The Second Commandment Of Family Business Succession: Create A Board

Jacob M. Engel Forbes Councils
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POST WRITTEN BY

Jacob Engel

Author and CEO of **The Prosperous Leader**. I help CEOs and their organizations prosper.

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Having a board as a private, family business usually seems like a nuisance at best and unnecessary at worst, especially when those board members are outsiders. "Why should strangers know all my problems or how much money I make or lose?"

Most owners of privately owned companies are both officers and board members. They and their family members usually own most if not all of the shares. No wonder, then, why board meetings are almost nonexistent or just a formality.

However, a board is a must, especially if you want to create a seamless succession. Why?

1. It keeps everyone accountable, as meetings and reports will be required.

2. It mitigates politics and allows the company to create a meritocracy, especially among independent directors.

3. It allows for a seamless succession plan to be implemented with continuous updates to the board.

So what type of board works best for a family business?

There are various types of boards, but the most common are the board of directors and board of advisors.

A board of directors has what are called “fiduciary responsibilities” and can be held accountable for lack of proper oversight or guidance. They have voting rights and will exercise them as needed. When companies bring in outside investors, the investors might get a seat on the board or they might insist on independent members. Many family businesses I've worked with initially started off with a board of advisors then gradually morphed that into a board of directors.

The purpose and goals of both boards are somewhat the same. The question is: What, if any, powers does the board of advisors really have? The answer is none, and they can be replaced very easily.

However, because they don’t have fiduciary responsibilities, one can attract very talented independent directors, and they will happily serve on the board, usually for a fee. They can bring significant expertise to the table and be a source of knowledge for the company. Plus, banks feel a lot more comfortable when there is outside guidance such as a board, and even significant hires feel reassured when there are outsiders involved.

What should you look for in independent directors?

It's wise to stagger the period that independent directors serve so that not all have to change at once and there is continuity. Additionally:

1. They should have family business experience (either having worked in one or advising one).

2. They should have a deep understanding of the issues, such as succession, etc.

3. They should be an open and honest communicator. The board must be able to dissent. It should challenge, probe and ask the tough questions.

4. They should have full integrity.

5. They should be committed to serving.

According to the *New York Times* article on family business management that I mentioned in my previous article, the board needs to be active to be effective.

There are three types of boards: active, passive and hyperactive.

The best board is the active board, which meets very regularly. There is usually a lead director who is more involved than just the regular, independent directors. They ask for reports and ask questions.

A passive board meets irregularly and often times is in the dark as to what's really happening in the company.

Hyperactive boards are usually the result of a company that has experienced serious turmoil and needs a lot of hand-holding and guidance.

On one of the boards I served on, initially, we started as a board of advisors, then we became a board of directors. We always had quarterly meetings with full financial reporting. We helped hire new accountants, lawyers and senior managers. We helped resolve internal conflicts, guided the CEO and his senior team on major issues, etc.

Boards with independent directors can play a very important role in all businesses, but especially in family businesses. I mentioned a few reasons: It creates accountability, allows for a meritocracy and can be very helpful in a seamless leadership transition. It should take the lead in the very sensitive issues that family businesses face when transitioning to the next generation, specifically to ensure that the right successor has been evaluated and given feedback to take on the leadership role.

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