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Directors and Officers

Liability Insurance

Outsiders on the Family Board Can Make a Difference

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Recently, a family business owner was advised that his company could really benefit from an outside board of directors. He resisted the idea. “If we had a board, it would have told us not to do the outrageously risky things we did to become successful,” he said.

His comment highlights two problems with the growing family enterprise. Success often substitutes as evidence of good planning. And family patriarchs and matriarchs are usually accountable to no one—and like it that way.

A board of directors could offer a solution for both dilemmas. Unfortunately, boards are usually an unused appendage. For most family businesses, boards of directors are made up of family members and the companies’ lawyers.

Surveys by Pervin & Co. in Canada in 1998 and by MassMutual in the United States in 1995 indicate that more than 60 per cent of family businesses have a board of directors or advisory board. But both surveys suggest that more than 80 per cent of board members are insiders—family and close associates only.

These boards exercise little authority. Less than half of the survey respondents believed that their boards made a contribution. It seems members’ principal function is to affix their signatures in the proper place to signify that a legally ordained meeting was held, even though it never took place.

Should things be any different? After all, the boss generally is the controlling shareholder. Why would the people with the most at risk want to be accountable to outsiders who would question all major decisions?

My own experience suggests three reasons why they should.

- First, an independent board lifts the family business owner’s aspirations, confidence and commitment. Its mere presence signals to employees and potential financiers that the family remains interested in keeping and expanding the business.
- Second, effective boards stimulate action on essential but taboo family issues. Too often, such topics as estate planning, succession, family compensation and benefits, dividend policy, and authority of family members—all loaded issues with family consequences—are set aside for more proper or more comfortable consideration. A board considers these to be routine points of business discussion.
- Third, managers gain professionalism and momentum by reporting to a board. When internal family disputes arise over the business—a time when communications in family businesses may become undignified directors act as the voice of reason.

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Making sure a board succeeds in a family business environment isn't easy. Family managers have to break out of old habits of authoritarianism and secrecy. They should also provide some guidelines for the board, such as a written mandate and clearly defined boundaries to set off their responsibilities from those of shareholders and management.

The family will also have to give up some of its sinecures. Everyone who sits on the board should be a contributing member, which means honorary positions are abolished. This can be troublesome when the honorary position is occupied by the chief executive officer's spouse, or a passive owner who understands little about business and does not work in the firm.

In fact, most insiders don't belong on the board—neither key employees, family members nor the company accountant or lawyer whose advice the business already has. Getting inside directors to leave can be a delicate matter. If insiders' board membership constitutes their chief source of company information, they still need to be kept informed once they're off.

Directors also have to make adjustments. They should appreciate that family-run firms are different from other businesses, and sometimes impose special demands. For instance, family businesses often embody deep-seated values or religious feelings that family members consider important. There may also be specific financial considerations for the family with respect to money it withdraws from the firm.

It's the family's job to forge a consensus on these matters and give board members a clear mandate. A board cannot function without family consensus, and perhaps the company can't either.

To work with an outside board, the family CEO's chief prerequisite is to have enough confidence to relinquish a degree of control. The leader must be convinced that the benefits justify surrendering some control.

If this condition is met, the CEO can learn to live with the board by following a few rules:

- Treat the board members as if they represented shareholder control of the business, whether or not this is the case. Competent board members will not stay unless they believe their decisions carry weight.
- Define the board's mandate, functions, responsibility and authority in writing.
- Encourage board members to learn as much about the business as possible and to improve any skills that would aid in the decision making process.
- Share business problems. Remember, everybody has them. The board cannot help unless it knows about them.
- Prepare for board meetings. The agenda and all additional relevant information should be sent to each board member in advance.
- Prepare minutes for each meeting, summarizing action plans and timetables.

The owner who is willing to make the giant leap from sole decision maker to accountability may find that an independent board provides a valuable source of business experience. It's a first step to making sure future successes don't depend on outrageous risk.

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