

THE FAMILY BUSINESS AND THE FAMILY ENTERPRISE:

UNDERSTANDING FAMILY-OWNED ORGANIZATIONS THROUGH THE LENS OF TWO FUNDAMENTAL FRAMEWORKS

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When seeking to understand the inner workings of a family-owned organization—whether a family business, family investment company, family office, or family philanthropic foundation—two key frameworks are useful guides:

- The Three-Circle Model of the Family Business System
- The Family Enterprise Framework

These two conceptual models provide a lens through which an observer can analyze a family-owned organization's activities, members, dynamics, interconnections, challenges, functionality, and an array of other helpful characteristics.

Each framework provides a clear way to sort one's observations about a family-owned organization into distinct categories. This sorting helps to organize and clarify one's thinking. It also reduces any sense of confusion about "Where do I start?" when analyzing the entity, which is a natural question given the complexity of these organizations.

Students and members of family enterprises say that when they use these frameworks, their family business or family organization "now makes sense." The models allow a user to both "zoom out" to gain a picture of the whole entity, and also "zoom in" to

see its independent parts or individual members—no simple task again considering the complexity of these organizations.

These two models are the creation of Professor John A. Davis, a leading authority on family enterprise, family wealth, and family offices, and a pioneer of the family enterprise field. They are illuminating, simple, and powerful frameworks that unlock understanding about family-owned organizations. You are invited to put them to use to map your own system, or one you know, to witness for yourself the informative power of the models.



FRAMEWORK #1

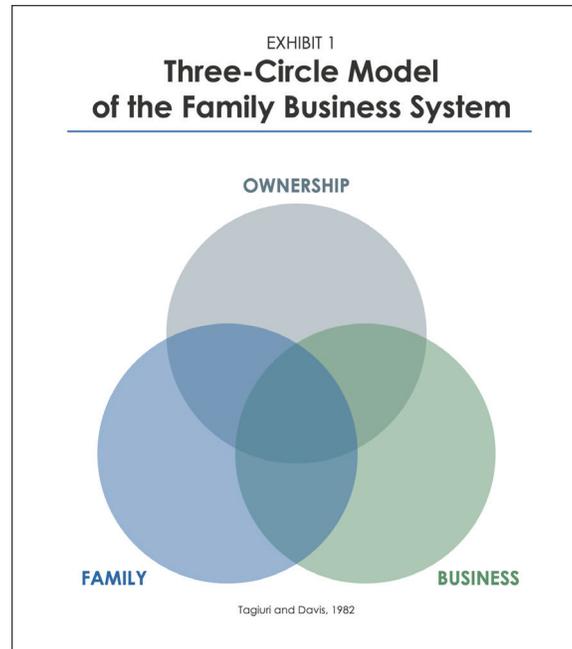
Three-Circle Model of the Family Business System

“
All family businesses can be described using the three circles, and each family business system can be uniquely understood with this framework.
”

– John A. Davis

The Three-Circle Model of the Family Business System is the main paradigm in the world of family business. It is used by families, leaders, academics, students, and consultants worldwide. Created in 1978 by Renato Tagiuri and John Davis at Harvard Business School, it quickly became, and continues to be, the central organizing framework for understanding family businesses.

This framework clarifies, in simple terms, the three interdependent and overlapping groups that comprise the family business system: (i) family, (ii) business (or employee group)*, and (iii) ownership.



*Note: The Business circle can also be used as a placeholder for other operating entities such as a family office or family foundation.

Below are four insights one can gain by using the Three-Circle Model to map and understand your family business system.

Insight #1: This is a System.

The overlap of these three circles, or groups, illustrates that they are interconnected. The interconnection and interdependence of its parts is why we formally label this a family business *system*.

This designation is significant. Being a *system* means that what happens in one group (or circle) influences the others. If you make a change in one circle, expect a ripple effect in the other two circles. If one circle is stalled or in conflict, it can affect the performance of the other two circles and of the entire family business system. On the other hand, a high-performing circle can help to bolster the other two circles and strengthen the overall system. By its nature, being a *system* leads to increased complexity in a family business, compared to a non-family business.

