Good Corporate Governance in Family Business

– Governance of Ownership, Business and Family

FINNISH FAMILY FIRMS ASSOCIATION

> FOR THE READER

Good corporate governance strengthens and clarifies the activities of the family firm while improving its competitiveness. Proper functioning and transparency of the roles and responsibilities of all organs in the firm are in the interest of the owners, other stakeholders and the whole company.

Family firms are characterised by nurturing, active ownership as well as specific family capital: patient financial, extensive social and tacit human capital. In family firms, owners are committed to the continuity and long-term development of the firm. Taking advantage of these characteristics can provide the family firm with substantial added value. It is particularly essential in family firms that the roles and responsibilities of the distinct owners, operative executives and the family are clear and that they are jointly defined and approved.

Family firms also utilize the organs of corporate governance in a specific manner. In family firms, jointly agreed corporate governance practices primarily act as concrete tools for developing and controlling business activities. For instance, the owners are aware of their various ownership roles and influence; the board of directors and the managing director have their own clearly defined roles and responsibilities, as do the the Council of Owners. The clearly defined corporate governance of family firms also creates added value to those activities with external stakeholders, for instance, in financial and investment processes.

It has been the aim of this committee to prepare independent recommendations that would assist family firms in actively developing their own well-functioning corporate governance. This recommendation utilise the unique characteristics of family firms in the best possible way to benefit the needs of both the owners and the company. The special characteristics of micro-companies have been excluded from this recommendation. Publicly quoted family firms should follow the corporate governance codes for enlisted companies in Finland specified by the Securities Market Association. These codes guide publicly quoted companies to govern business in a legitimate and transparent manner. Even the largest unlisted family firms follow in many ways the codes for publicly quoted companies. For unlisted companies, the Central Chamber of Commerce has published a toolkit for developing their corporate governance.

The success of family firms is dependent on their owners. Owners who are unanimous about the direction and means for developing their firm, and who select the best representatives from among themselves and external professionals to the firm's administration, are able to run profitable and successful family business. Controversies, uncertainties, and diverse expectations among the owners will dissociate and weaken the business, family and ownership. Good corporate governance offers a clear, concrete tool to commit all stakeholders of the firm and to ensure their responsibilty in their own activities. Majority owners who are capable and active are undisputed resources for family firms, though supportive and reliable minority owners are also crucial for the existence and continuity of family firms.

Espoo 14 May 2009

Liisa Leino

Liisa Leino

The Board of the Finnish Family Firms Association set a committee to prepare recommendations on Good governance for the Association on 13.8.2008. The committee was comprised of the Chairman, Ms. Liisa Leino (Leinovalu Oy, Chairman of Board); Secretary Ms. Minna Tunkkari-Eskelinen, PhD Economics; and the following Members: Ms. Satu Helkama (Helkama Bica Oy, Member of Board), Professor Seppo Ikäheimo (Helsinki School of Economics), Mr. Peter Seligson (Ahlstrom Oyj, Chairman of Board), Mr. Torkel Tallqvist (Hartwall Capital Oy, Member of Board), Mr. Max Oker-Blom, PhD Economics, Licentiate in Law (Oy Karl Fazer Ab). As representatives of the Association, Ms. Krista Elo-Pärssinen, PhD Economics, and Mr. Anders Blom, Managing Director, also participated as expert members in the committee work.

The working of the committee was active and comprehensive. The committee had altogether ten meetings. In order to utilise the extensive expertise of the committee, individual members of the committee developed recommendations within their own field of expertise. The work was compiled and integrated by the Secretary of the Committee and the Expert member of the Association Krista Elo-Pärssinen.

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On the cover: Mr. Kari Jussi Aho, Ms. Annakaija Lappalainen, Mr. Antti Aho, Mr. Juhani Aho, Mr. Ville Aho and Ms. Miia Porkkala from Aho Group Oy, who were awarded the 2008 Family Firm Prize.

> FAMILY FIRMS: LEADERS AT THE CORE OF THE ECONOMY

THE IMPORTANCE OF FAMILY FIRMS

The European Union has emphasised in its recommendation on business policy given to the member states this summer the importance of the continuity of family firms for the growth and competitiveness of Europe. The family firms form the backbone of the European economy.

According to different estimates, family firms account for 80–86% of the total amount of companies in Finland. Family firms employ over half the private sector's manpower, and 75% of the employees in small and medium size companies work for family firms. The family firm produces 40% of the company turnover and nearly half of gross national product of Finland. This share is almost the same as in all other western countries. Although the majority of the family firms are small or medium sized, one-fifth of the TOP 500 companies are family firms.

Over 30 family firms are listed in the Helsinki Stock Exchange[1]. Family firms create stability, are competitive, follow market trends, and renew themselves, as well as create additional value and create new entrepreneurship.

Family firms have great importance for local and regional economies and bring stability and permanence to their regions. The owners' regional commitment is strong and therefore the domicile of the firm often remains the same. The family firm has a unique position in the local community, which is both personal and commercial. They act usually as engines for regional economic development, since they have a positive attitude towards growth, and their own growth is usually more profitable than that of other companies. The owners of family firms as persons are committed to the development and continuity of their firms.

FINNISH OWNERSHIP AND FAMILY FIRMS

The Finnish nation did not gain prosperity until the end of the Second World War. Although this prosperity became nationally important, capital remained internationally scarce. The transition to becoming part of the European internal market area and the competition in the free economy have raised debate in every country concerning the ownership of companies and the role of daughter companies in the economy. Most importantly, the question of ownership is all about authority and the ability to control business affairs.

The normative framework of corporate governance culture has been based on non-family firm values. Over the last century, joint stock company legislation was formed based on the values of global, enlisted companies and the corporation (states, municipalities, cooperatives, foundations) which lacks a major owner.

