

**PRIVATE FAMILY ENTERPRISE
GOVERNANCE SURVEY:**

Why Family Business Success Matters for Canada



**Clarkson Centre
for Board Effectiveness.**



**Institute of Corporate Directors
Institut des administrateurs de sociétés**

Better Directors. Better Boards. Better Business.™



PRIVATE FAMILY ENTERPRISE SURVEY:

Why Family Business Success Matters for Canada

About the ICD:

The Institute of Corporate Directors (ICD) is a not-for-profit, member-based association representing Canadian directors and boards across the for-profit, not-for-profit, and Crown sectors. The ICD has more than 12,000 members and 11 Chapters across Canada and fosters the sharing of knowledge and wisdom through education, professional development programs and services, and thought leadership to achieve the highest standard of directorship.

ICD members across all sectors of the economy oversee well in excess of \$1 trillion in market capitalization and institutions that impact the lives of virtually every Canadian.

About the CCBE:

The Clarkson Centre for Board Effectiveness (CCBE) at the Rotman School of Management, University of Toronto, is Canada's leading independent corporate governance research body. CCBE's mission is to create practical tools and insights to improve the effectiveness of boards of directors in all sectors. CCBE's research focuses on effective disclosure, adoption of formal governance processes, pay for performance analysis and more. In 2013, a CCBE study found that Canadian family firms had dramatically outperformed the TSX Index over a 20-year period. Building on that result, CCBE launched an ongoing study into the governance of Canadian family enterprise. Why Family Business Success Matters for Canada is CCBE's first study of private family business.

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FAMILY BUSINESS & THE CANADIAN ECONOMY

Family business appears to be the most important contributor to the Canadian economy, no matter how you scrutinize the statistics. Research from the Alberta Business Family Institute found that family businesses employ six million workers, create 70% of jobs in North America, and provide 55% of all charitable donations. The institute estimates that family businesses contribute 60% of the Canadian GDP. It would be difficult to overstate the significance of these figures. Family enterprise defines the Canadian business landscape.

Meanwhile, research into the governance of family business – the processes, structures and decisions that enable them to succeed – is scarce, with the possible exception of succession planning. Resources on corporate governance are inherently biased towards large, public and widely-held corporations. As a result, family enterprise governance seems to some like an oxymoron, rather than an important area of study. Every family business employs a combination of formal and informal approaches to decision making, and that is the definition of corporate governance. For example, some family businesses find that good governance is a prerequisite for effective succession planning. By neglecting family enterprise in the broader conversation of corporate governance, we are perhaps risking more than we realize.

Governance Tools for Family Business

The purpose of the Private Family Enterprise Governance Survey is to begin to understand the approaches that family businesses take to governance, and to launch a broader ongoing conversation. It is not an area where easy solutions will be forthcoming. Good governance is complex, and sometimes elusive, even for thoroughly studied corporate structures. Only by engaging family businesses and business

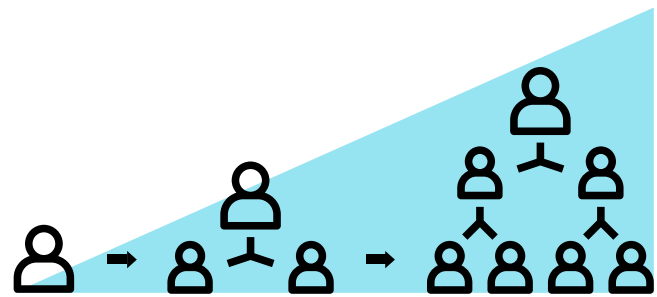
families directly can we understand which structures are appropriate at what times, and the most important challenges at various phases in a company's evolution.

Our report focuses on the evolution in formal and practical governance policies from generation to generation. The founding generation is often single-minded about growth, while the second generation prepares the transition to the third generation, which finally becomes more comfortable with outside influence. Each stage yields different risks and nuanced governance challenges for the business and the family. The input of advisory and fiduciary boards is sometimes unwelcome, and often crucial. Resources targeting family businesses could better mitigate this tension by communicating how good governance effectively manages the interests of all stakeholders, especially the family.

