is to document the latest research, as well as the personal insights, presented at the Conference and to share it with a wider family business audience.

This is our third annual Conference and proceedings report. Inside you will find information on some of the most pressing, timely and sensitive challenges facing families in business today. You will also find discussion on topics not presented in any other forum. Our Center is at the forefront of family business research; what we present here is fresh and important information for all who seek to support families in business.

Inside you will find:

Summaries of the best research during the past year on issues of performance, succession and governance

Personal insights from the perspectives of outside advisors, non-family executives and directors

Various challenges awaiting the successor generation represented by Kellogg alums and students

The 2004 Kellogg Award for extraordinary contributions to the field of family business

A new case study written specifically for the Conference documenting the difficulties of succession planning

Of course, none of this would be possible without the consistent and generous support of our co-sponsor partners, The Northern Trust and Duff & Phelps, LLC. Their strong commitment to this Conference and to our Center encourages our research, case writing, and publishing. We benefit greatly from their active partnership, value their wise counsel and look forward to a continuing collaboration.

Finally, this Conference is a celebration of family enterprise and the *enterprising families* who continue to be among the strongest and most important contributors in the field of business. It is our mission at the Center to recognize these families, document their successes, learn from their creative solutions to difficult challenges, and share this research with our students and the wider family business community.

Lloyd E. Shefsky

John L. Ward

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Northern Trust

William A. Osborn
Chairman and
Chief Executive Officer

June 14, 2004

To Our Valued Business Owners and Friends:

The central theme of our Family Business Conference is "Best Practices." It is also a co-sponsor goal in creating this conference each year. Thank you for the excellent feedback, participation and energy you all bring to help make this the experience we all desire. Collaboration is a best practice. In that spirit, I would also like to thank our co-sponsors, The Kellogg Center for Family Enterprise, especially John Ward and Lloyd Shefsky, as well as Duff & Phelps.

Serving the needs of the closely-held community remains what we hope is a best practice at Northern Trust. Families and businesses have trusted us for 115 years to help them reach their personal and business financial goals. We consider it a privilege, and we strive to get better every year.

The planning for our next conference is already underway. We hope this book will serve as a resource to you and your families over the next year to help you stand apart from the rest, in both spirit and best practices.

Best regards.

Sincerely,

• 311 SOUTH WACKER DRIVE, SUITE 4200 • CHICAGO, ILLINOIS 60606 • 312-697-4650 • FAX 312-697-0115

• CHESTER A. GOUGIS
President

DUFF & PHELPS, LLC

June 15, 2004

Dear Business Owner and Colleagues:

Family owned businesses represent the core of the U.S. economy. Duff & Phelps is very proud to continue its sponsorship of this excellent conference, which focuses on best practices and new ideas for this important business sector.

Duff & Phelps has been a trusted financial advisor and investment banker to family businesses for over 70 years. Part of our role in helping our family business clients achieve their goals is making sure that they are aware of the best and newest ideas in dealing with all of the unique challenges facing family businesses.

We look forward to continuing to work with Northern Trust and Kellogg to help bring this program to family business. We hope this conference gave you a better understanding of the unique and critical family issues facing your company.

Best regards,

Chester A. Gougis

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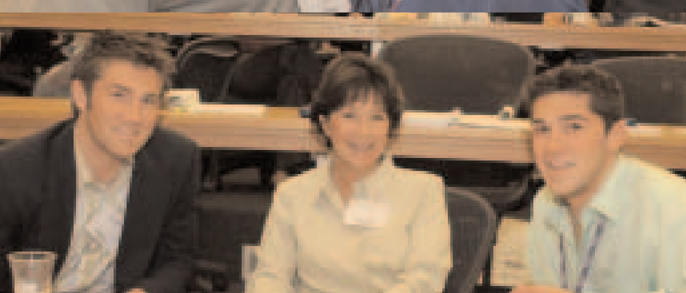
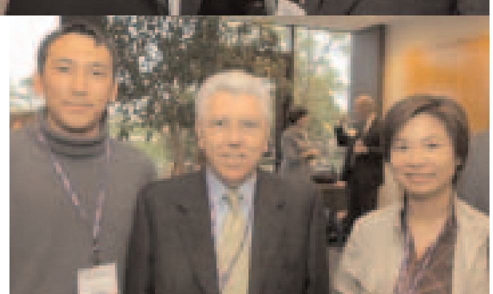
Corporate Advisors Since 1932





Contents

PRESENTER: John L. Ward
Clinical Professor and Co-Director
Center for Family Enterprises
Kellogg School of Management

Best New Research Ideas For Families In Business

This is a summary of the past year's outstanding new research on family business and family business performance. It includes a practical understanding of seven studies and shows how business families can apply that knowledge today. In addition, the presentation includes relevant real time audience feedback.

This session is unique in that it is the only time and place where such an overview is presented to business families.

Best New Research Ideas For Families In Business

Continuing a Tradition

One of the traditions of this program each year is to present what we perceive to be the best research that was done in the last 12 months on the subject of family business. We present topics that have had the most impact and contain the most important information for you to know in a way that we hope is useful and interesting to everyday thinking. That is the purpose of this session.

Family Business Gets "Discovered"

I call this year a breakthrough year. At last year's Conference we presented a piece of research that we singled out as the most significant new piece of research of the previous year, which was done by a couple of American professors, Ronald Anderson and David Reeb, who studied the S&P 500 companies.[1] Interestingly, they identified that about 30 percent of the S&P 500 are family controlled companies, which surprises most of the world. Even more interesting and much more significant, they discovered that the family controlled companies that are part of the S&P 500 Index substantially out-performed the index itself. They demonstrated with a great deal of academic rigor something that many of you have long felt is true; family controlled businesses out-perform non-family controlled businesses. Their paper was not published yet but shortly after our Conference, in June of 2003, it was published in the respected *Journal of Finance*, which means that for the first time in the thousands of years of family business history, the economists have figured out that there are family businesses. Behavioral scientists, on the other hand, discovered them a long time ago, because they became interested in family behaviors that occur inside of a business.

For the first time in the thousands of years of family business history, the economists have figured out that there are family businesses.

Now that economists have found family business, it leads to a couple of very predictable and very interesting next steps, which we have seen in the last 12 months. It leads to a whole group of people trying to understand how it can be true that family businesses are more profitable and more successful than non-family businesses, since conventional wisdom suggests the opposite. The economists have not only found family business, they have found a result about family business that surprises them. They are starting to ask the question: What is it about family business that makes it a superior form of enterprise?

Since the publication of Reeb and Anderson's study of the S&P 500, a whole new sphere of thinking has opened up, leading economists to analyze publicly traded family companies around the world to find out how they are different and under what conditions they are more profitable. Happily for the field, the economists have found this to be a legitimate area of interest and study. A great number of new people from some of the best universities in the world are now beginning to study family business and they are beginning to ask questions and trying to come up with theories and insights as to why family businesses behave as they do and in what conditions and under what circumstances they perform better, as well, or less well than other forms of enterprise.

A Look at Performance, Succession and Governance

The seven papers that I've chosen to summarize for you fall into three categories. One category looks deeply at the performance question. The second category concerns the succession question. The third category looks at the area of governance, which is closely related to economic success. With the addition of well-respected academics and academic journals to the study of family business, I expect that over the next few years, we are going to gain more insight as to how family businesses function from a theoretical point of view, as well as from the experiential point of view. The good news for family business is that it's nice to be noticed and respected finally. The bad news may be that other forms of business might try to behave a little bit more like a family business, in which case, competition may be a little bit tougher. Will the stock markets ever allow non-family businesses to behave like family businesses? They might, at least to some extent, which may mean that there is going to be some transference of learning from the family business experience to the non-family business experience.

I mentioned that family business was discovered about a year ago, by two Americans who studied the S&P 500. It didn't take long for that news to travel to Europe. This year, a multi-page feature article was published in a rather surprising place: *Newsweek* presented a study they commissioned by Thompson Financial, a financial analysis group.[2] The study looked at how well family controlled companies on European stock indices performed against the index.

Over the last 10 years, on average, family controlled companies on all of the major European stock indices also out-performed the index or out-performed the average of the non-family companies.

They noticed that over the last 10 years, on average, family controlled companies on all of the major European stock indices also out-performed the index or out-performed the average of the non-family companies. The early results reinforce that this is not just an American S&P phenomenon, but seems to be equally solid and strong in the European publicly traded, family controlled companies as well.

Pick a Stock, Any Stock

Which stock would you pick because you thought it was the best upward investment you could make? Would you pick the stock of a publicly traded family controlled company that is being led by the founder CEO? Would you pick stock in a company that is being led by the second generation family member CEO? Would you pick stock in a company that is being led by the non–family CEO of a family business? One research project showed that in the S&P 500, about 60 percent of the family controlled companies in the S&P 500 are run by non-family CEOs, 40 percent are run by family CEOs. Would you pick the stock that was a third generation family CEO led company, or would you pick a fourth generation family CEO led company? Would you pick a non-family business, or would you pick a company, which is not publicly traded, but is 100% family owned?

All of the following responses reported were part of a give and take dialogue established with the Conference participants. Answers are only representative of those in attendance at the Conference and voting on a particular question. They are not meant to represent the views of the wider family business community. Totals may not equal 100 percent due to rounding.

Which stock would you purchase?

Percent	*Answer*
30%	Founder CEO led
23%	2nd generation family CEO led
30%	Non-family CEO of family business led
6%	3rd generation family CEO led
11%	4th generation family CEO led

General research supports that the strongest investment would be in a company led by the founder CEO. My own research shows that the "all private family business" is the better investment, while the second generation family CEO led business performs below average. We will look at the question again later.

Advantages and Challenges in Family Business

Two professors, Danny Miller and his wife Isabelle Breton-Miller, from the University of Montreal, are leading strategy thinkers in the field of general management of all forms. They dove into the question of how family businesses are different in a positive way, and how they are different in a negative way.[3]

Challenges

Insufficient capital

Conflict of interest between management and family goals

Psychodynamic family conflict

No competent heir successor

Lack of professional managers

Advantages

Independent leadership

Family passion for continuity of business's mission

Strong values-based culture

Enduring personal relationships with suppliers, customers, community

Advantages

The Millers' found four qualities that make family businesses positive. Given that they perform well or better than the competition, which of these reasons best explains the competitive advantage of a family business: *independent leadership*, a strong person with a long-term view secure in the job, who can make courageous decisions; a *family passion for the business's mission* or survival; a *strong values-based culture*; the *personal relationships* that a family business forges?

Two pharmaceutical companies, Merck & Co., Inc. and Hoffman-LaRoche Inc., epitomize the passion for their businesses' mission. Both are performing extraordinarily well and are family controlled. Both of them see their businesses as more than just profit makers. Merck defines its mission and its purpose as one of curing disease. Hoffman-LaRoche does not manufacture generic drugs but prefers to get involved in research around drugs that they think can make a unique difference in caring for people's health.

The most recent *Fortune* magazine list of the best places to work in America contained a very high percentage of family businesses.

The most recent *Fortune* magazine list of the best places to work in America contained a very high percentage of family businesses: number one was The J. M. Smucker Company, a family business. About a month ago, the *Financial Times* showed a similar pattern with a significantly high percentage of European family companies being rated as the best places to work.

The fourth important factor with positive influence is the nature of the relationships that a family business forges with its customers, its distributors, its suppliers, its partners.

Now, I want to ask our participants what you think makes the biggest difference. To my knowledge this is the first time this question has ever been asked to a relatively large group of family businesses.

What is the biggest advantage of a family firm?

Percent	*Answer*
8%	Independent leadership
57%	Family passion for business's mission and survival
22%	Strong values-based culture
13%	Enduring personal relationships with suppliers, customers, community

What does family passion have to do with earnings per share? Everything, it would seem.

Disadvantages

But, economists and these strategists have also articulated that family businesses have some very distinct weaknesses. For example, one weakness is insufficient capital—you can't keep going to the public market and keep control at the same time. Maybe your company is privately held and you don't want to give up any shares. Perhaps your company is averse to debt and your family is growing very fast, so the great growth of the family is going to outstrip the rate of the growth of the business to create resources.

Second, there is a fundamental conflict of interest between the family's interest and the business's interest. Consider dividend policy, the business wants to retain profits while the family might want a payout. Think about employment policies. The family might want to encourage family members to join while the business might want to be restrictive based on merit. There might be many areas in which the best interest of the business and the best interest of the family are in conflict.

The third consideration concerns family conflict. There are going to be sibling rivalries and arguments and differences among family members, just because they are family members, and it is going to create a negative strain on the ownership group as well as on the business.

The fourth disadvantage is that it is difficult to have a competent successor. What is the likelihood that the next qualified CEO for a complex business just happens to be a family member?

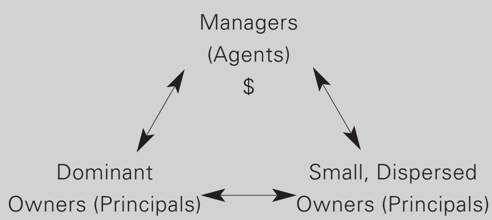
The fifth problem concerns the difficulty the family business has in attracting professional management to the organization. Maybe this is because the family doesn't want to be challenged or because there is not enough room for family members to grow in an organization with professional management, so they are less likely to seek it out.

What is the biggest disadvantage of a family firm?

Percent	*Answer*
13%	Insufficient capital
32%	Conflicts of interest between family needs and business needs
36%	Psychodynamic conflicts among family members
4%	No competent heir successor
16%	Lack of professional managers

Most of us recognize that the biggest issue is interpersonal while very few people would ascribe the lack of a family successor/CEO as being the biggest issue. I'd like to compare how you voted to your own personal role in business. What we see is that the more outside of the business, or outside of the family you are—the advisor, the independent director and the non-family manager—those on the outside looking in, the more you see the inherent role conflict between family and business as your greatest challenge. The people most in the business, which would be the next and the senior generations in the business, see psychodynamic conflicts among family members as the biggest disadvantage.

A (Very) Brief History of Business Theory



Separation of Ownership and Control
Agency Theory

A Brief History of Business Theory

The best research of 2003–2004 has its roots in 1932 and 1976. What I mean by that is 1932 saw an incredible change in how we understand and think about business. Two professors from Harvard Business School, Adolf A. Berle and Gardiner C. Means, wrote a book called *The Modern Corporation and Private Property*[4] that argued, for the first time ever, that the best form of business separated management from control. By that they meant that owners should not be managers. They said that managers should be a separate professional breed and owners should hire professional managers to look after their interests and not manage them for themselves. Over the last 70 years, this thinking has led to the phenomenal growth in business schools from a tiny handful to thousands worldwide. All of a sudden people realized that they needed to train and develop a professional cadre of managers to run the enterprises for others. Of course, the growth and the development of the large, public, widely held company was taking place at the same time and obviously continued through the post-war years at an even more rapid rate in North America as well as in Western Europe. The basic concept, for the very first time, was it is smart to separate ownership from management. It changed the whole landscape of business education and business thinking.

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Managers' Interests Diverge from the Owners' Interests

Then in the middle 1970s, three Nobel Prize winning economists, Eugene Fama, Michael Jensen and William Meckling, from MIT and the University of Chicago, came along and said that maybe separating ownership from management is the right thing to do, but there is a special problem. The special problem is you've got managers, called agents, who are professionally running the enterprise on behalf of a group of dispersed owners, called principals. The managers, they proposed, have a different agenda and different interests from the owners. These professional managers have their own self-interest at heart. They are interested in protecting their jobs, they are interested in their compensation, they are interested in their own status. Those are very, very important to managers but they may not be very important to the owner.

So Fama, Jensen and Meckling proceeded to try to figure out how to make sure we keep the managers honest and on the same page with the owners. They suggested implementing remedies that led to stock option compensation, and giving shares of stock to independent directors on the board. In addition, independent boards have all sorts of federal regulations around them to make sure that they are watching over management, to make sure management is operating in the best interests of the owners. Also, we gave all sorts of rights to owners, because we needed a way to make sure that the owners could protect themselves against the agents, who are supposed to be running the business on the owners' behalf, but who have their own agendas.

Dominant Owners

Shortly after that, a couple of economists pointed out an interesting observation. We have been talking about owners as if all owners are the same but they're not, they said. They contended that there is a special breed of owners called dominant owners who have effective control over the enterprise. This group of owners is different from the dispersed shareholders who can call their stockbrokers and sell their shares tomorrow morning, or diversify in any way they wish. This is a special group of owners who have a long-term commitment. They have an investment that is hard to get out of quickly and easily, and on top of all of that they may have a passion for the business. Because this kind of owner is so close, so powerful, so intense, he or she is going to have a whole lot of direct influence over their managers.

Dominant owners do not have as much of a problem managing the managers as dispersed owners do, ergo, the theory for family businesses being a superior form of economic enterprise.

Dominant owners do not have as much of a problem managing the managers as dispersed owners do, ergo, the theory for family businesses being a superior form of economic enterprise, because the proximity, the closeness, the tightness of the owners and the managers, keeps them on the same page. This applies to most of you here; if you are not the dominant owner at least you are relatives and you live in the same house, you live in the same neighborhood or you work in the same company. You've known each other all your lives. You are on the same page. We don't need to protect you from them; we don't need to protect them from you. More recently, economic theory recognized that, yes, dominant owners have a lot of power over managers, so they behave; but if dominant owners also have dispersed owners—if a publicly traded family controlled company has really powerful family owners, but is also publicly traded—then the dominant owners are going to cheat the dispersed owners. I don't mean cheat in a bad way, but dominant owners have very different interests from small, dispersed owners. The theory contends that dominant owners, because they are in control, are going to take advantage of the small owners to serve their own interests. You proved it just a few minutes ago. If you have a passion for your business then you'll probably compromise short-term earnings for the benefit of preserving the passion or applying the passion. You'll probably invest a little bit more to protect the business culture. You'll probably do a lot of things. Some economists would argue that what you are doing is for your own non-economic reasons and that you are taking money from the small owners, shorting them out of profit so that you can serve your non-economic interests.

Family Business and Debt

Because most family businesses do not go to the equity markets, but they do go to the debt markets, we might think that the family business would consider the family's interest over their creditor's interest.

On average, family firms take on less debt than non-family firms. True or False?

Percent	Answer
70%	True
30%	False

Your assumption is "true" and we know that to be a fact. I, as well as other people, have done some studies that show that family businesses do take on less debt than non-family businesses, which is not—according to the economists—rational. Economists feel that business should take on as much debt as possible because it is a lot cheaper than equity. Family businesses should take on as much debt as they can to feed the future growth of the business, to maximize long-term wealth. But families don't because they would give up control; AND STILL family businesses out-perform the market. This baffles economists. How could this be true?

Pinpointing Risk Adversity

Let's ask the next question, which comes from another research paper that I am highlighting for you. Family controlled companies in a growing market should be more willing to take on debt because they are interested in the long-term view and they want to build the enterprise for the long-term benefit. The question to you is—of all forms of family business, when do you think family firms are most risk averse? In the controlling owner stage where you have the founder or a single controlling person running the enterprise? The sibling partnership stage where you have several brothers and sisters or close cousins controlling the business as a team? Or in the cousin collaboration stage where you have anywhere from a dozen to hundreds of family owners who each own a little bit and ownership is spread out?

When are family firms most debt averse?

Percent	*Answer*
50%	Controlling Owner stage
19%	Sibling Partnership stage
32%	Cousin Collaboration stage

Your view on this is 100 percent wrong. The research I am referencing studied almost 1500 mid to large size family companies in the United States and what they found is that when family businesses are most risk averse is in the sibling stage, by far.[5] In fact, they are not more risk averse at the founder stage than the market and they are not more risk averse at the cousin stage than the market. It is only at the sibling stage that family businesses are more risk averse via debt. We've known that, in general, family firms are more risk averse and now we know when, during sibling partnerships, this risk averse behavior shows up the most. Why?

Sibling Stage Is More Conflictual

Researchers theorize that there is more conflict among the family members at the sibling stage than at any other time in the business's history, which affects strategic risk taking behaviors.

What these researchers theorize is that there is more conflict among the family members at the sibling stage and it is at that time that conflict scares people off from making risky decisions or makes it difficult for them to make a risky decision. The researchers theorize that there is more conflict among the family members at the sibling stage than at any other time in the business's history, which affects strategic risk taking behaviors. We don't know this for a fact but the data that we now have give some insight as to when family businesses are most risk averse.[6]

Who would you pick as the next CEO?

Percent	*Answer*
55%	Adequately competent son/daughter
0%	Adequately competent in-law
6%	Adequately competent inside manager
39%	Very competent outside manager
0%	Not competent son/daughter

Who is the Best CEO Succcessor?

You prefer an adequately competent son/daughter with your second choice being a very competent outsider. Before I tell you what the results of the research are, let me tell you two theories. These theories present a really interesting conflict. On the one hand, family members as successor CEOs have a unique set of insights and knowledge about the company. They have grown up in the family. They have grown up in the business. They have heard the stories all of their lives. Because of that, they have a sense for the business that nobody could understand better than they. Economists call that *idiosyncratic knowledge*. They have a competitive advantage in the world because they have special knowledge, a special intuitive sense that gives them a better ability to run the company than the most competent outside person. Having that really special touch and feel is superior according to one theory. The conflicting theory and argument on this is what I like to refer to as the Warren Buffet theory. Buffet compared picking your child as your successor to choosing the 2020 Olympic team by picking the children of the 2000 Olympic team.[7]

The most intelligent choice for a successor CEO is an adequately competent son or daughter.

So, which is the most correct? Interestingly, three people from the University of Singapore actually did research and applied a lot of economic theory to the question and they came to the conclusion that the most intelligent choice would be an adequately competent son or daughter, followed by an adequately competent in-law, inside manager, then an outside manager, and finally, a not competent son/daughter.[8]

Qualifications for CEO

What criteria, qualifications and background are most important for your successor to have?

Percent	*Answer*
50%	Familiarity with the business
9%	Long relationship with family
37%	Managerial competence
4%	External experience

The answer the research has found is that the order as shown above is best. The notion from the research of this past year is that the more feel you have for the business, however you got it, improves your qualifications to be the right CEO for that business. Growing up in the family and in the business is the best way to get the feel. Marrying into the family or being a long-term employee with the family is the second best alternative. Managerial competence is third. External experience, meaning having worked outside the family company before becoming the CEO is least important. We definitely advocate working outside the business in the youth stage, but this question asks if you would bring in a person from the outside to be CEO.

The economists have struggled with the notion that it is possible that somebody who was just born into a business family could possibly be the best qualified successor over the thousands of highly qualified candidates available in the outside world.

The economists have struggled with the notion that it is possible that somebody who was just born into a business family could possibly be the best qualified successor over the thousands of highly qualified candidates available in the outside world.

Idiosyncratic Knowledge

So what is this idiosyncratic feel? I am going to ask what you think is most valuable to your firm. And all five of these answers are what people say comprise that special feel, but which is primary? Is it the long personal relationship with suppliers, customers and distributors? Or personal relationships that began at home when you were a child with people who have known your family for 50 years? Or is that special feel a sense of history and perspective of how the company should make wise decisions over the long haul? Is it a very personal values-based relationship with your key employees? Is it a deep knowledge of the industry, maybe from having gone to trade shows when you were 15 years old? Or is that special feel a mastery of the company's culture?

Which is most valuable to your firm?

Percent	*Answer*
24%	Long personal relationship with suppliers, etc.
29%	Sense of history and perspective
4%	Long personal relationships with key employees
21%	Deep knowledge of industry patterns, etc.
22%	Mastery of company's culture

To my knowledge this question has never been asked of a large number of family business members. These examples are all characteristics of what is known as *idiosyncratic knowledge*. Which one is most important? They are all important. They are all part of the same definition. You just said which was most important to your business and you are pretty balanced. There are a pretty wide variety of reactions, which one would expect probably based on the nature of the industry, the nature of the business and so on.

CEO Compensation

We have just said, and the new research has shown for the first time, that coming from inside the family to be a CEO is a competitive advantage over coming from the outside as a CEO. Therefore, should a family member CEO be paid the same as a non-family CEO? There are two arguments. One argument is that if you are the optimal candidate because you have this extra special knowledge, it is not very transferable. It is valuable to your company, but it is not as valuable to anybody else's company. I can hire you cheap because I can appreciate you more than the market can appreciate you. The other argument contends that if you have this special knowledge, you're worth more to the company. They should pay you more.

A family member CEO should be paid the same as a non-family CEO of a family firm. True or False?

Percent	*Answer*
63%	True
37%	False

Two thirds of you think they should be paid the same. But is that the case?

Are family CEOs in fact paid the same, more, or less than the market?

Percent	Answer
18%	About the same?
38%	Usually more?
44%	Usually less?

The research has shown quite strongly that family member CEOs are paid less than market. They are paid less than market in two ways: They are paid less than market in base compensation (cash compensation) and they are paid much less than market in stock incentives (long-term compensation and equity based compensation). Maybe that makes a lot of sense because they have a huge amount of equity in the company already. Why must they get more equity incentive when their entire wealth is tied up in the business already? Not to mention their reputation and pride.

Interestingly, the other dimension of this we find is, if the business is in an industry that has lots of risk that the business cannot control, then family member CEOs are paid more than the market. What has been proven by another set of researchers over the last year is: Families who own businesses are sympathetic to their family CEOs and pay them more comfortably if they conclude that they are in an industry that has great volatility that management isn't expected to be able to control.[9]

The research has shown quite strongly that family member CEOs are paid less than market.

Another argument says that the family CEO should get paid commensurate with the amount of burden that he or she feels. Do successors to the family business feel extra pressure to perform, to prove their legitimacy, to validate themselves, or do they feel less pressure to perform because they feel secure in their jobs because they are members of the owning family? Or is there really no difference in the pressure to perform?

Which statement do you feel is most true?

Percent	*Answer*
84%	Successor feels extra pressure to perform
8%	Successor feels less pressure to perform
8%	No difference

Who Monitors the Family?

If we are worried about the family controlling owners doing things that are not economically optimal and therefore under appreciating other shareholders or other creditors, then the solution to the problem is to bring independent outside directors into the family board room. In a family controlled company we want independent directors involved to look after the interests of the family owners and also creditors and other owners or other interest groups.

What percentage of your board is fully independent?

