Institute for Family Business

NON-EXECUTIVE DIRECTORS IN FAMILY BUSINESS GUIDE

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FOREWORD

BY SIR JAMES WATES

CHAIRMAN, WATES GROUP AND IFB

I am pleased that the Institute for Family (IFB) has produced this valuable piece of work.

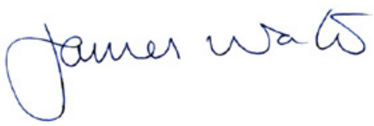
Expectations of businesses are evolving. With decreasing levels of trust in all institutions, there is greater emphasis being placed on companies transparently demonstrating good governance and showing that they are creating value not just for shareholders but for all stakeholders. Family businesses, whilst enjoying strong reputations, are not immune from these increasing expectations.

Boards of family businesses have to stay on top of this change, but there is a risk that boards dominated by family members can tend to be too introspective, or too retrospective.

Non-executive directors provide an inherently outward-looking and expert perspective, and so can provide a valuable 'third leg', complementing the distinct perspectives of family directors and executive directors.

Of course, every family-owned business is different, so each should enlist the support of non-executive directors in a way that is right for them. This publication helps family businesses – especially those who have not yet incorporated non-executive directors into their governance – understand the underlying purpose and objectives of their roles, and then to think through how to recruit non-executive directors, articulate their responsibilities, and ensure they are delivering value for the company.

Ultimately, when companies get it right, non-executive directors help create stronger, better governed businesses, and I commend this publication for helping you make that happen.



INTRODUCTION

BY ELIZABETH BAGGER

DIRECTOR GENERAL, INSTITUTE FOR FAMILY BUSINESS

The role of a non-executive director (also referred to as NEDs in this guide) is a vital topic often discussed in family business circles and for that reason, naturally, at the Institute for Family Business.

We know how important it is who a family business chooses to appoint and welcome onto their board. Many of the businesses we work with approach the decision with great care and consideration. So, with that in mind, we believe this guide will contribute to a small and growing body of knowledge on the topic.

We have sought a wide range of contributions from technical and subject matter experts as well as from experienced non-executive directors (family owners and independent NEDs) in order to give you as detailed and nuanced a picture as possible.

It is our hope that this short guide will give family businesses, the NEDs they appoint and those who look to serve on family business boards, insights, knowledge and guidance on all aspects of the journey.

The guide covers recruiting and appointing candidates, how to think about remuneration, the role of family and independent directors, the importance of alignment of culture and values, the role of corporate governance, rights and responsibilities, communication between the board and the family, board reviews and much more.

It's primarily aimed at businesses who are relatively new to working with independent directors. However, it can be read by all as the wisdom contained in it comes from experts and NEDs with many years of experience in their fields.

We are extremely grateful to all our contributors without whom this guide would not exist. A warm thank you to each of them.

SECTION 1

DO YOU NEED AN NED? YES, AND HERE'S WHY

By Elizabeth Bagger, Director General, Institute for Family Business

I remember one of the first conversations I had with a family business owner about non-executive directors. During the conversation the owner was explaining to a small group of us why they thought it was important to have independent non-executive directors on his board.

'They'll confirm when you're right, which feels good, and they'll tell you when you're wrong, which can save you a lot of time and money, it's a no brainer'.

I've often returned to their words when we've talked about NEDs at the IFB. And indeed, why wouldn't you have them? Why not get an outside perspective from someone who has committed to understanding your business and to its success?

However, there are many reasons why family businesses may be apprehensive about appointing NEDs. It strikes me that it's finding the right NEDs that is crucial. For most, a combination of family and independent NEDs works well, that being said, an outside perspective can be really crucial when working with family. They can be the voice of reason when family members don't see eye to eye, they may be the person who brings a completely different perspective (especially if that is what they were recruited for) as group think can make board room conversations rather stagnant or they may bring relevant sector expertise.

One business we worked with; said they saw it as crucial to hire people who thought completely differently to themselves so they looked for people such as philosophers to serve on their board (the company in this example was a European defence contractor).

In all the conversations I've had, I've heard good reasons to appoint NEDs and good reasons to approach these appointments with care. No matter the perspective, what stands out, the value that an outside perspective can bring to a family business and the balancing effect of an NED. If you want people who are going to help you develop your strategic direction as a company, who are part of your governance structure and involved in the oversight of your company's finances then it's crucial they get your essence as a business and as a family.

For an NED, it's critical they understand the role, the expectations and that they feel welcomed. Non-executive directors have a set of legal duties to comply with and must remember that whilst they are responsible for the running of the company, they are there in a non-executive capacity. The 'noses in, fingers out' approach.

When Should You Appoint an NED?

The complexity of your business and what makes up your family enterprise structure may be the indicator of when it's time to call on outside expertise and viewpoints. If that time is now, we hope this guide will serve you and help you along the way.

What non-executive directors can do for your company is expressed powerfully in the following quote:

"Many of the strongest and most admirable firms in the world...have implemented governance systems that make provisions for solving problems before they occur. They embody independent voices to counsel against poor or biased decisions."
Grant Gordon & Nigel Nicholson, Family Wars (Kogan Page, 2008)

RECRUITING AND APPOINTING NEDs

Many of the conversations we have with members, advisers and others about non-executive directors, are focused on the recruitment of said directors. Family businesses want to feel certain they get this as right as possible. That the NEDs they appoint understand them and their values and that they create the best possible circumstances for the appointees to be successful. In the following section, you'll find expert views and practitioner insights on this part of the process written from different perspectives.

Appointing Independent Non-Executive Directors

By Rhian-Anwen Hamill, Managing Director, RAH Partners Ltd.

Family businesses from large to small have been reviewing governance policies and structures over recent years with a view to strengthening boards with the right non-family non-executives. For some, the challenges brought about by the ongoing Covid pandemic have amplified any concerns they might have had; the pandemic has brought their needs more sharply into mind.

