

# **FAMILY BUSINESS GOVERNANCE AND INDEPENDENT DIRECTORS: THE CHALLENGES FACING AN INDEPENDENT FAMILY BUSINESS BOARD**

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## I. INTRODUCTION<sup>1</sup>

The primary purpose of this article is to identify, analyze and decipher the multifarious challenges of instituting fully independent boards of directors in family-run<sup>2</sup> companies, as well as to prescribe recommendations for these challenges. As more family businesses are established in North America, Asia, and other parts of the world, and as existing family-controlled enterprises are continuously being run and fortified by enterprising families, there is a constant rethinking on their business governance structure. Since a great majority of family businesses do not last beyond the first or second generation if not governed responsibly, the ultimate question is whether or not strategically placing independent directors will help empower these close corporations to last

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1. I express my great appreciation to my Wharton professor on Strategies and Practices of Family-controlled Companies, Prof. William Alexander, for providing useful insights and academic guidance during the development of this paper. I also sincerely thank Mr. Philip Clemens, Chairman and CEO of The Clemens Family Corporation and Hatfield Quality Meats, for sharing his time and practical wisdom on the independent board of his family company.

2. "Family-run," "family-controlled" and "family business" will be used interchangeably throughout the article. A family-run business is "typically one in which more than half the shares are controlled by members of the same family, or one that has been passed between generations." Business Link, Family-Run Businesses, <http://www.businesslink.gov.uk/bdotg/action/layer?topicId=1074039321> (last visited Apr. 22, 2008). Family businesses can also be described as "organizations where two or more extended family members influence the direction of the business through the exercise of kinship ties, management roles, or ownership rights." Renato Tagiuri, *Working With Relatives in the Family Firm*, HARV. BUS. SCH. Note 9-902-424, Feb. 2002, at 1.

beyond their expected lifecycles.

One of the basic questions that typically arise relates to whether there is a need for a board of directors to be established as the main governance structure. This question is premised on the ominous fact that family-controlled businesses<sup>3</sup> have restricted shares, have no open market for stock transfers, and may not necessarily be as large as publicly-held companies (with exceptions, of course). If there is a need for a board of directors, when should it be established in the history of the entity? Once instituted, who will populate the board of directors and why? Should all the seats in the board be occupied by the same family owners or should independent directors take their seats? Why should independent directors take the seats of family members who have run and developed the company for decades? What are the critical functions of independent directors and what do they bring to the table? Lastly, what should be the board's recommended composition (i.e., the configuration between insider and independent directors), the length of their terms of office, the number of boards (both family-run and publicly-held corporations) they can adequately serve on without sacrificing quality and dedication to work, the background of these independent directors, and compensation? Moreover, Dyer asks, "What should be the role and function of the board—rubberstamp, advisory, paper, or overseer?"<sup>4</sup>

Also known as close corporations,<sup>5</sup> family-run enterprises have been the backbone of industrial development in highly developed countries for a long period of time. From simple sole proprietorships and "mom-and-pop shops,"<sup>6</sup> to the United States' 33 of the world's 100 largest family businesses,<sup>7</sup> the United Kingdom's centuries-old royal companies,<sup>8</sup>

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3. Family-controlled businesses are described as "businesses, whether public or private, in which a family controls the largest block of shares or votes and has one or more of its members in key management positions." DANNY MILLER & ISABEL LE BRETON-MILLER, *MANAGING FOR THE LONG RUN: LESSONS IN COMPETITIVE ADVANTAGE FROM GREAT FAMILY BUSINESSES* 2 (2005).

4. W. GIBB DYER, JR., *CULTURAL CHANGE IN FAMILY FIRMS: ANTICIPATING AND MANAGING BUSINESS AND FAMILY TRANSITIONS* 67 (1986).

5. A close corporation cannot exceed thirty shareholders and is eligible to elect "S" Corporation status with the IRS. The stockholder has limited disposition of the shares. Close corporations cannot also make public offerings as defined in the Securities Act of 1933. DEL. CODE ANN. tit. 8, § 342 (2008).

6. DAVID S. LANDES, *DYNASTIES: FORTUNES AND MISFORTUNES OF THE WORLD'S GREAT FAMILY BUSINESSES* xi (2006).

7. Jane A. Pearl and Leah Kristie, *The World's Largest Family Businesses: Spotlighting the Wealthiest of the Wealthy*, *FAM. BUS. MAG.* <http://familybusinessmagazine.com/WorldsLargestFBs.html> (last visited Oct. 4, 2009).

8. See Leah Kristie, *The World's Oldest Family Companies: Cheers to the Survivors*, *FAM. BUS. MAG.* <http://familybusinessmagazine.com/worldsoldest.html> (last visited Oct. 4, 2009) (noting that family businesses have been suppliers of military fabrics for British troops, builders of royal palaces and residences, clothing retailers and tailors, shipping

Germany's family-owned and run small- and medium-sized businesses known as Mittelstand companies,<sup>9</sup> Japan's family-dominated pre-war *zaibatsu* conglomerates,<sup>10</sup> and Korea's family-controlled, government-assisted corporate umbrella organizations known as *chaebol*,<sup>11</sup> family businesses have served as the ultimate engines of growth and pushed world economies to where they have never been before. Family-owned and run companies constitute "a bedrock of commercial activity and creativity"<sup>12</sup> in every country in the world. Sadly, despite their integral and incomparable contributions to fueling economies and creating wealth in the world, some family businesses have earned the negative reputation of being severely dominated by a family patriarch or matriarch, his or her children or heirs. These dominating figures are often resistant to change, adamantly refuse to listen to outside advice, are unfriendly to independent directors, and establish boards filled with insider and grey directors. Numerous studies have been conducted on why controlling family members behave this way.

In the last twenty or so years, spurred not only by the need to mimic the move to independent boards by publicly-held institutions,<sup>13</sup> but also because of the valuable direction and monitoring provided by independent directors, family-controlled companies have been slowly shifting strategies by adding more independent members to their boards. The globalized business environment has also encouraged family firms to explore this option. Some companies have maintained an almost equal number of insiders and independents on the board. Others have gone to the extent of placing a clear supermajority of independent directors on the board. It is becoming the prevalent view that independent directors and independent boards help ease and minimize the problems normally associated with family-run businesses.

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agents, pottery makers, spinners, bankers, military uniform suppliers, and the like).

9. During the May 2008 Berkshire Hathaway annual shareholders' meeting, Warren Buffet announced that his company is interested in acquiring German family-run and owned businesses to establish its presence in Europe. Alistair Barr, *Berkshire Eyes German Family-owned Businesses*, MARKETWATCH, May 3, 2008, <http://www.marketwatch.com/story/berkshire-eyes-german-family-owned-businesses>.

10. See Haruhito Takeda, *Corporate Governance in the Inter-War Zaibatsu*, in *THE DEVELOPMENT OF CORPORATE GOVERNANCE IN JAPAN AND BRITAIN* 59, 62-63 (Robert Fitzgerald & Etsuo Abe eds., 2004) ("The principle of ownership was based on investment exclusivity, the limiting of investors to the same family, and the tendency to exclude potential sources of capital from outside the family."). Zaibatsu conglomerates were cartel-driven, tightly held companies that were structured as large holding companies. They typically supplied government requirements. *Id.*

11. Thayer Watkins, *Chaebol of South Korea*, <http://www.sjsu.edu/faculty/watkins/chaebol.htm> (last visited April 30, 2008).

12. Richard M. Clarke, *Family Dynamics and Board Duties: A Delicate Balance*, *FAM. BUS. MAG.*, Winter 2007, at 1.

13. Guido Corbetta & Carlo A. Salvato, *The Board of Directors in Family Firms: One Size Fits All?*, 17 *FAM. BUS. REV.* 119, 119-20 (June 2004).

This paper seeks to provide an analysis and synthesis of the issues, challenges, and resolutions facing family companies with regard to independent boards. It cites the strong advantages of purposefully placing highly competent independent directors as overseers, guides, analysts, monitoring agents, change catalysts, mentors, stewards, and sounding boards to and of the CEO, the successor, and other family members actively participating in running the business. The time has arrived when the patriarch or matriarch no longer holds the business together all by himself or herself,<sup>14</sup> or even with the aid of a responsible son or a daughter. Individual or sole leadership has had its day and its time has passed. Independent directors, as the new stewards, help steer the hands of these once ultra powerful individuals and families towards a better, more defined, socially responsible, genuinely empowered, and ethically governed stewardship of the family business in the hopes that it shall survive and thrive beyond a hundred or more years of creditable existence.<sup>15</sup>

## II. THE FAMILY BUSINESS CONTEXT

There are plenty of reasons why families go into business. For some, entrepreneurship is something coincidental, accidental, and unintended, leading to financial success and consistent business growth years later. Others have started a business to create a challenge after retirement, to augment a meager family income, to avoid starvation and poverty,<sup>16</sup> to support siblings, or for “meeting the needs.”<sup>17</sup> Some continue on the legacies of past generations by growing existing businesses. There are also individuals who craved for financial stability as a result of immigration and turned to business as their way to achieve this goal.<sup>18</sup> It has likewise served as an avenue of self-expression and self-enterprise. Donald Trump jumpstarted his career in his family’s real estate business in New York after studying at the Wharton Business School. Charles Henry Dow, Edward Davis Jones, and Charles Milford Bergstresser started Dow Jones & Co. in

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14. See ELFREN SICANGCO CRUZ, *SETTING FRAMEWORKS: FAMILY BUSINESS AND STRATEGIC MANAGEMENT* 75 (2005) (noting the need for family businesses to institute a board of directors in order to become globally competitive).

15. This is in contrast to the short life span which characterizes many family-run businesses. See generally JOHN L. WARD, *KEEPING THE FAMILY BUSINESS HEALTHY* (1987) (analyzing the challenges of maintaining the long-term health of a family-run business).

16. Gordon Brannan, *Bhiwar Enterprises*, Richard Ivey School of Business, The University of Western Ontario 9A86C051, Feb. 2007, at 1.

17. Michael J. Roberts, Sam Steinberg (A) and (B) (Condensed), *HARV. BUS. SCH. Note* 9-392-044, Mar. 1993, at 3-4.

18. Alexis Gendron, *Iggy’s Bread of the World*, *HARV. BUS. SCH. Note* 9-801-282, Mar. 2001, at 2-8.

a small basement office in New York in 1882 to help Wall Street analyze the rise and fall of securities, setting the stage for Hugh Bancroft to become Dow Jones president in 1928 (and creating a family empire in the process).<sup>19</sup> Warren Buffet started off by working at the investment company Graham-Newman, and after gaining some experience, he went back to Omaha and began a limited investing fund partnership with a group of friends, family, and associates called the Buffett Partnerships Ltd.--the staging ground for his highly successful Berkshire Hathaway.<sup>20</sup> These are immensely entrepreneurial people who started small with self-run family businesses that later graduated into large conglomerates. The short end of it is that there are a variety of reasons why people start family businesses. In fact, some first generation entrepreneurs may totally be unaware that they are building the foundations of multinational business organizations.

There are two theories commonly applied to corporate entities in general. The Agency theory espouses the view that, in the context of a board, directors are seen as agents and managers of the institution whose vital task is to protect the interests of only the shareholders as residual owners of the company.<sup>21</sup> They monitor the CEO and the implementation of corporate strategies, determine the level of CEO pay, plan for company succession,<sup>22</sup> and provide overarching supervision. These activities and functions allow the directors to ensure that officers are performing their roles in alignment with the interests of the shareholders.

In contrast to the Agency theory, the Stewardship theory is keenly interested in ascertaining that the directors' interests and motivations are aligned with the goals and objectives of the organization as a whole. This means that the steward's interest is aligned with the stakeholders'. Under this theory, the "board's primary role is to service and advise, rather than to

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19. Dow Jones and the Wall Street Journal are now securely owned by Rupert Murdoch after an emotional tug of war between Murdoch and the Bancroft family. See Joe Nocera, *A Family's Benign Neglect at Dow Jones*, N.Y. TIMES, Aug. 4, 2007, <http://select.nytimes.com/2007/08/04/business/04nocera.html?scp=1&sq=how+the+bancrofts+blew+it&st=nyt> (reporting Murdoch's takeover of the Wall Street Journal from the Bancroft family).

20. See Wall Street Week with Fortune, 'The Best Advice I Ever Got': Warren Buffett, Mar. 7, 2005, [http://www.pbs.org/wsw/news/fortunearticle\\_20050307\\_01.html](http://www.pbs.org/wsw/news/fortunearticle_20050307_01.html) (last visited on April 23, 2008) (chronicling Buffett's rise to prominence). See also Woopidoo! Biographies, Warren Edward Buffett Biography, [http://www.woopidoo.com/biography/warren\\_buffett.htm](http://www.woopidoo.com/biography/warren_buffett.htm) (last visited on April 23, 2008) (providing a concise biography of Warren Buffett).

21. See generally Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & ECON. 301 (1983) (analyzing the results of the separation of decision-making and risk-bearing functions within business structures).

22. See Barbara Spector, *Mike Henningsen's Bright Idea*, FAM. BUS. MAG., Winter 2003, at 1177-80 (noting that non-family boards of directors ensure objectivity in succession planning).

discipline and monitor, as agency theory prescribes.”<sup>23</sup> Stewardship as a model emphasizes: (a) values of service over self-interest; (b) responsibility by prioritizing long-term gains and values over short-term, myopic greed; (c) and develops good governance, clear working processes, open communications, and encompassing empowerment.<sup>24</sup> Collectivist and stakeholder-oriented, stewardship fittingly applies to the family business model setting.

Some scholars<sup>25</sup> suggest that a board dominated by insiders or company-affiliated directors (also known as “grey directors”) is a correct match for a company practicing stewardship. This is not always the case, however, and this view may be losing its advocates. More and more, family-run businesses, big and small, are revamping their board of directors by putting more independents than insiders or grey directors on their boards. A majority of family businesses should in fact welcome independent directors into the boardroom. This is part of the service and advisory functions of stewardship. Transparent processes, good governance, and an empowering atmosphere are the general results of placing independents in a board.

#### A. *Pros and Cons of a Family-run Business*

A family business is a natural subset of a close corporation, which is typified by a small number of stockholders, no ready market for the shares, owner-management, and substantial participation by the majority stockholder in the management and operations of the corporation.<sup>26</sup> It is similar to a partnership since “stockholders of a close corporation occupy a position similar to that of joint adventurers and partners . . . . [T]he practical realities of the organization and functioning of a small ‘two-man’ corporation . . . [is] to carry on a small business enterprise in which the stockholders, directors, and managers are the same persons.”<sup>27</sup>

Family-controlled corporations provide an innate synergy between parents, siblings, and intergenerational kin in helping and assisting each other run the affairs of the business. Since they are husbands and wives, brothers and sisters, uncles and nieces, grandparents and kin, there is an

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23. Corbetta & Salvato, *supra* note 13, at 123.

24. William Alexander, Presentation on Stewardship at Wharton School’s Course on Strategies and Practices of Family-Controlled Companies (Jan. 22, 2008) (on file with author).

25. See C. Sundaramurthy & M. Lewis, *Control and Collaboration: Paradoxes of Governance*, 28 ACAD. OF MGMT. REV. 397, 409 (2003) (“[I]nsiders . . . provide a rich knowledge of and strong commitment to the firm.”).

26. See *Galler v. Galler*, 203 N.E.2d 577, 583-85 (Ill. 1964) (listing the attributes of a closed corporation).

27. *Helms v. Duckworth*, 249 F.2d 482, 486 (D.C. Cir. 1957).

expected familial bond that potentially lays the foundation of good business governance and smooth interpersonal communication. Family businesses are good for openly communicating and mutually coordinating families.<sup>28</sup> If contrasted to a publicly-held corporation, family-run businesses or close corporations provide distinct advantages to shareholders, such as familiness and an easier vehicle for stewardship. Other advantages include trust<sup>29</sup> and mutuality of interests.

However, as stated earlier, there are also several disadvantages to family-run businesses. First, due to the closed and insular nature of the business, there is great opportunity for the majority shareholder to oppress minority shareholders, such as an older brother lording over a company to the detriment of a younger brother and his family who own fewer shares.<sup>30</sup> Similarly, rightful dividends may be withheld (refusal to declare), corporate earnings may be siphoned off, exorbitant salaries may be paid to the majority shareholder or his favored kin, or employment to a competent son or daughter of a minority shareholder may be unjustifiably refused.<sup>31</sup> Second, these entities create opportunities for “freeze-outs”<sup>32</sup> and squeeze-outs, two “draconian”<sup>33</sup> terms that imply oppressive, coercive, and preclusive tactics and devices used by the majority owners to force the minority owners out of the business.<sup>34</sup> Third, as a result of major disagreements, ego, pride, jealousy,<sup>35</sup> or simple lack of trust,<sup>36</sup> problems at home are brought into the workplace, resulting, for example, in a minority owner sibling being arbitrarily terminated (dismissed without cause) by a

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28. See generally Johanna M. Hurstak & Jennifer Raiser, *Salvatore Ferragamo, SpA*, 11 FAM. BUS. REV. 145, 145-63 (June 1998) (illustrating the benefits of family business).

