Family Business Board Composition: Do You Have the Right People Around Your Board Table?

Courtney Collette
Partner, and Head of Education & Research, CFEG

Choosing the right directors for the board of a family business is especially important in today's turbulent environment. How can owners assemble the board talent they need to take the family business to its next growth stage?

These corporate governance guidelines will help.

Properly composed and led boards are a great vehicle to grow the value and resilience of family companies.

Boards stabilize and steer the business, connect the owners' values and goals to strategic decisions, and provide oversight and guidance to management. Boards—when they really do their job—provide a forum for strategic discussions, analysis, and decisions—the types of conversations that grow and change a family company, determining whether it will be future-ready or vulnerable to disruption.

We are fans of well composed and well led boards. We have seen them lead family businesses to new growth opportunities, turn them around when they were in crisis and headed in the wrong direction, save them from fractious in-fighting, and get the business successfully into the next generation.

However, many family businesses are under-served by their boards. Low-performing boards and passive 'rubber stamp' boards (that approve whatever is presented) are all too common. Most family business boards don't anticipate key issues or challenge poor direction enough. Yes, board leadership influences this dynamic but poor board composition is a primary reason why boards don't help family companies as they should.

Board effectiveness – whether for an operating company, a portfolio of companies, a holding company, or a family office – hinges on assembling the right talent around the board table. This has always been true and is even more essential in today's era of rapid change.

How to do it well is the challenge.

Why is Composing a Family Business Board So Difficult?

When board performance is low, it is often due to having the wrong board composition.

Choosing board members is one of the most significant powers that owners have in a family business. But many owners don't exercise this responsibility strategically.

At the root are two common problems. First, rather than prioritizing the business' future needs when electing board members, owners often succumb to family politics, allowing relationship dynamics to override an objective professional decision of who is needed on the board. Second, owners do not think deliberately enough about the role and mandate of their corporate board of directors, and rarely discuss this topic as an ownership group. As a result, owners often underestimate what the board could and should do for the family business. They don't give enough attention to the capabilities needed on the board that would help the company achieve what it should.

Owners—especially owners that are not active in the family business—often don't really know what a good board could do for them or how to design or compose one. They tend not to set (or reset) the board's mandate and particular goals for the board. They don't understand the role of owners or the role of a board that represents the owners. They don't think about who should be on the board to reach important goals; they generally believe the board should be composed of family members and perhaps close allies of the family. As a result, they live with subpar board performance—often not even recognizing that it is subpar.

What is the purpose of a board of a family business?

The board is a critical part of the governance system of a family enterprise, giving direction to management and allowing the owners oversight over the company(ies). Family business governance plays a crucial role in achieving these aims.

High-functioning boards:

- *protect* and balance the interests of the owners and the company
- *oversee* the entity (i.e., from a fiduciary and legal perspective)
- *advise* on strategic decisions
- *ensure* the company is future-ready
- *discuss, probe, and solve problems* of critical strategic importance

Here are some telltale signs of subpar board performance:

- The board has grown in size over time and is too large for individual directors to feel accountable
- Family board members believe that they represent their branch of the family rather than all owners
- The board is composed mostly of managers who routinely discuss operations–an executive committee disguised as a board
- The board is composed of family member-owners who are not qualified to make strategic decisions, thus producing low-quality discussions and decisions
- “Independent” board members are employees or trusted friends of the family who don’t constructively challenge or add to ideas about company performance or direction
- There are no term limits or retirement ages, so the board ages with family management, limiting opportunities for other ideas to be expressed and for younger directors to prepare for a generational transition
- Board members reflect the experience needed to achieve past success, not the next stage in the company’s evolution
- Other opinions and new ideas are squelched by a dominating board chair
- Sub-par performance of board members is not confronted, to avoid family conflict
- Board meetings are dominated by family discussions and disagreements rather than substantive discussion of important issues

Notice how many of these deficiencies are related to weak board composition. The result is a veneer of corporate governance with a board that does not add value to the business or to the owners. The owners and company become accustomed to ineffective governance and they miss out on the benefits that a strong board can provide.

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Composing a Future-Ready Board: Guiding Principles

Family factors inevitably are a consideration when composing a family business board, but corporate governance best practices stipulate that the primary goal should be to maximize the benefits that a board offers the owners and company.

The skills needed around the table to achieve these benefits include a strategic perspective, a future-ready mindset, industry knowledge, objectivity, candor, varied skills needed for current and likely challenges, the skills to build consensus, the ability to make clear and timely decisions, and an appreciation for continuing family ownership, among others. These skills could be present in family members who qualify to serve on the board, but it's important to identify skills before names.

The most effective family business boards we have seen typically involve a relatively small (fewer than 10 people), active, and engaged group of directors.