At the same time, senior non-executive candidates are more interested in family businesses than at any time in the last several decades, attracted by the perceived long-term horizons, the aversion to debt typically seen in family businesses and a perception of strong 'values' driving the business. These seek to balance commercial returns with important 'soft' – but key – aims. This positive backdrop makes for a richer environment of candidates from which to choose.

Before approaching candidates, families must be prepared to spend a considerable amount of time in discussions with their advisors, particularly if this is to be the first non-executive appointed. As well as discussing the parameters of the role, the family business should be able to articulate the culture of their firm and family, the 'rules' (over and above the articles of association, for example if there is a charter) of the family, the business and its ownership. During this consultation or briefing period, the family should be encouraged to make explicit what might be 'known' within the family but which is often taken for granted, hard to articulate or unspoken – but which is precisely that which external advisors and candidates need to be aware of if the external appointment is to succeed. Most family businesses have many written and unwritten rules of how the family operates; it is important to have a good understanding of these for successful recruitment to take place. This is also a good time to fully air any diverse views about the appointment: this can be hugely beneficial even if they are conflicting. A careful and well-run process with transparency and trust at its heart, which explores and does not close down debate raised by the feedback from seeing candidates, should synthesise these diverse views and provide a way forward if handled skilfully.

It is important that a non-executive director, as well as having the skills and experiences stipulated by the family, be an individual who is able to speak with both integrity and diplomacy with the family. Anyone perceived as overly 'political' in their past can be disruptive. In family businesses more than any other types, being able to show that fairness has been a guiding principle of every part of the process of appointment is key.

Investing time with recruiters so they can advocate persuasively is important. Giving them time to get to know candidates and reference them adequately is also important. Good recruiting is an incremental and painstaking process and it takes time to do it well.

Generally, the recruitment process for non-executives takes several months and is carried out on a fixed fee basis. Candidate compensation depends on the time commitment and the size of the enterprise as well as the experience of the successful candidate. Fees are generally lower than in recruiting executives.

Key Issues Families Most Need to Think About: Tips for Success

By Susanne Thorning Lund, Partner, Chair & Board Practice, Odgers Berndtson

You believe your family business could benefit from an NED's guidance, wisdom and advice, and that he or she could act as a valuable checks and balances on your business and leadership team too. But is everyone aligned on what they expect from that NED?

It is inevitable that there will be nuanced preferences and priorities amongst family owners, directors and the managers of a business. Their personal experiences, aspirations for self and their families, and the role they hold in the business will all influence their opinions.

Critically important to ensuring the successful contribution of NEDs therefore, is that careful thought is given to what you expect of that newcomer. Remember too that immediate business pressures will look different next year; an NED is not just for now, but for five-or-more years ahead.

Family Non-Executive Directors

Family NEDs are regarded as the custodians of the values, ethos and culture of the business. But their role can be a delicate balancing act. As directors, they carry fiduciary responsibility for the totality of the business and have equal obligation to all the businesses' many stakeholders – the employees, customers, suppliers and others.

Visible to all, family NEDs can become the lightning rod for other family members' ideas or grievances. They can be the go-to person for management who may seek to influence the decision-making of the family.

A family NED doesn't just represent one branch of a family, therefore careful consideration should be given to selecting family NEDs. Clarity of role is essential, all the better to help distinguish family relationships from business relationships.

Independent Non-Executive Directors

When appointing non-family NEDs (iNEDs), it is an understandable default to prioritise someone who has worked in a family business environment before. But the ability to influence sensitively and effectively exists in other multi-stakeholder environments.

It is a delicate balancing act to find individuals who will be sympathetic to the DNA of the family ownership, yet also be prepared to challenge family views sensitively. Emphasis must be on securing an individual with whom the board can build a trusted, long-term relationship. A willingness to engage beyond the boardroom is an essential ingredient, enabling the iNED to pick up the 'mood music' in the business and amongst the shareholders.

But iNEDs are not family and whilst they build respect and trust, the indispensable value that they bring, aside from heightened performance monitoring and breadth of perspective and guidance, is their objectivity and impartiality. From the point of view of the iNEDs, they would wish to be assured that the family is willing to listen and that they are able to express their views; how open and transparent are you prepared to be?

Appointing NEDs to a family business is undoubtedly complex. Reaching consensus on what is sought can be difficult. What mechanism does the family and board have for objectively evaluating the family's and the business' requirements over the medium/longer term, which will help to define what 'good' looks like in an NED? Will the chairman facilitate that discussion, or could an independent external advisor be beneficial?

I believe, that handled with sensitivity and with clarity of purpose, an iNED can be a valuable addition to any family enterprise.

The Role of the NED

By Richard Lane, Partner, Farrer & Co LLP

Over many years of advising family-owned businesses, various thorny issues have arisen in respect of the appointments of independent NEDs to the board. The introduction of an NED has generally been a very positive experience for both company and individual but there are times when this has not been the case and the following are a number of areas to address in order to avoid failures. I have set them out in broad chronological detail across the appointment.

- **What are you looking for from your NED?** – (This is considered elsewhere but I make no apologies for repeating this here.) Significant thought should be given on a regular basis as to why a board might benefit from the appointment of a new NED; what are the areas that are not being addressed by the current directors? Can you find an individual to take on these responsibilities? NEDs are usually appointed for their personal qualities, experience and specialist knowledge.
- **Get used to being constructively challenged** – We see many businesses where the existing directors have not historically been subject to robust and detailed challenge in respect of the business and its operations. The board must now be willing to be actively challenged by the NED. That is his or her role. The ability for the executive directors to listen to and take on board constructive criticism is key to the success of the NED appointment.
- **Set the scope of the NED's responsibilities** – Before the appointment, it is vital (for both sides) to agree a clear written scope of the NED's role and responsibilities. Test the NED. We have seen directors being appointed believing their role is completely different to that envisaged by the board.
- **Bringing external perspective** – Your NED is expected to bring external insight and the benefit of their wider commercial experience to the board table. There is an expectation that the NED will have a role in sharing that knowledge with fellow board members.