Family firms do their business in the same global markets as any other company. Some of these family firms are listed. In order to maintain listing status in the stock exchange as a mean of financing their growth without losing the authority of the family on the firm, it is important for the family firm to ensure the option of dual-class shares with different voting power in the company law.

Listed family firms facing the dilution of the family's ownership need the know-how and norms to maintain and strengthen its authority without breaching the rights of minority owners. Reaching this balance is one of the aims of good governance in family firms.

SPECIAL CHARACTERISTICS OF FAMILY FIRMS

There is a distinct difference between family firms and other companies: family firms attempt to transfer the company from one generation to the next. Consequently, the family firm faces risks and business challenges differently than do other companies. A family business combines family, business and ownership. Conventionally, although these areas are perceived to be separate, in family firms they are strongly interrelated.

1) Part of Nasdaq OMX

A family firm is defined as follows[2]:

1. *The majority of voting power share belongs to a natural person, his spouse or other family members.*
2. *The ownership of votes may be indirect or direct.*
3. *At least one member of the family, or his legal representative, is in charge of the company management or governance.*
4. *Listed companies fulfil the definition of a family firm if 25% of the voting power shares belong to a person or his family member. Indirect voting power in a listed company must belong to the family.*

According to this definition, the family participates in the activities of the company via both ownership (majority voting power) and management.

Commitment is usually strong in family firms. Ownership of a family firm is often considered to be a gift from the previous generations or as a loan from successive generations. The aim of the family firm is to transfer the company to the next generation in better condition than it was when received from the preceding generation. ***A long-term strategy is appreciated*** more in family firms than the figures in interim reports. This way of thinking greatly influences business outcomes. The family's long-term, active commitment to the business increases the performance of the company.

In family firms, ***the capital structure in the balance sheet is usually strong***. The reasons for this might be the need to get prepared for the future independently from investors, as well as to ***guarantee the continuity of the business***.

Family firm culture is usually strongly based on ***caring about all stakeholders and other members in the community***. Family firms take responsibility for their employees, customers and sub-contractors. In many family firms, the turnover of personnel is low, and contracts with employees may continue from one generation to another.

In smaller family firms, there are less-formal organisation structures and processes, which enable the use of ***more flexible methods of management and leadership***, thus improving the efficiency of decision-making. Moreover, in family firms, it is usually easier to define the locus of authority, which in turn may accelerate decision-making.

The shares of family firms are usually ***illiquid***. They are transferred usually from one generation to the another as an inheritance, donation, or trade. Some of the family firms are listed in a stock exchange, which improves the liquidity of shares and enables new capital. Listed family firms combine the best sides of the family and listed companies. Ten of the best family firms in Europe combine the strength of the family and the discipline of listed companies.

The special characteristics of family firms – continuity, personal ownership, as well as tight interaction between family and business – influence the strategic choices and governance of the firm. In addition to the governance of family firms, attention must be paid to the governance of owners and families as well. These elements have different roles and importance, varying in accordance with the size, age and developmental stage of the company. In first-generation family firms, business activities and ownership are personalised in the founder or founders of the company. In the second or following generations of the family firm, when the number of owners is increasing and business is growing, the arrangements of governance have already become more complex and challenging.

2) This definition is approved by the Committee of Finnish Ownership (SONK) and European Groups of Family Enterprises (GEEF). The report on family firms conducted for the European Commission recommends the use of this definition for general purposes.

DIFFERENT ROLES IN FAMILY FIRM GOVERNANCE

Family firms are characterised by different roles related to business, ownership and family. (Figure 1)[3].

Owner, active in governance has three simultaneous roles: as family member, as owner and as manager. This kind of owner is a member of the board or the management.

Owner, non-active in governance is a family member and owner. This kind of person represents long-term ownership.

Non-owning, active in governance family member has two roles: as owner and as manager. This person is typically a spouse (in-law) or representative of next generation, who does not have the ownership yet, but is actively participating in business.

Non-family member, active in governance can be a member of the board or management.

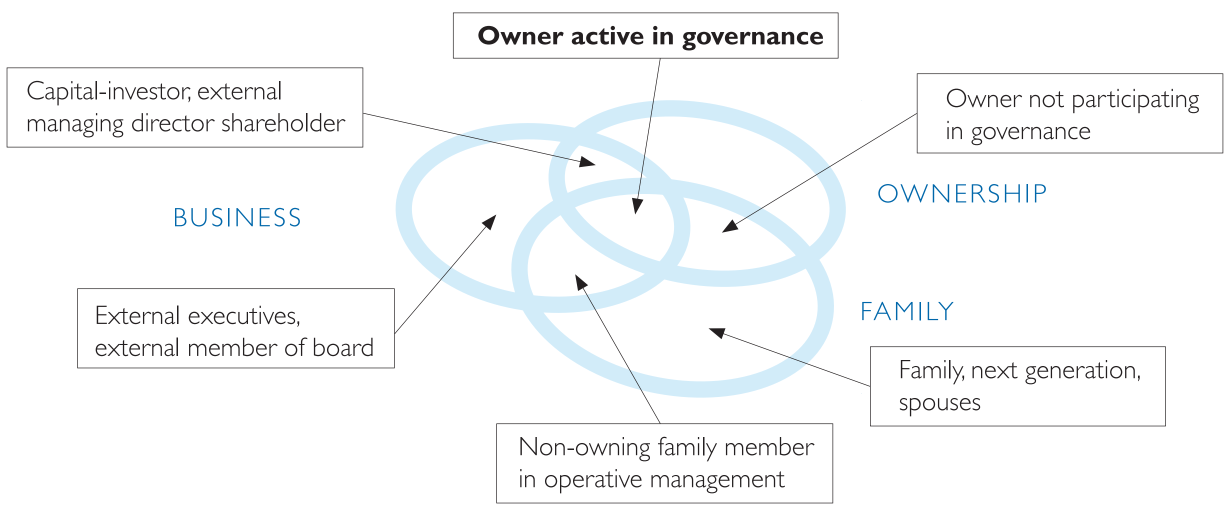
Non-family member, **owner** is usually a capital-investor or a managing director, who owns shares of the family firm. Non-family members bring capital and know-how to family firms.

