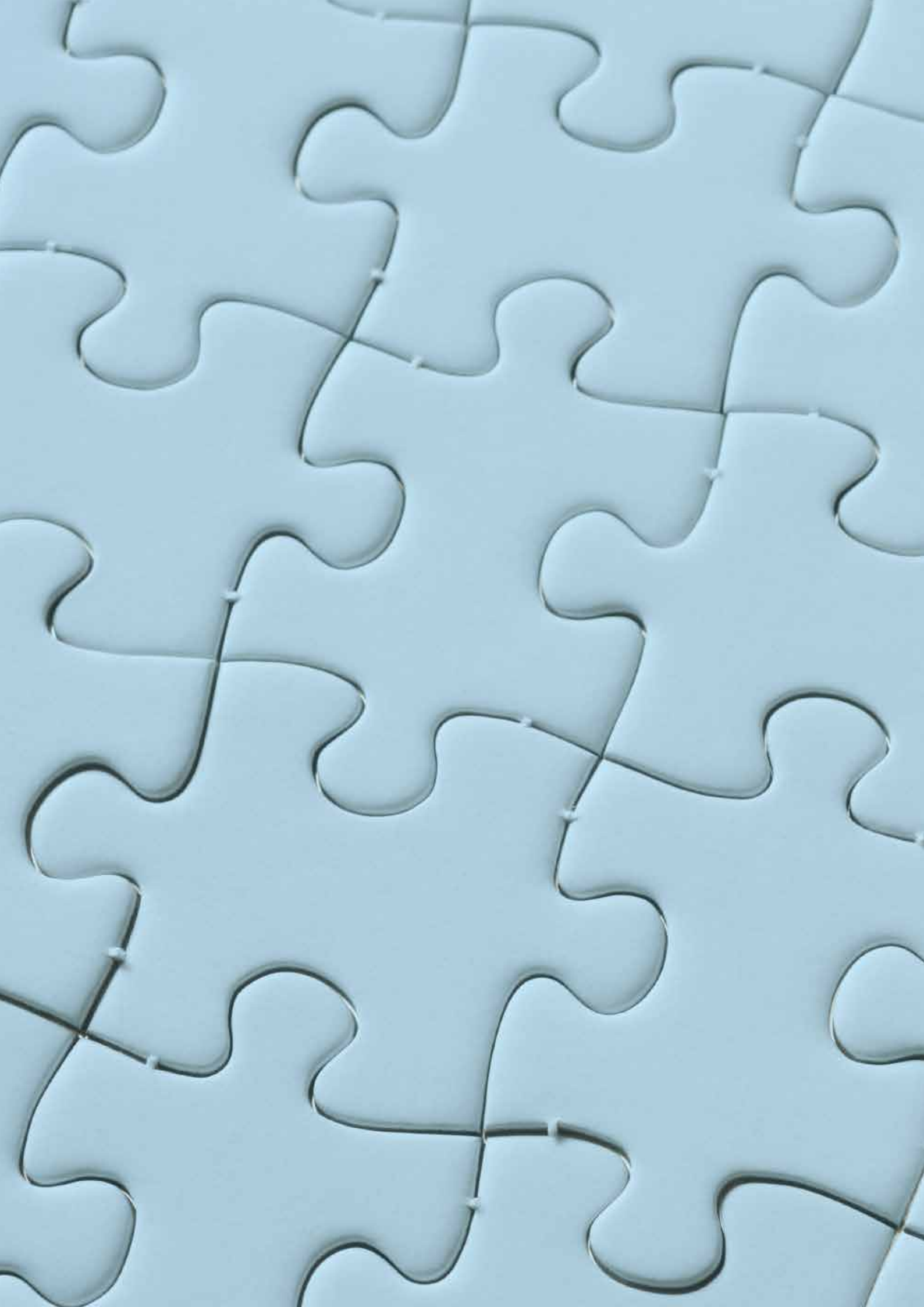




Keeping it in the Family?

How Independent Directors Add Value to Family Businesses







■ Executive Summary

Family businesses form the bedrock of economic activity around the world.

Family ownership can provide an outstanding foundation for commercial success and long-term growth. Inspired by a sense of purpose and tradition, and largely immune from the gyrations in sentiment and reporting demands that come with a stock market listing, family-owned businesses can think, plan and operate long-term.

Equally, however, the relative lack of external pressure and scrutiny can allow family companies to grow complacent, sclerotic and unable to keep pace with changing times.

Likewise, as family businesses expand and enter new markets, and as the reins of control are passed on to the next generation, the skills and experience needed to ensure long-term profitability can outgrow a family's management skills.

One solution is to appoint independent non-executive directors to the board.

Such directors serve a number of functions. They can heighten accountability, provide alternative perspectives and bring to bear critical experience from a variety of markets and business situations.

They can also act as a link between a non-family executive team, the board and the shareholders, and help to ensure that the overall governance of the family enterprise operates effectively.

But the move towards independent non-executive directors is not always easy. Discord can arise where non-executives feel marginalised from key decisions, or where communication between family members and non-executives is not free-flowing.