Percent	*Answer*
57%	0 – 25%
22%	26 – 50%
18%	51 – 75%
3%	75 – 100%

Professors Anderson and Reeb have built upon their research of a year ago, which reported on the performance of publicly traded family companies. They have concluded that business performance improves substantially, by 19 percent, when a family board has a significant number of outside directors.[10]

The Best Stock to Pick Is…

Referring back to my earlier question: Which stock would you purchase? Our research has shown that the best stock anyone could buy is in a private company that has a CEO from the family and has a majority of outside directors on its board.

John L. Ward

John Ward is Clinical Professor and Co-Director of the Center for Family Enterprises at Kellogg School of Management. He has a B.A. degree from Northwestern University, M.B.A. and Ph.D. degrees from Stanford Graduate School of Business. He teaches family enterprise continuity and is an active researcher and writer on succession, ownership, governance and philanthropy. He serves on the boards of four companies in the U.S. and Europe and is the author of four books that are leaders in the field: *Keeping the Family Business Healthy, Effective Boards for Private Enterprises, Strategic Planning for the Family Business* (with co-author Randal Carlock) and *Perpetuating the Family Business: 50 Lessons Learned from Long-Lasting Successful Families in Business*.

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9 Gomez-Mejia, Luis R., et al, "The Determinants of Executive Compensation in Family-Controlled Public Corporations." *Academy of Management Journal*. Vol 46, No. 2. 2003.

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PRESENTER: Lloyd E. Shefsky
Clinical Professor and Co-Director
Center for Family Enterprises
Kellogg School of Management

Issues And Answers

This session introduced Conference participants to the confidential voting technology that was used to gauge audience responses during the various presentations. The participants answered a series of questions, both personal and about their family business experiences, which were instantly tabulated and shared with the entire audience. The responses helped to determine the make-up of the audience, to explore theories developed during the presentations, as well as build a sense of shared identity among Conference participants.

Issues And Answers

Why We Are Here

We are pleased to bring together leading business families in a unique Conference that not only gives you information, but also relies on you for vital feedback at the time of our presentations. We have several reasons for bringing all of you together, key among them are the sharing of best practices and new research, the celebration of family enterprise, and the exchange of ideas and experiences with others who care about family business.

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There Is Wisdom In Crowds

When we share our ideas and experiences, most often something very powerful happens. James Surowiecki, a business columnist for the *New Yorker*, wrote about just this sort of phenomenon in his new book, *The Wisdom of Crowds*. His premise is simple but profound. He states that, "under the right circumstances, groups are remarkably intelligent, and are often smarter than the smartest people in them." It doesn't matter how brilliant those few smart people may be, large groups of people are often better at solving problems and coming to wise decisions in virtually all areas of life, including business.

Luckily, we have a large group of very intelligent people with us and it is our hope that all of you will help us gain new insights into the world of family business. Our Conference will draw upon the shared wisdom of our attendees by asking you questions about your own business practices and we will share these answers with one another through our innovative instant voting technology.

Audience Poll

At this point attendees were asked a series of questions that established the make-up of the audience including gender and age identifiers. Audience responses were confidential and instant. Following are answers to a number of those questions. Responses may not equal 100 percent due to rounding.

DEMOGRAPHICS

Your Gender?

Percent	*Answer*
71%	Male
30%	Female

Your age?

Percent	*Answer*
23%	22-33
28%	34-45
29%	46-57
15%	58-69
4%	70+

Which best describes YOUR ROLE with the family business?

Percent	*Answer*
5%	Non-family Manager
44%	Next Generation Family in Business
13%	Next Generation Family NOT in Business
23%	Senior Generation Family in Business
3%	Senior Generation Family NOT in Business
2%	In-Law in Business
3%	In-Law NOT in Business
2%	Independent Director of Family Business
4%	Advisor to Family Business

Have you worked elsewhere before joining your family business?

Percent	*Answer*
61%	Yes
19%	No
21%	Not applicable

COMPENSATION

Are family members (other than you) compensated?

Percent	*Answer*
22%	Lower than what they could get elsewhere?
47%	Approximately what they could get elsewhere?
32%	Higher than what they could get elsewhere?

Are you compensated?

Percent	*Answer*
34%	Lower than what you could get elsewhere?
36%	Approximately what you could get elsewhere?
30%	Higher than what you could get elsewhere?

OWNERSHIP

How many adult SHAREHOLDERS (or adult beneficial shareholders) does the family enterprise you represent have?

Percent	*Answer*
8%	One
49%	2-5
28%	6-19
16%	20 or more

Which of the following OWNERSHIP STAGES best describes your family enterprise?

Percent	*Answer*
31%	Single Controlling Owner
7%	Transition from Single Controlling Owner to another Single Controlling Owner
27%	Transition from Single Controlling Owner to a Sibling Partnership
9%	Continuation as a Sibling Partnership
17%	Transition from a Sibling Partnership to Cousin Collaboration
9%	Continuation as Cousin Collaboration

SUCCESSION

How many CEO successions has your family enterprise had while your family has owned the business?

Percent	*Answer*
31%	None
24%	One
17%	Two
29%	Three +

Has your family business ever "fired" (relieved) a CEO?

Percent	*Answer*
82%	No
18%	Yes

Has your family business ever "fired" (relieved) a family member employed at your business?

Percent	*Answer*
60%	No
40%	Yes

BUSINESS LEADERSHIP

Have you ever had a non-family CEO?

Percent	*Answer*
13%	Yes, promoted from within
10%	Yes, recruited from outside
8%	Yes, both from inside and outside
69%	No

What's your general experience with non-family CEOs?

Percent	*Answer*
23%	Quite good
9%	Not so good
69%	Never had one yet

CO-CEOS

Have you ever had Co-CEOs?

Percent	*Answer*
87%	No
13%	Yes

What was your general experience with Co-CEOs?

Percent	*Answer*
9%	Quite good
5%	Not so good
87%	Never had them

FUTURE LEADERSHIP

When will you next appoint a new CEO?

Percent	*Answer*
2%	Next 18 months
8%	18-36 months
24%	3-5 years
20%	6-10 years
17%	More than 10 years
29%	Undecided

Regarding your next CEO

Percent	*Answer*
18%	Identified and well known to family and board
21%	Fairly clear in mind of current leader
61%	No plan or process yet

Regarding your next CEO

Percent	*Answer*
27%	You are the likely next CEO
73%	You are NOT the likely next CEO

RETIREMENT

At what age do you predict the current CEO will fully step down—including transfer voting control?

Percent	*Answer*
8%	Under 60
19%	60-65
30%	65-72
20%	72+
23%	Probably at death

At what age did your last CEO fully step down?

Percent	*Answer*
14%	Under 60
26%	60-65
20%	66-72
21%	72+
20%	At death

What's your family's experience with your most recent succession?

Percent	*Answer*
13%	Very disturbing
25%	O.K.
27%	Quite Good
35%	Great

GOVERNANCE

How many independent (non-management/non-family) members are on your board of directors?

Percent	*Answer*
40%	0
10%	1
9%	2
40%	3 or more

Lloyd E. Shefsky

Lloyd Shefsky is Clinical Professor of Entrepreneurship, founder of the Kellogg Center for Executive Women and founder and Co-Director of the Center for Family Enterprises at Kellogg School of Management. He has a J.D. degree from University of Chicago Law School, a B.S. degree from DePaul University, and is also a certified public accountant. Thirty-four years ago, he founded the law firm, Shefsky & Froelich, Ltd., which specializes in advising entrepreneurs and their companies at every stage of development and where he is now Of Counsel. He is the author of *Entrepreneurs Are Made Not Born*, a book that has been translated into five languages and is on reading lists at major business schools. He is director and president emeritus of the Sports Lawyers Association, an organization he founded in 1975, which currently has 1,200 members who represent professional athletes and sports entities. In 1995, he received the Entrepreneur of the Year Award for his support of entrepreneurship from *Inc. Magazine*, Ernst & Young, LLP, and Merrill Lynch.

MODERATOR: John L. Ward
Clinical Professor and Co-Director
Center for Family Enterprises
Kellogg School of Management

A Family Succession Experience

PANELISTS/CAST

Charles Otes, Sr.
CEO, Chairman
Otes Construction, Inc.
(Played by Bill Mages)

Charles Otes, Jr.
Son of Charles
Vice President, Director
Otes Construction, Inc.
(Played by Chris Bell)

Maggie Kamin
Sister of Charles
Director
Otes Construction, Inc.
(Played by Fran Martone)

Kerri Kamin
Niece of Charles
Kellogg M.B.A. Student
(Played by Dani Sher)

Art Jablonski
President and COO
Otes Construction, Inc.
(Played by Brooks Darrah)

Tom Bannister
Director
Otes Construction, Inc.
(Played by Don Stroup)

Jay Smith
CPA
Reynolds & Peterson
(Played by Larry Carani)

Mary Otes
Wife of Charles
Director
Otes Construction, Inc.
(Played by Ann Clements)

Moira Otes
Daughter of Charles
Vice President, Director
Otes Construction, Inc.
(Played by Lori McClain)

The Otes Family: A Succession Experience was presented at the Conference as a demonstration case. The family and the company are not real, instead they are a composite of several families and their businesses that have faced the issue of succession with varying degrees of success. The case as presented was clearly focused to target specific succession issues and to help audience members recognize their own preconceived ideas when it comes to selecting who will run their companies in the future. Initially, audience members were not told that the panelists were actors.

A special thank you to Spark Creative, a business performance theater group.

A Family Succession Experience

Introduction to the "Otes Family"

In order to address a question vital to all family businesses, The Kellogg Center for Family Enterprises presented a "typical" business family forced to face the abrupt retirement of its long-time CEO and chairman due to unforeseen health concerns. The board of directors considered a number of qualified candidates, both within and outside of the family, as his replacement. The question facing the board was: Who should be the successor? This was the same question posed to Conference participants who were not told in advance that they were listening to a composite case. The case is compelling because it reveals how people's age, gender, experience and position—within the company and/or the family—affect judgment and the choices that they make.

THE COMPANY PROFILE

Otes Construction, Inc. is a company with $450 million in revenue and 425 employees. Headquartered in Cincinnati, the construction firm builds in the commercial, retail and industrial sectors in Ohio and northern Kentucky. The company was founded in 1940 by Jurgen Otes, a Scottish immigrant carpenter. It is now headed by his son, Charles, with two members of the third generation also in positions in the firm. The company has seen a 10 percent increase in revenue over the past two years after coming out of a three year slump.

THE PROBLEM

Charles Otes, Sr. is 65 years old and was recently diagnosed with serious health problems. His doctor advised him that for the sake of his health he must give up the stress of running his company—a company that he has led for many decades, since the death of his own father. Charles went to his board of directors and told them to begin an immediate search for his successor. Complicating matters is the fact that Otes Construction, while still a healthy company, has faced a number of years of serious business challenges due to industry wide changes in the construction of grocery store anchored malls—the Otes' niche. The company has been forced to modify its business model by adding the construction of high-end specialty shops to its grocery store staple.

Succession must be decided quickly among a number of qualified candidates. But the board must determine who among those candidates would be the best person to lead Otes into a future challenged by unstable conditions. Who would you pick?

THE CANDIDATES

Art Jablonski, 60, President and COO of Otes Construction, Inc.

Art Jablonski has spent nearly 35 years at Otes, rising from carpentry team leader to COO, a position he has held with the firm since 1994. He served in every managerial capacity, from apprentice to construction coordinator to chief estimator to his current post. He has profound knowledge of construction work and material processes.

According to Charles, Art is the family's Rock of Gibraltar, the true builder, and the source of tremendous contributions to the business. He is also known to be extremely good with people and a true friend of the Otes family.

Tom Bannister, 63, Independent Board Member of Otes Construction

Tom Bannister joined the Otes board as the first of two non-family directors in 1990. At the time, he was a partner in the Construction Industry Systems Practice of a major consulting firm. Since taking early retirement in 2000, he serves on several boards and teaches part-time at the University of Cincinnati.

Tom has been a personal friend of Charles for many years. They first got to know one another while coaching their sons in little league.

Charles Otes, Jr. (Chuck), 37, VP Estimating at Otes Construction, Inc.

Charles Otes, Jr., the oldest child of Charles, Sr., has served as vice president of estimating at Otes since 2002. He holds a degree in materials engineering from the University of Cincinnati and worked as an engineer for the regional utility company in Ohio and Pennsylvania, specializing in fatigue analysis and fracture mechanics for nuclear power plant construction. He joined Otes full time in 1999.

According to his Aunt Maggie Kamin, Chuck was initially reluctant to join the family company, perhaps hesitant to be compared to his father. He is a gifted engineer, accurate and careful. He is a good person to supervise a construction project. At present, he is in charge of estimating jobs, which is where the company can make or lose money. Art, with his great people skills, has been serving as Chuck's mentor.

Moira Otes, 35, VP Sales, Marketing, Customer Relations at Otes Construction, Inc.

Moira, middle child of Charles, Sr., started her career at Otes in 1994 after earning a B.S. in Psychology and an M.B.A. from Ohio State University, while working in marketing through a regional bank's management trainee program. At Otes, she worked in business development, marketing and customer relations and was promoted in 2000 to the vice president position she now holds.

Moira has been interested in being a part of the family business since she was small. She is the spark plug of the family and exceptionally driven. She has strong relationship skills and can sell almost anything at a profit. She is more interested in the business end of the company as opposed to the construction end. Moria is also the mother of young twins. Besides her older brother, Charles, Jr., Moira has a younger sister, Natalie, who is a teacher and not in the business.

According to her father, Moira has developed deep relationships with the high quality retailers that now make up much of Otes' client base and she is adept at keeping them satisfied during construction. His one hesitation is that as the firm searches for new projects they may be working further away from their home base and Charles is hesitant to send the mother of his young grandchildren away for long periods of time.

Grant Pendergast, 42, Son-In-Law of Owner of Otes Construction, Inc.

Grant Pendergast has worked as a consultant for a major global consulting firm for 14 years, most recently in the Construction and Real Estate Industries Practice with a focus on strategic and operational issues facing multinationals in developing economies. Prior to that, he worked with a construction products manufacturer in sales, marketing and planning functions. He has a B.A. in economics and an M.B.A., both from Wharton. He is married to Maggie Kamin's daughter Carolyn.

HISTORY

Otes Construction was started in 1940 by Jurgen Otes who gave one-third ownership to his older brother, Tony. The working relationship was soon strained, however, since Tony did not like being a junior partner to his younger brother. After just a few years the partnership dissolved and Jurgen bought out Tony causing not only a split in business, but also in the lifelong personal relationship that they had once shared.

In the following generation, Charles had a similar split with his brother, Peter. Peter, Charles and their sister, Maggie, each had one-third ownership. The two brothers, however, disagreed on the long-term vision for the company. Peter was a slow to no growth leader while Charles wanted to create a large and vibrant company. Maggie ultimately sided with Charles and in 1991 they bought Peter out. This caused trouble in the family since Peter was crushed by his sister's decision to back Charles over him. Currently, Charles' family has 58 percent ownership of Otes Construction while Maggie's family has 42 percent.

CONSIDERATIONS

Maggie, reflecting on their family's history, worries what choosing a successor will do to family relationships this time around. She is conscious that Charles and Mary's three children, Moira, Chuck and Natalie, have very different personalities. Moira wants to succeed her father; Chuck, while hesitant at first to join the firm has decided that he too wants to be considered for the leadership role; Natalie has no interest in working in the family business and is content to be a teacher. Maggie's oldest daughter, Carolyn, is a college teacher and not interested in running the business. Carolyn is married to Grant Pendergast, who Maggie would like to see enter the business some day. Maggie's youngest daughter, Kerri, is still a student working towards her M.B.A. and not yet seasoned enough to run the company. Of course, there are also qualified non-family members like Tom and Art or the company's close advisor and accountant, Jay, who could also provide able leadership, at least on an interim basis.

Complicating the successor issue is the fact that Charles, Sr. is not only CEO but also chairman of the board of Otes. How will the family chose a new chairman? Should it be the same person who is chosen CEO or should the board split apart the positions of CEO and chairman now? If so, should family continue to control the chairman position but have an outside CEO run the company or vice versa?

Audience Questions (Predetermined)

The following questions were staged for the audience in order to assure that the necessary questions would be asked for the maximum case teaching benefit.

Would you have been willing to be the CEO or to take a bigger leadership position in the company?

Maggie: I could never be qualified to make the everyday executive decisions. With Art here and with the commitment that Moira and Chuck have in the business, I could play an oversight role, if wanted.

Mary: I feel much the same as Maggie. I've learned, I think and Art agrees, that a strong family role in the company is important.

Art: To me the titles president, COO and CEO are not what's important. It's how we divide up our roles and that we are clear in our roles—that's what's very important.

Tom: Yes, as you heard implied, I was considered as a candidate and Charles persuaded me to be open-minded, if that's really what the family wanted. My wife wasn't as open-minded… at least not at first…

Jay: No. I'm in no way qualified to be the CEO. Even if I was, I would never want to risk or compromise my role as a trustee and advisor to the family.

Moira: I would have to honestly say that I feel I have the competence and confidence to lead the company. Of course, being a woman both fuels my ambition and tempers it. I am very able to be a realist.

Chuck: Well, Moira and Art have surely been in the company longer than I have—a lot longer for Art—and they have both put all their energies into it and done a great job. With their support, and as long as Maggie is comfortable, I think we could all play leadership roles in the company.

Kerri: Oh, no. I have final exams to take, and I haven't even taken Kellogg's family business course yet!

Charles, how's retirement going? Have you had second thoughts?

Charles: I haven't had time for second thoughts. Mary and I just returned from three weeks traveling all over Turkey and Greece. And this is the first spring of my life that golf can come first. I do hope you all know that I'd be delighted to take out any customers, at almost any time—so long as Mary hasn't made other plans for me. I've just gotten involved in the University of Cincinnati business school dean's council. Who knows, I might even try my hand at a little teaching someday.

Did the board consider co-CEOs?

Tom: Yes. We tried to consider every possible option. Co-CEOs interested us and also concerned us. We know family companies often go with co-CEOs for the wrong reasons.

Jay: Just to add, we tried to look at every combination of every title. We have a lot of excellent possibilities here.

Would you consider being/having co-CEOs?

Charles: I know the succession committee considered it. You know we've had problems in the past with family partnerships…

Moira: I think Chuck and I would have done whatever the committee thought was in the best interests of the company.

Chuck: Yes, I agree. I think we all want whatever is best, long-term, for the company.

Was Grant considered as a candidate?

Maggie: I'm sure the committee thought of him, and thought well of him. But I think he's kept a certain distance from all this—not wanting to crowd our family. It's complicated enough. He's obviously tremendously competent and I know Carolyn, my daughter, would like him to be around more, but we'll have the benefit of his good advice whenever we need it.

Did you do an outside search?

Tom: Yes, we decided at the beginning that it would be appropriate—and good for the candidates and for the family—to see the backgrounds of possible outsiders. We wanted the search firm to also interview the inside candidates. We also retained an industrial psychologist to help us.

Charles, would you be able/willing to stay on as chairman?

Charles: Possibly as non-executive chairman. But you all know that having the former CEO too close can be problematic.

What did the succession committee think about the chairman role?

Tom: We felt strongly that if we chose a non-family CEO, then we really wanted a family member as chair. We had a lot of spirited debate as to whether or not to split the CEO and chairman roles.

Audience Response to Otes Case Questions with Comments by John Ward

These responses were tabulated in real time at the Conference using handheld voting technology. Totals may not equal 100 due to rounding.

Considering your own role in your family's business, with whom do you most personally identify?

Percent	*Answer*
18%	Charles, as senior family CEO
9%	Mary, as senior generation spouse
33%	Chuck, as next generation successor male in the business
14%	Moira, as next generation successor female in the business
2%	Maggie, as senior family not in management
2%	Tom, as independent director
5%	Grant, as son-in-law not in business
5%	Art, as non-family executive
9%	Kerri, as next generation family not in business
4%	Jay, as non-family advisor

In making your decision on who you feel is the best candidate, what most influenced your thinking?

Percent	*Answer*
15%	Family Harmony
23%	Preservation of assets
62%	Growth of business

Do you think that son-in-law Grant should have been a candidate?

Percent	*Answer*
71%	Yes
29%	No

Does your family have an emergency succession plan?

Percent	*Answer*
32%	Yes
55%	No
13%	Don't know

What one thing do you not have that you think is most important to have?

Percent	*Answer*
10%	Buy-sell agreement
31%	Independent board
8%	Designated successor
11%	Acceptable successor candidate(s)
3%	Life insurance
24%	Shared family understanding
14%	Written crisis instructions

True or false: "It is better not to deal with succession until you need to. There are too many unknowns and uncertainties."

Percent	*Answer*
11%	True
89%	False

Who do you believe was chosen CEO?

Percent	*Answer*
40%	Art
4%	Tom
27%	Moira
3%	Chuck
6%	Moira and Chuck jointly
18%	Grant
2%	Outsider
1%	Other

Who should have been chosen CEO?

Percent	*Answer*
41%	Art
1%	Tom
35%	Moira
7%	Chuck
8%	Moira and Chuck jointly
7%	Grant
0%	Outsider
1%	Other

John Ward: Twenty-seven percent of you felt that Moira *was* chosen as the CEO, but 35 percent thought she *should have* been picked. Eighteen percent of you thought Grant, the son-in-law, was chosen, but only 7 percent thought he *should have* been picked. I look at these numbers and the one thing that stands out, in addition to the fact that Art was chosen first and Moira second, is that a large number of you thought that the family would not have chosen Moira, perhaps because she was a female and in her stead chose Grant, the son-in-law who was not working in the family company. But when you were asked what you thought was the right answer, many more of you voted for Moira and less for Grant. If we cross these results with the gender of our respondents we see that more women felt that Moira should have been chosen CEO—39 percent of the women thought Moira was the stronger candidate while 31 percent of the men preferred her.

If we look at these results as compared to age, we see something interesting and somewhat counterintuitive in that the younger generation of family members is more likely to support Art as the interim CEO over Moira or Chuck. Forty-four percent of the next generation working in business supported Art and an even larger margin, 60 percent, of the next generation not working in the business backed Art. The senior generation in business was evenly split between Art and Moira. As a matter of fact, 48 percent of the senior generation was ready to hand over the reigns to some combination of the younger generation whether Moira, Chuck or both of them.

What are your general experiences with non-family CEOs?

Percent	Answer
23%	Quite good
9%	Not so good
67%	Never had one yet

Those who have favorable experiences with outside CEOs, tend to lean more strongly towards Art.

What was your general experience with co-CEOs?

Percent	Answer
9%	Quite good
5%	Not so good
87%	Never had them

If you had successful, personal co-CEO experience, then 31 percent chose the combination of Moira and Chuck. Otherwise it was 5 percent of you who chose that combination.

WHAT THE POLLING SHOWS

Our polling has shown three things:
One, we've seen that *gender* influenced your perceptions of what should happen. Second, we saw that *age* influenced your perceptions of what should happen. Third, of course, your *past experience* significantly affected your perspective on what would be the right thing to do. We need to recognize that these are very complex subjective decision-making situations and be aware of how our own experiences and our own biases influence our perceptions as we make these decisions.

SUCCESSION

I also want to talk to you about succession. Entering into the subject of succession as a topic at a family business conference is very problematic. Everybody talks about it and nothing ever happens. Survey after survey shows that family businesses realize that succession is the number one issue facing them. If I were to poll you, I can be absolutely sure that 60–75 percent of you would say the same thing. Every survey of every family business audience, by every magazine, by every academic institution, has always shown succession to outnumber the second most important issue massively. So everybody knows it is the biggest issue and yet we also know it is a very difficult issue. The subject of succession is very problematic. In 60 percent of the cases when family businesses do not succeed it is due to succession issues, while only 10–20 percent do not succeed due to business issues.

In 60 percent of the cases when family businesses do not succeed it is due to succession issues, while only 10–20 percent do not succeed due to business issues.

Business families spend 80 hours a week worrying about industry pressures, competitive dynamics, changes in the world. Yet there is two to three times more risk associated with not addressing succession effectively over not addressing business successfully. Even so, most of us don't do it. Even in this extraordinarily sophisticated audience, a large number of you said, "We don't have a plan, but we should." It is a very difficult and emotional subject because this is very much a human process.

The principals of successful succession are:

Prepare for succession
Empower the next generation
Support the succession decision

But often what happens is:

Deny the need to plan
Control the business and family indefinitely
Ambivalence with the succession decision

At Kellogg we are embarking on a venture with colleagues from the Family Institute of Northwestern, which is one of the best, if not the best place in the country at understanding family systems as psychological systems. We are undertaking a multi-year research project that will look at the emotions involved in the succession process and see if we can better understand this emotional and very human process.

When succession is done right it is a competitive advantage.

When succession is done right it is a competitive advantage. We have shown that succession within the family, if possible, is preferred. It is the best way to capture that idiosyncratic knowledge and those soft, subtle advantages of a family business. In one sense, statistically, succession is our Achilles heel. It is by far the most dominant issue that causes us not to continue and yet on the other hand, we are getting increasingly strong evidence that properly done family business succession, from family generation to family generation, is a unique source of strength.

Following are the commandments of succession: please prepare, please empower, please support, please put an independent board in place: to help support the successor, to help facilitate the transfer, to help design the process.

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This is such a complex subject and rather than preach about the steps to succession what we really wanted to do was to try to engage you emotionally through this case study. We wanted you to, hopefully, take this very personally. We wanted you to dive inside it, identify with it, and find what pieces fit for you, what circumstances might have been relevant to your own experiences and to your own situation. We decided that the best way to give you this experience was with a case that encompassed as many of the key challenges to succession as possible, which led to the creation of the Otes Case.

While the Otes panelists are actors, the story is very real. The story is a composite of three real families' situations. We created a composite case because we wanted to capture the richness of each of the three experiences, in that way giving you a chance to find something in it that was applicable to your own personal experience. The script is absolutely real, but it is an amalgam of three families. Each of the real families on which the composite is based chose its successor differently: one chose Art, the non-family CEO; one chose Moira; and one chose Chuck and Moira. How each of these three turned out we do not yet know. Maybe it will work out, maybe it won't work out, or maybe it will work out for reasons different from what we understand. Not knowing the answer leaves it open for you to continue wondering and thinking about how to select a successor.

Appendix

Attendees broke into groups based on who on the Otes panel they identified with most either Charles Otes/CEO, or Mary/spouse, or Chuck/son, or Moira/daughter, etc. The groups engaged in deliberations that examined the complexities of the Otes case as seen from their particular perspectives.

