The Family Business Advisor

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Unlocking the Value of High-Performing Family Enterprise Boards

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In this article, we'll use case studies to help demonstrate how to harness the power of a high-performing board to gain insight, build a competitive edge and create value for family enterprise owners and leaders.

Nothing guarantees a board will work out well and add important value. It takes an investment of time and money. The first essential is owner commitment. Owners elect the board. So, the majority owners must want a high-performing board in order for it to get off the ground. Majority owners are always in control.

Majority Owner Control

> *The G4 majority owner and chair of a large family enterprise was presiding at a board meeting. He wanted to go ahead with plans to buy a helicopter. The board was generally cool to the idea. Finally, the chair suggested tongue-in-cheek, "All those against buying the helicopter, raise your hand and say: 'I quit.'"*

The board serves at the pleasure of the majority owners. But there is a balance of power. Over time, if the owners and leaders rarely listen, talented independent directors will withdraw support by resigning.

Often there is more than one owner that adds up to voting control. Irrespective of voting control, owners ideally speak in one voice to the board, articulating the owners' vision, values and expectations for business performance. This direction helps the board focus on seeing that the business is well run, in line with owner expectations.

A board provides the most value when it includes a critical mass of three or more independent directors. Independent directors are risk-taking peers unassociated with owners and the business. They can view the enterprise from a high-level, generalist's perspective.

Supporting Leadership and Family Harmony

> *A G4 CEO felt her board played a critical role in the allocation of capital. Outside family shareholders wanted an increase in dividends. Leadership saw the need to reinvest more in the business to build its long-term competitiveness and protect the goose that was laying the golden eggs. The board successfully arbitrated the divergent interests. Though not everyone got their way, most agreed it was a fair process that led to a reasonable outcome.*

The board is a steward for the owners' vision, values and company culture. It discusses and approves strategic direction and company positioning created by leadership. The board sees that leadership produces competitive returns for the risk undertaken and liquidity in line with owner expectations. It provides oversight for the sources and uses of capital.

The board's role in capital allocation often involves fairly arbitrating competing interests among family owners inside and outside the business enterprise. That typically makes a valuable contribution toward family harmony.

In addition, the board monitors and encourages ownership and leadership succession planning and oversees top leadership development, feedback processes and compensation. It is a sounding board for important initiatives, acquisitions and divestitures. The board is a supportive guide, validator and accountability forum for leadership.

Leveraging Expertise though Committees

> *A G4 manufacturing company board had a Compensation Committee chaired by an independent director. The committee engaged an outside compensation consulting firm to create a market-based top leadership salary and*

incentive compensation scale that smoothly related to the scales for the rest of the company employees. The consultant worked with the company's accounting firm and outside general counsel to create a synthetic equity plan. Top leadership salaries along with short-term and long-term variable compensation were linked with performance review processes that included 360-degree feedback reviews. Annually the committee recommended changes in officer compensation for board approval.

Boards delegate work to committees while retaining decision making authority. The three most common committees are Audit, Compensation and Nominating/Governance. Committees are typically chaired by independent directors and make recommendations to the full board.

Committees facilitate focused attention and arms-length fairness for important board areas of responsibility. Family owners outside the business often wonder about the pay received by owners working as leaders in the business. A Compensation Committee can help the board see that inside owners are fairly compensated as leaders while all owners are treated fairly in the areas of dividends, distributions and redemptions.

Providing Leadership Oversight

A second-generation manufacturing company CEO retired to take on the top professional role at a large national association. A non-family member was promoted to CEO. The oldest G3 and his younger brother were coming up through the ranks. Eleven years later, the non-family CEO made a decision the father would not have been able to bring himself to make. With backing from the board, he promoted the younger son to CEO.

High-performing boards ensure CEO effectiveness and the required depth in leadership for continuity into the future. As family companies grow large, it's usually necessary to recruit non-family talent. Independent directors often have the important role of balancing the needs of the company with the natural tendency toward favoring family members even when they aren't entirely up to a leadership role. After all, it is a family business. Businesses can continue to be family owned-when qualified and motivated NextGen family members want to be part of the business and the business is successful.