Family members, who have no role as owner or manager are typically spouses (in-laws) and representatives of Next generation. Family is a source of continuity, values and commitment.

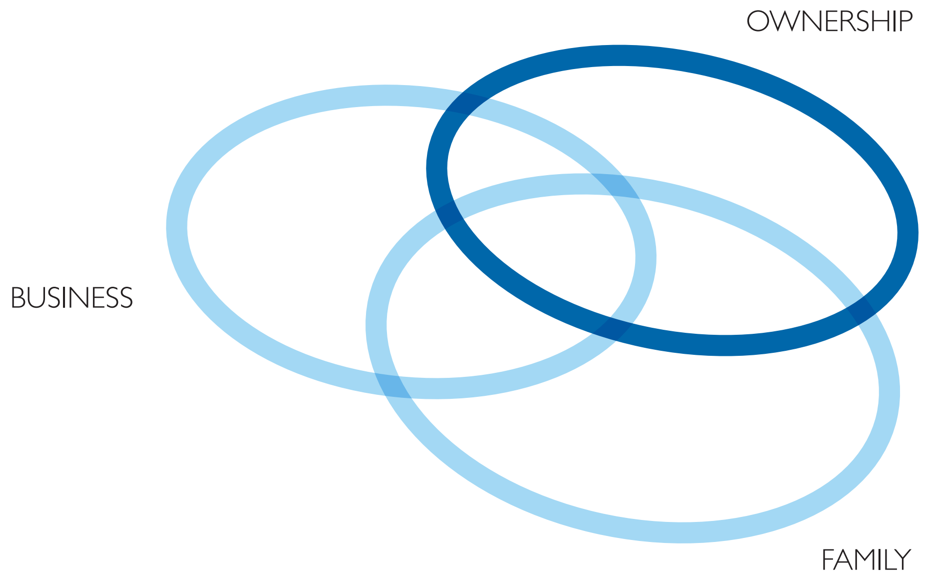
Each agent in the family business may assume a variety of roles (for example, owner-manager-family member) or may have only one role (for example owner). The alignment of these roles poses challenges, since they have different goals and expectations. As a family member, each person wants to maintain good family relationships; however, as the manager of a company, her/his own professional development should be considered, in addition to company performance. As an owner, she/he expects the success of the company and return on capital.

These recommendations of good corporate governance in family business are illustrated with three circles – ownership, business and family. We hope that this illustration improves the understanding of the different roles of each agent within family firms, as well as how they are expected to behave in these roles, how these roles are interrelated and how they materialize within governing bodies of the company. In addition, the goal of these recommendations is to help family firms develop their corporate governance practises and thereby improve their competitiveness.

ROLES RELATED TO GOVERNANCE OF THE FAMILY FIRM



3) Based on Tagiuri, R., & Davis, J. 1996. Bivalent attributes of the family firm. Family Business Review, 9(2): 199-208.



2.1 ANNUAL MEETING OF SHAREHOLDERS

The annual meeting of shareholders is the highest-decision-making body in limited liability companies. At the annual meeting, individual shareholders may use her/his official right to speak and question, as well as decision-making authority, on matters related to the company, as defined in the company act or amended in company by-laws. In family firms, the majority owner may try to influence decisions without official authority to do so. The owner should be cautious in her/his actions and speech, since they are usually carefully followed and often acted upon accordingly– regardless of whether this was about a joint action policy to be taken by all shareholders or merely a whim given by an individual owner.

The board of directors prepares the annual meeting in accordance with the company act and company by-laws. The matters decided at the annual meeting are accordingly defined. At annual meetings, shareholders decide on matters such as the composition of the board of directors and the disposal of distributable funds. These decisions are, however, extremely important in terms of the company's success. The decisions should take into account the values and dividend policy of the family firm as well as the company act.

2.2 THE BOARD

The board is elected by the annual meeting. In family firms, the role of the active majority shareholder in forming the board is decisive. Widely distributed and investor-driven ownership transfers the board nomination suggestions to the current board of directors which is familiar with the present situation of the company and knows best the capabilities needed for the firm. Listed companies often use nomination committees for this purpose. In the largest family firms, it might be one of the duties of the owners' council to propose member candidates for the board of directors.

Presentation of the candidates for the board of directors follows company-specific conventions and well-functioning practices. This presentation might be done at the annual meeting or in advance together with the annual meeting invitation.

The size of the board of directors should not be too large. Only a board of directors in which all the members are highly professional and have genuine authority to influence decisions can operate efficiently and provide added value to the company. The size of the company, extent of activities and current situation define the number of members, though in most cases the number can optimally range between three to six members.

In the selection of board members, family firms should also focus on constructing a suitable board structure to meet current challenges. Capable and professional shareholders on the board bring a strong competitive advantage for the company. Particularly, when a company is growing, it is also important to select independent members to the board who will bring external expertise and diversity to the board. It is useful to select at least two independent members to the board, since they will gain support from one another while working in the board with multiple shareholders.

In order to enhance the efficiency of the board, medium and large companies often rely on committees for tasks such as auditing and compensation. Committee members are selected from the board, and the committees prepare and present matters to the board for decision making. These committees do not have decision-making authority, but the decisions are made collectively within the board.

In family firms, the role of an owner who acts as the chairman of board is emphasised. The chairman ensures that the board works efficiently and actively, and utilises the expertise of all board members. Efficient board work can be guaranteed by using the written annual protocol of the board. In those cases when the managing director is from the outside of the family, it is usually in the best interest of the owners that at least the chairman of board is chosen from amongst family owners, as this guarantees close, responsible ownership of the family firm while assuring the control of the owners concerning the long-term development of the firm.