The long-term success of family business systems depends on the functioning and mutual support of each of these groups. Because of the interdependence of these three groups, the systems works best when the three groups are aligned in their goals. A business,

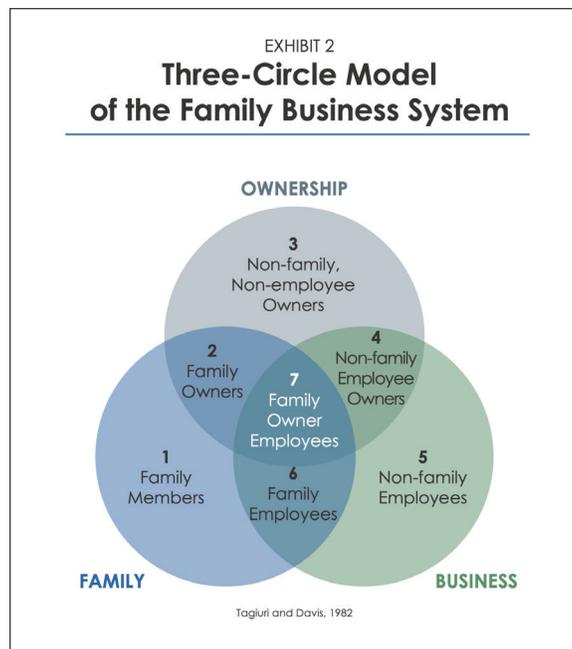
a family, and an ownership group each have their own purpose and goals, including some goals that they share in common. But they each measure success in distinct ways and have different expectations about the behavior of members of their group. To the extent that each group is mutually supported by the other two over time, each group will feel rewarded by being in this particular system and will likely want to sustain and perpetuate the system. Of course, if the groups are not compatible or well-aligned, or if they “pull in different directions,” the family business system will be uncomfortable, will function less productively, and will be less sustainable.

Insight #2: There are Seven Stakeholder Groups to Consider.

The Three-Circle Model identifies where key people are located in the system. Their positioning in the three circles reveals the different roles they hold.

An individual in a family business system occupies one of the seven sectors that are formed by these three overlapping circles. An owner (also known as a shareholder or partner) and *only* an owner (including a beneficiary of a trust) sits within the top Ownership circle. Family members occupy the left-hand Family circle, and employees of the company the right-hand Business circle.

If you have only one of these roles, you will be in just one circle. However, if you have two roles, you will be in an overlapping sector, sitting within two circles at one time. You may have three roles, in which case you would reside in the center of all three circles.



In the Three-Circle Model, the seven distinct interest groups (or constituencies or stakeholders) with a connection to the family business are these:

1. Family members not involved in the business, but who are descendants or spouses/partners of owners
2. Family owners not employed in the business
3. Non-family owners who do not work in the business
4. Non-family owners who work in the business
5. Non-family employees
6. Family members who work in the business but are not owners
7. Family owners who work in the business

Some individuals have one role—a family member or a non-family manager, for example. Others have multiple roles—such as a family owner, or a family employee or a family board member (both are considered to be in the business circle). Davis explains, “The overlapping areas in the Model indicate multiple roles and potential role confusion, leading to questions such as: “*Do I approach this conversation with my parent as their son/daughter or as their business partner?*” Role confusion means acting from a perspective in one’s various roles that does not fit the appropriate situation. This can lead to conflict.

Insight #3: Each Group Has its Own Legitimate Interests and Perspective.

The Three-Circle Model explicitly recognizes the several interest groups or constituencies in the family business system. Each of the seven interest groups identified by the Model has its own viewpoints, goals, concerns, and dynamics. It becomes apparent that every group in the system has its own, legitimate perspective and interests in the family business. All of the constituency groups in the family business system need to be respected and incorporated, in some appropriate way, into the decisions and policies of the company. The different viewpoints must be largely aligned and integrated in order to set a stable future direction for the family business system. Of course, every person occupying a particular constituency group will not necessarily share exactly the same views on all matters. These sub-differences can be their own sources of conflict in a family business system.

