The Family Business Advisor

THE FAMILY BUSINESS CONSULTING GROUP

Selecting Board Members: Guidelines for an Effective Nominating Process

By: Michael Fassler and Jennifer Pendergast
The Family Business Consulting Group

We all want the same results. All family businesses want to build enterprise value, protect family relationships, and maintain continuity through generations. The right board of directors (qualified, trustworthy, and objective) is a key factor in those results. But how do you assure you have the *right* directors, and that they will be trusted and respected by owners and management? A well-designed nominating process is key to getting the right people in place.

An important preface to this discussion is to understand the distinct types of directors — executive (senior management), family owners and independent directors. Executive directors typically qualify for their position because of the senior role they fulfill in the company (CEO, CFO, etc.) To determine who will serve in family director and independent director seats, a selection process is required. And, the process for family directors is often different from that used for independent directors. Here are some ways to make sure you find — and choose — the best directors for your business.

Set goals and ground rules

Before anything else happens, decide what you want to achieve (and how) while finding the right directors. For example:

- Deliver objective, qualified directors—whether family, management, or independent.
- Allow relevant stakeholders (such as owners or senior management) to help define the director profile.
- Assure that stakeholders support the directors selected by the process (by viewing the process as fair).
- Communicate clearly throughout the process, to ensure transparency.
- Define process and qualifications for both independent and family directors. Explain the differences.
- Clarify who owns each step in the process (to manage expectations).

Five basic steps

For both family and independent directors, the steps in the search process are the same:

1. Select a nominating committee
2. Specify candidate qualifications
3. Identify potential candidates
4. Screen, select, and recommend candidates
5. Nominate candidates for election by the shareholders

Now we'll go into more detail about each step and some differences between family and independent directors.

1. Select a nominating committee or group responsible for recommending directors for election (hereafter referred to as the nominating committee)

Family culture is a primary determinant of who is involved in the nominating process. For families with a more inclusive culture, the nominating committee might include family members who are not on the board whereas a more exclusive culture might include only board members. Some families cede nominating responsibility to non-family directors, others to the family and non-family directors, others to family directors, and some include family members who are not directors in the process. Business and family size and complexity also impact the composition of the nominating committee, with greater size and complexity calling for more structure and formality.

In most cases, the family selects *family directors* through a process run by the owners group, board of directors, or family council. In smaller families, family directors may be informally nominated by family agreement. If your family and business is large enough to produce many family candidates, be sure to document the process clearly so that everyone understands the eligibility requirements and qualifications. Decide who has the final say in candidate selection — family or other board members (including management and independent directors).

The board, or the nominating committee of the board, manages the nomination of independent directors. A group of owners can manage the process if *independent directors* are being added for the first time, then hand the responsibility over to the board in the future. Some families want a voice in the process beyond their family directors. They can represent the broader family by including, for example, the family council leader.

2. Specify candidate qualifications

For *family director* candidates, consider the value of diversity by family branch, age, and representation of non-employed shareholders. Important qualifications include candidates who have the mindset and competency to represent the interests of the full family ownership group, diplomatic dissension skills, and business acumen. Avoid preset divisions such as champions for different factions or family branches. Family directors should be prepared to read and understand business documents presented to the board.

Select *independent directors* for their business expertise, absence of any personal or financial interest in the business and appreciation for the family's culture and values. The independent director profile typically comes from the nominating committee, or the whole board, with input gathered from management and sometimes other owners. The committee specifies the qualifications in a prospectus, a formal document used to solicit board members, along with background on the family and their enterprise. Qualifications depend on the business and family situation, determined by what challenges and opportunities face the business (for example, consolidating industry, global expansion, generational succession) as well as what types of expertise are most relevant.

Important qualifications for all family business boards include family business exposure and appreciation, financial expertise, strategic mindset, P&L responsibility, and ideally prior corporate board experience. Board members must appreciate the culture and values of the family and demonstrate a stewardship attitude. Agreement on the definition of independence is a critical aspect of the specification. (An example of independence standards is included at the end of this article.)

No set of family or independent directors will perfectly meet all qualifications. As you develop the criteria, think about them in terms of "must have" and "nice to have." Otherwise, you can severely limit your eventual pool of candidates. Although the nominating committee takes the lead in developing the qualifications and gathers input from throughout the family, be clear in your process design as to which group approves the qualifications.

3. Identify potential candidates

The family council often identifies family director candidates. In larger families, it might be a family committee specifically named to recruit the most qualified family members. To help all family members see the process as fair, make sure everyone understands:

- How the council or committee reaches out to family members
- How family members express interest

Many larger families send an invitation for family members to self-nominate or nominate others several months in advance of the board election. The family council then reviews submissions of interest to determine which nominees are interested and qualified to serve. In more structured processes, nominees make formal presentations to the family or submit statements of interest (why they want to join the board and what they believe they can contribute).

In smaller families, choices are limited and often obvious and the process can be as simple as a family discussion.

In all cases, agree on qualifications and the nominating process *ahead of time*. The identification process is less likely to be divisive if the process is predetermined.

Focus on those candidates who are the most qualified and who represent the interests of the full ownership group. You want directors who meet their fiduciary responsibility to the entire ownership group along with stakeholder responsibility for employees, communities, and customers consistent with the family's values.

For *independent directors*, first determine whether you have access to a sufficient pool of qualified candidates who can meet your independence standards. If so, owners, board members and management can reach out to potential candidates on their own. If there is any concern about potential relationships between stakeholders and candidates, hire a search firm or consultant to manage the process. An added benefit is that a search firm will have access to a much broader pool of candidates.