In smaller family firms, the majority owners act both as a managing director and chairman of the board. As a company grows and the number of owners increases, it is beneficial to select two different persons to these positions. In this way, more know-how is gained to the board, and the managing director would not also need to act as his own superior on the board. Jointly agreed and written roles increase the transparency required by owners and stakeholders.

In companies with plenty of professional and capable shareholders for board work, it is useful to have clear, transparent guidelines on how the board memberships are distributed and rotated among these owners. For shareholders excluded from the board room, it may also be useful to construct a separate discussion forum, for instance, a Council of Owners. (chapter 4.1.)

Evaluating the work of family firm boards can provide a strong basis for the development of board activities. An annually conducted evaluation gives good information on whether the board is efficient and dynamic as a whole, and how each member contributes to the board work. This evaluation updates the skills of the board and identifies the needs of the company: Does the board contain enough and the right type of capabilities? The evaluation also provides required information concerning the adequate and timely rotation of board members. The use of experienced, older owners as mentors and experts increases chances to diversify and strengthen the capabilities of the company.

2.3 REWARDING THE BOARD

The aim of rewarding is to motivate the board members and enable recruitment and retain the best board members. It is wise to emphasise clearly to the owners the rewards of the board members and how they are defined, as well as, all their financial connections to the company. The annual meeting decides on the rewards provided to the board.

It is useful to pay compensation to the board members that is both competitive and motivates them. Even if the membership in the board is a position of trust from the owner's side, the compensation nevertheless indicates how much the work of the board is appreciated and what is expected from this work. Thus, paying only a minimum compensation may lower the quality of the board work. Many of the board members who are experienced and appreciated do most likely have membership on more than one board, in which case there is competition for their use of time. Through appropriate rewards, the company can increase the board members' interest in committing more time and effort to this specific company.

It is useful to pay a meeting allowance, though this may not guarantee anything other than active attendance at the meetings. In addition to a meeting allowance, it is wise to pay rewards that motivate the member to consider the success of the firm in her/his decision-making. Board members may be paid based on company performance either in the form of share-based or profit-based incentives. Defining success is dependent on the values and aims of the company. In share-based systems, ownership restrictions may encourage their use for board compensation. The profit-based system might be linked, for instance, to the development of turnover, operating profit margin, operating profit or return on capital. The use of other variable incentives might be challenging for family firms if a company is not publicly quoted or is not planning to be listed in the near future.

Particularly, in family firms, it is good to confirm that the success of a company is measured over the long term while board is evaluated and compensated. In order to confirm this, it may be useful to apply a bonus bank system for annual bonuses. Bonus banks lower the interest in manipulating annual profit either by influencing accounting numbers or through the timing of business activities.

The members of the board may differ in their rewards. As a rule, the compensation of the chairman of board is usually higher than that of other board member, due to the more extensive nature of his duties. The external board members who are independent of ownership do lack the incentives related to ownership. Therefore, it is highly important to find a motivating reward system for such members.

The planning, implementing and evaluating the reward system of the board members and management team should be kept separate. However, the performance measures for the rewards could be the same both for board members and management.

2.4 SUPERVISORY BOARD OF FAMILY FIRMS

In addition to official organs recognised by the company act, i.e., the annual meeting and the board of directors, there might be other unofficial organs in the family firms, such as a Council of Owners or a Family Council. These councils aim to express the will of the shareholders, for instance, regarding the future of the company and the disposal of distributable funds, as well as to enhance cohesion among shareholders. The aforementioned will is legitimized through the annual meeting and the board of directors.

The Council of Owners, which is more precisely described in chapter 4.1., can be given a more formal, permanent role by amending the company by-laws to include it as a supervisory board with certain tasks and selection procedures. In this manner, the supervisory board may combine its role as defined in the company act with the unofficial but highly important needs of family firms. Although the supervisory board is not mentioned in the corporate governance codes of listed companies in Finland, it is still recognised by the company act as an official organ. The existence of the supervisory board in the company is defined in the company by-laws. The role of the supervisory board involves supervising corporate governance activities by the managing director and the board of directors. In addition to this role, the supervisory board may be stipulated by the company by-laws to include selecting the board members. Otherwise, the supervisory board may be given tasks which only belong to the authority of the board, or tasks which are not legislated to any other organ of the limited company.

The supervisory board must be very well-led, and its tasks and responsibilities well-defined to all agents within the company. The members of the supervisory board should not become involved with the operative activities nor the responsibility areas of the board of directors.

2.5 AUDITING

The annual meeting of shareholders selects an auditor. In a public limited company, at least one of the auditors selected by the annual meeting must be approved by the Finnish Institute of Authorised Public Accountants.

In family firms, the auditor may in addition to the auditing act as a general advisor at least in the early stage of business activities. While focusing on research and development, production, sales, and marketing, an entrepreneur and family firm may have less time to devote to clarifying a complex legislation environment. Traditionally, auditors have had an important role in this respect.

In family firms, it is highly important to pay attention to the role of the auditor, who has been selected by the shareholders and who is an adviser to the management team. In order to avoid conflicting situations, especially in smaller family firms (the auditor is auditing his own advice), the executives of the company should aim for a situation in which the auditor and the advisor are different persons. Although this arrangement might be more expensive, especially at the beginning, it will better serve the interest of the company and its shareholder over the long run. In this manner, both the auditing and, for instance, tax consulting, are more objective and frequently more professional, since both of these fields of expertise nowadays require special skills.

Larger family firms may have an auditing committee. Auditing committees are needed especially when the business activities are so extensive that they require the preparation of business reporting and auditing in a smaller group than a board. There should be at least three members in the auditing committee, who should all be experienced either in accounting, book-keeping or auditing.

