

Independent directors for a family business

The most successfully governed family-controlled companies want independent directors who can help the business stand up to outside scrutiny and ensure that the company is on the right path to continued growth and profitability. **BY JOHN WOOD AND THAMES FULTON**

FAMILY-CONTROLLED businesses represent nearly 35% of *Fortune* 500 companies, and many have specialized needs when it comes to building their boards, greatly influencing the state of directorship today. The high profile of family-run or controlled companies from Wal-Mart to Motorola to Ford Motor (with Wal-Mart alone employing 1% of the U.S. workforce) shows that they attract the same level of attention from shareholders, consumers, regulators, and the press as other large public companies — while presenting higher stakes and unique issues for new directors.

Recruiting new directors to any company creates challenges for the nominating committee: Will the director “fit” with other members of the board? Can the newcomer add value to board deliberations? Will the new director have the skills to contribute in an effective and objective manner?

In family-controlled businesses, these concerns are magnified several-fold. The always-complex dynamics of composing an effective governing board can carry more emotional content. Longstanding agendas of different sides of the family — some that may go back for decades — can complicate board service, creating the need for a “voice of reason” to counterweight family factionalism and historical bias. Kenneth Novack, former chairman and current director of Schnitzer Steel, a *Fortune* 1000 company with

roots as a family firm, comments that in private family companies in particular, “Family identity and company identity are intertwined. If you have problems in the company, then you have problems in



Outside directors may be struck by how fixed the family members are on the original business model, long after it may have become obsolete.

— John Wood

the family. You can trip on these.”

The most successfully governed family businesses, whether privately or publicly held, have relied on independent directors to provide objectivity. These companies are jumping on a larger trend toward more independent directors in all companies, driven by both the “push” of regulatory changes and the “pull” from companies themselves who realize the need for some boardroom shake-up. In our work with the leadership of family firms around the world, we have seen a greater interest in “professionalizing” their boards. Companies want independent directors who can help the business stand up to outside scrutiny and ensure that the company is on the right path to continued growth and profitability.

Where are family-controlled firms seeing the greatest value in their independent directors? What are they looking for in recruiting these new board members? How many independent directors should they bring onto the board — and what should outside directors expect from their service? We have found certain commonalities among family companies and have developed best practices around these questions — practices that more and more family companies are adopting as they transform from start-ups to major global corporations.

Independent directors as a ‘reality check’

In recruiting directors from outside the company (and outside the family),

companies are seeing value in a variety of areas:

- The primary driver for bringing in outsiders is their **independent perspective**. When starting a business, founders of companies often rely on a group of external advisors — usually peers or close friends — who provide guidance on everything from the running of the business to how to transfer control to the next generation. Once the business has matured and the advisory process is more formalized, adding independent directors to the board is a natural extension of this “kitchen cabinet.” Schnitzer Steel’s Kenneth Novack, a family member director in the company, believes that adding an independent perspective is best done as early as possible in a company’s growth cycle. “You want to bring in independent directors as soon as possible — before there is an issue or a problem.” Having outside directors as part of regular board deliberations can offer a systematic “reality check” to the controlling family shareholders.

- Additionally, while most boards seek to add value by bringing in executives with **outside skills and experiences to question the status quo**, the need for this is much greater in family firms. Most of them are populated with leadership that hasn’t seen much beyond the immediate family business. With families passing down the reins from one generation to the next, the management and board may really only “know” one business, or even one product. Outside directors may be struck by how fixed the family members are on the original business model, long after it may have become obsolete. Given this limited set of perspectives on the inside, it’s critical that family companies recruit directors with experience outside the company and outside the industry to identify opportunities — and risks — that a company might not be aware of.

- Moreover, as a company grows, outsiders can **advise how to scale and expand** beyond the more entrepreneurial vision of the founders. Wayland Hicks,



As family businesses continue to grow as hotbeds of innovation, they will play a larger role in the market for director talent.

— Thames Fulton

who serves as an independent director for both Perdue Farms and Schnitzer Steel, said that directors from outside the family can be particularly helpful in giving the CEO a perspective on how certain issues would be dealt with at a public company. Succession can be one of the “choke points,” according to Kenneth Novack, who believes that “part of the role of the independent director is to create an environment where succession can succeed.”

- Independent directors can also serve to **bridge family branches**, which often

emerge in the second and third generation of the business. Personal agendas tied directly to family dynamics can cloud judgment, which can leave companies at the mercy of family power struggles if not balanced with an outsider’s perspective and influence. Without direct familial ties to any one group or individual, independent directors can bring balance and often a clearer head to conflicts involving the different family agendas.

What are family companies looking for?

The traditional path of choosing directors due to proximity or familiarity is fading fast in this economic and regulatory environment. Instead, in our work recruiting new directors for family firms, we are seeing a whole new set of “criteria” that companies utilize in their search for new board members. (It also must be said that even using an outside firm to recruit represents a huge shift for family firms, who have usually relied much more than other companies on the “who-you-know” board referrals.)

