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"Corporate Governance" in a Family Business: Who Needs It?

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Smaller family-owned businesses are often operated with a degree of informality that is both natural and efficient. The thought is that "corporate governance norms" are for someone else's business—the big guys with their in-house lawyers or big legal budgets. That attitude can be costly, particularly for a smaller, owner-operated business. Why? Corporate governance covers a wide scope. At its most basic level, good corporate governance includes holding regular meetings of the board of directors, keeping minutes of decisions or written consents to actions by the board, making records of the actions, approvals, and critical decisions of the organization. It includes keeping state and federal filings up to date. Corporate governance includes keeping a close eye on the financial statements (and those within the business who produce them.) Corporate governance includes encouraging an attitude of openness to differing perspectives within the board or among the executive team members. It may also include adopting various policies that guide the operation of the business: for example, conflict of interest policies; diversity policies; investment policies; and privacy policies. Some family business owners may believe that attention to corporate governance is unnecessary because there is general agreement on the operation of the business, and no one (other than, perhaps, the IRS) is looking over the shoulders of management to evaluate how things are done. Perhaps the business has operated for generations with management by consensus, expressed verbally and not committed to writing. But circumstances can change: family disputes may arise; long-simmering resentments may bubble to the surface; the business may hit a rough patch; and creditors may be looking for opportunities to enforce claims against shareholders or directors of the company. But it is not only when things start to go wrong that the level of attention to corporate detail becomes a factor. If things are going well and your business needs a line of credit to grow or a partner to provide additional capital, that person – whether a bank, a new equity investor, a strategic partner or anyone else – will likely want to confirm the basics of your corporate governance. If you cannot verify who your stockholders are, if you have not properly authorized company actions, if you have a board of directors unfamiliar with their responsibilities, you will be more exposed in the bad times and less likely to be able to take advantage of opportunities in the good times. If you have been neglecting basic corporate governance in your family's business, here are a few places you might start "cleaning house": • Confirm you have copies of your basic governance documents at the company's offices, including articles and bylaws, if a corporation, and an operating agreement, if an LLC. • Ensure there is an up-to-date capitalization table at the company's offices, including all equity ownership, all options grants (regardless of whether or not they have been exercised), and anything that is convertible into equity interests; • Confirm you have records of board of directors resolutions authorizing all issuances of all those equity interests. • Make a point to schedule regular board meetings, even if they are informal. Meetings should generally be quarterly, if not more frequent, and the board should make a point to actually discuss the state of the business at these meetings. • Take the time to educate your board of directors about their responsibilities and their fiduciary duties. Your family-owned business probably does not need a nominating committee, a written policy on diversity, or an entirely independent board of directors (although it might!), but every business should take the basic steps to maintain minimum corporate governance standards. Again, it will protect in the hard times and open up more opportunities in the good times.