The board should define the tasks of the auditing committee based on the needs of the family firm. The committee's tasks include following up on the preparation of the financial statement, supervising financial reports, monitoring internal control (if it exists) and the governance and control system of a company, official auditing processes and evaluating the independence of auditors and preparing a resolution for selection of an auditor. Other supervisory tasks and duties regarding the follow up of the company's financial position may belong to the audit committee, including the compliance with laws and regulations as well as communications with the auditor.

The auditing committee is a highly important organ for the financial control of a family firm. Over time, the committee members will gain considerable information and know-how, thus making it an important platform for growth and development of individual family members. However, it is vital to remember that the whole board is responsible for the success of the company and that the actual decisions are made in the board not in the committee.

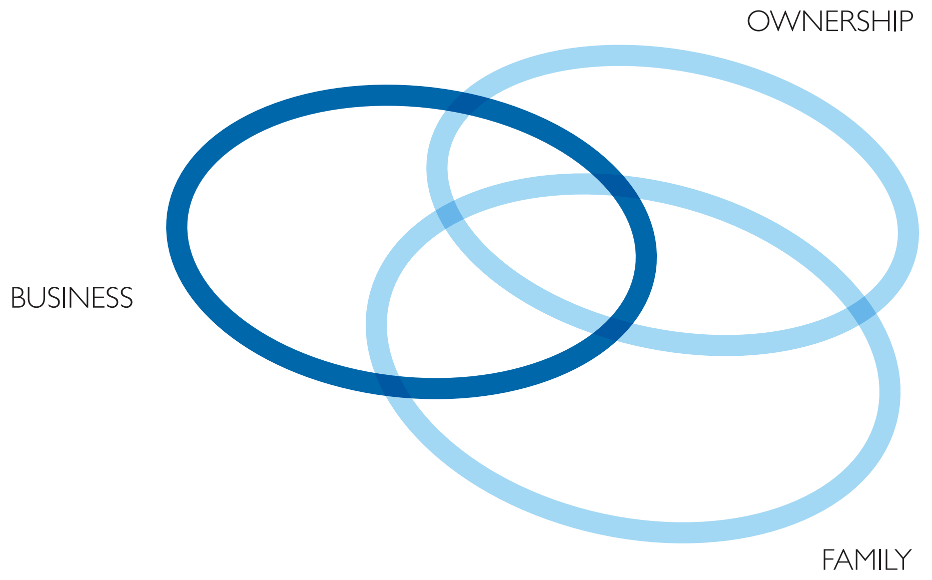
2.6 COMMUNICATIONS

Communications increase trust between persons. It is highly important that the owners and other stakeholders are aware of the activities occurring in the company. The transparency and openness of different processes improve the commitment of these parties and decrease misunderstandings and presumptions.

Communication is a strong tool for the unlisted family firms. It can be used to strengthen the aims of a company, as defined by the owners, as well as the company itself. The amount and the form of information distributed publicly should be at a reasonable level, and the distribution of other information is decided by the owner and the company. Each party (operative management, the board and the owners) must be aware and understand how they may and are allowed to use the information they have. For instance, matters dealt with by the board are confidential by nature, and are not for those outside the board. Moreover, information concerning clients, which are often asked for at annual meetings by the owners, should also remain confidential, belonging only to the operative management and the members of the board. In smaller companies, communications are handled without any unnecessary formalities – a normal within family communication is usually enough. In middle-sized companies, it is useful to have general guidelines concerning communications procedures. Listed companies follow their legislation and corporate governance codes for publicly listed companies.

Annual meetings of shareholders form the main event of communication and interaction in family firms. At the meeting, at least the managing director and the chairman of the board will be present. If needed, the key persons from operative management and auditing may be requested to be present. The annual meeting can be arranged jointly with, for instance, a family dinner or an introductory visit to a factory, which can act as a communications channel between all the shareholders. In this way, not only are important decisions made at the annual meeting, but a large amount of information is also distributed, as well as a identity is given to the ownership, with each owner gaining an opportunity to become familiarised with the activities of the company and its management.

The contents of the report of the board of directors are defined by law and each member of the board is personally responsible for the content of the report. It might be wise, and especially in publicly listed companies it is vital, to follow the scarce form of reporting as defined by law. However, wider communication concerning developments in the company with external stakeholders, and owners is necessary and significant. For this purpose, each company may tailor the most suitable and functional means of communication, such as annual reports or managing director's biannual reports to the personnel and shareholders. The company's internet pages may also act as a means of communication.



3.1 MANAGING DIRECTOR

The managing director is hired and dismissed by the board of directors. When selecting the managing director, it is important that the person in question is qualified and suitable for her/his position. Qualified refers to those professional qualities needed to manage independently and successfully the activities of the company. Suitability refers to the compatibility of principles and operations with the values and practices of the family firm. The compatibility of the managing director in the family business is defined based on the fit with the practices of major owners. This is the basis for business success in accordance with the best interests of the family firm.

For family members, the qualifications of the managing director must be the same as for others who would be hired as a managing director. It is useful to identify over the long-term potential candidates for operative management within the owner family. This is the way to confirm that the family members have a chance to participate in the operational activities of the company in accordance with their own personal skills.

The responsibility areas and duties of the managing director, chairman of the board and the board must be clearly written down and be acknowledged by the different agents of the company. In particular, good communications and cooperation between the managing director and the chairman of the board will bring extra strength and additional value for the company. Generally, it is the responsibility of the chairman of the board to communicate with the owners and to bring the opinions of the owners for consideration of the board.

Together with the managing director, a written management contract is drafted which is also important when selecting the managing director from amongst family members. The contract is accepted for the company by the board. The managing director is responsible for his actions only to the board.

3.2 REWARDING THE EXECUTIVES

The salaries of the managing director and other executives are constructed in accordance with the overall strategy of the company. Family companies are characterized by the values of the family and long-term continuity of company operations. It is thus important that the compensation plans should consider the mission, vision and the long-term goals of the company, as well as support and strengthen the implementation of the strategy and the annual action plan.

