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Getting Non-Operating Shareholders Appropriately Involved

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Over time and generations, a family business usually encounters increasing obstacles to shareholder unity. As the family grows, members will become geographically dispersed and some may never set foot on the premises. Greater numbers in each generation means share ownership dilution and typically an associated decreased economic interest for each shareholder. They are generations removed from the founder and may not have had direct interaction with their entrepreneurial ancestor. Spouses and their wide-ranging backgrounds, values and views are mixed into the family's heritage. For the observant and visionary family business manager, family leader or board member, these trends translate to a real risk for reduced commitment and represent a threat to continuity. It can happen quickly; one generation grows up spending their summers together and is fully engaged in the affairs of the business and the next generation's children don't know their cousins' names.

To counter these natural trends, the question among management, family leaders and the board is, "how do we get non-operating shareholders appropriately involved and engaged?" Aronoff and Ward, in their work *Family Business Ownership: How to be an Effective Shareholder* (2012), have used the term "involved owner" to describe individuals who:

"...are not employed in the business and may not even be on the business site very often. However, they are attentive to the issues facing a family business. They develop relationships with management, they make it a point to understand the company strategy, and they take the time to promote the culture of the business. In other words, they take a genuine interest in the company, offer support to management, and involve themselves as appropriate."

The challenge is to define what is "appropriate" and for some, whether to let sleeping dogs lie or to invest in appropriate shareholder involvement.

One View: "We've had some past bad experiences" or "It's too risky"

Family firms over time swing back and forth like a pendulum on the subject of involving shareholders. When skilled active owners find ways to contribute and do so without conflicts with management, younger family members benefit from the role model of their parents. When there have been conflicts - inappropriate meddling, individuals or branches acting out on entitlement expectations, or just well-meaning family shareholders, without knowledge or experience, inadvertently treading on management's turf - "involved ownership" initiatives will raise anxiety and be resisted.

Shareholder involvement is easily mismanaged and may be seen as representing more risks than upside potential. Management may consider non-operating shareholder involvement as a slippery slope toward blurring boundaries of authority and inappropriate entitlement behavior. At times it may not seem manageable; management has a business to run and the board chair has a board to manage - who can make sure "shareholder involvement" doesn't become a problem and remains meaningful and effective for those who participate as well as effective for the business? Perhaps sufficient management, board or family governance resources do not exist for adequate coordination.

An Alternate View: "OK, I buy that engaged shareholders are good; how have others had success?"

Those who experience positive results from shareholder involvement point to the importance of clarity about appropriate roles. If the activities, the boundaries and the benefits associated with the roles of executives, directors, shareholders, and family members are well understood, there will be less risk. Trust and respect between these roles is also critical. Management and the board have to trust that shareholders will not overstep their role and genuinely believe that these family members can add value with these "assignments." Likewise, the non-operating owners have to trust and respect that the board and management have the best insight around the roles they may appropriately play as engaged owners. Finally, successful businesses give a great deal of thought to how they can best engage shareholders and ensure that they put the appropriate resources to these efforts so that these lead to positive outcomes for the business and the shareholders.

If done well, benefits of specific, appropriate roles for shareholder involvement include:

- Greater commitment from non-operating shareholders and associated lower or flexible capital costs;
- Increased or maintained trust and alignment between non-operating and operating family shareholders - it can transition from an "us vs. them" adversarial shareholder environment to a "we" environment;
- More shareholders playing involved roles, especially when multiple, varied involvement opportunities are provided will enable the full diversity of shareholders (from student to young professional to retired artist…) to feel a special connection to their family's business and enable them to add value or "earn their inheritance";
- A more knowledgeable and motivated shareholder group that will be better able to form informed opinions on matters relating to their ownership such as risk tolerance, use of capital, appropriate governance;
- A protective, caretaking or defensive approach to shareholder relations can transition into one where shareholders see it as their own responsibility to effectively contribute. Where the patriarchal "we will take care of you" mind set can lead to dependence and entitlement, empowering shareholders with some responsibility may make them more appreciative of the work involved in making the business a success, and increase their sense of responsibility to contribute to that success.

Examples of Appropriate Involvement for Family Business Shareholders

1. Relationships with employees

- A shareholder personally meets all new hires to share family history and culture as part of their orientation of new hires;
- Shareholders attend new store, new plant, or new location openings;
- Shareholders participate in dedication of ships, stores, warehouses, acquisition events, and at key company celebrations such as retirement and employee recognition dinners and holiday parties;
- Shareholders attend key regional sales meetings, or appropriate portions of the meetings.