CRITICAL ELEMENTS OF SUCCESSION PLAN

The groups identified nine critical elements of a succession plan.

1. Career path of candidates
2. Independent evaluation process
3. Effective family communications process
4. Independent board guiding process
5. Defined qualities for the CEO role
6. Annual evaluation of the company's strategy
7. An advisor/facilitator to succession
8. Annual health check-ups
9. Pre-established emergency plan or process

CHAIR: Lloyd E. Shefsky
Clinical Professor and Co-Director
Center for Family Enterprises
Kellogg School of Management

MODERATOR: Chester A. Gougis
President
Duff & Phelps, LLC

PANELISTS: David C. Blowers
President
Personal Financial Services Illinois
Northern Trust

Brenda C. Barnes
President and COO
Sara Lee Corporation

Steven S. Rogers
Gordon and Llura Gund Family
Distinguished Professor of Entrepreneurship
Kellogg School of Management

Perspective: Outside Directors And Advisors

Panelists with extensive and varied experiences as directors and advisors offer their insights into the differences and similarities between family and non-family businesses.

LLOYD SHEFSKY:

Comparing Family and Non-Family Businesses

Here at the Center for Family Enterprises we study family business. We primarily study what it is, but to gain a complete picture, we also study what it isn't. One way we can do that effectively is through comparison. We compare family businesses to more traditional companies, although I tend to think family businesses are traditional. We will be hearing from people who sit on the boards of and consult with family businesses as well as non-family businesses.

In a way, the people who sit on the boards as outside directors may be the only people on the board of a family business who are not self-conflicted.

In a way, the people who sit on the boards as outside directors may be the only people on the board of a family business who are not self-conflicted. Their insights into the workings of family owned businesses are valuable because they are not as closely tied to the company in the same way as family members or close family friends.

Our moderator is Chet Gougis, president of Duff and Phelps, a financial advisory services and investment banking firm specializing in counseling both family and non-family businesses. Our panelists are David Blowers, of Northern Trust, president Personal Financial Services Illinois, which offers full financial services to both family and non-family businesses; Steve Rogers, distinguished professor at Kellogg, director of S.C. Johnson, W. S. Darley, and several non-family companies; and Brenda Barnes director of The New York Times, Avon, PepsiAmericas, Sears, Staples, LucasFilm, and recently appointed president and chief operating officer of Sara Lee.

CHESTER GOUGIS:

Family Businesses Take The Long View

In preparing for this panel, I began to think about how family businesses are different from more traditional businesses. At the same time I recognized that there are a lot of similarities as well because family businesses, at the end of the day, are businesses. My focus is as an advisor to the boards of family business companies. One theme that kept coming back to me is the difference in the time horizon or perspective that the owners, and to some extent the managers, of a family business have about their business. Much has been written lately about public companies and the fact that there is too much emphasis on quarter-to-quarter performance or one year results versus looking at the longer term. In response to that criticism there have been some reforms that seek to extend that time horizon to a few years, and that is certainly an improvement. At the other end of the spectrum, we see family owned companies that think about the business in generational terms.

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Family businesses are nothing if not practical, so they are certainly keeping an eye out for what is going to happen tomorrow, but they also take a longer view considering how a decision is going to affect business 10 years from now when the CEO may be turning over the company to the next generation. From an advisor's standpoint, this perspective affects the advice, the nature of the advice, and the nature of the investigation that you do for a family business. If the question being posed to you as advisor is how is a decision going to impact my business next year, then that is the question you are going to answer. If the question posed is how is it going to affect my business next year, but also how is it going to affect it five or 10 years from now, then the work and the assistance that you give to the company is going to be based on those considerations. Certainly all great companies, whether they are family businesses or public companies, have to think about the future beyond the next couple of years and the great companies out there do, but one of the advantages that we see in well-run family companies is that they have the luxury to think about things from a more long-term perspective.

Family Values

Another way family businesses differ from other businesses is that in family firms the values of the individuals that make up the family are an integral part of the way the company is operated.

Another way family businesses differ from other businesses is that in family firms the values of the individuals that make up the family are an integral part of the way the company is operated.

An advisor or an outside board member needs to take that into account. As a board member of a public company, you have to take into account the company's values and the interests of other stakeholders but, clearly, your principle mission is to maximize the value of the company on an economic basis for the shareholders of that company. That is your main charge and if that dictates moving a plant off shore or if it dictates making decisions that might be considered good decisions purely from an economic standpoint, I think that becomes much more paramount. In family companies it is pretty clear that there are other values that may have more importance and it is acceptable to take those into account.

There is nothing that says that the objective of a family company has to be maximizing the value to shareholders to the same extent that directors of a publicly owned company have that responsibility.

There is nothing that says that the objective of a family company has to be maximizing the value to shareholders to the same extent that directors of a publicly owned company have that responsibility. While there are many considerations that make family companies very different from other companies, there are also lots of similarities and none of these issues are black and white. Clearly, even public companies have to address other societal values, like recognizing their overemphasis on the short term over the longer term perspective.

DAVID BLOWERS:

Background

My perspective comes from over 21 years of business experience. The first 19 years of my career I focused more on public companies and the institutional side of our business at Northern Trust, while the last two years I've been involved in our personal business side. In addition, I was an unofficial advisor to my wife's third generation family business that was sold to Brunswick in 1997. My comments will be anecdotal rather than scientific or academic.

I will compare and contrast some of the differences between family owned companies and publicly owned companies that I have seen in my experiences at the bank.

Quality of Advisors

Let me start with a few general observations that are directed at family businesses. First, it is imperative to surround yourself with the best possible advisors. Do not be afraid to spend money on specialists as the situation warrants. We often hear the story of somebody who is going to sell their business or who is involved in working on a complicated succession plan or estate plan and we ask, "Who's your lawyer?" Often we hear that he is a family buddy or someone the owner has known since kindergarten. Wrong. That is not the person you should be working with at this most critical decision-making juncture in your family business. Second, as a CEO and leader of a family business, you must be sure to surround yourself with people, both staff and outside directors, who aren't afraid to tell you they disagree with you. Third and most importantly, you really must develop a course of action around succession planning and give potential leaders the proper exposure and experience to be able to take your family business either into the next generation or into the next important phase of its history. I think we are all familiar with the classic entrepreneur who thinks in terms of *if I die*, rather than *when I die*. You have to plan for the future. Everybody knows that. It just doesn't always get done.

I think we are all familiar with the classic entrepreneur who thinks in terms of *if I die*, rather than *when I die*. You have to plan for the future. Everybody knows that. It just doesn't always get done.

While I have suggested that these comments are meant for family businesses, these are really best practices in general and they apply to all businesses. I submit to you that there really is not much difference between the way a privately held enterprise and a publicly held business ought to be run.

Next, I will touch on four broad categories: leadership, strategic decision-making, regulatory compliance and capital raising.

Leadership

Let's take a look at some of the different influences and factors facing family businesses relative to their public counterparts as seen through the lens of my own experiences. I'd like to start with the general topic of leadership. While luck and good timing often come into play when public companies go out to get a new CEO or a new COO, public companies are really meritocracies. When Sara Lee went out to find a new president and chief operating officer recently and selected Brenda Barnes, they did so because she was the best available person in the marketplace. Leadership at family enterprises, on the other hand, is significantly more complex. Our family business clients often find it difficult to get the right people into the right places at the right time, and obviously that is especially the case when it involves family members.

Family businesses must balance different constituencies such as family members who work for the business, family members who don't work for the business, and professional managers who may be interested in playing a part in the success of the business by having either a direct or indirect ownership stake.

Family businesses must balance different constituencies such as family members who work for the business, family members who don't work for the business, and professional managers who may be interested in playing a part in the success of the business by having either a direct or indirect ownership stake. Balancing these constituencies affects everything from a business's ability to attract and retain top talent, to its ability to set the appropriate dividend policy as determined by their board of directors. Successful public companies tend to engage their shareholder bases through the investor relations function. However, increasingly, many of our successful family business clients communicate, and in some cases, educate their shareholders through formal family governance functions, as we saw demonstrated at our Conference last year by the Pella Corporation and the Follett Corporation.

A final point on leadership is that while public companies obviously enjoy a public market for their shares, this is a much more sensitive and complex issue for family businesses.

Strategic Decision-Making

Next, I want to look at strategic decision-making. As Chet said earlier, public companies live under the constant shadow of the quarterly earnings report. This pressure may cause public companies to under invest, which could have a negative impact on growth opportunities. Conversely, family owned businesses do not have the same quarterly pressure and, in my judgment, this is their greatest advantage.

Family owned businesses are able to focus on doing the right thing in the long term; as a result, we have seen in this recent difficult economy that many of our closely held businesses have not had to be as aggressive, in terms of their expense control initiatives, as many public companies have had to be.

Family owned businesses are able to focus on doing the right thing in the long term; as a result, we have seen in this recent difficult economy that many of our closely held businesses have not had to be as aggressive, in terms of their expense control initiatives, as many public companies have had to be. At the same time, strategic decisions at family businesses are often made in the context of the family shareholder base and this can lead to limitations of its own. Family businesses with large dividend dependent shareholders may be either unwilling or incapable of taking on additional business risks such as a leveraged acquisition or a significant capital expansion. In addition, family businesses may have to complete a partial buyout of certain shareholders before pursuing strategic imperatives.

Regulatory Compliance

I may have spoken a bit too soon when I suggested that the private company's greatest advantage was not being beholden to the Wall Street analyst. Indeed, there is a new regime in corporate America and it is called the Sarbanes-Oxley Act. As we all know, the Act establishes new standards for corporate accountability by requiring companies to report on the effectiveness of internal controls and procedures for financial reporting, while auditors are required to verify the findings. Public companies, especially small cap listed companies, spend an inordinate amount of their human and financial resources meeting the complex reporting and compliance requirements now imposed by the Sarbanes-Oxley Act. Of course, we all recognize that the new regime of disclosure has been brought upon us for very good reasons.

One of our small cap clients, a $175 million sales size company in a low risk business, spent a half million dollars in 2003 to comply with Sarbanes-Oxley.

One of our small cap clients, a $175 million sales size company in a low risk business, spent a half million dollars in 2003 to comply with Sarbanes-Oxley. They have recently made a new acquisition and their auditors are suggesting that it is a new business line for them. Therefore, they should expect that their 2004 fees will go from $500,000 to upwards of $750,000. This is an extraordinary outlay that does not necessarily lead to productive output. Similarly, in a public company context, the board book that went out in February to the members of the Northern Trust's own audit committee was 350 pages long. Needless to say, the ability to opt out of burdensome compliance and disclosure requirements is a significant, competitive advantage for privately held businesses. I should point out, however, that many of our family business clients have been actively implementing Sarbanes-Oxley Act provisions that are viewed as truly strengthening their company's corporate governance function. However, most have viewed total compliance to be cost prohibitive and unnecessary.

Raising Capital

Let me conclude by making a couple of remarks about the financial dynamics of public versus private companies. Overwhelmingly, our family businesses tend to finance their operations and growth opportunities through either internally generated cash flow or through debt capital. For obvious reasons, family businesses in general are reluctant to access the equity capital markets and thereby introduce another shareholder constituency. Yet the unwillingness to raise equity for growth may impede a family business's ability to compete against publicly owned counterparts or private equity sponsors, particularly in consolidating industries. Willingness to access capital markets can be a competitive advantage for large and mid cap public companies, however, the rising compliance costs associated with Sarbanes-Oxley and the valuation discount often attributed to small cap/low float stocks has actually encouraged some companies to think about going private again.

Governance costs will lead 20 percent of public companies to consider going private.

In fact, today's *Financial Times* suggests that governance costs will lead 20 percent of public companies to consider going private and in a recent *Business Week* the lead story was that in 2003, 86 companies became private again after previously being public companies. That said, we are seeing several family owned businesses that have been willing to raise alternative forms of capital in order to help them finance major acquisitions. This is an absolutely fascinating topic about which we've barely scratched the surface.

BRENDA BARNES:

CEO Key to Differences

I have served on a number non-family and family boards for the past several years and I'd like to focus my comments on the boards and how they are structured and what is different about them, not different from the standpoint of whether it is family owned or publicly owned, but how they operate differently and what is causing that difference. My observation is that it is more likely the role of the CEO than it is the ownership of the company that directs many of these differences. While Sarbanes-Oxley has put on numerous kinds of restrictions, even living within these restrictions there is a huge difference among boards.

It is more likely the role of the CEO than it is the ownership of the company that directs many of these differences.

On one end there are the CEOs who view their board as a necessary evil; all these CEOs want to do is get through the meeting. On the other end of the spectrum are the CEOs who view the board as an asset, and who see that the people sitting around their table can provide not only the necessary oversight, but they can also add value to the company. These are the two extremes.

Board Makeup

We may get an even clearer understanding if we look at who is on the board. If you have Company A where the board is considered a pain, you can look down the list of board members and you will likely see friends of the CEO, people the CEO went to school with, people who are somehow related to the CEO. While all these may fit the role of independence as defined by the Sarbanes-Oxley Act, there is a real tight connection with the CEO. It is obvious that the reason that this kind of board was picked was to act as a rubber stamp. I have experienced this, not currently, but when I was on a 100 percent publicly owned company. At this company there were issues of high management turnover, terrible morale in the company, plus other problems that I actually brought up to the board, but nobody wanted to listen because it was threatening the CEO. The friends of the CEO shut discussion down and we never got to that subject. So it is clear that who is picked for the board matters when it comes to what you talk about at the board level.

On the other end is the board that the CEO views as an asset. That CEO is typically looking for diversity, not of race and gender, but diversity of experience. The CEO will take a look at the board and say, "Let me look at the future and see what challenges I am going to have and how I can match up the skills of every person on the board to what my challenges are going to be." These leaders are trying to put a composite of people together that in total can give the best advice and direction for the company, whether in IT, or international sales, or another area.

Meeting Content

The next important consideration is meeting content. The CEO sets the agenda for the meeting. What does it look like? On the board where you just want to get through the meeting, every minute is filled with presentations. There is no time for discussion. You're looking at your watch wondering when you can go home. Why is that? It's because the leadership doesn't really want your point of view. They just want you to do what you have to do and get out of there and not cause any trouble.

Efficient Boards

The most efficient boards are the ones that get you the materials ahead of time. Directors get to read everything that is going to be presented and the meeting is geared around discussion issues. That is where the company gets the full value of the people around the table. If you want that value then you provide the information ahead of schedule and allow for the time to discuss it. I think Avon has a fabulous board. Every board meeting's agenda is designed that way, plus there is a two and a half day off-site retreat every year to discuss the strategic direction of the company. These meetings examine the company's past performance, look at the competition, and much more. The participants have a very healthy, vivid dialogue about what's going on in the external world and what it means for Avon's future. The directors participate fully. We roll up our sleeves and as a result of that we feel that we own the strategic plan and we then can support the decisions that are going to come over the next one to five years.

Exposure to Management

Another item that influences a board is its exposure to management. Again, if you are on the board where you just want to get through the meeting, nobody from management comes to the board meetings or makes presentations. The efficient board uses the meeting to showcase their key employees and have them present their business because they are closest to it. The board gets a chance to look at these key people. When the decisions come for succession planning directors know who may be in line for a leadership role.

Information

Depth of information is another key indicator of a successful board. Some businesses subscribe to the mushroom theory—put the directors under a dark tree and feed them a little fertilizer to keep them happy. On that kind of a board you don't get a lot of information to deal with because company leadership doesn't want you to know too much. That's just not good for a board. As a director, if your company is a retail company you better be out in the stores. You better be reading the analysts' reports. You better be reading those 300 page books that get sent to you, and you better come in and be prepared to get the bad news as well as the good news.

A company that values board input will not just spoon feed directors about how wonderful everything is; they will share what is really going on so directors know what the issues are and can make informed decisions.

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Board Input

This brings us to board input. A lot of times a company will bring you final plans and just say, "This is it. We've spent the last six months looking at this and we want your approval and, by the way, we have two minutes to do it." The company that values its board will plant the idea, work it a couple of times in the meetings, show them the work in progress, and not be fearful that they are presenting the board a case which has yet to be fully developed. The company is willing to show some vulnerability and take input from this diverse group that hopefully has something to add. They gear the board meetings around these big strategic issues and questions and work with the board to gather their input.

All companies choose how they want to use their boards. Companies that are looking for qualified people to join their boards, especially in this day and age, need to consider these issues. I don't know anybody who would want to join a board where they just sit there and listen and walk out of the meeting two and a half hours later. Life is too short and there are too many other things to do. If you want people worth anything they are going to be busy in other jobs or doing a lot of other work, so you have to offer them the opportunity to influence the company that they are participating in as board members.

Ethics

Most importantly, I think the whole question of ethics and values is absolutely paramount in business. I am not only referring to the ethics of the CEO, which I think is probably the most important criteria, but also the people who have joined the board.

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STEVE ROGERS:

Background

Like Brenda, I speak from the perspective of a board member. I have been privileged to have the opportunity to be a member of a couple of publicly owned companies. They are SUPERVALU, Inc., which is a grocery wholesaler and retailer. They do about $20 billion annual revenue and are traded on the New York Stock Exchange. The second is Duquesne Light, an electric utility in Pittsburgh, which has almost a $1 billion a year revenue. I also serve on the boards of two family owned businesses. They vary in size and product line as well. The first is S.C. Johnson & Son, Inc., a family owned company in its fifth generation. Johnson has about $8 billion a year in revenue from products that include Raid, Glade and Windex. I'm also on the board of another family, multigenerational business called W.S. Darley & Company. At W.S. Darley we do about $50 million a year in revenue. We make fire equipment, and fire trucks and we sell overseas. As a result of that sort of varied experience I feel pretty confident talking about what I believe are some of the differences between serving on a publicly owned company and a private family owned business.

I have observed, quite frankly, that on family owned business boards I am more reserved with my comments and my opinions and my insights. Why? Because I think it is important to be more respectful of the leadership of that company since there are typically some family dynamics going on behind the scenes that could come back in ways that may upset the family chemistry and the family relationships. I'll hold comments back for private sessions.

I believe with a family owned business there are more behind the scenes discussions going on than with publicly owned companies, this occurs because of a desire on the part of board members to show respect to the family member in the leadership position.

I believe with a family owned business there are more behind the scenes discussions going on than with publicly owned companies, this occurs because of a desire on the part of board members to show respect to the family member in the leadership position. Whether right or wrong, I believe that is an absolute fact. While I believe that as a board member I am responsible for helping to increase shareholder value for a family owned business, I must remember that the shareholders are primarily family members, and I am also responsible for fitting in and helping in a constructive way.

I find that with a family business my behind the scenes comments tend to be more in the nature of teaching and educating. I may pull the CEO aside or talk to him on the phone to give him my opinions rather than at the board meeting. In the publicly owned companies the CEO is nice and tough so we are tough on the CEO in those board meetings and the comments would probably be a little more frank, a little more caustic, a little less reserved and a little more critical. The thinking on these boards is that the CEO runs this company at our direction and there are no family considerations that we need to be concerned about. We will be respectful of the CEO and make sure that we don't disrespect her and admonish her in front of her subordinates since that is humiliating, but we would probably be a lot tougher on someone like Brenda in a board meeting than we would a family CEO.

I have also noticed that family owned businesses tend to have at the most one agitator on the board. I don't think they can afford to have more than one. Every company should have an agitator. Publicly owned boards can afford to have a couple of them. I've been given that title a couple of times, primarily with my publicly owned companies, and I take pride in it. But on the privately owned companies I have joined there was already an agitator in standing, so when I got on the board I just figured I would let him act the part and I would just sit back and be amused by the things that he said.

Another observation is that with a publicly owned company, as you well know, the board of directors basically is the boss. The directors are the ones who hire and fire the CEO. That is their primary responsibility. That is not the case with a family owned business. The board is really not the boss.

The reality is that the family member who is in the leadership of that company makes the ultimate decisions.

The reality is that the family member who is in the leadership of that company makes the ultimate decisions. That has been my experience and I am comfortable with that. I remember being in a board meeting for one of my family businesses. When a topic not on the agenda came up I asked, "Where did this come from? What was the catalyst for this change in the dividend policy all of a sudden?" Another board member informed me that it was the family patriarch who wanted it on the agenda so I said OK, and that was the end of the discussion. Am I guilty of not fulfilling my fiduciary responsibility? I don't believe so. I believe I am a practitioner of the realities of family owned businesses, and one of those realities is that the family decides certain things.

Here's another example. I remember we lost one of our board members from one of the family businesses I was on and it was time to replace him and we were asked to give some recommendations for some new candidates. This seemed a little different from the way the publicly owned boards that I serve on do business. On those we have a committee that nominates people and then we interview them and so forth. So I asked in the meeting, "Should we have more discussion about this new candidate?" No one said anything and it got kind of quiet in the room. I took the hint and just let it go. After the meeting I approached the CEO and asked why there was silence when I brought that point up. Remember that I was the junior person on the board and this was the first time I had ever been on a family board when a new member was being considered. He said, "Steve, I would like that decision to be mine solely. Historically that is how we have worked on this board with the CEO making the decision about the new board member." This is another case of the family basically making the decision and that's fine. In family businesses, for the most part, the family gets to make the decisions and the board members have to be comfortable with that.

Finally, I will never forget being at a board meeting for a family business and we were talking about our accounting firm and one of the family members talked about the accounting firm not doing a good job. He had some concerns about the accounting firm and the CFO disagreed with that family member. He disagreed with him once, he disagreed with him twice, disagreed with him three times and it became apparent that the CFO was supporting the accounting firm over the family member. For the most part, if you are supporting an investment banking or consulting or accounting firm, I'm probably not on your side. In my best Godfather voice I said to him, " Don't talk against the family." He got quiet and afterwards he thanked me for stopping him. As advisors and directors we need to be conscious about not talking against the family in that kind of public setting because it can be embarrassing and humiliating to the family member who is running the company if other family members are there observing it all.

The reality is that there are some major differences between being on the board of a family owned business and a publicly owned company.

The reality is that there are some major differences between being on the board of a family owned business and a publicly owned company. I believe you still can accomplish the stated objective of increasing shareholder value while being respectful and being knowledgeable and aware of those differences.

Audience Questions

As a director, what are your expectations for compensation when serving on a fully functional board in a private business?

Steve: I think it depends on the size of the company. S.C. Johnson is a Fortune 500 company and my expectation was that the compensation would be in line with other companies that size. W. S. Darley is a $50 million company. When they approached me to be on the board they had a certain number in mind that was lower than what I had in mind, although what I had in mind was significantly lower than my normal rate for leading workshops and so forth. We compromised because I recognized the size of the company and I had an interest in serving on this board because it would bring me closer to my entrepreneurial roots and I wanted to be a part of helping a small company grow exponentially if that was their objective. We settled on a fee for my first year on the board with the condition that if they were pleased with my performance and my contribution then the compensation could stay constant for a time. However, I wanted to participate in the value creation of the company. I understand it is a family company and they do not necessarily want to give stock to outsiders and that's fine. I told them we could work that out by giving me phantom stock. I was very explicit. I do not just want to work for a salary or a certain amount of dollars. I want to have something at risk just like the family members. I want to run my personal life in a way that says I have a vested interest in this company the same as they do. We have agreed to a phantom stock relationship where I get to participate in the equity appreciation in that fashion without them therefore having to give me ownership in the company. This agreement goes into effect during my second year with the company and is in addition to the fee that I receive.

Should a company negotiate a separate director's fee arrangement with each outside director?

Steve: In a privately owned company I think individual agreements are fine.

Just how important is the fee to a potential director?

Brenda: I think you have to have a motive other than money to want to serve on a board.

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I really do, maybe the reason is it is an opportunity to help out an entrepreneurial business. For example, the Lucasfilm board that I'm on pays a fraction of what public companies do, but what the company is doing in technology is exciting and I view it as a learning experience. Whatever your reason may happen to be, I think you have to have a different motive than money.

Chet: I think nowadays when people consider being on boards, especially private company boards, there is less assuming and more questioning. I think one of the big questions is: *What is my risk going to be being on the board?* Oftentimes it is less about the dollar compensation and more about insurance and best practices. We find more often now that prospective board members are interviewing the companies to make sure that they are a good fit.

What are your thoughts about a company having an advisory board instead of a board of directors?

Steve: There is a distinct difference between an advisory board and a board of directors. A board of directors is more formal and it has more legal liabilities associated with it. An advisory board is just that, they are advising and they don't have the same liability as the board of directors.

In the absence of a formal board, I would strongly recommend, at the least, creating an advisory board.

In the absence of a formal board, I would strongly recommend, at the least, creating an advisory board. You need someone to help you, someone to be on your team. You should not be doing this out there on your own. There are some other smart folks out there who would gladly participate and serve on your advisory board without worrying about the compensation. I serve on the advisory boards of a couple of very small entrepreneurial firms, and I do that for no compensation primarily because when I owned my company I had an advisory board and people did that for me. I believe all entrepreneurs should give back to the community of entrepreneurship and this is a good way to do that. If you have a formal advisory board be respectful of those folks' time by making sure that prior to the meeting there is an agenda that is sent out at least a week or two in advance. Make sure that parking is available for the people when they come to your site and that the meeting lasts no longer than two and a half hours. There is no reason to have anything longer than that unless it is a special one-time only meeting.

Steve, as a company owner yourself, did you have an advisory board, and if so, how did you choose the advisors?

Steve: I owned three companies and I did have an advisory board. Now, mine came in a reactionary fashion. When I got my financing from South Shore Bank they had suggested that I have an advisory board. I ignored that advice until I got in trouble. When the last Mideast war occurred, nobody was buying any products from the department stores that were my customers. We were in a recession at that time so I called my bankers and said, "Listen, I need some help, what should I do?" They reminded me that they had suggested that I create an advisory board two years earlier.

Entrepreneurs are typically Type A people who believe that they can go it alone.

Entrepreneurs are typically Type A people who believe that they can go it alone. But by this time I knew I needed help, so I asked my bank to recommend some candidates to be on my advisory board. My bank suggested that I ask my largest customer, Marshall Field's, and that is how I got an executive vice president from Marshall Field's to be on my advisory board. The bank also suggested another entrepreneur who was in my industry and then another entrepreneur who was a customer of South Shore Bank who had grown his company exponentially. The bank thought this man could serve as a role model for me. He joined my board and is now a good friend.

As advisors and directors to family companies, what is it you need to know about the family?

