Boards and Family Business: What Could Go Wrong?

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The benefits to a family business of having a board of directors are indisputable. A well-chosen board provides you with honest, objective opinions, uncolored by the kinds of relational issues that can muddy the waters of governance in an all-family enterprise. Having a board strengthens accountability, self-discipline, and strategic thinking because your board can ask the challenging questions that family members might not be willing to advance.

A high-functioning board grows your enterprise's value, too. According to research from Lodestone Global[1], 96% of companies who implemented boards of directors reported increased revenues, seeing an average revenue growth of 55%.

When might you consider forming a board?

- When the person responsible for business operations isn't the sole owner
- When other members of your family share ownership but not owners' responsibilities
- When ownership is spread across a large group of shareholders in increasingly smaller percentages
- When the business is transitioning to the second generation and beyond and ownership is seeking greater corporate governance

What can go wrong when you don't have a board of directors, or the one you have isn't effective? The kinds of internecine squabbles that can affect any family are amplified when the family ties include the family business; personality conflicts, concerns about nepotism, and abuse of power are less likely when a board has oversight.

Let's look at three different family businesses and how working with their boards (or failing to do so) impacted their organizations. *Names and other identifying characteristics have been changed to protect privacy.*

Apportioning Ownership

Three generations back, the Collier family business began with Bob Collier at the helm. Bob's two children, Gina and Gloria, each ended up with a 50% share when he passed the enterprise on to them, so from a voting and equity standpoint, it was an easy transition. Gina and Gloria each had four children, so, again, figuring out the ownership shares for each family member was simple. By the third generation each owner had 12.5% of the business, and each had an equal shareholder vote. But by the fourth generation, things got complicated as Bob's grandchildren had families of their own. One had a single child; another had four, yet another had no kids, and so it went. Now each of those Gen 3 family branches had to divide their 12.5% into disparate amounts, ranging from 12% to 3.1%, creating a big shift in the value of each person's ownership.

This complicated things: Although the shareholders were notionally committed to the idea of "one person, one vote," it was clear that the disparities between how many shares of ownership each family member held made that rule harder to justify. Not surprisingly, this created divisions and squabbles. The family saw this as an opportunity to work with a consultant to facilitate discussions on how ownership should affect voting on board members as well as other shareholder decisions. Will they stick with the "one person, one vote" rule, or will votes be apportioned by how large a percentage the family member holds, shifting the balance of power in the company's governance? From a board perspective, this is important because it is the responsibility of shareholders to vote family members and independents onto the board.

As is so often the case, in working with this family it's clear that communication is critical to working this out in a way that will prevent warring factions and other issues going forward. It's not an easy topic to approach, but fortunately I've worked with them for a number of years on other issues of governance, so the trust and solid communication is in place to move things forward. Much of the friction sprung from factionalism in the family's several branches, and part of the solution has been moving them toward seeing the enterprise as a whole, rather than as an aggregation of conflicting family branches. As the 4th generation moves forward, it's critical that they do so as a united family — and with that in mind, it was decided by the family to stick with the original "one person, one vote."

Are all the owners happy with that solution? Honestly, even a successful negotiation won't leave everyone involved completely satisfied — but they've decided they can live with that solution, because they saw that it was the right thing to do, not only for the health of the board and of the business, but for the family itself.

How to Hamstring a Board

Not every story has a happy ending, and this is a cautionary tale of how one person's determined grip on the reins can derail a board's efforts and effectiveness. Joan was the founder and sole owner of her business, and although she had a board on which two of her children sat, it was Joan as chairperson and majority shareholder who had control of any and all decisions the board made. She'd chosen a couple of friends from outside the family to fill out the board, which was effectively nothing but a rubber stamp for her decisions. We call this a perfunctory board, one that serves no real purpose, because a true fiduciary board equally votes on decisions put to the board vs. just going along with the desires of the chair in this case. The board could vote contrary to her wishes – but according to a very poorly written shareholder agreement, she retained the power to reject their decisions, and did.

The family itself was dysfunctional, and the adult children on the board had issues between themselves. When their mother died unexpectedly, all the conflicts and frustrations that had simmered under the surface erupted into open warfare. Two of the siblings could not be in the same room without a fistfight breaking out between them, creating a potentially fatal challenge to the continued health of the business. At Joan's passing, the shareholder agreement also required that her two sons be in agreement on any decisions made by the board — but that was impossible. They could agree on nothing; not on a budget, not on hiring, not on big ticket purchases. The other board members were appalled at their endless, fruitless bickering, and while they'd been loyal to Joan and wanted to do their best in her absence to support her vision for the company going forward, they were helpless to do so. Their resignations set the stage for the breakup and sale of the family business.

In this case, Joan's iron grip on decision-making set the wrecking ball in motion. When she was alive, she could manage the toxic dynamic between her sons. After her death, nobody could. Although the shareholder agreement she'd authored outlived her, the problems it left for her heirs were insurmountable. Had she created a proper, functional board, they could have helped the brothers and the company to move forward. But her unwillingness to create the necessary decision-making structures that could have kept cooler heads in charge, or to have the uncomfortable but necessary conversations with her boys ahead of need, finally demolished the company she'd worked so hard to build.

The Importance of Having Difficult Conversations

Succession presents many challenges, whether it comes unexpectedly as it did in in Joan's case, or even when the owner/founder has had time to think about his plan, as was the case with Dale. Dale's long-term health problems were a ticking clock on his tenure as CEO. There had never been a board in this family business; Dale had run things his way and had taken good care of his three sons and their families. Only one of the boys was involved in the business, the other two followed careers in other fields. When Dale passed, he left the business to his three sons in equal shares but chose the son who'd worked with him — the youngest — to head the enterprise going forward.

The bank demanded that the owners create a formal board of directors to ensure fiduciary accountability — and that's where the fractures in the family structure began to show. The two older brothers, who were part owners but not involved in the day-to-day operations of the business, felt that they were entitled to seats on the board to protect their interests. Neither of them had any real experience working in the business, nor did they have the business backgrounds or other qualifications a board member should have. Their demands created strife that nearly pulled the family apart.

That would have broken Dale's heart, I'm sure — but the fact is, he simply chose not to have the necessary tough conversations with his two older sons, explaining his choices around governance. Had he done so they might have more readily accepted the fact that simply being shareholders didn't qualify them to dictate the company's direction.

Conclusion

A board that doesn't function well, is hamstrung by the owner, or is populated with the wrong kinds of members can't do its job. Knowing what the purpose of your board is and making sure that it has the right people on it are critical to its success — as is listening to the advice they offer. If your family dynamics are such that you need help either forming or fixing your board, bring in a professional to guide the process, someone who can facilitate the conversations you'll need to get everyone moving in the right direction. That can make the difference between watching your enterprise be pulled apart or preserving and growing your family business for the next generation.

[1] "2020 Private Company Board Compensation Survey" report by Lodestone Global

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