Executive compensation must be competitive in order gain the most qualified and motivated management. A competitive salary also decreases the risk of losing the executives to other companies.

The reward system should estimate the influence of different elements of compensation on the motivation of the executives to create wealth for the owners, as well as, the cost effects of these different elements. In family firms, rewarding executives with share ownership might be difficult, though it could be possible if the family ownership or power structure is not excessively diluted or distorted.

Bonus systems may be used to support long term activities if the profit measures are closely connected to strategic goals or if a bonus bank system is used for paying the incentives.

The board decides the salary of the managing director. As regards other executives, the managing director will make a proposal to the board, which then decides about the amount and the structure of the rewards. It is useful if the board can rely on objective expertise in the construction of compensation systems.

The size and structure of the executive compensation would be important to disclose in an understandable manner to the owners, for instance, at the annual meeting.

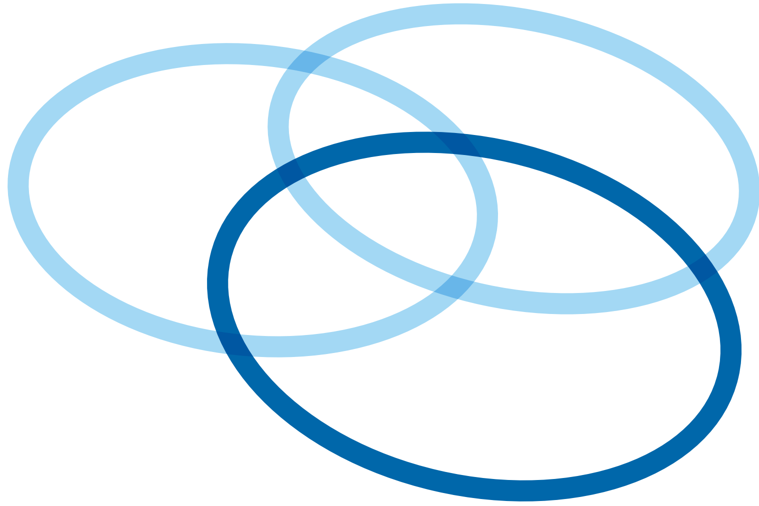
3.3 FAMILY MEMBERS IN OPERATIONAL ACTIVITIES

The nature of family ownership is embodied in those operational activities undertaken by family members. Each family member will bring along family values and reflect the family's commitment to the company. Working in their own company also brings extra responsibilities to family members. Family members must work in an exemplary manner, since they represent to the company the whole family owner.

For the future success of the family firm, it is critically important to have capable and motivated young family members to commit themselves to the development of the family firm. The next generation should be motivated to become familiar and committed to the operations of the family firm. It would be good to create close connections between the company and the next generation through internship arrangements, summer jobs, writing thesis, etc.

When a family member is hired to a managerial position, it is useful if the managing director participates in the recruiting process. The family member needs to fulfil the selection criteria for the position and must also be strongly motivated. As a general rule, the family members work in the company without any special privileges. If any exceptions are made to this rule, they must be generally known by the executives of the company. The expectations regarding the achievements are basically the same for family members as for any other employees. It is vital for the person himself, as well as for the whole organisation, that the promotion of a family member is based on achievements and personal abilities.

If there is need to dismiss a managerial level person from her/his duties, the managing director and the closest superior must be involved in this decision-making. When a family member to be dismissed in the best interest of the company is working directly under the managing director, one of the members of the board or the chairman of the board should be involved in the process.



Traditionally, good governance supports the communication of investor information. Good governance of family firms must be evaluated based on the starting-point of each family and which principles support the value management. Family ownership differs from traditional governance in that the owner of a family firm brings to the company a certain value world which actively affects the future success of the company. By contrast, in non-family companies, the responsibility for taking care of these matters belongs to the board and operative management, whereas the owners are solely in the investor's role. Therefore, in family firms there is a need for different forums for official and unofficial activities. The annual meeting of shareholders, the board of directors and the supervisory board are legal and official decision-making forums of the owners. Although the Family Council and the Council of Owners are non-legal, they act as complementary channels for interacting with the official institutions, especially within the family. They form part of the governance conventions for a future-oriented and proactive family firm.

4.1 COUNCIL OF OWNERS

Family ownership requires a special forum for defining the effect of the owner. Especially when the number of share owners is increasing, it is important to pay special attention to the question of how to channel the effect in order to best serve both the company and the shareholders. It is quite natural that, at the latest, by the time company shares are transferred to the third generation, different perceptions will arise on how to manage the company. Some of the owners might think that the steady flow of dividends is enough, whereas others may want to invest all their skills into the company, and there might also be owners who want to exit the company in search of better profits.

At this point, it is reasonable to found a Council of Owners with the purpose of mapping and defining the will of the owners. The Council of Owners will discuss the expectations of the owners regarding the company. It is useful to clearly write down and to communicate the will of the owners to all the shareholders, the board and the executives.

Usually, all the adult owning family members belong to the Council of Owners. In larger family firms, the Council of Owners can be constructed from representatives of different family lines. It is recommended that the number of members in the Council of Owners be kept to a maximum of ten persons. The Council of Owners meets in accordance with official meeting conventions. The Council of Owners might be given official status by changing it into the board of directors of the family firm. (chapter 2.4.)

In addition to mapping out the will of the owners, the Council of Owners could serve as a suitable forum for dealing with current company activities, financial results, family and company values, as well as selection of the board members. The Council of Owners should provide a structured manner for the owning family to discuss changes in the company and ownership structures. The Council of Owners is not intended to be a forum for decision-making, and it has no authority to interfere with business activities. It is allowed to show emotions in the work of the Council of Owners which is typical, and even recommendable, in such debates within family firms. If family members disagree regarding the future of the company, it might be best for each of the family members to have a reasonable way to exit the company. In such a case, the Council of Owners would provide a natural place for pondering the rules on the sale of shares.

