SILVERCREST
ASSET MANAGEMENT GROUP

The Importance of Independent Directors & Good Corporate Governance for Family Businesses

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When many people think of a business having a professional board of directors, they envision a large Fortune 500 corporation. But as many successful owners and leaders of family businesses already know, a business of any size can benefit from a board of directors with independent directors. A board should provide an objective view for senior management, which can be extremely beneficial for a family business that employs a number of family members in senior roles. It is important that when a family business decides to create a board, the composition includes independent directors with expertise and insights in key areas that can add value to the business. Regardless of whether a company's legal structure requires a board to have independent directors, their careful consideration and inclusion can have many benefits, which are outlined below.

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ACCOUNTABILITY OF SENIOR MANAGEMENT

The establishment of a board means that the CEO and the rest of senior management are accountable for their decision making through increased transparency of all major developments at the family business. For most boards, this usually involves a formal evaluation of the senior management, including the CEO. The board's real value in terms of evaluating senior management is less about being critical and more about providing constructive feedback. An efficient board should enhance leadership and stability at the senior management level.

TIMELY DECISION MAKING ON IMPORTANT ISSUES

A board implements a ready-made formal structure that ensures key strategic, operational and financial developments—such as acquisitions, key personnel decisions, and changes to dividend policy—are discussed on a timely basis. Boards can discuss a broad array of issues, whether they be relatively near-term operational issues or longer-term strategic planning initiatives. Having a board in place allows senior management to address contentious issues early on, which can be a real advantage compared to companies that allow important issues to linger or be ignored completely.

Independent board members should be selected for their skill-set and expertise in key areas (i.e. finance, technology, etc.) that they can bring to the board, including their network of industry and professional contacts.

ACCESSIBILITY TO EXPERTISE IN KEY AREAS

Independent board members should be selected for their skill-set and expertise in key areas (i.e. finance, technology, etc.) that they can bring to the board, including their network of industry and professional contacts. They are more likely to provide a critical perspective and to challenge the status quo, which is important as it will allow other board members to feel empowered to share their views more openly. One key statistic that highlights the importance of having independent board members is that 73% of family firms looking to grow aggressively have non-family non-executives (Source: PwC).

SUCCESSFULLY ADDRESS BUSINESS SUCCESSION ISSUES

A board of directors provides a family business with the structure to facilitate a successful transition in leadership from one generation to the next. A board is more likely to identify future succession issues and prepare for them years in advance. Independent board members can also act as mentors to the next generation of family business leaders as they prepare to take on additional responsibilities.

CASE STUDY: WHAT IS WRONG WITH MY COMPANY?

LET'S START WITH THE BOARD!

The CEO and second-generation family member of a third-generation family business were troubled by the declining market share of the company and were unsure how to address it. At the urging of his private banker, the CEO asked that firm's family business advisor to attend the next board meeting to help figure out what key issues needed to be resolved. Upon entering the board meeting, it became readily apparent to the advisor that one of the key issues with the family business was the board itself. The board consisted of the CEO, his long-time accountant/golf partner, the CFO who also happened to be the head of technology and operations, the head of business development and the company's legal counsel. Each of these individuals had been on the board for close to 15 years and were clearly all beholden to the wishes of the CEO.

During the board meeting, when issues related to finance and operations arose, all key decisions were essentially deferred to the CEO and no one was willing to give feedback that would be seen as critical of senior management. In fact, there was no discussion about strategic direction or long-term goal setting, which helped explain why the company had not made a significant acquisition or capital expenditure over the past 10 years. Although the family business did have a board, it was basically a committee set up to "rubber stamp" the CEO's decisions. When the advisor was asked for his honest opinion, he pointed out the need for independent board members to be appointed and the importance of a strategic plan to be created that would require input from every board member. Over the next few months, the CEO heeded the advice and appointed two independent board members who each had their own unique expertise. One board member had a background in investment banking and was an ex-CFO for a couple of companies in an adjacent industry. The other board member was a retired CEO in a similar industry who had a vast network of contacts. With the help of these two board members, who had previously been members on several other corporate boards, the board meetings became much more professional and board members were encouraged to share their views on key issues.

This open level of communication resulted in the board requesting from the CEO and senior management a five-year strategic plan to address the declining financial results at the company. Over the next six months, a strategic plan was developed and presented to the board for their consideration. The plan consisted of an M&A strategy, an overhaul of the finance department and the hiring of a COO to address operational issues at the family business. Over the next few years, the company completed two acquisitions, implemented a capital expenditure optimization strategy and significantly expanded both revenues and EBITDA. The professionalization of the board also allowed the CEO to off-load certain operational responsibilities, which allowed him more time to focus on strategic initiatives and key client relationships.

The fact that no family businesses are alike often applies to boards of family businesses. The composition of the board should reflect the maturity of the family business and be organic in the sense that it should be allowed to change over time. As the business grows in complexity, the board should also become more dynamic to handle the increasing level of strategic challenges and developments that can occur. Based on the industry a company is in, some boards may require more insight and expertise in a specific area, such as finance or technology.

Silvercrest, through the relatively recent addition of Seán O'Dowd as a managing director and family business advisor, now has the ability to consult with family businesses on the creation and composition of a board of directors to help companies continue to expand their business. This is just one of the many corporate-finance related services Silvercrest offers clients to help enhance and grow the family business/legacy for future generations.