the leadership blog

Adding Independent Directors to the Board of a Family Business

By Sonny Iqbal and Richard Stark

As family businesses evolve from small enterprises to large, complex operations, many of them intuitively understand that they must add non-family members to the management team along the way. Non-family executives bring additional knowledge of best practices and a range of perspectives and experience that allows family firms to grow and stay competitive with non-family companies.

But families are often slow to make similar changes to their businesses' boards of directors. This is unfortunate, as keeping a family company board in the family prevents the board from becoming the true strategic resource it can be. Independent directors who "know what good looks like" can help the board chart the company's path to the next level, expand its professional network and bring essential objectivity to board deliberations.

The root of reluctance

Despite the considerable benefits of adding carefully selected, independent board members, there are several reasons why many family enterprises are reluctant to do so. Independent board members are often viewed as potentially undermining the family's control of both the company board and company management—a control that owner families zealously safeguard. But their fear is often misplaced, since the owner family generally holds a majority of shares and therefore can vote board members in or out.

Just as family members behave differently when entertaining visitors than they do in private, many owner family board members are uncomfortable with the increased formality that comes with having an independent director in the room. But this is exactly the point. Having independent directors on the board professionalizes it like nothing else can. Now, family members must put aside their personal issues and histories as best they are able when in the boardroom, focusing on the job of providing objective oversight. And it's important to remember that professionalism flows in both directions: Independent directors are bound by the same rules of confidentiality that they would be on the board of a non-family company. What happens in the boardroom still stays in the boardroom, even when non-family members are present.

Some owner families also believe, incorrectly, that while strong boards may be important for non-family companies, a well-run board has less to offer a family firm. The basis for this view is rooted in history. The institution of the company board first arose to mitigate the problems that can arise when there is little or no overlap between the people who manage the company and the people who own it. So long as family members are in the CEO role as well as at several points across the executive committee (which is usually the case in all but the most mature family companies), this disconnect between shareholders and management—known as "agency cost"—isn't much of a concern. So it's easy for the owner family to see the board as little more than a statutory and compliance requirement for which family members or close advisors are perfectly adequate.

It's true that often there is little agency cost for the board of a family business to counter. But there are other reasons to professionalize the board by adding independent members. Such a board gives investors and financial institutions greater confidence that the business has proper oversight, increasing access to capital. The board can provide more seasoned counsel and mentoring to the CEO. Independent board members can also be valuable role models and resources for next-generation family members and can positively influence the family's decision-making style beyond the boardroom. Perhaps most importantly, the perspective of independent members can be particularly helpful in succession planning, risk management, compensation policies and in mediating conflicts that can arise between the family and non-family management.

Indeed, along with establishing a family charter, a task we discussed earlier (***"The Overlooked Document That Every Family Business Must Have"***), adding independent members to the board is the most important step a family company can take to maximize its longevity. This is why the boards of family companies often move to add independent members around the time that company leadership has passed to the second generation. This first generational shift not only involves succession planning but, usually, an increase in the number of family members and in the possibility of conflicting priorities. It is, in short, a vulnerable time in which even skeptics can start to see the value of objective insight.

Laying the groundwork

Before a family business adds independent directors, however, it is important to assess the current state of the board and identify areas where governance might need to be strengthened. Failing to do so sets the new members up for failure and will make the experience a frustrating one for all involved. There are three areas of particular importance:

Composition: Begin with an assessment of the current board. Do its members have the skills and experience to advise management on the key strategic issues the business faces, or does the board exist primarily to protect the interests of the owner family? Let the gaps in boardroom capability drive the search process for independent directors. Of course, it's unlikely that you'll be able to find everything you are looking for in one person—but then again, family boards should consider adding more than one independent director over time. It will be difficult to attract quality independent directors if the role is merely a token one. Having two or three independent directors, on the other hand, signals that an independent perspective is valued and has impact. (There is no set rule about how many independent directors a family board should have, although as a general trend, the more mature the business, the more independent the board.)

Culture: Independent board members cannot be effective unless they have the same access to informal discussions and key information as family board members. The board chair needs to ensure that the board operates with trust and openness around the table. Independent board members should be expected to have different views than family members—that is part of the value they add. This means more time for discussion and a commitment to fully working through conflicting arguments. Independent members should also have a thorough onboarding process which includes being paired with a senior director for informal mentoring and guidance.

Process: Adding independent board members is a critical step in professionalizing the board, but that professionalization needs to extend to other aspects of governance. Committees should have strong, experienced chairs and clear, unambiguous charters. There should be mechanisms to ensure that risks are evaluated, past decisions reviewed and that issues with longer time horizons (such as strategic planning, board performance and CEO and board succession) don't get squeezed off the agenda.

There is no doubt that adding independent directors to the board of a family company is challenging—it forces the family out of its governance comfort zone and into a higher gear. But precisely for this reason, adding independent directors is one of the most beneficial steps a family board can take.

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