One of the benefits of the Model lies in its neutrality. It does not favor one group nor one perspective over another. This can help to defuse tensions in the system by depersonalizing issues. The Model illustrates the power of different viewpoints, rather than assuming

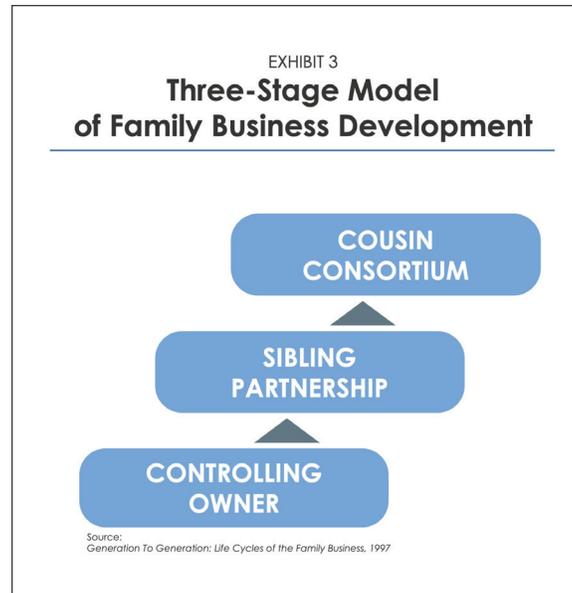
differences are caused by personality differences. “One of the benefits of a systems-oriented approach is that it alleviates some of the blaming that goes on in families,” Davis says. “People have told me that relationship tensions made more sense after they saw where their relatives were located in the three circles. For example: ‘My brother is always irritated at me because of the low dividends we pay. And I’ve been thinking, You’re so greedy. But when you see where he resides in the three circles, his position on dividends makes sense. He doesn’t earn a salary and benefits like I do working in this company, which he also owns, and he is financially reliant on the dividends. We talk about dividends now as *owners* of the business rather than strictly as siblings.’”

Insight #4: The System is Always in Motion.

The Three-Circle Model also teaches us that the needs and intersections of the three circles together, and of each interest group independently, evolve and change over time. The three circles are always in motion—never static.

Families, businesses, and ownership groups each operate in their own environmental context and are regularly reacting to, adapting, and morphing in response to changing conditions. For example, the family changes in size and diversity as in-laws (spouses) join the family, or couples divorce, or the next generation is born. The business operates within an industry, a market, a country, and a region which cause the business to react to particular disruptions, laws, regulations, consumer preferences, and changes of various kinds. The ownership circle morphs over time as shares pass to new owners, trusts and trustees are added, non-family partners are brought on, the company goes public, or other ownership changes. As described in the first section of this article, what happens in one group impacts the others—hence, the entire system is always in motion.

The three circles move together on a trajectory and must prepare for future challenges they will likely face, and not only address their current challenges. Fortunately, the development of each circle over generations is fairly predictable. This realization led to the creation of the Three-Stage Model of Family Business System Development (described in the book *Generation to Generation: Life Cycles of the Family Business*).



How to Use the Three-Circle Model

The three circles help users take a systems view of a family business system. This allows them to holistically understand the system and develop comprehensive plans to address issues and achieve goals.

You are invited to use the Three-Circle Model to analyze and map your own family business system. Here are some ways you can put it to use:

- Identify *where* individuals reside today and *where* they may be moving in the future, and therefore what their perspective on key issues is today and how it may change.
- Understand the *goals, interests, and priorities* of the seven stakeholder groups. Identify where they align and where they are out of sync.
- Locate *where* in the family business system issues or challenges are occurring.
- Catalog the strengths and vulnerabilities of the system and understand the interdependence of the three circles. It is useful to list the strengths and weaknesses of each circle and to consider how the characteristics of one circle are influenced by the other two circles. This analysis helps to diagnose *why* issues have occurred or spread from one circle to another.
- Explore the trajectory of each circle: how each circle is moving, and what is likely to change about each circle, and the entire system, in the future. Identify what kind of leadership, talent, and governance is needed for where the circles are heading.

- With this systems perspective, develop holistic, coordinated plans so all three circles move in the same direction.