- **Introduction to the business** – any NED should want to see the business, walk the floors and meet the management before and during their appointment. This should be organised by the board.
- **Initial period** – In the appointment letter, agree that during an initial period it is possible for either party to walk away at short notice. There are times where the role or the chemistry just does not work. Agreeing a long notice period from day one can be an expensive mistake.
- **NEDs have a shelf life** – NEDs need to maintain their position of independence. We have seen over time that a number of independent NEDs lose their objectivity. That is the time for termination. Often there is agreed a maximum tenure in the initial appointment letter, perhaps an initial term of three years and the possibility of a maximum of one further term thereafter.

The Role of the NED

By John Dunn, Independent Director

The crucial role of the independent NED should take account of the following:

- To enable NEDs to play a productive role in helping a family business grow, the company ought to have both a plan for growth against which individual decisions can be evaluated and a decision-making process fit for purpose. Perhaps the most important role of the NEDs is to make sure these foundations are in place and that they evolve as circumstances warrant.
- On a periodic basis, the board ought to pressure test the growth plan and NEDs should play an active role in helping both anticipate/identify obstacles to achieving the plan and commercially sensible paths around the obstacles. Having truly independent NEDs improves the chances that this review process will be productive and not just an echo chamber exercise.
- As part of its pressure testing role, NEDs should take the lead in exposing the business to informed outsiders able to provide a helpful— sometimes even uncomfortable— perspective on industry and economic/social trends relevant to the business. This is necessary to help overcome the reality of many family businesses that neither the owners nor the executives have extensive experience outside the silo of a single business/industry. Doing this often requires persuading the family and executives to give outsiders a 'peek inside the tent.' This is hard but it is an effort worth making.

- As 'they' say—hope is not a plan. So, while financial projections and mission/value statements are useful, should be reviewed by the board regularly and help inform decisions, they are not a plan and should not be regarded as such.
- In many family businesses, NEDs must be involved in balancing the needs of the business with those of the family. To do that well requires NEDs able to recognise that the needs of business and family might differ and a family willing to provide candid guidance about its needs. Independent NEDs likely have greater ability to lead the balancing effort since they have greater freedom to be objective.
- A decision-making process fit for purpose is one based on well organised, professionally prepared background materials containing both relevant details and clear identification of what the executives believe to be important all presented on a timely basis so that NEDs have a fair chance to review and reflect. In general, I believe listed companies are well ahead of family businesses when it comes to decision-making processes that is fit for purpose. NEDs should focus on closing this gap.
- As a board member, I am inherently suspicious of presentations which are long on detail and short on headlines. They create concern that there is either a desire to hide important facts by burying them or an inability to differentiate between wheat and chaff. Neither is a happy conclusion to draw.

INTERVIEW

Interview with Martin Radvan, Non-Executive Director, Chipita SA, Global Advisor Economics of Mutuality Foundation (Geneva), Mentor & Consultant

Q: You have worked with family businesses in executive and non-exec capacities for many years. Given your experience, what would you say are the most important things family businesses should look for in an independent non-executive director?

A: The primary criteria of experience, diversity, interpersonal skills etc, are of course the same as in any NED appointment, so I will focus on those that are important for a private business. There is no single answer but the primary factor should be firstly to establish what 'evolutionary stage' the business is at. A 'first generation/start up' may require specific business skills to enhance the family entrepreneur, to fill gaps in their commercial experience or to bolster a unique business need. A 'second generation' phase could likely be looking for advice/skills supporting expansion; e.g. geographic, channel etc or specific commercial experiences, enabling them to advise/assist during this stage of the business. A mature family business should look not to replicate professional executive management skills, but to bring in experience and challenge from more diverse external sources providing fresh perspectives on what can be a relatively closed environment or bringing expertise on specific business strategies or challenges.

Q: What, in your experience, are the potential pitfalls when family businesses appoint independent NEDs?

A: The most obvious pitfall is to appoint a 'quasi-CEO.' Someone who is qualified and perhaps feels they should be running the business. This is damaging for both parties and can lead to significant disruption. Another potential pitfall is to appoint only retired company executives, as this can in turn lead to a very closed environment.

From the independent NED perspective, the most common pitfall is to attempt to 'play' the family dynamics. Families are by nature complex and it's very unlikely that any external party will grasp the agenda and nuances involved in family decisions. Not being part of that family process over years will make it impossible to fathom all the drivers in the discussion, so it is vital for the independent NED to state their open opinion as a business person reviewing the business case in front of them.

Q: What are your key recommendations to family businesses who are looking to appoint their first NED?

A: As stated earlier, be very clear as to what stage of evolution your business is at and what are your next three-year ambitions? Then look for someone who can support/advise in these areas or bring fresh insights and perspectives to an enduring business opportunity or challenge. Chemistry with the board/owners is of course vital, but guard against perceived factional appointments or favourites.

Q: Finally, what has most surprised you about being an NED?

A: Coming recently from a very 'hands on' operational role, my personal learning has been the broader horizon and timelines required to advise effectively. This is coupled with the recognition that, despite the extreme diversity of industry, language, geography, and business stage etc, there are striking similarities between the dynamics within various boards.

DUTIES AND RESPONSIBILITIES

Board directors are legally responsible for running the companies on whose boards they serve; their role therefore comes with a set of duties and responsibilities both on the part of the company and the director him or herself.

A board of directors owes its primary responsibility to the company and its shareholders. In legal terms, this duty is known as a fiduciary duty. Fulfilling a fiduciary duty typically requires more than would be required to meet a normal duty under the law.

According to government guidance (gov.uk), it is in return for the benefits of limited liability that a company must be open and transparent. Board directors are registered in Companies House and a company must send information about its activities, annual accounts and who controls it to Companies House. It must also give details of its directors, who as mentioned above are responsible for the running of the company. A company is expected to keep these details up to date during its lifetime.

