

How to Achieve Success on Your First Family Business Board

By John Penn, William Hawfield, and Jack Moore

The rising tide of corporate governance in American business continues to spread beyond public companies. Anecdotal evidence indicates a growing awareness among substantial family businesses of the potential benefits that boards can bring to the business. In the past quarter century, the Family Firm Institute and many of its individual member-leaders have shown how the family, the owners, and the management of family businesses separate from each other in the progression from first generation to second, third, and beyond. In particular, the separation of ownership and management gives rise to the need for fiduciary boards of directors, as well as mechanisms through which family members can carry out their responsibilities as business owners. Just as the board of directors should speak as one voice in its oversight of the CEO and the business, so also family owners should speak as one voice in chartering and empowering the board to serve as overseers of the business.

Sixteen percent of the NACD membership are affiliated with family business as owners, executives, directors, and advisors. A 2005 series of in-depth interviews with 75 of these members revealed how family businesses are often helped through the challenging generational progression by family business advisors. These advisors bring an outside, professional perspective to help with ownership and leadership succession, formation of family councils, and creation of fiduciary boards with independent directors and formal governance practices.

It appears that there will be an ever-growing

demand for independent directors, many of whom have never served on the board of a family-owned business. If you are an experienced director or are curious about possibly serving on the board of a family business, then this article is written for you.

A Contrast of Risks and Rewards

At their best, family-owned businesses are effective competitors, offer satisfying career opportunities, and demonstrate superior corporate citizenship. Family business owners strongly identify with their companies and products. Similarly, owner-operators have an intense personal investment in the integrity and ethical standards by which their companies do business. Indeed, there is a blurring of the lines in which love of family actually crosses over to love of the business.

Family businesses are notable for their long-term horizons, another source of competitive advantage. Leadership turnover often occurs only once in each generation, and succession planning is accordingly done long in advance. Equity in the company is also held for the long term. Though family members who are not active in the business may push for higher dividend distributions, the company stock becomes a legacy and its owners are stewards for the next generation.

As long as the founding generation bears influence—either directly, through their children, or through a long-lasting legacy—family businesses do not forget their humble origins and remain committed to the well-being of their workforce and community. And the same intensely personal identity with the family business may give rise to significant philanthropic activities.

But at their worst, valuable enterprises that took decades to build can be torn apart by family disputes and irresponsible ownership practices. Family members may feel entitled to employment without merit, and excessive wealth may undermine their sense of urgency and drive for innovation. Founders so strongly identify with their business that they may not be able to let

Director Summary: The authors offer advice to potential directors of a family-owned business, using the case of Schuman, Inc., as a real-life laboratory for due diligence. When the offer comes, the director candidate must examine the family dynamic as carefully as the business itself.



go or to imagine that their children will be able to lead the company. As their years advance, the senior generation becomes increasingly conservative, holding onto the products, customers, and business practices that have served them well in decades past. As the second generation takes control, siblings may be unable to make decisions collaboratively, either as business leaders or as owners. Rifts can grow between family owners who work in the business and those who do not. Finally, as the generations progress and without a concerted effort to foster shareholder education, most owners evolve into passive investors, living at long emotional and geographic distances from the family business.

The dynamics of mixing family and business result in enterprises that operate differently, as compared to “regular” businesses, whether closely held or publicly traded. Therefore, as a newcomer to the world of family business, it is prudent that you keep your eyes wide open when evaluating the opportunity to serve on the board and then be ready for the unexpected in your first year or two of service, as you learn more deeply about the company and the family.

Facing Your First Opportunity to Serve

To help present the following guidelines and bring a sense of realism to the subject, we have created a case description (see sidebar on page 14) that embodies many of the dynamics and circumstances of a family-owned business. In this case, you have been referred to the company CEO, Helmut Schuman, as a board member candidate. After your initial dinner meeting, the CEO asked you to serve on his board of directors. You are pleased that your professional board skills and industry experience have qualified you to do this work. You are honored to be asked to help this family, this business, and these employees define and create the future they want. You believe in the mission and the products of the company. You respect Mr. Schuman as founder and leader of the company. It appears to be a great opportunity, but what should you consider about a family business board that is different from a board for public or private companies? Here are some questions related to family business boards and to this case study particularly. (For a longer list of questions, see Appendix A to the NACD publication, *The Board of Directors in a Family-Owned Business*.)

Who is behind the invitation? Does the Chairman/CEO really want an outside board member or is it in response to a demand by the bank, the CEO’s former wife, or some other party? This can be your litmus test. If he/she doesn’t really want advice or won’t listen to it, then it’s a waste of your time and their money. *You should ask Mr. Schuman and his two sons (in separate interviews)*

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why they want an outside director. In your interviews, try to discern whether Mr. Schuman is a good listener and open to suggestions.

