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Dealing with Conflicts of Interest on a Family Business Board

Last month, 180 leaders from over 100 companies attended The Private Company Governance Summit in Washington, D.C. including FBCG senior consultant **Stephanie Brun de Pontet** who served as a panel moderator for the session "Dealing with Conflicts of Interest on Private Company Board." The forum focused on how to create a clear distinction between a board member's role on the board and the other roles they may play within or for the company or the family.

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Panelists included Grant Lundberg, CEO, Lundberg Family Farms; Jim McHugh, Director, Southworth International Group Inc. and Kennebec Technologies Inc.; Ernest M. (Bud) Miller, Jr., Director, A. Duda & Sons, DKH, Incorporated, D&K Insurance Agency, ECI, Inc.
We asked Stephanie to share some of the concepts discussed during the panel as they relate to family businesses.

What kind of situations tend to create conflicts of interest on a family business board?

I think that family business boards have a greater potential for conflicts of interest because of the overlapping roles and relationships within the boardroom. You can have directors with parent-child relationships, shareholders working in the business, spouses, trustee/CEO, family branch representatives – the overlapping combinations are endless. That tension of "What hat am I wearing?" is not as common in public companies – or at least in those settings you probably are juggling fewer hats!

One example of how this can create a board challenge is when a shareholder director is in management, but not a senior leader, and the board is discussing issues that are a "couple of pay grades ahead" of this director. You can have boardroom conversations that may be questioning the strategic vision or even leadership capabilities of a senior leader to whom this family member reports in their day job. It's a tricky issue for these directors to provide insight and oversight to management in the boardroom, then report to the same upper management in their day jobs.

Another example of conflicting roles is when there are shares held in voting trusts. The trustees on the board are representing the interest of the trust beneficiaries and also serving because they are direct shareholders themselves. Additionally, they may be reporting to the board as senior management of the company. This is the kind of situation where those directors are inherently conflicted because they have to concurrently serve multiple roles.

Related party transactions can be another source of conflicts of interest when the business transacts with another business or entity that is not exactly "arm's length" and where interested parties may all have a seat on the board. The classic case is a business that pays rent to an LLC also owned by the family – but perhaps owned by a different constellation of shareholders in the family, or by a different generation of shareholders. If some directors have a stake in the other entity (either directly or through their children), they may advocate or be willing to "overpay" rent as a way to push income to those owners. This is not really in the best interest of the underlying operating business for which they have a fiduciary duty.

How do board directors create a clear distinction between their roles on the board vs. the other roles they may play within the company?

Everyone needs to be explicit about their roles in and out of the boardroom. The best way to start is by writing job descriptions. Resist the temptation to see this as a layer of bureaucracy, but rather see it as an opportunity to make roles and responsibilities more explicit to all. With the job descriptions and expectations, there is a shared understanding of where the boundaries lay in each role. This is not only valuable for the governance structure, but also helpful when transitioning from founder to the next generation to determine which decisions are for management verses ownership. Again, it comes back to knowing which hat to wear for different situations.

Another tool we encourage for clients is a Decision-Input Table for ownership, management and the board. In one column, list the types of decisions that need to be made and then in the other column, identify which group has the ultimate authority. Also list which group(s) should weigh in on specific topics. For example, deciding on the CEO's compensation is typically a board decision but management could have input regarding industry norms.

While there is no one-size-fits-all solution for this process, it is important to have buy-in from ownership, management and the board. This underscores the value of engaging in the hard work of alignment and developing a through thought process for collaboration. People might not be happy with the final decision, but they can trust the process if they had a voice and hand in its development.

What value does an independent director bring to these situations?

Independent directors offer a new perspective and much-needed objectivity on conflicts of interest. In a family business, talent is often home-grown and these directors can share their direct experiences on how other companies have solved similar problems or challenges with a fresh pair of eyes. They can also advocate for providing education to stakeholders and help build fair systems to address potential conflicts.

When it comes to next-gen leadership development, independent directors bring neutrality to the table that parents can't offer. They can identify which candidate is best for the position based on qualifications, not emotions. As a result, shareholders and management trust that the independent directors are advocating for the best interest of the family enterprise, not family members.

Last, but certainly not least, independent directors' neutrality and objectivity are key in helping with employment issues around compensation, perks and promotions. Nonpartisan directors ensure that the salary decisions will align with the company's strategic and human resources objectives.

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