This paper concludes that the success, growth and well-being of a family business is enhanced not just by appointing independent non-executives, but deploying, motivating and involving them appropriately.



■ What Is A Family Business?

Family-owned businesses account for two-thirds of the world's businesses and generate most of the world's economic output, employment and wealth.

In the UK, the Institute for Family Business estimates that family firms account for 65 percent of all private sector enterprises and more than 30 percent of GDP. Studies by McKinsey, the Harvard Business Review and others show family-owned companies outperforming their non-family counterparts in terms of sales, profits, and other growth measures.

Of course, these statistics conceal a world of variety. Family businesses range from small and medium-sized companies to large multi-generational conglomerates that operate in numerous industries and countries. Different family firms have different governance requirements based on their history, size, culture, ownership structure, life-cycle or stage of development.

The degree of family involvement in the business also differs. Some families take an active day-to-day role in the running of the business, while others take a hands-off, supervisory approach.

The use of the term 'family business' in this paper refers to companies where there is a significant controlling family interest or shareholding.

■ Why Appoint An Independent Director?

Independent directors can help family companies find a way to balance the dynastic expectations of a family with the needs of the business.

Because independent directors have no existing loyalties to family members or pre-conceptions about the business, they are particularly well placed to provide advice on contentious issues such as board appointments, succession planning, remuneration and retirement.

They can act as an impartial link between the board and shareholders in times of corporate stress, extend the range of experience in areas where family expertise may be lacking and bring to bear critical insights that a family might overlook.

Truly independent directors will also challenge family thinking by putting a greater level of objectivity into decisions affecting family members and ensure the company is run and managed for the benefit of all shareholders. One independent director told us: "Some family members see the business as there to satisfy their needs, but it should be the other way around. An independent director with the right personality can ask the question: what does this do for the business?"

Where a family executive team has an inclination not to make decisions when they should be made, because there is no external pressure to do so, an independent director can contribute a spur on those occasions.

They can also help to ensure that the decisions made are even-handed and impartial, and that all directors are treated as equals in board meetings. One independent director comments: "An independent non-executive director brings objective views to a discussion, without having the subjective 'burn' of a family interest."

Although independent directors play a key role in professionalising the board,

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the role itself is much broader than simply improving governance. “You do not want independent non-executives to be there solely for governance reasons,” says one independent director. “You want them be on the same side of the table discussing the issues that are going to take the company forward.”

Independent directors can play a vital role in business development, providing fresh perspectives, a strategic overview and opening up valuable networks for the business. They can also act as a sounding board for the non-family CEO and mentor young or aspiring family executives, passing on experience drawn from a wide range of companies and business challenges.

Who Should Serve?

Serving as an independent director in a family business is unlike other non-executive roles and requires particular skill and subtlety. The family environment is an emotional one, with a high degree of emphasis placed on relationships, trust and loyalty.

As one independent director highlights: “The role of the non-executive director is as a member and representative of the board, but able to consider also the needs and concerns of shareholders, both those on the board and in the wider family. This is a unique yet delicate role.”

Independent directors who make the successful transition from non-family to family owned businesses appreciate and understand the family ownership structure and the idiosyncrasies that can accompany it.

Family businesses often have their own style of communicating and resolving conflict which may be foreign to some non-executive directors. An independent director in a family business must be a

skilled and diplomatic communicator who can defuse tension where necessary.

“There are occasions where different parts of the family might think you are taking sides,” says one independent director. “Try to disarm them – the value of the independent director is his or her independence. You must be seen to be even handed with all.”

Another adds: “Independent directors must be direct but able to gain the trust and respect of the family at the same time. They can say what they feel behind closed doors, but they should never embarrass the family publicly.”

A successful independent director will fit the culture of the family business – it is essential that the values of the non-executive director match the values of the family.

Do they understand and appreciate the culture, history and ethos of the business? Will they be a safe custodian of our values and our wealth? Are they comfortable communicating with family members? These are the questions family members should ask themselves when hiring non-executive directors.

Equally, independent directors must ensure they have a full picture of the business before deciding whether to join the board. One independent director told us: “As a prospective family business non-executive, you must do your due-diligence. Speak to the auditors and the current non-executives of the family business to make sure it is a board you want to join.”

To make it successful, both the family and the independent director must be confident that the relationship can work, and that each has a fully informed view about the other.



■ Attracting Independent Directors To A Family Business

For some independent directors, joining a family business poses inherent risks – why enter an environment in which your ability to fulfill your director’s duties could be compromised?

Family-firms, however, offer distinct advantages that non-family firms cannot. They often provide a level of collegiality and informality rarely found in other corporate environments. Board members in family-owned firms may also exhibit higher levels of long-term stewardship, which helps to align the interests of the family with independent directors.

Equally, while non-family firms can be concerned with the quarterly reporting treadmill, family businesses tend to take a long-term view and emphasise trust, loyalty and a sense of pride in the family tradition.

“I was delighted when the family chair proposed the establishment of a board committee to dispense £250,000 in charitable donations unrelated to the profile of the business. That would never happen in a public company,” says one independent director.

Family businesses can also be more flexible and less bureaucratic than non-family firms. One independent director comments: “The ability to make quick decisions is perhaps the greatest strength of family businesses. You can talk through a topic in ten minutes and there is no need to put it to a committee or board.”

