Governance & Compensation: The State of Family Businesses in the Pacific Northwest

October 2018

Pacific Family Business Institute

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Pacific Family Business Institute

October 2018

Dear Family Business Owner,

The Pacific Family Business Institute is pleased to present *Governance & Compensation: The State of Family Businesses in the Pacific Northwest.* This study extends our ongoing research and offers valuable insights into the challenges, issues, and opportunities facing family businesses in the Pacific Northwest.

The survey, administered by Riley Research Associates, has been made possible through the generous financial support of our sponsors: Cascadia Capital, Moss Adams, and Davis Wright Tremaine. We are extremely grateful to them and to the 81 family businesses that participated in the interviews and/or online survey.

This report presents the key findings. We will draw on these findings as we continue to support family businesses navigating the challenging and dynamic business environment in the Pacific Northwest. At the same time, we hope our survey participants, other family businesses, and their advisers throughout the region can use the findings to identify and implement best practices around governance and compensation.

Please send us any questions or suggestions, or just let us know how you are using this report in your work, by sending a note to info@pacificfamilybusiness.com. Together, we can continue to help regional family businesses thrive.

Sincerely,

Richard Simmonds	Mark T. Green, Ph.D.	Ron Dohr, Ph.D.
Co-Director	*Co-Director*	*Co-Director*

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Executive Summary

In late 2017 and early 2018, the Pacific Family Business Institute (PFBI) conducted in-depth interviews and surveyed 81 family businesses in Oregon and Washington to gain a better understanding of regional best practices related to governance and compensation among regional family businesses. This in-depth study complements PFBI's previous surveys, which date back to 2012 and serve as a barometer of family business in the Pacific Northwest.

This report was made possible through the support of three sponsors who actively support regional family businesses: **Cascadia Capital, Moss Adams,** and **Davis Wright Tremaine**. All of these organizations are fully committed to family businesses in the Pacific Northwest and related research.

This report summarizes our key findings and recommendations. Additional details and copies of the questionnaire will be made available upon request.

The Value of Governance

Good governance can be time-consuming and expensive, but the value of a Board of Directors is widely accepted, with 80% of respondents considering Board contributions to be "valuable." Most family businesses recognize and appreciate the value of having a formal Board of Directors with regular meetings, defined processes, committees, compensation and independent Directors.

Most of the respondents govern with a Board of Directors, and this is especially true for companies with greater sales, revenues, generational history, and age. Businesses that have both a Board of Directors and a Family Council are more likely to have independent (non-family) Directors.

Board Member Compensation

Approximately two-thirds of respondents compensate their Directors. Independent (non-family) Directors are the most likely to be paid, while family members who work in the business are the least likely to receive compensation in exchange for their Board service. Most Boards provide various perks to their Directors.

Most of the respondents believe that Board Members are satisfied with the amount they are paid for Board service. However, the more specific question of whether *family* members serving on a Board of Directors are receiving adequate compensation may be an area for further study.

Urban vs Rural Practices

This study reveals profound and surprising differences between rural and urban governance practices. Rural respondents are more likely than their urban counterparts to have an active Board of Directors, and those Boards are generally smaller. Rural companies also tend to report greater satisfaction with their governance structures.

In addition, rural companies are more likely to recognize and emphasize the need to mentor family members regarding their roles in the family business and governance.

Board Composition, Recruitment and Retention

Within the study sample, on average, a Board of Directors comprises four family Members and three independent Members. Surprisingly, nearly 40% of Boards have no independent Members.

About half of the organizations surveyed have formal written policies or guidelines for Board Membership. “Specific expertise” and “trust by the extended family” were the most sought-after criteria for selecting independent Board Members.

Most respondents indicated it was easy to retain and recruit Board Members. Most Boards have little turnover and do not have term limits. When Board Members do leave, they most often cite age or retirement as the reason. Therefore, families should consider instituting term limits that will give them the flexibility to renew their Boards as the governance needs of the business change over time.

Board Operations

Boards of Directors typically spend about 20 hours every year in formal meetings. In addition to regular Board meetings, respondents hold special meetings, typically to address revenue or cost issues.

A typical Board of Directors focuses on internal issues in meetings 60% of the time, tends to operate with a Compensation and Audit Committee, and provides developmental opportunities for Directors. Older and larger, multigenerational family businesses that are more likely to have a formal Family Council to guide family decision-making.

The meeting frequency for both Boards of Directors and Boards of Advisors tends to be greater for older, larger and more complex organizations that are also top performers in their industry. Board Chairpersons work an additional 80 hours or more, on average, within their leadership role.

Best Practices for Family Business Governance

As a family business and the owning family age and grow in size and complexity, with multiple locations and greater strategic challenges, formalizing the Board governance processes becomes increasingly important. Respondents broadly acknowledged that formal processes such as job descriptions, terms limits, clear meeting agendas, selection criteria, and developmental programs for Directors can help to strengthen the overall governance system for family businesses.

The specific needs for formal Board governance and structure will change and evolve over time as a business grows and the needs of the management team and the family become more complex. As family businesses grow and evolve, the need for independent (non-family) Directors and their ability to bring an external perspective to the Board of Directors becomes more critical and more valuable.

Given that nearly 40% of Boards have no independent Members, there seems to be a significant opportunity for family business advisors to educate regional family businesses about the potential advantages of having independent Directors serve on the Board.

A Note to Readers

For clarity and readability, we have adopted the following conventions:

- The terms *Board of Directors, Board of Advisors, Family Council, Directors, Advisors,* and *Members* (when referring to Family Council Members or Board Members) have been capitalized throughout this document.
- In graphs and tables, these terms are abbreviated as *BOD, BOA,* and *FC*.
- *Directors* and *Members* are used interchangeably.
- *Independent Directors* are individuals who serve on a Board but are neither family members nor employees.

This report comprises five sections:

- **Part I** focuses on governance type and respondents' satisfaction with their current system of governance.
- **Part II** focuses on family businesses that have a Board of Directors and/or a Family Council.
- **Part III** focuses on family businesses with a Board of Advisors.
- **Part IV** draws conclusions from the survey findings and presents recommendations for family businesses and the professional advisors who serve them.
- **Part V** describes the survey methodology, respondent characteristics, and information about the survey sponsors.

PART I: GOVERNANCE STRUCTURE

In Part I, we focus on governance type and respondents' satisfaction with their current system of governance.

To draw useful conclusions and make recommendations based on the data, respondents were classified based on whether they have one or more of the following governance (decision-making) structures:

- **Board of Directors** (Part II)
  A Board of Directors (BOD) is the governance body of an incorporated firm and has a fiduciary responsibility. Its members, elected by shareholders, have decision-making authority and typically approve the corporate direction, create committees when needed, hire and monitor senior executives, and establish executive compensation. They are legally bound to the business and may be held liable for the consequences of a firm's actions or inaction.

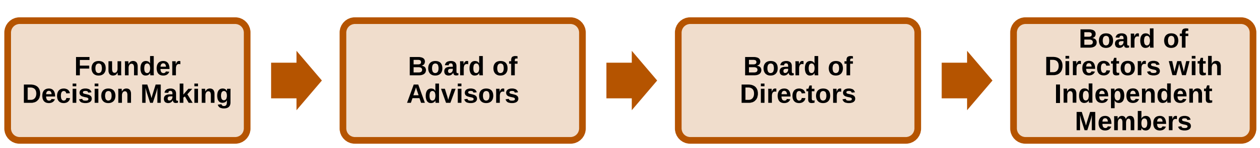
- **Family Council** (Part II)
  A Family Council (FC) is the governance body of the family, and its representatives are elected by family members. The Family Council develops the family's vision for the business, aligns family values, and serves as the communication link between the Board and the family. A Family Council can be especially helpful in transitioning family leadership across generations.

- **Board of Advisors** (Part III)
  A Board of Advisors (BOA) is a governance body that provides non-binding, strategic advice to the management team of a business. The members of a Board of Advisors do not have decision-making authority or fiduciary responsibilities. Businesses generally choose to have a Board of Advisors so that they can benefit from the knowledge and advice of experienced professionals.

Governance (decision-making) follows the needs of a business and may follow one or both of the continuums shown below.

Family Governance Continuum

Business Governance Continuum

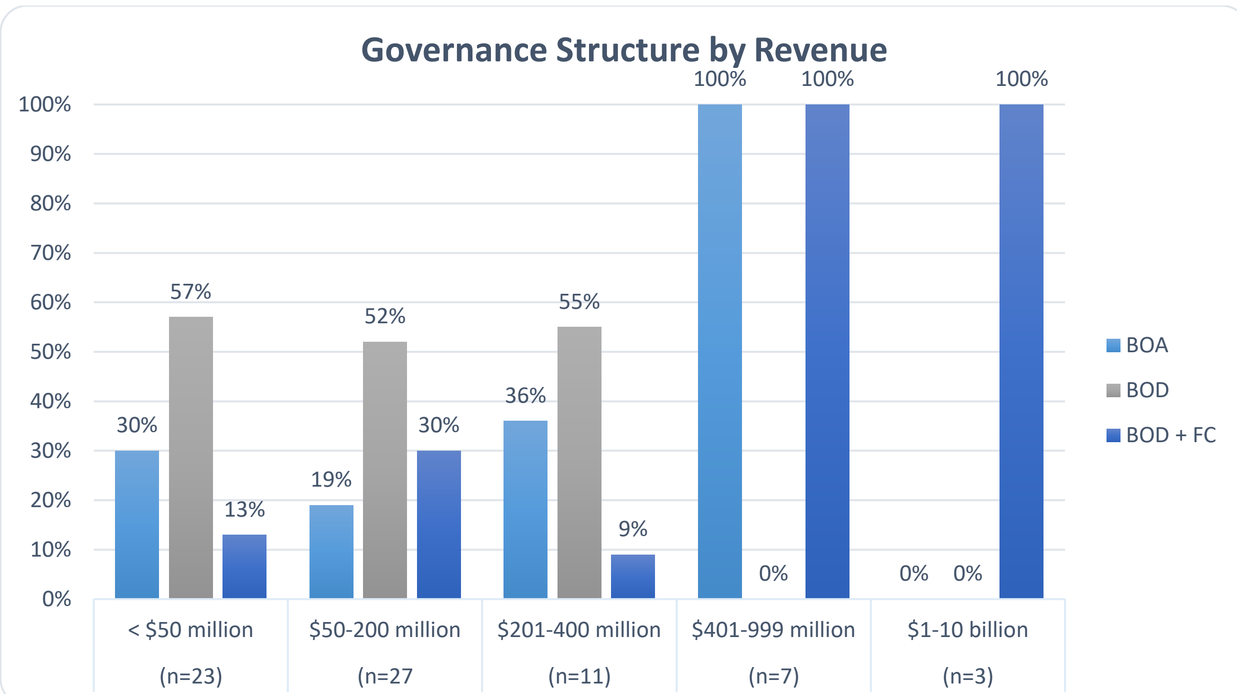


The evolution of governance often begins with an owner in search of a sounding board, and initially it may simply involve meetings over coffee. Over time, these discussions may evolve into a Board of Advisors, a family-only Board, a Board with family and independent members, and finally a Board of Directors in which the majority of the members are not part of the family.

The prevalence of these three governance structures appears to be a function of the business' revenue, industry performance, age, and location as described below.