You can also use the Three-Circle Model to answer a specific question. For example, why are two sibling owners so regularly in conflict with one another, and what can be done to improve the relationship? It could be that they reside in different parts of the Three-Circle Model and have some different interests and goals. It could also be that they have a problematic history as siblings. And their relationship could be weakened by the fact that they each have children employed in the family business who are competitive. Without a plan to address the sibling conflict, important owner-level conversations are likely to be stalled or derailed—and no company can afford to be slow or indecisive in today’s fast-moving environment. A plan to address this conflict should take into account the various influences on their relationship, made more understandable by the Three-Circle Model.

In this situation, the siblings can use the Model to ask themselves:

- Where do the siblings and other key stakeholders reside in the three circles?
- What are the siblings’ differences in perspectives, goals, interests, and priorities given where they reside?
- How is each sibling influenced by other circles or stakeholders in the system?
- What is likely to change about each circle, and the entire system, in the near future? How might this impact the sibling relationship as circumstances shift?
- What do the siblings need to prepare to do and decide on in the near future? How can they get ready to do this effectively? For example:
 - o Would a family council help to bring the family closer together?
 - o What about clearer employment policies for family members?
 - o What does the next generation need to heal and not replicate this tension in their generation?
 - o Perhaps an owners’ council would address the needs of the owners and reduce tension.
 - o Relationship counselling could be in order for repairing the sibling relationship.



FRAMEWORK #2

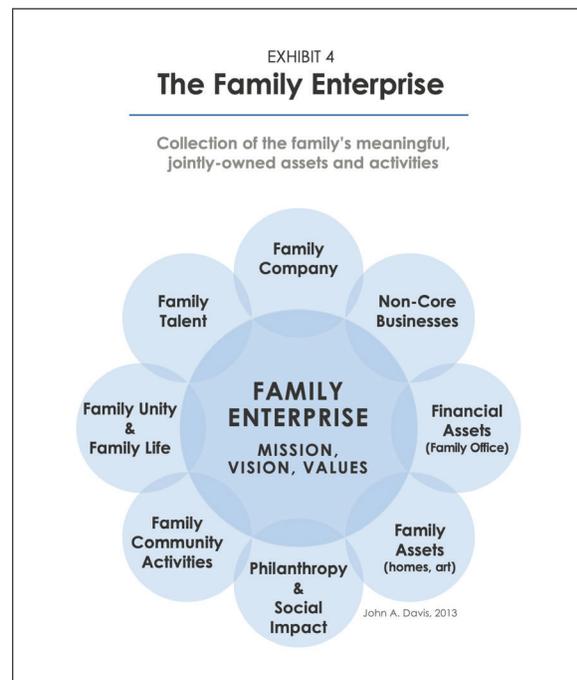
Family Enterprise Framework: Understandings Beyond the Family Business

“ *When families enlarge their lens to take into account all of the important activities in the family enterprise—not just the family business—this allows for more thorough, coordinated strategies and long-term continuity.* ”

– John A. Davis

A family’s company is typically the family’s most important asset and its dominant activity. While central to a family, its company is only one of several assets and activities that an enterprising family typically considers meaningful and wants to grow and perpetuate into the next generation. The family company is part of a larger system called the *family enterprise*.

A *family enterprise* is the collection of a family’s meaningful, jointly-owned activities and assets (economic interests) that help to identify, support and unite the family. Typically, this includes the primary family business, other operating businesses, financial assets, perhaps some real estate investments, family assets like homes or art collections, philanthropic and community activities, and other pursuits that carry the family’s name, reputation, and DNA. Typically, a family wants to perpetuate its meaningful activities and assets, and it is helpful to view them as a collection tied together by a common purpose, direction, and values.



Professor John Davis developed the concept of the broader family enterprise—describing the range of activities that families engage in and that define them—to have a more holistic view of a family’s experience and interests. When families enlarge their lens to take into account all of the important activities and assets in the family enterprise, this allows for more thorough, coordinated strategies and long-term continuity for the entirety of the family’s interests.

Below are four insights one can gain by using the Family Enterprise Framework.

Insight #1: Every business family has an enterprise broader than just the family business.

Most business families are intensely involved with the owning and running of their family company. The family business is a constant companion at family gatherings, the subject of many if not most family conversations, the career focus for many family members, a measure of family status, the source of most family wealth, and a vital part of the family’s history and identity. It may appear that a business family has no other interest as important to them as their company.