29. See generally Robert Galford & Anne Seibold Drapeau, *The Enemies of Trust*, HARV. BUS. REV., Feb. 2003, at 88-95 (arguing that the productivity of a business organization is directly correlated to the level of trust within that organization).

30. John S. Powell, *Your Risks as a Board Member*, FAM. BUS. MAG., Autumn 1993, at 1-2.

31. MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS: CASES AND MATERIALS 329 (9th ed. 2005). See *Donahue v. Rodd Electrotpe Co. of New England, Inc.*, 328 N.E.2d 505, 517-19 (Mass. 1975) (holding for an increased duty of loyalty in the close corporation context due to the asymmetric distribution of power among majority and minority stockholders).

32. See *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 662 (Mass. 1976) (explaining that one feature of close corporations is the ability of majority stockholders to oppress, disadvantage or “freeze out” minority stockholders).

33. See *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1388 (Del. 1995) (declaring supermajority voting provisions, shareholder rights plans and the ilk “draconian” because of their use in protecting the corporation from perceived threats).

34. See *id.* (citing advance by-laws, supermajority voting provisions, shareholder rights plans and repurchase programs as examples of “draconian” tactics).

35. See WARD, *supra* note 15, at 3 (stating that many family businesses find family relations and infighting to be a stumbling block).

36. John L. Davis & Kacie LaChapelle, *J. Perez Foods (A)*, HARV. BUS. SCH. Note 9-801-147, Mar. 2001, at 1-12.

dominant, older sibling.<sup>37</sup> Fourth, old wounds related to past family bickering tend to surface and take precedence when running family-based organizations.<sup>38</sup> Fifth, and more importantly, business patriarchs or founders, overwhelmed by egotism and fueled by their need to stay in power for fear of reaching the point of needlessness,<sup>39</sup> may unwittingly or intentionally restrain the growth of the next-in-line by failing to listen to advice, dismissing the next generation's suggestions, failing to collaborate, and disregarding their own weaknesses.<sup>40</sup> Sixth, family members, as jugglers of various corporate hats (owner, shareholder, manager, director, family office holders, and others), have immense conflicts of interest and a lack of transparency that *may indirectly* subject the business to the Sarbanes-Oxley Act.<sup>41</sup> Other negatives are the often emotional bases of leadership and work ethos,<sup>42</sup> the prevalence of informality, incessant feelings of undervaluation by the family as sources of conflict,<sup>43</sup> the always-in-the-shadow-of-dad sentiment,<sup>44</sup> centralized decision-making processes, and the occasional lack of correlation between business skills

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37. See *Merola v. Exergen Corp.*, 668 N.E.2d 351, 355 (Mass. 1996) (noting that despite the possible specter of illegally discharging minority owner-managers, "[n]ot every discharge of an at-will employee of a close corporation who happens to own stock in the corporation gives rise to a successful breach of fiduciary duty claim. The plaintiff was terminated in accordance with his employment contract and fairly compensated for his stock. He failed to establish a sufficient basis for a breach of fiduciary duty claim . . .").

38. When running a family business, it is often very difficult to separate family affairs and pure business activities. Normally, family biases, prejudices, infighting, and past conflicts tend to consistently surface, typically overshadowing business-only matters.

39. William Alexander, Lecturer, Presentation on The Outgoing Generation at Wharton School's Course on Strategies and Practices of Family-Controlled Companies (Apr. 22, 2008) (on file with author).

40. See DYER, *supra* note 4, at 59-61 (analyzing the importance and possible shortcomings of the founder in developing firm culture).

41. See François de Visscher, *Board Members Beware: Ethics Issues Abound*, FAM. BUS. MAG., Winter 2005, at 2-3 (explaining the need for family companies to professionalize in the face of sweeping reforms instituted under the Sarbanes-Oxley Act). See also Matthew K. Donovan, *Are You Ready for Corporate Reform?*, FAM. BUS. MAG., Spring 2003, at 1-3 (arguing that the Sarbanes-Oxley Act has serious implications for private family-owned businesses).

42. There are family businesses where the founder or founding owner believes that he alone can lead the company, and if reforms are necessary, only he can conceptualize and implement them. Emotionally, this bullheaded founder/leader seldom has trust in other people, whether they are non-family managers or his own kin. In some cases, a son or the eldest child of the founder is appointed as successor not because of abilities, education or experience, but purely because of blood ties.

43. See DENNIS T. JAFFE, *WORKING WITH THE ONES YOU LOVE* 88-91, (Conari Press 1990) (analyzing common sources of interpersonal conflict within a family business).

44. See Peter Grant, *Family Divide: At Cablevision, Father-Son Split Looms Over Future*, WALL ST. J., Jan. 24, 2005, at A1 (discussing the difficulties faced by Cablevision CEO James Dolan in escaping the shadow of his father, the company's founder).



and power conferment (nepotism).<sup>45</sup>

*B. Contrast to Publicly-Held Corporations: Market Model vs. Control Model*

Family businesses differ from publicly-held corporations in their chain of command.<sup>46</sup> The latter are typically composed of thousands of diversified shareholders who do not know each other, have no participation in the business except owning the shares and reaping dividends, and have no familial ties to each other or to the leaders of the business.<sup>47</sup> Publicly-held companies also have corporate officers appointed by the board of directors, who themselves are selected by the shareholders during annual shareholders' meetings.<sup>48</sup> Currently, a typical public company's board is composed of approximately ten members, 90% of whom are often independent directors, while the remaining insider is the CEO.<sup>49</sup> Conversely, family businesses generally are controlled primarily by family members, their boards of directors are often composed of blood kin with a sprinkling of independents, and their shareholders are often under-diversified, consisting mostly of relatives.<sup>50</sup> There are exceptions to this rule, as there are very large family corporations in the United States that would rival any publicly-held company.<sup>51</sup> Family firms are business groups that have three levels of command—the owners, the board of directors, and the firm's top management—often consisting of the same

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45. See Craig E. Aronoff & John L. Ward, *Rules for Nepotism*, NATION'S BUSINESS, Jan. 1993, at 64 (arguing that family members should be required to meet certain objective qualifications before being invited to join the family firm).

46. See Corbetta & Salvato, *supra* note 13, at 123 (discussing the distinct theoretical perspectives to understand the characteristics of boards of directors).

47. ROBERT D. MCCRIE, SECURITY OPERATIONS MANAGEMENT 18 (2nd ed., Butterworth Heinemann, 2006).

48. DEL. CODE ANN. tit. 8, §§ 141-142 (2004).

49. See Martin Lipton & Jay W. Lorsch, *A Modest Proposal For Improved Corporate Governance*, 48 BUS. LAW. 59, 67 (1992) (arguing that corporate boards should be limited to ten members). See also Roger Raber, National Association of Corporate Directors' President and CEO, Corporate Governance in the Global Economy: Roles and Responsibilities of Corporate Directors, Address before the Research Institute of Economy, Trade & Industry, IAA (July 26, 2006), available at <http://www.rieti.go.jp/en/events/bbl/06072601.html> (stating that the National Association of Corporate Directors' optimum board size is eight to eleven members).

50. See Peter Davis, *Make-or-Break Criteria for Outside Directors*, FAM. BUS. MAG., Spring 1993, at 1-2 (noting that boards of family-owned corporations often serve an advisory function with little actual authority).

51. Examples are brewers Anheuser-Busch, Molson Coors Brewing and snackfoods company Mars. See Eleanor Wason & Jessica Hall, *Vanishing Independence for Large Family Companies*, THE INTERNATIONAL HERALD TRIBUNE, July 14, 2008, <http://www.iht.com/articles/2008/07/14/business/deal15.php> (discussing difficulties faced by family-run companies such as Anheuser-Busch in the modern business environment).

individuals, mostly from the same family.<sup>52</sup>

The Control Model is the ideal representation of family business organizations in Asia, Europe, and Latin America.<sup>53</sup> It features a concentrated shareholder base, illiquid shares, a tendency to be secretive, an intense focus on long-term strategy, a majority of insiders on the board, and a significant overlap between management and ownership.<sup>54</sup> In particular, the Japanese Company Community corporate system reflects this model.<sup>55</sup> Close corporations have these characteristics as well.<sup>56</sup>

On the other hand, the Market Model is applicable to publicly-held organizations generally found in the United States and United Kingdom.<sup>57</sup> These businesses have dispersed shareholders, such as institutional investors and individual stockholders.<sup>58</sup> Although there are controlling shareholders in certain companies, there is generally a “fluid aggregation of unaffiliated stockholders.”<sup>59</sup> Share ownership is very liquid as owners can easily sell them to the public.<sup>60</sup> These businesses are governed by strict corporate governance duties and have high levels of periodic or annual disclosure.<sup>61</sup> There may be cases of short-term performance bias rather than long-term growth focus.<sup>62</sup> The board is populated by outside

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52. L. T. Larsson & L. Melin, *The 2nd International Conference on Corporate Governance and Direction at the Henley Management College: The Board of Directors Driving Swedish SMEs Forward: Some Observations from a Non-executive Director Perspective* (1999).

53. See Suzanne Lane et al., *Guidelines for Family Business Boards of Directors*, 19 *FAM. BUS. REV.* 147 (June 2006) (noting that the Control Model is prevalent in geographical areas where ownership and control rights are concentrated).

54. Joseph H. Astrachan et al., *Generic Models for Family Business Boards of Directors*, in *HANDBOOK OF RESEARCH ON FAMILY BUSINESS* 320 (Panikkos Poutziouris, et al., eds., 2006).

55. Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 *DEL. J. CORP. L.* 189, 213-14 (2000) (noting that the Company Community system grants employees a level of informal control which serves to decrease “the diversity of the interests among those controlling the firm”).

56. *DEL. CODE ANN.* tit. 8, §§ 341-356 (2008).

57. Astrachan et al., *supra* note 54, at 319.

58. *Id.*

59. *Paramount Commc’ns Inc. v. QVC Network, Inc.*, 637 A.2d 34, 43 (Del. 1994) (“Control of the corporation is not vested in a single person, entity, or group, but vested in the fluid aggregation of unaffiliated shareholders.”).

60. Laura Nyantung Beny, *Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, 32 *IOWA J. CORP. L.* 237, 249-52 (2007).

61. *Id.* at 269-70. See also Gary K. Meek, Clare B. Roberts & Sidney J. Gray, *Factors Influencing Voluntary Annual Disclosures by U.S., U.K. and Continental European Multinational Corporations*, 26 *J. INT’L BUS. STUD.* 555 (1995) (studying the factors influencing voluntary disclosure of strategic, nonfinancial and financial information).

62. See generally Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 *U. CHI. L. REV.* 187 (1991) (examining multiple models of corporate governance and their influence on, *inter alia*,

independent board members and ownership of the shares is separated from the company's management.<sup>63</sup> Many family corporations in North America tend to reflect the Control Model, but large family corporations may already be mirroring the Market Model.<sup>64</sup>

For family-run enterprises, there must be a constant balance of the culture, personalities, and self-interests as "board-management relations in family firms are often described as requiring simultaneous independence and interdependence, distance and closeness."<sup>65</sup> This balance is not always seen in publicly-held corporations,<sup>66</sup> since shareholders do not know each other, shares are held in street name by the securities firm, and these residual owners are usually rationally apathetic to the day-to-day activities in the business.<sup>67</sup>

### C. *The Role of the Board of Directors*

The role of the board of directors in a family-run company has certain similarities to boards of publicly-owned corporations. The board's roles in publicly held companies are the selection, evaluation, and rewarding of CEOs; monitoring of the officers' compliance with national and state laws, IRS policies, and SEC rulings; and other supervisory functions.<sup>68</sup> Boards of public companies likewise approve corporate strategies, assess these strategies periodically, and undertake CEO evaluation and board performance self-evaluation on a regular basis.<sup>69</sup> "A good board will regularly question its own work; this self-examination enables the board to

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profit horizons).

63. *Id.*

64. Stephen J. Simurda, *Going Public in a Rollup*, FAM. BUS. MAG., Summer 1997, at 1. See Wayne Messick, *Family Business as Big Business: It's Not Just Mom & Pop Anymore*, IBIZRESOURCES, <http://www.familybusinessstrategies.com/articles03/3263wdm.html> (last visited Sept. 19, 2009) (profiling several large, publicly traded family-owned corporations); Pete Engardio, *Mom-and-Pop Multinationals*, BUSINESSWEEK, July 14 & 21, 2008, at 77-78 (noting that small family businesses are increasingly sourcing services from across the globe).

65. Corbetta & Salvato, *supra* note 13, at 122.

66. See Samuel C. Johnson, *WHY WE'LL NEVER GO PUBLIC*, FAM. BUS. MAG., May 1990, at 1 (stating that dealing with diverse shareholder expectations and potential takeovers encumbers most public corporation CEOs).

67. STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 202-03 (Oxford University Press 2008) (arguing that shareholders are rationally apathetic because the costs of expending time and energy to make an informed decision outweigh the possible benefits).

68. *Id.* at 157-62.

69. See Daniele Marchesani, *The Concept of Autonomy and the Independent Director of Public Corporations*, 2 BERKELEY BUS. L.J. 315, 319-21 (2005) (discussing the different roles of boards of directors in the operation of large companies).

become a 'learning organization.'"<sup>70</sup> Board members do not perform day-to-day functions, as these are reserved for the corporate officers.<sup>71</sup> They provide advice and counsel to the officers and to the organization at large, lend their reputation to the firm, and, at times, use their social, professional, and political networks to further the company's interests.<sup>72</sup> Since these directors may also be directors in other large firms, they are able to bring with them vast amounts of corporate wisdom and experience.

Family business boards with independent directors have similar qualities to independent boards of publicly-held companies. However, insider boards are a different story because the owners are usually the managers themselves.<sup>73</sup> For very small operations or sole proprietorships, the husband or the wife is the sole owner and manager, the children perform some work, and they employ one or two employees.<sup>74</sup> They may not even have a board.<sup>75</sup> If they do, it is most likely composed of a brother, a sister, and everyone else working in the business.<sup>76</sup> These boards might be paper-only boards to satisfy government requirements for incorporation.<sup>77</sup>

Larger, more sophisticated, and more evolved family-owned businesses will have boards with a few outsiders.<sup>78</sup> Some will even have a majority of independent directors.<sup>79</sup> These boards perform servicing,

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70. F. Friedrich Neubauer, *Good Boards Engage in Self-Evaluation*, FAM. BUS. MAG., Summer 1995, at 1.

71. See Marchesani, *supra* note 69, at 319-20 (explaining the role of boards of directors of large companies).

72. See Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 SAN DIEGO L. REV. 781, 805-07 (2003) (explaining the relational role of the board).

73. See Peter Davis, *The Politics of Family Boards*, FAM. BUS. MAG., May 1990, at 1 (stating that most privately held firms' boards are mere legal fictions, dismissed because they are seen as obtrusive to the owners' creativity and entrepreneurial spirit).

74. Brian A. Blum, *The Goals and Process of Reorganizing Small Businesses in Bankruptcy*, 4 J. SMALL & EMERGING BUS. L. 181, 188 (2000) (opining that small businesses comprise "Mom and Pop running their little store").

75. See Interview by Dr. Nagendra V. Chowdary with John A. Davis, Senior Lecturer of Business Administration at Harvard Business School (May 2007), available at [http://www.ibscdc.org/executive-interviews/Q&A\\_with\\_John\\_A\\_Davis\\_3.htm](http://www.ibscdc.org/executive-interviews/Q&A_with_John_A_Davis_3.htm) (discussing his research on managing family businesses, including the different types of family businesses and how to manage conflicts within family businesses).

76. See John A. Davis, *Governing the Family-Run Business*, HAR. BUS. SCH. WORKING KNOWLEDGE, Sept. 4, 2001, available at <http://hbswk.hbs.edu/item/2469.html> (discussing the ways to achieve effective governance in a family business).

77. See John A. Davis, *Organizing the Family-Run Business*, HAR. BUS. SCH. WORKING KNOWLEDGE, Oct. 1, 2001, available at <http://hbswk.hbs.edu/item/2536.html> (suggesting recommendations about how to create an effective board of directors).