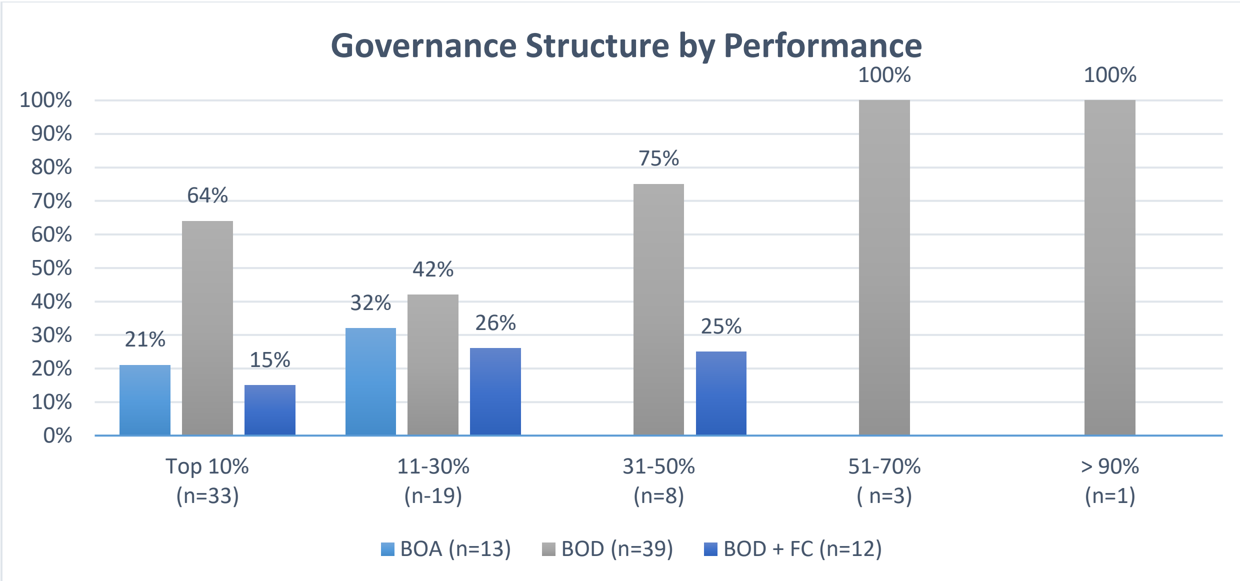
Type of Governance Structure

Companies with higher sales or revenue are more likely to have a Board of Directors as shown in the following graph.

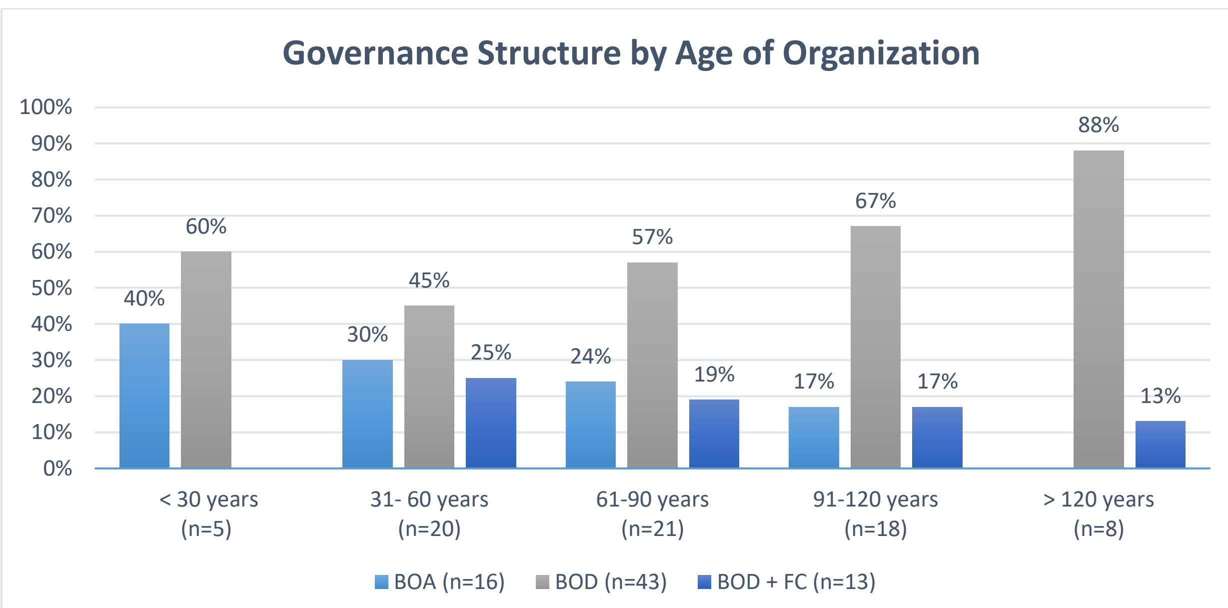


Businesses that perceive themselves as the strongest performers within each industry are more likely to have a Family Council than weaker performers.[1] We believe this is because the existence of a Family Council provides structure for aligning family and business planning, which leads to stronger business performance.

[1] Respondents were asked to assess their performance in relation to that of their competitors.



Older businesses are less likely to have a Board of Advisors or Family Council, but more likely to have a Board of Directors.



General Perceptions on Governance

Family businesses are generally pleased with their governance structure. More than 80% of all respondents indicate that they are *satisfied* with how their company is governed. The following table indicates respondents' satisfaction with their governance based on whether they have independent Board Members.

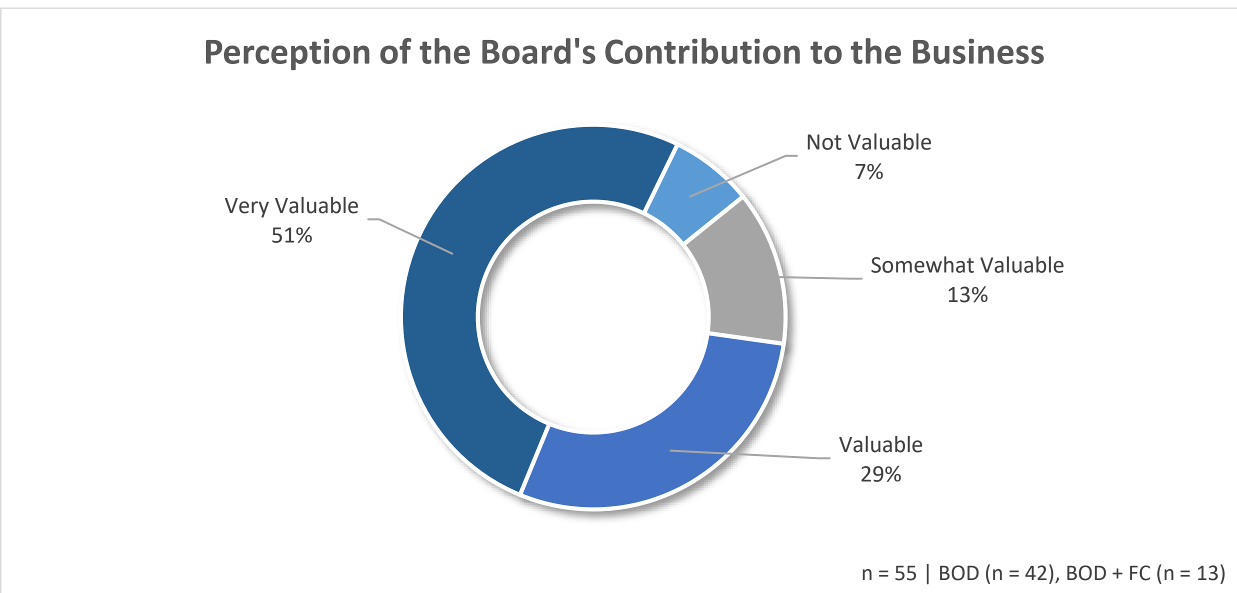
How satisfied are you with the way the business is governed?						
	Total	Very Dissatisfied	Dissatisfied	Satisfied	Very Satisfied	No Response
At Least 1 Independent Board Members	64%	2%	9%	23%	31%	35%
No Independent Board Members	36%	0%	14%	59%	10%	17%

Those satisfaction ratings are highest among businesses that are older, have greater revenues, have Family Councils, are top performers in their industry, or are located in rural areas.

In addition, 93% of respondents perceive at least some value in the Board's contributions to the family business.

The Value of the Board

About 80% of respondents believe the Board's contributions are **valuable** or **very valuable**—and this rises to 100% for respondents with a Family Council.



Part II: Boards of Directors and Family Councils

In Part II, we focus on businesses that have a Board of Directors and/or a Family Council. Part III presents responses from businesses with a Board of Advisors.

Board Composition

Board Membership

All of the larger businesses (those with revenues of at least $400 million) have a Board of Directors. Respondents report an average of seven Directors. The number of Board Members increases with the age of the company and with the strength of performance within the industry.

Independent Board Members

On average, respondents report having **seven** Board Members, and larger businesses have more independent Board Members. Family businesses with less than $50 million in revenue have an average of **two** independent Board Members. In contrast, businesses with more than $700 million in revenue have an average of **five** independent Board Members.

Younger businesses have 2–3 times more family members on their Boards than older businesses do. In addition, businesses located in a large city or metro area have more Board Members (7.6) than those in a rural area (5.4).

Formal Board Governance

Family businesses would be well advised to consider having more independent Directors, perhaps forming a Family Council as the focus for greater family participation.

Nearly 40% of Boards have **no independent Directors**. Businesses that have a Board of Directors *and* a Family Council tend to have more Board Members who are independents or who are family members who do not work in the business.

Businesses that have only a Board of Directors, without a Family Council, have equal numbers of family Directors and independent Directors.

	BOD Only	BOD + FC
How many people serve on your Board of Directors?	6.6	7.5
How many people serving on your Board are family members employed by the company?	2.8	2.1
How many people serving on your Board are family members not employed by the company?	2.8	4.3
How many people serving on your Board are neither family members nor employed by the company (i.e., independents)?	2.8	4.0
How many people serving on your Board are employees who are not family members?	1.6	1.0

Non-family employees are the least likely to serve on the Board of Directors, while family employees are the most likely to be on the Board.

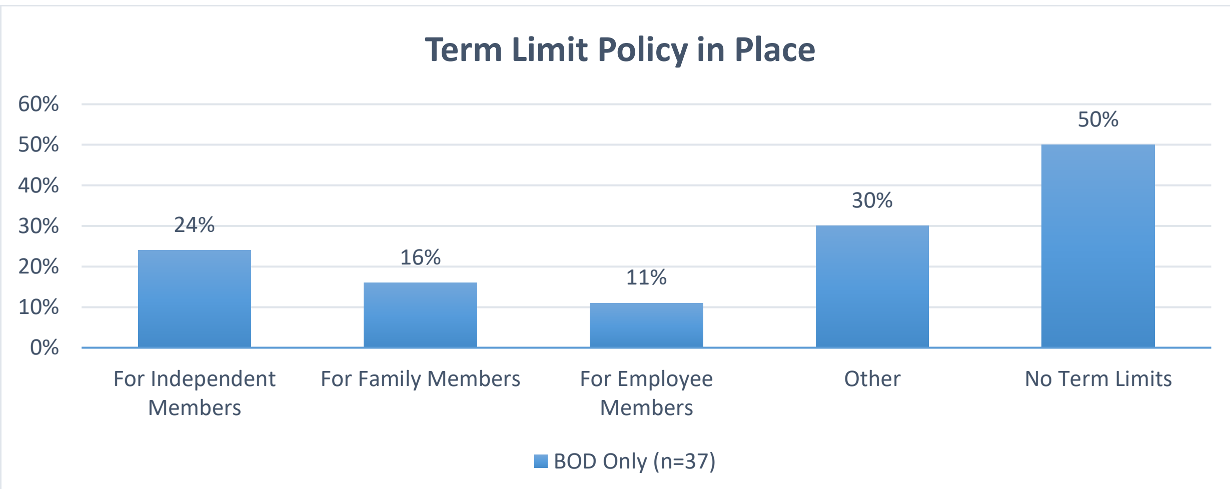
We also found that most businesses with a Family Council choose to have their Family Council President serve on the Board of Directors; this additional position on the Board of Directors may explain the difference in Board size in the first row of the previous table.