Chet: I think that it is important to know at the very beginning who the decision-maker is and on what basis decisions are made. On the surface you may have a board that looks like it operates like a traditional company, but then, as an advisor, you realize that very often it is still one person who is making the decisions and that person may be the patriarch of the family who is no longer even the CEO. That may be the accepted way that company operates and you need to know that as an advisor. In addition, there may be other values and other considerations that are very important to the family in running that business, and they may not necessarily have to do with economic considerations. If you are the one running the company, it is important that you communicate these issues to your advisors and board members. You really have to spend time with those board members or advisors when you begin that relationship to bring them up to speed on those kinds of things. It may mean that you as owner need to do a little bit more behind the scenes informal conversations and meetings with those people.

Dave: Let me add just a slightly different perspective. As bankers we are advisors, but we are also creditors. We have to understand the social and the family issues, but we also have to understand the financial issues very clearly, especially if the company gets into a difficult situation. We may not be able to be as respectful as Steve suggests that he tries to be, but part of that is because of our fiduciary responsibility. Bankers may come into conflict if decisions are being made that do not make financial sense for the company and wind up putting our capital at risk.

Steve: I always want to find out the family members' philosophy on growth. Are they interested in moderate growth? Exponential growth? What is their philosophy on profitability? Maximize profit at all costs? Are they great risk takers or risk adverse? I like to get a sense of the leader's intellectual capacity. I like to work with smart people and that means a combination of street smarts as well as book smarts. Finally, what is their overall vision for this business going forward the next five years to 10 years?

I always want to find out the family members' philosophy on growth. Are they interested in moderate growth? Exponential growth? What is their philosophy on profitability? Maximize profit at all costs? Are they great risk takers or risk adverse?

What advice do you have for companies that are just getting started on the process of establishing a formal board?

Steve: I would say first of all, you could contact Professors John Ward or Lloyd Shefsky; we have a paper that has been written here at Kellogg about board creation, advisory board creation and so forth and we can make that available to you. Secondly, I think you need to look at your company and try to identify what skills would be ideal to have on that advisory board. You should think about some skills that you don't presently have, for example, maybe someone with a financial background, or if your company is growing, then a person with a background in raising capital because you are going to need outside capital. Think about composing a board of people with complementary skills.

At our board meetings we really want to get input from our board, but all of us in my family like to talk and we have a lot of people in our family so it seems like we spend a great deal of time with presentations. How do you suggest we structure our meetings?

Brenda: A very simple starting point would be to send the presentation out ahead of time and end it with a list of discussion items. When you get to the board meeting you do not go through the presentation again. You have to rely on everybody in the room reading it beforehand because that is part of the duty of being on a board. Go to the last page and say, "Here are our discussion items." Then the CEO or the chairman has to facilitate that discussion and if people get off track they've got to bring them back to task and make sure that everyone has the opportunity to have a say. It is a very hard thing to do because people work really hard on presentations and they want to stand up and go over every page while you are sitting there saying, "I've already read every page."

Steve: If I could add something. I really believe there is tremendous value in family owned businesses having someone on their boards who has served on a publicly owned board and a public for profit company board. As a result of being on a publicly owned company board, I'm able to bring best demonstrated practices to this private board or family board in terms of processes, in terms of how the meeting runs, in terms of gaining consent and so forth.

As an independent board member, how much time do you really spend on that company's business?

Brenda: Some of my boards meet as many as eight or nine times a year, so you have the meeting itself, you have the preparation beforehand, you have reports, in addition to visiting or experiencing the product or service. I am a firm believer that if you are on a board you should get to know the company somehow as a consumer of the product or services. In taking my new job with Sara Lee I have already dropped three boards and probably will drop another because there is just not enough time.

Steve: I would say that the time that one spends working outside of the board meetings is at least three times greater than the board meetings in terms of reading all the material in addition to being available to the CEO and other members of the board at any time.

I think the good board members are those who make themselves available and make it very clear that they are available.

I think the good board members are those who make themselves available and make it very clear that they are available. Good companies are those that won't abuse that because they recognize that someone like Brenda also has other things going on in her life so they will use her time respectfully.

Please talk about the roles of board committees, especially as they pertain to the evaluation of the CEO and of other family members, and also about the idea of having executive sessions for the outside board without the family/CEO being involved.

Brenda: I'll answer that from a public company's perspective first. Meeting without the CEO present is now taking place in every public board there is. A few of the boards I was on before already had this practice in place for some time and I always found it a very constructive, helpful forum to talk because you didn't embarrass the CEO in front of subordinates. In terms of committees, I think you have to rely on them to do the key work of the board. There is more time and more focus at the committee level. Hopefully, you get the experts that are most in tune to that particular subject to serve on the appropriate committees.

Steve: The way the public companies that I serve on operate is to have the executive session without the CEO in attendance. With the family businesses, we have never had a meeting without the CEO or the family member present. At S.C. Johnson, the CEO is not a family member but the president is a family member. We have never had a formal executive meeting without the family member. How do I feel about that? I don't think it has hurt our ability to talk frankly with each other. I find that at those meetings where we have an executive session with the family member, we get inside information about what is going on with the family in addition to what is going on with the business. Those sessions provide us with insight on personal aspects of family issues that may be affecting the business in some way. I am content with the present setup.

Have you had experience on any boards where board members evaluated the other board members?

Brenda: That type of evaluation is moving very slowly. There is no in-depth evaluation that I've experienced on individual directors. Most evaluations I have seen simply ask if someone is doing a good job or not doing a good job, almost as simple as that. I think it is going to happen but the comfort level with an in-depth assessment has to increase somewhat first.

Steve: Brenda is correct, it is moving slowly because there are some board members who sit in a room and will say very little, but they make their greatest contributions behind the scenes. So when you talk about evaluating people, it becomes difficult to evaluate all of your peers because you don't know what is going on in private.

There are some board members who sit in a room and will say very little, but they make their greatest contributions behind the scenes.

What is your experience with separating the CEO position from the chairman of the board position?

Brenda: On the public boards that I serve on I've seen the separation in two situations: one, when the CEO was coming in as a new person and the board felt that it would be helpful to have a chairman in place to help ease in the person who was becoming the CEO. It was for a very limited duration. In *The New York Times*, which is a family business, there is a separation because there is a non-family member who acts as CEO and then a family member is the chairman and publisher. I personally don't have a strong point of view on which is right or wrong. I think that each circumstance is individually driven and there are times when it does make sense and times when there is no need for it.

Steve: I have a strong opinion. I prefer to have that separation. I believe it is the best way to run a company.

The CEO should not be the chairman of the board because I think in that instance too much power is centered in that one position.

The CEO should not be the chairman of the board because I think in that instance too much power is centered in that one position. Three out of the four companies that I am associated with have separated out the roles of CEO and chairman, and we are presently having this discussion with the other company, which is a public company.

Have you dealt with succession planning for a family business?
Steve: S.C. Johnson transferred the leadership of the company from Sam Johnson, who was a fifth generation leader of the company, to Fisk Johnson, a sixth generation family member, about 18 months ago. There was a lot of discussion prior to the transfer, primarily led by Sam Johnson, though it was pretty unanimous when it came out that Fisk was the best person to lead the company particularly since it was a given that a Johnson family member would be in the leadership position of the company. Fisk turned out to be well trained by Bill Perez, the CEO of the company, who for five or six years trained Fisk to become his boss.

Brenda: My comments are on succession both in the family and in the corporate world. Businesses have got to be thinking about succession five to 10 years before they actually need it to happen. *The New York Times* is a good example. The chairman of that company and publisher will always be a Sulzberger. They have the controlling stock. They are constantly meeting as a family, as well as meeting with us as a board to plan experiences that the family members need over the course of their entire careers to get them as prepared as possible to take leadership positions. If you wait until two years out then you will never have a candidate in place in a public or family owned business.

Chester A. Gougis

Chester A. Gougis, president of Duff & Phelps, LLC, joined the firm in 1979 from the corporate finance group of Harris Trust and Savings Bank. He graduated magna cum laude from Harvard University in 1974 with a B.A. in economics. He received his M.B.A. in finance and accounting, with honors, in 1976 from the University of Chicago. He is a member of the Economics Club of Chicago, The ESOP Association, National Center for Employee Ownership, Valuation Study Group, Executive Club of Chicago, and the Business Valuation Association. He sits on the board of trustees of the Chicago Symphony, Network Chicago, Ravinia, and the Greater Chicago Chapter of the National Multiple Sclerosis Society. He also sits on the board of directors of The Night Ministry and is affiliated with the Chicago Urban League.

David C. Blowers

David C. Blowers, president of Northern Trust's Personal Financial Services Illinois, is responsible for all personal and private banking, trust/fiduciary and commercial banking services provided through the main Chicago complex and 19 financial centers in the metropolitan area. He received an M.B.A. degree in finance from Kellogg School of Management, Northwestern University, and a B.A. degree in government from Lawrence University. He is a member of the board of managers of the YMCA of Metropolitan Chicago, a vice chairman of the Chicagoland Chamber of Commerce, a trustee of Network Chicago and Music and Dance Theater Chicago, and director of the Friends of Prentice and the Heartland Literary Society. He is also a member of the Kellogg Alumni Advisory Board, the Fellows Association of Leadership Greater Chicago, The Economic Club of Chicago, Chicago Commonwealth Club, and the Exmoor Country Club.

Brenda C. Barnes

Since 1998, Brenda C. Barnes has served on the board of directors of *The New York Times*, a family enterprise. She also serves on the boards of Avon Products, Inc., PepsiAmericas Inc., Sears, Roebuck and Co., Staples, Inc. and Lucasfilm, Ltd., and as chairman of the board of trustees of Augustana College. She completed a 22 year career at PepsiCo, during which she held a broad range of senior executive positions retiring in 1997 as president and chief executive officer of Pepsi-Cola North America. In July 2004, she became president and chief operating officer of Sara Lee Corporation. Brenda received her B.A. in economics from Augustana College, her M.B.A. from Loyola University and her doctorate from Augustana College. She is a former adjunct professor of management and strategy at Kellogg School of Management.

Steven S. Rogers

Steven Rogers is the Gordon and Llura Gund Family Distinguished Professor of Entrepreneurship at Kellogg School of Management. He teaches entrepreneurial finance, is the director of the Levy Entrepreneur Institute and is a frequent lecturer in Kellogg Executive Programs in the U.S., Toronto and Hong Kong. He currently serves on the boards of several businesses including two family businesses that are three or more generations old: S.C. Johnson & Son, Inc. and W.S. Darley & Company. Before joining the Kellogg faculty, he owned and operated two manufacturing firms and one retail operation. Prior to that, Steve worked at Bain and Company, Cummins Engine Company and UNC Ventures, a venture capital firm. He received an M.B.A. from Harvard Business School and a B.A. degree from Williams College.

CHAIRPERSON: Carrie Meek '04
Meek's Lumber, Sacramento, CA and Springfield, MO

MODERATOR: Barry Merkin
Clinical Professor
Management and Strategy
Kellogg School of Management

PANELISTS: Avi Steinlauf '98
Edmunds.com, Inc., Santa Monica, CA

Zachary Gund '00
Coppermine Capital, Boston, MA

Henry Borger, Jr. '02
Ladco Company Ltd., Winnipeg, Canada

Perspective: The Next Generation

Panelists talk about the challenges they have faced and the choices they have made since returning to their family's business after graduating from Kellogg.

CARRIE MEEK:

Update

I was a participant on the Next Generation Panel at last year's Family Business Conference and it is my honor to be chair of the panel this year. I am a second year student at Kellogg and I graduate June 2004. I am also the co-chair of the Family Enterprise Club along with Jorge Herrera and Doug Osrow.

I come from a family business, Meek's Lumber, which was started in southwest Missouri in 1919 by my great-grandfather Pappy. He proceeded to acquire several more lumberyards through the years and the business grew. He had one son, my granddad, who went into the family business and took over for Pappy. In the 1950s, my granddad was having trouble getting his lumber supply in the Midwest, so he took a train out to California to scout their supply systems. He ended up buying a mill while he was out there. No one completely understands the decision, but I think he just fell in love with California. He spent the next few years going back and forth between California and Missouri and started acquiring lumberyards in the California and Nevada areas. When I was about two years old my granddad died and my dad, who was 31, and my uncle, who was 33, immediately took over the family business. They continued running the business out of Missouri, but over the years they began to understand that we needed to have a family member move out to California and start running the yards because there was a growing leadership issue out there. When I was eight and my sister was 12, we moved out to Sacramento and that was where I finished growing up.

Today, the Midwest division continues to be run by my uncle and the West Coast division is still run by my father. We have 45 yards in total and we do about $300 million a year in sales.

2003 Panel Update

If you saw our panel last year, you will remember that I was the person who was on the fence and wasn't really sure whether or not I would join the family company. Yesterday, I accepted a job outside the family business. I am going to work for Knight-Ridder in a leadership rotational program. I decided to go back into media, which I've always enjoyed, and will be working for the *San Jose Mercury News.*

If you saw our panel last year, you will remember that I was the person who was on the fence and wasn't really sure whether or not I would join the family company. Yesterday, I accepted a job outside the family business.

Here is an update on the other panelists from 2003. Jay Owen was last year's moderator and his family owned Dominick's before it was sold. He is here in Chicago doing investment management for Morgan Stanley and he and his wife recently had their first child. Jamee Field, whose family once owned Marshall Field's, graduates in 2004. She is still planning on going into non-profit management and hopes to work in the area of environmental issues and environmental studies after taking a summer off to travel. John Nelson is working in the family business, Spatz Labs, and he is doing very well. This has been the year of implementation and innovation for them and John reports that they are spending quite a bit of time in China where they are outsourcing much of their manufacturing. John also reports that they have now set up an independent board of advisors that "provides an independent voice that challenges our assumptions and stretches us as a company every day." While we didn't hear back from Andrea Paiz directly, I have heard through the grapevine that she is flourishing now that she is back in Guatemala and working in her family's business.

I now introduce our moderator, Professor Barry Merkin, whom I have had the privilege of working with for the last two years in preparation for this Conference. Barry has been CEO of four companies including Dresher, Inc., which was named one of the best small businesses in America by *Forbes* and *Business Week*. In 2000, he received an Entrepreneurship Award from Ernst and Young. He has served as director for several companies and teaches New Business Formation at Kellogg where he has been on the faculty for 10 years.

BARRY MERKIN:

Challenges Between Generations

If succession isn't the number one problem in a family business, it is right up there at the top. The number two challenge is communication between parents and children. For the younger generation, this is often challenging, difficult, or impossible. The world's worst sentence starter I can use in my own family is: *when I was your age*. Basically, as parents, that is all we've got to work with: *when I was your age*. The problem is *when I was your age* was before all the scandals, before Amazon.com, before eBay, before Microsoft, before everybody stopped smoking, before we had weapons of mass destruction, before we had offshore jobs, before India and China were superpowers, before we had women in high places, before a whole lot of stuff. It is interesting to think about what it was like when I was your age, except it isn't really like that any more.

It is interesting to think about what it was like when I was your age, except it isn't really like that any more.

Today, we've got the opportunity to listen to some young people in business families and, hopefully, to ease some of that parental impediment. I am going to start by asking the panel to introduce themselves and to give you a little background. You will note Carrie did a great job of putting this diverse group together. We've got representation from the East Coast, West Coast and Canada. We've got different types of family situations, and totally different types of industry represented. Yet within all that diversity, you'll find some common denominators that I think will hit home.

AVI STEINLAUF:

Edmunds.com, Inc.

I'm here representing a company called Edmunds.com. For those of you who are not familiar with it, it is an automotive information site primarily on the web, where folks can get information like reviews, pricing, and other related information for the automotive industry. You can use our site when you are interested in purchasing or selling a car or getting information on the maintenance of it.

I'm second generation in our family business. My father, Peter, is a seasoned entrepreneur who built a business in southern California in the outdoor advertising industry and sold it in the mid-80s. However, he wasn't yet ready to retire. My dad had always been fascinated with the power of information and information-based companies so when he came across a little niche publisher called Edmunds Publications in Long Island he was interested. The company published pricing guides for new and used cars and trucks and only had a handful of employees. My father bought the company in the late 1980s. In the early to mid-90s my father began dabbling in online technologies. Edmunds.com became the first company to provide consumer automotive information on the Internet.

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Online Business Model

In 1995, we put up our first website and in 1996 we sort of stumbled into our business model online. We developed our first partnership with a company that had put together a network of car dealers and it needed to get leads of potential customers to that network of dealers. We, on the other hand, had all of these consumers who were coming to our site to get information about buying new and used vehicles and this company was willing to pay us a bounty for those potential buyers. Since that first partnership, we have developed a number of similar partnerships and we have built a nice size business with just that sort of fundamental business model. We've got about four and a half million people coming to the site on a monthly basis. We provide information free to consumers, sell those leads to manufacturers or dealers, and the consumer has the opportunity to get in touch with those businesses if they desire to make a purchase. We've also got a traditional online advertising model where primarily the large automotive manufacturers have the opportunity to target their ads on a contextual basis. Our site has 800,000 different pages so manufacturers target their ads to consumers visiting parts of the site that specifically relate to what they are selling.

We are sitting on a tremendous amount of very interesting data and when you analyze that data you begin to get quite a bit of market intelligence.

We are sitting on a tremendous amount of very interesting data and when you analyze that data you begin to get quite a bit of market intelligence. The automotive industry is obviously a large part of our nation's economy and to some extent we've got a leading economic indicator with respect to what is going on in that industry and there are many people interested in accessing that data.

Today, we've got a profitable company of almost 200 people based in Santa Monica, California.

Joining: A Personal Choice

I graduated from a small liberal arts college in New York called Yeshiva University in 1993. I spent three years working in New York for Coopers & Lybrand, now PricewaterhouseCoopers, in their market analysis division. This experience gave me a good idea of what corporate America was like and what it was like to work for a big company with lots of resources. In 1996 I applied to Kellogg and graduated in 1998. During my summer internship I worked for Intel in northern California, which confirmed my growing interest in the world of technology. Although I was interested in going into the large corporate American technology world, I knew that I had this opportunity at Edmunds, which was growing quickly at that time.

Ours was not a company that had been around for generations and generations in a fairly well established business. We were a small company in a cutting edge industry. In 1998 the Internet was still in its infancy and it was an interesting time to be in this expanding arena. For me, there was really no pressure associated with making the choice to join the business other than self-imposed pressure. I felt that if I chose to continue to earn my stripes on my own by getting a job in corporate America and then eventually join the family business I would miss out on an opportunity to be involved in a high growth period for our family business. So much was changing very quickly. There was a lot of innovation that was going on at our company and I wanted to be a part of it, so I decided to join the family business after graduating from Kellogg. I have been there ever since and have done a number of different jobs at the company. At present, I am executive vice president for strategy and development.

There was a lot of innovation that was going on at our company and I wanted to be a part of it, so I decided to join the family business after graduating from Kellogg.

Growing Company

We've experienced greater than 10 times top line growth since I joined in 1998. We have invested most of the proceeds back into the business because we see continued growth potential for the future. We have gone from a company with three employees, when my father purchased Edmunds, to nearly 200. I'm the only other family member who is involved full-time, other than my father, who is a very active CEO. I've got two sisters, one of whom is another Kellogg alum, but she has decided not to join the business for the time being and is doing creative consulting. Both sisters are married but neither of the brothers-in-law are in the business at present.

Finally, let me mention governance. We've got a diverse group of people advising us including a board of directors that we've established with a majority of outside directors. Our board includes two financial investors, a Kellogg professor, a former president of Leo Burnett, as well as the former president of Mitsubishi North America.

ZACHARY GUND:

Coppermine Capital

My family business is private equity, therefore, it differs a bit from the other panelists' companies in that we don't have a brand that has been established over many years. In fact, no business that our family has been involved with has ever been passed from one generation to the next. About a year and a half ago, I started a fund called Coppermine Capital, which is really a sister fund to our family fund, Gund Investment Corporation, based in New Jersey. So in essence, I am a part of the family business. The decision to join the family business was pretty simple and really more a question of *when* not *if* I was going to do it. I grew up hearing stories of my great-grandfather starting a brewery in LaCrosse, Wisconsin, growing it and then selling it to G. Heileman Brewing Co.

After World War I, my grandfather bought the rights to the process for making decaffeinated coffee and sold it to The Kellogg Company. Eventually it became what is known today as Sanka.

After World War I, my grandfather bought the rights to the process for making decaffeinated coffee and sold it to The Kellogg Company. Eventually it became what is known today as Sanka. Growing up and hearing these different stories and then seeing the industries that my father was involved in was exciting for me.

I remember my father would take me along to various quarterly board meetings when I was young and I was a little uncomfortable being there. I was always wondering if I deserved to be there. My father did a great job of assuring me that, yes, I did deserve to be there and it was a valuable learning experience for me.

Outside Experience First

Rather than join my father's firm right after college, I decided to go out and gain my own experience in the working world. I spent my two first years teaching and quickly realized that I was more interested in business. I took a job in operations with a company in the water filtration industry and spent a little over four years there. Like my teaching job, this was unrelated to any of the family businesses with which we were involved. After that I came to school at Kellogg, then subsequently spent about two years with another operating business. My goal was to gain operating experience in order to be more useful to the businesses in which our family company was investing.

Branching Out

While I wanted a relationship with the family business, I had a different focus in mind. That is why I started Coppermine Capital. Coppermine Capital is focused on niche manufacturing businesses in the U.S. As an interesting side note, many of the companies we work with are family businesses. I see a lot of entrepreneurs who have started their businesses and run them for many years and are now trying to decide if they should sell them. Coming from a family business background myself, and having dealt with many family businesses before gives me an advantage in my dealings with them. I feel that I have a greater understanding of the owners' needs and concerns and unlike many other private equity funds with limited partners we do not buy businesses and then flip them after five years.

Even though I have my own company, I regularly leverage the family office in a couple of ways. All of our accounting as well as our legal matters are addressed through the family office. To streamline that, I talk with either my father or some of the partners in his fund on an almost daily basis. I rely on them for the outside perspective necessary when examining different business opportunities.

HENRY BORGER, JR.:

Ladco Company Limited

I grew up in Winnipeg and started out as an aerospace engineer. I went to Worcester Polytechnic Institute for a mechanical engineering degree. Then I went to Stanford for a master's degree. After a few years of working with Bombardier Aerospace, a maker of regional and business jets, I decided that I wanted to return to the family business. I needed an M.B.A. to do that and was fortunate enough to go to Kellogg to get one.

My grandfather was a real entrepreneur and was involved in various ventures from hockey teams to bus manufacturers.

The family business is quite old. It started in 1919 in Winnipeg as a small construction company founded by my grandfather, John Henry Borger. My grandfather was a real entrepreneur and was involved in various ventures from hockey teams to bus manufacturers. But the construction company remained the core business. Our interest in real estate grew out of our construction activities—partly by chance. When the landowner can't pay the construction company for servicing the land, the construction company gets the land. My grandfather passed away in the mid-1970s and control of the company passed to three of his sons, my father, Henry, Sr., and my uncles Ralph and Alan. There were also two other sons and one daughter who had a stake in the business but were not in a position of control. After my grandfather died, my uncle Alan became president and ran the company.

Diversification into Real Estate

For the last 30 years or so, most of our company's growth has been in real estate. We acquired land and developed residential communities. We kept the commercial components of these communities, such as apartment buildings and neighborhood shopping centers, and managed them ourselves. Today we own one hotel, several shopping centers and about 1000 apartment units; we also manage another 500 units. We still have the construction company, which is involved in the installation of sewer and water services, the construction of city streets and highways and the supply of road-building materials. Nearly all of our assets are in Winnipeg. My uncle passed away in 2000 and his son, Alan, who is about 10 years my senior, is now the CEO and president.

Professionalizing the Family Business

Alan, my cousin, had to do the heavy lifting when he entered the business in the 1990s. He was trained as a lawyer and later received an M.B.A. from the University of Virginia. He faced some incredible challenges when he first went into the business. I consider myself fortunate because I don't have to deal with the problems that he has already overcome. In fact, I might not have decided to return if Alan hadn't succeeded in professionalizing the head office and making it more of a meritocracy. He has also reduced the number of family employees to three: Alan, his brother, and myself. There are still challenges and I'd say we are only half-way through. At the head office level we have made the transition to a third generation business, but the division level seems to resemble a second generation business, which may not be surprising because the leaders of those divisions were trained by members of the second generation. I think the next challenge we have is to bring those divisions up to a more professional level.

Heavy Lifting

Here's one example of my cousin's heavy lifting. There were a couple of very senior executives, who were not performing and almost seemed to be working against our company's interests. For example, my cousin gave a tenant briefing document to one of these executives and said, "This concerns our tenant. Do not show this to our bank, because our bank is also the tenant's bank and we don't want this information to be shown to the tenant." The executive didn't send the document. Instead, he had his secretary retype the document onto different letterhead, and then sent it on to the bank. That type of behavior, you would think, would be cause for immediate dismissal but it wasn't. It took a long time, over five years, for my cousin to gain enough power, collect enough evidence and convince his dad to change personnel. You probably all realize that the toughest problem in business is the people problem and that you have to have strong people on your executive team. But I don't think that my dad and uncles realized the importance of a healthy organization and the damage that a few "bad apples" can inflict. I think my uncles and my dad rarely fired people. It was really difficult for them, no matter what the situation. They treated their employees like they were their kids or siblings and they were not going to let them go. My cousin almost left on numerous occasions because he felt frustrated by the slow pace of dealing with these organizational issues.

I think my uncles and my dad rarely fired people. It was really difficult for them, no matter what the situation. They treated their employees like they were their kids or siblings and they were not going to let them go.

Audience Questions

Avi, how is your board of directors organized?

Avi: Almost four years ago, we put together a formal board of directors. At the time we had the opportunity to get some seasoned people involved, so right now we've got nine directors. We've got my father, my mother and myself to represent the family and management as well. Then we've got Kellogg Professor Mohanbir Sawhney, an expert in technology, the ex- Mitsubishi president and the former Leo Burnett president, plus the three financial experts who are investors. I think at times it is stressful because they don't necessarily go in the direction that we want them to go and they don't necessarily understand the issues the way we do. Sometimes there are challenges because their interests are never going to be exactly aligned the way we would hope, or the way one would structure in a textbook, but overall I think we get a tremendous amount of benefit from them as individuals, as well as from them as a group. It has been very helpful for us and having the outside perspectives are good and at the end of the day we can choose which of those ideas we'd like to go with and value most. The outside directors have voting rights, but I guess they are only with respect to certain things, because the family owns the majority of the stock and has a controlling interest.

