The Family Business Advisor

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What Makes for a Great Family Business Board?

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Family businesses with engaged boards perform better, but this does not happen overnight. There are many factors and decisions that go into the evolution of a highly productive board from understanding ownership and governance roles to establishing director criteria and compensation.

It often starts with owners identifying skilled directors who in turn operate in a manner that engenders owner trust and confidence. An effective director has the competencies, experiences and savoir faire to see that leaders successfully carry out owner-values and goals for the company. By understanding the different governance responsibilities, ownership can build a board to help the family business grow and prosper now and into the future.

The Owner's Role in Governance

Owners have an interest in a competitive return for the risk undertaken and liquidity when desired in a manner that protects the financial health of the business enterprise. Producing competitive returns in the long run is made possible when a business serves the needs of its employees, customers and suppliers and is engaged in the communities in which it operates.

The board of directors is elected by the owner majority. Directors serve at the pleasure of the majority owners so there's no risk of losing control. On the other hand, independent directors who are regularly unheeded can withdraw their support by resigning. That's the balance of power. In reality, on healthy boards there is respect and candid discussion among all directors. They engage with each other as well as owners and leaders to see that the company is well run.

In a family business, directors may also be owners and leaders in the company. That can be confusing for people with more than one role and unclear to others as well. In given circumstances, a good start is for each family member to consider: "What hat am I wearing?"

Whether owners do or do not wear other hats in the family enterprise, they have an active role to play: Understanding the business. Its relationships with stakeholders. How the board, company leaders and employees live owner-values. Owners consider what kinds of directors and director experiences will allow the board to function at a high-level and how the board can be shaped to add the most value.

In highly-functional, family-owned businesses, there are often family meetings and sometimes the family elects a family council. Family governance processes help develop a majority or consensus view on owner-related issues or responsibilities. Though not always practical to achieve, the ideal is for the owner group to speak in a unified voice. One of their important roles is to agree upon criteria to be met by directors on the board.

The Effective Director

The role of a director is not to run the business, but to see that it is well run. The owner group creates criteria for their directors in answer to the question: Who will help us grow and prosper now and in the future?

Great directors feel they have as much to learn as they have to give. They listen, ask insightful questions and share experiences that resonate with fellow board

members and company leaders. Great directors build positive rapport and are supportive while also holding leaders accountable.

An effective director has a desire to listen and learn. They come to meetings prepared and on time. Directors help assess, encourage and support advances in company strategy. They encourage and facilitate succession planning, risk assessment and the development, support and evaluation of senior leadership.

In the spirit of continuous improvement, high-performing boards engage annually or bi-annually in feedback and evaluation processes. Family members, owners, board members and leaders weigh-in with ideas for board improvement.

The Independent Director Difference

A director can be considered independent when they are not a family member, close personal friend, professional advisor to the family or company or a current or recent employee.

An independent director is not a supplier or customer of the company and not a financial partner with a family member in another venture. They bring skills and experiences that can be applied in a way that's perceived as fair by the full range of owners and stakeholders.

Establishing Criteria for Directors

Family owners develop criteria that reflect what's important for the company's future which then guide the recruiting, selection and retention of directors. The criteria or elements of these criteria can apply to family members, owners, independent directors and company leaders.

As part of an intentional development process, NextGen owners or future owners can become board observers. Explicit criteria give interested NextGens something to strive toward. Typically, observer seats are limited, often to a range of one to three. NextGens are elected to their observer seats and serve for a term, typically a couple of years. An independent can be assigned as a mentor to each NextGen board observer.

According to our research, family businesses with independent representation on their boards reported a much higher level of board effectiveness than respondents with no independent directors. And reported effectiveness increases with the amount of independent representation.[1] That's a powerful incentive for creating and maintaining a family business board with three of more independent directors.

Independent directors should be active, healthy, risk-taking peers. They may or may not be a current leader in a company, but their skills and experiences should be current and represent where the company would like to go. Perhaps they are from a bigger company or a company located elsewhere or competing in markets that are attractive. They may possess skills that the company needs in greater depth. Family business experience is important – either at the board or operating enterprise level, or both. Great directors are effective listeners and graceful in their interactions with others.

On high-performing boards, each director brings relevant knowledge and experience, which may include domain expertise, a deep network of contacts and resources, or perspectives that can help elevate the business.