The Companies Act 2006 identifies the duties of a director of a company as follows:

- **Duty to act within powers** – this means to act according to the company's constitution and that a director should only exercise their powers for the purpose for which they were granted
- **Duty to promote the success of the company** – a director must act in what he or she believes to be good faith to promote the success of the company, for the benefit of all its members
- **Duty to exercise independent judgement** – this does not prevent a director from acting in accordance with a company's constitution or agreements the company has entered into
- **Duty to exercise reasonable care, skill and diligence**
- **Duty to avoid conflicts of interest** - a director of a company must avoid a situation in which he/she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company

- **Duty not to accept benefits from third parties** – a director of a company must not accept a benefit from a third party conferred by reason of his/her being a director, or his/her doing (or not doing) anything as director
- **Duty to declare interest in proposed transaction or arrangement**

Additional information about the above duties and responsibilities can be found here.

The above lists the legal requirements of a board director. The contributions that a director makes to a board often go beyond these legal obligations and are covered widely in other segments of this publication.

PAY AND POLICIES

Many things make someone join a company board as a non-executive director and whilst conventional wisdom suggests that you should not appoint a non-executive director who needs the money, pay is an important factor in the type of talent a company is able to attract.

The IFB recently carried out a benchmarking survey to assess what factors influence non-executive director fees. Whilst geography, age of the firm or sector didn't have a significant impact on pay, the turnover of the company and the number of directors on the board did. The higher the turnover, the larger the board and the larger the fees paid to the non-executive director.

Non-Executive Director Pay in Family-Owned Businesses

By Carl Sjostrom, Founder, Viti Solutions

To attract and retain non-executive directors means offering suitable individuals an attractive opportunity to give up their time and expertise, as well as backing the business with their reputations. At first glance the fee structures tend to be simple: since these are not employees one typically pays a flat fee for board membership and may add to this where there are additional duties. Many companies use simple rules of thumb to determine fee levels, such as estimating the time requirement and multiplying it with a notional professional services rate, or paying in line with market data for a group of similar organisations. However, like with all remuneration, spending some time on the design may improve the quality of talent that can be attracted and the cost-effectiveness of the reward.

Most NED pay practices are derived from institutional investors' requirements, which may or may not be optimal for a family-owned business. For example, institutional investors prioritise independence from both management and shareholders, whereas a family may value qualities, such as proven trusted advisors, individuals that have expertise and experience that is rare or expensive, or someone who can act as an ambassador for the firm. Quoted companies also have accountabilities to a broad set of shareholders and are scrutinised in a different way for which there tends to be a premium. Simply budgeting time or looking at market data may therefore not be optimal when determining fees and the expected contributions of NEDs may not be as uniform for a family firm.

What the NED brings to the table tends to put the most pressure on fee differentiation within the board, but the role of the board itself tends to impact the positioning in the market. This is why the oft quoted correlation between size of company and NED fee rates often fails for many private companies, as there may be a premium or a discount depending on what the family needs the board to do. For example, the board may do less of the conventional oversight duties and instead be tasked with taking an invention from concept to commercialisation, preparing a sale or to only have partial oversight. Hence, some companies will need to pay differently to others - and some may want NEDs to participate in the firm's value growth whilst others will see incentive participation as a distraction. As with executive pay, the 'franchise' of the business vs. that of the individual NED will also matter greatly, i.e. who adds to the standing of the other?

The other aspect that families often struggle with is the governance of fees. Examples of points of friction are when family members have board roles, when an NEDs contribution begins to resemble an executive role and in the recognition of work for different committees of the board. To resolve this requires a robust set of principles and processes. It does not, however, need to be overly complicated. Defining and being clear on how the family wishes to see fees determined, what contributions will be valued and how fees should be delivered will go a long way to achieve a basis from which fees can be developed over time.

SECTION 2

FAMILY AND NON-FAMILY NEDS. WHAT'S THE DIFFERENCE?

In the governance of a family firm, it is key that family and non-family work well together and are aligned around the purpose of the company.

Non-family, or so-called independent, directors and family directors may have the same fiduciary responsibilities but they will interpret their roles differently. There is much to be gained from understanding these nuances and working to enhance them. The same is true for the relationship between the company board and the family/shareholders.

The following segments cover key aspects of the roles of family and independent NEDs and communication between the board and the family.

Family and Non-Family NED as the Role of the Lead Director?

By Carlos Arbesu Riera, Family Business Adviser, Globaliura, and Non-Executive Director

By definition, governance must be separated from management. As we know, in family businesses there is an inclination to have executives on the board serving as directors. That is the reason why the NED´s role is crucial on a family business board.

NEDs can be family or non-family, and each type brings different positive aspects to the board of directors. If possible, family businesses should try to have a good mix of family and non-family NEDs on their boards.

Family NEDs

Family NEDs are especially important on the family business board, because of their natural detachment from the skews of management involvement. But there are other positive aspects to consider:

- Sensitivity about the family purpose to governance: mission, vision for the future (long term) and values.
- Coordination and harmonisation of the different decision-making bodies and help to ensure the functioning of the whole governance system: management, board, shareholders.

- Family consensus that allows the adoption of fast decisions on important issues and serious matters.

A particular role to consider as family NED is that of the family council chair as a board member.

Non-Family NEDs

Non-family NEDs should be highly relevant for boards as long as they show respect for the independence of its functioning from management and family.

The things you should expect from your non-family NEDs include:

- Skills and experience focused on certain aspects of the business.
- Client focus and innovation, strategy and value creation.
- Knowledge of the business environment, markets and competition.
- Compliance and sensitivity for stakeholder issues and corporate social responsibility.
- Objectivity and impartiality in decision-making.

The Lead Director

A particular role to consider for non-family NEDs is that of the Lead Director. The Lead Director´s role will gain traction in the family business governance field. Its importance relies on two considerations. First, the Chair of the family business board can be a family executive and/or CEO, so in these cases there is a need to bring balance to its role. Second, the Chair of the family business board does not necessarily have much experience in governance and management of boards and directors, so the lead director role should help the chair in the leadership of the board.