Our survey results take us one step closer to understanding the diversity of governance needs among family businesses. Through further engagement with owners, directors and managers, the development of tools and resources that are sensitive to these needs will finally become a reality.

SURVEY RESULTS: COMPARING BOARD USE BY STRUCTURE

One third of our survey participants indicated they have no board structure. Lack of structure doesn't necessarily equate poor governance, but governance structures often grow as family businesses mature.



On the right path:

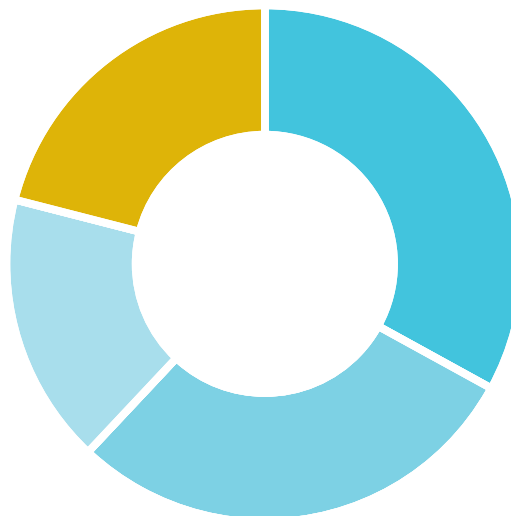
67% of family businesses have some kind of board structure.