When to Add Independent Directors to the Board

There is no right answer as to the timing and approaches to adding independent directors to the board. One perspective is that, when a business exceeds a level like $20 million in annual revenue and is profitable, there may be a good case for a board with independent directors. Sometimes it takes a generation for a family business to get to that point, but certainly not always. Most importantly, the owners and leaders must be ready and willing to invest the time necessary to orient independent directors, prepare focused pre-read materials and engage in candid discussion of important big-picture issues and opportunities at the board meetings themselves.

There are advantages of a fiduciary board with independent directors. For example, if the majority owner dies unexpectedly, a fiduciary board is in position to make decisions in the best interests of the remaining shareholders. On the other hand, some family businesses feel more comfortable starting with an advisory board with independent directors. Outside of crisis, there is typically little difference between a high-performing

advisory board with independent directors and a high-performing fiduciary board with independent directors.

To help build and preserve family harmony and better business performance, the key is the presence of three or more independent directors with skills and experiences that can help the company grow and prosper.

Mix of Inside and Independent Directors

Again, there is no right answer as to the ideal number of independent vs. inside directors. Since a board with three or more independent directors correlates with better business performance over the long run, many family businesses start with the assumption that the board should include three independent directors. Then one, two, three or four family owners can be retained in the mix to create a board with a total number of four to seven directors.

Each board member has a duty to represent all shareholders; not a particular family branch or a particular investor.

Board members serve at the pleasure of the majority owners. Majority owners who don't like what independent directors are doing can make a change. So, if having a small board is an important priority, there is no worry about having a majority of independent directors on the board.

Often the CEO is a member of the board. All owners including multi-generational family business owners want the board to perform its role of seeing that the CEO is doing a good job leading the organization. What are ways of mitigating the inherit role conflict of being both a director and the CEO?

The CEO as an Inside Director

In some family businesses, the majority owner is also the Chairman of the Board and the CEO. As the generations unfold, particularly when non-voting shares and sometimes voting shares are dispersed, a lead independent director is often elected, or the Chair and CEO roles evolve to be different people. Sometimes there is a family Chair and non-family CEO, or occasionally there is a non-family Chair and a family CEO.

Independent directors often carve out time on a board meeting agenda to meet among themselves. This facilitates candid discussion, consensus and valuable feedback for a family Chair and / or CEO. It demonstrates that the board is independent of company leadership and helps engender trust in the board among all owners.

Determining Director Compensation

Typically, inside directors are not paid for their role on the board. They are paid for their role as leaders.

Board directorships are not a good way to get money to family owners. It can be a trap that inhibits creation of a high-performing board that helps the company grow and prosper.

For independent directors, most companies pay an annual retainer plus a fee for each meeting attended. The fees vary significantly but there are studies annually showing director compensation ranges and medians by private company size that can be used as a guideline. Independent directors don't serve on boards for the money. But on the other hand, they want to feel that their time is valued.

Director Length of Service

While many family business boards elect directors annually, board members are often asked to think in terms of serving at least 3 to 5 years. Through open communication, succession is staggered so that board members depart in different years.

It usually takes a year for a director to get to know the owners and the business. After that, so long as the director is engaged and active, they can make a positive contribution for many years.

Generally, after 10 years or so it may be time for a director to move on. Not necessarily because of how well they're filling their director role. But rather because it may be valuable for owners and leaders to have a different director in that seat to add new ideas and fresh perspectives.

Typically, owners and board members will consider the appropriate time for retirement. Some directors in their 70s are active, healthy and engaged in business marketplaces and enterprises. Others a decade or more younger are not. Generally, an arbitrary retirement age does not serve the interests of the Company. On the other hand, high-performing boards have respectful processes for moving off the board those directors who are no longer active and engaged.

In Sum

Owners have an important role in electing great inside and independent directors and developing NextGen directors. Great directors gracefully listen and learn, share experiences, constantly improve and see that the business is well run. Effective boards distinguish the roles of directors and leaders, engender owner trust and add tremendous value that improves company performance in the long run.

[1] Adapted from Pendergast, Jennifer, John Ward, and Stephanie Brun de Pontet. *Building a Successful Family Business Board*: Palgrave Macmillan, 2011, 17-23.

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