- Helping the chair in the setting of the agenda of the board.
- Implementation of best practices of governance: reporting, information, etc.
- Coordinating the NEDs, family and non-family, but especially non-family.
- Leading the evaluation of the board and directors.
- Communication with shareholders and the family council.
- Coaching family members in management and/or board.

"For most companies but perhaps especially for family run businesses there can be 'accepted wisdom'" in policy and strategy. These might be approaches that have served well but that might not always be that wise! An NED will help the board use family culture wisely but not necessarily always.

A good NED will not be a devil's advocate i.e. challenging for challenges sake, but will have a range of skills and experiences that add breadth and texture to the board. Rather like the herbs & spices in a recipe, a small amount will add a great deal to the final result".

Stephen Falder, Owner and Non-Executive Director, HMG Paints Ltd

Communications Between the Family and the Board

By Juliette Johnson, Founder, Juliette Johnson Consultancy

Non-executive directors can be especially valuable in family businesses when they have the opportunity to play a wider role in carefully fostering communication between the family and the business and at times, amongst the family themselves. Their knowledge and objective criticism often bring much needed independence and objectivity to shareholder discussions coupled with their ability to build consensus between generations of the family; the board and family shareholders or its representative family council body; and between family and non-family executives.

With their unique ability to remain completely independent and objective, free from allegiance to any particular family branch or generation, and able to probe sensitive issues in ways that minimise the possibility of friction, NEDs are in an ideal position to enhance communications between the family and the business. Especially as shareholders become more distant and detached from the enterprise, keeping everyone informed and updated is a key part of maintaining shareholder confidence and gives wider reassurance that things are on track.

There will also be times when NEDs are required to help guide the shareholders on 'big-ticket' decisions on which family owners have the final say, such as a change in strategic direction, a big acquisition or a significant change in gearing. As the number of family shareholders not involved in the business grows, NED guidance and independent communication can be a real help in making these decisions and avoiding surprises. Having the NED as a sounding board, providing input, insight and objectivity, can be invaluable.

There may also be occasions where the NED needs to play a role assisting communication between family members within the business itself – disagreements on direction, the younger generation become frustrated or siblings/cousins with different approaches, to name a few. A respected NED is able to help to build partnerships between generations and different branches, ensuring everyone has a voice and feels well represented.

With its particular emphasis on communication, serving as an independent director in a family business is unlike other roles and requires particular skill and subtlety. Being a member of and representative of the board, but also being in a position where they're informed and able to consider the needs and concerns of shareholders, both those on the board and in the wider family, is a unique and delicate role, based on mutual trust and respect.

Not all NEDs can play this unique role but the right kind – one who understands family dynamics and aligns with the family's values and culture, has the ability to make a real impact. From early on, they need to build an understanding of how decisions are made in the family, the impact of the ownership structure and any particular idiosyncrasies that exist. They need to take the time to explore the wider family stakeholder relationships and understand how the family communicates its views to the business. All family businesses have their own style of communicating which may seem somewhat unusual, but the earlier this is understood, the easier the NED will find their feet and the greater the impact they can have in fostering the relationship and enhancing communication between the family and the board.

THE EXPERIENCE

James Viner, Family Non-Executive Director, EBS Group

James joined the EBS Group board four years ago, having previously been involved in large businesses for the past 30 years and a trustee for a number of charities.

James explains...

We've always had family members involved in running the business as well as independent NEDs. When the final family executive director was contemplating retirement; we developed a family charter with the help of external advisors, set up a family council and established the Family NED (FNED) role to be a bridge between family shareholders and the board. Our family council meets four times a year and the FNEDs attend ex-officio. We are now establishing a 'shadow council', with a view to involving the younger generation. We have 100+ shareholders, many of whom are under the age of 25, so engaging the next generation with the business is very important for the future.

As part of our family governance process, we looked at what shareholders wanted from their business e.g. in terms of investment vs. business activity. This led to a letter from the family shareholders to the board expressing the parameters within which the board should operate such as strategy, acquisitions and disposals, debt levels, dividend policy etc.

The Role

I have a job description that sets out my functions, responsibilities and KPIs. A key element of the role is acting as a link between the board and shareholders.

We have a great team of professional directors and managers. As NEDs, our role is primarily to support the people who run the business and bring outside expertise and perspective. It's also to be a family voice on the board and to represent the board to the shareholders.

Our Chairman, who became non-executive from 1 September 2020, was previously the only family member in a leadership role in the business. Family continuity has for that reason been high on the agenda. We've also had a bit of a restructure recently and there is now a good balance on the board between executive and non-executive members.

Striking the Right Balance

As I mentioned, we work hard to ensure that shareholders have the right level of information.

Getting the balance right is an interesting tension with a large shareholder base.

The Family Council will obviously have more information than everyone else but all shareholders need to be equally informed. Another interesting tension can be found in what the board does and doesn't share due to commercial sensitivities.

One of the challenges facing an NED is to manage different people's expectations and aspirations and to remain hands-off from the detail. For me personally it's been a great learning curve as I was used to big blue-chip businesses and being very involved in the day-to-day activity.

Issues on the Horizon

A key issue we are looking at is succession planning. How do you get the next generation interested and involved if you they don't necessarily feel excited about the business?

Also, we may need to structure things differently with the ongoing crisis becoming a catalyst for that change.

CULTURE, VALUES AND A COMPETITIVE EDGE

"A healthy corporate culture is a valuable asset, a source of competitive advantage and vital to the creation and protection of long-term value. It is the board's role to determine the purpose of the company and ensure that the company's values, strategy and business model are aligned to it. Directors should not wait for a crisis before they focus on company culture"

UK Financial Reporting Council, 2016

According to the management guru Peter Drucker, 'Culture eats strategy for breakfast'; this may have an even greater meaning for family firms as their culture is often heavily influenced by the values of the owning family and the why and how are often more important to family owners than the what. Whether written down, hung on walls or expressed when recruiting talent to the business, the culture and values of a family firm helps to shape the strategy and operation. What could be deemed the 'ways we do things around here'.