Are there any specific criteria that you had in mind when you were soliciting a board member? Also, what kind of compensation do you offer these individuals?

Avi: For us, when we brought in some investors from the outside, one of the things that came along with the investment was board representation, so for those spots it was fairly easy. When we were going through the trouble of putting a board together, we really wanted to have a broad group of people; so in addition to family, and the financial investors, we wanted to get people within our affiliated industries. We got somebody from the automotive industry, which is our bread and butter. We got somebody from the "traditional" media and advertising world because it was somebody with whom we had a previous relationship and who we thought could bring quite a bit of value to the table. Then we brought in Professor Sawhney, who really had a very interesting perspective and the direction we were taking the company fit into the way he was thinking and he could bring a lot of value to the board. We've ended up, I think, with a very nice cross section on our board that helps give us a good perspective. As for compensation, they've all got options that we've granted. We've got an employee stock option plan for all the employees as well.

Carrie, can you tell us a little bit about the family dynamics that allowed you to have the freedom to choose whether or not to go into the family business?

Carrie: I think that the way that we were raised and what our father always taught us was to go out and find something that really interests us and for which we have a passion and then to pursue that passion. I think that there was no real choice for my father's generation. It was just assumed that he was going into the business. I think that although it has been something he has really loved to do and has had a lot of success in, he feels that my sister and I should find our own paths and determine what we want to do.

How is competency developed in your company for a family member?

Avi: Kellogg is fairly structured and they give students a good deal of direction as to what their options are. One of the options I had was to go into the family business at the time of graduation. I had to weigh the fact that it was a small business that wasn't all that well structured. It was important for me to develop my own structure, to work out with my dad exactly what it was that I would be doing and how I would be adding value. It was important to me and it was important to him to spend the time doing that. While I don't have a specific management path where I am on this job for a year and one-half and that job for a year and one-half, I have managed to get a pretty good view of the business over time. I have been able to work it out for myself, while at the same time taking advantage of different development opportunities as they come up.

Zack: In my situation it was really the outside managers who helped. They are very secure in their positions and I wasn't a threat at all. Communication was key, with both my family and the directors being very open to what I wanted and what my goals were.

Henry: We have no formal process. We are a small leadership group: my cousin, our COO, and myself. I am learning as I am going along. My cousin has said that when he returned to Ladco he would have liked to work for each division for six months or so, but there was just too much to do. I would like to do something similar, but I'm faced with the same problem of too much work. We are a thin team and we don't have a lot of redundancy.

How do you earn the respect of your peers as a new family member coming into the business?

Avi: I think it is based on the work product. Are you there in the trenches with the people who are doing the work? Are you working through the problems? Are you putting in the hours?

I think to a certain extent we family members may work a little bit harder.

I think to a certain extent we family members may work a little bit harder so there is never an impression that, "You guys are getting a free ride." There are more issues with respect to compensation and other sorts of benefits associated with being part of the family. But for me, those are not as important as commanding the respect of my peers and clients and the way to do that is to work hard.

What's the most difficult issue you have working with your father? Secondly, tell us a little bit about working through that issue.

Avi: I think our biggest difficulty has to do with our different business styles and our different personality types. We have come to understand that there isn't necessarily one right way to do something; there could be multiple right ways. We have to respect each other's perspective and approach issues where we disagree in a way that is not confrontational but ultimately productive. It is something that is difficult to work through on an ongoing basis. Perhaps it sounds trite, but I think over time there is a mutual respect that grows out of working through those issues.

Zack: I would say for me my biggest issue is dealing with expectations on both sides, my expectations of my father and, his of me. The way we resolve that is through communication and being open and honest and having those conversations as often as possible, whether it is a small detail or a larger strategic decision.

Henry: I think our biggest issue is how the construction division should be run. My cousin and I want more formal processes, where my dad ran the division more "off-the-cuff." My cousin made a point of pushing his dad and my dad to learn about current business thoughts and practices through reading books and magazines and having prolonged open-ended discussions. By continuing this with my dad, we hope that he will be more receptive to our plans for his old division.

Is it important to work elsewhere before you come into the business?

Henry: I worked for 10 years outside the family company in engineering. My engineering experience has not helped me much in my current position and I think I could have learned so much more about our business if had I started working here earlier. On the other hand, I succeeded in establishing a career on my own and could choose to come back on my own terms. I think that's very important.

Zack: I found the experience invaluable. I think you learn so much from other people's ways of operating a business and seeing the day-to-day interaction with people outside of your own family. It is good to step out of the family and see how others run their businesses. For me it was really, really helpful and a good confidence builder.

Avi: Working outside the family business was very important. I was able to prove that I could earn my stripes elsewhere. Oftentimes I call upon some of the experiences I had in a different environment and I think that is invaluable.

Do you feel it is incumbent upon you to push for control of voting rights now or can you wait to inherit?

Henry: I anticipate that I'll get my dad's shares eventually and there is no hurry. I'm the only son and my sister will probably be happy with being a passive investor.

Zack: I said in the beginning that we've never had a business that has been transferred from one generation to the next and yet there are three principal businesses right now that we're involved with that my father is debating whether or not to pass on to my brother and myself. It has inspired a lot of different conversations. We have not resolved this yet. He could just as easily sell the businesses and that would be the end of it.

Avi: I would say that ours is not a cut and dried situation. I think it is more of a process and I think I do have a say and I'm involved in what goes on and over time certain things will become apparent. I am in a fortunate situation where my dad is pretty young and I've still got a lot to learn so pushing the issue right now is not something with which I am concerned.

Carrie, if you and your sister are not involved in the business, are you still planning to keep it in the family or be involved in any way or is it going to be sold?

Carrie: I would say right now we are in a real period of transition and we are having these discussions. My uncle has four children and his oldest son has gone into the business whereas in our family neither my sister nor I have gone into the business at this point and probably won't in the future. I think that is a real question and we are meeting to talk about where we want to go. My uncle and his son are in the business; will they want to sell? Will both families want to sell? Is one family looking to sell more than the other? Within the West Coast division we have appointed a potential successor to take over after my father retires as president, should we decide to keep it in the family. If that does happen, my sister and I have both agreed that we would be actively involved along with our father in some sort of chairman position for the West Coast operation of the business.

All four of you have talked about dad; do you have any comments about mom? I know that at least in our family enterprise, mom has a significant amount of representation in the decision-making.

Avi: California is a community property state, so my mother has 50 percent of the ownership and while she doesn't play a formal role from an operating perspective, she does play a very significant role, though in a more informal manner. Mom is very much a force, has board representation, and is very well aware of what is going on.

Zack: It is a tough question for me. My father is blind, so my mother is a big part of the business, not so much from an ownership perspective but obviously as his "eyes." She goes to many, if not all, of the meetings that he attends. From that dynamic my mom is very much a part of the business. She would never admit that. She would not say that she has anything to do with it. In addition, she also has ownership.

Henry: My mother hasn't been involved with the business but she knows what is going on and she guides me in a more personal way. That's been positive.

Carrie: I definitely feel that in terms of my development and my career choices my mother has been as involved as my father in helping me make the biggest decisions in my life. I think it is easy to refer to my father because he is in the day-to-day operations of the business. But I definitely think that from a standpoint of understanding the real family dynamics, particularly when it comes to interacting with my uncle's family and the cousins, that my mother has a great intuition in terms of really knowing what kind of impact the different decisions we make as a family may have on the family as a whole. I think that is just invaluable.

Barry Merkin

Barry Merkin is Clinical Professor of Management and Strategy at Kellogg School of Management where he has been teaching entrepreneurship since 1993. He has a B.A. degree in American civilization from Brown University and an M.B.A. from Harvard Business School. He was president and CEO of four companies, most recently Dresher, Inc. (NYSE), three-times named as one of the "Best Small Companies in America" by *Business Week* and *Forbes*. He has held numerous professional leadership roles, including the Young Presidents' Organization, World Presidents' Organization, American Association of Entrepreneurs, Harvard Business School Club and the National Conference of Christians and Jews. His corporate directorships have included Follett, Transmedia, Charter Communication and All Phase Electric. In 2000, he received one of the Ernst & Young Entrepreneurship of the Year Awards.

Carrie Meek

Carrie Meek is a fourth generation family member of Meek's Lumber. Meek's is a building materials supplier with more than 80 years of experience in the industry. Her great-grandfather started the company in 1920 in southwest Missouri. Meek's has earned a reputation for being a provider of expert service as well as quality building and home improvement merchandise. Currently, there are 45 building centers in the Midwest and on the West Coast with headquarters located in Sacramento, California and Springfield, Missouri. Upon graduating from Northwestern University's Kellogg School of Management in 2004, Carrie took a job with *San Jose Mercury News*, a Knight-Ridder publication.

Avi Steinlauf

Avi Steinlauf is the newly named Chief Operating Officer for Edmunds.com, the leading automotive information resource. Previously, Avi served as Edmunds.com's vice president of marketing, overseeing its advertising, public relations, content syndication and wireless initiatives. Before joining Edmunds.com in 1998, he was a senior industry analyst for Coopers & Lybrand's knowledge strategies group, where he analyzed and reported on media and communications industry trends. Additionally, he managed reactive research, recruiting, training and development. Avi holds an M.B.A. degree from Northwestern University's Kellogg School of Management and a B.A. degree from Yeshiva College.

In 1988, Avi's father, Peter Steinlauf, purchased the 22-year-old three-person company, Edmunds Publications, which sold its automotive guides to consumers, libraries, and credit unions. He moved the company to California, explored new publishing options and in 1994 developed a service offering car pricing data on demand through a pre-web, text-only site. Soon after, the company became Edmunds.com launching its own website of up-to-the-minute automotive pricing and information and growing to about 200 employees. A new service, Edmunds2Go, lets consumers access much of the data through wireless devices such as cell phones and personal digital assistants.

Zachary Gund

Zack Gund is managing partner of Coppermine Capital, Boston, MA. In addition, he oversees investments for Coppermine Capital Partners, a venture capital fund focusing on investments in emerging technologies. Prior to joining Coppermine he worked at Ucentric Systems, a home networking software company, and was involved in business development at the National Broadcasting Company (NBC). He has an M.B.A. from Northwestern University's Kellogg School of Management and a B.A. from the University of Vermont. His family's business is Gund Investment Corporation, a private equity fund located in Princeton, NJ, where his father, Gordon Gund, is chairman and CEO.

Henry Borger, Jr.

Henry Borger, Jr. is vice president of strategic initiatives and a third generation family member of Ladco Company Limited. Henry entered the family business immediately after graduating from Northwestern University's Kellogg School of Management in 2002. Prior to joining Ladco, Henry practiced stress engineering with Bombardier Aerospace Ltd. and completed a management consulting internship with Cap Gemini Ernst & Young. In addition to his M.B.A., Henry holds a B.S. from Worcester Polytechnic Institute and a M.S. from Stanford University.

Ladco's history dates back to 1919 when John Henry Borger, Henry's grandfather, founded a small construction company in Winnipeg, Canada. Today, Ladco is a diversified corporation with interests in land development, commercial and multi-family real estate, property and asset management, heavy construction and building products, and hospitality. Alan Borger, Henry's first cousin, is Ladco's current president and CEO. Ladco is professionally managed, employs approximately 500 people and is owned by four family holding corporations, which correspond to four of the founder's sons.

Case Discussion: Scott Family Enterprises

CHAIR: John Ward, *Clinical Professor and Co-Director*
Center for Family Enterprises, Kellogg School of Management

PANELISTS: Jim Scott, *Chairman, Scott Family Council*
Vice-Chairman, First Interstate BancSystem, Inc.
Chairman, Padlock Ranch Company
Chairman, Homer and Mildred Scott Foundation
Chairman, First Interstate BancSystem Foundation

Chris Scott, *Member, Scott Family Assembly*

Randy Scott, *Director, First Interstate BancSystem, Inc.*
Director, First Interstate BancSystem Foundation
Member, Scott Family Council

Lynette Scott, *Director, Homer and Mildred Scott Foundation*
Director, First Interstate BancSystem Foundation
Member, Scott Family Council

Charles Heyneman, *Director First Interstate BancSystem, Inc.*
Director, Padlock Ranch Company
Vice-Chairman, Scott Family Council

Dick Fellows, *President, Scott Family Services, Inc.*

This case addresses the critical issues of succession and the development of fair practices for family governance and representation. The Scott Family is transitioning its leadership and governance from the second generation of siblings to the third and fourth generations of cousins.

Scott Family Enterprises is headquartered in Montana; assets include banking, ranching and foundations.

It was an honor to have members of the Scott family and management share their varied insights and points of view with Conference attendees.

Case Discussion: **Scott Family Enterprises**

Was the Scott Family ready for the transition of empowerment from the second generation to the third? Letting go is not an even or smooth process and the Scott Case shows how difficult this progression can be, but it also shows how a family's good faith and hard work can bring about the necessary changes in leadership.

The case begins with a third generation family member questioning the unannounced changes made in the director selection process, which directly affected members of the third generation seeking membership to the board of directors.

Conference attendees considered the following questions after reading the case, but prior to hearing the family presentation. Summaries of the attendees' answers follow.

What are the expected governance issues the Scott family is facing?

One family notion versus branch representation

Second generation needs to trust in the abilities of the third generation

One person one vote versus per share voting

Outside board member participation

Criteria/guidelines for family members to join the business

Compensation of family members

Improved communication processes throughout the whole governance system

Values of the third generation in comparison to second generation

New processes/rules created then disregarded or broken

Development of director competencies among family members

Selection process for family directors

How would you recommend the Scott Family Council respond to the letter?
(The letter was written by a member of the third generation who was questioning the unannounced change in the approved family director selection process.)

Acknowledge the letter and explain the rationale for the decision

Consider readdressing the issue

Promise clear communication before future decisions are made

Second generation should state its expectations for third generation

Second generation should apologize to third generation and explain actions

Don't rescind decision; go forward

Revoke the vote and review the policy

Should family members in governance roles have performance evaluations? How?

Yes, family members should be reviewed

Need mutually defined job descriptions as a starting point

Family conducts review with mediation by outside advisors

What views/direction should family owners provide their business and board?

Emphasize essential family values

Remember mission of the founder

Provide clear financial expectations

Establish shareholder redemption policy

Create effective crisis management program

How should family owners reconcile their views/direction for the business?

Written documentation

Family meetings

Frequent communication, e.g. newsletter for family members

How would you have selected family members to the board?

Ownership should engender participation since it is only fair that risk be decided by owners

Branch representation can be less divisive for family, but is birthright the best criteria?

Merit selection best for the business, but who chooses?

Rotation would appease dissident family members, but no continuity for board

A Unique Family Study

Excerpt from the January 29, 2003 letter written by a third generation family member of the Scott Family Council after the rules for reviewing candidates for director positions were changed:

"The entire family endured a painful process to develop guidelines for elections and qualifications for these posts, the Family Council and the 2nd generation does not have the right to rewrite the rules without the consent of the Family Assembly … A policy was developed that was voted on and accepted by the Family Council on how the election process would be conducted, that too was also not adhered to by the Family Council … What has transpired has the real potential to move us apart. The Family Council needs to ensure that their behavior is consistent with our values and mission statement."

JOHN WARD:

The Scott Family Case is an exciting and timely study of the challenges that face a family business as it moves from sibling partnership to cousin collaboration. As a case study, it offers us a unique opportunity to view up close the sensitive issues that families face when they transition from a second generation partnership with just a few owners to a third generation alliance of cousin owners that can number in the dozens or even hundreds. In the Scott case, they are moving from a partnership of five siblings to a collaboration of 19 cousins, plus spouses. This transition from siblings to cousins is often marked by chaos and misunderstanding as the family strives to create and implement processes for turning over leadership from one generation to the next. The most challenging issue is how to create fair rules when there has not yet been a process by which to create rules fairly.

In this case, we will look at the concepts of:
- Sibling partnership to cousin collaboration
- Governance processes
- Enterprising family
- Family office

From Sibling Partnership to Cousin Collaboration
About half of you in the audience are facing very similar issues within your own families and this case will be very pertinent. For the rest of you, who are a generation away from this transition, you might be tempted to ask: *Why do I want to worry about the cousin transition when I haven't even made the transition from founder to siblings yet?* This is a fair question. My answer is that most of the problems that arise when families transition from the sibling to cousin generations were already simmering a generation earlier. Had the family seen these potential issues earlier they would have been able to deal with them and prepare themselves better for the transition to come a generation later. What you do from the first and second generation gets telegraphed into the third generation. It is, therefore, never too early to start changing some behaviors in ways that will be of benefit to your successors.

Perspectives Vary From Siblings to Cousins
Below are the common challenges facing family businesses as they evolve from a sibling partnership to a cousin collaboration.

Governance Processes
When you are in a cousin situation or when you are moving toward a cousin situation, governance processes become extremely important. Governance processes address how large families, many with members who do not work in the business, provide direction to the businesses they own. How do they provide direction to the business they own even though they are not the managers of it AND how do they provide representation of family members to the board?

Key to the success in these governance processes is that they are fair.

Key to the success in these governance processes is that they are fair. Once you reach the stage where there is a large number of cousins, you cannot run by 100 percent unanimous consensus any longer. There will be some decisions that you will be making based on some principles of process or democracy rather than total unanimity. Whenever you have a process that everybody isn't 100 percent in agreement with, the critical question becomes: *Even if you don't agree, will you accept?* You don't need to agree to accept. If you perceive that the process by which that decision was made is fair, then you can accept an outcome that may not be your preferred outcome. I would argue that by the time you get to large groups of siblings or large groups of in-laws and certainly by the cousin stage, that is probably one of the most fundamental issues that family businesses face. Are the governance processes that you put in place perceived to be fair by the constituents?

Sibling Generation Perspective	*Needs to evolve into*	Cousin Generation Perspective
Branches	➤	One Family
Fiefdoms	➤	One Business
Business as Glue	➤	Business as Means
Equality	➤	Merit and Inequality
Family Leads Business	➤	Important Non-Family Leadership Roles
Business Leadership Equals Family Leadership	➤	Separation of Family & Business & Governance Leadership
"Operating" Ownership	➤	"Active" Ownership
Supportive, "Advisory" Board	➤	Critical, "Fiduciary" Board
One Form of Involvement	➤	Multi Forms of Involvement
Internal Family Office	➤	Separate Family Office
All Family on Family Council	➤	Representative Family Council
Exclusive Values	➤	Inclusive Values
Informal Education	➤	Formal Education
Expectation of Commitment	➤	Voluntary Commitment
Unanimous (Near) Consensus	➤	Democracy
Business Gives Charitably	➤	Family Gives Philanthropically

Are the governance processes that you put in place perceived to be fair by the constituents?

One of the reasons the Scott case is such a wonderful opportunity for us, and such a unique contribution to family business documentation, is that the Scotts are right in the middle of dealing with these governance issues. Like all family businesses, eventually you have to set up processes before you have processes in place to help you create them. How can a process be fair if the process itself is new to people? It is the classic dilemma. The first time you establish governance processes, you will be putting them in place by a process that has not yet been deemed fair by your constituents. How do you set up these brand new governance systems and how do you generate enough good will in the family to tolerate the inevitable mistakes? Governance processes become core with the perception of fairness at the center of that core.

Enterprising Family

We like to think of a family like the Scotts as an *enterprising family* because not only do they own businesses, but they have other family institutions as well. They have family foundations, they have a family office, they have multiple family businesses and they have a family council. In the governance system they have multiple institutions. We like to refer to a family that has multiple family institutions serving a variety of purposes with a variety of family members engaged in them as an *enterprising family*. It is a useful concept because as the transition to a cousin family business takes place the business is not going to be the center of the universe for every single member of the family. It is not the *raison d'etre* to hold the family together for every member of the family, but if you have a diversified portfolio of family institutions and interests, then you have an ever increasing number of opportunities to capture the interest, the involvement, the participation, the care and the commitment of more of the family member group. Some family members may be thrilled with being involved in business governance while other family members will not be interested.

If you have a diversified portfolio of family institutions and interests, then you have an ever increasing number of opportunities to capture the interest, the involvement, the participation, the care and the commitment of more of the family member group.

An *enterprising family* has a variety of opportunities to capture different peoples' interests. Perhaps it will be the family foundation or the family council that will appeal to the different interests, competencies and skills within the family.

Family Office

With the Scott case, we see a family that is in the early stages of setting up a family office. To my knowledge there is no family business case written on early stage family offices, or family offices at all. This case gives us a glimpse of what a family office might look like, what it might do, how it might work, how it might be governed, how it might be manned, how it might be staffed.

I want to introduce Jim Scott, who is a member of the Scott family and chairman of the Scott Family Council, to provide a little bit more background and perspective on the case.

JIM SCOTT:

A Family History

What we will be talking about primarily is the transition from siblings to cousins, but it is my belief that you can't really understand our situation unless you have a little bit of information on where we came from and what the first generation was like. Our parents were born at the beginning of the 20th century. They were children of new Americans, emigrants who had settled in Nebraska. Our dad was the younger of two children and grew up on a small chicken farm outside of Lincoln. I never met my dad's or my mother's parents though I know that my dad's mother was very focused and she helped to develop his sense of ambition. My mother was the oldest of nine. Her dad ran for attorney general in Nebraska and was an advocate for prohibition.

Dad worked his way through engineering school then got a job in Alabama in the late 1920s. My parents saved money, bought stock, bought some more stock on margin, and lost everything they had in the market crash of 1929. They subsequently moved back to Lincoln where they lived with my mother's family for a couple of years and in the early 1930s my father got a job as a laborer for a company named Peter Kiewit Sons, a construction company. Eventually, Mr. Kiewit asked my father to move into the main office. He was the fifth person in the office of the Kiewit Company. He opened the first office for Kiewit outside of Lincoln in our hometown of Sheridan, Wyoming in 1936. From the 1930s through the 1960s he was part of a team that transformed that little company into the largest and most successful construction company in America. Kiewit was a private company so it created a lot of wealth for the people who worked in that company. Dad started a ranching operation in 1943 and in 1968 he bought the bank in our hometown. Over the years, our family built the ranch into one of the most significant ranches in this country and the bank into the largest bank in Montana and Wyoming.

Dad started a ranching operation in 1943 and in 1968 he bought the bank in our hometown. Over the years, our family built the ranch into one of the most significant ranches in this country and the bank into the largest bank in Montana and Wyoming.

Mother was the guiding light of our family and was a great source of support for dad. They were an incredible team. They were successful individually, but most successful as a partnership. Of all their successes, they were most proud that their kids could work well together. It was important to them that we learned to do that.

The second generation, my generation, was born from 1931 to 1949. There were five of us with almost 19 years difference from first to last. In those days, dad traveled a lot and was rarely home. As brothers and sister we all worked together, but there was a lot of competition among us. We found ways to manage that, however. Like a lot of siblings, what we did was develop our own deals, our own responsibilities and areas of expertise, so as not to be in too much competition with one another. Dan is the oldest brother and he ran the ranch and built it up over the years. Scotty, our next brother, was the athlete and he was in the construction business, then he became the Wyoming banker and then the entrepreneur—always our leader. Susan, my sister, is the conservationist, the feminist, and above all the humanist. She is the one who encourages creativity. My brother Tom is the Montana banker. He is an incredibly focused banker. I, too, was a banker for a number of years and then, when my dad died in 1993, I became a leader in our family foundation. When our father died, we began the family governance process that helped to make official my role as the glue in the second generation and as the bridge to the third generation.

We were able to work well together because we found tools to help us do just that. Early on, we found a personality test that helped us to understand that we were all different and that in similar situations we might react in our own ways because of these differences. We all went to a similar leadership program where we learned about negotiations and we learned the importance of active listening. We were careful to remember the family values that held us together. That is how we overcame our sense of competition and we were able to become a team based upon mutual trust and respect.

A New Era

For me, our case represents the end of that era, the end of the sibling partnership. At the start of the case we were facing a very difficult issue of how to do succession. We needed to figure out how we should select the next generation of family members to be on our most important board and it was a highly charged issue. It was important. There were issues of branch representation, issues of ownership, issues of perceived competence and real competence. We didn't mean to get together that fateful day described at the beginning of our case. It wasn't planned that we would all be together, but we were. As you might have gotten a sense from the case, we worked very hard. It was intense. We came to what we thought was the best decision we could in a delicate situation and we were greeted with mistrust, miscommunication and misunderstanding, and that's where we stood.

Ours really is an interesting example of the transition from the sibling partnership to this chaotic but wonderful cousin collaboration.

The greatest challenge to the second generation clearly is letting go. It is also understanding that the business relationships we had built as siblings are in the past.

The greatest challenge to the second generation clearly is letting go. It is also understanding that the business relationships we had built as siblings are in the past. We are now working with cousins, some of us are still there as second generation, but the reality is it's a new system. I think one of the best ways to address that is to come back to family values and principles. We need to be aware of the values that guided the first and second generations and use them to shape the guiding principles that will lead the family in the future.

JOHN WARD:

Introduction of Scott Family Members

I now introduce five more members of the Scott family. While we have them here we will ask some very essential questions. Namely, how do you get dozens of family members to have a consensus on the risk appetite and the rate of growth or maybe even the values and the vision of the family as a collective? That is a very profound question that they are dealing with now. The Scotts are also facing the issues of deciding how the family can set direction as a large group and how this big family can participate in family governance.

Joining Jim Scott, who is the youngest of the second generation is his wife, Chris, Charles Heyneman and Randy Scott, from the third generation, and Randy's wife, Lynette. Also present is Dick Fellows, president of Scott Family Services, Inc., the family office.

RANDY SCOTT:

Confusion and Mistrust

The letter protesting the way the second generation handled bringing the third generation into leadership positions brought up problems that we were already noticing at the family council level. We had invented a process to invent a process for getting family members onto the board and into leadership roles and we thought it would work. The original concept was to have three members on our review committee: the chairman of the board, the head of the Scott Family Council and a board member, a retiring board member in this case. Since we were going to be transitioning to another chairman the following year, both the existing chairman and the future chairman decided they would be at the meeting in question. We went into the meeting thinking that we would have three people maybe four doing the review, but to our surprise there were six, five of whom were from the second generation. All of the talk that had been going on about starting to have the third generation take more responsibility and take part in the work that was going on seemed insignificant all of a sudden because to all appearances the decision was going to be made by the second generation. That was the catalyst for the letter from a third generation family member who felt the carefully established rules had been broken.

