Guidelines for Family Business Boards of Directors

– *Suzanne Lane, Joseph Astrachan, Andrew Keyt and Kristi McMillan*

Corporate Governance has become a catchphrase in recent times. In the wake of failures of large businesses in protecting shareholder interests, there have been loud calls for governance reforms in business. Prominent family business researchers, Suzanne Lane, Joseph Astrachan, Andrew Keyt and Kristi McMillan, studied corporate governance issues and their management at large corporates compared to mid-sized family owned firms. They found that many of the corporate governance practices that have become popular at large business firms might actually prove to be detrimental to family businesses. These practices are suitable for large firms with dispersed ownership and independent boards with external members, but may be too complex or even harmful for private businesses with a concentrated shareholder base and family insiders in the management and on the board. These practices may even prove to be detrimental to the unity in the owner family.

Authors suggest that the need for distinct governance practices arises due to the differences in the approach of shareholders of these two types of businesses. Compared to a large firm with dispersed shareholding and distinct ownership and management, a family business often has the two combined and its ownership tends to be concentrated. The shareholder interest in case of large companies is limited to short-term growth in earnings. However, the objective of shareholders of a family business is to maximize the long-term wealth that benefits current, as well as future, generations.

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Keeping the aforementioned distinctions in view, the authors suggest a set of guidelines that advocate how family-owned business must promote accountability in governance through effective and competent functioning of the board. These guidelines cover most of the important dimensions of the board’s nature and conduct and are constituted under the following heads -

Qualifications – Beyond business competencies, skills and background, which are essential qualifications of a board member, the most important qualification of a board member is the ability to hold the management accountable and the discipline to not interfere in company operations.

Size – Smaller boards are easy to manage but their feedback and oversight is insufficient whereas, larger boards though lead to greater feedback and accountability, they may inhibit full participation. The authors suggest that the size of 7 to 12 members with distinct competencies as the most effective board size.

Independent Outsiders – Having outsiders on the board is advocated to promote objectivity and probity. However, the authors do not attach must importance to board members being outsiders or insiders. They opine that in order to promote objectivity and accountability, the board members must make their decisions on the merits of the case.

Frequency of board meetings – The focus of board meetings is communication, conflict resolution, and accountability. To attain this, authors suggest three to six meetings of the board per year. Fewer than three meetings point to lack of accountability and more than six meetings point to managerial functioning of the board – both instances must be avoided.

Content and process of board meetings – The content of board meetings must include all vital issues brought forth by senior executives to the board. Boards should make decisions by simple majority vote to create better accountability. Additionally, all relevant board information must be captured in a board manual.

Board member selection – A nominating committee must be formed with board and non-board members, which should invite opinions from all board members on board's needs and criteria for nominees. It must be held accountable for the board selection process.

Board commitment – Board members must devote sufficient time and effort to their responsibilities and actively contribute to the company's performance.

Board term and turnover – Authors believe that a board member's term must be for a limited, yet not necessarily be for a fixed period. They also suggest a process for assessing the contribution of the director and standards for "keep/let go" decision-making.

Board evaluation process - The board must review (with the help of independent third parties) its own processes annually and make changes where necessary.

Leadership: role of chairman and CEO – these two roles must be combined only when the single person can do the two jobs effectively without causing an imbalance of power.

Board compensation – The authors recommend that directors must be paid for their time commensurate to that of the company's CEO. They oppose giving stock options/stocks to board members as part of their compensation.

In addition to the above guidelines, the authors advise the boards to ensure -

- Creation of communication channels/forums between minority and majority shareholders.
- Involvement of shareholders (and family goals and desires) in Strategic Decision Making.
- Approval of strategic plans of management and monitoring them regularly.

The family business must aim for a competency-based board with a balanced focus on monitoring and collaboration.

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