78. See George G. Raymond Jr., *Between Father and Son Stands . . . The Board*, FAM. BUS. MAG., Winter 2002, at 4 (recalling the benefits of outside board members in the resolution of certain disputes at Lyon-Raymond Corp.).

79. See Comments of Andreas Sohmen-Pao, Managing Director of BW Shipping

advising, and supervising functions; guide the entity to target goals and the proper use of assets and resources; hire and fire the CEO; help develop and finally approve long-term strategies; and periodically assess the management and the board itself.<sup>80</sup> They also protect the interests of the shareholders, oversee the family's participation in the business, perform "diligent oversight,"<sup>81</sup> and "help make big-picture business decisions."<sup>82</sup> Boards are critical in succession issues, as they pick who will succeed the founder or existing CEO.<sup>83</sup> Boards should ask challenging questions to management<sup>84</sup> and, likewise, should interface with management on behalf of the shareholders.<sup>85</sup> For Alexander, family boards are preeminently constituted to "maximize shareholder value under the guidelines and constraints given to it by the shareholders."<sup>86</sup>

Directors must be able to coordinate with the CEO (through the human resources department) on the list of potential successors, to guide and coach the successor-in-waiting or heir apparent (if an insider), to wisely intervene (if needed) in emotional outbursts due to succession crises, and to conduct a fair and reasonable selection process.<sup>87</sup> They must also keep the company on track with any succession plan it has developed, and prevent the founder-CEO from unduly extending his or her term of office or delaying his or her predetermined retirement.<sup>88</sup> A two-to-three-year window for transition cannot unilaterally be extended to a five-to-

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Managers, in Knowledge@SMU, *The Source of Competitive Advantage in a Family Business is the Family*, Mar. 3, 2008, available at <http://knowledge.smu.edu.sg/article.cfm?articleid=1123> (stating that his family's firm is comprised of a mix of family members and independent directors).

80. See Nancy Langton, *The Role of Boards of Directors in a Family Business: Three-Circle Model Helps Define Role*, THE GLOBE AND MAIL, September 26, 2005, at P1, P3 (discussing how directors of a family business help manage the financial health of the business).

81. See MILLER & BRETON-MILLER, *supra* note 3, at 211-213 ("[D]irectors are the critical nexus between shareholders and top managers. It is they who must establish and oversee the executive incentives and monitoring mechanisms.").

82. John A. Davis & Keely Cormier, *Board Directors of the Family Firm*, HARV. BUS. SCH. Note 9-800-025, Mar. 2001, at 3-5.

83. A CEO who handpicks his successor, without guidance and in absolute mockery of his board of directors, is a corporate tyrant who fails to serve the interests of the shareholders. Concomitantly, this elucidates an example of a disempowered, failing board.

84. See Marc A. Schwartz & Louis B. Barnes, *Outside Boards and Family Businesses: Another Look*, 4 FAM. BUS. REV. 269, 279-80 (Fall 1991) (assessing survey results from interviews with CEOs about the areas that outside directors are the most and least helpful).

85. Alexander, *supra* note 39.

86. *Id.*

87. See Ivan Lansberg, *Independent Directors in the Middle*, FAM. BUS. MAG., Summer 1999, at 4 (declaring that boards of directors should help owners assess the feasibility of and assumptions underlying their vision for the future).

88. *Id.* at 7.

seven-year window.<sup>89</sup> If provided with unfettered discretion, founders tend to keep themselves at the helm until the day they die.<sup>90</sup> The board must be strict in this regard, yet they should also be the sounding board of the departing executive.<sup>91</sup> It may be good that at least one of the independent directors is of the same age and stature as the departing founder-CEO so that the former can explain his or her own transition process and how he or she was able to successfully cope with life after twenty or thirty years in power.<sup>92</sup> While all of these are the ideal functions of the board, the reality is different. In the 2002 American Family Business Survey, approximately half of the respondents' boards were found to have met only once or twice per year, while 13% of those who responded never met at all. Seventy percent (70%) of the respondents said they have no board subcommittees, while a substantial number reported weak board performance.<sup>93</sup> Worse, the survey revealed that most family businesses do not even use their directors in the CEO succession process.<sup>94</sup>

As in the case of publicly-held companies, directors in family businesses have certain fiduciary duties to the shareholders and the corporation.<sup>95</sup> They must exercise their duties in good faith, with the care that a typically prudent and responsible person in a similar position would do under similar circumstances, and in a manner that the directors (even non-family, minority directors) believe is in the best interests of the corporation.<sup>96</sup> Boards make sure that managers manage the company optimally.<sup>97</sup> Boards that fail to perform their specific functions include paper boards, management committee impersonators, shareholder group impersonators, and mere crony groupings.<sup>98</sup>

In both family businesses and publicly-owned corporations, directors may be classified as insiders, grey, or independent. For family businesses, insider directors are family members who run the businesses, such as the CEO or a kin who is the Vice-President. Grey directors are not fully independent directors as they have significant business or relational ties

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89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.* at 7-8.

93. Mike Cohn, *Why Some Boards Work Better Than Others*, FAM. BUS. MAG., Winter 2004, at 1.

94. *Id.*

95. See JAMES J. JURINSKI & GARY A. ZWICK, TRANSFERRING INTERESTS IN THE CLOSELY HELD FAMILY BUSINESS 27 (2002) (discussing tax and business issues that affect family firms).

96. *Id.*

97. See generally Ira M. Millstein & Paul W. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 COLUM. L. REV. 1283, 1318 (1998) (observing the link between active board monitoring and corporate performance).

98. Alexander, *supra* note 39.

with the company, yet were still considered as “outside” directors in the past. Grey directors may be customers, suppliers, bank officers, or other industry members. They may also be outside advisers who have existing or previous contracts with management. Independent directors, on the other hand, are non-aligned, neutral directors who have absolutely no ties with the business by themselves or through their next of kin, do not have existing or previous contractual arrangements with the corporation, and have never been an employee or officer. Some of these independent directors are CEOs or presidents of other large boards or institutions, deans or distinguished professors of business schools, or professionally trained individuals. An independent board, therefore, would be a company board whose members are primarily composed of directors who are neither insiders nor grey directors, nor otherwise affiliated with the company one way or another.

For Corbetta and Salvato, the critical measure of a board of directors is board capital, which is comprised of (a) adequate board size, (b) directors’ personal and occupational background and knowledge, and (c) board activism that encompassed collective processes and access to information.<sup>99</sup> For them, the ideal governing bodies for successfully-run family businesses would be “large, active, and external boards, the latter characteristic usually meaning that nonexecutive directors should not have personal or professional relationships with the family or the firm.”<sup>100</sup> Though assisting in resolving family squabbles and dramas goes with the territory, independent directors must not be so drawn into battle that they lose competence and neutrality. Stone has argued that:

Outside directors are not shrinks. They’re businesspeople trained to focus on business problems . . . [b]ut if they are confronted with a family situation, say, a rivalry between siblings for leadership, they could help move things forward by defining the leader’s role and structuring a communication process that acknowledges that both siblings want to be leaders.<sup>101</sup>

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99. See Corbetta & Salvato, *supra* note 13, at 128 (“According to this logic, a large board entirely composed of insiders (i.e., current and former officers of the firm) will provide less resources and network links than an equally large board composed of insiders, business experts (e.g., current and former senior officers and directors of other firms), support specialists (e.g., lawyers, bankers, insurance company representatives, public relation experts), and community influentials (e.g., political leaders, university faculty, leaders of social or community organizations).”).

100. *Id.* at 121.

101. Deanne Stone, *The Outsiders*, FAM. BUS. MAG., Winter 2007, at 4.

1. Is a Board of Directors Needed and When? The Case of Vietri, Inc.

It has been argued that not all family business enterprises need independent directors. Indeed, some family businesses, especially those that have been recently established, may not need the presence of an independent board at all, or at least not during the formative years.<sup>102</sup> If the businesses are too small, lacking a professional management team and effective financial systems, a formal board may be dangerous and a distraction.<sup>103</sup> The reason is that companies in their very early years are, or should be, more concerned with how to ensure the following week's payroll, what products to develop, and how these products should be marketed and sold. Oftentimes, a board "champion" is needed to change the status quo of having no board of directors.<sup>104</sup> This "champion" may be the founder himself, a successor, or a long-time manager who can convince the company leadership that a board of directors will help steer the business to greater heights. Boards ought to be seen as valuable contributors by both first generation entrepreneurs and by well-seasoned family business executives. They bring in not only sound advice and experience from the outside, but they may also serve to redirect the company to the route it should have taken in the first place. Family companies derive substantial benefits from formal boards "of outside directors consisting of a majority

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102. Howard Fischer & Jane Stevenson, *Building the High-EQ Board*, FAM. BUS. MAG., Summer 2007, at 2. The Quaker Chemical Corp. is a leading global provider of process chemicals, chemical specialties, services, and technical expertise. *Id.* For the first thirty or so years of its corporate existence, there was a board of directors populated only by insiders. *Id.* This was from 1918 to circa the 1950s. *Id.* When Peter A. Benoliel took over from his father in 1960s, he recruited two outside directors. *Id.* By the time the company went public in 1972, the board had a majority of outside directors. *Id.* By 1997, it had an eleven-person board, eight of whom were outsiders. *Id.* It is still a very successful and profitable company today.). "Sigismundus W. W. Lubsen, a Dutch citizen, succeeded Peter Benoliel as CEO in May 1993, breaking a decades-long tradition of family leadership. Lubsen restructured the company, cutting the workforce by 10 percent and earmarking the savings for the growing Asian and South American markets." *Quaker Chemical Corporation*, ANSWERS.COM, <http://www.answers.com/topic/quaker-chemical-corporation> (last visited on Mar. 11, 2009). But Mr. Lubsen's term as CEO was short-lived as he resigned in mid-1995 to join Netherlands-based Heineken N.V. *Id.* Then Chairman of the board Peter Benoliel stepped in as Acting CEO. *Id.* By 1997, Peter Benoliel vacated the position of Chairman of the board but remained a board member. *Id.* He left the board in 2005. *Id.* He had served as CEO for a total of 27 years and Chairman for 17 years. See Donald J. Jonovic, *What Most Businesses Need Before an Outside Board*, FAM. BUS. MAG., Winter 1993, at 1-2 (suggesting that an independent board may not be effective until the company has made it past the "transition between entrepreneurial venture and professional management").

103. See Donald J. Jonovic, *Outside Review in a Wider Context: An Alternative to the Classic Board*, 2 FAM. BUS. REV. 125, 126 (Summer 1989) (discussing why an outside board of directors may be inefficient for family companies).

104. See Davis, *supra* note 50, at 3.



of independent, risk-taking peers.”<sup>105</sup>

In fact, there are some family-controlled businesses which started in their very first (founding) year with a fully operational, formal board of directors. In the case of Vietri, Inc. (named after an Italian fishing village) of Hillsborough, North Carolina, a leading wholesaler of Italian ceramics, the two founding sisters, in the same year they founded the business, assembled a board of directors made up of themselves, close friends, and experts.<sup>106</sup>

Luckily, the two Gravely sisters, Susan and Frances, who were traveling in Italy with their mother in 1983, chanced upon very finely crafted ceramic plates in the Amalfi coast where they were having lunch.<sup>107</sup> They immediately located the ceramicist, conducted “due diligence” in the next three days with the help of an interpreter, and struck a deal with the ceramicist to be the exclusive distributor of his products in the United States.<sup>108</sup> Success immediately followed. With success, they put in place a formal board of directors to guide them through growth and the growing pains of their lucrative dinnerware import business.<sup>109</sup> One thing the sisters did wrong, however, was to appoint themselves as co-presidents of a thriving company.<sup>110</sup> Certainly, tensions erupted between them that threatened the very fabric of the family, not just the business.<sup>111</sup> But since they had the foresight to create a board at the infancy stage of the business, it became easier to manage and resolve the crises that came about. The board they instituted was not an independent board; rather, upon their father’s counsel, it was a board composed of friends who had experiences in certain areas of business that the sisters did not.<sup>112</sup> Although the board met only once a year, the sisters communicated with their board members individually half a dozen times per year, whether to seek business advice or as a sounding board for ideas.<sup>113</sup> Despite being an insider board with one annual formal meeting, it was still a body that was able to assist, serve, and advise the founders.

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105. See Jonovic, *supra* note 103, at 129.

106. See Deanne Stone, *Making a Sibling Startup Work*, FAM. BUS. MAG., Spring 1996, at 1-2 (discussing the history of Veitri, a family business that sells imported dinnerware and suggesting that a major reason for the company’s success has been its board of directors, consisting of the owners’ close friends).

107. *Id.*; Vietri, *About Us*, <http://www.vietri.com/aboutus/aboutus.cfm> (last visited Apr. 30, 2008).

108. Vietri, *About Us*, <http://www.vietri.com/aboutus/aboutus.cfm> (last visited Apr. 30, 2008).

109. Stone, *supra* note 106, at 5-6.

110. *Id.* at 6.

111. *Id.*

112. *Id.* at 4-5. This meant that their board members were all grey directors as they had familial or relational ties with the owners of the business. *Id.*

113. *Id.* at 5.

At one point, Susan Gravely was approached by a dinnerware company that wanted to be bought out by Vietri, Inc.<sup>114</sup> She was very interested and excited with the prospect. But after consulting with the board, it was decided that the businesses were not complementary.<sup>115</sup> Had she not listened to the board's sound advice, or if Vietri, Inc. had no board at all, then the sisters could have immediately jumped into a business venture not knowing the traps and liabilities of that company. In time, the board proved instrumental in making the sisters-owners more mature and sensitive in their approach to the business. Susan eventually became the president and Frances became the vice-president for marketing.<sup>116</sup> They were able to "[carve] out separate domains" for each sibling.<sup>117</sup> Many years later, when the board recommended to Susan Gravely that she needed to designate a successor just in case something happened to her, she maturely, yet painfully, anointed Vietri, Inc.'s ten-year accountant instead of her sister, Frances.<sup>118</sup> The latter accepted the decision.<sup>119</sup> The board, in essence, played a key role in ensuring that the sibling rivalry ordinarily found between sisters did not threaten to consume the enterprise.<sup>120</sup> Vietri, Inc. continues to be a profitable business today.

*D. Fiduciary Duties of Loyalty, Care and Good Faith to Minority Shareholders*

Duties of loyalty, good faith, and care are not exclusive to publicly-held corporations. In a family business, these duties are owed by majority shareholders/directors to the minority. A breach of the duty of care may render a family company director (or officer) liable for negligence, while a violation of the duty of loyalty may render such director (or officer) liable for unfair self-interested transactions and other improprieties. The difficulty with applying these duties to family companies or close corporations is that minority shareholders are not adequately protected. Termination of a family member/corporate officer may be justified as fair, given the circumstances. The decisions of a board will be judged, initially, in line with the "business judgment rule"—the presumption that the decisions and actions of a board of directors were based on adequate information and good faith, reached with the best interests of the company in mind, and that good business practices and reliable processes marked

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114. *Id.*

115. *Id.*

116. *Id.* at 6.

117. *Id.*

118. *Id.* at 7.

119. *Id.*

120. *Id.*

these decisions as used by courts of equity. Some of the critical determinants would be if the shareholder/family member was treated unequally, and in the process his legitimate or reasonable expectations were defeated (what other similarly situated shareholders would have expected and believed as fair). The extent of the lack of disinterestedness (a component of independence) and absence of abuse of discretion will also be tested. Grossly negligent or uninformed boards will most often be held accountable and liable by courts of equity.<sup>121</sup>

In a 1988 case, the trial court judge ruled that there are four specific fiduciary duties that shareholder-managers in a close corporation (such as a family business) owe each other: (1) to act with that degree of diligence, care, and skill which ordinarily prudent persons would exercise under similar circumstances in like positions; (2) to discharge the duties affecting their relationship in good faith with a view to furthering the interests of one another as to matters within the scope of the relationship; (3) to disclose and not withhold from one another relevant information affecting the status and affairs of the relationship; and (4) to not use their position, influence, or knowledge respecting the affairs of the organization that are subject to the relationship to gain any special privilege or advantage over the other person or persons involved in the relationship.<sup>122</sup>

More recently, board directorship has become riskier. The onslaught, in 2000-2001, of scandals such as Enron, Worldcom, Tyco, and Adelphia has made life more difficult for CEOs, CFOs, and directors of public and privately-held companies. One problem with serving as a director (whether as an insider or an independent) in a family-controlled business is that the candidate is not usually informed of, or educated about, the potential liabilities facing board members. Directors in family businesses must bear in mind that they are not immune from shareholder lawsuits<sup>123</sup> that center on self-dealing transactions or unethical behavior. They can instantly get caught up as blameless participants in a family feud that they have nothing to do with, except being a director in the family company.<sup>124</sup> In fact, they may even be closer to the line of fire because of the closed nature of the business.<sup>125</sup> Directors may be sued “by shareholders, competitors,

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121. See *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985) (holding that a standard of gross negligence is applied in business judgment director liability).