All of the talk that had been going on about starting to have the third generation take more responsibility and take part in the work that was going on seemed insignificant all of a sudden because to all appearances the decision was going to be made by the second generation.

The Remedy

Since then, we have been working hard to correct that and we have been reviewing the process. In fact, we constantly review that process so it has changed several times. Currently, we are working with two outside board members instead of one like we did the first time. We also have one family council representative, one family board member representative, as well as Dick, who is the head of our family office. We now have five people conducting reviews, three of whom are non-family members. We have put together a standardized application process. One little change we made is that now the Scott Family Council will go to the board that is looking to fill a position and ask them what competencies and criteria they are looking for in the new family candidate. Our review committee will do whatever it takes so that the people applying for the position know exactly what the board is looking for and what is important to the board at this time.

Trust

We have spent a lot of time working on trust issues recently and the third generation now realizes that the second generation was not trying to hurt anyone or disregard what was right for the family by their actions last year. Originally, the third generation did not trust the second generation because they were making all the decisions. Since then, we've worked hard on developing the trust between the third generation and the second generation. I really believe that now trust has been established and that the third generation understands that the second generation, the council of elders, is there to help us.

The next part of the process is building faith within the family council. Each member of the Scott Family Council is working to be open and understanding and concerned about the desires of the other members of the family council. I think we have done a really good job of working towards that in the last year. The good faith and trust being built in the family council then needs to spread to the much larger Scott Family Assembly. In our case, we have nine people who are speaking for 50 people and we must have their trust to represent them and their wishes.

JIM SCOTT:

Emotional Issue

I want to clarify one thing. As you read through the case, you will remember that two of my brothers who were initially present at the meeting in question left before a vote had been taken. The reason that my brothers left the meeting where we were to review family leadership candidates wasn't because they had another meeting to go to, but because the discussion that we were having was so emotional and so difficult that they finally had to leave. The issue we were facing was one of trying to resolve conflict of interest. I was the person who changed the rules, and it was done on the fly, because we had developed a review committee whose members were going to have to evaluate their own children. It seemed the way to address that was to expand the review committee and not have people vote on their own children. We decided at that point that no family member should be put in the position of having to vote on his or her mother, father, brother or sister. Two months later, collectively as a family council, we again changed our process. As we thought more about it we recognized that we all have conflicts of interest and if we could acknowledge those conflicts of interest, put them out on the table, then we all deserved to be trusted to make the right decisions for the whole group.

CHRIS SCOTT:

The Role of the In-Law

I'm the youngest of the five sibling spouses; none of us have been involved in the family business or any of the family enterprises. So what was our role in all of this? I would say that at some level it was in the background.

> As the spouse, you are the counsel every night for your husband or your wife.

As the spouse, you are the counsel every night for your husband or your wife. You bounce ideas back and forth between one another. You are your partner's sounding board, and in addition, you are influential in developing your children's and their cousins' roles and as a mentor to the other spouses. That is the role I think that I have played. Even though I came out of a generation where Gloria Steinem told women to be empowered, I chose to raise my family without going to work outside of the home. But I was very involved in philanthropy and grew my interest in conservation and now work on a national level. I also recognize that successful enterprises depend on good communications. That is why I set up a family newsletter. The newsletter contains interviews with various people who work in our enterprises, which helps the family get to know about them and what they do in our different concerns. The newsletter is called *Relatively Speaking* and runs items on the foundations, the bank, the ranch, as well as a forum for family members to share our stories – something that had never happened before. The newsletter has grown and has now been taken over by a third generation member who, with the aid of a hardworking group of contributors, produces this important vehicle for family communications.

In an additional move to improve communications, I set up a family website. I think information leads to empowerment. We now automatically e-mail everyone in the family when something has been posted to the website so they are alerted that there is new information for them to consider. A third generation family member is developing it even more. I also think that one other important role the second generation spouses can play for the family members coming up is one of mentorship. The young need the encouragement and support from those of us who have been around the family and its various enterprises for some time. I look forward to my children marrying and having partners that I can encourage in this family enterprise.

CHARLES HEYNEMAN:

Family Council

One of the core purposes of the Scott Family Council is to develop and articulate its sense of direction and rules for the businesses that it helps govern. The family council is also the forum where education, career planning and preparation for a role in governance take place. We realize that the family council has to prepare family members to be knowledgeable and responsible shareholders and we need to be sufficiently unified so that we can speak our expectations with one voice. These are all important family council initiatives.

> One of the core purposes of the Scott Family Council is to develop and articulate its sense of direction and rules for the businesses that it helps govern.

Here is an example of how our family council represents our interests. Last summer, bank management planned to update their strategic plan and the family, needless to say, was keenly interested in what this meant for them. As owners we had certain expectations for growth, profitability, liquidity and risk. The family council, at the behest of the family assembly, presented themselves to the bank board. We presented our organization and the work we had been doing over the past four or five years. We described our values and our vision. We proposed that the family be informed of the strategic plan after the board received the plan from management. This didn't mean that the family was requesting veto power or that the family intended to dictate the strategic direction of the company but that we wanted to assess whether the plan impacted ownership goals and whether the family values and vision supported the strategic plan. Management and the board were quite appreciative of this approach.

Once the plan had been presented to the board, senior management went to great lengths to present it to the family members and we had some very informative evenings with the family sitting down together with senior management talking about the plan and discussing the implications. This was a great start of dialogue and parallel planning. We also intend to go forward with this process with the ranch soon.

JOHN WARD:

The ranch has a new CEO and the ranch is going through some strategic challenges, but the Scott Family Council is not quite ready with its values, visions and goals for the ranch. It is one thing to have mechanisms and processes for the family to communicate to the business boards the family's wishes, but how do you keep them parallel? How do you keep them in sync because they are both very dynamic moving targets? Business is constantly moving and you've got a professional CEO who is trying to stay ahead of it and then you have a very large family with very complex processes trying to keep up and lead it. It is a fundamental dilemma.

LYNETTE SCOTT:

Future Issues

One of our future issues deals with the question of competencies: what are they for a particular position, what person has them, and how do we develop them? We have worked very hard in the family council on these questions and we have written competencies for every position that we elect. We are again going through a phase of rewriting our self-nomination forms. The self-nominating forms will have those competency questions on them and candidates will have a chance to show their qualifications for that position as they fill out the forms.

> We found out that you can never have too much communication, and every time you think you have said enough, you haven't said enough yet.

In addition, another big issue we will continue to face concerns communication. We have worked very hard on improving communication within the family. We found out that you can never have too much communication, and every time you think you have said enough, you haven't said enough yet. Trying to keep our family engaged will be very difficult, so the communications have to be open and interesting for them. In order for us to keep our children engaged, we have to go through all the processes and prove that when we say we will educate you for leadership positions we will do it. I feel that is what we have done.

Our family office has been given a challenge. They are going to interview every family member to determine each person's goals. We will find out whether a person's goals are enterprise related or if he or she wants to become a gardener. Determining these goals will help us to get the right people in the right positions so that we can continue to be a successful enterprise. We feel it is very important that the young children have an exposure to the business. None of them are forced to look at the business, but they should have exposure to it. This exposure will, hopefully, tell them and us if they want to enter into this wonderful journey with us. As I keep telling Jim, "When we don't have family in the businesses, why have the businesses?" Without family members engaged in the business we are no longer a family business, and to me that is very important. We want to keep those children engaged and that is our chore, to see that the future generations find it as important to be a family and a family in business as we do.

DICK FELLOWS:

The Family Office

We are entering into our fourth year as a family office and it is still a work in progress. Our primary function in the family office is to support the Scott Family Council, so if I were to break it down into the primary areas, then I might just back up four years and describe the situation when we first formed the family office. As some of you can imagine, perhaps from your own families, for our first six months we thought the primary focus of the office would be planning issues. At first about 60 percent of the time we spent in the family office was related to financial planning, tax planning, estate planning. We now find that two-thirds of our time is spent dealing with governance support, family education, family development and communications. It hasn't taken long for us to realize those issues are probably more critical in the Scott family than the technical ones. We have attorneys and accountants that can help us with those technical issues.

The role that we are playing right now is to provide support for the various governance activities. As Randy mentioned, the family office now coordinates the review committees and I serve on each of the committees that interviews director candidates and makes recommendations to the respective boards. Lynette touched on the development of family members, which is huge. I see that probably becoming a full-time position at some point in the family office. Another aspect of our role is to identify informative programs being offered that can help in the education of family members, so I have to acknowledge that I have been picking up brochures about leadership programs offered here at Kellogg.

The family office is also interviewing all the third and fourth generation family members who are 18 and older asking: What do you want to do?

The family office is also interviewing all the third and fourth generation family members who are 18 and older asking: What do you want to do? What is your career plan? Do you have any interest in governance within the family structure? The family office needs to support the Scott Family Council as they embrace that challenge for the family. We support, as Chris mentioned, the communication activities of the family. We are doing a major upgrade on the family website and we have family involved in that from a technical standpoint. The newsletter that Chris started is now in the hands of her son. We provide the support for that. We still do the financial planning and tax planning and estate planning, which are very important. It is harder to acquire the expertise required for all of these other activities on the outside. Scott Family Services, the family office, is still evolving as we seek to meet the many and varied challenges that face a family with such diverse interests.

JOHN WARD:

I'm hearing from Dick what I've heard from a few other family office chief executives, that their real job is to be dean of the family university. We have an opportunity for one question from the audience.

Audience Question:

Do all these structures have a basis in legal contract? If somebody is dissatisfied are there grounds for legal action or is all the effort and the sweat and toil here a matter of good will and good intention?

Jim: I hope I don't have to find out the answer to that question. The Scott Family Council has a constitution. We have values and a vision. We have policies but we don't have by-laws. For Scott Family Services, we actually formed a corporation two years ago, and we capitalized that and that does have by-laws. That is a legal structure. Of course the enterprises, both foundations and both corporations are legal entities. I'd have to call the family and the Family Assembly a voluntary organization that you can leave but you can always come back to also.

Jim Scott

Jim Scott is a second generation Scott family member. He has been a director of First Interstate BancSystem, Inc. since 1971, a director of the Padlock Ranch Company since 1976, a director of the Homer and Mildred Scott Foundation since 1989, a director of the First Interstate Foundation since 1990, and a Scott Family Council member since its inception in 1999. Jim currently serves as chairman of the Scott Family Council, vice chairman of First Interstate BancSystem, Inc., chairman of the Padlock Ranch Company, chairman of the Homer and Mildred Scott Foundation and chairman of the First Interstate BancSystem Foundation.

Chris Scott

Chris Scott is married to Jim Scott and has been active in Scott Family Assembly activities for many years. Chris was involved in developing the Scott Family newsletter and website and continues to support communication activities of the family. She is also active in various philanthropic organizations and currently serves on the national Board of Governors of the Nature Conservancy.

Randy Scott

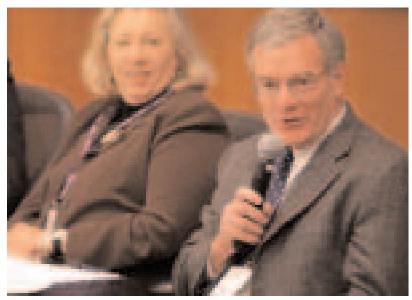
Randy Scott is a third generation Scott family member. Randy worked in various capacities for First Interstate BancSystem, Inc. for a period of 20 years. He was a director of First Interstate BancSystem from 1993 through 2000 and was elected again in 2003. Randy has served as a director of First Interstate BancSystem Foundation since 1999. He also serves as a Scott Family Council member and has been very involved in various family business education activities.

Charles Heyneman

Charles Heyneman is a third generation Scott family member. He has been employed as an application developer in the data processing area of First Interstate BancSystem since 2000 and has been employed within the company in various other positions since 1993. Charles was recently nominated for the Board of Directors of First Interstate BancSystem and assumed that position in May. He was elected to the Board of the Padlock Ranch Company in 2003. Charles also serves as a Scott Family Council member and is the vice chairman of the council.

Lynette Scott

Lynette Scott is married to Randy Scott and currently serves as a Scott Family Council member. She is also serving as a director of the Homer and Mildred Scott Foundation and was recently elected a director of the First Interstate Foundation. Lynette also chairs the Family Unity Network for the Scott Family Council and has been active in directing an early childhood development initiative of the Homer and Mildred Scott Foundation.



Dick Fellows

Dick Fellows is president of Scott Family Services, Inc., a family office formed in 2001 that provides services to Scott family members and their business enterprises. Dick was employed by First Interstate BancSystem for 22 years prior to his employment with Scott Family Services. During his last 10 years of employment with First Interstate BancSystem, he managed the Trust Financial Services Division of the company. Prior to his employment with the Scott family and their banking organization, Dick worked for the accounting firm of KPMG Peat Marwick.

(Part A) Defining Fair Process For Cousin Owners

January 29, 2003

Scott Family Council

Dear Scott Family Council,

As a family we have worked hard to structure our family to thrive in future generations, and, with all the hard work that the Family has endured, it pains me to see how the latest election process and the actions of the 2nd generation will surely fragment our family further....

The entire family endured a painful process to develop guidelines for elections and qualifications for these posts, the family council and 2nd generation does not have the right to rewrite the rules without the consent of the Family Assembly .... A policy was developed that was voted on and accepted by the Family Council on how the election process would be conducted, that too was also not adhered to by the Family Council ....

There were only two posts available for the FIBS board and why were there three candidates selected?

What has recently transpired has the real potential to move us apart. The Family Council needs to ensure that their behavior is consistent with our values and mission statement. We need to ensure that our behaviors move family members to active involvement.

I look forward to meeting with the Family Council to discuss my reactions to the process and to the outcomes of our "One Family Quest." Please let me know how we can make that happen as soon as possible.

Hopefully yours,
Third generation Scott family member

Introduction

On the morning of January 22nd, 2003, members of the Scott Family Council met to ratify the nomination of three third generation cousins to serve on the board of First Interstate Bank, a family controlled regional banking power in Montana and Wyoming.

The board of First Interstate BancSystem (FIBS) was composed of six family members, the CEO and ten outside directors. (**See Exhibit A1: FIBS 2002 Board of Directors Makeup.**)

In 2001, as part of the board policy to encourage family board participation and to ensure family continuity from the second to third generation, the five Scott family siblings from the second generation[1] (**See Exhibit B1: Scott Family Genogram**) decided to reserve two board positions for the third generation in order to provide family members with an opportunity to learn governance and prepare for eventual stewardship. The two board positions were for three years each with a two term limit and were currently filled by Sandy Suzor and John Heyneman. Suzor was completing her first term. Dan Scott, having reached age 72, was the first second generation member to reach the mandatory retirement age. Therefore there were two family positions available[2].

The selection process to determine the next slate had not gone well. The process had called for interested family members to submit a self-nomination letter to the Family Council -- the Scott's governing body that the family established in 1999 to help it handle governance issues. The Family Council in its current form was reorganized in late 2001. (**See Exhibit C1: Scott Family Council.**) Five candidates applied. A review committee would then interview and nominate the two most qualified candidates.

The review committee had been selected by the Family Council (FC) which was empowered by the family to organize the selection process and submit the nominations to the FIBS board for approval later that spring. In his capacity as FC chairman, Jim Scott, 53 years old and the youngest second generation sibling, requested to expand the review committee so that direct family members were not put in a position of having to vote for their sons or daughters. Review committee members would abstain from voting for their nuclear family. The committee included three second generation members – "Scotty", FIBS chairman, Tom Scott, FIBS CEO, Dan Scott, FIBS retiring director - and one non-family advisor – Jim Haugh, an outside FIBS director.

On the afternoon of January 21, 2003 the committee met at the bank's headquarters in downtown Billings, MT to interview the candidates. Choosing to participate as non-voting observers were Jim Scott, Dick Fellows - the president of the Scott's family office - and Susan Heyneman, the only sister in the second generation. Therefore, it happened all five second generation siblings attended the meeting. After conducting the interviews the review committee decided at the last minute to expand the number of board positions and recommend three nominees instead of the two as originally planned. Sandy Suzor, Randy Scott, and Julie Scott were recommended for board positions. Commitments were made to Jon Scott and Charles Heyneman that development opportunities would be provided to prepare them for board positions in the future. (**See Exhibit D1: 2003 FIBS Board Selection Process.**)

At the January 22nd Family Council meeting to review the committee's decision, the process and outcome generated a lot of discussion with several family members expressing disappointment and concern that the result seemed to be motivated by second generation concerns for family branch representation.

"The five of them would get together and make the decisions. That's the way it has always been. It seems like we take two steps forward and one step back," commented John Heyneman, one of the third generation cousins.

"A political battle was fought during this election, a battle of representation of ownership and succession by family lineage," wrote Jon Scott, another third generation cousin.

While acknowledging that the process needed to improve, "the third generation has to trust that the second generation will not do anything to their detriment," said Tom Scott, one of the second generation siblings on the review committee.

As the chairman of the Family Council, Jim was deeply pained by the discord and disappointment that the process engendered. Although he felt that the selection decision was the right one at the time, he also knew that the process was not perfect and needed to improve.

Over the years, Jim had been instrumental in keeping the family focused on family unity, development, and good governance practices. Dan Scott, the oldest second generation sibling, called Jim, "the conscience of the family. Without Jim's determination, we wouldn't be as far along as a family as we are." Tom Elliott, an outside director of the family's Padlock Ranch, remarked, "Jim is extremely persistent in his commitment to a real sense of family and a real sense of governance. He has a lot of patience and involves a lot of people to make decisions."

Background

The Scotts owned two major enterprises: First Interstate BancSystem, one of the largest privately held banks in the country, and the Padlock Ranch, a substantial ranching operation along the foothills of the BigHorns Mountain range. The family businesses were started by Homer Scott who along with his wife Mildred divided ownership equally among their five children: Dan, Homer Jr. "Scotty", Tom, Susan, and Jim. In addition, the family grew to include nineteen third generation cousins plus their spouses and a growing number of fourth generation members.

Since Homer's death in 1993 at the age of 89, the important family decisions were made by the five siblings of the second generation. The second generation had all been close to Homer and witnessed first hand the lessons and values passed down from a very demanding, hard charging founder. "Having grown up under the same roof," Tom Scott would say, "we heard the same lessons and values from our mother and father and we were used to talking about difficult issues with our brothers and sister." Furthermore all the siblings had at one point or another in their careers been involved in running and overseeing the family enterprises: Dan at the ranch, Scotty, Tom, and Jim with the banks, and Susan in the governance of both. Over the years they developed a consensus approach to decision making.

By contrast, the third generation of cousins was far more numerous and their familiarity with each other and involvement with the family businesses were more varied. It became apparent that the informal decision process that worked well with the second generation was not going to be effective with the third generation of cousins who had grown up in different homes, at different times with varied life experiences.

As some in the second generation neared retirement age and were planning to step down from their directorship positions, increasingly the responsibility of enterprise oversight would fall on the third generation of cousins.

In Family Council meetings questions about the future were explored. With far more cousins than board positions, how should the family select members to serve as directors? (**See Exhibit E1 – History of Third Generation Board Service.**) As the family businesses grow ever more complex what qualifications should family members possess to serve as directors? Should the family select the most "qualified" candidates and how would those qualifications be determined? Or should the selection be based on family branch? Or should it be by ownership representation? Over the years, some branches of the family had lessened their percent ownership interest, and others had increased their percent ownership interest. Dan Scott remarked, "I find it hard to accept that a family branch that has a more substantial ownership interest may not be represented. If you owned 10% of a public company you would expect a seat on the board." Should there be term limits to encourage development of other qualified applicants?

Jim knew that the selection process had created a lot of mistrust and hurt feelings. The frustrations risked jeopardizing the progress the Scotts were making towards a more unified family. He understood that the family needed to reflect on what had happened, learn from this experience, and refine the process in order to move forward. "We have tremendous potential as a family, with great diversity, quite a bit of competition," he would say, "but we are well intentioned and have great instinct."

HOMER SCOTT: FIRST GENERATION FOUNDER

Homer Scott had started as a day laborer in Lincoln, Nebraska during the depression and would eventually help build Peter Kiewit Sons into one of the biggest and most profitable construction companies in the U.S. As Kiewit's fourth employee he expanded the business West in the forties and fifties and helped build many of the country's highways including roads to Yellowstone and Jackson Hole. He retired as a director and as one of the company's largest shareholders.

In addition to his long and remarkable career at Kiewit, Homer started two successful enterprises, a ranching operation in 1943 and a banking business in 1968. Over the years, the banking business grew to become the First Interstate BancSystem with 58 branches in Wyoming and Montana and 2002 assets over $3.5 billion. The Padlock Ranch developed into the 10th largest cow-calf operation in the country with approximately half a million acres under management, an area three-fourths the size of Rhode Island.

In his later years, Homer with his wife Mildred started the Homer and Mildred Scott Foundation to give back to the community of Sheridan, Wyoming where they lived. With a community banking system, the ranching operation, and a philanthropic foundation with 2002 assets in excess of $22 million, Homer left his children three successful family enterprises, an indelible work ethic, and a strong sense of community service. "He was a hard driving, remarkable man… he has made a difference in a lot of people's lives in this part of the country," said Dick Fellows.

RANCHING: A FAMILY LEGACY

By the time of Homer's passing, the second generation was actively involved in the family businesses. Dan, the oldest sibling, started working at the Padlock Ranch in his childhood. Following college graduation he started his own ranch which he later merged into the Padlock. In 1970 he took over management.

The Padlock Ranch started with 3000 acres and 300 calves. In 2002 the ranch employed 55 people, and sold 12,000 calves a year. The ranch irrigated 5,000 acres of farmland and annually produced 11,000 tons of dry hay, 20,000 tons of corn silage, 15,000 tons of hay silage and 60,000 bushels of barley to support its grazing operations. Under Dan Scott's leadership the Padlock Ranch became one of the premier cow-calf operations in the country by integrating production agriculture to supply its feeding programs, enabling the ranch to control the decision of when to sell its calves.

Although the ranch represented a sizable asset to the family, its illiquid nature and the family's concern over the potential need to sell some of the land to pay future estate taxes led the five siblings of the second generation to develop a partnership structure in order to minimize estate taxes and to preserve the ranch as a legacy for future generations. "It was important to us that there was a place where successive generations could gather and feel an emotional connection. We wanted this ranch to be a living heirloom," said Jim Scott.

In 1999, the Padlock Ranch elected its first outside director, Tom Elliott, who had spent 25 years running his family's seed and animal stock ranch business, which sold Black Angus cattle semen and embryos worldwide. Elliott and the family members on the board led the effort to help management develop enterprise accounting to better assess operations. "We needed to understand which parts of the operations were doing well and contributing positively, and where there were drains on the organization. Then we could make sure that the ranch's goals were aligned with the family's goals. The Scott family wanted the ranch to be an example of environmental stewardship and, therefore, by definition, not maximizing short-term economic return," he said.

In 2002, Dan Scott retired and the board (**See Exhibit F1 – 2002 Padlock Ranch Board.**) considered internal candidates and conducted an external search for a new CEO. For the first time in the history of the family's for-profit enterprises they selected a non-family CEO. Dan reflected, "you really have to love the place and I viewed this more as a way of life that is 24 hours a day 7 days a week. Not many family members are interested in this way of life."

BANKING: THE FAMILY FINANCIAL ENGINE

The bank business started when Homer acquired a controlling interest in the Bank of Commerce in Sheridan, Wyoming in 1968. Two years later he bought a controlling interest in the Security Trust & Savings Bank of Billings, Montana. The family kept buying new banks and opening new branches in the two rapidly expanding states. Homer, Jr. ("Scotty") was entrusted to run the Wyoming banks, while brother Tom managed the Montana branches. In 1986 as the banking enterprise grew, the family decided to merge the two banking operations to reduce duplication. Tom was tapped to be CEO of the combined entities while "Scotty" became chairman.

Tom Scott built the family banking business into a regional powerhouse focused on community banking. In 1986 the Scott banks entered into a franchise relationship with First Interstate Bancorp, a California based super-regional bank. In 1995 the California franchisor was acquired by Wells Fargo. The family acquired six of their Wyoming and Montana branches and in the process grew its asset base by 40%. The Scotts have retained the First Interstate BancSystem name. In 2002, with 1800 employees, FIBS was the leading bank in Wyoming and Montana. The family controlled 80% of the stock and employees and directors owned the remainder.

In 1990, the bank created the First Interstate BancSystem Foundation to direct a portion of the company's philanthropy towards causes that the Foundation Board believes are appropriate for the company. (**See Exhibit G1: First Interstate BancSystem Foundation Board.**) Over the years, the Foundation has focused on regional economic development and assistance to disadvantage communities within markets that the bank serves. In 2002, the Foundation and the bank's branches gave a combined $2.2 million through grants, branch donations, and employee gift matching program to 28 communities.

In 1999, the family faced a decision on whether to go public. An IPO of the banking operation presented many advantages. The money would have provided funds to pursue acquisitions. A public stock offering would have also meant increased liquidity for the family shareholders. While some family members were involved running and working at the bank, others were engaged in different business pursuits and could have used the liquidity in their respective endeavors. A public stock offering would have helped the family diversify its assets and facilitate estate planning.

To help evaluate the IPO idea, the family consulted with FIBS director Jim Haugh who had previously headed the banking and tax practice for the Big 4 accounting firm KPMG. After listening to all five branches of the family, Haugh advised the Scotts to keep the bank private, for its role as an economic engine for the family as well as for its contribution to the community. "They too modestly underestimated how good they were at running the bank and how they affected their communities," he remarked. "The Scotts had an intense desire to engage in the life of the community in a positive way. There is a strong loyalty that the employees had towards the Scott family. This bank was a paradigm in making a difference in the lives of so many people." The Scotts decided to commit to private control of the bank for the next five to seven years.

Additionally, Haugh recommended that the family work with an outside family business consultant to strengthen its family cohesiveness and its sense of collective purpose. "Each family branch was gravitating away from the center in its own direction." The shared vision emerged to remain private -- unless new strategic opportunities required a new assessment.

In 2004 Tom Scott was scheduled to retire as CEO of the bank holding company and "Scotty" was expected to retire as chairman. With an excellent COO in place another non-family CEO of a Scott enterprise was likely.

THE RISE OF THE THIRD GENERATION

The nineteen members of the third generation of the Scott family and their spouses convened for the first time in the summer of 1993[3]. They agreed to meet annually as a group to get to know each other better. Several were actively involved in the family businesses. Most pursued other careers – some far from home.