4.2 FAMILY COUNCIL

The Family Council is a discussion forum for maintaining and improving the unity of the family. The Family Council, for instance, organises activities in which all the family members may participate, including the spouses and other family members who have no ownership relation to the company (for instance, traditional festivities, training occasions, charity work, training of the next generation). The council must have jointly prepared and written action principles and practices. The Family Council may also define the will of the owner if no separate Council of Owners exists. It is not, however, the Family Council's role to become involved with the business activities.

It is important to elect persons of different age with different skills and personalities. In the larger family firms, the Family Council might be constructed from representatives of the different family lines. The representative membership of the Family Council may be on a voluntary basis or other criteria might be set, similar to that for membership on the board. A precondition for an active Family Council is that there is renewal through, for example, the rotation of its members.

The number of members on the Family Council should not exceed ten persons. The members of the Family Council may found working groups which could include more members from the family lines. These working groups should act according to separately specified time periods and goals.

The tasks of the Family Council may be divided as follow:

1) Communications and interaction
Communications and interaction are vital in family firms especially amongst the family members. The representative members of the Family Council represent the voice of the family and are responsible for communicating information on matters dealt with at the formal meetings to their family or family line. This interaction might be strengthened, for instance, by arranging a social event at the same time as the annual meeting of shareholders.

2) Commitment
Generally, the Family Council is founded in order to commit family members to responsible ownership and the owning family. The Family Council provides a forum for pondering the continuity of the company and family ownership, as well as for discussion regarding the common will (alternatively in the Council of Owners), training of the next generation, and problems related to competition between family members. The Family Council faces the challenges of the future by raising family members into good owners.

3) Transmission of the tradition
Honouring and respecting the traditions of the founder(s) of the company is realised in different ways created by the Family Council. (social events and training).

4) Guaranteeing the unity of the family
The Family Council aims to maintain family harmony through its existence and activities. It aims to maintain family connections and internal communication within the family, as well as promotes understanding of the role of the owner. The founding of the Family Council is especially recommended for increasing interaction between family members.

5) The next generation
Membership in the Family Council might be a useful way to familiarise the next generation with activities in the family firm. The Family Council may act as a platform for preparing family members for membership in other bodies, including the governance and administration of the family firm, thereby committing the next generation to various possibilities, duties and responsibilities of ownership.

For example, the Family Council of a listed company might discuss how to react to certain current proposals, such as changes in the structure of the board of the company proposed by the nomination committee. The position taken as a result of this discussion would not, however, proceed to the agenda of the board, even though the existence of the Family Council is known to the company.

The owners are obliged to follow the rules of good corporate governance, and the Family Council is not allowed to take a public stand regarding the activities of the publicly listed company. All the shareholders are equal. In listed companies, the family may not assume a role different from that of any other owners. To some extent, this type of structure restricts the position, aims and activities of the Family Council. For instance, the exchange of communication is much more restricted in a listed company than in a non-listed family firm.

The further the family-owner is from the daily activities of the company, the more important is the position of the Family Council. When the number of family owners changes and the next generation begins to get involved in the activities, this is the right time to reconsider the structures and the conventions of the Family Council.

No matter whether good governance have been dealt with and planned in the supervisory board, Council of Owners or Family Council, it is recommended that these family principles, values and guidelines be written down into a single document. An appropriate name could be considered by each for such a document.

4.3 RAISING THE NEXT GENERATION

When the family firm is transferred from one generation to another, one of the greatest challenges is to maintain entrepreneurial and innovative attitudes. When founding the company, the first-generation owner-entrepreneur had a mission that he was willing to work towards both day and night as well as undertake great risks. The future owners of the family firm must be encouraged to continue this entrepreneurial attitude in order to make them responsible family-business-owners instead of mere investors.

Family firms need to consider early enough how to raise the members of the next generation into intimate, responsible, and qualified owners. In a young, small company, it is easier to recognise the successor of the company and train her/him systematically to fill her/his post and duties. Of course, this requires that the founding and next generations agree about this. The situation becomes more complicated if the group of owners and those willing grows larger.

Usually, the first contact with the family firm is gained through summer or seasonal jobs. These experiences are vitally important for young family members, and being successful in these tasks has great importance for the future. After having graduated, it also is usually beneficial for young family members to gain experience outside the family firm, where they will benefit from a more neutral position to learn as well as make mistakes. As they become more experienced, it becomes easier to assume responsibilities in the family firm and to offer themselves to the company. Some of the family firms have even a separate training programme for the next generation, involving training the next generation for responsible ownership and expanding their understanding of the business activities.

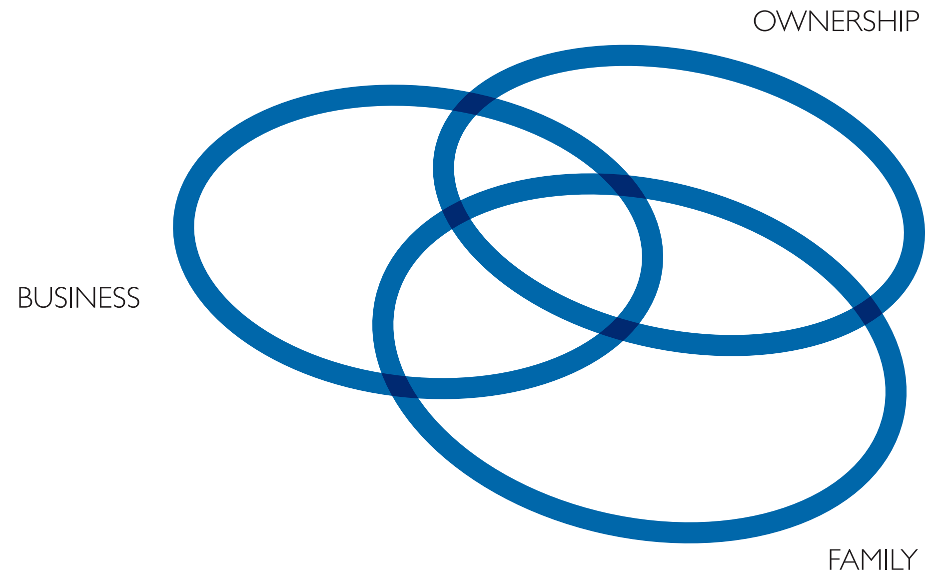
Characteristics of different kinds of ownerships should be increasingly introduced to the next generation. All do not need to have, nor should they aim for an active role. There is, nevertheless, a great need for different kinds of owners in the family firm: active, business-experts, owners who do not participate in governance at all but transfer the family traditions, and patient general supporters.