122. See *Rosenthal v. Rosenthal*, 543 A.2d 348, 352 (Me. 1988) (detailing the four fiduciary duties owed by business associates to each other).

123. See Powell, *supra* note 30, at 1-2 (noting that family directors may be subject to shareholder lawsuits).

124. *Id.*

125. See Visscher, *supra* note 41, at 2 (“[A]ccording to a *Wall Street Journal* report, a study of more than 200 corporate fraud cases brought before the Securities and Exchange Commission between 1987 and 1997 revealed that most financial-statement fraud is committed by companies with tiny market capitalizations.”).

suppliers, unions, customers and other private citizens, and even by . . . fellow directors,”<sup>126</sup> as well as by employees and the government. Although this may spook putative independent directors or make it harder for family businesses to retain them, adequate director and officer (D&O) insurance may assuage possible restlessness and fear of liability.<sup>127</sup> There are specific insurance products for independent directors in family-controlled entities.

### III. POWERFUL OR POWERLESS? THE CHALLENGES OF INDEPENDENT DIRECTORS

One important quality that a very successful family business founder-CEO often lacks is objectivity. The CEO may be the best in the industry and control the organization in an optimal and ethical manner, but still lack the necessary impartiality and emotional detachment that generally characterize present-day CEOs of publicly-traded companies. Founder-CEOs may be too attached or too close to the enterprise,<sup>128</sup> feeling that it is a legacy handed down by esteemed forefathers or a legacy they are handing down. They may be too sympathetic with workers’ plight, or too caught up with the notion of family and close family ties.

A CEO may also overreach<sup>129</sup> and be too self-absorbed or may not want to relinquish the power and authority he earned throughout the years. Instead of identifying redundancies that may impede efficiency, he may retain employees who serve the same function out of loyalty. This may be to the company’s detriment in the long-run. As Dyer put it:

[B]ecause founders are often reluctant to have a governing board review their decisions, there are no checks and balances. Without an outside perspective to give the decisions a “reality check” . . . there is a strong possibility that the business will join 70 percent of those that fail in the first generation. In a number of cases, we have seen founders who, because of poor information or because of age and senility, make decisions that

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126. See Powell, *supra* note 30, at 2 (noting the various groups able to sue directors).

127. See Visscher, *supra* note 41, at 3 (finding that retaining and attracting directors requires remedying the fear of liability).

128. Robert K. Mueller, *Differential Directorship: Special Sensitivities and Roles for Serving the Family Business Board*, 1 FAM. BUS. REV. 239 (1988) (describing the likelihood of the family executive to be too close to the business to have a correct perspective on issues facing the company).

129. See, e.g., Shel Horowitz, *Sam Steinberg's Non-Lasting Legacy*, U. MASS. AMHERST FAM. BUS. CTR., 2008, [http://www.umass.edu/fambiz/articles/business\\_tales/steinberg.html](http://www.umass.edu/fambiz/articles/business_tales/steinberg.html) (last visited Jan. 29, 2009) (describing how a founder’s refusal to trust control of his business to anyone outside his family damaged it and forced its sale).

destroy the business.<sup>130</sup>

Independent directors, due to their detached relationships with the company and lack of any special or financial relationship with its members, fill in the gap as objective and emotionally-detached arbiters. They help keep the balance of the ship and provide the captain with relevant information and corporate wisdom that will steer the firm away from disaster. Playing both the hull and the keel, they are able to perform an effective role as to where the company is sailing. Dubbed as strangers and outsiders, independent directors possess the qualities that a successful family CEO or entrepreneur may lack. They similarly have the prerogative to recommend an alternative course of action, redirect business goals, constructively criticize management programs, and advise on matters pertinent to corporate growth. They may also fill in any skills or networking gaps that hound the owners. Similarly, independent directors “deal with the pragmatic realities and idiosyncrasies of the family owners.”<sup>131</sup> At bottom, independent directors are not powerless or impotent in any way. In fact, they may sometimes be viewed with a suspicious and envious eye by family members, both within and outside of the board, as they may be a repository of authority.

The presence of independent directors may galvanize the family board members to spring into action relative to succession issues, business projections and plans, hiring and firing policies, competence of the management team, and the retention of professional consultants. These things may have been neglected by family boards since they are accustomed to trusting an older sibling to do everything and, thus, have waived accountability and transparency. According to Howard Fischer and Jane Stevenson, “To create the ideal board for your company, you need outside directors who will hold you accountable. You should have the right mix of talents, personalities, and experience. Above all in a family company, you need people with high emotional intelligence.”<sup>132</sup>

#### A. *Concrete Understanding of the Family Culture*<sup>133</sup>

Despite wielding tremendous authority or the potential to be very influential, independent directors often face opposition from within the board and beyond it. Instead of being supported as steward-arbiters, they may be showered with skepticism and distrust, if not malice. The familial

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130. DYER, *supra* note 4, at 71.

131. Davis, *supra* note 50, at 1.

132. Fischer & Stevenson, *supra* note 102, at 1.

133. See WARD, *supra* note 15, at 18 (“The culture of the family business—its leadership and its organization—influences the achievements of the business far more than any other factor.”).

and relational setting of a family business is not traditionally open or receptive to strangers. According to Cleveland family business consultant Donald Jonovic, ““They’re used to playing close to the chest, so bringing in an outsider is like disrobing in front of a stranger for the first time. Taking that initial step is hard to do.””<sup>134</sup> The reason for this is simple: as a close corporation, they are accustomed to working with dad or mom, with an uncle or an older sibling. In-house supervision and advising is enough; bringing in a boardroom “policeman” from the outside is suspicious. The introduction of an independent director to the board—which could be interpreted as the arrival of a professional critic with policing functions but who has contributed nothing to the corporation’s working—may be the sign of a shake-up that some family members, including the company president and chairman, fear.<sup>135</sup> As a corollary, independent directors are accused of not knowing the business and/or the industry to be worthy of any policing functions.

As a natural reaction to the entry of someone new into a pre-existing family business culture, the independent director must not expect a red carpet upon his arrival. The independent director must, on the contrary, be on guard as to the sensitivities of the directors he will be working with and those in the management. It will take time and effort to be completely absorbed and accepted by a family business board and its management. The initial blemish of distrust and lack of knowledge of the inner workings of the company can gradually be swept away if the independent director behaves professionally, and takes the time to understand the culture and business dynamics, comprehend corporate finances, and internalize office or board politics. Friendliness, approachability, prompt attendance, active and educated participation in board meetings, and working with a positive aura will work wonders. Once successfully integrated, the independent director is set to do wonders for the family-controlled company. As dispassionate and open communicators, they can mediate between family members.<sup>136</sup> They can also contribute to succession programs, transition periods, selection of key officers, and other important business decisions.

Absent a complete understanding of the family culture, the independent director may never get beyond the initial impression he makes as a stranger lacking in specific business or industry knowledge. If approached poorly, the independent director can forever remain the suspicious outsider that he initially is. A good example of a family culture where this idea can be applied is the Wolf Organization. A national

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134. Stone, *supra* note 101, at 2 (quoting Donald Jonovic).

135. See Mike Cohn, *Are You Ready for ‘Outsiders’?*, FAM. BUS. MAG., Spring 2003, at 2 (describing the difficulties inherent to choosing directors in a family business setting).

136. See Raymond, *supra* note 79 (noting the calming influence of dispassionate outside directors on familial relationships).

provider of construction materials through its lumber yard, with a well-known advertising and marketing agency, the Wolf Organization is hard to miss in the materials industry.<sup>137</sup> Founded in 1843 by Adam Wolf, the business has grown from a very modest dry goods and lumber store in rural Pennsylvania into a more than \$250 million enterprise.<sup>138</sup> The Wolf Organization's website touts that, "Wolf and his descendants developed the business into a family heirloom, strengthening it from generation to generation."<sup>139</sup> The business has a unique transition structure which forms a crucial part of their family culture. The business is typically bought out by one or two sons from the father at market value, implying the certainty that siblings who refuse to buy-in to the business or who do not have the means to purchase the business will be deprived of both ownership and participation.<sup>140</sup> Though this seems common or expected in the larger business world, it is not so common in the family business setting. The result, again caused by the family culture, is that sons, who buy the business from their parents, do not treat the entity as a family legacy. Rather, they treat it as a mere business venture that they are not required to perpetuate.<sup>141</sup> The family buyers are trained since childhood to see the business as an investment opportunity. Therefore, when it is the sons' time to purchase the business they simply act as interested investors and financial buyers—assessing the company in terms of potential return on investments, capitalization structure, liquidity, sufficiency of assets and other criteria normally used by an outsider buying a company.<sup>142</sup> This extreme view of perceiving the family business merely as a business, plus the market value or cost associated with acquiring it, may have caused the substantial divestiture of the sixth generation.<sup>143</sup> Since the family business was seen simply as an investment, when there is a good deal to sell it, the best option is to take the opportunity to liquidate.<sup>144</sup> As of now, only 30% of ownership in the family business remains in family hands.<sup>145</sup> The other 70% of the shares has been acquired by a private equity firm.<sup>146</sup> And of the

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137. See Operating Divisions: The Wolf Organization, <http://www.wolforg.net/divisions.htm> (last visited Jan. 29, 2009) (describing TWO's operating divisions as distribution and advertising).

138. See About: The Wolf Organization, <http://www.wolforg.net/about.htm> (last visited Jan. 29, 2009) (describing the history of the Wolf Organization).

139. *Id.*

140. Tom Wolf, former CEO of the Wolf Organization, Presentation at Wharton School's Course on Strategies and Practices of Family-Controlled Companies (Apr. 15, 2008) (on file with author).

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. Wolf, *supra* note 138.

146. *Id.*

30%, not all owners are family-related, as some are outside investors.<sup>147</sup>

This family culture<sup>148</sup> must immediately be understood by any independent director serving on the board of directors of the Wolf Organization. If this is not clear to such director, he may constantly be asking—to the point of annoyance—why family members, who formerly led the business, are intent on cashing out of the business. He may question why the business is treated more as a financial investment rather than as a genuine heirloom to be passed from one generation to the next. Mistaking family culture for stewardship, he may press hard for alterations to it, unaware and uninformed that this has been a family tradition for over 150 years. Instead of helping the organization, he may in fact be hurting it. Instead of performing a harmonizing role, he may be dividing the family members.<sup>149</sup> As one Illinois family consultant has stated:

“Outsiders can never know the whole history of family resentments [or culture]; they can only be aware of the surface issues. Part of [the] . . . job as the outsider is getting everyone on the board on the same page. The biggest value an outsider can bring is helping the family find consensus on a plan of action for moving ahead.”<sup>150</sup>

In addition, a company leader who fails to learn and understand a company’s culture and adopt it runs the risk of running the company in contradiction to how the founders and older generation employees envisioned.<sup>151</sup>

There is no one way by which independent directors should approach their role in the board. It will depend upon the circumstances of the business, its internal workings, the board politics, and primarily the attitudes and belief system of the patriarch/matriarch and progeny. The

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147. *Id.*

148. See Corbetta & Salvato, *supra* note 13, at 126 (“[T]he *culture* dimension measures the degree of identification between family and business values, and the impact such values have on the firm, as mediated from the family’s commitment to the business.”).

149. See Lansberg, *supra* note 87, at 2 (“Independent directors can bring a wealth of business experience and strategic skills to the boardroom table, but without an understanding of the interplay of family and business, the independent directors may be truly unprepared to help resolve some of the organizational dilemmas that arise in family enterprises. Forced to deal with those issues, they may become disillusioned and quit, or they may become a detrimental influence, seeking to impose solutions inappropriate to the circumstances of the system they are serving”).

150. Stone, *supra* note 101, at 4 (quoting Dennis Kessler, a consultant specializing in family businesses).

151. See John A. Davis et al., *Stevenson Industries (A)*, HARV. BUS. SCH. Note 9-802-086, June 2005, at 14 (“[T]o bring in a chief operating officer who would first learn the Stevenson culture and grow into the CEO position. Paul Steel had the track record, but the nature of a leader in a family company is extraordinarily tricky. It’s the nuances of the personal relationships that, in the end, make it or break it.”).



approach must be flexible, open, communicative, and even contingent.<sup>152</sup> A given director must understand the family culture if they are to be effective in their servicing and advising functions.

*B. How Can Independent Directors Improve Company Stewardship?*

As non-company insiders, independent directors sitting on the boards of family-run businesses report to no one except the shareholders and the company as a whole. They are neither subservient nor beholden to the founder/president, and they are not necessarily friends with the heir-apparent. Moreover, they are not blood relatives of any kind. Thus, they have a very unique role in that they can serve and guide management, curtail excessiveness, police regressive policies, and promote the interests of the corporation. As Stone has discovered:

Governance specialists have observed that outsiders are often the only directors willing to challenge a family company's leadership. In fact, [Jeff Hester, who used to run Pierce Foods based in Winchester, Va.,] has found that he does his best work when disagreeing with a family member. "I concentrate on what's best for the company," he says. "I may side with one person on one issue and another on a different issue, and over time, if I'm lucky, they'll see that I don't play favorites. I make a point of never repeating any 'he said/she said' conversations. It takes diplomacy to explain why I see things differently, and it takes time to develop the family's trust."<sup>153</sup>

Independent directors help professionalize the company. Independent directors also add more neutrally-minded professionals and reduce conflicts of interests (or the appearance of conflicts of interests)<sup>154</sup> which are usually found in close corporations. This does not mean that independent directors are recruited precisely to contradict or disagree with the founder-CEO or make life more difficult for him. They do not necessarily comprise a so-called "opposition party." They are there to encourage stewardship while creating a family-friendly atmosphere where ideas can be discussed and

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152. See Corbetta & Salvato, *supra* note 13, at 124 (noting that differently-structured businesses lend themselves to differently-structured boards).

153. Stone, *supra* note 101, at 1.

154. See Visscher, *supra* note 41, at 1 ("That's why my own family business--a fourth-generation global market leader in advanced metal transformation and coatings, based in Belgium--is adapting our governance system to allow for greater independence and to reduce any potential conflict of interest. For example, while most of our directors are family members, the majority of the audit and nominating committee members are outsiders. We also have reduced family representation on subsidiary boards. Sarbanes-Oxley does not prohibit family members from sitting on subsidiary boards, but we have taken extra steps to avoid the appearance of a conflict of interest.").

business plans harmonized.

As they are total outsiders to the business, it is easier for independent directors to look inside the box from the outside. Insiders are too trapped inside the box to wield an impartial view. Founder-CEOs are oftentimes so immersed in operating the business that they seem to neglect the basic question of who will succeed them in case of retirement, death, or disability.<sup>155</sup> Other insiders, if asked who should take over the business, would immediately and forcefully declare “my son” or “my daughter,” or at times, “my in-law.” The problem is that there are occasions when none of these family members is the right fit for the job and, as a corollary, a non-family vice president or regional manager is the best fit. In that case, will the founder-CEO step up to the plate and declare his son, daughter, or in-law ineligible at this time and push for the non-family vice president or manager? Hardly, though it happens. Conversely, independent directors will rarely have qualms about declaring the non-family manager is the best for the position. This sort of action conforms with an independent director’s stewardly objectives of providing objective service over self-interest, and looking at the broad, long-term gains and values over myopic sentimentality. With clear processes and open communications, they will be able to succeed in their objectives even with the stubbornness of the family, the founder, or both.

In case the family business is in the process of moving towards being publicly-held, in alignment with stewardship, independent directors will also play an important role. During this process the business is considered a “threshold company,”<sup>156</sup> and many problems may arise for which neither the founder-CEO nor the family might be prepared. Independent directors fulfill the roles of preceptors, technical advisers, and arbitrators.<sup>157</sup> As preceptors, independent directors can tutor the CEO of the family business on how to become the CEO of a publicly-managed firm. As technical advisors, they can show the CEO how finance, taxation, securities, marketing, and law interact with each other.<sup>158</sup> An outside board can serve as an informal “court of first resort”<sup>159</sup> when family conflicts arise.<sup>160</sup> Though it is not their duty to meddle in family squabbles, the board may serve as an informal forum—with the independent directors as arbitrators—

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155. MGMT. CONSULTING SERVS. DIV., AM. INST. OF CERTIFIED PUB. ACCT., ASSISTING CLOSELY HELD BUSINESSES TO PLAN FOR SUCCESSION 21/100-1 (Am. Inst. of Certified Pub. Acct’ s. 1992).