Neither Fiduciary
or Advisory Board

33%

Both Fiduciary &
Advisory Board

17%



Fiduciary Board

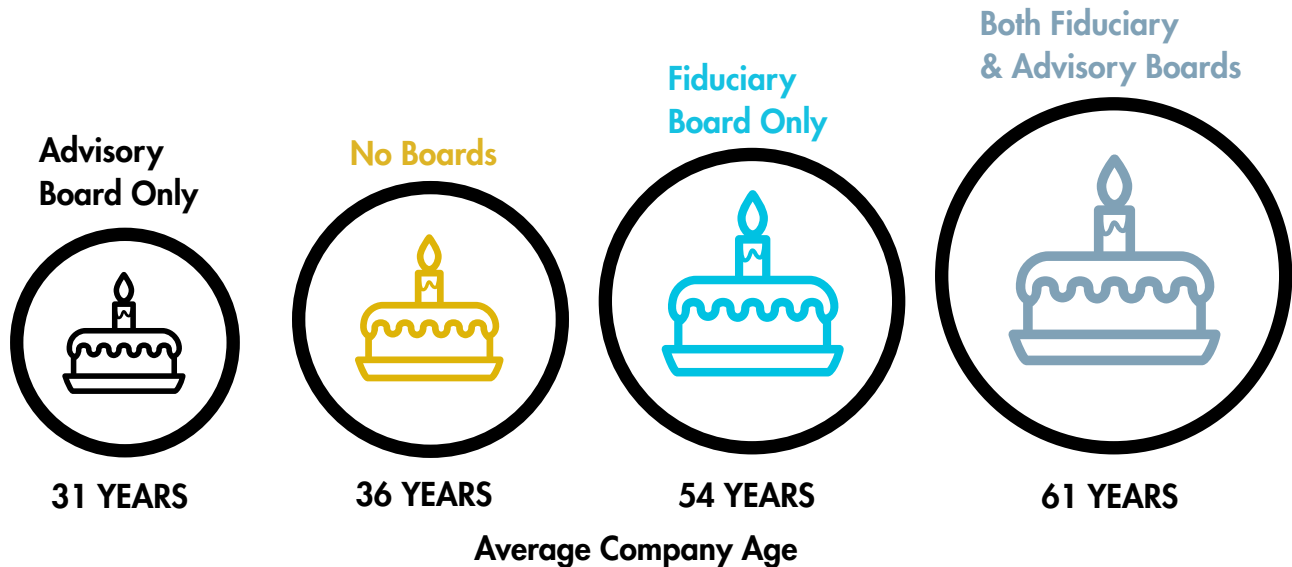
29%

Advisory Board

21%

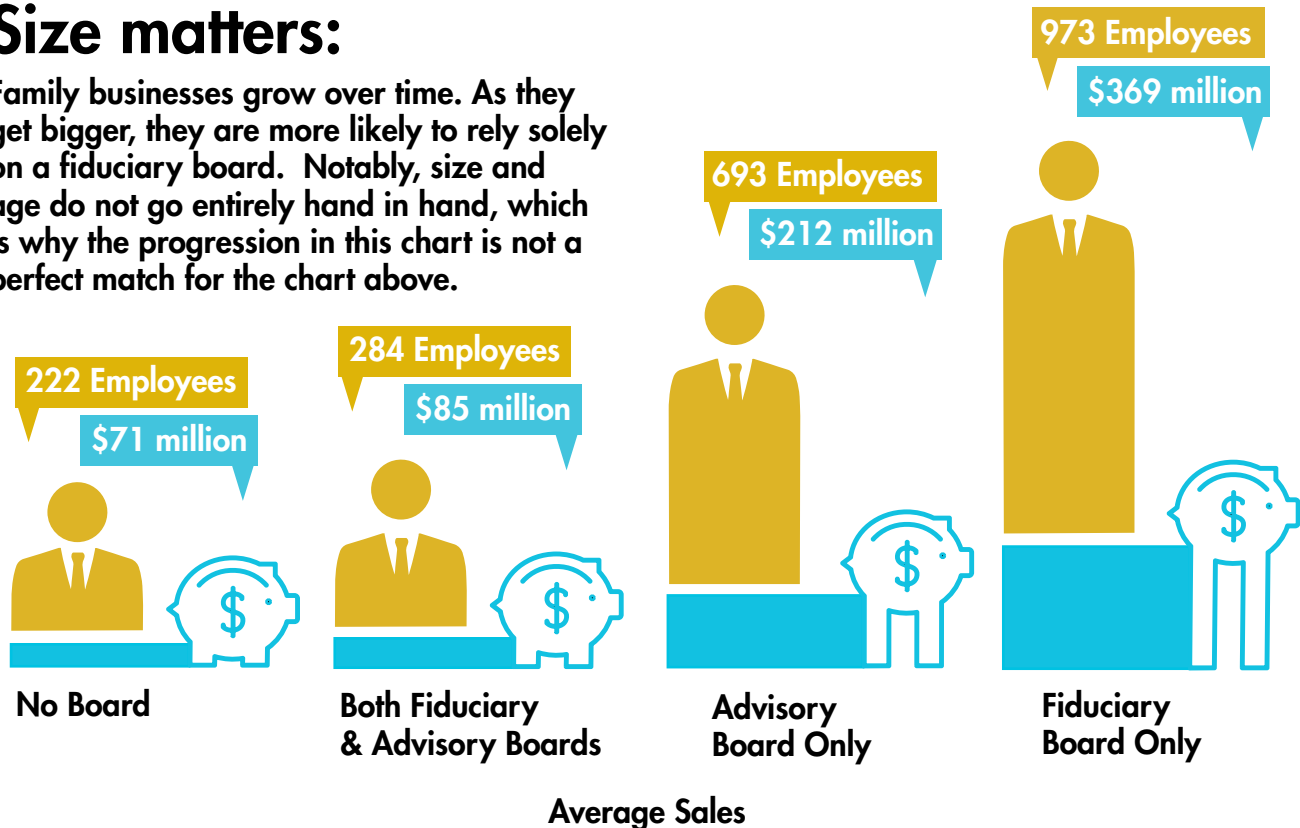
With age comes maturity:

Generational shift is a reliable predictor of the adoption of family enterprise governance structures and processes. Advisory boards are excellent at transitioning family business toward formal governance, and many companies retain their advisory boards even after they implement fiduciary boards. As we can see, approaches to good governance vary significantly, and so change does not always happen at the same pace for all companies.