Independent directors can help make the necessary choices like identifying whether a family member is ready or will likely ever be ready to ascend to overall leadership. Or that a younger family member is a better fit for overall leadership than their older sibling. Or how much of the profits need to be reinvested in the business for its long-term prosperity and not paid out in dividends.

Best Practices for Board Alignment and Performance

The board's functions, duties and responsibilities should be defined in writing, often referred to as a board charter. The board charter identifies who is on the board, independent director standards, committees, the board's role, meeting cadence, terms, evaluation processes, compensation and protections. Protections include things like director indemnification, director and officer insurance along with confidentiality and non-disclosure requirements.

A director orientation manual should be kept up-to-date and reviewed periodically with all directors. It can include:

- History and development of the company
- Ownership history
- Sales, product and competitive history
- Leadership organization chart
- Board charter
- Bios of key leaders and all Board members
- Five years of financials
- Budgets and projections of products, markets and organization financials

High-performing boards evaluate their own performance on a regular cadence, typically every couple of years. Evaluations often involve a third-party interviewing board members and following up with a survey. The output enables developmental feedback for individuals including the chair, typically delivered in private conversations. It also enables feedback for the board as a whole, usually provided in a pre-read and discussed during a board meeting.

Maximizing Board Meetings

To prepare for meetings, high-performing boards will:

- Put the most important high-level opportunity or challenge first on the board agenda. Limit the number of high-level opportunities or issues on the agenda to 2 or 3 at most.
- Have the CEO write a 2-3 page brief for the board on

the marketplace, company performance internally and in the market context, an overview of the 2 or 3 high-level opportunities or challenges to be discussed and what leadership would like from the board at the upcoming meeting.

- Have the CFO write a narrative summary of financial results identifying the reasons for key variances and looking forward to how opportunities or issues are likely to play out in the coming months and year. This narrative will be a cover note for the financials that will also be provided in the pre-read.
- Put all perfunctory decisions second from the end in the form of a Consent Agenda item where it is moved, seconded and voted on in one package to avoid wasting the board's time.
- Leave the discussion of financials to the end of the meeting agenda. Everybody reviewed the pre-read, so this should simply be about questions and a wrap-up.
- Assure that all information to be discussed at the board meeting is in the agenda and pre-read materials distributed to all board members at least a week in advance.
- Optionally, as a good practice, hold an informal dinner the night before the board meeting to catch up personally and so everyone can get to know each other better.
- Open the board meeting with a quick statement: phones off, full attention, what's said in the room stays in the room, it's about discussion, hearing different experiences and perspectives, we all trust and respect each other, we're here to see that the business is well run-in line with the ownership's vision, values and expectations for business performance.
- Tee up each topic. There can be a recap by the CEO or another top leader of no more than 5 minutes. The expectation is that all board members have studied the pre-read materials and thought about related experiences they've had that may resonate. The chair notices if some board members are remaining silent and encourages them to share their thoughts. The chair also notices if someone is dominating and in a gracious manner, steers the conversation to others.
- The board may wish to get to know top leaders who do not normally attend board meetings or learn more about a functional area. For that purpose, the chair can have a leader deliver a presentation with a Q&A at the end. In that case, the number of high-level opportunities or challenges on the board's agenda should be limited to 1 or 2 for that meeting instead of 2 or 3.
- Generally, invest the board's valuable time in interactive discussion, not listening to presentations that are in the pre-read information provided a week in advance.
- As directors, support the chair who manages board meeting time and sees that the meeting ends on schedule.
- Follow a healthy practice to have an executive session immediately after the board meeting (could be over lunch) involving the chair and the outside directors.
- As needed, after meetings the chair can meet with the CEO to discuss feedback from the executive session.
- Strike a good balance with the minutes, memorializing the gist of discussions and decisions for the board's use and posterity while protecting company interests.

Return on Investment

There is no guarantee that having talented independent directors on a board will automatically bring significant value to a family enterprise. However, with commitment and hard work, it can be a highly worthwhile endeavor. Experience shows that companies with boards that include three or more independent directors tend to perform better in the long term. This potential can be further enhanced by putting in the necessary effort to prepare and facilitate interactive board discussions that are truly relevant and valuable.

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