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Family Business Boards: Demystifying the Process

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Longtime readers of *The Family Business Advisor*® know how often we point to an independent board of directors as a critical ingredient to long-term success in a family business. Yet by most accounts, the vast majority of family businesses still do not have independents on their boards, and many never use the board they have in any sort of oversight or governance capacity.

Why does this pattern persist and what can we do to remedy it? First, let's review the basics of business governance and then we'll tackle some of the most common concerns we hear about from families when we broach the topic of setting up an independent board.

So what is governance anyway? A "governance entity" is usually a few individuals who represent the welfare of a larger group by providing oversight and broad strategic direction in a way that protects both the interests of the individuals and the group as a whole. In a business setting, a board of directors is the governing entity, providing oversight of management to ensure that the interests of ownership are protected.

In a family-controlled business, where management and ownership overlap, the interests of management are aligned with those of ownership — perhaps diminishing the need for tight oversight. While some argue that this is why a family business doesn't need a board, this view is shortsighted. First, it is likely that over time not all owners will be involved in the management of the business, creating some possible tension between "inside" and "outside" owners that independent board directors could help alleviate. Second, while the overlap of management and ownership may reduce the need for oversight, the additional overlap of family relationships in a business context increases the emotional complexity of certain key decisions (from compensation to succession planning) that would be beneficially impacted by the presence of trusted independent board members.

Quoting the introduction of the *Family Business Governance* book by Aronoff and Ward: "A business that is well governed is free to work toward the highest and best objectives of business — maximizing profit, improving strategy, creating jobs, fostering employee development and serving all stakeholders, including shareholders, employees, customers, suppliers and the community." As these are goals most business owners would hold dear, what are some of the common objections we hear to setting up an independent board?

Business owners fear that setting up a board will somehow rob them of the control and authority they enjoy in their business. While the role of independent directors is to provide business leadership accountability that is distinct from family accountability, it is important to remember that directors in a business serve at the pleasure of the owners. Directors who have been recruited in a thoughtful manner and oriented to the needs of the business have no desire, nor any authority, to "take over" your business or even dictate how the business should be run. These individuals are usually selected for the wisdom and experience they can offer that is deemed relevant to your business' needs. Directors are there as a resource for the chief executive — optimally, they are a sounding board to provide advice and insight when the company is faced with key strategic decisions.

Business owners may feel intimidated by the formality and accountability that come with a board. While the work required to prepare for quarterly board meetings may feel daunting when you have never done it, it is an excellent way to set aside the necessary time and mental energy for strategic business leadership. Too often we see brilliant business people get bogged down in the details of managing their businesses, and they do not ever invest in the time needed to lead their businesses. As a result, the business fails to grow and evolve at the rate it otherwise could. An effective board of directors can help keep the business leader focused on the key strategic issues that should be his or her priority.

There are those business owners who actually want a board but feel overwhelmed by the process. "Where would I begin?" they wonder. "Who would I ask?" While it may feel intimidating to set up a board of directors from scratch, if you break up the process into smaller steps it can feel manageable.

First, convene an owners meeting. All owners must be in alignment about what they want from a board and about their shared vision for the business (so they can clarify this for the board).

Second, determine the needs of the business going forward — are you facing a period of growth? Do you have to make a strategic change in your use of technology? Understanding the near-term needs of your business will help you determine the skill sets you want in your directors.

Third, draft a prospectus (typically about a three-to-five-page document) explaining why you are seeking outside board members, detailing a bit about the business (including the family's involvement), explaining what you are seeking from a board and what you anticipate the time commitments to be, and clarifying compensation.

Even if you have already identified director candidates, it's essential to complete this process. It ensures that the ownership group is on the same page concerning the purpose, role, and profile of the board.

This document will help you recruit appropriate independent board candidates, and by constantly referring to it the entire ownership group will be reminded of why you are making this commitment to good governance.

Conclusion

Developing an independent board is a significant step in the life of a family business. In our experience, boards can be one of the most powerful tools in ensuring the longevity of the family business. Keys to a successful independent board include:

- Ensuring that all owners understand the role and responsibilities of the board and are ready to incorporate outside thinking into business strategy and oversight.
- Clearly specifying expectations of directors in advance of hiring them.
- Seeking directors who understand family business and have dealt with the major strategic issues your business will face.
- Committing the time and energy required to use the board effectively (prepare materials in advance, including a structured agenda, and actively facilitate the meeting to ensure input from all directors).
- Ensuring that owners provide ongoing input to the board on their vision, values, and goals for the corporation, and providing opportunities for board and owner interaction.

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