One unexpected finding is that 22% of LLCs have a Board of Directors, 22% have a Board of Advisors, and 56% have both a Board of Directors and a Family Council. This is surprising given that they are not legally required to have a governance board, and we believe this finding speaks to the benefits of having a governing body.

Term Limits

More than half of the respondents have no policy regarding term limits for Board Members. Of those that do, businesses are most likely to have term limits for independent Members.

Businesses that have a Family Council are less likely to have term limits for independent Members or family members who work in the business. Businesses with revenue exceeding $400 million are 60% more likely to have independent Board Member term limits.



Families should consider term limits as a mechanism that allows family to improve their Boards' effectiveness, promote greater diversity on the Board, and allow for renewal of the Board as the needs of the business change over time.

Term Limits

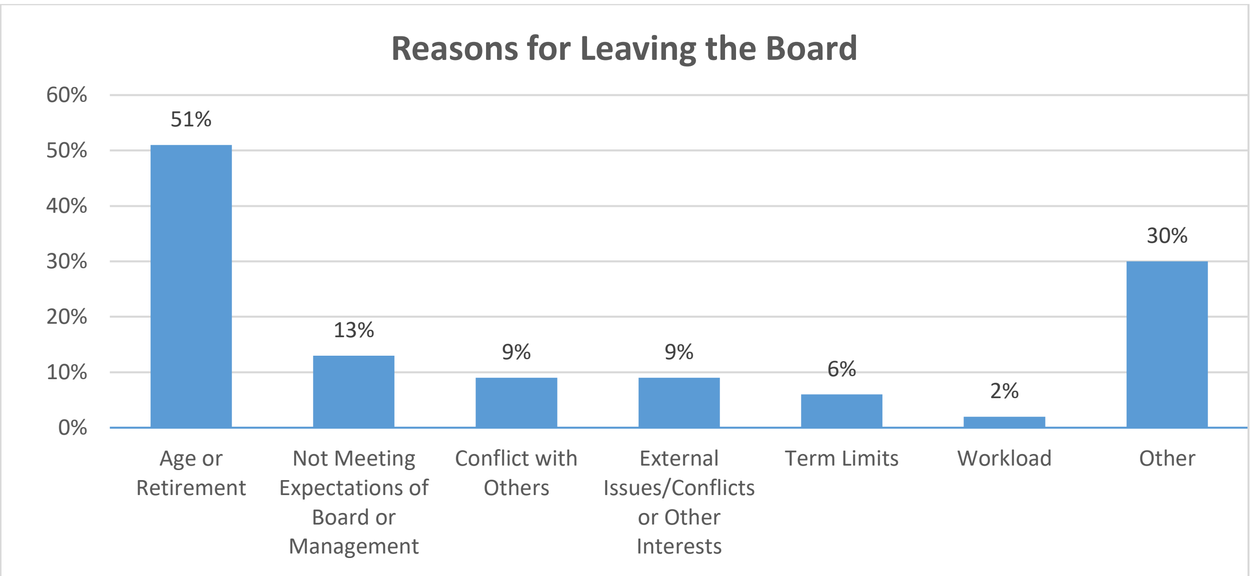
Having term limits allows family businesses to refresh and renew their Boards as their needs change—yet a shocking 50% of respondents to not have term limits in place.

Selection Criteria

Recruitment and Retention

Family businesses report that it is slightly easier to retain current Board Members than to recruit new ones, but they don't perceive either task as being difficult. On a scale of 1 to 4, where 1 signifies *not difficult* and 4 signifies *very difficult*, respondents assigned an average score of 1.5 to recruitment and an average score of only 1.1 to retention.

Although Board Members have many reasons for stepping down, Directors most commonly cite age or retirement as their reason for leaving the Board.



Almost three-fourths (73%) of respondents indicated that none of their Board Members have left in the past two years; the others reported that only one Member has left during that same time period. No respondents reported the departure of more than a single person.

On average, Board Members serve for 15.6 years.[2] This long average raises signifcicant concerns about family businesses' ability to renew and refresh their Boards as their needs change.

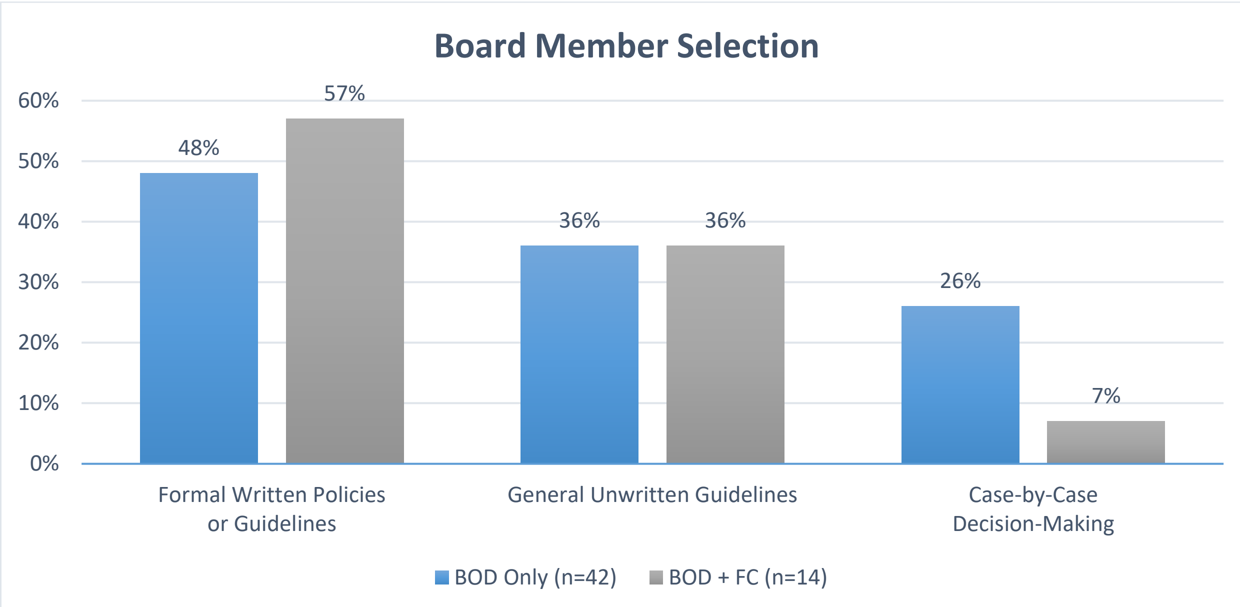
The Importance of Board Renewal

The old axiom was that family businesses need one new business idea every three generations. The new axiom is that you need ***three*** new ideas ***every*** generation—and that these ideas should be strategic or entrepreneurial with a significant impact on the way in which the family does business. To encourage this type of idea generation, frequently renewing the Board of Directors, perhaps on a five-year schedule, is critical.

[2] This average tenure was calculated by assuming that a response of "lifetime membership" equates to 35 years of Board service.

Policies/Guidelines for Board Membership

About half of all the respondents have formal written policies for selecting Board Members.



As businesses grow in sophistication and size, formalization becomes increasingly important. Unwritten policies may be sufficient in the early stages of a business, but eventually these unwritten accords need to be committed in writing to encourage stakeholder buy-in and consistent enforcement.

Formalization of Board Governance

Families should consider the benefits of formalizing their Board governance. This could include developing a vision statement, conducting a skills gap analysis, engaging in more strategic recruiting, improving the onboarding process, establishing term limits, evaluating Directors' performance, adding independent Directors, and more.

Criteria for Selecting Family Members as Directors

Respondents used the following four-point scale to evaluate the importance of selection criteria:

1. Not considered
2. Considered
3. Important but not required
4. Required

Among businesses that have only a Board of Directors, *willingness to serve* (2.9) and *company ownership* (2.8) are the most sought-after criteria when selecting family members for the Board.

Among businesses that also have a Family Council, *company ownership* (3.4) and *trust by extended family* (2.7) were the most important selection criteria.

	BOD Only (n=50)	BOD + FC (n=14)
Willingness to serve	2.9	2.6
Company ownership	2.8	3.4
Trusted by extended family	2.5	2.7
Industry experience	2.4	2.4
Branch of the family represented	2.1	2.5
Previous experience with our company	2.1	2.2
Specific expertise	2.0	2.3
Current company employee	1.9	1.8
Diversity (e.g., gender, race, ethnicity, age)	1.6	1.8

Younger businesses consider "ownership" to be an important criterion for Board representation. As businesses age, this becomes a less important factor.

Similarly, when selecting family Board Members, younger business are more likely than older companies to focus on which branch of the family tree each individual represents.

Criteria for Selecting Independent Directors.

When asked specifically about selecting independent (non-family) Board Members, respondents again used a four-point scale to evaluate the importance of selection criteria:

1. Not considered
2. Considered
3. Important but not required
4. Required

Among businesses that have only a Board of Directors, *specific expertise* (2.7) and *trust by the extended family* (2.6) are the most sought-after criteria when selecting independent Directors for the Board.

Businesses that also have a Family Council identify the same two traits as their most important selection criteria along with *industry experience*.

Selection of Independent Directors

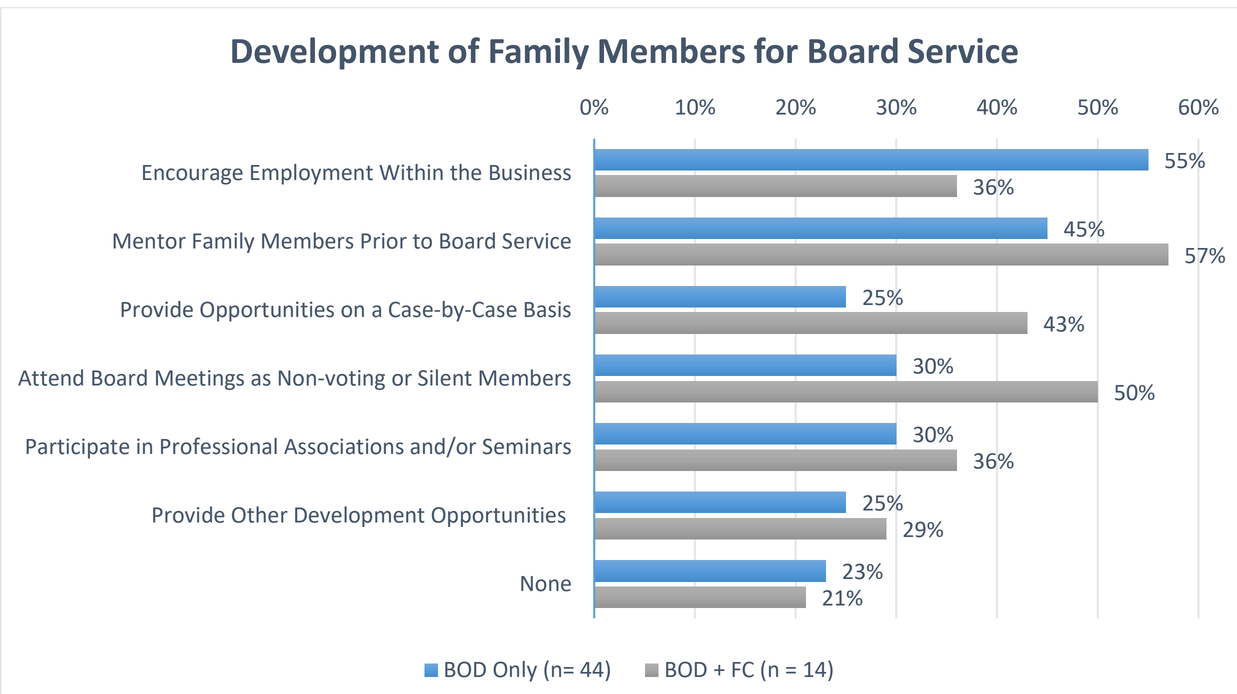
When selecting independent Board Members, family businesses are most likely to seek candidates who are **trusted** by the extended family and have specific **expertise**.

