The importance of outside directors on the board of family firms

One of the key mechanisms for professionalization of family businesses is institutionalization of the corporate board. In recent years, there has been considerable interest to understand the role of the board in family firms. Does corporate board impact firm performance? Answer to this question was inconclusive from the research studies done in the 1980s and 1990s; there was little evidence for the direct relationship between board structure or composition and financial performance of firms. Research done in the past decade, however, is indicating that the relationship between board structure and firm performance is more indirect and complex than was initially thought. Findings from recent studies suggest that the relationship between board structure and firm performance is intermediated by board processes. In other words, structure or composition of the board determines the interaction processes within the boardroom, which in turn affect the firm's performance. If so, then how does the structure or composition of the board shape the board processes? A recent study by Bettinelli (2011) examined this relationship; findings of her study were published in the Family Business Review recently.

Bettinelli examined family businesses based in Italy that were known to actively use their corporate board. She found that presence of outside directors (i.e. those who do not belong to the family, business or the ownership group) on the board had beneficial impact on the board processes. For instance, board members were more committed to the board's tasks. Presence of outside directors tended to increase the level of effort each board member was willing to make in the board meetings. Also, the degree of cohesiveness of the family was found high as the board members were positively engaged with each other and were motivated to be part of the board. Besides, board members were able to effectively use their knowledge and skills for the benefit of the company.

Bettinelli primarily attributed the beneficial impact of outside directors on the board processes to the psychological factors that arise in group settings. Bettinelli argued that as the outside directors are unrelated to the family, their presence on the board motivates other board members, particularly the family members on the board, to behave constructively in order to create a positive impression on these 'outsiders'. For the same reason, family members are also motivated to deal with their internal conflicts positively to avoid embarrassing the family in front of non-family outsiders. The practical implication of this study is that the family businesses that extensively rely of board of directors for corporate governance should incorporate more outside directors on their board.

Source: Christina Bettinelli (2011) *Board of Directors in Family Firms: An Exploratory Study of Structure and Group Processes*. Family Business Review. 24(2)