An example scenario: a family business outsources the search to a consultant. The consultant assembles an initial pool of twenty-two qualified candidates and narrows it to the ten most qualified. The nominating committee selects six of the ten candidates for in-person interviews and eventually chooses three independent director candidates to recommend to the board.

Once a potential candidate expresses interest in the position, let the nominating committee or search firm manage interaction with the candidate. The party who recommended the candidate should never conduct the screening interview.

Everyone involved in seeking candidates needs to use appropriate language to describe the recruiting process. Let each candidate know that others are being considered. Explain that a multi-stage interview process will allow them to get to know the board and the company situation. Based on these interviews, both they and the board can decide whether there is a fit. Your candidate sources and their contacts must understand the screening process. Whether you are identifying candidates for a family director or independent director position, use the power of your published qualifications. Interested parties can determine whether pursuing the position makes sense for them.

4. Screen, select, and recommend candidates

When the family owners select the *family directors*, the nominating committee does not screen candidates. During recruiting for *independent directors*, the nominating committee gathers background information from resumes, bios, and online research. This information helps the nominating committee or the search firm screen out obviously unsuitable candidates.

Ideally, when you have identified a pool of candidates, one person conducts screening interviews by phone with all of them. If the same screener speaks to all the candidates, the results are more likely to be consistent. The goal of phone screening is to capture additional information and confirm candidate interest. This step gives the nominating committee enough information to decide which candidates to interview in person.

Whether phone interviews are conducted by a single or multiple members of the nominating committee or the search firm, use a consistent set of questions. Use a "screening matrix" to record results, with the candidate names on one axis and all candidate qualifications on the other. Include job experience and cultural fit. An honest review of which candidates check the most boxes in the matrix can tell you who your top choices for in-person interviews should be.

The next phase of screening is in-person interviews. The goal of this phase is to narrow the list of candidates to those best fit for an offer. The operative term here is "best fit." By this point all candidates will have been screened sufficiently to be a "fit" with the qualifications. Also, the in-person interview provides another point to sell the candidate on the opportunity and helps the candidate assess whether the position is still of interest. Ideally, in-person interviews occur close in time to one another. Long time lapses between interviews make it harder to compare candidates. The nominating committee usually conducts the in-person interviews, sometimes with coordination from a consultant. When organizing for the interview, work from a standard set of questions that address culture and qualifications fit. Add candidate-specific questions as appropriate.

Additional engagement for director candidates might include, for example, a facility tour, lunch with next-generation shareholders, and a "meet and greet" with the ownership group. The nominating committee can follow up later with owners to get their impressions of the candidates. The family business culture helps to determine who, beyond the nominating committee, participates in the interview day. Regardless of the degree of inclusiveness, be clear with all stakeholders that the process provides for the nominating committee to decide which individuals they will recommend to the board for nomination.

5. Nominate candidates for election

In some cases, candidate selection is clear to the entire nominating committee. In other cases, you need more discussion. When choices are not unanimous, ask all nominating committee members to vote for their top two choices or to rank choices in order of preference. This technique can make a selection clearer. If the group cannot reach consensus after ranking, the group chair can ask each person to explain how they ordered their candidates, what they favor most in each, and what concerns them about candidates lower on their lists. The group might need to go back to individual candidates for information if some committee members still have concerns.

When you have agreement on a list of candidates, give your information on the candidates to the ownership group, who vote to elect them. In addition to sharing bios or resumes, the nominating committee can write a brief, outlining their experience with the candidate through the interview process and the reasons they believe the candidate is worthy of selection. In some cases, and depending on state law, owners can elect board candidates as a group (an election of the slate) or they might be able to vote for candidates individually. We favor the ability to elect individual candidates where possible. When the nominating process works well, all candidates receive strong support and owners feel they've had a choice.

Importance of process

Your board of directors has ultimate responsibility for ensuring that your company is well managed, that all owners and other stakeholders are represented, and that management sets and achieves performance expectations aligned with owners' expectations. Selecting them is not a job to be taken lightly. You want the right people in the room. Design a process that helps you find the directors with the best fit and that gives owners and management confidence in those selections.

The process is your roadmap and guide. Use the process to avoid impulsive or emotional decisions and keep the focus on the goal — finding the right directors for your family enterprise.

Independent Director Standards Example

The ABC, Co. Board of Directors has adopted the following independence standards to assist it in the assessment of Director independence.

A director will be presumed to be independent if the Director:

1. Is not
   - a. an existing ABC, Co. owner
   - b. the spouse of an existing ABC, Co. owner
   - c. an immediate family member or descendant, or spouse of same, of an existing ABC, Co. owner
   - d. the beneficiary of any trust established by persons described above
   - e. the executor, administrator, or personal representative of any person described above who is deceased or legally incompetent
2. Has not been employed by ABC, Co. in the past five years
3. Is not affiliated with a significant customer or supplier of ABC, Co.
4. Is not an advisor or consultant to ABC, Co. and is not employed by or affiliated with a company that is an advisor or consultant to ABC, Co.
5. Has no personal service or consulting contracts with ABC, Co.
6. Is not employed by a company where any of ABC, Co.'s Management or Ownership serve on that company's board of directors
7. Is not an immediate family member of an individual who is, or has been during the past five years, employed by ABC, Co.

Jennifer Pendergast is a senior consultant with The Family Business Consulting Group, Inc., and can be reached at pendergast@thefbcg.com or 678.296.2190.

Mike Fassler is a principal consultant with The Family Business Consulting Group, Inc., and can be reached at fassler@thefbcg.com or 269.382.8144.

To learn more about The Family Business Consulting Group and how we serve families like yours, call us at (773) 604-5005 or email us at info@thefbcg.com. There is absolutely no obligation.

Reprinted from The Family Business Advisor®,
A Family Business Consulting Group, Inc.® Publication

The Family Business Advisor