Three cousins, John Heyneman, Dan's daughter Trink Morse, and her husband Tom, chose to work at the ranch. Another three - Julie Scott, Jon Scott, and Charles Heyneman - were pursuing management careers at the bank. Randy Scott had worked at the bank from 1976 to 1999. Additionally, James Scott Jr. recently joined the bank's management training program.

Other cousins were unsure as to what career and leadership opportunities were available. They didn't know if the family enterprises offered positions to any family member who expressed interest nor how in-laws or ex-spouses would be treated. And if they did work for the family, how compensation and performance reviews would be handled. "As a family member you have always been told by your family and are conscious that others will be watching and you have to always work harder than everyone around you," commented Julie Scott, a branch president at First Interstate.

In 1998, questions of third generation commitment as well as leadership and governance succession concerns at the bank and the ranch led the Scotts to mobilize to prepare for a generational transition. They questioned what it meant to be a family; explored the family's vision, mission and values; discussed what governance structure would ensure the family's legacy and the continued success of their enterprises.

"As a third generation group, we didn't know each other very well. The subsequent reunions that the third generation organized were one of the best things that we ever did," said Randy Scott. "In the past few years I have also seen a sincere effort on the part of the second generation to try to bring the family closer and to plan a transition."

SCOTT FAMILY GOVERNANCE: A FAMILY IN TRANSITION

Since 1993, the Scott family had been meeting each August for a family reunion. In addition the third generation began its own yearly social gathering in February, held a "cousin" camp at the Padlock Ranch during the summer, and published a newsletter, *Relatively Speaking*. The meetings also served as a way to update the family on shareholder matters. (**See Exhibit H1 – Scott Family Meeting History.**)

At the September 1998 family reunion, the Scotts discussed the idea of establishing a Family Council to represent the family and to oversee the family's interests in business, foundations, family financial services, and family education. The family formed several committees to further develop the family's governance process: A Family Council task force, an Education Committee, a Communications Committee, a Family Mission, Vision, and

Values Committee, and a Succession and Leadership Continuity Committee[4]. Family members volunteered to chair or co-chair the various committees and to recruit more members. (**See Exhibit I1 – Family Council Task Force and Committees.**)

A task force worked with outside family business consultants and studied other families' governance structures. In March 1999, under the leadership of Jim Scott, the task force unveiled the new family governance structure at a family gathering in Red Lodge, MT. It included a constitution, with a set of family values, family vision and mission statements, and a charter for a Family Council including its purpose, structure, and funding. (**See Exhibit J1, J2, and J3 – Scott Family Constitution Preamble, the Scott Family Values, Vision, and Mission Statement, and the Family Council Charter.**)

The task force also defined the Family Assembly to include all those older than fifteen years of age who were direct descendants of Homer and Mildred Scott or were married to a direct descendent. The Family Council was to be comprised of between seven to nine members. All second generation members served on the initial Council. Four members of the third and fourth generations were eligible to serve and an annual democratic election would be held to select them. Terms would be staggered and last for three years. Council members who reached the age of 65 would leave the Family Council and join the Council of Elders which was to mentor family members and to provide guidance.

The objectives of the Family Council were stated as following:

Demonstrate our values to future generation

Invest in talents, enable education, develop creativity, and leadership and reward merit

Ensure high quality governance and ownership oversight of the family's enterprises

Encourage and reward involvement

Encourage compassion and commitment to make a positive difference in our community

Promote focused philanthropy while celebrating diverse pursuits

Listen to the ideas of others and create reliable partnerships

Achieve a common mission without sacrificing diversity

Promote innovation, risk taking and entrepreneurial spirit

Cherish individuality, creativity, independent thinking, and freedom of choice

Celebrate family and personal growth

Embrace life, personal joy, shared fun and celebration as foundations to our individual and family vitality

The new family governance structure was ratified and endorsed by the family at the Red Lodge meeting with "Scotty" calling this "the official beginning of the passing of the torch from the G2s to the G3s." To help bridge the transition, all five second generation siblings volunteered to serve on the Council for the first year. At the end of the first year Dan and "Scotty" would then found the Council of Elders, which would include the other second generation siblings as they reached 65. Five members of the third generation completed the first Family Council: James Scott Jr., Val Heyneman, Julie Scott, Randy Scott, and Heather Waddell. The first meeting of the Family Council took place on June 18, 1999 in Billings at the bank's headquarters.

The first Family Council meeting concluded with a meeting of the second generation to discuss plans for an Owners' Council to explore shareholder goals. The second generation siblings felt that there were some issues that needed to be discussed in an ownership forum before they were brought to the Family Council for further resolution. These issues included management succession, growth strategy of the operating businesses, and board composition. The initial composition of the Owners' Council consisted of the five second generation members. They agreed to meet twice a year, to vote by share ownership if consensus was not achieved, and to report back to the Family Council.

By May of 2000 third generation concern that the Owners' Council kept the second generation in control of important family financial decisions caused the Family Council to reorganize. The Owners' Council was disbanded in favor of a multi-generational Ownership Committee which became responsible for ownership education and enterprise governance.

FAMILY GOVERNANCE ISSUES

The Scott family faced several questions. One was how the family viewed itself in relation to its businesses. The Scotts reflected on whether they considered themselves a "family business", a "business owning family", or an "enterprising family." By family business, they meant that the businesses served family members personal interests and needs. A business owning family meant that they looked at their businesses mostly as professionally managed investments. To them an enterprising family meant that all the enterprises were synergistic means to accomplish the collective, long-term vision and mission of the family.

An enterprising family demanded that the family take very active leadership to strengthen their enterprises and to assure that the enterprises reinforced the values of the family. Ultimately, the Scotts resolved to be an enterprising family. It was a way to make a difference in society and to accomplish the family's mission of unity.

Another governance concern was how to make family decisions given the varying degrees of stock ownership among family members. Over the years some family branches bought or sold shares from or to each other. They debated whether decisions should be made by one share one vote which favored family branches with a higher percentage of ownership or whether it should be one person one vote which would favor family branches with more family members. In the end the Scotts decided to embrace a "one family" vision. In that spirit the family adopted a one person one vote process that assumed that each individual member would vote in all business and family matters in the best interest of the whole family regardless of family branch of origin.

In early 2000, the family created the Scott Family Services office (SFS), headed by Dick Fellows, who had been one of the family's most trusted advisors for 25 years. Dick had been a tax advisor to Homer and to the family enterprises. He had also been CFO and founder of the HR department at the bank and led the bank's Trust department for eight years.

The second generation siblings agreed they needed a trusted advisor to support them in their personal financial and estate planning. Dick also felt that there was "a need to be able to understand and combine the estate planning of all five families to understand how it was going to affect the bank and therefore all the families. For example, one third of the bank stock will eventually be held in various family foundations[5]. Family members needed to be trained as trustees and for grant making, investment management and fiduciary responsibilities."

There was also the recognition that the family needed support in succession planning and family governance as it was going through the generational transition. A main goal of the office was to provide support to family members in their personal development and to prepare them for family leadership and governance positions.

To that effect SFS would have the responsibility for implementing the Continuity Planning, Organizational Succession and Evolution system (CPOSE). The CPOSE system defined the competencies needed for the various governance roles, evaluated the qualifications of family members for those roles, and provided training and development for family members to prepare for those roles in order to be successful.

"I think there is a realization that family issues of succession were coming faster than family members would think," according to Dick.

A "FAIR PROCESS": SELECTING THIRD GENERATION COUSINS FOR BOARD POSITIONS

The 2003 bank directorship nomination process left family members questioning whether the family was practicing its stated goal of selecting the most qualified candidates regardless of branch representation and whether it was progressing towards its vision of the "one family" concept. Jim was deeply concerned as he recognized that the family was going through a difficult generational change, from the informal collective consensus driven approach of the second generation siblings to a more formal democratic collaborative method among third generation cousins. The family needed to develop a fair process to select directors among the cousins that could serve as a blue print for all future elections and selections.

With two operating businesses, a family foundation, a corporate foundation, a family office, and a family council, the Scotts had several upcoming board positions to fill. (See Exhibit K1 – Scott Family Boards – Schedule of Family Director Openings.) "We need to grow from our experience and improve the process for us to progress and for more people to accept the outcome," commented Charles Heyneman, a third generation cousin and vice-chairman of the Family Council.

"We need to prepare our third generation. In order to facilitate the transition, we need trust, structure, commitment and competencies," Jim said. "We need to develop a clear understanding of ownership and governance and a good board development program for family members who wish to serve. Our biggest achievement will be the successful transition in generational leadership."

NOTES

1 The five Scott siblings from the second generation, Dan Scott, Homer Jr. "Scotty", Tom Scott, Susan Heyneman, and Jim Scott were the children of Homer and Mildred Scott and headed the five Scott family branches.

2 Third generation representation on the bank board evolved when the second generation decided in 1993 to have one third generation director. Randy Scott was selected. Subsequently, John Heyneman replaced his mother Susan on both ranch and bank boards. In 2001, the second generation decided that there should be two third generation positions. Sandy Suzor was selected to follow Randy and John's status changed from representing his mother to being the other third generation director.

3 The Scotts held their first family gathering in many years in August of 1993. The meeting was to discuss the new partnership of the Padlock Ranch to minimize estate taxes and preserve the Ranch as a family heirloom. The gathering was made more profound by Homer Sr.'s death three days before the meeting. The family resolved to meet annually and renew their commitment to each other.

4 Subsequently the Task Force approved a Family Fun Committee to ensure that having fun together at family meetings was a high priority, in part to encourage attendance.

5 As part of their estate planning several second generation siblings were planning to create individual family foundations and transfer some of their ownership interest to these charitable organizations.

EXHIBIT A1

First Interstate BancSystem
2002 Board of Directors

Director	Title and Relationship to the Family	Member Since	Term Expires
Homer Scott, Jr.	Chairman of the Board 2nd generation family member	1971	2004
Thomas W. Scott	Chief Executive Officer 2nd generation family member	1971	2005
Lyle R. Knight	President & Chief Operating Officer	1998	2003
James R. Scott	Vice Chairman of the Board 2nd generation family member	1971	2003
Dave Crum	Outside Director	2000	2004
Gary Jennings	Outside Director	2001	2005
Bob Nance	Outside Director	2001	2005
Elouise Cobell	Outside Director	2001	2003
Terry Payne	Outside Director	2000	2004
Rick Dorn	Outside Director	2001	2003
Joel Long	Outside Director	1996	2004
Dan S. Scott	2nd generation family member	1971	2005
Jim Haugh	Outside Director	1997	2005
Bill Ebzery	Outside Director	2001	2004
Larry Suchor	Outside Director	2001	2003
Sandy Suzor	3rd generation family member	2000	2003
John Heyneman	3rd generation family member	1998	2004

EXHIBIT B1: SCOTT FAMILY GENOGRAM IN 2000

1st Generation	2nd Generation	3rd Generation	4th Generation
Homer A. Scott, Sr. (1904 - 1993)	**Dan Scott (1931-)**	Randy (1954-) & Lynette (1957-)	Shad (1981-), Kayla (1982-), Shann (1986-), Devin (1990-)
Mildred Scott (1906-2000)	Jeanne (1933 -)	Ronald (1954-) & Audra (1969-)	Jeremy (1980-), Geoffrey (1982-), Bailey (1993-)
		Riki Davidson (1957-)	Rebecca (1983-)
		Risa (1959-)	
		Rae Ann Morss (1961-) & Tom (1958-)	
	Homer A. Scott, Jr. (1933 -)	Susan Baker (1957-) & Troy (1967-)	Brekken (1993-), Bayler (1994-), Blake (1997-), Blayne (1999-), Bridger (2003-)
	Janet (1935 -)	Sandy Suzor (1959-)	Sara (1982-), Sam (1991-)
		James (1969-) & Jill (1971)	James (2001-)
		Homer R. (1971-)	
	Susan Heyneman (1938 -)	Alexander (1959-) & Andrea (1962-)	Alexander (1994-), Allison (1996-), Andrew (2000-), Devin (1990-)
	Jack (1929 -)	Charles (1960-) & Valeria (1969-)	Kyle (1993-), Ethan (2000-)
		James (1961-) & Julie (1957-)	Jesse (1988-), Troy (1990-)
		John (1967-) & Heather (1968-)	Quinn (2000-), Aria (2003-)
		Thomas (1969-) & Kate (1962-)	Jamie (1981-), Alex (1988-), Jacob (1993-), Spencer (1995-)
	Thomas Scott (1943 -)	Julie (1971-)	
	Joan (1948 -)	Jonathan (1974-) & Jennifer (1975-)	
	James Scott (1949 -)	James (1977-)	
	Christine (1948 -)	Courtney (1980-)	
		Dana (1987-)	

EXHIBIT C1

Scott Family Council 2002 (all family members)
Three Year Terms Unless Otherwise Noted

NAME	Tom Scott
RELATIONSHIP	2nd generation
TERM EXPIRES	At age 65
NAME	Jim Scott
RELATIONSHIP	2nd generation
TERM EXPIRES	At age 65
NAME	Lynette Scott
RELATIONSHIP	3rd generation
TERM EXPIRES	2003
NAME	James Scott, Jr.
RELATIONSHIP	3rd generation
TERM EXPIRES	2003
NAME	Julie Scott
RELATIONSHIP	3rd generation
TERM EXPIRES	2004
NAME	Randy Scott
RELATIONSHIP	3rd generation
TERM EXPIRES	2004
NAME	Charles Heyneman
RELATIONSHIP	3rd generation
TERM EXPIRES	2004
NAME	Troy Baker
RELATIONSHIP	3rd generation
TERM EXPIRES	2005
NAME	Kate Heyneman
RELATIONSHIP	3rd generation
TERM EXPIRES	2005

EXHIBIT D1

2003 First Interstate BancSystem Board Selection Process
For third generation board positions

Selection process

November 9, 2002 Family Council (FC) meeting. Family Assembly (FA) empowers FC to organize selection process and submit nominations to FIBS board. Two positions will be open. Terms are for three years with a two term limit.

December 17, 2002 FC meeting. FC discusses director nomination process and approves plan. FC sends memo to FA on December 18, 2002 communicating nomination process.

Memo explains selection is based on “most qualified candidates” to emphasize professionalism, reward merit and promote “one family” approach.

Interested family members are asked to write a letter of self-nomination. Beforehand Scott Family Services office distributes to FA members documents describing board responsibilities.

Self-nominations close on January 13, 2002. Five candidates submit self-nominations to the FC: Sandy Suzor, Julie Scott, Jon Scott, Charles Heyneman, and Randy Scott.

Jim Scott, FC chairman, sends copies of self nominations to FC, Council of Elders, and all candidates.

On January 14th, 2002, Jim sends memo to FC describing the interview process and identifying the review committee. He recommends expanding the review committee so that review committee members would not be put in a position of voting for their own children.

The review committee consists of second generation family members Tom Scott, “Scotty” Scott, Dan Scott, and also outside director Jim Haugh.

In the memo, Jim mentions that he also will be attending the interviews as FC chairman and that Dick Fellows would attend in his capacity as Scott Family Services president.

Susan Heyneman, as a Council of Elders member, decides to attend the interviews as a non-voting observer.

Review committee interviews the five nominees on January 21st, 2003.

Sandy Suzor is recommended for a second term with “Scotty,” her father, abstaining.

Subsequently Tom Scott and Dan Scott from the review committee excuse themselves from the selection meeting because their children are candidates.

The remaining group comes to a consensus that there should be three third generation board positions.

Randy Scott and Julie Scott are also selected. Commitments are made to Jon Scott and Charles Heyneman for development opportunities to help prepare them for future governance positions.

The Family Council meets on January 22nd, 2003 to review, discuss, and ratify nominations.

Review committee composition

Tom Scott – FIBS CEO, 2nd generation
Homer Scott, Jr. – FIBS chairman, 2nd generation
Dan Scott – board member, 2nd generation
Jim Haugh – outside board member

Other attendees of the interview process

Jim Scott – chairman of the Family Council, 2nd generation
Dick Fellows – president of Scott Family Services, non-family member
Susan Heyneman – Council of Elders, 2nd generation

Third generation candidates

Julie Scott
Randy Scott
Sandy Suzor
Charles Heyneman
Jon Scott

EXHIBIT E1

History of Third Generation Board Service as of 2003

FAMILY MEMBER	TERM
	First Interstate BancSystem
Randy Scott	1993 to 1999
	Elected for a three year term in 2003
John Heyneman	1998 to 2004
	Second three year term is up in 2004
Sandy Suzor	2000 to 2006
	Serving second three year term
Julie Scott	Elected for a three year term in 2003
	Padlock Ranch
Ron Scott	1985 to 1994
	1995 to 2000
John Heyneman	1998 to 2004
	Second three year term is up in 2004
Rae Ann (Trink) Morss	2000 to 2006
	Serving second three year term
Charles Heyneman	2003-2006
	Elected for three year term in 2003
	Homer and Mildred Scott Foundation
Lynette Scott	2003-2007
	Elected for a four year term in 2003
Sandy Suzor	2003-2006
	Elected for a three year term in 2003
	First Interstate BancSystem Foundation
John Heyneman	1997-2004
	Term expires in 2004
Randy Scott	1999-2007
	Elected for three year term in 2004
Sandy Suzor	2002-2005
	Term expires in 2005
Jennifer Scott	2004-2007
	Elected for three year term in 2004
Lynette Scott	2004-2007
	Elected for three year term in 2004
	Scott Family Council
Val Heyneman	1999-2000
Heather Waddell	1999-2002
Risa Scott	2000-2002
James Scott, Jr.	1999-2003
Lynette Scott	2000-2003
Julie Scott	1999-2004
Randy Scott	1999-2004
Charles Heyneman	2001-2004
Troy Baker	2002-2005
Kate Heyneman	2002-2005

EXHIBIT F1

Padlock Ranch
2002 Board of Directors

Director	Title and Relationship to the Family	Member Since	Term Expires
Wayne Fahshotz	Non family President and CEO	2002	2005
Dan Scott	Retired CEO, 2nd generation family member	1968	2003
Tom Scott	2nd generation family member	1976	2005
Jim Scott	2nd generation family member	1976	2004
Tom Elliott	Outside Director	1999	2006
Jim Haugh	Outside Director	1999	2005
Burke Teichert	Outside Director	2001	2004
Trink Morss	3rd generation family member	2000	2006
John Heyneman	3rd generation family member	1998	2004

EXHIBIT G1

First Interstate BancSystem Foundation
2002 Board of Directors

Director	Title and Relationship to the Family	Member Since	Term Expires
Homer Scott, Jr.	2nd Generation	1990	2004
Tom Scott	2nd generation	1990	2007
Jim Scott	2nd generation	1990	2005
Lyle Knight	COO, First Interstate BancSystem	1998	2005
Elouise Cobell	Outside Director, First Interstate BancSystem	1998	2004
Gary Crum	VP and Branch Administration Officer, First Interstate BancSystem	2000	2004
Randy Scott	3rd generation	1999	2007
Sandy Suzor	3rd generation	2000	2005
John Heyneman	3rd generation	1997	2004

Scott Family Meeting History since 1993

August 1993 – General Family Meeting - Family holds first general gathering of family members in many years. Scheduled purpose is to review Scott Land and Livestock Partnership. Homer Scott's death a few days before the event and his funeral added profound significance. Randy Scott added to FIBS Board. Third generation organizes. Family decides to meet annually in August. Third generation agrees to meet in February.

February 1994 – Third Generation Meeting - Dayton Community Center third generation retreat. Themes include discovering a shared history, building friendship and affirming trust.

August 1994 – General Family Meeting - Family holds second reunion. Padlock Ranch partnership reviewed. Trip to Crow Fair. Survey of reunion experience conducted. Third generation holds general meeting. Family Booklet titled *Padlock Ranch* is distributed to all family members. It includes second generation discussion of family values, vision, and a third generation commentary and financial report.

February 1995 – Third Generation Meeting - Third generation retreat at 320 Ranch, Big Sky. Topics on estate planning and trusts.

August 1995- General Family Meeting - Third summer reunion. Second generation provides a panel discussion. Ranch tour. Pill's birthday at Powder Horn. Ranch rodeo and cook out.

February 1996 – Third Generation Meeting - Third generation retreat at 320 Ranch, Big Sky. Topics include Wells acquisition and Freeze partnerships.

August 1996 – General Family Meeting - Fourth summer reunion. Presentation on Wells Fargo acquisition and FIBS newly acquired banks. More discussion about Freeze partnerships. Report on the Padlock breeding program. Pills birthday at Powder Horn. Square dancing, volley ball, mountain bike ride, and four wheeling.

November 1996 – Family seminar - Family education seminar. Decision to develop survey of family progress made since 1993.

February 1997 – Third Generation Meeting - Third generation retreat at Big Sky Meadows.

August 1997 – General Family Meeting - Fifth family reunion. Review and interpretation of Family Progress Survey. Task Force reorganizes focusing more on action items.

October 1997 – Task Force Meeting - Task force meets in Big Sky. Action items are reviewed. Decisions to develop another survey to solicit family for their interests. Family reunion frequency is extended to 18 months.

September 1998 – General Family Meeting – Family discusses concept of family business and resolves to be an enterprising family. Tasks force is formed to develop Family Council governance structure.

October 1998 – Family Council Task Force Meeting – Task force clarifies committees' responsibilities and role of chairs. Add Family Fun Committee to Task Force.

November 1998 – Family Council Task Force Meeting – Task force prepares for upcoming general family meeting in March.

March 1999 – General Family Meeting – Update on Padlock and Bank status. Task force unveils Family Constitution, Values, Goals, Mission and Family Council charter. Family members endorse and ratify. All second generation members volunteer to serve on initial board. Five self-nominated third generation members are added in May.

June 1999 – Family Council Meeting – First meeting of Family Council. Jim Scott is elected chair, Heather elected vice chair. Discussion of role of Family Council. Specific goals and action plans are set for 2000. Second generation discuss the need for an Owners' Council.

September 1999 – Owners' Council Meeting – Second generation form Owners' Council. Define structure and voting. Discuss shareholder strategy and risks, leadership succession, board composition and governance.

November 1999 – Family Council Meeting – Review video project, newsletter, archive, family employment policy, and family member education. Discuss newly formed Owners' Council. Request for nominations for three upcoming Family Council Board positions.

May 2000 – Owners' Council and Council of Elders Meeting – Discussion of concept of Owners' Council and the design of an Ownership Committee. Discussion of preparation of G3 owners and directors, the G3 director election process, observer role, board succession, independent directors, strategy overview, management development succession, family philanthropy, foundation governance, estate planning, family office and role of Council of Elders.

May 2000 – Family Council Meeting – Coordination of Estate Planning. Reorganization of Family Council. Family Office is providing new set of services to the family.

June 2000 – Family Council Meeting – Review last year's programs. Council reorganizes. Four committees are created and chairs appointed.

August 2000 – General Family Meeting - Family reunion.

Review goals of new Family Council Committees.

September 2000 – Council of Elders Meeting – Review proposal for the creation of the Scott Family Services Office.

September 2000 – Ownership Committee – Review Ownership Committee's role and set near and long term goals.

September 2000 – Ad Hoc Finance Task Force Meeting – Review identification and allocation of family business related expenses.

March 2001 – Ownership Committee's Council Meeting – Review family board director policy.

July 2001 - Family Council and Family Assembly Meeting – Review the work of the Ownership Committee, Padlock Facility Taskforce, Padlock Recreation Taskforce, Helping Hearts, and Archive project. Description of the Family Office services including the Governance Development and Ownership Committee, the Family Council Coordination and Communication, Philanthropy Services, and Personal and Professional Services.

November 2001 – Family Council Meeting – Review committees' activities. Ownership Committee provides a historical perspective of the business goals of the family enterprises.

February 2002 – Family Council Working Group Meeting – Preparations for the upcoming Shareholder's Meeting in March. Family Council develops proposed changes to the Family Council Charter to include oversight responsibilities of the business enterprises. The Family Office presents an outline of the Continuity Planning, Organizational Succession and Evolution system (CPOSE).

March 2002 – Scott Family Shareholders Meeting and Family Council Meeting – Update of Family enterprises. Family Office introduces the CPOSE system. Family Council approves adding oversight responsibilities of the business enterprises to its Charter and embraces the concept of Parallel Planning as a way to align family and business goals.

April 2002 – Ownership Committee Meeting – Ownership Committee meeting. Clarification of ownership committee structure and evolution, update on CPOSE, and discussion of parallel planning.

July 2002 – Family Assembly Meeting – Review of the last nine year journey and overview of the Family Governance Structure.

July 2002 – G2 Meeting. Forum on the state of the family and generational transition.

July 2002 – G3 and G4 Meeting – Discussion of family survey, upcoming projects, and the formation of a vision for the continuing generations.

August 2002 – Family Council Meeting – Family Council prioritizes responsibilities and organizes to implement upcoming work.

September 2002 – Family Council Meeting – Clarify priorities and goals of FC and agree on what needs to be done, when, and who.

November 2002 – Family Council Meeting – Review prioritization of council responsibilities, compensation report, and director and trustee nominations, CPOSE competency descriptors, and Scott Family Service plan. Review of Strategic Planning for the Family Business book.

December 2002 – Family Council Meeting – Review of board selection and nomination process. Request for self-nominations. Identify Review Committee.

January 2003 – Family Council Meeting - Review and ratification of Homer and Mildred Scott Foundation and First Interstate BancSystem nominees for director positions.

March 2003 – Family Council Meeting - Review board selection process, develop fair process selection, and review parallel planning next steps.

EXHIBIT I1

Family Council Task Force

Family Council Task Force To propose a Family Council, and its structure and the process to select members. Coordinate and access the work of other committees. Jim Scott chair, Val Heyneman, Heather Waddell, John Heyneman, Julie Scott and Randy Scott.

Education Committee To propose an educational agenda for family education in business, philanthropy, and personal development. John Heyneman chair.

Communications Committee To create and implement strategies to communicate family and enterprise information to the family. Randy Scott chair, James Scott, Chris Scott, and Alex Heyneman.

Family Mission/Vision/Values Committee To refine these family statements and to guide the family as it addresses its business-owning vision for the future. Val Heyneman chair, Jon Scott., Susan Scott, and Lyle Knight (non-family FIBS COO).

Succession and Leadership Continuity Committee To identify the roles and qualifications for family successors to the business and foundation leadership roles. Heather Waddell chair, Dan Scott, Sandy Suzor, Homer Jr. "Scotty", and Jim Haugh.