Size matters:

Family businesses grow over time. As they get bigger, they are more likely to rely solely on a fiduciary board. Notably, size and age do not go entirely hand in hand, which is why the progression in this chart is not a perfect match for the chart above.



SURVEY RESULTS: COMPARING BOARD STRUCTURES

Advisory Boards

Advisory boards are an effective gateway for family businesses to access the expertise of outside advisors, without the pressure to empower advisors with formal or legal responsibilities.

KEY TRENDS

Advisory boards are usually adopted in the 1st generation, within the company's first 30 years.

63% of all advisory boards are paid, at an average of \$27k in cash per year

Advisory boards are chaired by family members 44% of the time

34% of advisory board members are women

(24% for fiduciary boards)

Advisory boards are 63% more likely to have combined chair and CEO roles

(compared to 48% for fiduciary boards)

Fiduciary Boards

Fiduciary boards enable family businesses to rely on a group of independent experts for crucial business decisions, while they maintain control. Directors have a significant legal duty to the company, and are accountable for the outcomes of their decisions. The family now has a truly formal governance structure.

KEY TRENDS

Usually appointed
in the 2nd/3rd
generations

More likely than
advisory boards to
reach constructive
consensus

56% of directors
are family members

60% of all fiduciary
boards are paid, at
an average of \$39k
per year

61% of fiduciary
boards hold in
camera sessions
without management

Meetings are often
shorter than advisory
board meetings

(1/2 day or less compared to up
to a full day)

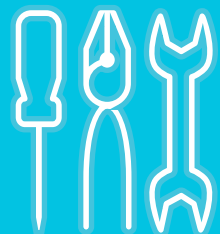
SURVEY RESULTS: COMPARING GENERATIONS

1ST GENERATION:

The Builders

The business is growing, but the foundation may need some work.

The first generation of a family business is preoccupied by growth. The family fully commits time, money, and passion, leaving little time or desire for formal processes. With the founder prominently involved in the business—ensuring creation of value for the next generation—systems to ensure a smooth transition between generations are rare.

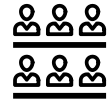


By the numbers

93% founder is involved in the business



32% have a fiduciary board (55% for 2nd gen)



54% have a shareholders agreement



TOP GOVERNANCE CONCERNS

Today:

**Growth &
Performance**



Expected in 5 Years:

**Developing
the next generation**



BUILDING GOVERNANCE STRUCTURES IN A HIGH-RISK,
HIGH-GROWTH ENVIRONMENT CAN BE MESSY:

“The new shareholders agreement will eliminate the board of directors and shift control of the company to the shareholders alone. I personally think that is a mistake, but can’t influence much since I’m just one member of the family.”

2ND GENERATION: An eye on the future

The second generation proves that the founder's effort pays off.

A successful transition to the 2nd generation proves the efforts of the founder, who prepares to step back. The focus shifts to developing the 3rd generation, and formalizing important structures, practices, and policies. Companies are larger, more complex, and have a greater number of stakeholders with unique demands that need to be managed.

WHY AREN'T YOU CONSIDERING FORMING A BOARD OF DIRECTORS?

"Founder didn't want a board. 2nd generation is more interested."

"Founders do not believe in change. They won't share family issues with outsiders."

A new generation means more family members. More family members means more formal structure...



Boards by the numbers

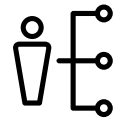
82% have shareholder agreements
(compared to 54% in 1st gen)