Businesses with a Family Council place greater emphasis on *specific expertise* and *diversity* but assign less importance to *previous experience with the company.*

	BOD Only (n=40)	BOD + FC (n=11)
Trusted by extended family	2.7	2.7
Specific expertise	2.5	3.5
Industry experience	2.4	2.7
Previous experience with our company	2.1	1.3
Friend of the family	1.6	1.7
Diversity (e.g., gender, race, ethnicity, age)	1.6	2.5
Current company employee	1.4	1.0
Company ownership	1.3	1.2

Preparing Family Members to Serve on the Board

About half of the respondents identify family members who will serve on the Board in the future, encourage them to work for the company, and mentor them in preparation for their future role. However, about one-fifth do not provide any development opportunities for those individuals.



As companies age, they spend more time developing the next generation of the family for Board service. In addition, older businesses, those in rural areas and those working primarily in Oregon encourage and mentor future family members more than their peers. Best practices may include encouraging or requiring family members to work for the company, engaging family members in mentor relationships, and inviting family members to attend Board meetings.

Preparing Family Members for Board Service
Businesses with both a Board of Directors and a Family Council are much more likely to support and encourage the development of family members. Requirements such as working outside of the family business for 3–5 years are key to building better Boards and preparing for the next generation for leadership roles.

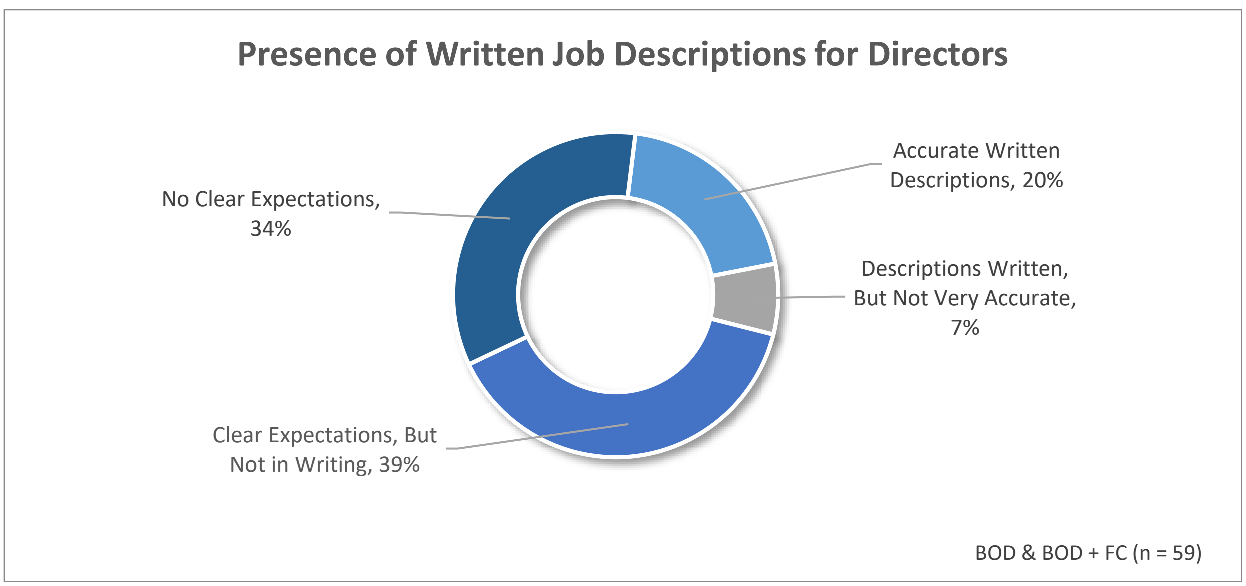
Businesses that have a Family Council in addition to a Board of Directors are more likely to allow future Board Members to attend Board meetings as silent Members, but less likely to ask them to work in the business.

Family Councils following best practices typically encourage family members to attend Board meetings as a way to help them become better owners. They encourage or require family members to delay employment in the business, instead gaining 3–5 years of experience in another company. For example, one of our consulting clients is a Pacific Northwest business whose suppliers are small family businesses in other parts of the world. In order to ensure that family members gain valuable, global experience, the business requires family members to earn a college degree and then work *internationally* for three years before beginning to work in the family business.

Roles & Scope of Involvement

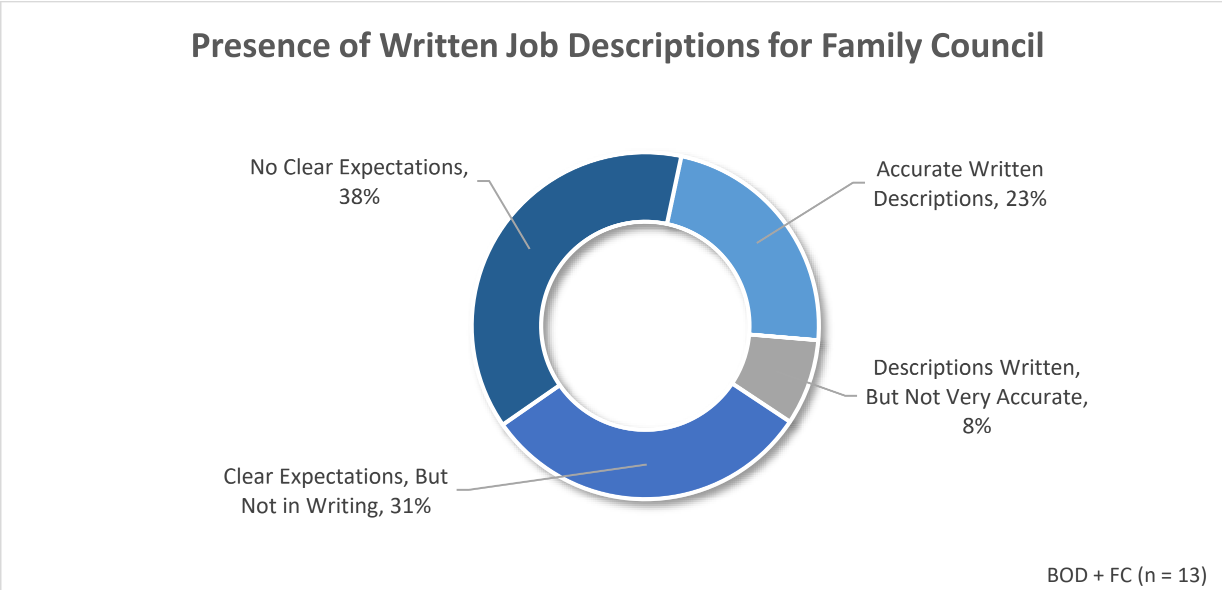
Job Descriptions

About half of the respondents have written guidelines regarding the role of their Directors, but those Board job descriptions are not as accurate and precise as they should be. Only about 20% of respondents report that they have accurate, written job descriptions of what is required of a Board Member, while 34% have no clear expectations in writing or otherwise.



Businesses with greater revenues are significantly more likely to have written guidelines, which supports the correlation between Board formalization and industry performance.

Family Councils report similar challenges in the written descriptions of the roles of their Members.

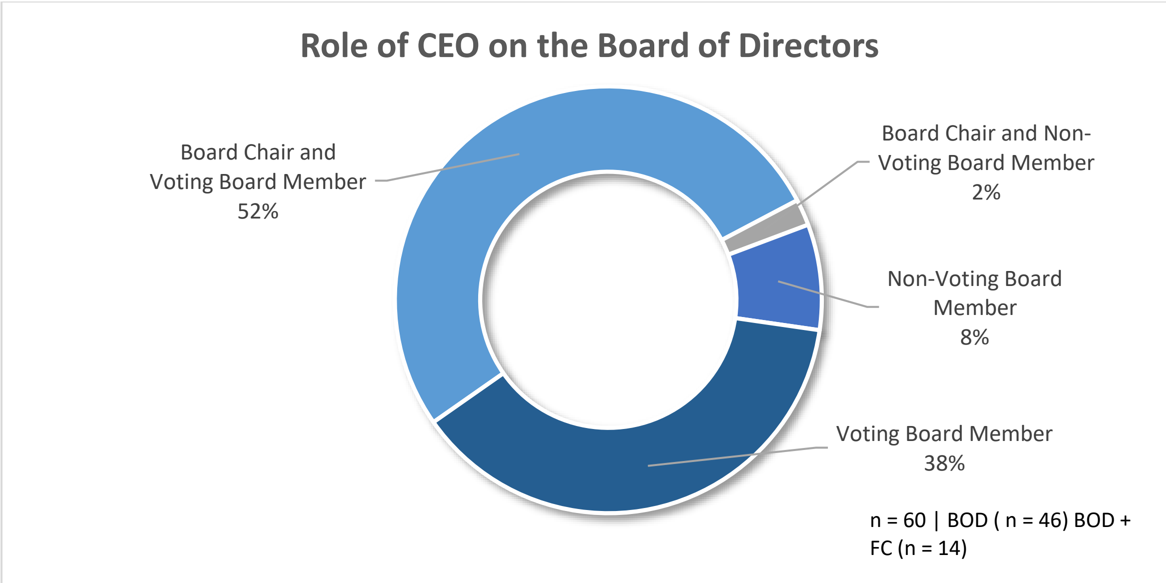


The Chief Executive Officer

In 76% of organizations, the CEO or the most senior executive in the company is a family member. Businesses with a Board of Directors and a Family Council are more likely to have a non-family CEO. Specifically, among all businesses with a Board of Directors, 80% have a family member serving as the CEO; in contrast, among businesses with a Family Council in addition to a Board of Directors, only 68% have a family member serving as the CEO.

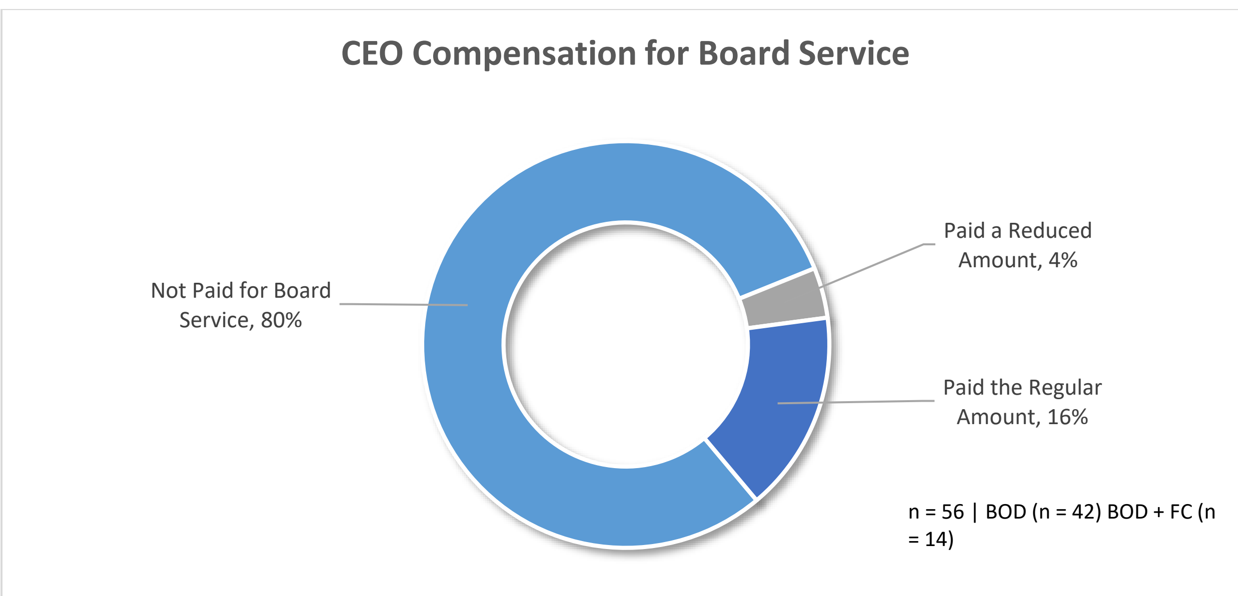
More than half of the respondents report that the CEO chairs the Board of Directors, and in almost all of those businesses the CEO is a voting Member.