The sense of mission and purpose found in family businesses can not only give them a competitive advantage over non-family firms, but also make them an attractive

prospect for independent directors considering their next career move.
Recruiting Independent Directors

Family owners can be so close to their business, and emotionally involved, that they overlook the need to ‘sell’ the opportunity to potential outside directors.

Although the commitment, culture and pride of the family are each unique selling points, the recruitment process itself is frequently the most significant factor when attracting independent directors to family businesses.

Many independent directors use the recruiting phase to gauge the family’s level of openness and whether they truly embrace the concept of independence on the board. As one independent director told us: “The key question facing any independent non-executive in a family business is whether the family is willing to listen.”

Independent directors will have many questions about the firm’s financial position, long-term strategy and business operations. As one independent director points out: “Prospective non-executive directors will want to explore whether they ‘fit’ the generational profile of the family business and the shareholders’ growth aspirations.”

They will also take time to explore the wider family stakeholder relationships and how the family communicates its views to the business. It is essential that family board members are open and transparent with interested candidates.

Similarly, when it comes to attracting independent directors, it makes a difference whether they are one or one of several. Many independent directors we spoke to expressed caution at joining a family

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business where they would be the sole independent director, or where there was only one other independent non-executive.

One director says: "I would be reluctant to join a family business if it only has one non-executive director. Decisions are likely to be made over Sunday dinner and you may get rolled over."

Another adds: "They are not going to win the argument with the first appointment. They must be seen to be making several independent appointments."

No non-executive director wants to be employed as a token independent. To attract top talent, family businesses must build a track-record of genuinely independent non-executive appointments.

■ Retaining Independent Directors On The Board

Once an independent director has joined the board, it is the chair's job to ensure that family board members handle the transition well and create the right environment for the non-executives to participate and contribute fully.

He or she is responsible for ensuring that independent directors have sufficient information to discharge their duties. The chair must also help create an environment where independent directors are able to express their views candidly to the family.

To retain independent directors on the board, they must have the same degree of influence as family members. Equally, because it can be difficult to separate family relationships from business relationships, clarity of role is essential.

Board appointments should also be made in a fair and meritocratic way. Many independent directors we spoke to highlighted nepotism as one of the main drawbacks of working in a family business.

One independent director told us: "If you are running a world-class company, you need world-class directors. No family member should feel they have the right to be there. It must be a meritocracy and they must add value."

While it is a human failing that family members often act in favour of those who are part of the kinship, the perception of nepotism may result in disillusionment among independent directors and may lead them to conclude that their position is untenable.

Family businesses should ensure that only family members with the requisite skills, knowledge and experience are appointed to the board.

Making independent directors feel as much a part of the business as family members, and giving them genuine accountability and tangible input into board decisions, is a key way of ensuring loyalty, commitment and long-term stability.



■ Conclusion

In these turbulent times, family business owners face many challenges.

Is the composition of the board fit-for-purpose in the light of market changes? Is family discord affecting the performance of the business? Is there a qualified and willing family successor who can take the business forward?

In confronting these challenges, an increasing number of family business owners are recognising that the long-term success of their company will be greatly enhanced by the appointment of outstanding independent directors.

In addition to giving the family business access to skills and experience that it may not otherwise have, an independent director can bring objectivity and outside experience to bear in board decisions.

They can also open up important networks for the business and help to ensure that

the overall governance of the family firm operates effectively, fostering open and constructive debate and assisting with strategy and succession planning.

While the value of independent directors in family businesses is increasingly recognised, appointing them to the board is a delicate process. Reaching family consensus on non-executive appointments can be difficult.

A delicate balance must be struck in finding individuals who are respectful of the unique DNA of family ownership but are also prepared sensitively to challenge the executive team and prevent groupthink.

Done right, the appointment of independent non-executive directors to the board of family-owned companies can help ensure commercial success across the generations.

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■ About Odgers Berndtson

Odgers Berndtson is one of the leading international executive search firms and the largest in the UK. Our reputation for excellence and integrity has been established over 40 years. We act as trusted advisors to clients who need help recruiting for important positions.

Odgers Berndtson's Board Practice is responsible for some of the most important recent Chairman and Non-Executive Director appointments as well as for executive board roles.

As part of a truly global firm, the Board Practice spans all major markets. We work with a wide range of FTSE and AIM-listed companies, international groups, private equity-backed businesses, family-owned organisations, and small and medium sized enterprises.

We have a thorough understanding of board and committee structures, and board dynamics. Our team includes experienced directors of publicly quoted and privately held companies. In short, we know how boards work.

Odgers Berndtson has been an influential voice in the corporate governance debate. We understand how the principles of good governance, applied practically and not by rote, can help create strong, effective boards that add real value to an organisation.

Our wide experience and deep knowledge is brought to bear on every board appointment we undertake.



■ Our People



■ Susanne Thorning-Lund

Susanne is a Principal in the Chair and Non-Executive Director Practice. She has over ten years experience of advising on senior board appointments in family-owned businesses and pan-European engagements, working with our international partnership.

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