GOVERNING THE FAMILY BUSINESS

Building Your Board. Building Your Business.
Not a Silver Bullet

What if we could...

• Achieve new levels of accountability within our organization
• Strengthen our businesses
• Solve our most challenging business problems
• Find new connections and resources

What do you want to take away?

Today

• Why?
• The Truth About Board Best Practices
• Why Are Family Businesses Different?
• The FB Governance System
• How?
• Panel
• Breakouts
Exercise 1

What are the biggest challenges facing our business?

_________________________________________________________________________________________________________
_________________________________________________________________________________________________________
_________________________________________________________________________________________________________

What are the biggest challenges facing our family?

_________________________________________________________________________________________________________
_________________________________________________________________________________________________________
_________________________________________________________________________________________________________

A Vital Family Business...

• Needs to adapt to changes in the environment
• Observe
• Orient
• Decide
• Act
Why Have a Board?

Managing Complexity

FAMILY LARGEST
Not enough attention paid to the business

OWNER LARGEST
Most likely a harvester or proprietor

MANAGER LARGEST
Probably no estate plans or inappropriate estate plans
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<th>Age Span</th>
<th># of Family</th>
<th># of In-laws</th>
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<td>Typically 1-5</td>
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<td>10-20 yrs</td>
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Why? – Family Business Credibility

Exposing our ideas to outsiders

- ____________________________________________________________________
- ____________________________________________________________________
- ____________________________________________________________________
- ____________________________________________________________________

Why? – Board Role in Succession

- Can Help ____________________________________________________________________
- Can aid ____________________________________________________________________
- Approves does not ____________________________________________________________________
  - ____________________________________________________________________________ selects
  - ____________________________________________________________________________
- Add ____________________________________________________________________________
- The Board’s main job is ____________________________________________________________________
Why? – Research

- 85% of CEO’s who put a board in place said it was their single best management decision
- Outsiders increase value (but occupation of board member has no effect)
- Outside directors decrease risk of internal fraud
- Help with Succession

Goal

Survival on Your Own terms

- Family business can be strongest form of business
- Honesty, open communication, and candor strengthen relationships
- Boards can promote honest & open communication

When should a family be careful?

- Culture of extreme secrecy
- Insecure CEO
- Inability to allow outside influence
- Unwillingness to invest sufficient time or money

Purpose of Governance - Generic

- Governances is a process that aims to assure that an organization produces a worthwhile pattern of good results while avoiding an undesirable pattern of bad circumstances
- A process assuring, on behalf of those governed, a worthy pattern of good while avoiding an undesirable pattern of bad.
The Truth About Best Practices: Market vs. Control Model

Four Quadrants of Governance

![Four Quadrants Diagram]

What is the Board’s Role in the Family Business Governance System?

Ownership Pyramid

![Ownership Pyramid Diagram]
<table>
<thead>
<tr>
<th>Topic</th>
<th>Category</th>
<th>CFO</th>
<th>HR</th>
<th>President</th>
<th>VP - #1</th>
<th>VP - #2</th>
<th>Exec Team</th>
<th>Family</th>
<th>Owners</th>
<th>Board</th>
<th>Non-Family Board Members</th>
<th>Secondary Decision Process</th>
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Notes: The table represents an accountability matrix with various topics and categories. Each cell indicates who is accountable for the topic, based on the role or position, with options such as CFO, HR, President, VP, Exec Team, Family, Owners, Board, or Non-Family Board Members.
Common Elements of Family Business Governance

Ownership, unity and family cohesion is a Family Business’ greatest strategic advantage.

- Family Meetings
- Family Council
- Family Assembly

- Board of Advisors
- Board of Directors

- Shareholders Meeting
- Family Office
Role of a Family Business Board
To provide accountability to management for articulating and achieving a vision and a strategy that is consistent with the values and mission set forth by the family.

What do we mean by accountability?

Definition
Doing what you say you will do
• By when you say you will do it
• To the level of quality that can reasonably be expected
Communicating as quickly as possible when you know you will not be able to
Cleaning it up as quickly as possible

How is accountability interpreted in the business world?

What gets in the way of people being accountable in the workplace?
Family should provide Board...

- Clear sense of values
- A vision for the family’s relationship with the business
- Clear boundaries between family and business
- Clear expectations for the company
  - Financial
  - Industry (what businesses to be in)
  - Family role
- Support Board approved strategy

Board should provide Family...

- Basic strategic plan
- Industry/Supplier info
- Status of succession planning
- Important successes/concerns

Board Recommendation

Has the ability to hold the company accountable and the discipline to not interfere in company operations.