Engaging the Family with Non-Family Executives
Having a non-family CEO can bring much-needed experience but can also introduce strife among family members. When introducing non-family executives, having a strong Family Council can encourage family members' continued engagement and reduce the risk of alienation.



The likelihood of having a CEO who is also a family member is greater among younger businesses, businesses that have annual revenues of less than $50 million, and businesses that are primarily based in Oregon.

In most cases, the CEO does not receive additional compensation for Board service: 80% of the respondents (and all of the larger business) do not offer the CEO additional compensation for serving on the Board.

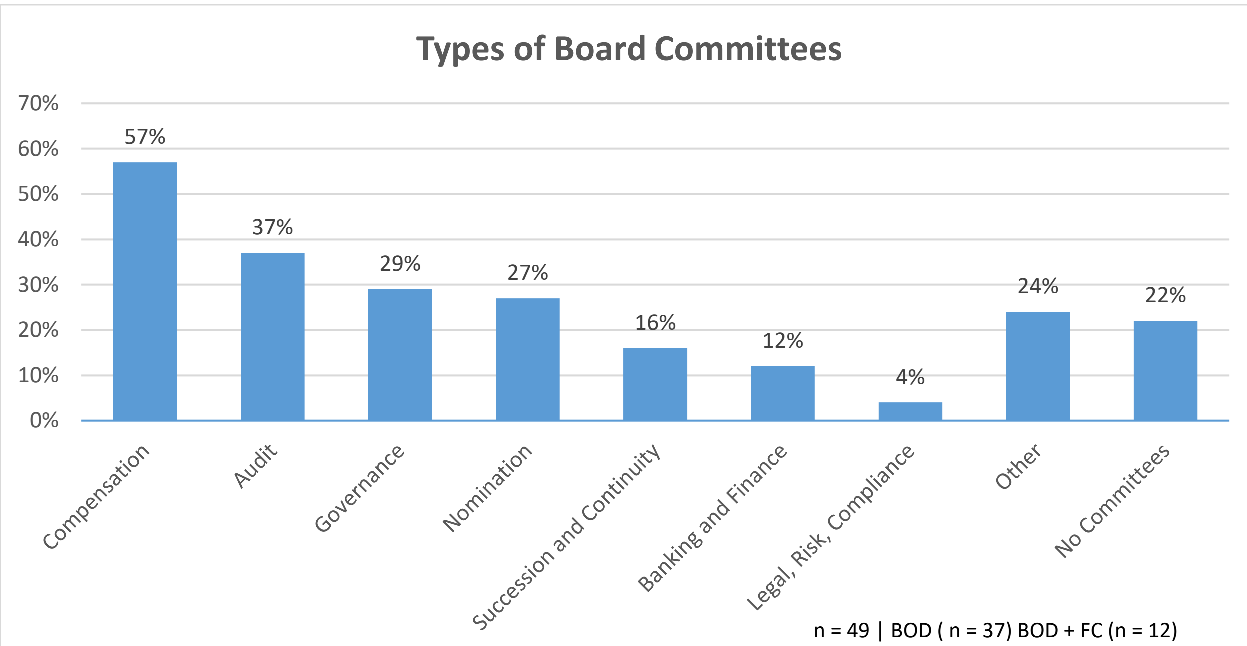


Board Committees

About four-fifths of all respondents have Board committees. The most common committees are Compensation and Audit Committees; the least common committees are Finance and Compliance Committees.

Family businesses that are LLCs, have multiple locations and are less than 30 years old are the least likely to have Board committees.

A higher percentage of those with Family Councils are likely to have all of the committees listed in the following table, except for a Banking and Finance Committee.



Meeting Frequency

On average, a Board of Directors meets 3.6 times per year. Older organizations, C corporations, and top performers meet more often than their peers. Special meetings are convened primarily to respond to financial, revenue, or cost issues.

Compensation and Audit Committees
Compensation and audit committees are the most common standing committees and seem to be a best practice for successful family businesses.

The average Family Council meets 3.3 times a year. As expected, businesses with Family Councils did not report any meetings for revenue or cost issues since they do not have an operational role and leave revenue or cost issues to other governance entities.

Average Number of BOD Meetings Per Year	BOD Only	BOD + FC
Total number of Board of Director meetings	3.6	3.4
Special meetings for financial issues	3.2	1.7
Special meetings for revenue or cost issues	2.3	0
Special meetings for personnel issues	2.2	0
Special meetings for responding to opportunities	2.0	1.2
Special meetings for responding to threats	1.9	1.0

Older organizations, LLCs, and top performers meet more often than their peers.

Board Meeting Topics

Respondents report a 60/40 split in focusing on internal/external issues during their annual Board of Director meetings. Businesses with greater sales and revenue, businesses in rural areas, and businesses that are not top performers in their industry spend a greater proportion of their meetings focusing on internal issues.

Average Annual Time Commitment	
Board of Directors 20 hours in meetings 75 hours for Board Chairperson 16 hours preparing for meetings 17 hours in committee meetings	**Family Council** 21 hours in meetings 20 hours as the Council Chair 11 hours preparing for meetings

Businesses with both a Board of Directors and a Family Council report spending about 36% of their Board meetings on internal issues. For businesses without a Family Council, that figure is 68%. In addition, older businesses tend to spend less time focused on internal issues than younger businesses.

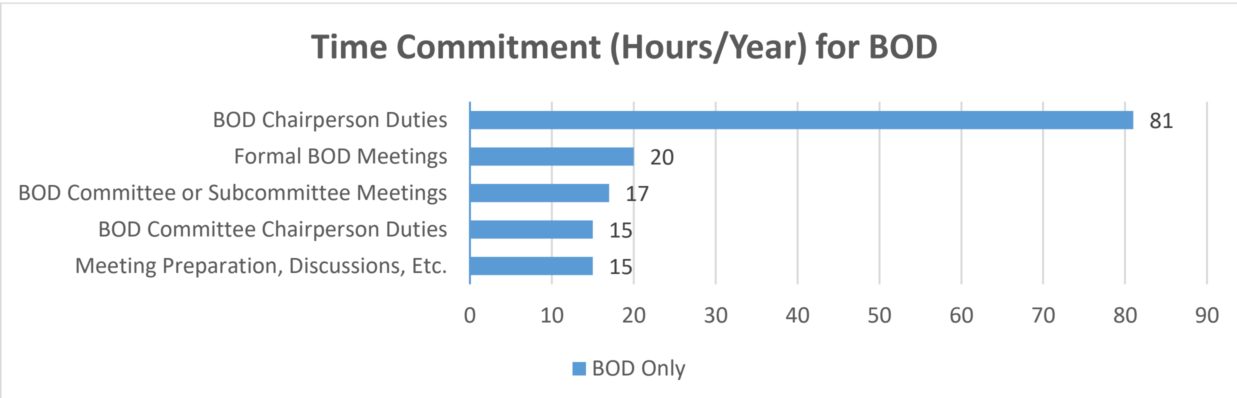
Time Commitment

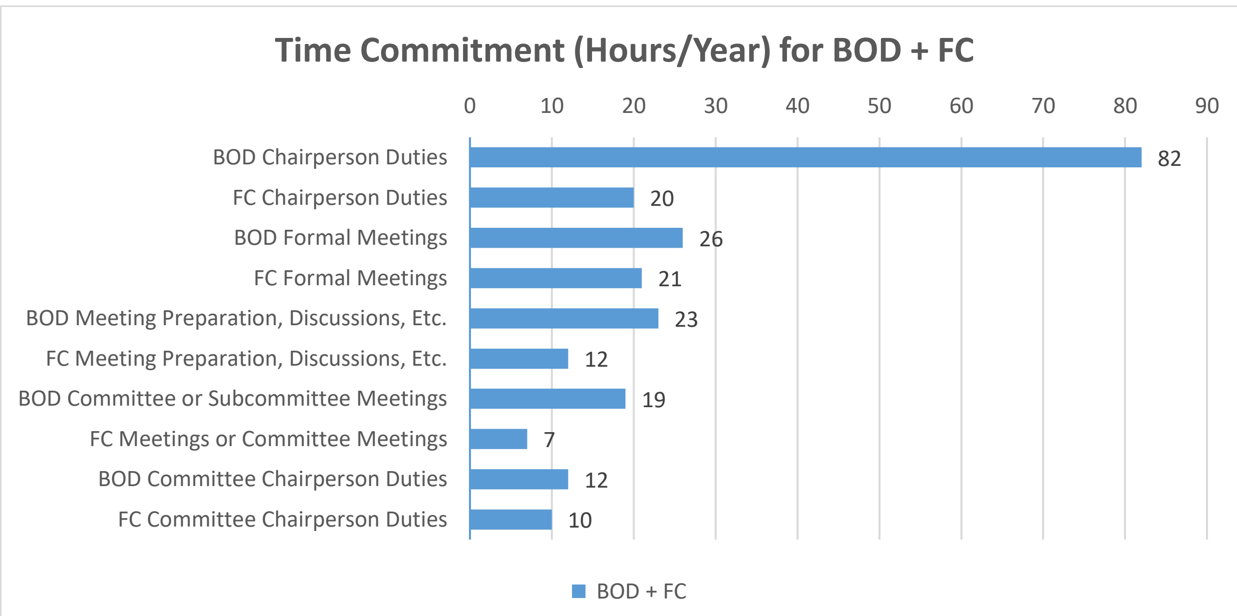
Respondents report spending about 20 hours per year in formal Board meetings. Those with Family Councils spend 26 hours per year in Board meetings and 21 hours per year in Family Council meetings.
Family Councils offer significant benefits to family businesses, but they also require a significant commitment. Most Family Councils in this study report meeting more than three times per year, and those of the top industry performers meet more frequently.

Businesses that are older, have higher revenues, are located in mid-size cities, and are top performers in their industry spend more time in formal Board meetings and formal Family Council meetings than their peers.

Regarding the time commitment required of leaders, respondents indicated that, on average, Board Chairpersons work an additional 80 or more hours per year in their leadership role and Family Council Chairpersons work an additional 20 hours per year in their leadership role.

Serving as the Committee Chairperson on a Board of Directors demands an additional 12–15 hours per year, while serving as the Committee Chairperson on a Family Council demands approximately 10 additional hours per year.





Factors in Determining Compensation for Directors

Respondents used the following five-point scale to evaluate the importance of factors in determining compensation for Directors:

1. Not considered
2. Not important
3. Somewhat important
4. Important
5. Very important

The input of the family business owners is the most important factor in determining compensation for Board Members. This is especially true for businesses that have a Family Council. The least important factors include the length of Board service and the CEO's compensation.

The following table presents the mean scores for various factors in determining the Directors' compensation.