But families characteristically do have other meaningful interests. Over time, business families tend to naturally collect assets and activities beyond the family business. They create, acquire, and grow companies, other investments, philanthropy, social or community activities, and family traditions. These are typically accumulated opportunistically due to one or more family members’ interests, personal relationships, good instincts, fortunate timing, and/or persistent hard work. The family enterprise can become a large, complex collection of assets and activities (sometimes whose underlying purpose and logic can be difficult to explain); other times, the family enterprise remains small and straightforward. Regardless of their scale, these joint assets and activities provide a center of gravity around which the family orbits as they shepherd the family enterprise together.

Accumulating meaningful assets and activities beyond the family business is prudent for a family to do. Over generations, the family business generally employs a smaller percentage of family members while at the same time, ownership becomes diluted which produces smaller ownership stakes per person (a natural function of growing families). These factors (among others) can cause family members to grow distant and less connected to the company. It shouldn’t be the only activity where family members can come together, contribute, be recognized, or receive financial rewards. Davis says, “I have

never seen a business family stay successful for generations that did not have a strong family enterprise with activities outside of the family business to keep the family unified, connected, purposeful, and moving in the same direction.”

Every business family has a family enterprise broader than just the family business. What is yours? How was it assembled over time? Was it opportunistically or deliberately constructed?

Insight #2: Your family’s purpose is broader than your family business.

Once families define their family enterprise, they begin to understand their family mission as extending beyond just the family business.

Successful families ensure the continuity of their success by being strategic as a family. One way they do this is to establish a clear and compelling mission (or purpose) that drives the family. It answers the questions: What does the family want to build together? What is the family fundamentally trying to accomplish or achieve together? What motivates the family to stay together?

In early generations, families tend to answer these questions with business-focused responses (e.g. “We want to build a great business. We want to dominate our industry. We want to be known for producing high quality products in our region.”). But over time, families need to feel that their purpose extends beyond having a successful business. Most families develop ambitions that have to do with staying together while making an impact on the world (e.g. lifting certain communities, bettering society, advancing movements, saving the environment, or bringing resources to particular populations). In later generations, this is especially important to keep the family together as fewer family members become involved in the family business.

The objective for a family is to design, organize, and manage its family enterprise so that the entire enterprise is productive and meets the goals of the family. It must be led by the family’s core tenets: its Mission, Vision, and Values (found at the center of the family enterprise diagram). These are central to the success of a family enterprise. Assets and activities should be chosen and aligned to pursue the family’s mission and vision, and to be demonstrations of the family’s core values. Davis says, “Family success, in any generation, refers to a family making progress toward achieving its mission and living by its values.”

Your family's purpose is now, or will likely soon become, broader than your family business. What is your family's mission? What is your family fundamentally trying to accomplish or achieve together?

Insight #3: The family enterprise should be deliberately designed to meet the family's goals—and should change as needed.

The design of a family enterprise includes selecting assets and activities that the family is proud of, that help the family achieve its important goals, and that engage family members. Families have wide latitude to define their assets and activities in any generation. Davis says, "I applaud a family that changes its activities and grows its assets to better pursue the family's mission. I credit a family even more when it revises its mission and activities to accomplish even more than it previously thought possible. The visioning and architecting of the family enterprise is the work of *family strategic planning*—the guiding map for family leaders."

No family enterprise is static. It must morph over time to reflect the changing interests of the family or the changing dynamics of an industry. Periodically, activities or assets are added (acquired) or removed (divested) as the family's goals, needs, and interests evolve. Your family enterprise is a "living" system that should be updated from time to time, particularly as a generational transition approaches. It is important that the next generation feels enthusiastic and motivated to own and lead a family enterprise that represents them. It is useful to poll family members from time to time to understand their connection to the current family enterprise, and to gauge how their interests and goals are changing. After all, you need a family behind the enterprise that is excited and energized by, and interested in contributing to, the family enterprise, or it will run out of fuel.