Spectrum of Business Governance
Board Evolution

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<tr>
<th>Ownership Stage</th>
<th>Ownership Structure</th>
<th>Role of board</th>
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<tr>
<td>Start up</td>
<td>1 shareholder</td>
<td>• Evaluating business model</td>
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<td>• Evaluating new products/ideas</td>
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<td>• Providing connections</td>
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<td>Founder – owner</td>
<td>1 moving to multiple shareholders</td>
<td>• Assuring succession/exit plan</td>
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<td>Sibling – Partnership</td>
<td>Managing growing family tree move to cousins</td>
<td>• Compensation</td>
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<td>• Successor development</td>
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<td>• Feedback on family issues</td>
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<td>Cousin Consortium</td>
<td>Providing liquidity</td>
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<td>Valuing shares</td>
<td>• Monitoring family involvement</td>
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<td>Global Family Enterprise</td>
<td>Keeping shareholders engaged</td>
<td>• Monitoring multiple businesses</td>
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<td></td>
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<td>• Assuring clear family expectations</td>
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Advisory Board

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<td>Decisions are binding on management</td>
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<td>Lower costs</td>
<td>Additional costs of insurance</td>
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<td>Ability to Hire/Fire the CEO</td>
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How Big?

- Larger boards promote greater accountability (more eyes, more accountability)
- If the board is healthy (more people does not create paralysis)
- If board members can handle open dissent and brutal candor
- If directors can render good judgment and desire their judgment to be evaluated
- 7 to 12 members recommended

Family vs. Non-family

- Critical question is: Who will the CEO listen to?
- Typically, family if:
  - Can vote self on
  - Analytical
  - Relevant business experience
  - Relevant business contacts
  - High degree of family trust

Independent Outsiders vs. Insiders

Independence is largely irrelevant to achieving accountability

- Outsiders can be swayed
- Independent outsider’s are not associated with firm performance in private family business
- In public companies, the magic number is two outsiders for every family member
- Accountability is the key

How – Director Qualifications

- Open dissent
- Communication
- Understanding of business
- Collaboration with management
- Can keep management and company accountable!!!
How – Director Qualifications

If outsiders

• No conflicting relationships
• Critical thinkers
• Experience on effective boards
• Family business sensitivity
• 5 year rule
• Common issues
• Not your advisors
• Open dissent is critical
• 3 Board rule

Exercise 2

What are the 3 most critical qualifications from this list for our family?

_________________________________________________________________________________________________________
_________________________________________________________________________________________________________
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Criteria

The most critical qualifications for a director are to hold the company accountable and to have the discipline not to interfere in operations.

How – Finding & Recruiting

• Develop a profile
• Generate Candidates
  – Networks (family, friends, associate, etc.)
  – Meetings, educational seminars, etc.
  – Professional search
• Evaluate Candidates
  – Nominating committee
  – Phone interviews
  – Face to face
• Documents
  – Prospectus
  – NDA and board book (complete or abbreviated)
• Expect 25 to 35% say yes

Board Recruiting: Board Book

Table of Contents

1. Company
2. Industry
3. Board
4. Family

Director Pay

At Rate Equivalent To The CEO

CEO’s Annual Pay
250 working days
Board Orientation

- Complete board book
- Meet senior executives
- Meet senior / important family
- Industry education (formal, association and industry news and magazines)
- Any formal training needed (ethics, HR)
- Operations tours
- Sometimes customer, suppliers and creditor meetings

Director Tenure

- Reviewed regularly
- Reviewed seriously
- Clear criteria for keep/let go decision-making
- Serve at pleasure of owners

Meetings

- Research says 3 to 6 meetings per year

Agenda

- Key items brought forth by management
- Review of past activities and strategy status
- Items board members feel are important to discuss

Meeting Rule

\[
\text{# people} \times \text{# items} \times \text{# minutes} = \text{Total minimum meeting time}
\]
**Meeting – Agenda Recommendations**

- Circulate to board for comment before
- Time allocation
- Follow the agenda
- Important items first
- Always have a financial review
- Board members need to be prepared.

**Sample Agenda**

1. Call to order
2. Strategy review
3. Financial review
4. Risk/Legal
5. HR / Leadership development
6. Succession
7. Family Issues

**Meeting Decision-making**

- Simple majority vote to create accountability
- Quicker
- Only if members can live with and support vote

**Running an Effective Meeting**

Chair controls the meeting and makes sure that:

- People talk uninterrupted and not for too long
- People don’t go off topic unless all agree
- Decisions are reached through a pre-agreed decision making process
- Chair participates at a minimal level
- Encourage examples when people differ
- All have a chance to talk
- Help others see boundary between family and business issues
Chairman/CEO Duality

- Roles may be combined if one person can do both jobs effectively
- Chairman counsels, not directs, the CEO
- Combined roles reduce performance

Evaluation

- Communication
- Meetings
- Committees
- Strategy
- Financial and Legal
- Achieving Financial Goals
- Succession

Monitoring Strategic Execution

- Regular check-ins
- Benchmark against LT goals
- Identify obstacles
- Evaluate strategies

How – Improving Your Board - Research

- Boards in less than 50% cases meet more than once or twice a year
- Lack of CEO chairman duality increases performance
- Two outsiders to each family member improves performance
- Board diversity reduces likelihood of strategic change

Board Resources

- NACD
  http://www.nacdonline.org/
- Directors and Boards Magazine
  http://www.directorsandboards.com/
- Conference Board Directors Institute
  http://www.conference-board.org/knowledge/govern/govInstitute.cfm
- The Institute of Internal Auditors
  http://www.theiia.org/
• Corporate Governance Net
  http://www.corpgov.net/links/links.html