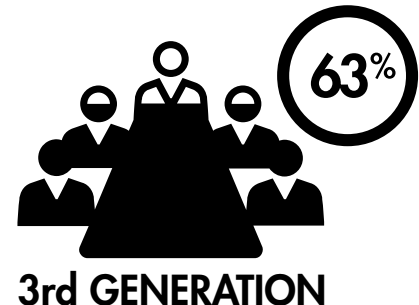
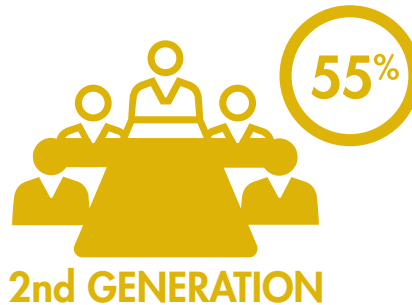
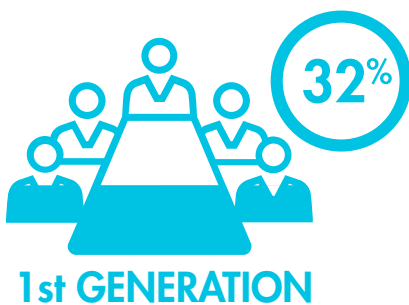
42% have codes of conduct for family
members (compared to 19% in 1st gen)



90% family ownership, but spread
among more owners



More than half of 2nd generation companies have formal fiduciary boards.



Family members in 2nd generation businesses report increased concern over the development of the next generation, but still only 22% of companies have a succession plan for owners.

3RD GENERATION AND BEYOND: Letting Outsiders In

By the third generation, the founder is usually no longer in the picture, and the influence of outsiders has grown.

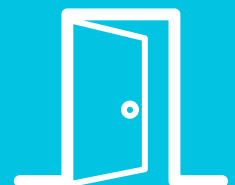
The businesses of our 3rd and 4th generation participants are an average of 75 years old. Between the 2nd and 3rd generations, the focus moves back to corporate performance. CEO succession is a top concern for the first time, but is still perceived as a distant reality. In the meantime, 3rd and 4th generations build independent boards and reduce reliance on informal advisory boards. If they haven't already, governance processes are becoming rigorous and formal.

OUTSIDERS ARE HAVING AN IMPACT:

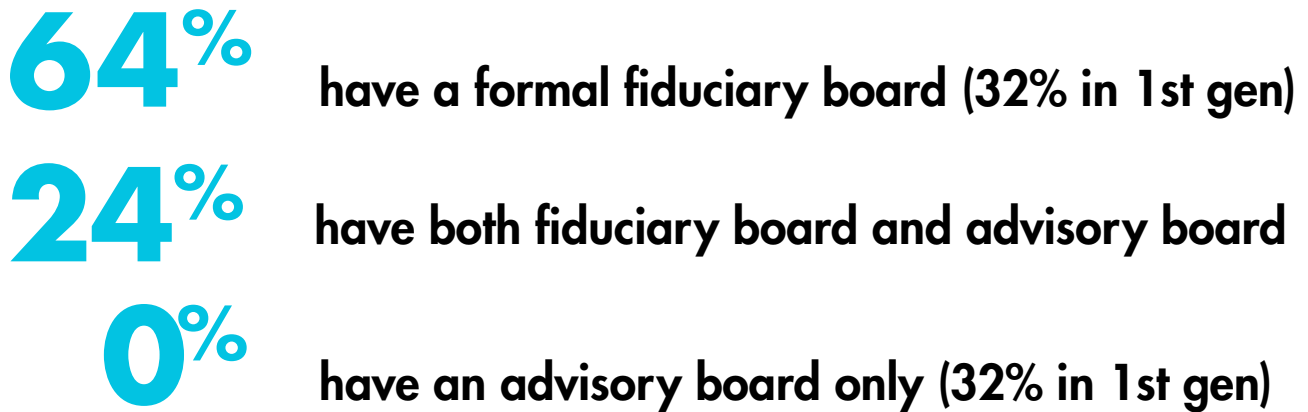
"Having independent oversight with different viewpoints and skills so far has met/exceeded our expectations in terms of independent directors adding value"

The influence of the founder persists

(founder is still involved in 35% of 3rd generation family businesses)