	BOD Only (n=28)	BOD + FC (n=11)
Family owner input	2.9	3.5
Pay surveys purchased from consulting firms or business associations	2.3	2.1
Informal survey of personal business contacts	2.1	2.6
Amount paid in the past	2.1	2.1
Pay surveys available for free online or from recruiters or other vendors	1.8	1.5
Pay received by senior managers	1.5	1.7
Individual negotiation with each Board Member	1.5	1.2
Formula based on time spent on the Board and the CEO's pay	1.3	1.5

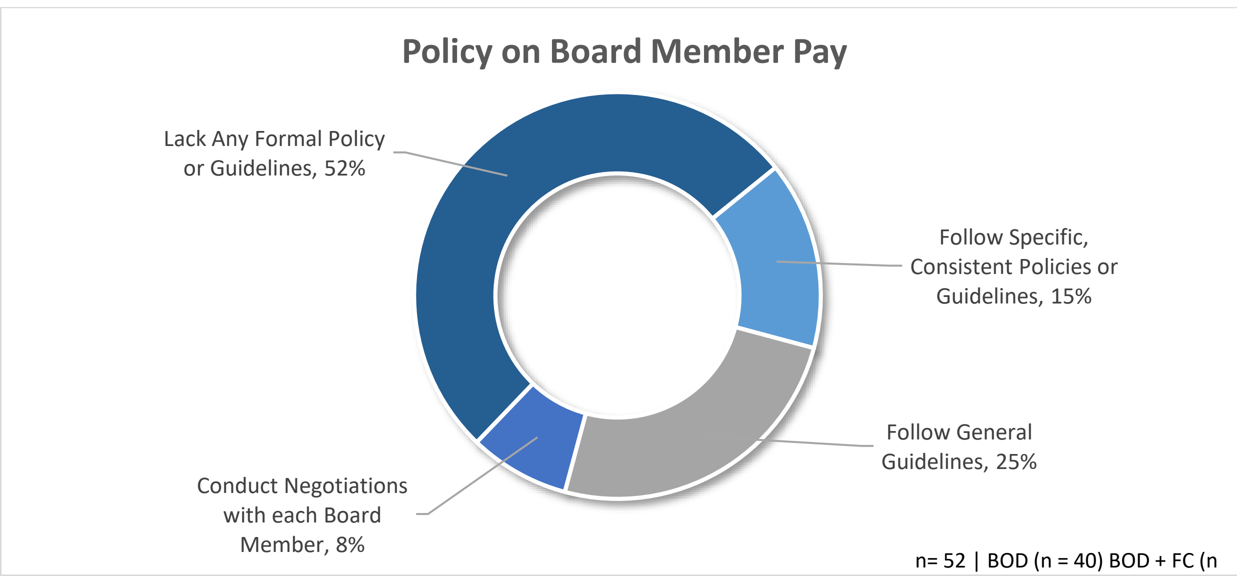
In addition, respondents used the following four-point scale to identify who has influence in determining the compensation for Board Members:

1. No influence
2. Little influence
3. Moderate influence
4. Strong influence

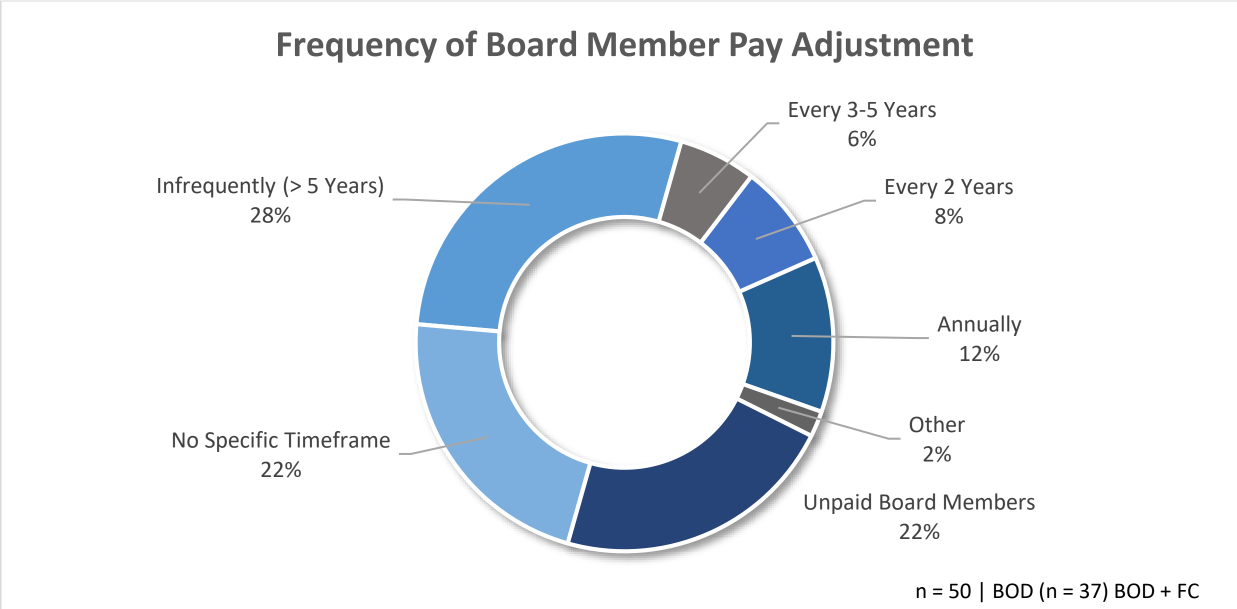
	BOD Only (n=36)	BOD + FC (n=12)
Owners	2.9	2.8
CEO / President	2.8	2.2
Board Chairperson	2.7	2.5
Board's Compensation Committee	2.4	4.0
Overall Board	2.2	3.3
Family Members	2.0	1.7
Company HR or Compensation Professionals	1.1	1.4

Among business that have only a Board of Directors, owners and the CEO have the strongest influence in determining Board Members' compensation. Among businesses that also have a Family Council, the Board of Directors' Compensation Committee has the greatest influence (with the maximum possible score of 4.0) and the overall Board has heavy influence.

Only 15% of respondents report following consistent, specific guidelines in establishing Board Members' compensation. However, among those with a Family Council, one-third of respondents follow such guidelines.



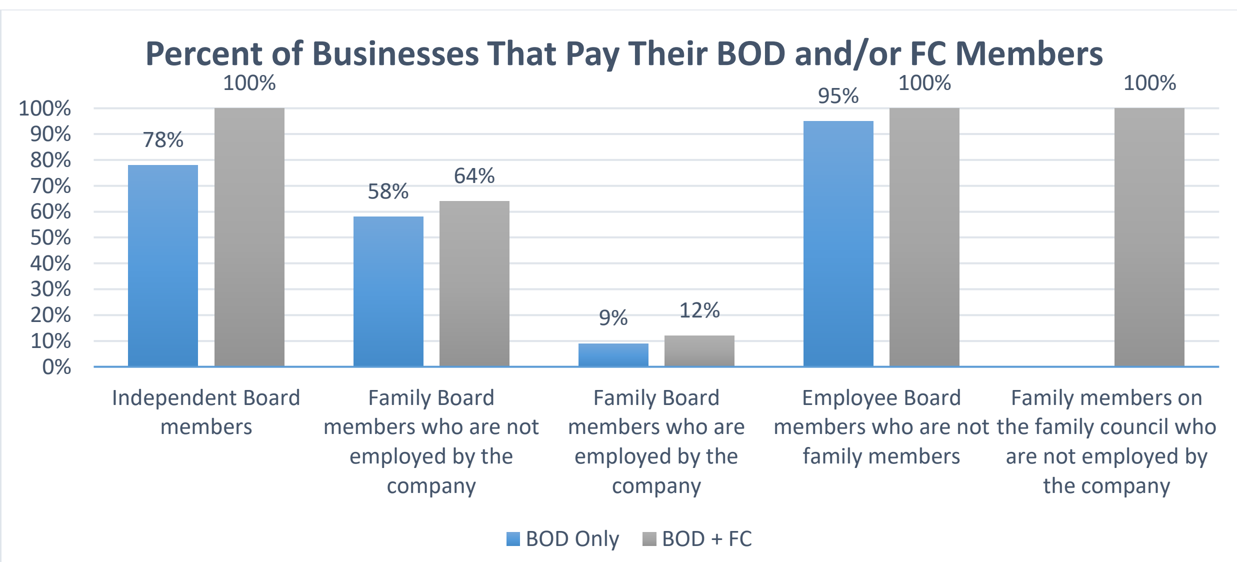
About half of respondents have a timeline or plan for adjusting Board Members' compensation over time. The other half do not have a formal policy or guidelines for determining Board Members' compensation, or do not compensate their Board Members.



Compensation for Directors

About 64% of the governance Boards have paid Members. Businesses that have greater revenues, those that are top performers in their industry, those that are older, and those that are located primarily in Oregon are more likely to pay their Members.

Independent Board Members are the most likely to be paid, while family members who are employed by the company are the least likely to receive additional compensation for their Board service. Businesses with a Family Council are more likely to pay independent Directors than those that do not have a Family Council.



Respondents were asked to estimate the amount of payments made to Board Members within various categories. Among those who offer an annual cash retainer or fee, the amount ranges from $4,500 to $78,000 as shown below.

	Indepen-dents	Family Members, Not Employees	Family Members and Employees	Non-Family Employees	Board Chairperson	Chairperson of Board Committees
Fixed Annualized Cash Retainer or Fee	$32,000	$33,000	$28,000	-	$78,000	$4,500

Others offer a per-meeting fee, which ranges from $300 to $6,500, depending on the participant's role and whether he/she participates on site or remotely.

	Indepen-dents	Family Members, Not Employees	Family Members and Employees	Non-Family Employees	Board Chairperson	Chairperson of Board Committees
Per-Meeting Fee: Onsite	$2,400	$4,000	$2,500	$6,500	$4,200	$300
Per-Meeting Fee: Remote	$1,200	$800	-	$1,000	$1,500	-

Other types of compensation for the Board Members include the following:

- *Annual cash incentives based on company performance, earnings, or profits*
  Some respondents use a percentage-based calculation, while others report an amount ranging from $11,000 to $17,000.
- *Equity-like compensation, including the estimated value of phantom stock, stock value units, restricted stock, stock, or options*
  Two respondents offer a four-year long-term incentive plan[3] (LTIP): one at $25,000 and another at $800,000. A third business reports developing an LTIP.
- *Reimbursement of travel expenses*
  Two businesses reimburse their Board Members' travel expenses, but they did not specify the amount.
- *Charitable contributions*
  One respondent reports making a $25,000 contribution to a charitable organization in the name of the Board Member.

Compensation for Family Council Members

About one-third of respondents pay their Family Council Members; this is highly correlated with business size. Another one-third do not provide compensation but do reimburse Council Members' travel expenses. The remaining one-third do not provide any compensation or reimbursement.

[3] A long-term incentive plan (LTIP) is an equity-like incentive calculated on the change in value of the business.

Among the 36% of respondents that pay their Family Council Members, all of those paid Members are family members who do not work in the business.

Respondents were asked to estimate the amount of payments made to Family Council Members within various categories, such as per-meeting payments (remote or in-person) or fixed annualized cash retainers. None of the Family Councils have any paid family members who work in the business.