156. Thomas L. Whisler, *The Role of the Board in the Threshold Firm*, 1 FAM. BUS. REV. 309, 309-10 (1988).

157. *Id.* at 314.

158. *Id.* at 314-15.

159. *Id.* at 315.

160. *Id.*

leading to pacified discussion and face-saving.<sup>161</sup>

C. *An Advisory Body in Lieu of an Independent Board?*

Family business boards are caught in a quandary: they want their privacy yet they need outside advice and counseling. There have been suggestions that, in order to achieve these objectives, they must get outsiders into the picture but not directly into the policy-making. The presence of outsiders has led to either: (1) advisory boards composed of some outsiders which give the CEO-founder, management, and insiders-only board specific input or expertise, as needed<sup>162</sup> or (2) advisory boards working only with management (the founder-CEO at the helm) when there is no board of directors.<sup>163</sup> The latter is the result of recommendations that, in order to eliminate potential lawsuits against directors, family businesses of a certain size ought to reconsider their boards of directors and replace them with advisory councils with experienced outsiders.<sup>164</sup> It is also the result of a family business that is not yet ready to form a board of directors but is in need of outside expert advice.<sup>165</sup> An advisory board—composed of an “accountant, an attorney, the senior owner-managers, perhaps an industry consultant, and possibly a representative of non-participating shareholders”<sup>166</sup>—conceptually shields the outsiders from lawsuits as it does not represent the corporation but merely makes recommendations. One important matter to acknowledge, however, is that “[t]he risk of legal liability should not be a controlling element in deciding what type of board [(formal or advisory)] is best for a family company.”<sup>167</sup>

Would putting a former or present CEO of a well-run business into the pool of company advisors be the same as appointing him as an independent director on the board? Can the scope of the functions of an advisory council even compare to that of a fully functioning, non-rubberstamp board of directors? Can advisory boards serve well as “a half-way house?”<sup>168</sup> It must be stated that the role of professional advisors and advisory bodies is

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161. *Id.*

162. Charles W. Murdock, *The Formal Board vs. The Advisory Board*, FAM. BUS. MAG., Spring 1997, at 1.

163. *Id.*

164. *Id.* at 2.

165. See Jonovic, *supra* note 102, at 125 (explaining that companies only require outside boards when they reach a certain level of development, but may require outside advice earlier).

166. *Id.*

167. Murdock, *supra* note 163, at 2.

168. FRED NEUBAUER & ALDEN G. LANK, *THE FAMILY BUSINESS: ITS GOVERNANCE FOR SUSTAINABILITY* 99 (1998) (suggesting that an advisory board can be a compromise between no outside influence and the actual sharing or delegating of power to people outside the family).

very much distinct from that of an independent director and an independent board.<sup>169</sup> The rules governing an advisory body or council usually state that the advisory body does not represent the company. Rather, its activities are merely hortatory;<sup>170</sup> it has no enforcement power, and it serves at the pleasure of the company CEO or president.<sup>171</sup> Though important in some respects, the council makes its members beholden to, if not dominated by, the CEO or president. The members' independence is hence called into question.<sup>172</sup>

But the readiness of a family entity to fully accept and truly form an effective board must be taken into consideration.<sup>173</sup> There are family businesses with multimillion-dollar earnings and with almost one hundred employees but which may not yet be ready to have a board.<sup>174</sup> Specifically, the owner-managers may not yet be prepared to handle the balancing nature and advising function of an independent body such as a board of directors.<sup>175</sup> Boards cannot be forced upon a company; that would itself be coercive and draconian. Closely-held companies and their founder-CEOs must be convinced, gradually over time, to wholeheartedly accept into the fold a governing board. Lasting change does not happen overnight. Forming a competent board does not happen in a week.

It must be explained to the founding family that a board can potentially work wonders for the enterprise. The founding family's call for privacy should be balanced with the need for informed, active, flexible, and fiscalizing directors inside the board. Professional advisors, such as retained law firms, accountants and auditors, management consultants, and the like, are not in a position to effect real and substantial change. Even assuming their assistance was sought in the first place, they are mere recommenders of appropriate action.<sup>176</sup> Usually, the boards receive written reports from advisory bodies or outside professionals and make their decisions based on these reports. A fully independent director who negotiates, mediates, clarifies, discusses, and rationally disagrees with managing family members ought to be recognized differently from a mere recommender of action.

Oftentimes, founder-CEOs need to be exposed to independent director

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169. See Murdock, *supra* note 163, at 2 (stating that unlike an independent board which has final authority for the management of a corporation, an advisory board serves at the discretion of the CEO).

170. NEUBAUER & LANK, *supra* note 169, at 100-02.

171. See Murdock, *supra* note 163, at 2 (contending that the bylaws of an advisory board often state that the board has no power).

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

positions themselves in order to recognize the importance of independence and the wisdom independent directors bring to the table. If a founder-CEO is tapped to serve as an independent professional in another family company's advisory body, he or she will soon realize that the group is just advisory and wields no substantial power.<sup>177</sup> The founder-CEO might find it useless to be sitting in a seemingly lame-duck post and may resign eventually.<sup>178</sup> If the founder-CEO is tasked to be an independent director, on the other hand, he or she will find value and fulfillment in the position as he or she is able to help guide the business. He or she may perhaps be encouraged later on to add independent directors<sup>179</sup> to his or her own board,<sup>180</sup> assuming he or she has none. If the reality, however, is that the company is ill-prepared at the moment for a formal board, then an advisory council or "review council,"<sup>181</sup> may be the next best option.<sup>182</sup>

*D. When Should Independent Directors Take Their Seats?*

Before this particular question is answered, it must be asked, "When should a board of directors first be constituted?" John M. Nash, founder and President Emeritus of the National Association of Corporate Directors (NACD), recommended that business owners who never had an active board (most likely start-ups or even long-established businesses that simply saw no need to create a board) might want to begin the process by creating an advisory board, as opposed to starting with a full-fledged board of

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177. *See id.* (contending that the stereotypical family board ratifies almost all of a CEO's actions).

178. *Id.*

179. *See Roberts, supra* note 17, at 1-14 (discussing the history of the family-run business founded by Sam Steinberg). Lawyers, like any professionals, would be great contributors as independent directors. *Id.* If the lawyer's firm is not consulting with or retained by the company, and the lawyer is not linked by blood or employment, then he or she can perfectly fit the role as an outsider to the board. *Id.* He or she can provide great legal advice, guide the company as to where it can go and where not to go, and update the directors on current developments in law. *Id.* He or she can help iron out succession issues, the family charter, reincorporation matters, acquisitions or mergers, and other business decisions that would need legal expertise. *Id.* He or she can assist in taxation issues as well. *Id.* An example would be the personal attorney of Sam Steinberg who once sat as a director of the board of the then-dominant Steinberg's supermarket chain in Quebec. *Id.* But it must be pointed out that he sat as a grey director (he was then employed by Sam Steinberg) and not as an independent one. *Id.*

180. *Id.*

181. Jonovic, *supra* note 103, at 125, 135-36. Jonovic, as early as 1989, cautioned about abruptly instituting a formal board in an unprepared family business atmosphere. *Id.* at 127. He notes that boards can fail through "misplaced diplomacy," "inappropriate direction," "presumed synergy" or "infallibility." *Id.* at 130-31.

182. *See Powell, supra* note 30, at 9 (discussing the preference by some companies to establish an advisory board, rather than a formal board).

directors.<sup>183</sup> Other than avoidance of liability,<sup>184</sup> an advisory board may be a good start for business owners who fear that a board with outside directors might unduly interfere with their decisions. An advisory board can easily evolve into a full board with monitoring capabilities, once the business owners realize that the board is not a threat, but rather, a complement to the entity and the owner's business goals.<sup>185</sup> Ideally, instead of treating the board as a threatening structure, founders should regard a board as a "deliberative peer body"<sup>186</sup> which serves as "a conscience, a memory, a forum, and a support system. . . . [F]amily companies . . . [should] realize that having outside directors can be an enormous asset in achieving the owners' dreams and strategic objectives."<sup>187</sup>

There is a lot of truth in Nash's pronouncements. However, there is equally as much truth in the argument that it may also be in the best interest of the family-run company for the founder-CEO to constitute a board of directors in the early stages of founding the business. This decision will have to be reached based on several factors already enumerated, such as the preparedness of the founder-CEO to receive outside advice, the circumstances of the business, and the openness of the business family.<sup>188</sup> An early board will presumably help resolve early pains. A forced board is certainly going to be a mocked board: the founder may treat the board as though it does not exist or may even fail to call a meeting. If the founder realizes the merits of a board very early in the corporate history and is not constrained or threatened with directorial advising and check-and-balance prerogatives (as was the case of the Gravely sisters of Vietri, Inc.), then the business will ultimately benefit.<sup>189</sup> Mathile describes, in a self-confessing article, his earlier hesitation about immediately forming a formal board when he acquired control of a company,<sup>190</sup> but he knew he needed help. After committing the mistake of anointing a board of cronies, he subsequently fired them and constituted a truly independent body which gave him sound advice and served as his confidants.<sup>191</sup>

In the event that such founder does not see it fit that a board ought to be constituted very soon after he organizes the business or just after he

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183. *Id.*

184. *Id.*

185. *Id.*

186. See Murdock, *supra* note 163, at 1 (discussing the various forms of "peer bodies," which include a legal board and an advisory board).

187. Fischer & Stevenson, *supra* note 102, at 2.

188. Powell, *supra* note 30, at 9; Murdock, *supra* note 163, at 1-4.

189. See Stone, *supra* note 106, at 1-2 (suggesting that the Gravely's business was successful from its inception, in part, because it had an experienced board of directors).

190. Clayton L. Mathile, *A Business Owner's Perspective on Outside Boards*, 1 FAM. BUS. REV. 223, 231 (Sept. 1988).

191. *Id.* at 231-34.

makes his first few sales, then at the very least a board must be constituted when it is in the process of professionalization.<sup>192</sup> This is, in Jonovic's view, the point of "significant evolution" and "threshold phase" which comprises formalized shareholder agreements, agreements on goals and business objectives, accurate accounting information, and a strong, coordinated middle management.<sup>193</sup> Alexander also notes that, other than the period of professionalization, boards should be constituted once the company reaches the point when the first non-employee shareholder appears.<sup>194</sup> Boards may also be constituted after the formation of a family council and the drafting of a family constitution.<sup>195</sup>

In preparation for a board, other than ego-readiness of the founder-CEO, businesses must develop a board manual<sup>196</sup> containing everything from business history, shareholder expectations, remuneration, meetings, directorial expectations, time commitments, and committees.<sup>197</sup> Directors must likewise be screened, interviewed, and selected well.<sup>198</sup>

Normally, once a business institutes a board of directors, the board will initially be filled with insiders—in other words, family members and close friends.<sup>199</sup> Sam Stevenson of Stevenson Industries, despite professing his commitment to managerial professionalism, started the practice of appointing non-family external board members, who happened to be his father's attorney and his own childhood sailing buddies.<sup>200</sup> This may be

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192. See Jonovic, *supra* note 102, at 1 (suggesting that once a business is truly set up as a going concern, an independent board of directors should be put in place to provide an objective long-term view of the business).

193. See *id.* ("A board does not become important or potentially effective until the company is well through the 'threshold' transition between entrepreneurial venture and professional management.").

194. Alexander, *supra* note 39.

195. See CRUZ, *supra* note 14, at 74 (noting a family business' readiness to implement a board of directors in spite of continuing management by family members).

196. Gardner W. Heidrick, *Selecting Outside Directors*, 1 FAM. BUS. REV. 271, 273 (Sept. 1988).

197. *Id.* at 275.

198. See Fischer & Stevenson, *supra* note 102, at 3-5 (suggesting that a rigorous selection process for directors is critical to selecting the right board).

199. See Stone, *supra* note 106, at 4 (discussing how the successful Gravely sisters, who founded Vietri, Inc., initially turned to their friends to sit on the company's first board of directors).

200. Davis & LaChapelle, *supra* note 36, at 3-5. This is quite unfortunate since external, non-family board members should be as far divorced from the family as possible. *Id.* However, his father's lawyer and his own childhood sailing friends were too close to the family and to him. *Id.* This may have called into question his adherence to avoid nepotism and his commitment to strict professionalism. *Id.* More particularly, in 1986, the board of Stevenson Industries was composed of three family members, three company executives, and three non-family outsiders (the family lawyer and Sam's two childhood sailing friends). *Id.* This meant that all nine board members were either insiders or grey directors with no independent director at all. *Id.* The situation improved in the 1990s. *Id.*

because of the trust the family had in them and the way by which they were selected and appointed. If a board is made up primarily (or exclusively) of family members or childhood friends, little effort for the selection and the appointment of directors is needed. The sad reality, however, is that this type of board does not perpetuate the business and may lead to its abrupt conclusion.<sup>201</sup> Arbitrariness may be the name of the game. If a board is to be constituted, it must either be a completely independent one or stacked with as many independent directors as possible.<sup>202</sup> The more independent directors, the better it is for the company; the more inside family members, the worse it is for the business.<sup>203</sup>

When should family boards have independent directors? Is there a dollar amount or business size that must be attained before the owners engage independent directors? The most opportune time for the entry of independent directors is the time the board is constituted, or at least “the sooner, the better.”<sup>204</sup> For sure, businesses will first want their own kin to be on the board; this is human nature and quite understandable.<sup>205</sup> Humorously, Jonovic writes that most business owners prefer insiders as directors since this makes it a “nice, comfortable board, chosen from a wide range of hangers-on, non-entities, and relatives . . . [typically consisting] of Him (*he’s The Boss, after all*), his spouse (*who won’t ask embarrassing questions*), and someone—most often an attorney/friend—who writes up the minutes (*of the meetings he never holds*).”<sup>206</sup> Jonovic surmises that independent directors should be added when the company is reasonably successful, when there is a stable management structure, and managers and advisors are competent. Also, the boss has “gotta wanna” add independent directors.<sup>207</sup> After a reasonable amount of time from the inception of the board, independent directors must come in.<sup>208</sup> Waiting too long will act as a self-insulation device for the founder to do whatever he or

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201. *Id.*

202. See Gerald Le Van, *The Real Value of Outsiders on the Board*, FAM. BUS. MAG., June 1990, at 1-2 (contending that independent directors can provide the CEO of a family business with the best advice on important decisions).

203. See generally Schwartz & Barnes, *supra* note 84, at 279-80 (examining the findings of a study of CEO attitudes towards inside and outside board members).

204. *Id.* at 284.

205. See DONALD JONOVIC, *THE SECOND-GENERATION BOSS: A SUCCESSOR’S GUIDE TO BECOMING THE NEXT OWNER-MANAGER OF A SUCCESSFUL FAMILY BUSINESS* 174 (1982) (providing multiple explanations for business owners’ preferences for family members on directorial boards).

206. *Id.*

207. See *id.* at 175-76 (contending that the effectiveness of a director depends on the owner’s willingness to consider and utilize the board’s recommendations) (emphasis omitted).

208. *Id.*



she pleases and to buy whatever he or she wants.<sup>209</sup> Keeping outsiders off the board may just be a personal vanity of the founder at the expense of business survival.<sup>210</sup> By the time the independent directors finally arrive, the place may already be a big mess.

*E. Contra-Indications to Independence*

There are some family companies that do not have an independent board<sup>211</sup>—in fact, they may not have a real board at all, but rather a fictitious or paper one just to satisfy the requirements of the IRS and protect the corporate shell.<sup>212</sup> This plan is not beneficial for the business or the shareholders. If the board of directors exists only on paper, or if the concept of a board is not taken seriously, a host of problems may surface later. There are many reasons that family companies object to an independent board. The founder-CEO may not want a real board because he or she may not want to share power, cultivate potential critics (no matter how constructive) to his or her leadership style and non-inclusiveness, train and educate board members, or have board interference.<sup>213</sup> Years of having “paper boards” will also harden the resolve of this founder-CEO when he or she is placed in a situation, perhaps based on the rapid expansion of the company, where outside advice is necessary through a formal board.<sup>214</sup> He or she may end up nominally appointing a board, but never treating the directors with the respect that they deserve as conscientious fiscalizers or fiscal managers.<sup>215</sup> Even worse, he or she may not listen to them at all.<sup>216</sup>

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209. See Davis, *supra* note 50, 1 (stating that most family company managers do not want an independent board because they want to be free from board interference when making decisions).