The emphasis on values and culture in family firms can act as a strong competitive advantage in attracting talent who look for more than financial remuneration.

In the following section, we look at the competitive advantage of family firms in bringing onboard the right non-executives, how values and culture can add value to the search and we look at the role of the board in setting, promoting and protecting family firm culture.

The Family Business Competitive Advantage for Talent

By Simon Fenton *et al*, Spencer Stuart

Joining the board of a well-run family-owned enterprise can be a very attractive prospect for a seasoned executive – an opportunity to help a business with a unique heritage and strong and distinctive culture through a critical stage of its development such as digital transformation or international expansion.

However, family businesses do need to choose wisely and recognise that not everyone with a stellar reputation in the corporate world will be a good fit for their board. The nature of the role, the stakeholders, the dynamic around the boardroom table, and the issues facing family-controlled firms can be very different, perplexing many a new non-executive from a non-family background.

When appointing a non-executive to serve as an independent voice in the boardroom it's important to be clear on several points: What you want them to contribute? Where are the boundaries? What topics are off limits? Who do they answer to? How involved will they be in the decision-making process?

It helps if the prospective non-executive has worked with a family business at some point in their career; this will reduce the likelihood that they become frustrated by an unorthodox governance framework or an opaque decision-making process. Independent non-executives need to be comfortable working alongside founders/owners who have a deep connection with the past; they also need to share a commitment to securing prosperity over the long term.

The most effective independent non-executives are mentally and emotionally flexible. They are content with being advisors and constructive agitators, willing to accept the limitations of their role, and sympathetic to the core values and complex relationship dynamics that often lie at the heart of a family business.

Adding independent directors to your board (two or three is ideal) is a critical step, especially when it is designed to expose the business to new thinking and much-needed expertise. While bringing a specialist onto the board can be a relatively inexpensive way of acquiring expertise, family businesses should be careful about using such an appointment to substitute for a lack of skills within the business.

The assessment of a potential independent non-executive director should be conducted with just as much thoroughness as when hiring a senior executive from outside the family. It is helpful to look beyond past achievements and pay particular attention to how the individual's style fits with the board culture. The good news is that excellent tools exist to help identify which experienced board directors and senior executives will work best inside your unique environment.

Providing there is clarity around roles and responsibilities, a willingness on the part of the family to be challenged, and a strong cultural fit, the benefits of having independent non-executives around the boardroom table are immense.

The Importance of Cultural Fit and Alignment of Values when Appointing External NEDs

By Harry Friend, Partner and Member of the Board Practice, Inzito

I would never argue that family businesses are better, they are just different. Within each family business, there are differences. Head-hunters need to mine deep enough to understand the difference, in order to deliver a successful search.

The value that independent directors can add to family businesses is hard to argue against. By appointing the best non-executive directors, businesses will often bolster their strategic plans and management processes, make more robust financing decisions, strengthen their succession plans and achieve greater continuity when control is passed between generations.

One key difference we need to be aware of when hiring for family businesses versus other companies, is in the way internal appointments are made. Often with internal appointments, years are spent assessing their capability to step-up to the plate whereas with an external search process, due diligence and assessment is done over a period of only weeks. It is therefore crucial to get external appointments right. We have to understand that an external appointment is often a big milestone for family businesses, as it can be a shift from what may have been the natural path of appointing someone internally, even to the board.

Another unique thing about family businesses is timeframe. Most family businesses have a clear view that they wish to hand over a bigger, better, more successful enterprise to future generations. Family businesses have a consistency of ownership and the ownership tends to have a longer timeframe - this has a bearing relevant to hiring non-family members. Because of this timeframe, their vision and values become fundamental, as they have sustained the business over the long term.

Non-executive directors joining the board of a family business cannot contribute and perform, unless they align very strongly with these values and vision. That is different to being comfortable with the values. In a family business, you cannot be misaligned with values. This may not be different or better than what you have to do when hiring for a Plc but headhunters have to understand the reasoning more deeply.

So, how do executive search firms identify these values? Sometimes they are written but sometimes we cannot read them - we feel them in the ether and in conversations. Often, we can see it with what they do beyond their business.

→ How do the family members interact?

- What relationship do they have with their local community?
- What investments do they make in their core business?
- And what risk appetite do they have?

These actions help gauge the sort of character and values that should be prevalent in any prospective independent non-executive director. Lifting the bonnet to identify these values requires careful handling.

Particular to family businesses is the deep sense of belonging and identity, and even the gentlest inquiry can feel like a personal invasion. Thus, it is crucial for the search partner to build secure relationships by demonstrating empathy, respect and care. In a Plc, you spend a lot of time dealing with shareholders but you don't live with them. In a family business, you live with the shareholders. It is only once this knowledge is acquired, that the cultural fit of candidates can be tested. This is achieved by the search firm diligently assessing individuals during the interview and referencing process, not only for their experience and knowledge, but their personality, behaviour and relationship building skills. The approach must include carefully crafted questions that are skilfully posed in order to surface rich and relevant insights. During the process of assessing cultural fit, it is important to reflect upon whether strong matches still allow for considerable diversity of thought and that candidates are able to share alternative perspectives sensitively.

The search partner also plays a key role in imparting business knowledge to candidates and highlighting the hallmarks of family businesses such as their long-term outlook and often complicated family relationships. This not only helps establish whether there is a fit, but also facilitates the smooth transition of the successful candidate. Furthermore, search partners must recognise challenges that emerge for their clients during engagements. Covid-19 is no exception. It may be that firms need support in bringing additional skills to the boardroom to help them maintain their culture and values in the era of remote working. As constant change remains a feature of the commercial landscape, businesses and their appointed search firms must work together seamlessly to generate maximum value from partnerships.