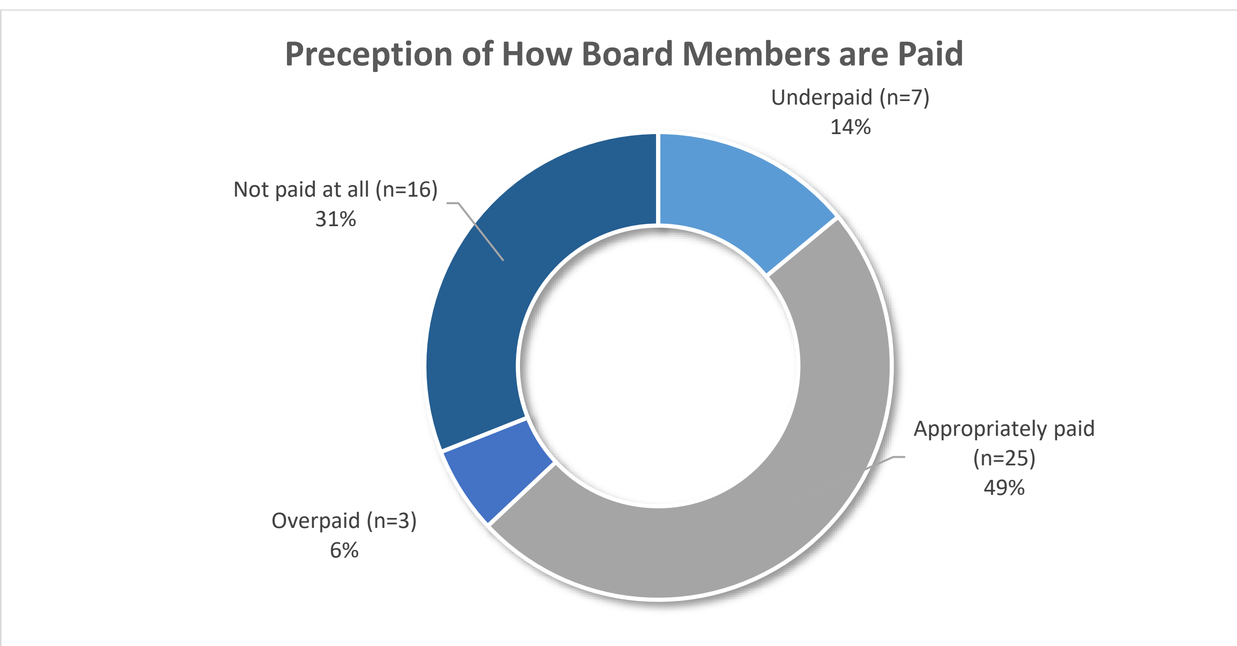
The following table shows the average compensation for the Family Council Chairperson and other family members on the Family Council who do not work in the business.

	Family Members, Not Employees (n=2)	FC Chairperson (n=2)
Amount of a fixed annualized cash retainer or fee	$1,500	$3,500
Amount of a per-meeting fee	$700	$800
Amount of a fee for each meeting attended remotely by phone or online	$200	$300

Satisfaction with Board Member Compensation

More than one-third (36%) of the survey respondents do not pay their Board Members. Among those with a Family Council, 46% do not pay their Board Members.

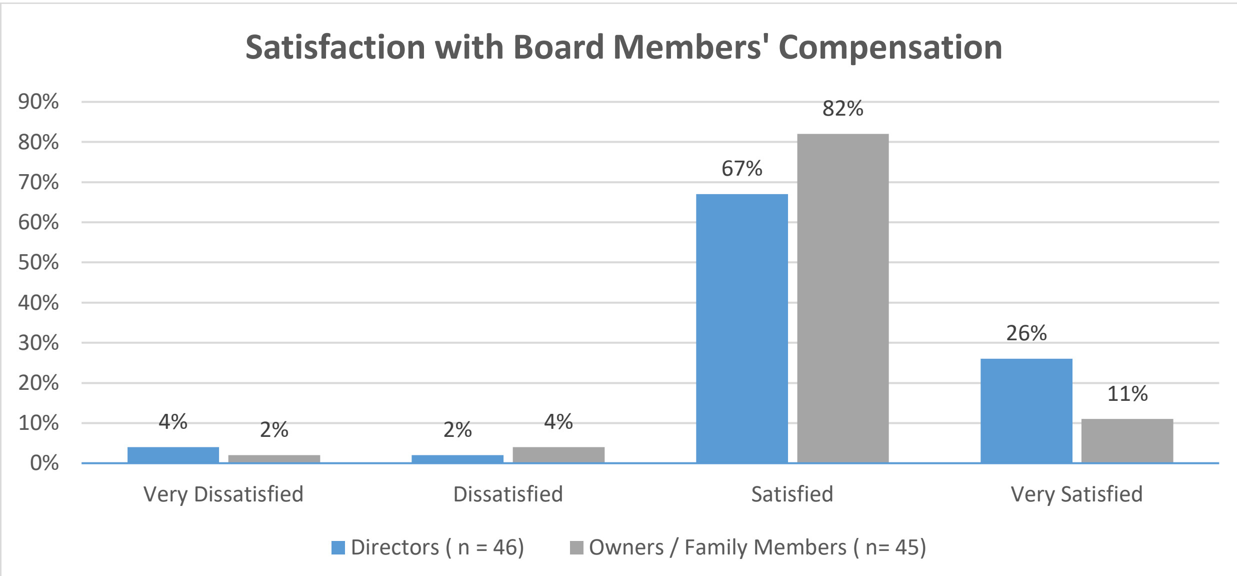
About 49% believe the compensation is appropriate, 14% believe the Directors are underpaid and the remaining 6% believe the Directors are overpaid.



Satisfaction with Directors' Compensation

As described under "Factors in Determining Compensation for Directors" (page 23), family businesses rarely conduct thorough research to establish compensation for Directors. Rather than relying on consultants' advice or a review of best practices, the CEO or family typically makes a "gut decision." Interestingly, these individuals believe that Directors are being paid adequately. Additional research is needed to determine whether those Directors would agree with that assessment.

Most of the respondents believe that Board Members, owners, and family members are satisfied with Board Members' compensation.



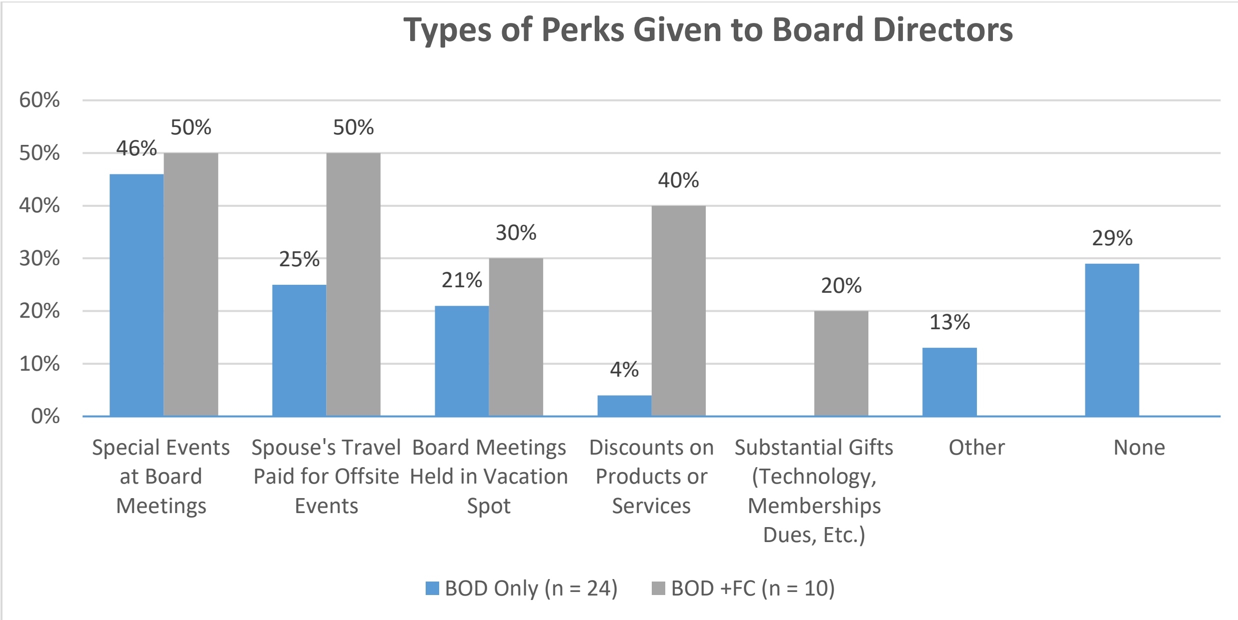
Perks for Directors

About 71% of respondents report offering perks to their Directors. These perks include invitations to special events, travel for the spouse or significant other, use of vacation spots, company discounts, gifts, etc. Of the 29% that do not provide any perks, none have a Family Council.

Businesses with a Family Council are more likely to offer all the perks mentioned above, especially travel expenses for the spouse and discounts on company products. Interestingly, businesses that have only a Board of Directors (that is, businesses that do not have a Family Council) do not report offering any substantial gifts to their Directors.

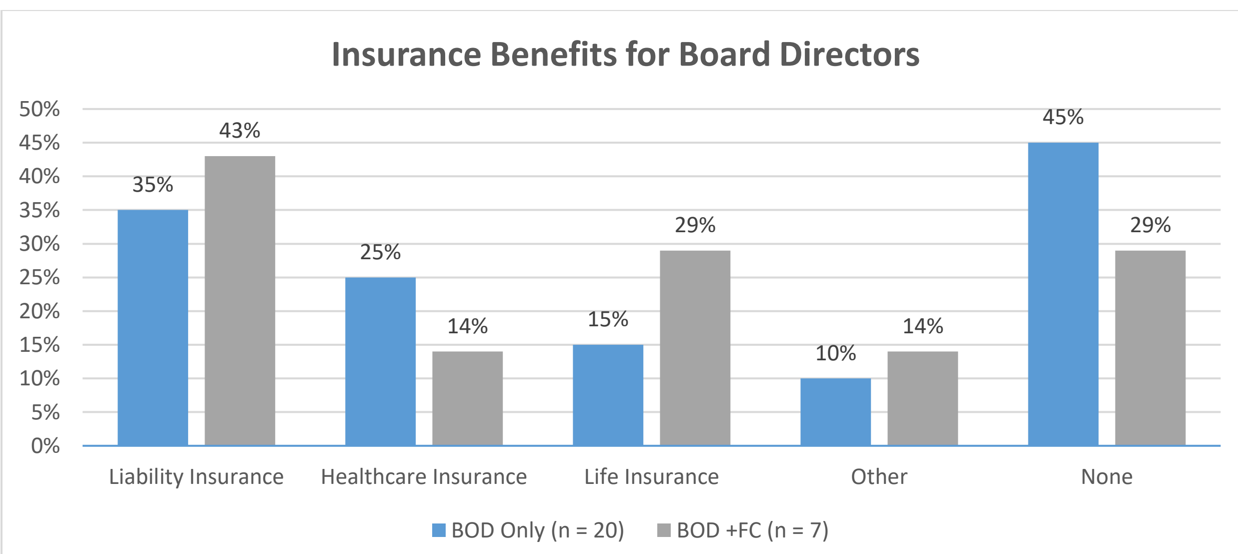
The Perks of Board Service

Many family businesses provide perks to their Board Members. Approximately 50% of the survey respondents organize Board dinners, 30% invite spouses to attend, and 25% hold Board meetings in resort-like locations.