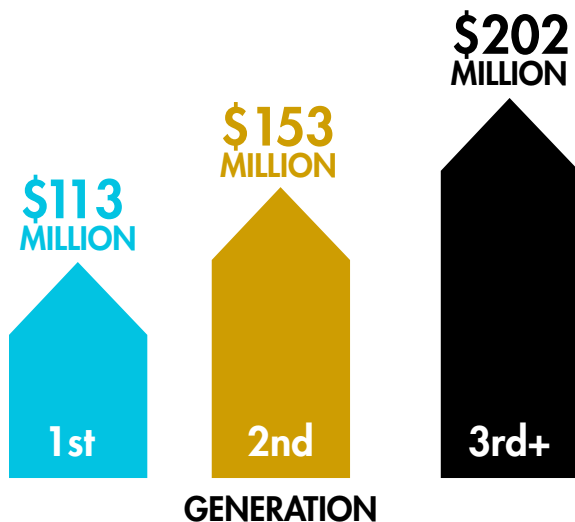


Boards by the numbers

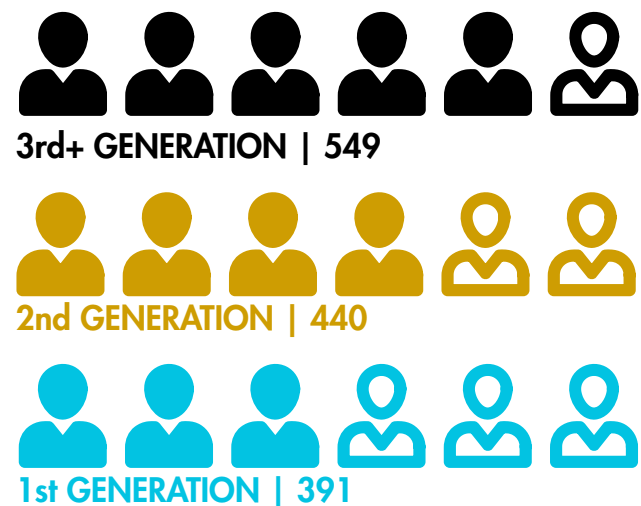


Growth continues steadily into 3rd & 4th generations

Average Sales



Average Employees



TOP GOVERNANCE CONCERNS

Today:

Financial/Performance

Expected in 5 years:

CEO Succession

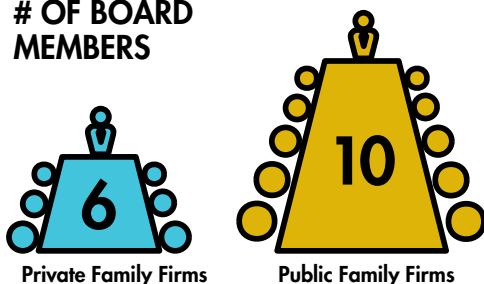
GOVERNANCE FOCUS: DIFFERENCES AT PRIVATE AND PUBLIC FAMILY FIRMS

Private family business boards can create a governance structure that works for their needs by benchmarking board structure and process adoption to larger, publicly-listed family firms. To highlight current differences and potential opportunities for alignment, we've compared your fiduciary board structures — using responses you provided in the 2016 Private Family Enterprise Survey (23) — to Publicly-Listed Family Controlled firm boards (public family firms). In 2015, the Clarkson Centre for Board Effectiveness collected board governance information on 40 of the largest Canadian public family firms.¹ Here are some comparisons between your responses as a private family business and Canadian public

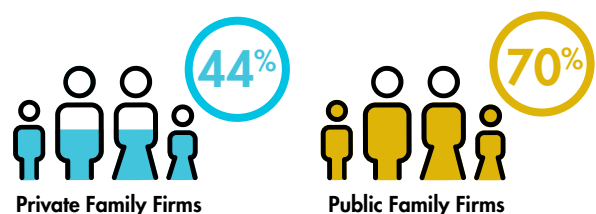
Board Size:

Private family firm boards are much smaller than public family firms, almost by half. Private firms tend to have boards made up of directors that are owners, managers or advisors. Public family firms often have more outsiders on the board, but include family members or trusted advisors by increasing the total number of directors.