How are decisions made, really? The real decision maker may not be obvious in a family business. It could be the founder’s wife or the tie breaker in the family shareholder structure. Understanding who that decision maker is and what they want is critical to being effective on a family business board. *In this case, Mr. Schuman is the real decision maker. The rest of the family tries to convince him of their point of view. He loves the attention and the power.*

What are the values and style of the founder? The founder’s style and values have a profound effect on the company and the board. They shape everything. Do you share the same values and style? If you do not fit the founder, you should not join this board. He will not change and you will have to compromise yourself to stay. *The founder is visible and has voting control. His values and style may be continued by the two sons. Be sure you respect him and them.*

What is the succession plan for the founder and will it work? Family businesses must first decide if they require a family member to be the next CEO or not. If they want a family member as the next CEO, who is the candidate and how well prepared is he or she to take that position? If they are open to outside professional management as part of their future, then you need to know if all the family agrees with that structure and when they want to make the transition. *The two sons are in position as “co-presidents” to succeed the father as CEO. Leadership succession has not yet been decided. Who does the father support? Who does the mother support?*

What do the shareholders want? In multigenerational family businesses, the owners from different generations often have different views on key issues: Keep or sell the business? Guaranteed employment for family members or not? Reinvest earnings or distribute large dividends? *For now, Mr. Schuman decides how much money to take out or to reinvest in the business. He has decided he wants family (sons) to work in the business. There is no family council so there is no unified family position on the questions*



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mentioned above. The family, led by Mr. Schuman, needs to study and agree on their approach to these issues so that the board will know what the family wants.

What is the board's composition? Who else has been on the board or is currently a member? Is there high turnover? If you are the first non-family member and the only outsider, bringing a professional approach to the board meetings may be a real challenge. *In this case, you will soon be the only outside board member. The rest are family members. You may be challenged or ignored when you try to change the governance process.*

Are there potential legal disputes between family members? Visit the company's legal counsel to get insight into issues that are not readily apparent. Buy-sell agreements and shareholder documents and minority shareholder rights should be reviewed. *Schuman, Inc.'s ownership structure will probably lead to problems. The former wife could be disruptive. When Mr. Schuman dies, his shares go to his current wife. How will she vote them? When the wife dies, there will be no one with a majority ownership. There are several generations of owners with different cash needs and agendas. The company needs a clear and aligned process for transferring ownership to the next generation. Without this planning and control, arguments and legal disputes could erupt.*

As a newcomer to the world of family business, it is important that you prepare yourself for the unexpected. We have given you a starting point, which should provoke other questions for further discussions. We definitely don't want to scare you away from taking family board positions. Many of them are very rewarding and satisfying opportunities to add value to the companies and to meet some outstanding family members in the process.

Best of luck if you decide to accept your invitation to a family business board. ■

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a board advisory firm. He has founded or led three companies and has served on 28 advisory boards and boards of directors. **Jack Moore** is fourth generation family member and former director of Benjamin Moore & Co. He serves as advisor to NACD's Family Business Initiative.

Family Business Case: Schuman, Inc.

Founded in 1962 in Waltham, Mass., Helmut Schuman began a printing company to serve the specialty printing needs of Boston's medical community. In the past four decades, the business has grown to a full-service printing and document management business with revenues of \$250 million, a workforce of almost 800, and serving hospitals and communications companies nationwide.

The business was founded by Helmut and his two older brothers. Helmut holds the title of Chairman & CEO and is majority shareholder with 60 percent of the stock. His brothers have passed away, but their children have retained their stock.

Helmut is still active in the business and comes into the office every week when he is in town. He loves the business. He approves all the new products and sets the direction of the business. Helmut and his new wife travel a lot to visit customers around the country. His two sons, who were given operating control 10 years ago, are co-presidents of the business. One is an engineer and the other is a lawyer, but they devote most of their time to running the business.

The company is owned by 15 family members across the three branches of the family. Helmut's first wife owns 5 percent of the company. Upon his death, Helmut's shares will go into a trust with his current wife as sole beneficiary. Upon her death the stock will be given to his two sons in equal shares.

The board is a statutory one, comprising Helmut, his two sons, a cousin (a university business professor), and a long-time friend of Helmut's. His friend has asked to resign from the board. The board meets 2 or 3 times a year.

There is no family council, but Helmut holds shareholder meetings occasionally. The company appears to be sound financially, although it is already May 1st and the shareholders have not yet received their year-end financials from their long-time accountant. Their bank of 20 years speaks well of the company.

The industry is going through a big consolidation. Technology is driving down costs, and some competitors are moving operations offshore to save on labor costs. The company has installed new cost tracking software to manage their costs better.



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Further Reading on Family Business Dynamics

Carlock, Randel S. and John L. Ward, *Strategic Planning for the Family Business*. New York: Palgrave, 2001. An explanation of why there needs to be coordinated, simultaneous, parallel planning for both the family and the business.

Danco, Leon A. and Donald J. Jonovic, *Outside Directors in the Family Owned Business*. Cleveland, Ohio: The University Press, 1981. A classic exposition on the mindset of founders and how and why boards can bring value. Out of print, but still available through the Internet.

Doud, Ernest A. and Lee Hausner, *Hats Off to You—2: Balancing Roles and Creating Success in Family Business*. Glendale, CA: Doud Hausner & Associates, 2004. A comprehensive look at the several challenges faced by family owned businesses in succession planning and business continuity.

Fowler, Dean with Peg Masterson Edquist, *Love, Power Money: Family Business Between Generations*. Brookfield, Wisconsin: Glengrove Publishing, 2002. Numerous cases used to illustrate the intertwining of love among family members, power struggles for control, and disputes over money.