



Getting on Board: Corporate Governance in Family Firms

'Corporate governance' is a catch-all phrase referring to standards of ethical behaviour or corporate accountability among publicly traded companies. For family firms, corporate governance is the structure that oversees the members of the operating business. This structure can take the form of a formal board of directors or informal board of advisors (or both) that ensures management's strategy is both in line with family owners' desires and executed in a timely manner.

Boards of directors and advisors can be far more complex in family-controlled enterprises than in non-family companies due to the unique relationships and interdependencies that exist in family firms. This complexity can make it difficult for family firms to understand how, or even if, they can benefit from adopting a corporate governance structure, not to mention what that structure should look like.

In this two-part series, the Business Families Centre (BFC) bridges existing (and often conflicting) research and expert advice in an attempt to demystify two key family firm corporate governance topics: board effectiveness and board composition. In doing so, the BFC hopes that business families will be better able to identify what corporate governance is, what

about it works (and why), and whether or not it is right for their businesses at this time.

Does Corporate Governance Work for Family Firms?

Twenty years ago, a well-known study concluded that boards of directors, strategic planning, and frequent family meetings were correlated with business longevity over multiple generations.

Today, however, academic opinions on board effectiveness vary greatly, and there is little conclusive empirical evidence that boards contribute to family firms' success or improve overall performance.

Part of the problem is that measuring the success or efficacy of a board is not a straightforward, cause-and-effect assessment. There are many general factors that make measurement extremely complex, including a firm's size, age, debt-to-equity ratio, average annual sales growth, and profit variability; a board's level of influence on the CEO; the CEO's satisfaction with a board; and board diversity and independence. Other dynamics unique to family firms only add to this complexity, including the various ways in which family members impede or help their board.

Indeed, there are so many variables at play in the corporate governance of a family firm that it is difficult to pinpoint a link between the implementation of boards and increased firm performance or overall improved functioning.

Dr. Jennifer Pendergast, co-author of *Building a Successful Family Business Board* and senior consultant with the Family Business Consulting Group in Chicago, acknowledges that there is no conclusive evidence linking governance structures with firm performance: "There really isn't a lot of proof in the field," she says in an interview with the BFC. "It's largely anecdotal."

Despite this lack of empirical proof, Pendergast and other leading academics and advisors continue to praise the role of corporate governance in family firms. "It's the process that's very important," says Pendergast. "It's how the board works together. If the structure creates good process, this helps the business [to succeed]." In this sense, it is less the formality of the board that is lauded, than the communication and decision making process the existence of a corporate governance structure creates.

The Case for Evolving Boards

This subtle, but important, distinction provides a practical argument in favor of informal boards, particularly for small or developing family firms unsure of the need for, or rigor required by, a formal board. In fact, many experts now suggest that family firms exploring corporate governance start with non-binding advisory boards, which have the potential to organically evolve into more a formal governance structure (i.e., board of directors) as required by the needs of the family and the business.

“[W]hen a family business gets to the point where they think they’d like some additional advice, they don’t have to go to a corporate board to start with; they can just have an advisory board,” says experienced board member Bill Sheffield. “It’s a way to get advice that you can ignore if you don’t like it. But you get it, and then you get a sense of whether it’s valuable, and a number of experienced directors are willing to do that.” Sheffield should know – in addition to being a corporate director at Canada Post and Velan, Inc., he serves on the boards of several private family firms and the Institute for Family Enterprise Advisors (IFEA).

Sheffield says that directors on advisory boards are willing to contribute because they spend less time and have less liability than corporate board directors but are still able to be of service. He recommends advisory boards as a good first step as they hold very little risk for a family and include the potential to become more

formal later on if the family wants to grant members voting privileges or other benefits.

By no means does this mean that all family firms without existing corporate governance structures should simply proceed to establish advisory boards – corporate governance for the simple sake of corporate governance is highly unlikely to create a tangible benefit in a vacuum. Rather, advisory boards provide an introduction to the benefits of corporate governance for those family firms ready to commit to the process and communication that boards require.

Family Governance First?

Some experts suggest that the origins of evolutionary corporate governance must start even closer to the family, as corporate governance in the absence of a healthy family may do little to ensure improved business functioning. Ruth Steverlynck, principal of Your Family Enterprise and IFEA board member, argues that if family firms practised family governance before corporate governance, they would be better trained to use effective communication skills, trust in each other, hold regular family meetings, and know where the boundaries between the family and the business lie, blazing a path that could evolve into corporate governance practices.

Although she firmly supports the value of corporate governance in family firms, Steverlynck emphasizes that governance mechanisms need to operate successfully between family members before corporate gover-

nance can successfully function in the business. She says that the vast majority of enterprising families do not realize that governance activities can and should be applied to family relationships before they are applied to the business. According to Steverlynck, without learning the tools of governance as a family, families are not be able to carry those same skills into governance of the business where they would reap the most rewards.

Board Composition

In the absence of empirical data linking corporate governance to family firm success, academics and experts in the field are increasingly looking at the creation of structures and practices that support and encourage family members to communicate and trust one another as a means of ensuring success from one generation to the next. But what should those structures look like? Join us for the next installment in this series, where the BFC examines the complex subject of board composition and, in particular, board independence.