Culture as the 'Secret Sauce' of the Family Firm Preservation

By Carlos Augustin, Chief Engagement Officer, Axialent

While most family-owned businesses recognise that the long-term success depends on their people, they may not have been able to build a culture that sets a standard of behavior that will ensure lasting success and wealth preservation.

More often than not, family owned businesses fail because the family lacks a shared culture and set of values. It means when new members join the business, they are badly orientated and don't share the same vision: because there isn't one defined in culture, but only in words, at best. The family begins to argue amongst themselves instead of focusing on the business. This has an impact across the board: the 'it' dimension of the business and its capacity to preserve wealth; the 'we' dimension of relationships between family members; and the 'I' dimension, which may involve self-value and personal wellbeing

So, if you are concerned about long-term success, you should consider culture as the main responsibility of the board.

But what is Culture?

Culture can be an asset that supports family business success, or it can be a hindrance.

In most family-owned businesses, culture is created as a consequence of how the business and family dynamics are run over time (reactive approach). But in some family-owned businesses, culture is considered a strategic pillar, within these family-owned businesses, it is designed, developed and measured (proactive approach).

Few family-owned businesses can claim their culture as a competitive advantage. Those who do, recognise that it is an advantage that enables family wealth preservation and fosters the family bond.

Culture is a set of learnt beliefs, values and behaviours that have become the way of life in the family and in the business. It results from the messages that are received about "what is really valued around here". Most of these messages are non-verbal. Family members pick up these messages and adapt their behaviour to fit in.

Six key principles every family-owned business board should focus on to make culture a lever for long-term success.

1. **The desired culture:** The board should establish the family's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All family members must act with integrity, lead by example and promote the desired culture.

2. **Necessary resources:** The board should ensure that necessary resources are in place for the company to meet its objectives and measure

performance against them. The board should also establish a framework of prudent and effective control.

3. **The current culture:** The board should assess, understand, and monitor the current culture. When it is not satisfied that policy, practices or behaviour throughout the business family are aligned with the company's purpose, values and strategy, it should seek assurance that family leaders have taken corrective action.

4. **Leadership:** 'Shadow of the leaders falls long' so leaders have to 'walk the talk'. Leaders, in particular the family leaders, must embody the mindsets and behaviours aligned with the desired culture, embedding this at all levels and in every aspect of the business and family dynamics.

5. **Exercise stewardship:** Effective stewardship should include engagement about culture. Family members should challenge themselves about the behaviours they are encouraging in the family and in the business and to reflect on their own culture. Besides behaviours, there are other two sources of messages that shape culture: Symbols (how time is spent, rituals and stories, how budgets are allocated, etc.) and systems (planning and budgeting, performance review and reward, etc.).

6. **Communication:** The culture and values of a family business are not something you do to people, so we can't simply slap it up on the wall; instead, we need to create it and live it. Members of the family from the older generation to next generation should understand (and then tell others) what it means to work for our family business. Once purpose, values and culture have been defined, the real gains come from communicating it effectively to all stakeholders. The best way to do this is to tell a compelling story, to dig into the set of narrative structures that have underpinned mankind's stories over the eons and define the story of your business family.

So, are you ready to make culture the 'secret sauce' of your family firm preservation?

Board Reviews – Why and How?

By Peter Swabey, Policy & Research Director, The Governance Institute

For most of us, a performance appraisal and feedback are a regular part of our working life; one that we either welcome or approach with trepidation, depending on how well we perceive ourselves to have performed during the period under review, but most of us perceive this to be a healthy part of the employment process.

Boards of all organisations, large or small, are no different and can benefit from a periodic review of how well they are performing, both as individual members and as a team. There are two reasons for this: firstly, for self-development, both individually and collectively, as a tool to improve performance. And, secondly, to provide reassurance both to themselves and to other stakeholders that the board is performing its duties effectively. As Jonathan Sumption QC commented,

"The prime risk that shareholders take is that the management of a company will mismanage it."

This has become regularised practice both in the UK and, increasingly, throughout the world. For example, the UK Corporate Governance Code states that "There should be a formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors. The chair should consider having a regular externally facilitated board evaluation. In FTSE 350 companies this should happen at least every three years. The external evaluator should be identified in the annual report and a statement made about any other connection it has with the company or individual directors."

How, then, should an organisation prepare for a board review? Probably the most important factor to consider is what you are seeking to achieve. A board review being undertaken for its own sake or to meet a compliance requirement is unlikely to be insightful but a board review where there is a specific problem that needs to be addressed is likely to be very different from one where the central issue is a health check or guarding against complacency or inertia. Another, almost as important factor, is the wholehearted support of the chair and, to a lesser extent, the rest of the board. If the board has not bought into the process, then again, the outcome is likely to be less valuable.

Once the purpose of the review is identified, the organisation can decide whether to seek an internal review, perhaps led by a senior director or by the company secretary or governance professional, or a review facilitated by an external service provider. The reasons for this decision and the choice of any external provider should be carefully documented and reported on to stakeholders as appropriate. In either event, key requirements are confidentiality and independence, even for an internal review - directors are unlikely to speak freely if they are not confident that their views will not be reported back in detail. Any review must be honest and rigorous if it is to be effective and it must offer the organisation a clear and time-based action plan for any changes that may be identified. Progress against identified actions should be monitored and, where applicable, reported.

CORPORATE GOVERNANCE AND THE ROLE OF THE NED

"Corporate governance measures lead to long-term success and keep peace in the family. Corporate governance measures at the family and business levels provide good solutions to family ownership challenges and often are indispensable to the long-term success of the family business—and peace in the controlling family, especially with succeeding generations".

Report, 5 Governance Challenges for Family-Owned Businesses, OECD

As the above quote and the following contributions show, there is much a family business can gain from implementing good corporate governance. This along with culture is very much the essence of the role of the board.