210. See Le Van, *supra* note 203, 1-2 (suggesting that an inside board may not really challenge the CEO of a family-run business).

211. See Davis, *supra* note 50, at 1 (discussing the circumstances that give rise to the need for family-owned companies to form an outside board; in contrast, an “inside board” is composed of only family members, close family friends, professional advisers with contractual relations with the company, and past or present employees); Schwartz & Barnes, *supra* note 84, at 272 (noting a survey of family-owned business CEOs that found that the majority of respondents had boards composed exclusively of insiders).

212. Davis, *supra* note 50, at 1.

213. See Murdock, *supra* note 163, 1-3 (discussing the distinction between a formal board and an advisory board).

214. Alexander, *supra* note 39.

215. *Id.*

216. See Clarke, *supra* note 12, at 2 (recommending that directors develop a thorough understanding of the family owners’ values, goals and plans to avoid being ignored by the owners). Board members must determinedly persist without being obnoxiously offensive, and must have, not an ounce of patience, but an entire army of patience and stamina. *Id.* This patience is what Clarke calls Patience Quotient (PQ) which is definitely much longer than in publicly traded companies. *Id.*

If a corporation has been run solely, yet successfully, by the founder-entrepreneur for the last twenty or so years, the sudden formation of a board of directors may make him or her cringe at the prospect of power divestiture, leading to a board in form but not in substance.<sup>217</sup> By the time the founder finally creates an independent board, he or she most likely has already morphed into a recalcitrant, unbending, and uncompromising tyrant,<sup>218</sup> whom Sonnenfeld describes as a “[m]onarch.”<sup>219</sup> Such tyrants, unappreciative of board independence, do not know how to “[pull] back from involvement,” or “[assess] with detachment,” or even “[learn] not to be.”<sup>220</sup>

If a formal board is constituted, but only sporadically and discretionarily listened to by the founder, or coerced to agree to pre-ordained executive decisions, then the directors become ineffectual.<sup>221</sup> It turns the governance institution into a mere rubberstamp,<sup>222</sup> clearly at the beck and call of the founder. If the independent directors allow themselves to be intimidated or dominated by the founder, then they metamorphose into empty, ceremonial figures—names that management can trumpet as independent voices that are actually muffled, stifled mutes.

Another contra-indication to independence would be secret, non-board

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217. Murdock, *supra* note 163, at 1-2.

218. See Le Van, *supra* note 203, at 1-2 (using a hypothetical CEO of a family-owned business to demonstrate the advantages of having outsiders as board members). Long-serving founder-CEOs often confuse themselves with their business legacies. *Id.* They are often unyielding and do not appreciate being challenged. *Id.* In reality, no one dares challenge him or her, not his or her son, lawyer, and certainly not his or her accountant. *Id.* His or her consultants do all his or her biddings. *Id.* No one would want to push him or her back. *Id.* This makes him or her a tyrant. *Id.*

219. JEFFREY SONNENFELD, *The Hero's Reluctant Farewell*, in *THE HERO'S FAREWELL: WHAT HAPPENS WHEN CEOs RETIRE* 58, 70-71 (Oxford Univ. Press 1998). According to Sonnenfeld, as one of the CEO's departure styles, “[m]onarchs do not leave office until they are decisively forced out through the death of the chief executive or through an internal palace revolt. This palace revolt may be in the form of ultimatums, the resignations of top officers, or the action of the board of directors.” *Id.* at 70. Other departure styles include that of the “general” who leaves office marked by a similar coercive exit; he “plots his return and quickly comes back to office” since he believes that he needs to save it from the hands of the incompetent successor. *Id.* Another style is the “ambassador,” which is the Stewardship practicing type. *Id.* at 70-71. Ambassadors peacefully and timely leave office, serve as mentors to the next-in-line CEO, and may remain on the board but are not out to “sabotage the successor.” *Id.* at 71. Lastly, “governors rule for a limited term” and abruptly shift to other outlets of leadership, but seldom return to help or maintain contact with the firm. *Id.* Governors can be compared to CEOs who serve for two to four years after getting the boot or resigning, they totally cut off any connection with the firm (of course after getting a hefty golden parachute and related emoluments). *Id.*

220. Renato Tagiuri, *Life Stages and Their Tasks*, Harv. Univ. VII8-10, at 1-2.

221. See DYER, *supra* note 4, 67 (claiming that the role and function of the board must be established).

222. *Id.*

decisions made by key family members that are subsequently attempted to be rammed down the throats of the board.<sup>223</sup> An accepted reality in the family business situation is that key family members may want to retain control even if they are not part of management or are not board members.<sup>224</sup> In collusion with the person in charge, whether it be the founder, CEO, or an older generation's former leader, some important family members may devise plans or make decisions behind the back of the duly constituted board and then try to run these decisions through the board.<sup>225</sup> Independent boards must immediately see these things from afar and prevent them from being passed on as board decisions.<sup>226</sup> Undermining legally constituted boards may be a way to retain or attain power by family members who were either bypassed or are in a current family struggle.<sup>227</sup> Boards must not fall prey to these schemes, as they contradict the very foundation of what independence is all about.

#### IV. ADVANTAGES OF A MAJORITY OF INDEPENDENT DIRECTORS

As stated earlier, founder-CEOs tend to be very subjective and fail to look at themselves properly in the mirror.<sup>228</sup> They tend to believe that what they are doing is always, or almost always, right.<sup>229</sup> There is usually nobody there to constructively criticize them, and no one from the officer's group is willing to stick his or her neck out to challenge the legitimacy or viability of the decision of "the grand old man."<sup>230</sup> If the founder-CEO thinks a large competitor should be bought, this deal will most likely push through, barring any antitrust issues.<sup>231</sup> If he or she perceives it a proper time to invest in domestic or foreign companies, be they related and strategic or otherwise, then most likely no one will be able to pull him or her back.<sup>232</sup>

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223. See generally Davis, *supra* note 73, at 1 (discussing the implications of an agreement between brothers in a partnership that, when enacted by a newly formed board, threatened to destroy the partnership).

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. See Le Van, *supra* note 203, at 1-2 (arguing that even successful CEOs of family businesses need help from advisors in making big, risky decisions).

229. *Id.*

230. *Id.* See Hamilton Nolan, *The Old Men of Media Moguldom*, THE HUFFINGTON POST, July 8, 2008, [http://www.huffingtonpost.com/2008/07/08/the-old-men-of-media-mogu\\_n\\_111496.html](http://www.huffingtonpost.com/2008/07/08/the-old-men-of-media-mogu_n_111496.html) (affirming elderly CEOs' desire to work until they die and the inability of younger counterparts to intervene).

231. Roberts, *supra* note 17, at 3-4.

232. *Id.* See John Cook, *Murdoch Buys Brooklyn Paper*, GAWKER, Mar. 10, 2009, <http://gawker.com/5167657/murdoch-buys-brooklyn-paper> (questioning Murdoch's decision

Hence, the adoption of active, strong, well-informed, and independent boards can easily be justified by the founder-CEO's inability to know either the company's limits or his or her personal limits.<sup>233</sup> Independent boards are well suited to rein in the founder-CEO at the precise moment, and to provide timely and sagely advice when the CEO is out of control or excessively reckless.<sup>234</sup> Insider directors, usually family members, will generally not have the temerity to clarify, much less duel, with the founder-CEO.<sup>235</sup> They will typically submit to the founder-CEO's wishes to the detriment of the family business and its shareholders, either because of family culture, their own narrow self-interest, or passivity.<sup>236</sup> In certain situations, the contrary is true: a younger brother, daughter, or son may be continuously fighting with "the grand old man," chastising him for the littlest or most trivial things, and imputing malice to every move.<sup>237</sup> Independent boards may be able to bridge the widening gap between shareholder interests and the egocentricity of the founder-CEO, and perhaps even the gap between "the grand old man" and his rival kin.<sup>238</sup> According to Fischer and Stevenson, independent boards lead to "increased professionalism and accountability; greater credibility with the company's various stakeholders; a clearer sense of corporate mission and strategy; access to top-quality advice at a fraction of the cost of consulting firms; and broader perspective on top-level policy decisions."<sup>239</sup>

Considering the many advantages of independent boards, the selection of independent directors is critical. Family friends, next-of-kin, sailing buddies, or childhood best friends should simply not make the cut; neither should retired company managers, individuals who serve on a very large number of boards, and even professional consultants who have conflicting interests.<sup>240</sup> There are many important criteria to consider in selecting an independent director in a family business.<sup>241</sup> The following represents a partial list:

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to buy Brooklyn Paper).

233. See Le Van, *supra* note 203, 1-2 (noting the value and desirability of boards composed of experienced outside directors).

234. *Id.*

235. *Id.* On the other extreme, they may be dueling all the time, which also demonstrates the need for independent boards. See Davis, *supra* note 73, at 1 (noting that a board can serve to comfort a family CEO who is constantly criticized by his family).

236. See Roberts, *supra* note 17, at 3-4 (discussing the history of the business founded by Sam Steinberg).

237. See Raymond, *supra* note 79, at 1-7 (recounting a retired family CEO's struggles with his unyielding and demanding father, when the father was president and the son was a sales manager).

238. *Id.*

239. Fischer & Stevenson, *supra* note 102, at 9-10.

240. NEUBAUER & LANK, *supra* note 169, at 115-16.

241. Le Van, *supra* note 203, at 1-2.

1. Need for integrity, honesty, commitment, professionalism, and a strong sense of service;<sup>242</sup>
2. Not conflicted in that he or she has no prior or present business ties with the company, and is not related by blood by a reasonable number of degrees;<sup>243</sup>
3. Has run or is running a successful family-run or publicly-held business (to add quality to the board and to the corporation as a whole);<sup>244</sup>
4. Does not need to have absolute expertise in the industry or know the day-to-day operations of the company (in fact, the independent director ideally should not have operational knowledge or expertise in the same industry where the business operates);<sup>245</sup>
5. Possession of a clear understanding of people, their basic psychology, the concept of familiar relations and interactions, and general working relationships (with emphasis on the idiosyncrasies of the founder-CEO);<sup>246</sup>
6. Open to understanding the basic history of the company, transition problems in the past, and the interplay between the founder and his children;<sup>247</sup>
7. Embodiment of stewardship, particularly in succession issues;<sup>248</sup>
8. An empowering attitude and outlook—particularly for leadership succession and life in general;<sup>249</sup>
9. A congenial, mentoring persona;<sup>250</sup>
10. The right skills and expertise, such as “core technologies, research and development, marketing, and finance,”<sup>251</sup> depending on the company’s current state of business<sup>252</sup>—

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242. *Id.*

243. *Id.*

244. *Id.*

245. See Stone, *supra* note 101, at 2 (discussing how the CEO of a family business used his experiences on the board of a different company to develop general criteria for choosing individuals to serve on the board of his own company).

246. Alexander, *supra* note 39.

247. See Le Van, *supra* note 203, at 1-2 (arguing that insiders, such as the founder’s children, should not sit on the board, but should attend board meetings in an educational capacity).

248. Sydney Finkelstein & Eric M. Jackson, *An Early-warning System to Guard Against Failure*, FAM. BUS. MAG., Winter 2007, at 2-3; Robert C. Elliott, *A Process for Managing Wealth and Well-being*, FAM. BUS. MAG., Winter 2008, at 1-3.

249. James H. Biteman, Franklin Harris & Sons, Inc., Harv. Bus. Sch. Note 9-377-019, 1976, at 1.

250. See Fischer & Stevenson, *supra* note 102, at 5 (asserting that directors of family businesses should be willing to mentor the owner’s children to minimize intergenerational tensions).

251. Davis, *supra* note 50, at 2.

252. Fischer & Stevenson, *supra* note 102, at 3-4. For example, when the company is in

essentially, boards should have the right mix of directors;<sup>253</sup>  
 11. Emotional Intelligence (EQ);<sup>254</sup>  
 12. Leadership, crisis experience,<sup>255</sup> sensitivity to family and business conflicts, ability to actively listen, and the resolve to act as mediator or counselor if the situation calls for it;<sup>256</sup>  
 13. Sufficient chemistry with the founder-CEO and other board members;<sup>257</sup>  
 14. Willingness to undergo periodic or annual assessment and performance survey; and  
 15. Willingness to follow a duly crafted board or company manual.<sup>258</sup>

A. *Deadlock Breakers, Mediators and Conflict Managers*

One of the risks that independent directors must expect is that there will be long histories of family bonding as well as conflicts, which they will never entirely know about.<sup>259</sup> An outsider and a stranger to the internal workings of the family, he or she is propelled into a position that may appear very formal and amiable in the boardroom, but may actually be

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the process of going public, it will be useful for someone on the board with experience in that area. *Id.* The independent director need not be a securities lawyer or a former fund manager. *Id.* However, he or she needs to have a thorough understanding of the mechanics and requirements of going public to help the company successfully enter the world of publicly-held enterprise. *Id.*

253. *Id.* More important than the size of the board is its mix of talents, experience, and personalities. *Id.* To be effective, a board must operate as a balanced system with healthy group dynamics. *Id.* Each individual's personal and professional qualities must be aligned with the company's strategic objectives. *Id.* The ideal directors are neither dominant nor reticent. *Id.* They are candid yet tactful and always mindful that the role of a director is to help the owner of the business realize his or her dreams. *Id.*

254. *Id.* They need to have a fine sense of boundaries that enables them to know when the board should get involved and when it should not. Many issues that arise are close calls. Where to draw the line becomes especially problematic if there is no process like a family council to deal with issues arising in the business that affect the family. This kind of boundary management is a question not only of when to get involved, but also of when to exert influence. *Id.*

255. See Cohn, *supra* note 136, at 2 (arguing that board members must be able to competently minimize the negative impact of unexpected problems).

256. See Davis, *supra* note 50, at 2 (stating "board members have to know when to push and when to back off; they must be skilled at depersonalizing discussion of sensitive issues."); see also Edwin A. Hoover & Colette Lombard Hoover, *Ethical Dilemmas of Right-vs.-Right*, FAM. BUS. MAG., Autumn 1997, at 4-7 (discussing foundational principles that can help a mediator resolve generational disputes in a family business situation).

257. Davis, *supra* note 50, at 2. For Davis, this is a "make-or-break criteria." *Id.*

258. Jayne A. Pearl, *Dealing with Dissent*, FAM. BUS. MAG., Winter 2007, at 7.

259. See Edwin T. Crego Jr., *When to Get Involved in a Family Conflict*, FAM. BUS. MAG., Mar. 1990, at 1-3 (stating that there are both conflicts that only the immediate family is aware about and ones in which outside mediation is sought to help resolve the issue).

running berserk due to long-standing family disagreements.<sup>260</sup> Even before the independent director accepts the task, he or she must ask himself or herself whether he or she has the patience, the stamina, the skills, and the fortitude to do well as an outsider.<sup>261</sup> The independent director may be accused of bias along the way, may get sued in the process, and may be unsavorily dismissed as inept.<sup>262</sup>

One drawback of being an independent director is that one may be perceived as too independent from the wishes of the family. His or her actions may be interpreted as a revolt against the family.<sup>263</sup> For example, in one family business board comprised of seven directors (four independents, two insider-family members, and an outsider CEO-director), the four independents voted to hire a headhunter to look for a worthy CEO successor; this action did not sit well with the two insider-family directors because they wanted one of their own to head the company.<sup>264</sup> This “revolt” ended with a legal ploy consisting of the institution of a Family Business Council that mobilized thirty (30) or so family shareholders, the resignation of the four independent directors, and the election of one of the family members as CEO.<sup>265</sup> Though some may perceive this as a blow to the notion of independent directors in family-run businesses, in fact it is not—the independent directors simply performed their role as emotionally detached, neutral, and objective board members. As conflict managers, these four independent directors may have felt that resigning (because they stuck to their conviction that an outsider is a better successor) was the best way to resolve the conflict. Even with this “revolt” scenario, the consultant who advised the family to set up the Family Business Council stated that it is important for family boards to include independents as “[t]hey can bring in fresh ideas and objectivity, and often can defuse potential conflict among family members.”<sup>266</sup> Indeed, if the independent director is up to the challenge, he or she can provide perspective, neutrality, and objectivity that

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260. See Peter Davis, *Taming the Emotions that Upset Business*, FAM. BUS. MAG., Dec. 1990, at 1-4 (noting that personal family emotions can negatively affect a business).

261. See Leon Danco, *Where to Find Top Talent for Your Dream Board*, FAM. BUS. MAG., Winter 1996, at 1-4 (stating that many of the qualities needed for an independent board member of a family company can be found in board members of large public companies).