While certain objectives — e.g., matching specific competencies with those needed for the forward-looking strategies of the business — are becoming increasingly common among nominating committees in both family and non-family firms, family businesses often request a more nuanced set of behavior and people skills:

- **“Deft candor”**: Most family firms are looking specifically for directors who can bring a “deft candor” to the job. Outside directors are needed for their empathy and patience in the face of family drama. But just as important is an ability to be “super”-independent and offer candid opinions about board and management decisions. One of the companies for which we conducted a search felt that

John Wood is vice chairman and global managing partner of Heidrick & Struggles’ Chief Executive Officer & Board of Directors Practice. Based in New York, Wood has an extensive track record of recruiting CEOs and board directors for a broad range of international clients.

Thames Fulton, a principal with Heidrick & Struggles’ Chief Executive Officer & Board of Directors Practice, oversees the firm’s family governance activities across a variety of sectors. He is based in Chicago.

the independent directors they brought on needed to take their independence even more seriously *because* of the presence of the family. They wanted these directors to strike an opposing point of view during deliberations — even if they agreed with the family — so that contrary views could be aired and seriously discussed.

This kind of candor involves a delicate balance between being empathetic to a family's long-held beliefs and values and

Family businesses often request a more nuanced set of behavior and people skills in board candidates.

being able to see when they are getting in the way of the company's growth and profitability. A typical example might be a family's unwillingness to close operations in the state or town where the company was founded. Many family firms have strong ties to the local community, going back generations, and are loathe to give up the social and cultural ties to their hometown. And while this decision to remain in a community despite financial consequences can be understood and accepted in a private company, in a public company it may draw considerable shareholder pushback. "Best practice" family firms bring on directors who can call out ties to specific locations, products, or business models that may no longer be serving the bottom line. At the same time, they must be able to communicate honest opinions in a way that family members find easier to accept.

As director Wayland Hicks commented, "Family companies have founder values that have been passed on through generations. A director coming onto a private, family board must be sensitive to the fact that there can be differences between the backgrounds of the (family) management team and the independent directors with experiences in public companies. This will cause each of them

to deal with issues differently." Director candidates should go into the process understanding these sensitivities.

- **Diplomacy:** Many of the more self-aware family businesses also understand the need for directors who can serve as "diplomat" — those with a skill for bringing people together who have divergent interests. We work with global companies who readily admit to having divided family factions, but actively bring on independent directors who can advocate for the company as a whole, not for any one faction. Well-governed firms value these kinds of diplomats who earn the trust of all parties and can conduct a kind of "shuttle diplomacy" when needed.

Independent directors stepping into a family firm will see quickly that the rules of engagement with the rest of the board and management can be very different than their other board service. But given the importance of their role in playing the independent diplomat, family board service can offer down-in-the-trenches opportunities that add invaluable experience and insight to one's "board résumé."

How many independent directors do you need?

Bringing on independent directors is really about lowering the risk for the family owners.

Ideally, private firms still under full ownership of the family should have two to three independent directors; having just a single outsider is too isolating for that one director, and a minimum of two is needed to truly affect board dynamics. For public companies — whether still majority family-controlled or with the family being a large but minority shareholder — independent directors should form the majority of the board in order to represent the full range of interests.

There are nuances to this formula. In companies with one large or supervoting single shareholder, it's less important to have independent voices on the board. If the controlling shareholder wants to run things his or her way, he's the one

with most at stake. But if a company has a much more diffuse and geographically dispersed group of family owners, a plurality (vs. a majority) of independent directors allows for enough unbiased perspective to come through.

Recruiting onto a family board

For boards seeking to bring on independent voices, best practice calls for an equally independent party to direct this effort. Ideally, the head of the nominating committee should be someone other than a family member, and/or the firm should use an external consultant to advise this process. Third parties can cast the net much wider than the often somewhat limited universe the family members know. Relying only on family contacts severely limits the talent pool and perpetuates the insular nature of family firms, not allowing them to leverage the qualified director candidates on the market.

Is it easy to recruit onto the boards of these firms? The structure of the family business and board definitely has an impact on the recruiting cycle. It is much easier to recruit an outsider when the majority of the board is independent (or close to it). There is less risk for the director in these situations in that he or she isn't being put up as the lone outsider or entering into a no-win situation in which family control bogs down governance.

Opportunities for prospective directors

As family businesses continue to grow as hotbeds of innovation, they will play a larger role in the market for director talent. Small, family-owned businesses are the roots of the next Fortune 500, and these companies are increasingly employing strong governance measures much earlier in their life cycles. Watching the best of these companies evolve can reveal unique opportunities for prospective directors looking to make an impact — and can show even non-family businesses the value of independent voices in the boardroom. ■

The authors can be contacted at jwood@heidrick.com and tfulton@heidrick.com.