

# Board recognition and reward

Now that the family has put its governing board in place it faces the challenge of how to effectively communicate with the directors and how to reward them. Randel Carlock and Ludo Van der Heyden offer some advice

One of the concerns that business families face when inviting independent directors to their board is how to professionally manage these new board members and to ensure that these invitations lead to higher performance.

The most important factor in motivating and retaining good board members is structuring an environment that is both professionally challenging and personally rewarding.

Talented professionals demand clear, professional expectations and guidelines for the roles they will assume and for their relationships with executives and family members.

In short, both groups need to consider the following issues:

- What is the board's relationship with the family and the existing ownership groups?
- What policies and processes does the board need to function effectively (eg, term of office, the role of the chair, relationships with the family)?
- How will directors be rewarded?

## RELATIONSHIPS WITH EXECUTIVES AND THE FAMILY

An important consideration when professionalising a family business board with independent directors is defining the board's relationship with influential shareholders, the shareholders' assembly, and the family council.

***"Good governance requires careful planning and coordination between the family, the board and the executive team"***

In closely-held firms governance is often too informal and excessively based on seniority with insufficient clarity on decision-making authority. Conflict will inevitably arise when a professional board is expecting to be ultimately responsible for governance, but in reality discovers that they are left out of key discussions, not given full informa-

## SYMPTOMS SIGNALLING POOR BOARD PERFORMANCE

- Meetings dull and boring.
- Limited chance to get to know board peers.
- Board chair is not a leader.
- Board learns about major events or decisions out of board context (informal discussions or, even worse, in the newspaper).
- Board frustrated at being held unfairly responsible for problems while not feeling it directs anything.
- Board doesn't know senior executives, important staff or shareholders.
- No one asks the board what they can contribute or what is expected from them.
- No board communications between scheduled meetings.
- Board discusses, but doesn't identify, concrete action agenda for executives which the latter will report on at stipulated time.
- Board lacks timely and detailed information on the business.

tion or, in the worst case, overruled by family members without any explanation.

Interviews with directors about satisfaction with their board roles identified several issues that left them feeling disconnected from the governance process. There are governance practices that directors found undermined their role and reduced their motivation to prepare and attend board meetings, engage in board discussions and, ultimately, consider re-election (see above).

What is distinct about governance in family firms is that good governance requires careful and detailed planning and coordination between the family, the board and the executive team. The first benefit of independent directors is that they lead to a formalisation and professionalisation of business discussions.

They also help to improve relationships between executives and the family that were unclear – ranging from excessively distant at times to unnecessarily close and intervening at others. It is often this complexity that creates

conflicts, rather than the underlying issues themselves.

Meeting the professional expectations of the independent directors also leads to similar benefits for family board and family council members whose motivation typically increases as well.

One golden rule for family members engaged in family businesses is to be more professional in relationships (rather than less), whether this pertains to family members, executives, or board members. Professional board members, if well chosen, can lead the way in this regard.

### BOARD POLICIES AND STRUCTURES

Directors are elected for terms set by the corporation's charter or by-laws and typically serve three to five year terms with the possibility of a certain number of renewals to follow.

Traditionally, businesses had a stated retirement age for directors, but more enlightened firms have recognised that capability may be a more relevant factor than a director's age.

***"A high-performing board is a well-functioning team led by a chair who builds effective working relationships within the board"***

As soon as a family or its executive team learns of the benefits of good governance, they soon realise that a key ingredient to board success is the proper selection and introduction of new board directors.

It is essential that both the chair and the family are involved in these discussions following an explicit and transparent process. This selection certainly cannot be left to the board itself as is more typically the case in a publicly-listed firm where the board too often has a full hand in determining its own destiny.

Poor board performance often leads to poor business performance and opportunities for private equity funds whose first action often is to restore effective governance practice.

A last point in terms of membership terms is to consider a maximum number of renewals. However good outside directors are, they gradually and unavoidably start to look and talk like insiders. In addition, most of us do not have an infinite repertoire of skills and competences. For both of these reasons, we view it as good governance to limit the maximum number of consecutive terms served by outside directors to two or three.

Though this has a cost in terms of functioning, it is the best way to ensure that an outside view remains present at the top.

Retiring board members do not need to be forgotten or ignored, as they then grow the firm's network of advisors and relationships – something that can be very useful to the

## THE CHAIR'S LEADERSHIP RESPONSIBILITIES

- Chair board meetings.
- Coach board members and supervise board committees.
- Communicate with the senior executives, family and shareholders.
- Lead the assessment of the company, the performance of the CEO and the senior executives' performance, and that of the board itself.
- Organise agenda and information sharing (including presentations and reports to shareholders and family members).
- Monitor the firm's strategic, financial and organisational position.
- Advise and support the CEO and executive team.
- Continuously improve governance processes.

firm's continued development and needs to be managed as well.

A high-performing board is a well-functioning team led by a chair who builds effective working relationships within the board and between the board, the shareholders and the firm's executives, principally its CEO.

The firm's governance relationships are the chair's responsibility. In this regard, the chair may benefit from a clearer title, such as chief governance officer (CGO). This more adequately describes the role as being complementary with that of the CEO.

The chair, together with the board members, sees to it that the firm benefits from proper and effective governance processes, much like the CEO leads the management and business. Board members, and particularly independent directors, need an effective chair to represent them and ensure that they have the resources and information to perform their assigned responsibilities.

A full discussion of the CGO role is beyond the scope of this article but it is important to realise that an effective chair is a critical factor in the board's performance and contribution (see above).