OF BOARD MEMBERS



% OF BOARD THAT ARE NOT FAMILY MEMBERS

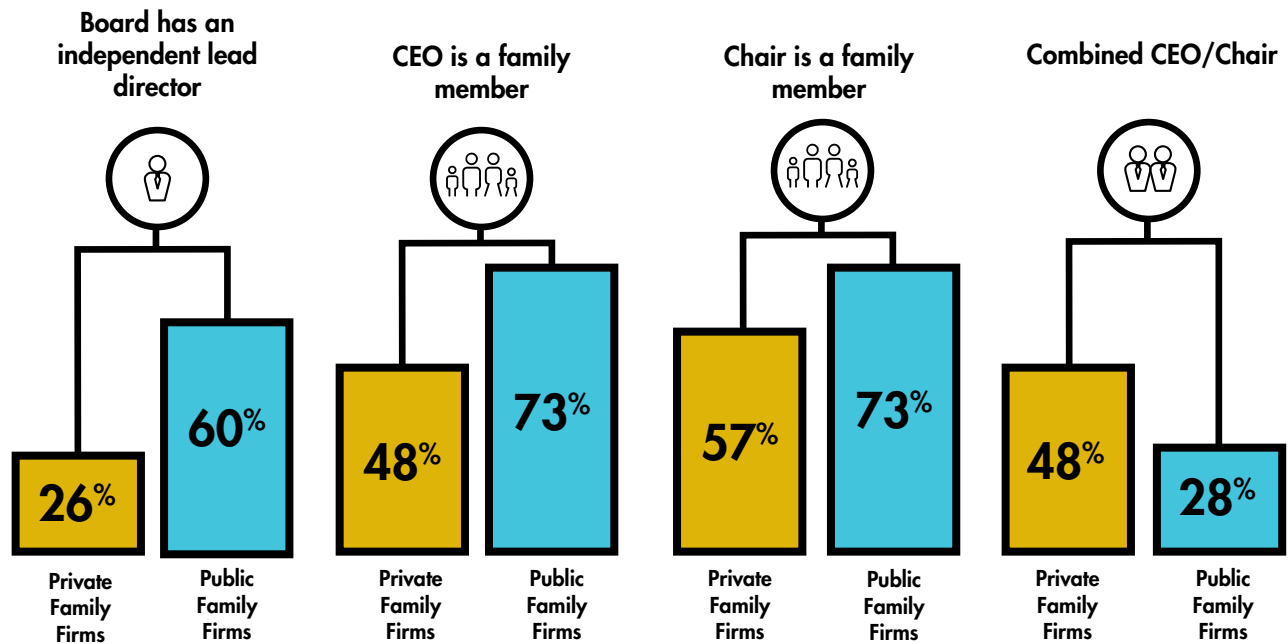


¹ The Clarkson Centre defines public family firms as public issuers with at least 30% of votes controlled by a family entity. A family entity may be a holding company, an individual or a group of individuals. Ownership must have transitioned to at least a second family generation, or a second generation must be clearly positioned as a successor. In other words, founder-controlled corporations are not included here unless a successor with a family relationship to the founder has been identified and clearly articulated in public documents.

Family Control:

Some families perceive fiduciary boards as threats to the control of their business. Families not only control 62% of private family firms, but also manage the company and appoint family members as board chairs. If the Chair is a family member, a Lead Director can provide useful independent oversight by chairing meetings without family or managers. These structures enable public family firms to implement a robust governance model that includes a fiduciary board, while continuing to maintain a comfortable level of control.

FAMILY FIRMS ARE MORE LIKELY TO FILL THE CEO AND CHAIR ROLES WITH FAMILY MEMBERS, BUT ARE LESS LIKELY TO HAVE A LEAD DIRECTOR

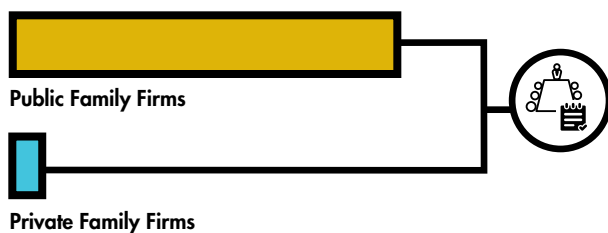


Board Evaluations:

Public family firms are more likely than private family businesses to have formal board and director assessments. This is not surprising, as assessments can be onerous, and potentially tricky from a cultural perspective.