All meetings are open and all family members are welcome to any meeting.

EXHIBIT J1

Scott Family Constitution Preamble

Like a river, a family flows across time. Believing a family begins with a mother and a father is like believing a river begins when it comes around the bend into one's view. An immediate family is where we naturally focus. But even it is fluid and changes, overtime. Some of the forces of change, like gravity, are predictable. Others, unexpected love or grief, are not.

A family is a community in a world where connectedness is increasingly difficult to find. Today we are more mobile and less bound to a place. We are less tied to a lifelong career, less tied to a shared religion or congregation. Family is one place where common blood, experience, joy, and values can provide the bond that satisfies our need for community.

A family is a rich environment for successful enterprise. Entrepreneurial and visionary founders can pass on their vision, expertise, and capital to future generations. Healthy family cultures can be successful business cultures. Family teams can be enterprise teams. The long-term nature of family provides patient capital. Family supportiveness can allow businesses to survive tough times.

As positive as family can be for spiritual, social and financial well-being, centrifugal forces seem to pull families apart. Only a fraction of family businesses survive past the second generation. Anecdotal evidence suggests that family can become more disconnected or conflicted rather than more cohesive over time.

For our purpose, the Scott Family "comes around the bend" with the marriage of Homer Scott and Mildred Sandall. The founding couple shared a deep love and respect for each other and a set of core values that guided them through life. They were unusually successful, by any measure. The five children, who make up the second generation, while separated by years and with diverse personalities, share the experiences of common parents and the immersion in their values. They also share the experience of working together in the family enterprises. Over the years the second generation has learned to live and work together, to respect each other's strengths and to forgive each other's weaknesses.

There is much work and joy to share. The process of building family is never complete. Like the river, a family's journey is a cycle, always beginning, always flowing.

EXHIBIT J2

Scott Family Values, Vision, and Mission Statement

THE SCOTT FAMILY VALUES

The Family's Reputation & Legacy

Empowerment and Education of Family

Community Investment and Involvement

Family Relationships, Teamwork & Diversity

Quality & Stewardship

Honesty & Trust

Empathy & Compassion

Hard Work, Discipline & Accomplishment

Shared Fun, Celebration & Joy of Life

SCOTT FAMILY VISION

In 2010 our family is closely knit with evolving relationships among members. We demonstrate loving kindness, tolerance and trust among one another. Family members have ongoing education and participate in family governance and family-focused activities. We are an enterprising family and our investments provide positive returns and reflect our values. We have a positive impact in our communities as individuals and as a family. We embrace our family values and heritage, promoting them in our lives and business endeavors.

SCOTT FAMILY MISSION STATEMENT

Our family is committed:

To develop our heritage for the benefit of all future generations and all whom the family serves;

To live out our core values, recognize they may evolve over time, and pass them on to successive generations;

To steward all of our talents, material and other;

To foster the development of each family member's maximum potential;

To be entrepreneurial and build upon our talents for the benefit of the family and our community.

EXHIBIT J3

Scott Family Council: Its Purpose, Charter, Structure and Funding

INTRODUCTION

We believe that the Council should exist to serve the family and to support its Mission. While the Mission recognizes that our material talents are a part of our heritage, we believe the Council is not primarily a business ownership council. The Family Council will surely address ownership issues such as whether we are an "enterprising family", family employment, family liquidity needs, etc. However, the Council is a service entity that neither usurps shareholder rights or responsibilities nor duplicates the roles of boards or management.

FAMILY COUNCIL CHARTER

The Family Council is responsible for marshaling the energy and resources of the family for the accomplishment of its Mission. The primary constituents of the Family Council are the family members, including those who are no longer living and those who are not yet born. Other constituents include our communities. The Council should have a long-term focus.

The Council's specific objectives shall include:

Demonstrate our values to future generations

Invest in talents, enable education, develop creativity and leadership and reward merit

Ensure high quality governance and ownership oversight of the family's enterprises

Encourage and reward involvement

Encourage compassion and commit to make a positive difference in our community

Promote focused philanthropy while celebrating diverse pursuits

Listen to the ideas of others & create reliable partnerships

Achieve a common mission without sacrificing diversity

Promote innovation, risk taking and entrepreneurial spirit

Cherish individuality, creativity, independent thinking, and freedom of choice

Celebrate family and personal growth

Embrace life, personal joy, shared fun and celebration as foundations to our individual and family vitality

COMPETENCIES OF COUNCIL MEMBERS

When selecting Council members, the family may look for the following competencies. These statements serve as a guide and we recognize that none may demonstrate them all, nor do we want these statements to discourage anyone from seeking to be a member of the Council:

Commitment to one family concept

Interest, engagement, and passion for the Family and Family Mission

Good communication and listening skills. Ability to support and inspire others

Good organizational skills

Open-mindedness

Reflect the Family Values

Commitment to the Family Values and Mission without regard to personal gain

Critical thinker and problem solver

PROPOSED GENERAL STRUCTURE FOR THE FAMILY ASSEMBLY, FAMILY COUNCIL AND COUNCIL OF ELDERS

The Family Assembly shall be made up of all those older than 15 years of age who are direct descendants of Homer and Mildred Scott or are married to a direct descendent.

The Family Council shall be made of 7-9 members of the Family Assembly. All second-generation members may serve on the initial Council.

No later than the age of 65, second generation members and their spouses shall become members of an honored Council of Elders (Dan and Scotty are grandfathered on the Council for one year). Among the responsibilities of the Council of Elders include a) ensuring maintenance of family history, b) orientation of young Family Assembly members, and c) mentoring and counseling the Family Council and family members.

Up to four members of the non-second generation Assembly will be eligible to serve on the Family Council. If interested in serving, they shall write a letter of interest/self-nomination to the Family Assembly. A democratic election shall take place among the non-second generation Assembly annually to elect these members.

Terms of Council Members shall be staggered and last for 3 years. The initial Council shall structure terms so that generally 2, but no more than 3 members shall be up for election in future years. If a member is unable to serve their full term their position will be filled at the next election.

The Council will attempt to reach consensus on issues. When necessary, votes will be taken using one person/one vote.

Family Council meetings are open to all family members of the Family Assembly. Council members, however, reserve the right to call for an executive session.

Council members may serve more than one term, and serve them consecutively, but non-second generation members must resubmit a letter of interest/self-nomination for each term.

Family Council shall elect a chairperson and vice-chairperson. The Council shall determine compensation, if necessary.

COUNCIL FUNDING

The Council shall determine its budget. Half of the necessary funding will come from the members of the second generation (5 members @ 10% = 50%). The distribution of the remaining 50% will be paid in equal amounts by the remaining members of the Family Assembly from the 3rd and 4th generations.

EXHIBIT K1

Scott Family Enterprise Boards
Schedule of Family Director Openings as of January 2003

First Interstate BancSystem (Three year terms)

TERM EXPIRATION DATE	NUMBER OF OPENINGS
2004	2
2005	2
2006	2

Padlock Ranch (Three year terms)

TERM EXPIRATION DATE	NUMBER OF OPENINGS
2004	2
2005	1
2006	2

Scott Family Services (Three year terms)

TERM EXPIRATION DATE	NUMBER OF OPENINGS
2004	3
2005	3
2006	3

Family Council (Three year terms)

TERM EXPIRATION DATE	NUMBER OF OPENINGS
2004	3
2005	3
2006	3

Homer and Mildred Scott Foundation (Varied length terms)

TERM EXPIRATION DATE	NUMBER OF OPENINGS
2004	1
2005	1
2006	1
2007	1

First Interstate BancSystem Foundation
(Three year terms except for bank branch representative)

TERM EXPIRATION DATE	NUMBER OF OPENINGS
2004	2
2005	2
2006	1
2007	3

(Part B) Addressing Family Goals And Visions In The Family Enterprises

On March 5th, 2003 the Scott Family Council met to review its board nomination and selection process and to develop a new planning framework for its enterprises that they called parallel planning.

Jim Scott, the Family Council chairman, knew that the family was eager to explore ways to improve the selection process to choose family members for director positions following the emotional experience of the bank board nominations in January. At that time the family struggled with its stated values and its vision of "one family," and had reverted to branch representation in its selection process.

With the help of outside consultants, the Scott family developed a set of revised guidelines in nominating and selecting candidates. (**See Exhibit A – Fair Process guidelines.**) All agreed that family decisions would be easier to accept if one believed that the process to make those decisions was fair. With board elections at its Padlock Ranch, First Interstate Foundation – the non-profit organization of the family controlled bank – and Family Council later this year, the family resolved to repair earlier damage and to move forward as a unified enterprising family.

Scott Family Enterprises (Part B)
Addressing Family Goals And Visions In The Family Enterprises

A CHANGING FAMILY AND MANAGEMENT LANDSCAPE

In January 2004, Lyle Knight was scheduled to succeed Tom Scott as CEO of the First Interstate Bank. Tom would succeed “Scotty” as chairman of the board with “Scotty” continuing as a director for a three year term. At the Padlock Ranch, Wayne Fahshotz had already replaced Dan in 2002. Both CEOs were non-family members. The third generation of cousins was eager to take a more active role in the governance of the various family enterprises.

Soon the second generation would no longer be active in the management of the family enterprises and a new mixture of non-family top management and second and third generation board members would guide the businesses. As the family progressed in this changing landscape, Jim felt that the family needed to ensure that the First Interstate Bank and the Padlock Ranch would represent the family’s interests in the future.

Bank management was actively engaged in a strategic planning process exploring ways to grow the bank both internally and externally. One priority included making new acquisitions. At the ranch, Wayne and his team were considering a major restructuring that would reduce the scope of the business, cut costs, and substantially trim the Ranch’s debt. Now more than ever the enterprises needed to know the expectations of family shareholders.

“We as a family need to understand the risks in our companies. Whatever strategy the bank pursues, we should make sure that we can understand and support it,” stated Charles Heyneman, a third generation member and vice-chairman of the Family Council. “We need to ask what it means for a business to be owned by the Scott Family, what is unique about that, and what key strategic issues the company is facing.”

“We worked hard to keep the businesses family owned. And if the five families want to keep and maintain our enterprises then it should be done intentionally,” added Sandy Suzor, another third generation cousin and FIBS director.

PLANNING FOR EFFECTIVE STEWARDSHIP

As the Scotts prepared their plans for generational succession, estate planning, and liquidity, Jim wondered the best way to coordinate family expectations and to communicate them with the Bank and the Ranch? "We are continually striving to understand as a family how to manage our companies and to be good stewards of our assets," he said.

Each year the Scotts have convened to celebrate their unity, share their joy with each other, and appreciate their diversity. They have attended cousins' camp, published a newsletter, collected and archived their heritage. They have adopted a family constitution, defined their values, and clarified their family's vision and mission. They have created a Family Council to serve that mission, an Elders Council to mentor younger members, a family office to support financial planning and personal development, and a human resource system to develop succession and leadership plans. Now they struggled with exercising their proper role as owners.

The siblings of the second generation were learning the bittersweet experience of letting go of control, yet were proud of their accomplishments and the capabilities of their children. As deceased founder Homer Sr. helped build the roads of the West and pave the way for the family's considerable future, the descendants of Homer and Mildred were collectively building the foundation to bridge successive generations. In their own way, they were echoing Homer's philosophy when he said, "I am only a steward of these assets while I am here."

EXHIBIT A
Fair Process Guidelines

No surprises – everyone knows the issue and the call to decision beforehand

No conflicts of interest – personal interest and agendas are disclosed

No rush – everyone feels that they have time to prepare and time to present their views

Sincere care – each participant feels respected and heard

Mutual commitment – genuine effort is made to find a "win-win" solution before a vote or decision

Good conduct – if proceedings were videotaped and shown to future generations, the process is a good example of which all would be proud

Objective outsiders – independent directors or family facilitators represent the interests of everyone, not some

Post-decision review – everyone discusses their views of the process and agrees to review the results of the decision later

RECIPIENT: The Bonnier Family
Bonnier Group
Stockholm, Sweden

SPEAKERS: Carl-Johan Bonnier
Chairman of the Board
Bonnier Group

Hans-Jacob Bonnier
Executive Vice President, Dagens Industri
Bonnier Group
Chairman
Bonnier Family Foundation

Kellogg Award For Special Contributions To Family Business

The Kellogg School of Management named the Bonnier family of Stockholm, Sweden as the recipient of the 2004 Kellogg Award for Special Contributions to Family Business. The annual award recognizes a business family that has consistently shown leadership in the field of family business and a willingness to share their expertise with other families in business.

The Bonnier Group is a publishing, media, information and entertainment conglomerate with international holdings. Supporting freedom of speech has been a key tenet of the Bonnier family for 200 years.

Kellogg Award For Special Contributions To Family Business

THE BONNIER FAMILY: GENEROUSLY SHARING THEIR EXPERIENCES

The Kellogg School of Management and its Center for Family Enterprises named the Bonnier family of Stockholm, Sweden as the 2004 recipient of the Kellogg Award for Special Contributions to Family Business. Each year, this unique award recognizes a business family that has made very significant, generous and personal contributions for the benefit of other families in business.

For years the Bonnier family has been devoted to promoting the values of family business and helping other family businesses learn more about planning for continuity. Hundreds of business families have benefited from the Bonnier's experience and efforts. The Bonnier Group has been a successful business enterprise for 200 years through nine generations. They were pioneers in supporting family business education and research. They have offered their experiences as examples in cases and research articles demonstrating how large and old business families build sustaining cultures for their family members and employees. They are founding partners of the Family Business Network in Sweden, participants and financial supporters of the Family Business Network International. They have created national prizes for successful entrepreneurship in many countries and host family business gatherings with participants from all over the world. They willingly share their experiences, insights, history and views for the benefit of others.

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Significant and unique in the field of family business: A few years ago they opened their business, family archives and family to a doctoral student at the Stockholm School of Economics. The student, Annelie Karlsson Stider, did a dissertation based exclusively on studying the anthropology of this family over the generations and through time, which led to one of the breakthrough concepts in the field of family business education—the concept of the family business as an heirloom.

GENERATIONS OF SUCCESS

Gerhard Bonnier opened a bookstore in Copenhagen in 1804. Eight generations later, the business is still led by family members and has evolved into a leading diversified media conglomerate with $2.5 billion in sales that operates more than 200 companies in 20 countries, most in northern Europe. The company publishes newspapers, magazines, books, business press, business information, films, radio, television programming and electronic media. Within the last 10 years, operations have rapidly internationalized so that 47 percent of sales are generated outside of Sweden, with plans to continue to increase that share. Owned and operated by sixth and seventh generation family members, the Bonnier Group is headquartered in Stockholm, employs 11,000 and is privately held by 73 members of the family.

ACCEPTANCE COMMENTS BY CARL-JOHAN BONNIER AND HANS-JACOB BONNIER

Carl-Johan: The Origins of Sharing

Some may wonder why we care so much about family business and why we spend so much time in sharing what we have learned. I can trace the start of that to 15 years ago in 1989 when our uncle died at the age of 82. He was the leader of our company and kind of a loveable dictator. We had no problems with the family harmony before, well with the harmony maybe, but not with the decision making because he made all the decisions. When he died in 1989 we found ourselves in the situation where we really didn't know how to structure the governance in the company. Some in our family happened to go to IMD, which is a business school in Lausanne, Switzerland where John Ward and some other American colleagues were lecturing about this subject. That gave us a start on a very good governance structure.

It took us almost 10 years to proceed through the generation shift, but we profited from this experience and we wanted to give back to others what we had learned.

It took us almost 10 years to proceed through the generation shift, but we profited from this experience and we wanted to give back to others what we had learned. We have exchanged experiences with many other similar companies in Europe and we have benefited from that also. By joining together with other family businesses we also form an important lobbying group. In Sweden and in Europe it is important that there is a large group, an important group that can shape opinion and policies that are good for our kinds of companies. These are the main reasons why we have involved ourselves with family business education.

Hans-Jacob: Family Structure

First I want to share a little about our history. Our company is in the ninth generation today. There are 73 owners, 27 women and 56 men. Sixty of the owners are over 18 and 12 are working in the company. The founder was Gerhard Bonnier who originally came from Germany to Copenhagen to start a publishing business there and he took the name Bonnier, his original name had been Gutkind Hirschel. He was an entrepreneur; he did all sorts of things. He even became editor-in-chief of a daily paper, which he published himself. He almost went bankrupt. He was the father of 11 children—three went to Sweden. Albert, the tenth child, started in the business at 17 years of age and became his father's business successor. Then came Albert's son, Karl Otto, who had two sisters but at that time women weren't accounted for in business so Karl Otto became sole owner. The fourth generation was my grandfather Tor, and his five siblings. The two girls didn't enter the company and one boy became a scientist. Three boys, Tor, Ake and Kaj, entered the company and became owners. In those days you didn't become an owner if you didn't work in the company. Tor and Ake put a lot of pressure on Kaj, who was CEO of the book publishing company and he didn't like that so he sold out in 1952-53. The ownership of the company went to the Tor and Ake branches of the family. In the fifth generation, 95 percent of the shares went to four people Albert, Johan, Lucas (Tor's sons) and Gerhard (Ake's son). Tor's three sons split the ownership, but Albert was the strong one who really was the board, general assembly, management and everything else in one person. Gerhard got all of his father Ake's ownership, so power was balanced a little. Simon, Karl-Adam and Michael, the last three sons of Tor, were each given a small percent of their brothers' stock.

Now, we come to the sixth generation, my generation. Perhaps what is interesting is the process of how we selected my younger brother Carl-Johan as the leader of our generation. We grew up together and are very close. We know each others' strengths and for me it was very natural that the most capable and suitable person should lead the generation, and that was Carl-Johan. It was a rather natural decision. There was no formal selection process, although he was elected in our general assembly.

When our generation took over leadership, we issued some new shares of stock and we offered Kaj's grandchildren the chance to buy back into the company again because we knew that they had been unhappy that he had sold out to his brothers. Two of Kaj's grandchildren bought into the business and at the same time we allowed two more relatives, Simon and Karl-Adam, to buy in, that way the company got some fresh capital.

Carl-Johan: Family Agreement

The 73 owners, or in some cases their parents, agreed not to sell the company within the next 30 years, which is one generation.

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BONNIER FAMILY TREE

9 Generations — 73 Owners
12 working in different positions in the company

1st Generation	2nd Generation	3rd Generation	4th Generation	5th Generation	6th Generation	7th/9th Generation
Gerhard (1778–1862)	**Albert (1820–1900)**	**Karl Otto (1856–1941)**	**Tor (1883-1976)**	**Albert (1907-1989)**	Charlotte Jeanatte	**11**
				Johan	Dan Hans-Jacob **Carl-Johan (1951-)** Albert Margaretha Malena	**15**
				Lukas	Jaquline Daniel Jan Peder Jonas	**17**
				Simon	Sam Betty Felix	**4**
				Karl Adam	Mattias Lisen Tor Johan Adam Louis	**3**
				Michael	Giacomo Filippe	
			Ake	Gerard	Karl Otto Eva Pontus Ake	**13**
			Kaj	Tomas	Kaj Marie	**2**

The agreement also states that anyone who wants to sell can sell their shares back to the company. The price is a function of the company profits and would today be 30 percent of what a fair market price would be. So far, no one has sold. All the shareholders get a stable dividend. While it is not so high, it is stable regardless of what the profits in the company are.

GOVERNANCE

General Assembly

The 73 family owners make up a general assembly, which meets formally once a year, but the shareholders gather together at least four times a year for different purposes where we communicate, discuss issues, and meet the managers in the company. Every person votes according to their number of shares in the assembly. Twelve of the 73 family shareholders work in the company in different positions. For instance, two are book publishers, one is a magazine publisher and one is a financial advisor and so on. The family members all work for different bosses in the company.

Holding Company

We have a holding company, Albert Bonnier AB, which has a 12-person board, all of them are family members and I am the chairman. These are mainly the family members in our generation working within the company, so it is very practical. The holding company does not have financial decision-making power, that lies with the operating company where all the investment decisions are made. The holding company does, however, have ownership of the business. At the holding company level we discuss family matters, plan strategies and keep ourselves informed.

Operating Company

Bonnier AB is the operating company, which oversees the various divisions. I serve as the chairman of the board. Bengt Braun is CEO and president. The Bonnier AB board is composed of five family members, five external directors and three representatives of the employees.

Management Board

A management board comprised of the CEO, the CFO, the HR and division CEOs oversees the various divisions in the company.

Six Divisions

There are six divisions within the company: books, magazine group, business press, newspapers, business information and entertainment. Each division has a separate CEO.

Hans-Jacob: Family Foundation

In the general assembly of the Bonnier Family Foundation we have one vote per person. The family foundation, like a family council, is occupied with family issues and there are a number of committees for people to choose among. We try to involve as many of the owners as possible who do not work in the company. We try to get them engaged in some manner in the various foundation activities.

The family foundation, like a family council, is occupied with family issues and there are a number of committees for people to choose among. We try to involve as many of the owners as possible who do not work in the company.

The family foundation board consists of eight people and the holding company board appoints two of those. The remaining six are voted for by the general assembly. They have six-year terms with two members rotating off every other year. There is a nomination committee of four people, two are appointed by the general assembly for a six-year term and two are those who are leaving the board. They nominate their successors. That is the structure of the elections. The aim of the family foundation is to keep the family together, to encourage family education, to distribute scholarships, especially to those in the family who don't want to work in the company but want to get an education in another field. We help them finance that. There are also two people who are deputies to the board. One is the chairman of the company, the other one is the chairman of the next generation group. We call the next generation group Gutkind and Company. Gutkind was the name of our founder and in German it means "good child." Gutkind and Company is for young family members from 16 to 32 years of age. They have a steering committee (like a board) that is elected every year. There are seven people on that committee and they have a chairman.

Then there are different committees, like the family mansion committee. In the mansion, we have a portrait gallery, started by my great-grandfather, of all the authors that we have published during the years. It is a rather unique collection and it is in the family mansion, where Carl-Johan lives. The portrait gallery and the rules, regulations and renovation of the mansion are taken care of by this committee. The financial committee safeguards the foundation's capital. The family archives committee supervises all of the letters and correspondence to and from the authors that we have published since the beginning. In addition, we have started to collect all the family diaries and letters that we could find. The archives are growing quite fast and we have let researchers come and use them.

The education committee mainly concerns itself with awarding scholarships and also family education.

Nurturing the Future Generations

Six or seven years ago we realized that the young people of the family didn't know one another. We thought that this might be a difficult and dangerous situation for the company's sustainability.

I want to talk a little more about Gutkind and Company. Six or seven years ago we realized that the young people of the family didn't know one another since some of them live in the United States, England, France, Portugal, etc. We thought that this might be a difficult and dangerous situation for the company's sustainability. So, in order for them to get to know each other and to learn to respect each others' ideas and personalities, we started holding seminars for them on general things like finance, balance sheets, loans and different things like that. We especially included seminars on company operations, company culture and family culture. They have a lot of fun when they get together, as well as learn about the family business.

Audience Questions

How do you financially support the activities of the Bonnier Family Foundation?
Hans-Jacob: We have no employed personnel. All of the 19 family members work for free. As for the activities we do, we have an understanding with the CEO so the holding company pays for the costs. But I can imagine one day that there will be a CEO who says no and then we will have to finance ourselves. That's why we try to build up a reserve.

Carl-Johan: Mainly, we take from the profit in the company to support the foundation. For instance, we have just started to build an art gallery in Stockholm, which will be managed by the foundation, but financed by the company.

Why did you set the buyback price for shareholders who wish to sell at 30 percent of what you thought the market value was?
Carl-Johan: Well, we do not want them to sell. This price was agreed upon by everybody and was written into the new shareholders' agreement that we created in 1998-99. Before that, the buyback price was zero.

Isn't it better to let dissident family shareholders get out of the business?
Carl-Johan: It is a balance. Neither the company nor the shareholders can afford to pay the real market price. Thirty percent of market price was settled on as a compromise. So far it works well because no one has sold and everybody is quite happy.

This was a shareholders' agreement that was unanimously approved?
Carl-Johan: It was unanimously approved, but of course some of the new shareholders were not there at the time. They will have the chance in 2030 to change this agreement. The old agreement before ours was made in 1953. There is a chance for each generation to decide what their generation wants to do. Also, remember that our company is 100 percent family owned. No one is allowed to sell externally.

Can you explain a little about your stable dividend?
Carl-Johan: We paid approximately $9 million this year in dividends and it has been increasing all the time from when we first started. Even in the years we have had a loss we issued the dividends. The policy was discussed quite a lot in the holding company and we came to this decision. We all understand that it is difficult to go to the external capital markets and that we have to finance expansion with our own funds. So we agreed on a dividend calculation that would allow us to retain enough capital for these needs while still providing a stable return to stockholders.

Can a family member be a CEO and who makes that choice?
Carl-Johan: The board of directors in the operating company hires and fires the CEO. A family member can be CEO. I was CEO before becoming chairman. But I must admit, I think the best situation is when a family member serves as chairman and the operating company has an outside CEO.

Hans-Jacob: Of course it should be added that no family member reports to another family member. They all have professional bosses who hire and fire them. They work in the company just as anybody else, but then they sit at the shareholders' meeting as owners.

Do you have a process through which the professional management prepares the next generation of family leadership?
Carl-Johan: No we don't, but we should. We have discussed it. We have the Gutkind seminars where we educate, we lecture; managers lecture to this group of maybe 30 kids, but that is not specifically mentoring. I believe when we figure how many in the next generation may be interested in working in the company then we will have them working at operation levels in the company.

Hans-Jacob Bonnier

Hans-Jacob Bonnier obtained his M.Pol. Sc. Degree from Stockholm University. During his career at Bonnier, he has held management and leadership positions at Duni Sarl in France, Duni A/S in Norway, Bonnierförettagen, Bonnier Business Information and Dagens Industri. He is chairman of the Family Business Network in Sweden, the European Business Press Federation and the Bonnier Family Foundation. He is also vice chairman of the Albert Bonnier AB Board.

Carl-Johan Bonnier

Carl-Johan Bonnier received his M.Sc. degree in economics from the Stockholm School of Economics. He joined Semic International in 1978 and was promoted to president in 1983. He was appointed executive vice president of AB Bonnierföretagen in 1987 and president and CEO in 1992. He was elected chairman of the board in 1998. He is also chairman of SNS and Bonnier Cityfastigheter, and a board member of several companies in the Bonnier Group.

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