The notion of a "team at the top" is helpful in this regard. This certainly will be the case with regards to relationships with executives, the team notion replacing the traditional notion of hierarchy. Again, viewing particular family members – eg, with responsibilities for the family through its council – as part of that team at the top of the family business is a distinctive and important characteristic of family firms.

### COMPENSATING AND REWARDING DIRECTORS

It is quite a common fact that most directors in firms are not serving primarily for the compensation they receive but rather for the intrinsic or psychological rewards that come from working for a family with talented and interesting people, helping others face new business challenges, or supporting them to develop new personal competencies.

This is particularly the case in family firms, where a relationship with the family often can be very rewarding. Hence,

the true reward system may lie more in developing a context for meaningful and effective board functioning than in any financial reward system. This is not to say that the reward system is not important, or can be dismissed.

Our view is that the reward system needs to be simple to administer, fairly applied and based on both extrinsic (money, prestige) and intrinsic (meaningful experiences, personal development) rewards.

On the financial side, we recommend a simple calculation that we call "the Rule of 250ths" for determining the financial compensation for board members.

This model is based on calculating the CEO's daily compensation based on 250 days of work. If the CEO is paid €500,000 annually a board member would receive the CEO's daily rate or €2,000 for each day of board activity.

To ensure that the board member is well prepared we suggest adding one day for board preparation and travel. For example, if the board has four one-day meetings per year, board members would under this rule receive a total of eight days of daily CEO compensation, or €16,000.

Additional activities, such as serving on board committees or an annual board retreat would be compensated on the same basis, and would be added.

***"A professional board requires an investment in time and resources to ensure that the family accepts this change"***

The CEO's compensation typically reflects the firm's size and complexity and this guideline automatically accounts for the latter. It provides a simple process for aligning the board's compensation with that of the firm's senior executive, immediately removing importance comparisons and putting them on the same level.

Additionally, we recommend that the shareholders, management, and family members recognise the board's contribution.

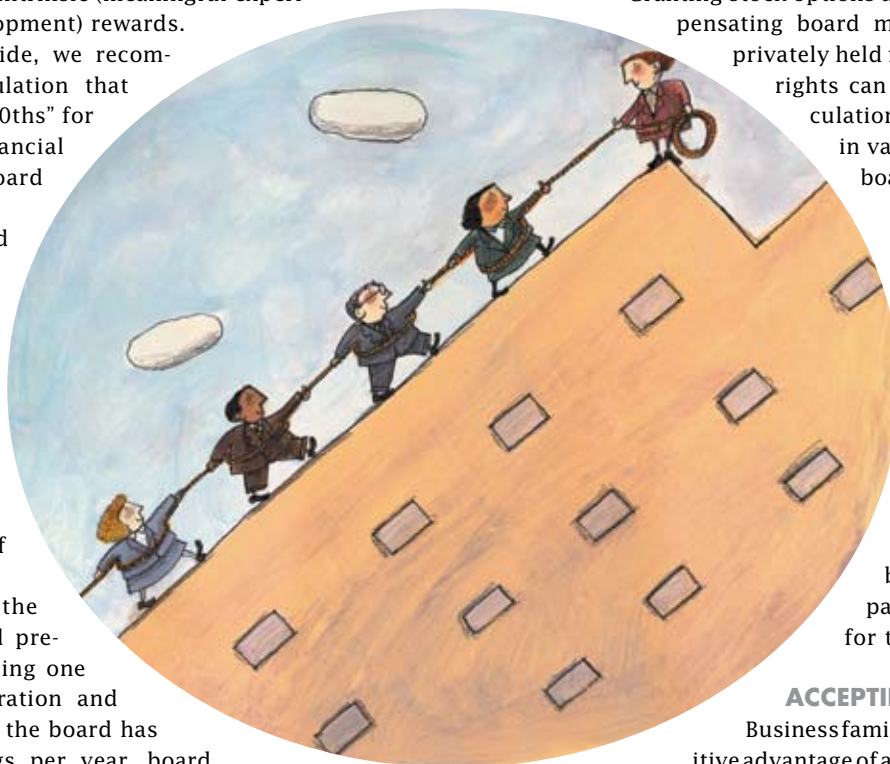
Use of company facilities and discounts on the company's

products (at the same level as the executives benefit) would be equally good ideas, with excellent payoff in terms of board commitment.

However, families would do well to remember that it is the social rewards of being recognised and being "part of the family" that might motivate many directors.

Granting stock options are another tool for compensating board members for service. In privately held firms stock appreciation rights can be created using a calculation of the firm's increase in value that occurs during a board member's service.

While much has been written on the subject, we recommend that board members be prohibited from exercising such options for considerable time – say a minimum of 10 years, so as to compensate for long term value gain, and remind board members a principal duty is value creation for the next generation.



**By working as a team, the board's performance will be greater**

## ACCEPTING CHANGE

Business families that want the competitive advantage of a professional board must appreciate that independent directors change the nature of the family's relationship with its business and with itself. It requires new and more professional thinking and behaviours.

A professional board requires an investment in time and resources to ensure that the family accepts this change in its role, that the board has an accurate understanding of its role and that everyone fully recognises how the board's performance contributes value to the business and family, economically and emotionally.

Given that the value of governance is far from fully shared even in publicly listed firms across the world, we can see that the opportunity for improvement in this regard is considerable amongst family firms. ●

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**Bonus feature:** To find out what the authors advise families to do in order to effectively evaluate a board member's performance, visit our website: [www.familiesinbusiness.net](http://www.familiesinbusiness.net)