These boards have five characteristics:

1. **High-altitude and strategic perspective:** We like to say that good boards operate at 30,000 feet (9,000 meters)—high enough to survey the terrain (e.g., industry trends, economic conditions, family trajectory). They are clear about their mandate and what the owners want the board to deliver. They routinely get out in front of issues, scan the horizon for signals of change and disruptors, assess the strategic implications, scenario plan outcomes, and ensure that management plans ahead.
2. **Forward-looking competencies and skills:** Boards should be designed for where the company needs to go, not where it's been. Start with your business vision and challenges; what capabilities are required on your board? From there, you can assess current capabilities, and identify gaps to be filled.
3. **Diverse set of perspectives:** A diverse board has been shown to improve problem solving and decision making,[1] and it responds to calls for inclusion from family members, company stakeholders, and regulatory agencies. Age, gender, generation, and experience are important factors to consider.
4. **Few (or even no) company executives:** Executives tend to steer discussions to operational issues and can make it difficult for the board to openly evaluate company performance and management. Only the CEO and perhaps the CFO (executives with a strategic view) should be on the board (in a voting or non-voting role). Other executives can participate in some board discussions on an as-needed basis.
5. **Mix of independent and family owner voices:** The objectivity, skills, and experience of independent directors is

[1] Research study conducted by Cloverpop, author Erik Larson, cited in Forbes, September 2017

hugely beneficial to a family business board. There is strong evidence that a majority of independent directors improves family business board effectiveness.[2] Early-generation boards typically are dominated by founders and family members, with independent advisors added in later generations; families should not wait that long before launching a well composed, independent board.

Board Member Selection

Every board member must be held to high standards and be able to add value to group discussions. Here are some special considerations for the selection of independent and family directors.

Independent Directors

Independent directors should provide grounded experience in areas relevant to where the business needs to go, serving as a sounding board for both management and the family. They bring an objective perspective to discussions, diffuse emotionality, increase trust in the board by non-executive owners, and strengthen the general perception of the board's professionalism.

Selection criteria of independent directors include:

- Complementary industry, functional, and family business experience and knowledge
- Independence of mind (and wallet)
- Genuine interest in family ownership and the multigenerational longevity of the business
- Ability to listen and probe, respectful candor, a team orientation, and availability for board meetings
- Good fit with the family's values, culture, and dynamics
- Trust and confidentiality

Referrals from current directors, company executives, and business associates, search firms, trade associations, and director registries—all are good sources for independent board member candidates. Candidates should be vetted by the board's nominating committee and interviewed by key owners and current board members. Customers, suppliers, company service providers, and friends of family members or company managers should be avoided.

Family Directors

The presence of qualified family directors signals the family's commitment to the business and usually encourages a long-term perspective on key issues. They can reinforce the family's vision and values and serve as a link to other governance forums (e.g., Family Council, Owners Council).

It is important, however, that they be willing and able to meaningfully contribute to board discussions and decisions. Family candidates for the board may be current senior executives or former executives

[2] Building a Successful Family Business Board, John Ward, Jennifer Pendergast, Stephanie Pontet, 2011

of the company, or have relevant outside experience. Family director qualifications include an understanding of the industry, the business' strategy, operations (at a high level), the organization, the company's financial statements, and the owners' goals. They must be unifiers and willing to represent the owners at large, not just their branch or part of the family. They should have the interest, time, and skills to participate effectively on the board team and to serve on board committees.

Family director responsibilities, and the criteria and process for their appointment need to be clearly defined. Typically, this is done jointly by the Family Council and Owners Council.

We have seen the benefits when families develop formal programs to identify and develop family talent for board positions. The development process usually takes at least several years before a family member is ready for board service.

Do you have the right people around your board table?

A deliberate and strategic approach to the composition of a family business' board of directors is an important way for owners to ensure that their boards can provide the governance needed to address challenges and seize opportunities in today's fast-changing environment. Composing the board is not a one-time event, though. Boards should evolve and refresh their membership over time, to remain high-functioning and future-ready.

Processes to evaluate board performance and change board composition, periodically and at critical milestones, also are needed for board renewal. Staggered term limits[3] (for family and independent directors) provide regular opportunities to tap into new talent for changing business conditions and strategic priorities, and to engage rising generations in charting your family enterprise's future.

Board composition is one of several factors in the design of an effective board. Board leadership, agenda setting, evaluation, compensation, committee design, accountability, connecting to the owners, and other factors also impact board performance. But as leadership guru Jim Collins would counsel us, good performance starts with "getting the right people on the bus."

[3] Typically, independent and family directors are permitted to serve two terms of 4-5 years each, with exceptions allowed. Age limits also may be adopted, also with exceptions.

About the Author

Courtney Collette
Partner, and Head of Education & Research, CFEG
ccollette@CFEG.com

Courtney Collette is a Partner and Head of Education & Research at Cambridge Family Enterprise Group (CFEG). Since 2011, she has led its education programming, research studies, and publications. She designs curricula for seminars, workshops, and online courses for family enterprise audiences worldwide. She has authored several publications on family enterprise, including articles, Harvard case studies, and the book, Next Generation Success. Ms. Collette spent over a decade as a trusted advisor to business families on governance, succession, next generation readiness, and family unity.

About Cambridge Family Enterprise Group

Cambridge Family Enterprise Group (CFEG) is a global advisory, education, and research organization that serves family enterprises with growth aspirations—enabling them to flourish across generations. As a go-to trusted partner for the world's enterprising families, CFEG offers a wide range of services to navigate changing times, build pathways for continued growth, and achieve lasting success. Its pioneering thought leadership, strategies, and programs are used by families, family businesses, and family offices worldwide. Since its founding in 1989 by Professor John Davis, CFEG has advised and educated thousands of families from more than 70 countries.