



Independent director in unlisted family owned business

D Balasubramaniam and Dr TR Madan Mohan

Browne & Mohan

Board & CEO Advisors, Management Consultants

Family ownership is the most prevalent form of ownership structure in many countries. Family owned business can be a single-owner firm to large industrial houses. In a family ownership the family members don several roles, common ethos, identity and principles transcend multiple- generations, and munificence is a major driver of business. Each family owned business has unique set of challenges. Many single owner run business may lack clear business norms, and policies, processes. Many family organizations may have limited use of capital budgeting, risk management and working capital management techniques and long term planning may be completely missing. Some family business, however large they may be, may have no clear plan to sustain the profitability of their business across markets and customer segments, improve predictability of revenue growth so that mutli-generational growth can be sustained. Wealth management may also be nascent in many of these businesses. Proper planning of short term and long term investments, and protection of corpus may be missing. Most family business also don't invest sufficient energies into succession planning and business continuity.

There is no shortage of advice for family business. From personalized guru's and Chapels, peer groups, friends and family many snippets of advice flows. However, the advice is ad hoc and generic in nature, not applicable to their organization. Moreover, their applicability to the company requires lots of rehashing, reshaping the data. Family business owners need advice that is professional, unbiased, consistent and appealing to their way of doing business. They also realize a need to adopt appropriate governance practices to propel them to next level of organizational growth. In recent years, corporate governance in family business has gained significant research interest (). Role of independent directors in listed family business, the corporate governance practices and challenges are sufficiently explored (). However, unlisted family businesses which form the large base of growth drivers in any economy has not received sufficient focus. In this article we present our experience as independent directors in couple of Indian organizations.

What Qualities do Family businesses seek in independent directors?

Unlike the listed firms that hire independent directors to meet the regulatory requirements or to appease minority shareholders concern, private business companies hire for following reasons.

- 1) **Solid industry background.** Independent directors with loads of year of experience are sought to help master the nuances of the industry and prepare companies to succeed in the industry. Family businesses seek our directors who not only stimulate good discussions on industry, but offer deep insights and share experiences on what not to do.
- 2) **Deep knowledge of the market.** Family businesses prefer independent directors when they are expanding to newer markets where their prior experience may not stand much water. Family businesses that are entering newer customer segments or distribution models prefer directors with a good understanding of the industry nuances, the competition, government laws and markets, etc.
- 3) **Broad governance experience.** Experienced family businesses at the crossroads of transition or inter-generational transfer prefer to bring in independent directors for prior board experience. Family businesses planning to raise capital from markets and professionalizing their management also prefer directors with broad governance experience.
- 4) **Well networked.** Most first generational family business or single-man operations with no major brand capital, seek out independent directors for their social connections. In industries with high outsourcing opportunities or OEM dominant industries, independent directors who could open the doors for business through their networks are preferred.
- 5) **Easy going and available to roll up sleeves when required.** First generational family business and single-owner businesses are conservative and hesitant to bring in outsiders who are too direct and transactional. They prefer independent directors are easy going, and compassionate. With limited bandwidth for monitoring and

Browne & Mohan

Board & CEO Advisors, Management Consultants

control, they also expect the director to own and drive some of these activities.

Roles of Independent director in a family business

Independent director can be broadly of active or passive type. Active types involve in strategy making and guide implementation process without actually interfering with the CEO and the senior managers. Passive directors limit themselves to their advisory role. In our understanding the most valuable independent director brings the following.

1) **Focus on profitability:** constantly reminds the purpose and means of establishing the company, the stakeholder value created by the company, number of revenue streams, etc. They raise questions and offer constructive ideas to better the company's revenue, how to do better than industry, help in arriving at cost comparison against the best in the industry, etc. They help in defining and honing the business mix. The components of business model you choose to play determine how fast you grow.

2) **Focus on De-risk:** focus on broadening business mix, segmentation, market geographies, reduce dependence on some key people, skill sets that are likely to mature or new skill sets that would be in demand and finally, reputation of the firm. They help in identifying innovations (either radical or incremental), help build portfolio of products/services targeting different consumer groups, thus reducing dependence on a products or a market.

3) **Focus on Sustainability:** by constantly asking for extending the reach of their company into the economy, find newer opportunities and increase the richness of marketing engagement with its partner. They also continuously focus on sustaining creative friction within the company by approving creation of cross-functional groups, newer R&D teams, and novel commercialization models. They also focus on extending the management in the company, prodding for self-organization and responsibility at multiple levels, so that continuous streams of leaders emerge.

4) **Focus on professionalism:** by constantly encouraging multiple perspective at the board level, transparent and creative discussions about

business, and act as a go between people to reduce ego frictions. They are not afraid in asking the right questions and asking them all in a fair and professional manner. They also do not mind digging deeper if some answers are not satisfactory or do not ring the right tone. They attempt to delineate the CEO and Chairman roles and hence bring more clarity in day-to-day operations and strategic views.

Based on our experience and our readings of the industry, independent directors are broadly involved in following roles:

1) **Provide guidance.** Family owned business like independent directors to offer guidance and assistance in finding opportunities for the firm to grow, align with new partners, explore new markets and change the status quo. In some companies, the family ownership may be seeking specific guidance to reduce CEO stress and bringing in professionalism.