The genuine and active involvement of non-operating shareholders is often received well by employees in the business. Shareholder visits arranged by management are interpreted as caring and indicative of the importance of the unique family culture. It sends a message of continuity and the long-term commitment of the owning family. Employees who are proud of their results and of company's performance are eager to show non-operating family shareholders what has been accomplished and what is new and challenging. Shareholder interaction with employees requires little from a shareholder yet yields huge intangible returns.

2. Interacting with customers, distributors and suppliers

- Owner-to-owner relationship building visits to counterpart family owners of supplier and customer companies;
- Attending and representing the company at industry events and trade shows;
- Accompanying management on visits to selected customers' facilities;
- Joining dinners with key customers, distributors or vendors on a purely social level.

Many family firms take advantage of their non-operating shareholders for competitive purposes by selectively inviting them to participate in customer or vendor events. It could be just a lunch after a morning meeting, where the shareholder recites the history of the family's ownership of the company and personally explains what it means to the owners for the company to have long-lasting and loyal relationships with its customers. Vendors, distributors and customers view a positive relationship with owners as an advantage and welcome these interactions.

3. Participating in auxiliary governance activities

- Selected shareholders participating with board members in the selection of a firm to periodically audit the culture of the business with an emphasis on the family's values applied to the business;
- Selected shareholders involved in nominating committee functions — the board nominating committee may ask for shareholder voice through a survey or by adding ad hoc members to its committee;
- Investing in relationships between independent board members and family shareholders - dinners, social events, board/shareholder activities associated with the annual meeting - and board/shareholder meetings with a purpose beyond the annual shareholders meeting (e.g., a step in strategic planning). For some families, relying only on social interactions for relationship building can seem forced and awkward, so purposeful meetings with agendas may be best. For others, social gatherings are just right.

The board needs to be careful to avoid blurring the lines between shareholder and business governance when involving family shareholders, yet there are advantages to inviting a shareholder's voice and participation in selected activities. When they do, the board is genuinely listening to the interests and perspectives of family shareholders. The board does not have to take such steps, but when it does, it is elevating the importance of shareholders and purposefully recognizing their contribution. As a result, shareholders are encouraged to step up to the responsibility of the invitation. Of course, with additional opportunities to interact with directors shareholders benefit greatly and are influenced by hearing board members' views.

4. Family Council Examples

By-the-family-for-the-family shareholder examples through the structure of a family council include:

- Organized and facilitated meetings of senior management and family shareholders to directly discuss the family role, opportunities for shareholder involvement, expectations and how to avoid boundary mismanagement;
- Family council organization of shareholder representatives who travel to remote regions where family groups reside away from the business to deliver business and ownership education.

Implementation

As with many family business initiatives, there is not just one way to implement and manage non-operating shareholder involvement. Options are:

Management can lead it: It can identify specific projects and select/invite family shareholders who are skilled and well networked (to maximize influence) with the broader family;

The shareholders can make it a Family Council responsibility: In addition to the commitment enhancing mission and vision development roles of a Family Council, shareholders can provide leadership by identifying productive, appropriate shareholder involvement roles.

Greater commitment through involvement can be organized by a board committee: Perhaps an ad hoc committee made up of family, independent directors and invited non-operating family shareholders or a standing committee, which does the same.

Caveats

Not all family shareholders are right for every shareholder involvement activity or opportunity. Merit, skills and fit should be a consideration in every invitation to expand family shareholder roles for greater involvement. Too few opportunities that fit too few shareholders may do more harm than good. Family shareholders have a reciprocating responsibility to embrace the philosophies of merit and good fit, and to welcome self-awareness and candor for its achievement. Finally, there should be a willingness on the part of family shareholders to take direction with respect to how to best participate, from management, the board or the family council.

Too many family firms end up in an avoidable standoff around the appropriate role for non-operating shareholders. Management often holds the view that shareholders do not deserve involvement opportunities until they self-educate on investment and financial matters and shareholders are reluctant to invest in their own development if they see management as not disposed to involving them in anything of any significance or importance.

Participation does not have to be continuous; it can be intensive for a while then non-existent for a while. It can also be purposefully viral-with participation from a carefully selected influential few, the entire family can be positively affected. The best solution is not always broad, democratic participation.

Finally, the ideas and examples provided above are meant to augment other critical requirements: a solid vision; a set of well-articulated core values; a mission that provides purpose and inspires passion; an aligned board; effective policy and practice regarding family employment; and strong family and business governance, to name a few. Shareholder involvement cannot be appropriately developed or supported in the absence of these. Yet, as your family moves down the generations, the commitment of the ownership group to the business and the patient capital this provides cannot be taken for granted. While it takes some work to determine the right programs for your family and business, it is a critical investment in the long-term health of the enterprise.

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