MODELS & STRUCTURES

Balancing Representation with Qualification on Family Business Boards

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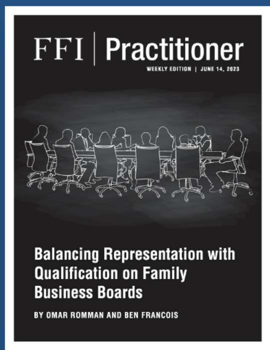

From *FFI Practitioner*

In this week's *FFI Practitioner*, contributors Omar Romman and Ben Francois explore the topic of how to balance family member and independent director participation on the board. In their article, Omar and Ben provide a case example and seven practical steps a family enterprise advisor can take to help a client find the right balance.

A few years ago, the patriarch of the Tanner family* passed away after 40 years of running the family business, one of the largest private banks on the East Coast.

His four children, all of whom were in their fifties, were suddenly facing some important decisions, many of which they were not prepared to make. Without their father, who had led the business and the family for decades, they had to determine where and how they could best contribute as owners to keep their father's legacy intact. Only one of the four was working in the business, and the others had been largely uninvolved as owners. The most pressing decision they had to make together was who would represent the family on the Board of Directors.

Each of them was interested in stepping up. Their father had instilled in them the importance of family members staying involved in the business, and they all believed that it was important to have family members on the board. But there weren't enough seats to accommodate everyone, and besides, individually they were not nearly as skilled or experienced as the independent directors. With no one willing to give up their opportunity to serve on the board, how would they decide?

Most business families include family members on their boards to maintain a sense of family ownership and oversight of the business. There are other good reasons to have family directors, including oversight and bringing the perspective of the family and ownership to the board and management – especially when it comes to values, purpose, and a long-term outlook.

On one hand, the board is a great vantage point from which to understand the issues and opportunities the business is facing. Sitting on the board is often viewed as a position from which power and influence can be wielded over the business, so the position is coveted by many family members. On the other hand, the demands of high-performing boards are often beyond the interests or capabilities of some family members. Directors must possess certain experience and perspectives, make time to prepare for meetings, and be active participants in the board meetings themselves.

The result is that many families find themselves in difficult positions, either excluding some family members from being board members or opening membership up so widely that the effectiveness of the board is compromised.

Choosing family members to sit on the board can be a wonderful opportunity to grow both leadership and business skills in the current and next generation of owners, while deepening their sense of psychological ownership. How do you advise a family business to build a high-quality board that takes advantage of the benefits of family directors without compromising on its effectiveness?

Sidebar

In our experience, family businesses can do seven things to address this issue.

1. **Build a strong shareholder forum to take the pressure off the board.** Shareholders often find themselves interested in board membership as a way to understand what is going on and to exercise influence over the business. Their seats on the board are often their only window into the business, and those left off the board can feel disconnected from their ownership. When shareholders have their own forum where they can come together to be informed about the business and make owner-level decisions, the pressure to serve on the board lessens. This often comes in the form of a shareholder council or some other body that organizes shareholders on a regular basis to keep them informed and to ensure their voices are heard. With such a forum in place, owners generally feel better about leaving their board seats to those who are most qualified.

2. **Build a board that is fit for purpose.** High-functioning family businesses are clear about the role of the board, and they understand that the role can change over time depending on the circumstances of the business or the

family. This clarity of purpose will drive the composition of board membership. How many independent directors? How many family directors? What skillsets and experiences do we need right now? For example, a business that is facing a crisis or is in a turnaround situation will need a board that is more engaged in the day-to-day operations. Alternatively, a business that is highly regulated, such as banking, may need a board that is thoughtful about risk and the legal environment in which the business operates.

3 **Be clear on the expectations for family directors.** It is unlikely that the family directors will have the same set of eligibility criteria and expectations that you have for independent directors—that's ok. Family directors play a different role, and successful business families are explicit about that role. We often see family directors act as the "family translator" reminding the independent directors and management of the family's values, definitions of success, and outcomes they hope to avoid. At the same time, these family directors are often asked to be a conduit back to the shareholders to share information about the business.

4 **Create clear rules for board membership.** Defining clear criteria for membership as well as a transparent selection process for family directors is critical. Most boards benefit from a diversity of education and experiences, opening the door to a wide range of individuals that can contribute. While this diversity can be healthy, we recommend that family businesses agree on the base-level requirements of what it takes to be a board member, including any specific education or experience requirements. This will allow the board to engage on topics in the range and depth required to effectively oversee the business and hold management accountable. Even one board member who does not meet the base-level qualifications can hamper the board's ability to perform its job.

5 **Create a clear process to select family members.** In order to reduce the potential for conflict in the family and on the board, we recommend designing a clear process for how family directors are selected. The exact selection mechanism is less important than the family and the board understanding how it will be done. While not everyone may agree completely with the standards and processes, they will be less likely to object if they understand that those standards are being applied equally to everyone.

6 **Train family members to be effective directors – before and during their board service.** All successful boards, family businesses or not, commit to improvement and development. The most effective family businesses consistently educate family members to prepare them for board service, in areas such as family values, company history, financial acumen, industry dynamics, and governance. Families also provide other focused learning opportunities:

- Board observer roles
- Director on smaller company or subsidiary board
- Director on non-profit board
- Board committee roles
- External education programs (e.g., NACD)

7 **Encourage the idea that the board represents all the shareholders.** Successful directors do not use the board as a forum to advocate on behalf of one person or a small group of shareholders. All board members should be advocates for the entire shareholder group, whether they are family shareholders or independents. Approaching their board responsibilities in this way will encourage family directors to engage in a healthy problem solving

dynamic rather than an adversarial one. Boards that embrace this culture are also more likely to keep the trust of the family shareholders who know that their interests are being properly represented.

Initially, the Tanner family struggled with the ideas above, but eventually settled on a family director policy that covered these topics. They also agreed to specific professional and education requirements for board membership and sponsored the education of any family members interested in preparing themselves for a role on the board.

Their new agreement rebuilt the stability in their family ownership, giving them clarity as to who would serve on the board and what the process would be to bring on new family board members in the future. It also created stability in the board itself, which no longer needed to broker the discussions between family members on these topics, allowing them to focus on their role overseeing the business. Finally, it has laid the groundwork for the next generation members, who now have a framework for how they might one day join the board.

Maintaining the bonds between the family owners and their business is key to a successful generational transition, and an effective family board membership policy is an important part of that. Striking the balance between family inclusion and effectiveness can pave the way for the next generation of family members to maintain their involvement in the business, even for those who choose not to work in the business. As the connection between the owners and the business, the board plays a critical role in family businesses, and a thoughtful approach to family board membership can last a generation.

**The name, location, and all other identifying details have been disguised.*

About the Contributors

Omar Romman is a Partner at BanyanGlobal. For the past eight years, he has worked closely with leading family businesses around the world to support them in the design of their governance strategies, ownership structures, and succession plans. He also supports business families with the assessment and development of next-generation leaders and with the establishment and professionalization of family offices. He has published articles on family business governance and has spoken at several conferences around the world on the topic.

Ben Francois is a Partner at BanyanGlobal, where he helps the owners of family businesses and family offices make and implement decisions on generational transition, ownership structure, governance, and capital allocation. He is a frequent writer and speaker on family business topics for leading publications and organizations including *Harvard Business Review*, *YPO*, and *Family Office Exchange*.

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