2) **Improve visibility and network value**
Independent directors participate in firm sponsored events as experts and consultants to showcase talent and provide key networks.

3) **Act as a sounding board and a confidante**
In many a first generation family business independent directors are seen as sounding boards where partially defined or tentative plans can be bounced off to obtain feelers. Moreover, they may also be involved to act as a neutral party to minimize "self-seeking behaviour" of the family members and to arrest "private gains over company losses".

4) **Ensure fiduciary requirements are met**
Independent directors act as audit committee members, validate whether the taxes are paid in time and regulatory requirements are complied.

5) **Provide consistency, longevity and knowledge for the company**

Independent board members play a unique role of checking for continuity of ideas and assumptions, longevity of plans and efforts and learn from historical perspective.

Browne & Mohan

Board & CEO Advisors, Management Consultants

Challenges faced and strategies adopted by Independent Directors

Independent directors in family owned unlisted firms face following unique challenges:

1) Ensuring independent neutral advice

Independent directors realize the family's choices and decisions may not be in the best interest of the firm and must exhibit their independent views and advise. Major areas of disagreements would be in placing loyalty over performance, leadership changes, ownership and responsibilities, investments and exits. Documenting disagreements and revisiting the plans is one best strategy that works best.

2) Prioritizing the change process

Many family owned businesses, especially the SMB, lack formal planning process and the change management process is often ad hoc. Independent directors add value to the company by bringing in a method to manage the priority of changes and ensuring the governance of change is managed well.

3) Managing "guidance" fatigue

One of the biggest challenge independent directors must be prepared is the pace of change may be limited by resources and in many quarters the governance guidance may not be varying much. Sticking to a rolling plan with same objectives and keeping the motivation and guidance at highest becomes a challenge for most independent directors.

4) Familial role & conflicts

Unlike a corporation, family members and their extended relations may have different rights, expectations and responsibilities in the business. This sometime can lead to conflict and jeopardize the sustainability of the business. Unique privileges, access to privy information and independent management are issues independent board members have to grapple with. Other key areas of conflict are succession and distribution of wealth. Independent directors must stick to their professional role, and offer solutions that mitigate the business

continuity risk , but also preserve the family harmony.

Conclusion: Independent directors in family owned firms have key role in expanding business growth and continuity. Not only there are various types of independent director roles emerge, they are capable of performing multiple roles. While there could be several ties between the family and independent directors, adhering to principles of independence and mediation may be more useful for the family enterprise. With increasing market complexity and need for independent recommendations, demand for independent directors is likely to increase. Family businesses will serve their interest better if they invest in right independent director, offer the right environment to review and direct the advice to bring growth and sustainability.

Bibliography

Adam, R.B. and Ferreira,D. (2007)"A theory of friendly Boards", Journal of Finance, Vol.62, Iss 1, 217-250.

Anderson, R and Reeb. D (2004), Board Composition: Balancing family influence in S&P 500 firms", Administrative Science Quarterly, 49, 209-237.

Bammens, Y, Voordeckers W, and Gils, A.V. (2008) "Board of Directors in Family Firms: a generational perspective", Small Business Economics, Vol. 31, 163-180.

Benjamin, H.E and Weisbach, M.S. (2003) "Board of Directors as an Endogenously Determined Institutions: A Survey of the economic literature", Economic Policy Review, Vol. 9, 2003, 7-26.

Clark, C.D. (2006) "The Independent Director in Chinese Corporate Governance", Delaware Journal of Corporate Law, Vol 31, 125-228.

Clark, C.D. (2007). "Three Concepts of Independent Director", Delaware Journal of Corporate Law, Vol 32, 73-111.

Huse, M (2000) " Board of Directors in SME: a review and research agenda", Entrepreneurship & Regional Development, 12, 270-290.

Browne & Mohan

Board & CEO Advisors, Management Consultants

Johannisson, B and Huse, M (2000) "Recruiting outside board members in small family businesses: an idealogical challenge", Entrepreneurship & Regional Development, 12, 353-378.

Kevin, H.P, Kiel. G.C and Nicholson, G. (2010) "How Boards Strategise: A Strategy as Practice View", Long Range Planning, Vol. 43, 33-56

Neubauer, F and Lank, G.A (1998) "The Family Business: its Governance for Sustainability", Routledge, New York.

Varottil,U. (2010) Evolution and Effectiveness of Independent Directors in Indian Corporate Governance, Hastings Business Law Journal, Vol. 6, No. 2, 281-286.

Browne & Mohan insight are general in nature and does not represent any specific individuals or entities. While all efforts are made to ensure the information and status of entities in the insights is accurate, there can be no guarantee for freshness of information. Browne & Mohan insights are for information and knowledge update purpose only. Information contained in the report has been obtained from sources deemed reliable and no representation is made as to the accuracy thereof. Neither Browne & Mohan nor its affiliates, officers, directors, employees, owners, representatives nor any of its data or content providers shall be liable for any errors or for any actions taken in reliance thereon.

© Browne & Mohan, 2013. All rights reserved

Printed in India