In 2018, the IFB was part of the BEIS coalition who developed the Wates Principles under Sir James Wates' leadership as chair of the group. The Principles were developed to make it both meaningful and as easy as possible for private businesses to report against them. You will see them referenced in Sir James' closing piece below.

Necessary Skills and Abilities of the Family Business Board

By John Dunn, Independent Non-Executive Director

Sometimes stating the obvious is brilliant. That is certainly the case with the Wates Principles and their guidance says that: "effective board composition requires... a balance of skills, backgrounds, experience and knowledge." This is a magnificent and user-friendly description of diversity and vastly superior to the check the box approach which has become all too common.

Highly noteworthy guidance from the Principles is the idea that no group of NEDs can be as productive/helpful as they should be if they all come out of the same silo. So, while board search specifications emphasising industry and exec/c-suite experience and narrow subject matter expertise may capture what the owners believe they want, they may not describe what the business really needs.

Specific skills useful to being an effective NED include a solid record of being:

1. A curious learner able and willing both to acquire and absorb information
2. A good listener able to formulate questions in a constructive manner
3. An effective 360 communicator

The acid test of 360 communication skills is whether the person has the ability to effectively tell owners, execs and fellow board members what they need to hear knowing it is not what they would like to hear. Also, can the person ask pertinent questions that constructively challenge approaches and ideas that insiders hold dear.

The acid test of listening/constructive questioning skills is the ability to ask questions which constructively challenge approaches/ideas that seem so obvious to insiders they believe them to be beyond challenge.

Experience with family businesses is another desirable skill for NEDs. This is so because family businesses often have their own decision-making parameters and timelines. An NED with family business experience—in whatever capacity—will be better able to understand and adjust to this reality. Adjusting that includes accepting that one's advice might not be followed.

The need for a balance of skills etc. should not come at the price of foregoing good personal chemistry amongst the board because without good chemistry the board's experience—no matter how balanced and impressive—will not be deliverable on a user-friendly basis. The Chair has a special role in creating/maintaining chemistry. The Chair's task will be easier if NEDs have a track record of working successfully in a team setting with individuals from different backgrounds, experience and skills.

The Wates Principles and Legislation

Sir James Wates, Chairman, Wates Group and IFB

From my decades of experience in the Wates Group, and especially as Chairman of the company since 2013, I know that non-executive directors can make an extremely positive contribution to the governance of a family-owned company.

This conviction was at the front of my mind as I worked with a Coalition Group and the Financial Reporting Council in 2018 to develop the Wates Corporate Governance Principles for Large Private Companies.

Those principles, available on the FRC website, were developed in parallel to the Government's introduction of the Companies (Miscellaneous Reporting) Regulations 2018, which requires large private companies to disclose their corporate governance arrangements in their directors' reports. This applies to companies with more than 2,000 employees or those with a balance sheet of more than £2 billion and annual turnover of £200 million. This means there are very diverse companies who are needing a structure upon which to evaluate and improve their governance: not just family businesses, but wholly-owned subsidiaries of listed companies and private equity owned ones as well.

Accordingly, we avoided taking a tick-box approach. The guidance provided in the publication refrains from the sort of prescriptive provisions that are in the UK Corporate Governance Code for premium listed companies, and we stopped short of saying that all boards must include non-executive directors.

Nonetheless, the Coalition Group felt strongly that non-executive directors are a hugely valuable element of good corporate governance, and the guidance we drafted clearly highlights their benefits.

Nowhere is this more prominent in the Wates Principles than in Principle Two: Board Composition. Both the principle itself and the accompanying guidance establish the need for diversity on the board and a combination of skills, backgrounds, experience and knowledge held by directors.

The guidance says: "Companies should consider the value of appointing independent non-executive directors to offer constructive challenge. Appointment of independent non-executive directors should be subject to a transparent procedure."

Furthermore, the guidance notes that "Regular evaluation of the board can help individual directors to contribute effectively and highlight the strengths and weaknesses of the board as a whole." I believe that non-executive directors – and especially those who are independent and have experience sitting on other boards – can play a significant role here.

The need for independent challenge runs throughout the Wates Principles and is picked up again in the guidance for Principle Three: Director Responsibilities: "The provision of independent challenge in board and committee decision-making should mitigate the risk of individuals having unfettered powers. Independent challenge encourages constructive problem-solving that benefits companies in the long-term."

In addition, the guidance to Principle Three emphasises the importance of ensuring that 'the quality and integrity of information provided to [the board] is reliable'. The expertise, external frames of reference, and independence of non-executive directors mean they can play a valuable role here.

While every company is different, good practice – as, for example, articulated in the UK Corporate Governance Code for premium listed companies – suggests that certain board committees – on audit and remuneration, for example – are best chaired by non-executive directors.

Indeed, the guidance for Principle Five: Remuneration explicitly states that "The establishment of a committee is a way some boards may wish to delegate responsibility for designing remuneration policies and structures for directors and senior management. Such a committee might benefit from the contribution of an independent non-executive director."

I also believe that non-executive directors can add value in identifying and managing conflicts of interest (which is mentioned in the guidance for Principles One and Three). And with their externally-facing perspectives, non-executive directors can ensure consideration of reputational risk and best-practice tools in developing an internal control framework to evaluate opportunity and risk (described in Principle Four).

So, across the range of the Wates Principles, non-executive directors will be beneficial. I would think that any company applying the Wates Principles rigorously would come to the conclusion that non-executive directors are an essential aspect of good governance.

ACKNOWLEDGEMENTS

We hope this guide is helpful to you and that it has given you new insights or confirmed existing knowledge about the importance and potential of non-executive directors. We also hope that you find the guidance in this booklet informative and that it will act as a point of reference for you on the many different stages of your NED journey.

We are extremely grateful to all our contributors who have penned valuable contributions in their areas of expertise and experience.

You can find out more about all the contributors by contacting the IFB at info@ifb.org.uk

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