BOARD EVALUATIONS ARE NOT COMMON AMONG PRIVATE FAMILY FIRMS

Formal Director Evaluations



Formal Board Evaluations



CONCLUSIONS & NEXT STEPS

Conclusions

We created the Private Family Enterprise Governance Survey as a conversation starter. Only by engaging directly with family businesses will we be able to gain an understanding of the unique governance strengths inherent in family ownership and management. Conversely, we will only really understand the challenges presented by family enterprise governance – and, hopefully, the solutions to these challenges – by hearing about them right from the source.

Our study tells the story of the evolution of family businesses, from the entrepreneurial vision of the founder, to the formalization of robust and sustainable governance structures. As we continue to examine this evolution, with the help of family businesses, we hope to learn what governance approaches are likely to yield the best results, and help to illuminate the path to sustained success. By supporting family enterprise, we are supporting the most crucial part of the Canadian economy.

Next Steps

Ongoing Direct Engagement

CCBE and ICD will continue to engage with survey participants and other family businesses on an ongoing basis to bolster our understanding of their experiences, and ensure that our report is having the promised impact.

Follow-Up Survey

In two years, CCBE and ICD will launch the second edition of the Private Family Enterprise Governance Survey, building on the foundation that we created in 2016-17. The results of the follow-up survey will highlight any shifts or emerging trends, and ensure that the dialogue with family business continues.

Acknowledgements:

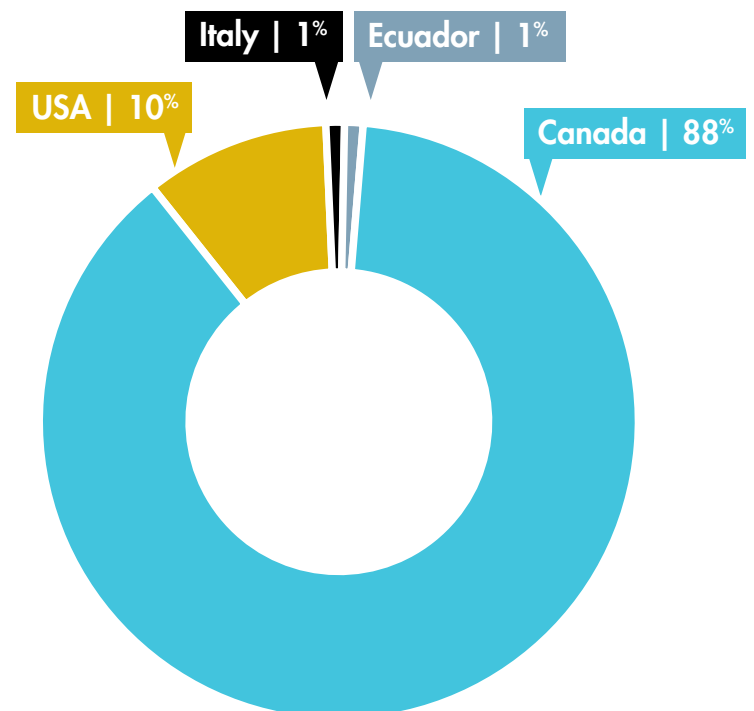
CCBE and ICD would like to thank The Family Enterprise Exchange (FEX), Family Business Magazine, The Family Business Catalyst and Pervin Family Business Advisors for their support throughout this initiative.

METHODOLOGY: Who participated?

Between October 2016 and February 2017, the Clarkson Centre gathered online surveys from 118 individuals, each representing unique family businesses. Among those participants who identified the location of their company's headquarters, 88% were based in Canada.

Survey participants answered 75 questions focusing on company demographics, family governance and corporate governance.

Following the close of the survey, CCBE conducted 10 follow-up telephone interviews with survey participants in order to gain anecdotal perspectives on the results of the survey.



Location of Survey Participants by Country



Rotman School of Management
UNIVERSITY OF TORONTO



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