262. See Powell, *supra* note 30, at 1 (noting that an independent director may be sued by a disgruntled family member who is a shareholder in the family business).

263. See Kevin McManus, *Whose Company is This Anyway?*, FAM. BUS. MAG., Feb. 1990, at 1-7 (noting that a statement by an outside director that Challenge Machinery Co. would no longer be a family company was a misstep because it was seen by the two family board members as “fighting words”).

264. *Id.*

265. *Id.*

266. *Id.*

the family sorely lacks.<sup>267</sup>

One of the independent director's roles, although it will not appear in any written formal responsibilities, is to act as a deadlock breaker.<sup>268</sup> Often a situation arises where the patriarch-owner will not agree with the suggestions of his son or daughter (the successor-in-waiting), and it will be up to the independent directors to display magnanimity, professional maturity, and grace under pressure in order to quell a potential uprising.<sup>269</sup> Consider a situation where the patriarch-owner wants to fire a vice president whom the son or daughter considers a friend and a talented co-worker. It is up to the independent directors on the board to vote according to their conscience and break the impasse. This responsibility is of course shared with insider directors as well.<sup>270</sup> If the board decides to side with the father, it is the role of the independent directors to explain to the son or daughter, who just walked out of the room and threatened to resign, as to why they voted that way.<sup>271</sup> Perhaps their vote is explainable by their intrinsic wisdom not to directly pit the father against the son or daughter.<sup>272</sup> Had they voted in favor of the son or daughter, there may have been tremendous, deleterious consequences, such as the father radically declaring the sale of the company.<sup>273</sup> Whatever vote they cast, as deadlock breakers, independents must be able to soothe the relationship of the family leadership.<sup>274</sup> They likewise ought to provide better perspective to founder-owners who have created a "legend" status for themselves,<sup>275</sup> which almost

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267. *Id.*; see *All You Need to Ask When Hiring a Consultant*, FAM. BUS. MAG., Autumn 1994, at 1-13 (noting that the independent director's objective nature and neutrality should reflect, if not surpass, that of professional advisors and consultants specifically advising family-run businesses).

268. See Kelin E. Gersick, *What's in April's Best Interest?*, FAM. BUS. MAG., Spring 1995, at 1-13 (noting that in a family business board composed of a divorced man, his former wife, and a third person, the third person-director was compelled to decide the fate of the business when the divorced man got an offer to sell the print business--a move that was very much objected to by his former wife); see also Ivan Lansberg, *One for All and All for One*, FAM. BUS. MAG., Autumn 1995, at 3 (commenting that in Europe, the mediator or deadlock breaker is known as a "nonfamily *consiglieri* who is given considerable authority to help manage rivalries and disagreements").

269. See Clayton P. Alderfer, *Understanding and Consulting to Family Business Boards*, 1 FAM. BUS. REV. 249, 252 (1988), available at <http://fbr.sagepub.com/cgi/content/abstract/1/3/249> (discussing interpersonal and professional dynamics of family boards and role of independent directors within this context).

270. *Id.*

271. *Id.* at 252-53.

272. *Id.* at 253.

273. *Id.*

274. *Id.*

275. Richard Salomon, *Setting a Standard for Future Generations*, FAM. BUS. MAG., Summer 2005, at 2.



always leads to the subjugated status of their next-in-line kin.<sup>276</sup>

Independent directors can also act as mediators of family and business strife. According to Tagiuri, one way to break out of old, unproductive interaction patterns is to “[p]ut a buffer person between”<sup>277</sup> the feuding family members.<sup>278</sup> This could be the mother, a distant aunt, a grandfather-cum-founder, or even a long-serving non-family executive.<sup>279</sup> As trust catalysts, these individuals may be able to allay dissidence and foster harmony in the family and in the business.<sup>280</sup> Other than these insiders or family members, independent directors may themselves be mediators. They need not be playing the mediating director role only during the quarterly board meetings; they can also easily do so when the father or the son calls upon them for private suggestions or revelation of confidences.<sup>281</sup> They must rationally explain to whoever is seeking their guidance that people must generally “[a]ccept some differences in [each other’s] objectives.”<sup>282</sup> Independents must also realize that they cannot “expect two highly rivalrous personalities to work well together”<sup>283</sup> and should bear this in mind when trying to understand the differences between them<sup>284</sup> in the hopes of seeking resolution. On a wider scale, the board as a whole must be a reliable mediator.<sup>285</sup> Ward postulates that a board of directors is a “mediating mechanism”<sup>286</sup> that will be useful in conflict resolution.

*B. Forestalling Oppression and the Excesses of the Controlling Shareholder*

There is a saying that tyranny breeds tyranny. It has been said that “the atrocities of the demagogues and the re-establishment of successive tyrannies in France can be explained in terms of the moral and intellectual depravity of the populace prior to the Revolution, a depravity caused, again, by centuries of misrule and superstition.”<sup>287</sup> In other words, a tyrant

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276. *Id.*

277. Tagiuri, *supra* note 221, at 1.

278. *Id.*

279. See Lansberg, *supra* note 87, at 2 (noting the need for the independent director to be involved in the selection process of a successor to ease family tensions).

280. *Id.*

281. Heidrick, *supra* note 197, at 271.

282. *Id.*

283. *Id.*

284. See David Keirse, *Different Drummers*, in PLEASE UNDERSTAND ME II 1, 1-3 (1998) (examining how people are fundamentally different in ways that are not easily changed).

285. See WARD, *supra* note 15, at 157 (analyzing the challenges of maintaining the long-term health of a family-run business).

286. *Id.*

287. CIAN DUFFY, SHELLY AND THE REVOLUTIONARY SUBLIME 130 (2005).

who has been ruling a certain country or fiefdom risks, with his life and limbs, that, upon his overthrow, he shall be strung up the way Mussolini was summarily executed and his body hung upside down in Milan for public viewing; or the way Romania's erstwhile dictator Nicolae Ceausescu was overthrown and executed after a two-hour kangaroo trial during the bloody Romanian Revolution of 1989.

As applied to the tyranny of a family founder such as Sumner Redstone,<sup>288</sup> he of course will not suffer exactly the same physical fate as past political tyrants; however, he may suffer something similar. If he oppresses and dominates a sibling, a son, or a daughter too excessively during the length of his leadership, the successor may implement the same or comparable viciousness when the founder is finally led out of the boardroom. This could translate to the possible abrogation of his long-term policies, a drastic change of corporate vision, selling off profitable subsidiaries, firing of his pet people, discontinuation of favorite products and services, and the like. It may well be said that he is at least metaphorically being hanged upside down. If the successor does not take revenge on the founder's legacy, he may do so on the employees and senior managers, and the cycle of tyranny continues. Ward has stated that "[m]any successors . . . rebel against past business practices instead of trying to understand them . . . [and] eagerly propose new systems, seeking to introduce changes that reflect their own identity."<sup>289</sup>

It is better that oppression by a past generation does not carry over to oppression by the current and future generation. But corporate excesses, misjudgments, and mishandlings are quite common in family-run enterprises,<sup>290</sup> especially since the founder thinks he can do absolutely anything, as it is his business.<sup>291</sup> Sumner Redstone, at eighty-four years old and still the chairman and controlling shareholder of Viacom, Inc., has allegedly been trying to force his daughter, Shari off the Viacom board.<sup>292</sup> This comes after Shari and Sumner united to force Sumner's son, Brent off the board of the family's privately-held movie theater chain, National Amusements.<sup>293</sup> Brent Redstone has since sued his father and National

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288. See *infra* note 297 (discussing the Redstone family dispute).

289. WARD, *supra* note 15, at 199.

290. See MILLER & BRETON-MILLER, *supra* note 3, at 12 (summarizing related research by scholars relating to mismanagement in family businesses).

291. Louis B. Barnes, *Precista Tools AG (A)*, HARV. BUS. SCH. Note 9-488-046, 1989, at 3-4.

292. Sarah Gilbert, *Heir Apparent: Shari and 'Daddy Dearest' Sumner Redstone*, BLOGGINGSTOCKS, Mar. 21, 2008, <http://www.blogginstocks.com/2008/03/21/heir-apparent-shari-and-daddy-dearest-sumner-redstone/>.

293. Peter Cohan, *Will Irascible Old Monster Sumner Redstone Sell Viacom?*, BLOGGINGSTOCKS, July 19, 2007, <http://www.blogginstocks.com/2007/07/19/will-irascible-old-monster-sumner-redstone-sell-viacom/>.

Amusements, seeking the dissolution of Viacom and CBS.<sup>294</sup> Brent also accused Sumner Redstone, the legendary founder, of favoring his sister and excluding him in important business decisions.<sup>295</sup> This family squabble has since been resolved, at least for the time being.<sup>296</sup> When Sumner Redstone leaves office, either voluntarily, removed by board pressure (such as Michael Eisner's resignation from Disney some years back after a lengthy litigation and extreme pressure),<sup>297</sup> or escorted by an undertaker, it is unknown what Shari and Brent will do. If Shari or Brent is chosen to succeed him, will he or she sell bits and pieces of the company for immediate liquidity? Will he or she share or forsake their father's vision? Will he or she sell Viacom, Inc. after it has achieved so much? Will they retaliate against the iron-hand hegemony of their father, and if so, to what extent?

These questions seem to have no answers at present. It may very well be that, upon his exit, Sumner's heirs/successors will lead the company in a fair, democratic, ethical, and stewardly manner. But it is too early to tell, as "the grand old man" appears to have some years left.<sup>298</sup> What is interesting is what the Viacom board is doing (or not doing). Conceptually, the board should be able to curtail such excesses from the founding parent, as well as temper the probable retaliation or vindictiveness by the successor once he or she assumes the top post. Of the eleven members of the Viacom board, four certainly are insiders, while seven appear to be independent directors.<sup>299</sup> What can they concretely do to ensure that there is adequate succession planning, a smooth transition period, and that oppression and tyranny are avoided? This is an independent board, is it not? The independent directors are bound, particularly under Viacom's Corporate Governance Guidelines (revised December 2007) to "make independent, analytical inquiries . . . [and] should exhibit practical wisdom and mature judgment . . . . A majority of Viacom's directors will meet the criteria for

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294. CNNMoney.com Staff, *Redstone's Son Sues Family-Run Firm*, CNNMONEY.COM, Feb. 15, 2006, <http://money.cnn.com/2006/02/15/news/newsmakers/redstone/>.

295. Jenn Abelson, *The Redstone Saga: Falling Out Puts Future of Cinema Chains Run From Dedham in Doubt*, THE BOSTON GLOBE, Aug. 1, 2007, available at [http://www.boston.com/business/globe/articles/2007/08/01/the\\_redstone\\_saga/](http://www.boston.com/business/globe/articles/2007/08/01/the_redstone_saga/).

296. Greg Griffin, *Redstones Settle Feud Over Family Business*, DENVERPOST.COM, Feb. 6, 2007, available at [http://www.denverpost.com/search/ci\\_5164430](http://www.denverpost.com/search/ci_5164430).

297. The Associated Press, *Eisner Resigns from Disney Board of Directors*, USATODAY.COM, Oct. 6, 2005, available at [http://www.usatoday.com/money/media/2005-10-06-eisner-board\\_x.htm](http://www.usatoday.com/money/media/2005-10-06-eisner-board_x.htm).

298. Joe Flint and Tiffany Hsu, *Sumner Redstone Dodges a Grilling*, LOS ANGELES TIMES, Apr. 30, 2009, <http://www.latimes.com/business/la-fi-ct-milken30-2009apr30,0,1461293.story>.

299. Viacom, Inc. Board of Directors, available at <http://www.viacom.com/aboutviacom/Pages/boardofdirectors.aspx> (last visited May 1, 2008).

independence established by the New York Stock Exchange (NYSE) corporate governance listing standards.<sup>300</sup> But are these independent directors too powerless to do anything against the bull-strong founder?<sup>301</sup> Though any prognosis now may seem specious at best, the Viacom board, despite its independence, is not a good model of family business governance. The board has certainly achieved many important things in other areas, but it has failed to keep in check the excesses of the majority shareholder. It is not serving its role as corporate conscience and acts like a highly enfeebled governance mechanism that is powerless instead of empowering.

This only goes to show that having independent directors on family boards does not *ipso facto* solve all problems. If they do not perform their fiduciary duties and responsibilities well, then their independence is subject to question. Despite the advantages of more independent directors on a board, it must also be remembered that such a prescription is not automatically applicable or suitable to all businesses run by families. It has been noted that “family business managers and consultants should realize that increasing . . . the proportion of unaffiliated outsiders [on the board] will not lead to improved performance under all conditions. It is important to reflect on the contingent situation created by various aspects of family involvement in the business.”<sup>302</sup> As far as Viacom’s board is concerned, due to the company’s sheer size and complexity, it is appropriate for it to have a majority of independent directors. That said, however, the independent directors ought to continuously and meticulously balance and effectively advise “the grand old man,” Sumner Redstone.

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300. Viacom, Inc., *Corporate Governance Guidelines*, [http://www.viacom.com/investorrelations/Investor\\_Relations\\_Docs/Corporate\\_Governance\\_Guidelines12-13-07.pdf](http://www.viacom.com/investorrelations/Investor_Relations_Docs/Corporate_Governance_Guidelines12-13-07.pdf) (last visited May 2, 2008).

301. The situation on the Viacom board and the dominance of Sumner Redstone is similar to many Chinese family businesses (“CFBs”). See Jennifer Chiang, *Chinese Family Business: Corporate Governance, Succession, and a New Generation of Asian Leaders* 8 (Apr., 2009) (unpublished final paper, University of Pennsylvania Wharton Business School) (analyzing issues arising due to paternalism in Chinese family run businesses). “Most CFBs are still dominated by the founder-entrepreneur who reigns as the patriarch over all aspects of the business. Decision-making is centered on the patriarch, and leadership is directive and authoritative. Paternalism reinforces the organizational rigidity and hierarchy of the family business system: the patriarch often dominates the boardroom at the expense of minority shareholders. This is further compounded by the family’s innate distrust of non-family outsiders. ‘There is reluctance to bring in professional managers because this requires reaching outside the bonds of the family, where trust is low.’ As a result, the majority of CFB boards are ‘rubber-stamp’ boards with no real monitoring mechanism. Most of the directors are family insiders whose chief concern is the family welfare, and not the rights of minority, non-family shareholders. This is a common phenomenon not just in Chinese family businesses, but also prevalent in Korean family-dominated chaebols.” *Id.*

302. See Corbetta & Salvato, *supra* note 13, at 132.

C. *The Model Independent Board: The Clemens Family Corporation*

While the Viacom board may not be an ideal independent body, the independent board of directors of the Clemens Family Corporation is. The Clemens board, more famous for its subsidiary, Hatfield Quality Meats, presently has a blend of outside and inside directors,<sup>303</sup> with three insiders and four independent directors. Of the three insiders, one is the CEO (Phil Clemens), while the other two are family members who are not employed by the company.<sup>304</sup> Currently brimming with stewardship, the Clemens Family Corporation and its board were not always pretty pictures to observe.

In 1999, the board (then known as the board of Hatfield Quality Meats, as the holding company Clemens Family Corporation was still to be formed) was puzzled as to why the company was in a downward financial spiral.<sup>305</sup> Even their contributions to charity were going down.<sup>306</sup> After consulting with the board, Phil Clemens spearheaded a rapid, behind-closed-doors corporate upheaval that revitalized the entire company, but also bred familial discord, albeit temporarily.<sup>307</sup> With the help of a strategic consultant, it was decided that a succession planning committee should immediately be formed and given plenary powers.<sup>308</sup> After three months of deliberations, the resolutions of the committee were astounding and radical: long-entrenched family directors and employees were asked not to return to the company.<sup>309</sup> The board, which was originally composed of ten family representatives and two independents, was disbanded.<sup>310</sup> It was also decided that two family middle managers needed to gain outside experience. The board of directors was heavily reconstituted with four old family directors asked not to return; two thirty-five year family employees were dismissed; a parent company known as Clemens Family Corporation was created; and an Owners' Advisory Council was established.<sup>311</sup> Phil Clemens, due to his competence and vision, was promoted to CEO and Chairman of the Clemens Family Corporation.<sup>312</sup> The blitzkrieg-like change was unprecedented and caused a lot of suspicion, as well as a sense

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303. Answers.com, The Clemens Family Corporation, <http://www.answers.com/topic/the-clemens-family-corporation> (last visited Oct. 4, 2009).

304. Interview with Phil Clemens, CEO & Chairman of The Clemens Family Corporation (Apr. 24, 2008) (on file with author).