How often does your family revisit and redesign your family enterprise? Do you engage the next generation in these conversations? Do you know to what extent your family is energized by your current family enterprise, and how your family enterprise needs to change to maintain family enthusiasm?

Insight #4: There are many roles needed to keep the entire enterprise functioning. Each of the activities and assets in the family enterprise need to be well led, owned, planned for, and coordinated.

When considered as a whole, it is easy to see that it takes a team of people in different leadership, ownership, and oversight positions to make the family enterprise successful

for another generation or more. Each of the important assets and activities need to be well led, owned, and governed so they remain on a successful trajectory. What roles are needed to sustain your family enterprise and to attract and engage the next generation? Does your family enterprise offer family members a place to contribute their time and talents?

In addition, a family's important assets and activities need to be well planned for—not just the family business. An annual process to plan strategically for these different assets and activities is helpful.

They must also be coordinated, because a problem in any area of the family enterprise can reverberate and create difficulties in other areas. It's not uncommon, for example, for family friction to develop over who gets to use the family's vacation house. If unresolved, this dispute can appear in unrelated areas of the family enterprise such as in business meetings or philanthropy discussions, as family members attempt to work out family tension in other settings. Good rules for the vacation house (fairly administered) can be as helpful as good rules for family employment in the business.

If the family enterprise is not very complex and the family not very large, coordination among the various parts of the enterprise can be accomplished informally (e.g., periodic check-ins and discussions of joint interests). When the family enterprise and family grow and become more complex, it is helpful to think through how these different activities can be coordinated and what governance is needed to achieve the family's goals and to keep the family supportive of family success. For example, developing and deploying family talent to lead the various activities and assets should be coordinated centrally by the family (typically by the family council).

How to Use the Family Enterprise Framework

The Family Enterprise Framework helps users take a big picture view of the entirety of their family's meaningful assets and activities. This allows families to evaluate the effectiveness of their family enterprise to understand to what degree it is currently—and will continue to—motivate, define, and unite the family to continue building value together. It also allows for coordinated strategic planning for the entire family enterprise.

You are invited to use the Family Enterprise Framework to map and plan for the future of your own family enterprise. Here are some ways you can put it to use:

- Take stock of your family enterprise today. Map your family enterprise, labeling each “petal” or sub-circle in the framework with the jointly-owned assets and activities that are important to your family.
- Measure the effectiveness of each activity or asset group (or “petal” in the flower model).
 - o Is this the right family enterprise for your family currently? How connected is the family to this collection of assets and activities? How effective is this collection of activities and assets at helping your family achieve its mission (or purpose)?
 - o Is it the right family enterprise for your family moving into the future? How motivated is the family, including the next generation, to continue to build this array of activities and assets in the future?
- Define how decisions are made in each area. How effective is decision-making? How coordinated are decisions and planning across the entire family enterprise?
- Define the necessary roles required to lead, own, and oversee each activity and asset group. Are you developing family members for these roles? Are you identifying gaps in family talent where you may need to bring in non-family talent?
- With this family enterprise perspective, develop holistic, coordinated plans for each area of the family enterprise so they move in the same direction.

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Courtney Collette is Chief Operating Officer of the Cambridge Institute for Family Enterprise, a research and education institute devoted to multigenerational family enterprises. Since 2011, she has led its education programming, conferences, research studies, and publications. As head of education programming, Ms. Collette designs curricula for seminars, workshops, and online courses for family enterprise audiences worldwide including bespoke private programs for individual families and organizations. She has authored several publications pertaining to the success of family enterprises, including articles, Harvard case studies, and the book, *Next Generation Success*, a 10-year study of next generation talent development in global family enterprises. Ms. Collette spent a decade as a trusted advisor to business families on the issues of governance, family relationships, succession, and next generation readiness.

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The Cambridge Institute for Family Enterprise is a global research and education institute dedicated to the real issues facing family enterprises. It is a place where progressive members of family enterprises come to learn, exchange ideas, develop themselves and position their enterprises to be not only successful, but sustainable over generations. Its sister organization, Cambridge Advisors to Family Enterprise, is a highly specialized, international, advisory firm that assists family enterprises with navigating the new economy, solving sensitive issues, and making the entire family enterprise strong and united over generations.

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