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Why your family business needs directors who are truly independent

BY LAWRENCE SIFF

Doctors are advised not to operate on their family members, and there is good reason for this: Judgment can get skewed and the result can be less than ideal. Likewise, a director should not have an overly emotional tie to the company he or she is in essence "operating" on—whether that tie be a family connection or financial dependence. If there is one thing that great boards have in common, it is that they include truly independent directors.

Not all non-family directors qualify as "independent." Independent directors are beholden to no individual or single faction of the family and are not afraid to ask tough questions about the business: its management, structure and goals, for both the short term and the long term. Freed from legacy concerns and immediate financial dependence on the company, these directors are not worried about building the best company for today; rather, they are concerned with building the best company for tomorrow, for the benefit of all shareholders.

Having worked in and run family businesses for over 30 years, and advised more than 135 family businesses in the past six years, I have seen all kinds of boards—running the gamut from rubber stampers to growth creators. I have come to appreciate the difference a board can make in a family business's trajectory.

Some of my clients have talked for years about forming a board but never actually do it. Their reasons are varied. Often, they are afraid of giving up control (even though they will more than likely control the board through the voting structure), concerned about the amount of work involved in putting a board together or not convinced that a board can add real value.

While all these reasons are understandable, they are obstacles to real growth. Business owners who don't—or won't—put a board in place usually are overlooking the fact that they need to reinvent their companies. The proud legacy their family has built has become a confining box rather than a platform for growth. I constantly have to remind clients that they must reset and recalibrate their strategy every three to five years and they must review and test their assumptions. For one thing, they can bet their competitors are doing this.

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And this is where independent directors can be so valuable. They can help transform a company by providing objectivity, sage advice and fresh perspectives, and by guaranteeing that there is transparency with *all* family members. They ensure that the company is professionalized, that objectives are measurable, that both management and the board are held accountable for their actions. They can bring new lessons, different insights and connections the business would otherwise never have access to. Because they are not tied to the past, independent directors are free to focus on the overall strategy to create economic value for the company now and in the future. They create the framework and conditions for long-term growth and continued success.

How boards can help

One family-owned company faced stagnant growth in its businesses but had a healthy balance sheet. We advised the owners to bring on two independent directors. One of the independent directors convinced management to pursue a major acquisition in an adjacent field and helped source the acquisition, while the other shared due diligence materials and introduced the company to key experienced service providers (attorneys, auditors). Both directors were essential in negotiating the ultimate structure and pricing of the deal, which would not have happened without them. The acquisition resulted in a return in less than three years (cash on cash), a 35% increase in revenues and a 45% boost in profits. The kicker? This company had to be persuaded to bring on two independent directors, the first such directors in the business's more than 100-year history. Now the family is practically evangelical on the subject.

When a family business does not have a board, I often encourage the owners to form a board of advisers, which may eventually be a steppingstone to a board of directors. A board of advisers offers counsel but is not bound by the governance, fiduciary and legal responsibilities of a board of directors.

Directors often say, "Financials tell the story," but, more specifically, the financials reflect decisions that were made. A company might make more money by cash-cowing a division, but what would the impact be on the company's future? A seasoned independent director who has had experience with numerous companies in a variety of situations knows the importance of committing resources and the impact of doing so—and how a company's capital situation affects decisions along these lines. Shareholders who are dependent on dividend payments have different objectives from those who can comfortably invest in the future.

I have seen independent directors guide companies for the future and make recommendations that have increased profits by the millions, either through stronger negotiations with key vendors or by leveraging the company's strengths in entirely new verticals. The independent directors' insight and deep relationships can open up doors for the family business.

A board's role is to govern and guide; the watchword is "oversight," not "overstep," though the line can be a fine one. Independent directors can be called upon to assist in a high-level strategic decision or to help handle a delicate conversation with a non-performing or underperforming family member—with no unpleasant ramifications at the next Thanksgiving dinner.

A strong board with independent members holds management accountable for day-to-day decisions. It holds itself accountable for strategic decisions that help define focus while eliminating initiatives that are no longer relevant. The best independent board members are strategic thinkers, serve the interests of all shareholders and take seriously responsibility for leadership succession. Finally, they must respect and honor the values the family has evinced over the years.

What independent directors bring to a board

- Balanced focus on present state and future needs
- True objectivity
- Transparency for all shareholders/stakeholders
- Proper assessment of risks
- Elevation of the company to the next level

Family businesses face unique circumstances and conditions that aren't present in other businesses, even private ones. There are often emotional sensitivities that must be taken into consideration as the family contemplates its legacy and anything that might affect it. But family businesses also have the great advantage of being able to manage for the long term rather than worry about satisfying impatient shareholders on a quarter-to-quarter basis. Of course, the business must be positioned to survive long term, and that is why family members should look outside when thinking of the future.

The time to bring on an independent director is now. Independent directors might not have all the answers, but they know how to ask the right questions. Effective independent directors can have a significant and meaningful impact. They bring objectivity and focus to the family business, help balance present and future needs and elevate the company to the next level of profitable growth. FB

Finding the right director(s) for your business

No matter how stellar an independent director's qualifications on paper, the director must fit in with your company's culture, your family and the business itself. The best independent directors understand not only that there are different levels of risk but also what level is right for your family and the business. Properly managing risk means thinking through all the alternatives and evaluating them in the context of the company's long-term objectives.

You should identify potential candidates who meet your business's most pressing requirements (or get help from some trusted advisers or an executive recruiting firm to find the right people). Of course, that means clarifying the goals for the business, and making sure that the decision makers are in agreement. Are you focusing on growth through acquisition, looking to expand overseas or eyeing new offerings? You can't expect a potential director to be equally knowledgeable and experienced in every facet of business.

Whether a company is assembling a board from scratch or revamping an existing one, I often recommend starting small, with just one or two independent directors. This gives people a chance to get comfortable with the idea and also get a sense of the value that they bring. It has been my experience that companies that create the most value are those whose boards are voted in by the majority of the shareholders.

And, of course, you want directors who are truly independent. Beware of any candidates or directors who:

- Tell you what you want to hear.
- Are mirror images of the owners.
- Have an ax to grind or have their own agenda.
- Are afraid to disagree with you or your management team.
- Control the conversation by dominating or diverting it.

Independent directors can be catalysts for change. They can help you assess risks and ensure that the risks you take are appropriate ones. They can help you set a strategy for long-term growth that balances the needs of today with the goals of tomorrow, and elevate your company in a way that honors its legacy while further burnishing it. Most of all, they can bring transparency and objectivity, focusing on where you're going instead of where you've been. ***— L.S.***