The Family Business Advisor

THE FAMILY BUSINESS CONSULTING GROUP

The Value of Diversity in Governing Family Enterprises

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You may have one or more governing bodies in your family enterprise: a family council, an owners council, a corporate board, perhaps a foundation board – or other groups that represent the larger family. You depend on these governing bodies to make decisions that reflect constituent expectations. When you think about that objective, what are the circumstances under which you can maximize the chances of fulfilling expectations for the broad group of extended family members? The short answer is it is not easy to create those circumstances.

Typically, the low hanging fruit in terms of creating the most harmonious decision-making group is simply to seek out like-minded individuals. And why not? When you are sitting around the table with people who think like you do, idea generation is easy, discussions are not typically drawn-out, and decisions get made. It is efficient. That said, is it optimal? Does it represent the diverse opinions you witness across the large family? Will your decisions reflect multiple opinions and preferences? Will you be able to defend your decisions?

Strength in Diversity

Any important decision made by a governing body must be vetted based on input from a representative group that asks the right questions, investigates the assumptions made in data gathering, and embraces the challenges associated with distinct viewpoints. How do you help to ensure that the governing body can do just that? Throughout 2020, we have seen many of our clients pay close attention to the real value that diversity brings. And while diversity within the same family may not appear to be obvious at first glance, it exists; and diversity should be sought out.

Diversity builds strength and increases effectiveness within governing bodies that are composed of either all family members (often family and owners councils) or some family members (corporate boards). Hopefully something here will help you to consider ways in which the composition of those decision-making groups will sustain and strengthen stewardship among your family, key non-family management, suppliers, and financial partners.

In the last few years, a number of social movements have brought concerns of diversity to the forefront of business activities. Corporations like Pepsi, for example, announced huge investments into their goals of achieving gender parity in their workforce, and racial diversity in both their workforce and their supply chain as a response to the social activism in 2020. The response to campaigns like Pepsi's has been somewhat lukewarm: social justice activists question whether such investments can lead to real change, while business academics question if such investments can lead to positive financial performance. Diversity continues to be a topic of inquiry for publications like the *Harvard Business Review*, particularly in response to increasing legislation mandating gender diversity on governance boards.

Expanding the Meaning of Diversity

It is helpful to clarify what diversity entails, and to consider the recent data regarding diversity when giving suggestions for how diversity can improve the performance of governance systems. We define diversity more broadly than gender or racial lines: while a diverse board should include female members (indeed, this has been a legislated requirement for publicly traded companies in California since 2020, while countries such as Norway, Spain, France, and Iceland all require that women comprise 40% of the board), the concept of diversity should be expanded to include racial, sexual, educational, and generational diversity.

Expanding the definition of diversity beyond gender equality is well-founded: a 2015 review of 140 research studies found that the relationship between female board representation and performance found a positive relationship with accounting returns. In a 2019 HBR article, authors interviewed 19 board directors in response to such data, working with the Chairman of the Board at Deloitte to develop recommendations on diversity in governance. Their first recommendation? Expand the view of diversity; many of their interviewees suggested that both social and professional diversity would be helpful for increasing the diversity of perspectives on the board.

This recommendation for diversity of perspective is equally well-founded. Several studies on decision-making have suggested that developing a positive culture around dissent is essential for strong judgment in a leadership capacity. Dissent comes from diversity; specifically differences in:

- Educational backgrounds,
- Professional backgrounds,
- Generational gaps, and
- Elements of social diversity.

Valuing Diversity of Thought

Jared Landaw, in his 2020 HBR article on diversity in boardrooms, focuses on cognitive diversity as a requirement for improving financial performance. For his study, he interviewed 18 directors of underperforming firms who had been subject to shareholder activism by the Barington Capital Group, an activist investment firm that assists publicly traded companies in designing initiatives to improve long-term value. His findings were that cognitively diverse boards were more likely to challenge the status quo, which then led to improved financial performance. Cognitively diverse directors also helped with changing the culture in the boardroom. As one of the interviewees stated:

> "The new directors [on our board] brought not just a diversity of opinions and perspectives, but a diversity of behavior—a willingness to openly challenge management and other directors, which was missing from the boardroom. By having more open debate, it created an environment where others saw it was good and healthy to have frank discussions regarding important decisions. When members of the board began challenging each other—and listening to each other's viewpoints—it led to positive outcomes. Good healthy disagreement led to good decision-making."

Embracing Family Diversity

Landaw recommends that boards recruit racially, ethnically, and gender diverse directors who can bring new professional backgrounds, skills, and experiences in areas relevant to the company's strategic and operating needs, and who can introduce new views, perspectives, and approaches to problem-solving. In a family-owned business, this definition needs to include a multigenerational, and multi-branch board that can represent the many generations dedicated to preserving the familial legacy.

Boards that promote open communication or are egalitarian instead of hierarchical in their decision-making style, are more likely to benefit from social and professional diversity in the boardroom. It is not enough to simply add diverse voices to the board or council; the governing body needs to adapt to support the diversity of opinions in order to experience the benefits from diversity in decision-making. And studies have provided evidence that a culture that supports dissension, while sometimes challenging, will typically result in decisions that are of higher quality

If you seek continuity through generations, it cannot be realized without strong stewardship in the family. Stewardship is not innate, it is developed over time, as well as earned by the groups responsible for steering the ship. Those groups discuss, debate, and make important decisions, and must be equipped for those critical responsibilities.

> "The need to understand the optimal composition of family governing bodies that will best serve the collective, the community, that *is* our family."

Homogeneity is an Illusion

Understanding our family isn't easy. How could the siblings I grew up with be so different? What does this new generation really think, believe, want from life? Add to that, the need to understand the optimal composition of family governing bodies that will best serve the collective, the community, that *is* our family. What we know is that homogeneity will not accomplish that goal; and that a governing body that is made up of members who bring diverse philosophies, experiences, education, and opinions will likely in the long run, equip us with true representation; with recommendations and decisions that can be made with confidence, on behalf of the people we love.

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