Outside directors bring experience to your board

BY DAVID J.P. MEACHIN

As his aunts and uncles left the boardroom, John feared for the survival of the family business he headed. They had voted down another investment that would have enabled the century-old candy business to compete more effectively. The family seemed to care mostly about receiving their shrinking dividends. Yet the plant used production machinery built by John's great-grandfather. Marketing and advertising had ground to a near standstill. New products were not even on the agenda. Why, John wondered, did the family board not listen to him or his like-minded cousins?

Others in situations such as John's, which occur all too often in family-owned businesses, have found a solution. They are recruiting experienced independent, non-family directors to join their boards. This article lays out key considerations for those considering such a path: why, when, what and how.

Why independent directors should be included on your board

Though family-owned businesses are not bound by the same rules as public companies and thus are not required to have an independent board of directors, they can benefit from outside perspectives and expertise.

As family businesses grow and enter new markets, and as the reins of control are passed to succeeding generations, often the family's management skills fall short of the talent and experience needed to ensure long-term profitability. Businesses that have traditionally made a single product are particularly vulnerable to increasingly fierce global competition and changing consumer tastes. Without an external perspective, family companies can grow complacent and fall behind in a changing environment. This is where well-qualified independent directors can bring value by questioning the status quo.

Experienced independent directors can:

- Offer an objective big-picture view and question the business purposes of proposed initiatives.
- Guard against emotion-driven decision making.
- Alleviate growing pains by drawing on their experience with similar transition stages.
- Exert timely pressure to make decisions and embrace change.
- Help develop short- and long-term strategies.
- Draw on business contacts and personal networks to spur business development.
- Ensure effective corporate governance.
- Help resolve disparities among family members and oversee succession.
- Reassure outside investors.

The family, having brought new thinking into the business, should thoughtfully, objectively consider the independent directors' opinions.

When to invite independent directors on your board

As a business matures and processes become more formalized, adding independent directors is a natural next step after informal advisers. Independent directors should be in place before the company reaches major—and often predictable—transitions. Ideally these directors should be in place and adding an independent perspective early in a company's growth cycle, before red flags arise from either external or internal sources.

The chairman or the chief executive officer of a family business may well play a key role in deciding when to bring in independent directors. He or she may recognize catalysts stemming from the increasing complexity of the business or family relationships.

Large ownership groups make decision making complicated. They require a more formal decision-making structure and clear delineation of roles among owners, management and board. Independent directors can help take the company beyond the family's original vision in a coordinated and strategic way.

Sometimes independent directors join the family business board at roughly the same time as a family council is established to more closely focus on the family's needs. As

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the business transitions from one generation to the next and families become larger and more complex, creating separate business and family boards can improve the overall health of both the business and the family.

What to look for in an independent director

An independent director should fit the culture of the family business and share the values of the family. An independent director in a family business must be a diplomatic communicator who can mediate and reconcile competing or conflicting viewpoints. He or she needs to be able to voice opinions in a manner that the family members are comfortable accepting.

It is not always easy to present new and potentially unwelcome views, and balancing honesty and diplomacy is a valuable skill indeed. Along with sharing his or her perspective, the independent director should also be able to ask probing questions, listen thoughtfully and credit the views of long-time officers and employees.

It is important that the family understand that it will no longer be business as usual. The family management has now become accountable to others.

An appropriate candidate will have most, if not all, of the following attributes:

- Familiarity with both the marketing and the technical aspects of the industry.
- Talents and experience different from those of the CEO and the family board members.
- Good governance practice geared toward taking the company forward.
- A network of contacts that could prove beneficial for the business.
- High standards.

Of course, prospective independent directors will conduct their own due diligence, and they need a full picture of the business before deciding whether to join the board. For a successful outcome, both the family and the independent director must be confident that the relationship can work, and that each has a fully informed view about the other.

How to effectively include an independent director into the fabric of a family business

The move toward independent directors is not always easy. This role in a family business is unlike other independent board roles and requires particular skill and subtlety. The family environment is an emotional one, with a high degree of emphasis placed on relationships, trust, loyalty and recognition of all family shareholders. As stated earlier, the independent director must be a diplomatic communicator and perceived as even-handed while at the same time being able to sensitively challenge management and prevent groupthink.

Discord can arise when non-executives feel left out of key decision making, or when communication between family members and independent directors is not a two-way dialogue.

While we have focused on the need for empathy and understanding on the part of the new directors, the family also has a responsibility for making the arrangement successful. The family, having brought new thinking into the business, should pay attention to and thoughtfully, objectively consider the independent directors' opinions on board issues and management decisions.

It is also important that the family understand that it will no longer be business as usual, just with another person or couple of people around. The family management has now become accountable to others. This point should be made 100% clear to all family members.

For most family businesses in a growth phase, the best-practice board probably consists of approximately seven or eight directors, of which three or more are independent. (In a public company board, by contrast, the trend is increasingly for virtually all directors, other than the CEO, to be independent.)

Most qualified candidates will not want to be the sole independent director. Such a position would be considered too isolating, and no one wants to be perceived as a "token independent director." A family company could begin with two independent directors to provide good board dynamics, and plan to increase the number of outside board members over time.

Appropriate remuneration in the form of cash and equity or equity equivalents must be factored into the relationship. It is beneficial to set up a yearly review of board members to allow both the company and the independent board members to determine fit and performance.

Making independent directors feel as much a part of the business as family members are, and giving them genuine accountability and tangible input into board decisions, is probably the most likely path to ensuring loyalty, commitment and long-term stability. FB