305. *Id.*

306. *Id.*

307. *Id.*

308. *Id.*

309. *Id.*

310. *Id.*

311. *Id.*

312. *Id.*

of betrayal and jealousy.<sup>313</sup> The board and management were later successful in allaying fears through the proper timing of the release of information, open communications with employees, and a spirited education campaign.<sup>314</sup>

A company with a very humble foundation and deeply rooted in values,<sup>315</sup> the Clemens Family Corporation did not always have an independent board.<sup>316</sup> As of 1973, there was a majority of family members as directors with just a handful of outsiders.<sup>317</sup> These outsiders were listened to at first, but their ideas were not implemented simply because of a prevailing attitude that the “family members know better.”<sup>318</sup> This continued until the board was, as stated, completely revamped in 2000 by including independent directors, purging the old timers, and selecting family members who did not have managerial responsibilities, except for the CEO.<sup>319</sup> Part of the strategy was to create an Owners’ Advisory Council whose main objective, other than to set owners’ expectations, was to interview and recommend candidates for the Clemens board.<sup>320</sup> The board meets five times per year, has four standing committees, and is subjected to annual review.<sup>321</sup>

In an interview with Phil Clemens, he stated that the typical family business board in the United States is composed of all insiders.<sup>322</sup> This is due to the fact that the founder-owner and the board believe they already know everything about the business, which is simply incorrect.<sup>323</sup> He pointed out that independent directors have a variety of tasks that cannot be done by the very subjective founders or family members, such as serving as balancers on the board, and interviewing for and selecting the next CEO.<sup>324</sup> If family member-directors will pick the next CEO, they will certainly pick their own son or in-law with little or no regard to their level of competency.<sup>325</sup> He also mentioned that it would be best to try to avoid

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313. *Id.*

314. John L. Ward & Christina N. Goletz, Clemens Family Corporation (B): The Process of Change, Kellogg Sch. Mgmt KEL116, 2004, at 1-5.

315. The Clemens Family Corporation, <http://www.clemensfamilycorp.com/> (last visited May 3, 2008).

316. Interview with Phil Clemens, *supra* note 305.

317. *Id.*

318. Phil Clemens, CEO & Chairman of The Clemens Family Corporation, Presentation on How to Instill Values in the Business at Wharton School’s Course on Strategies and Practices of Family-Controlled Companies (Apr. 3, 2008) (on file with author).

319. *Id.*

320. *Id.*

321. *Id.*

322. Interview with Phil Clemens, *supra* note 305.

323. *Id.*

324. *Id.*

325. *Id.*

directors whose independence might be questionable (e.g., suppliers and customers).<sup>326</sup>

Additionally, he recommended that generally (and depending on the size of the board in question) family boards should at least have three independent directors for balance.<sup>327</sup> Independent directors are identified and recruited through word-of-mouth, but the assistance of search firms and the Family Firm Institute (FFI) is most laudable.<sup>328</sup> What should be guarded against, he noted, is whether the independent director really exercised his independence and objectivity on vital board decisions.<sup>329</sup> Did he exercise his own judgment? Was it a credible independent decision, or was he forced by the family to vote that way? Coercion and deception should be avoided at all times.<sup>330</sup> Directors also must not serve too long, as they will easily become attached to personnel, become friends with the CEO, and thus lose their independence.<sup>331</sup> He asks: how can you vote against the CEO when he has already become your friend and colleague? Phil Clemens thus suggested that the minimum time to serve should be three years (electable every year) and the maximum ought to be ten.<sup>332</sup> This time period will leave a comfortable average of around seven years of board service.<sup>333</sup>

Based on his own experience, independent directors who become close friends with the CEO should resign.<sup>334</sup> Phil Clemens resigned from boards he served on in New Jersey and Florida simply because he could not perform his role as monitor and conscience when he had become good friends with the person he was supposed to oversee. He simply told these boards he had to resign.<sup>335</sup> For him, independent directors are fresh eyes, eager individuals who see the bigger picture of the company and prescribe workable solutions.<sup>336</sup> Though independents may sometimes be viewed with antagonism, management generally appreciates outside board members because they know outsiders are going to be fair, as they do not have ties with the business.<sup>337</sup> It is also best, he mentioned, that independent directors do not come from the same industry as the

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326. *Id.*

327. *Id.*

328. *Id.*

329. *Id.*

330. *Id.*

331. *Id.*

332. Presentation by Phil Clemens, *supra* note 319.

333. *Id.*

334. *Id.*

335. *Id.*

336. *Id.*

337. *Id.*

corporation's industry.<sup>338</sup> He himself is a director in a successful flower company and his thoughts and opinions are most valued.<sup>339</sup> He similarly postulated that it is hard for independent directors—in fact very dangerous—to meddle into family problems and squabbles.<sup>340</sup> “That simply isn't their duty.”<sup>341</sup>

There are times when independent directors can play mediating roles, but the maintenance of family unity is not one of their chief functions.<sup>342</sup> On the charge that independent directors do not know the business they are asked to monitor, Clemens stated that independents are not tasked to know every corner of the business.<sup>343</sup> The nature of the job of an independent director is to select the next CEO, provide insight from the outside, oversee management, give a different yet fresh perspective, and present the bigger picture objectively.<sup>344</sup> It is not the nature of their job to interfere with the day-to-day affairs or to know everything there is to know about the company.<sup>345</sup> His company's criteria for independent directors are: (1) currently a senior management individual from a successful business, with preference for Presidents or CEOs; (2) strong financial background and clearly understands the need and value of business metrics; (3) unquestionable ethics and integrity; (4) embraces the visions, values, and culture of the Clemens Family Corporation; and (5) proposed directors shall not have a conflict of interest with any Clemens Family Corporation business.<sup>346</sup>

#### V. THE IDEAL FAMILY BUSINESS BOARD: BOARD SIZE, FREQUENCY OF MEETINGS, AGENDA, PLANNING AND PROGRAMMING

It is difficult to pin down a perfect board size for most family-run businesses. Several factors have to be considered. These factors would include the size of the organization, the length of time it has been in business, and its annual returns. A family company should typically have five to eight directors<sup>347</sup> (or seven to twelve directors for larger entities),

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338. *Id.*

339. *Id.*

340. *Id.*

341. *Id.* This statement of Phil Clemens in 2008 echoes a statement by one of the independent directors interviewed by Schwartz & Barnes in 1991 who stated, “I shouldn't be involved in there [family dynamics.] It's not my business, and I should be where I can be more objective than they are.” Schwartz & Barnes, *supra* note 84, at 280.

342. Interview with Phil Clemens, *supra* note 305.

343. *Id.*

344. *Id.*

345. *Id.*

346. The Clemens Family Corporation, Board of Directors Adopted 2001, *available at* <http://www.clemensfamilycorp.com/pages/board-of-directors.aspx>.

347. Davis & Cormier, *supra* note 82, at 5.



with a majority of independent directors. Insider directors should consist of the CEO and a few family representatives who need not be employed in the company or even be direct family members. They can be representatives elected by the shareholders, the family, or the family council.<sup>348</sup> In the long-run, due to possible tensions or conflicts of interest, it may be better to avoid appointing as directors family members who are going up in the corporate ladder. If an employed family member is already a very senior manager and is seen as a potential successor, then it may be a good idea to give that individual a directorial role so that the board can assess his or her viability and leadership.

In terms of frequency of meeting, it will again depend on many factors. As seen in the case of Vietri, Inc., its board had been meeting only once per year,<sup>349</sup> yet communication between the owner-managers and board members was constant and open throughout the year.<sup>350</sup> The Vietri board assisted greatly with issues ranging from transition and succession, to sibling rivalry.<sup>351</sup> On the average, a family board should meet between four to six times per year, with the agenda set up by the CEO in consultation with the independent directors.<sup>352</sup> More importantly, each meeting should be “a virtual seminar in business administration and human dynamics, with everyone present both teacher and student.”<sup>353</sup>

The independent directors, as stated above, should outnumber the insiders and the grey directors. As is the case of the Clemens Family Corporation, of the seven board members, only three are insiders (the CEO Philip Clemens and two other non-executive family members), and four are totally independent board directors.<sup>354</sup> The ratio between insiders/grey and independent directors need not reach the present dynamics of publicly-held corporations, which stands at one to nine, with one insider director (the CEO) and all the rest independents.<sup>355</sup> A good 70:30 or 60:40 ratio of independent directors to insider/grey directors would be a healthy composition of a present-day family board.<sup>356</sup> As much as possible,

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348. *Id.*

349. This practice of meeting only once a year may have changed.

350. See Stone, *supra* note 106, at 5 (explaining how the sisters take advantage of the board members' expertise outside of the annual meeting).

351. *Id.*

352. Ellen Frankenberg, *With Apologies to David Letterman: Ten Reasons Not to Create an Advisory Board*, FAM. BUS. MAG., Autumn 2003, at 2 (“A typical board agenda might include (1) reviewing management’s implementation of the strategic plan, (2) comparing last year’s financials with this year’s, (3) helping determine the feasibility of expanding into a new region or product line, (4) discussing reports from department heads and (5) developing criteria for selecting the next CEO.”).

353. Raymond, *supra* note 78, at 7.

354. Interview with Phil Clemens, *supra* note 305.

355. *Id.*

356. *Id.*

however, grey directors—meaning the corporation’s service providers (e.g. lawyers, accountants, bankers), CEO friends, business dealers and suppliers, and other friends of family members (e.g. golf buddies of an uncle in the business) —should be avoided.<sup>357</sup> They are usually beholden to the family or dominated by the CEO or a kin very close to him, and therefore lack independence.<sup>358</sup> They may eventually end up diminishing the integrity of the board.

The family business board ought to schedule yearly planning meetings or retreats.<sup>359</sup> Business Planning, it must be recalled, is a very inclusive activity.<sup>360</sup> Thus, the business of the board need not be confined to formal meetings or telephone conversations. Camaraderie, interpersonal communication, friendliness, candor, and familiness must permeate the board in all of its activities. One of the better ways to achieve this is an annual retreat which will discuss and program future plans.<sup>361</sup> This will help the board relax and get to know each other better, over and beyond their impressions of each other in the boardroom.<sup>362</sup> This can be done every six months if time permits.<sup>363</sup> According to John A. Davis and Keely Cormier, family business boards should meet quarterly for a day or more each time.<sup>364</sup> Three of the four annual meetings should last one day, while the fourth should be a live-in retreat between the management and board to plan the following year’s programs.<sup>365</sup>

Board members should also have limits on their terms of office. Directors should have a one to three year term limit, with reelection permissible, and should be compensated based on prevailing market norms.<sup>366</sup> Neubauer and Lank advocate the suggestion by John Ward, who stated that companies should pay directors per day for board services in a manner similar to the “daily wage” of the owner-CEO (owner-CEO’s yearly pay divided by 250 working days).<sup>367</sup> The compensation to directors should not be extravagant, but reasonable enough to incentivize attendance,

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357. See Davis & Cormier, *supra* note 82, at 6 (noting how some CEOs have found their companies to be most benefited by “unbiased, objective views from outside directors”).

358. See MILLER & BRETON-MILLER, *supra* note 3, at 219 (comparing the governance, philosophy, and organization of winning family controlled businesses versus common practices).

359. See Neubauer, *supra* note 70, at 2 (suggesting there should be a reasonable number of board meetings per year as well as biannual retreats in places away from the business).

360. *Id.*

361. Davis & Cormier, *supra* note 82, at 3.

362. *Id.*

363. *Id.*

364. *Id.*

365. *Id.*

366. NEUBAUER & LANK, *supra* note 169, at 124.

367. *Id.*

and must include retainer, board, committee fees, and perquisites, if any.<sup>368</sup> Also, a nominating committee ought to be responsible for screening and selecting potential directorial candidates,<sup>369</sup> with assistance from human resources consultants or search firms.<sup>370</sup> John A. Davis recommends that family shareholders should not only understand board member qualifications, but must likewise “participate, when useful, in the screening of board members.”<sup>371</sup> Board directors should not spread themselves too thin by serving as directors in more boards than they can possibly handle both physically and mentally.<sup>372</sup> This practice is frowned upon by the public and the business community.<sup>373</sup> Directors should ideally serve on, at most, three to four boards, the ceiling of which can be adjusted depending on the director’s expertise, time availability, and lack of conflicting interests, among other factors.<sup>374</sup>

Self-evaluation<sup>375</sup> by the board should be part of its programming.<sup>376</sup> Who is performing well, who is absent for no justifiable reason, and who is not performing up to par are questions that must be answered and addressed by the board if it is to be an effective governance structure.<sup>377</sup> This will ensure that it is not made into a rubberstamp by the founder or CEO.<sup>378</sup> It will also check the egos of the board members as they may think they are superbly performing when, in fact, they are not.

## VI. CONCLUSION

The concept of a family-run business is eternal and will not wither away. Families will be starting new entrepreneurships or continuing businesses that have been handed down to them from the prior generations. As such, it is good to continually explore its strengths and identify its problem areas so that updated and relevant solutions are made. Family businesses are very important in the economic fabric of any country. One need not look too far: a third of Fortune 500 firms are owned by

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368. Heidrick, *supra* note 197, at 276.

369. Joseph Astrachan, Andrew Keyt, Suzanne Lane, and Kristi McMillan, *Fostering Accountability in the Family Business Board*, FAM. BUS. MAG., Winter 2007, at 3.

370. Davis et. al, *supra* note 152, at 8-9.

371. John A. Davis, *Responsibilities & Rights of Family Shareholders of a Family Business*, HARV. BUS. SCH. 9-801-264, Jan. 2001, at 1.

372. JAMES F. REDA, STEWART REIFLER, & LAURA G. THATCHER, *THE COMPENSATION COMMITTEE HANDBOOK 72-3 (2007)*.

373. *Id.*

374. *Id.*

375. NEUBAUER & LANK, *supra* note 169, at 121-123.

376. *Id.*

377. *Id.*

378. *Id.*

families;<sup>379</sup> family-controlled businesses account for over half of U.S. employment and approximately 78% of new jobs created.<sup>380</sup> Additionally, 80-90% of all businesses in North America are family-run enterprises averaging fifty or so employees, and quite keenly, 39% of family-owned businesses will change leadership in the next five years.<sup>381</sup> Asian businesses are predominantly family-owned enterprises, while in the European Union, family firms comprise about 60-90% of all businesses, depending on the country.<sup>382</sup>

To ensure that family-run businesses go past the first and second generations, one of the key governance mechanisms is the institution of an independent board. Consultants have argued that boards of directors must not be the first line of attack and are advocating for an advisory board that will eventually morph into a formal board of directors.<sup>383</sup> There is truth and pragmatism to this argument, but if the company is ready for a board and the founder-CEO is enlightened that a well-chosen board is a “fountain of knowledge,”<sup>384</sup> then its constitution need not be delayed by years or decades.

The foundation of an independent board is independent directors.<sup>385</sup> Independent directors promote cohesion, provide perspective and neutrality, and check and balance the founder-CEO. They serve to aid the board in its decisions due to their expertise and years of serving as corporate managers or CEOs. They can also act as mediators in case there is a family conflict that is teetering on destroying the business, which they, as a corporate conscience, cannot simply sit by idly while the founder, the heir-apparent, and the family tear each other apart. Failure to decisively act may lead to a violation of their fiduciary duties as directors, which means that serving on the board is not risk-free but risk-laden. Hence, a strong commitment to serve, mental fortitude, and educated evenhandedness are critical.

It is true that “family and business cultures, which shape governance systems, differ widely across geographical boundaries, as well as over time and business life-cycle stages.”<sup>386</sup> Essentially, this means that family

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379. See MILLER & BRETON-MILLER, *supra* note 3, at 3 (noting that thirty-five percent of S&P 500 companies as of 2003 are family-controlled businesses with the founding family on board as executives or as very influential owners).

380. *Id.* at 2.

381. Stuart Diamond, Presentation on Family Business at a University of Pennsylvania Law Course on Negotiations and Dispute Resolution (Nov. 29, 2007).

382. See LANDES, *supra* note 6, at xi (noting that “[i]n the European Union, family firms make up 60-90 percent of businesses, depending on the country . . .”).

383. Murdock, *supra* note 163, at 1-4.

384. Raymond, *supra* note 78, at 4.

385. *Id.*

386. Corbetta & Salvato, *supra* note 13, at 124.

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business governance varies from place to place and from time to time. This also means that independent boards are relevant based on existing circumstances of the family business. Though outside boards are not mandatory for the survival and functioning of *all* family businesses in *all* relevant stages of their life cycles, having one will increase the chances of surviving well beyond the first and second generations.