

# A PLANNING GUIDE FOR TRANSFORMING YOUR COMPANY'S BOARD OF DIRECTORS

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An effective board of directors that is strategic and productive can help to significantly strengthen not just your business, but also your family. In our work, we find an increasing number of families are recognizing the potential benefits of *board development*—the process of formalizing their board, with the goal of deriving greater benefit from their governance efforts. This includes the addition of independent directors.

## **Evolution of a family business board**

Some families run their companies with oversight from a board made up exclusively of family members, or family members along with non-family managers (known as "insiders"). This board structure can serve the business well for a number of years. But over time, particularly past the second generation, there is great value in changing the board composition to include outside, independent directors along with owners. Independent directors bring fresh thinking and challenge assumptions upon which you have managed your business for years. This can help generate meaningful new strategies to move the business forward.

Many families initially find it uncomfortable to think about outsiders on the board. You might be very private and have concerns about sharing confidential information with people not in the business. Or perhaps you feel

that there is little that outsiders can add because they don't understand the "unique" aspects of your business. You might wonder who would even be interested in sitting on your board. All are common concerns among family business owners who have not developed a formal board.

Yet business owners who have decided to include outside directors on their boards soon find that those concerns were unfounded. In fact, CEOs are often surprised at how quickly independent directors integrate with others and how much value is added early in the relationship.

Many are further surprised by how independent directors affect the dynamics within a business-owning family. The presence of independent directors often supports more civilized and self-managed behavior. We behave differently when there are non-family members in the room, and it is typically for the better.

### **Adding independent directors**

We find that board development success is a function of thorough planning. The motivation for the transition must be carefully considered, and expectations for the board and for individual directors must be developed and clearly communicated. There are a number of steps associated with developing an outside board that enhance your chances of success:

- 1.** Clarify what you hope to achieve by bringing in independent directors. Ask for input from other shareholders and from company managers. It is likely that director candidates will ask you about your goals for the board when they meet you, so having a ready response is helpful. It also helps to get shareholders on the same page.
- 2.** Identify some key strategic challenge you anticipate in the next five to ten years. This will help you develop profiles of the kind of directors you are seeking. For example, you might anticipate consolidation in your industry that might threaten your market share, your margins or your ability to meet growth targets. Others who have experienced similar challenges would add value to your board. Or you might be considering a number of mergers or acquisitions over the next several years and could benefit from related experience with executing such a strategy. Perhaps the business would be well served by some stronger financial expertise on the board. If a leadership succession is on the horizon, you might appreciate input from directors with experience in the oversight and management of generational transitions.
- 3.** Establish a small committee of about three or four people that is responsible for managing the director recruitment process. This is often called a nominating committee. Momentum and efficiency are essential to the process, and delegating planning responsibilities to a small group works well.
- 4.** Create a board prospectus, which will serve as an educational and marketing tool to recruit new directors. The prospectus is a brief document (typically two to four pages) that outlines a number of important matters.
  - A brief summary of the business: key products, markets served, number of employees, overall strategic focus.
  - Rationale for your decision to seek new directors.
  - Responsibilities of the board.
  - Board structure (how many insiders/outside, meeting frequency, board compensation).
  - Director profile (includes specific education/experience/attributes you are looking for in new directors).

5. Use the prospectus to solicit interest from a variety of sources. You may need to reach beyond your existing network in order to find candidates who meet your criteria. Consider reaching out to peer networks and adviser groups for referrals.

Once a group of qualified potential directors has been developed, the process of interviewing candidates and selecting those with "the right fit" is similar to any other hiring process. The recruiting process usually works like this:

- The prospectus is distributed to candidates, who are typically first screened in telephone interviews. An objective at this stage is to reduce the list to "A-level" candidates, who can be reviewed by the nominating committee and further narrowed down (if necessary) in order to arrive at a list of people who will be interviewed in person.
- In-person interviews are conducted in order to determine whether a candidate is suitable. Résumés and bios often can confirm that someone has the expertise and experience, but the "chemistry fit" is at least as important, and is best assessed in person.
- Once the nominating committee completes the interviews, committee members should discuss the candidates and reach consensus on who best meets the established criteria, as well as who presents the best cultural fit with the group. The candidates' personalities should be considered with a view to determining which mix of individuals will likely work best together.
- At the conclusion of this process, an invitation is extended to those candidates who best meet the needs of the business.

### **Onboarding of new directors**

Orientation of new directors is an important step in ensuring that the newcomers add value as early in their tenure as possible. An "orientation book" should be developed to educate new board members about the company and the board. Here are some items that might be included:

#### ***Board information***

- A description of the business.
- Board charter or bylaws.
- Bios of directors and key executives.
- D&O insurance policy.
- Company bylaws.
- Minutes from one year's worth of previous meetings.

#### ***Business documents***

- Strategic plan (if it exists).
- Retirement plans, if any, for key managers who plan to retire in the next three to five years.
- Organization charts.
- Company financials: consolidated statements for five years plus detailed statements for the previous year.

- Valuation (if available).
- Any market research that will help educate directors about the markets in which you compete.

### ***Things to do (over time)***

- Meet with family members.
- Meet with key executives.
- Tour company locations/offices.
- Visit with customers and suppliers.

You might have other relevant items that could also be included in the orientation packet for new directors, such as a history of the business, information on supplier relationships, licensing agreements or details of pending litigation.

### **Planning for board success**

Successful board meetings are, in large part, a function of careful agenda planning. Typically board meetings cover some standing issues, such as approval of minutes, financial performance for the last quarter and key personnel changes.

Most boards meet quarterly. It's common for each quarterly meeting to be organized around one of a rotating set of themes. These areas of focus could include the annual strategic direction of the business, talent development and succession, customer relationships, and a deep dive into financial analysis, including a review of the company's borrowing power and banking relationships. There are many options for themes; the point is to facilitate thorough examination of a specific facet of the business at regular intervals.

Often board meeting agendas are too ambitious. A meeting with too many topics on the agenda leaves directors and managers dissatisfied. The directors feel that nothing was discussed in adequate depth, and managers don't get the counsel they hoped to receive. Optimally, the board chair, together with the CEO, develops an annual agenda that covers the most important strategic themes related to the business.

### **Ensuring an effective transition**

A transition to independent board members is significant. Although there are important strategic benefits, the decision to change the composition of the board is an emotional one for family shareholders. The following questions may help your family to assess whether a board transformation will benefit your company and whether you are ready to undertake this important initiative.

- Is the business facing some key strategic challenges that may require some material changes in the business model, or in the environment in which the business competes?
- Are you anticipating a change in business leadership, where a new CEO might benefit from additional strategic guidance and accountability?
- Are destructive behaviors or communication styles hindering the effectiveness of board deliberations?
- Do you feel that the value you extract from your current board is limited?

We know from extensive research on board development that independent directors bring value beyond what can be achieved through a board composed exclusively of insiders. It is the responsibility of the nominating

committee and management to ensure that a rigorous process is developed to search for and recruit directors, as well as to prepare them for their important role in the development and support of strategy moving forward. If carefully selected and educated, independent directors can bring enormous value and support to all stakeholders in your business, including shareholders, management and the family.

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