The representative of the next generation who will participate in governance may be trained and initiated through various means (e.g., Councils of Owners and Family Councils, working groups, supervisory boards). However, it is important to recognise that, for instance, the work at the supervisory board carries personal legal responsibility and already requires strong experience.

4.4 EXPENSES OF FAMILY GOVERNANCE

The activities of the Council of Owners and the Family Council, as well as the training of the next generation cause expenses which are not immediately related to business activities. According to the law on taxation of business incomes, the expenses caused by either acquiring or preserving the business income are tax-deductible from business taxation. This right to a tax deduction has been widely interpreted to include all direct and indirect expenses resulting from business activities. The private expenses of the owners are not therefore tax-deductible expenses.

Thus, the expenses caused by the annual meeting of shareholders are tax-deductible, since holding an annual meeting of shareholders is considered a duty based on the law on limited companies, even if it is a meeting of owners. Furthermore, it is also assumed that the expenses caused by meetings of the Council of Owners and the Family Council and the training expenses of the owners, i.e., the shareholders, would be considered tax-deductible. However, it is important to keep in mind that such expenses are reconsidered on a case by case basis, and a tax-bound must, for instance, in the case of tax audit, prove how these expenses are related to the business activities. In these cases, it is justified to appeal to the tax expert preferably already in advance when planning the activities.



Common to all the family firms is the power of family ownership. It not only provides a variety of possibilities but also responsibilities regarding the governing of the company, business and the family. Companies differ in nature, as do families. Therefore, the structures regarding governance can also vary considerably. For instance, the age, scope of the business, the share of family ownership, as well as the number of individual owners influence the selection of the governance tools. In selecting of these tools, it is vital to consider means for securing the competitiveness and continuity of the company.

The owner has a major role in family firms. In order to get her/his voice heard and to ensure that the interaction between different institutions will be functional, at least one of the owners must be active in the governance of the company – at the core of ownership, business activities and the family.

Good governance and the responsibility of the owner in developing the business is emphasised in the family firms, since intervention of the external owners is not usually possible when there is the need for a change in business activities. If a well functioning and active relationship does not exist between the owners and the management, the economic base of the family might decline over time. For this reason, a family firm cannot afford to have a passive board. The work of the board is highly important in family firms, since successful communication with the stakeholders of the family firm –two-way interaction – brings additional value to all of the parties. Properly functioning board work enables the family firm's activities to become more efficient, and improves the company's ability to make profits, which over the long run ensures the future and the continuity of the whole company.

The guiding principles for family firms allow the owners of family firms to create the rules of ownership and to get them approved by as many owners as possible. Success in this project requires interaction and discussion within the family. This interaction will also commit the parties involved to follow commonly agreed rules. The most important factors in this process are transparency as well as clearly defined tasks and roles of different institutions for guiding the corporate governance of the company.

Each family firm has special characteristics that should be utilised in the development of good corporate governance. When changes occur in the company, ownership or family, for instance, in the form of a change of generation, it is wise to update the governance structures. At best, good governance can provide a family firm with an active, continuous additional value and competitive advantage. The aim of good governance in family firms is to ease and make the governance of the company and the family more efficient.

> THE FINNISH FAMILY FIRMS ASSOCIATION

The Finnish Family Firms Association was founded in 1997 with the name of Family Business Network Finland. It became a nation-wide association of family firms in 1999. The founder of The Association was deceased, Mr. Peter Fazer, who succeeded in assembling the owning families with diverse activities under one single umbrella.

The mission of The Finnish Family Firms Association has crystallized in improving of preconditions of operation of family firms and responsible ownership. One of the special aims is to secure the continuity of business activities.

The Finnish Family Firms Association acts as a communications network of Finnish family firms, an interest organization, as well as an expertise and education institution.

Education, research, taxation, and influencing on development of business and on society in general are subjects of which the Association forms the aims of the family firms. The Association's duty is also to convey these aims to and influence on the decision-makers.

The values of The Finnish Family Firms Association are familiness, continuity, trust and transparency. Based on these values it is necessary to bonder the questions of responsibilities of ownership. How to act as a responsible owner? How should I as an owner run the business and grow it?

The vitality and uniqueness of The Finnish Family Firms Association is partly driven from the presence of different generations. For the responsible next generation owners The Finnish Family Firms Association acts as a useful way of networking, developing and gaining content to one's own life mission. It is also a platform for different generations to communicate and learn to know each others.

The Finnish Family Firms Association is an active education institute which amongst other things prepares the next generation for responsible ownership. In addition to the importance for the continuity of family firms this activity has also vital importance in the context of larger society and national economy.

In order to form a joint affect it is also required being together. Therefore, The Association organizes lots of chances for interaction between its members.

In 2009 there were over 300 member firms in the Association which of total turnover amounted roughly to 30 billion EUR and which employed almost 150.000 persons. Ms. Anne Berner is acting as Chairman and Mr. Anders Blom as Managing Director of the Association.

FINNISH FAMILY FIRMS ASSOCIATION

www.perheyritystenliitto.fi