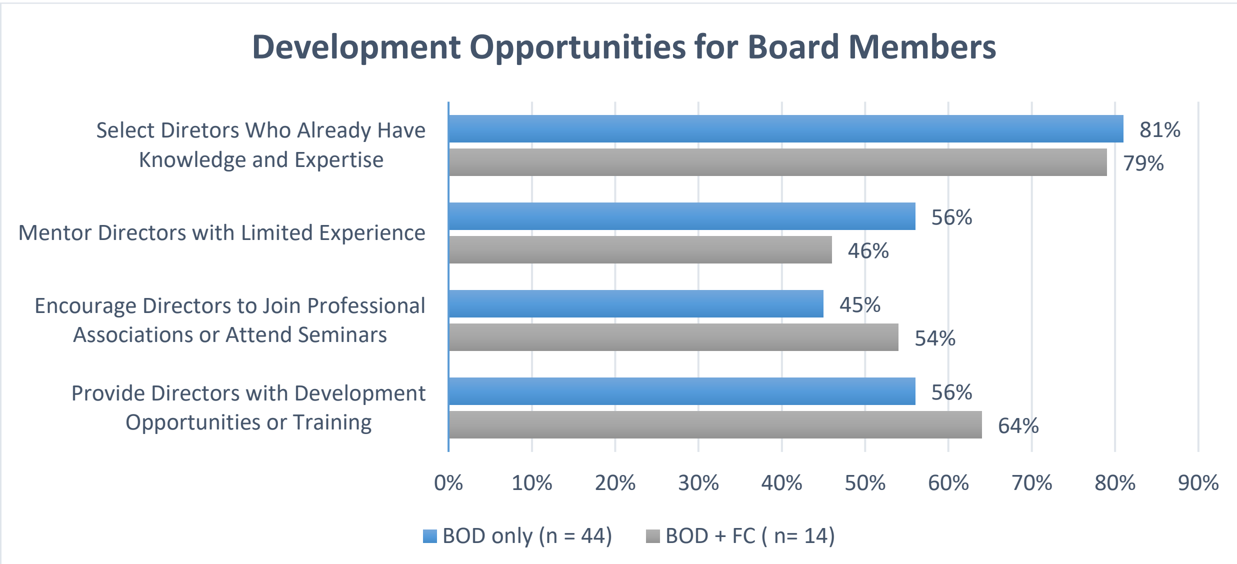
Insurance Benefits for Directors

About 60% of respondents report providing liability, life, health, or other insurance to their Board Members. Those with a Family Council are more likely to provide insurance benefits (except healthcare insurance) to Board Members. Respondents consistently report providing liability for Directors, but additional research is needed to determine whether this is truly a perk or rather a requirement, such as mandatory directors and officers liability insurance.



Learning and Development Opportunities

About 80% of the respondents select Board Members based on their knowledge and expertise. To encourage continuous learning, almost half of the family businesses report providing learning and development opportunities for their Board Members. These opportunities include mentorship for new Members and encouragement join attend workshops or seminars on topics related to governance.



Older businesses, businesses with greater revenue, and businesses in large cities tend to provide more development and mentorship opportunities for Board Members. However, encouragement to attend workshops or join professional organizations seems to decrease as the business becomes older, earns greater revenue, or expands to multiple locations (both rural and urban).

Businesses organized as LLCs are more likely than their peers to encourage all types of learning and development activities for their Board Members. Businesses with Family Councils are more likely to encourage their Board Members to join professional associations, but less likely to provide mentorship opportunities for Board Members with limited experience.

Development Opportunities

Proactive family-owned businesses provide opportunities for current and future board members to develop their governance abilities. These opportunities may take the form of classroom training, university courses, and/or engagements with governance consultants who meet with the Board for effectiveness and evaluation.

Part III: Boards of Advisors

In Part III, we focus on family businesses that have a Board of Advisors.

Board Composition

Board Membership

On average, a Board of Advisors has six Members who represent a combination of independent (non-family) Members, family members who work in the business, family members who do not work in the business, and non-family employees. The size of the Board of Advisors is larger for businesses that are older and those that are top performers in their industry.

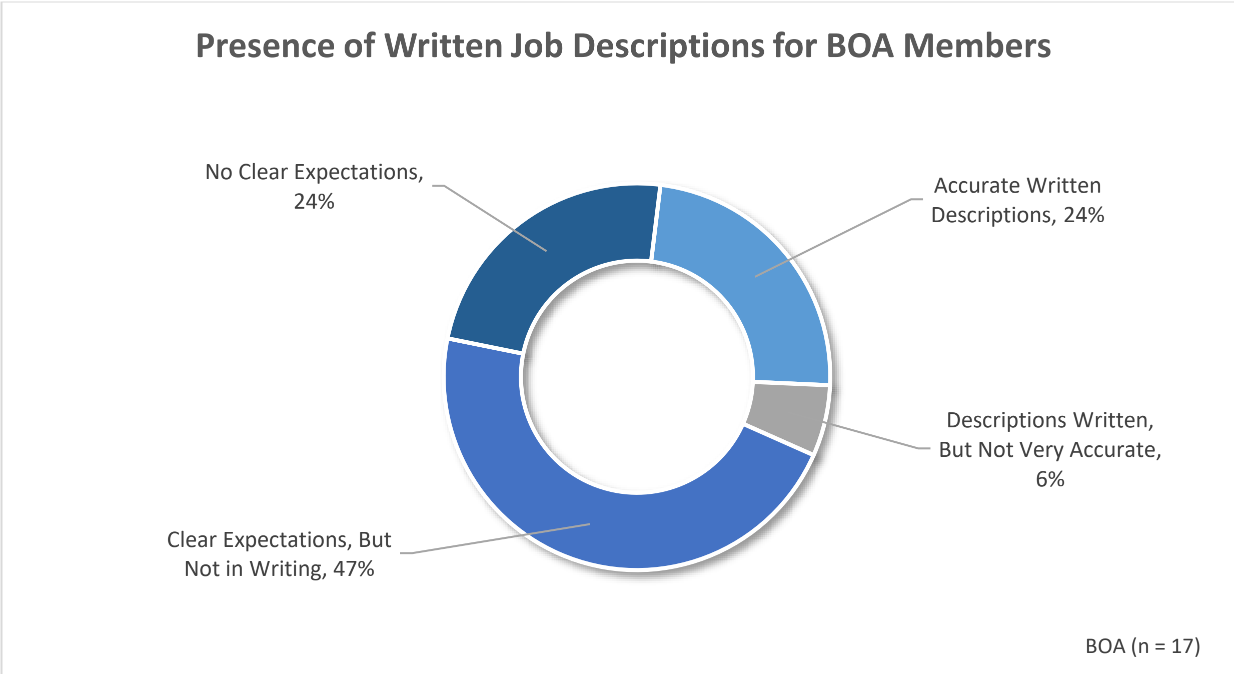
	Average (for n=17)
How many people serve on your Board of Advisors?	5.5
How many people serving on your Board are neither family members nor employed by the company (i.e. independents)?	2.8
How many people serving on your Board are family members employed by the company?	2.3
How many people serving on your Board are employees who are not family members?	2.1
How many people serving on your Board are family members not employed by the company?	1.8

Employees who are not family members are the least likely to participate in the Board of Advisors, while independents are the most likely to participate.

Roles and Scope of Involvement

Job Descriptions

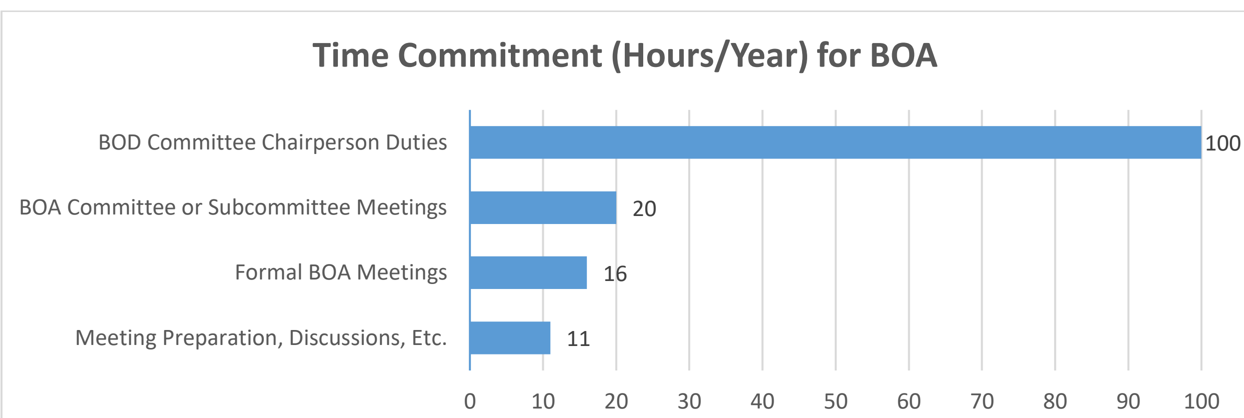
About one-fourth of family businesses report having accurate, written descriptions of what is required of those serving on the Board of Advisors. However, an equal percentage of respondents report that their business lacks clear expectations, written or otherwise.



Meeting Frequency and Time Commitment

The average Board of Advisors meets 4.1 times a year. Older businesses, C corporations, and top performers meet more often than their peers.

Family businesses report spending an average of 16 hours in formal Board of Advisor meetings each year. Among Members with leadership roles, the typical Chairperson of a Board of Advisors works an additional 77 hours, and a typical Committee Chairperson works an additional 100 hours.



Compensation and Benefits

Board Members' Compensation

More than half (53%) of the family businesses with a Board of Advisors have paid Members. Another 24% of family businesses reimburse Advisors for their travel expenses but do not provide other compensation. The remaining 23% offer no compensation whatsoever.

Businesses with greater revenues, those who are top performers in their industry, those that are older, and those that are located primarily in Oregon are more likely to pay their Advisors.

Businesses are less likely to pay family members who serve on the Board of Advisors; 83% do not provide any additional compensation to family members who serve on the Board of Advisors and are also employees of the businesses. In addition, 38% do not provide compensation for serving on the Board of Advisors to non-family employees or family members who do not work in the business.

Average Compensation

Respondents were asked to estimate the amount of payments made to Members of the Board of Advisors within various categories, such as per-meeting payments (remote or in-person), stock options, cash incentives, etc. The following table shows the average compensation for Members of the Board of Advisor who are independent or are non-family employees. Note that none of the respondents have any paid family members, Chairperson, or Committee Chairperson on their Board of Advisors.

	Independent Advisors	Non-Family Advisors and Employees
Amount of a fixed annualized cash retainer or fee	$8,000 (n=1)	-
Amount of a per-meeting fee	$2,400 (n=7)	$3,000 (n=1)
Amount of a fee for each meeting attended remotely by phone or Internet	$3,000 (n=1)	$2,000 (n=1)

Note: Although 53% of Board of Advisors pay their Members, many respondents chose not to answer these questions, which accounts for the low response tally.

In addition, one respondent reports reimbursing travel expenses.

Part IV: Conclusions and Recommendations

Careful review of the survey findings confirms many beliefs about best practices in family business, but also reveals a few surprises. Here we combine these findings with years of consulting and management experience in family businesses to present our top three key takeaways as well as recommendations for family businesses and the professional advisors who serve them.

Takeaway #1: There is value in formal governance.

Respondents broadly recognize the value of Board contributions, and the presence of a Board of Directors, Board of Advisors, and/or Family Council is associated with better industry performance. However, simply having these governance structures in place is not a guarantee of success.

As family businesses grow in size and complexity, governance structures and processes require greater formalization as reflected in job descriptions for Board Members, terms limits, clear meeting agendas, selection criteria, and developmental programs for Directors.

Recommendation:	Families should consider the benefits of formalizing their Board governance. This could include developing a vision statement, conducting a skills gap analysis, engaging in more strategic recruiting, improving the onboarding process, establishing term limits, evaluating Directors' performance, adding independent Directors, and more.

Takeaway #2: Family Councils bestow many benefits.

Family businesses with a Family Council are orders of magnitude more professionalized than those without. This is an unexpected finding. Although most family business professionals recognize that Family Councils are important, we did not realize that they were such a fundamental factor in family business performance. As businesses thrive and ownership families grow, Family Councils also become larger and more sophisticated, and they have more resources at their disposal.

While a Board of Directors effectively governs the operating business, a Family Council governs, empowers, and develops the *family*. Nevertheless, there are relatively few Family Councils in the Pacific Northwest; that governance structure is more common on the East Coast.

Among the respondents in this study, having a Family Council is correlated with many best practices, including the presence of more independent Board Members, more robust Board committees, and full agreement that Board contributions are valuable. (Family businesses without a Family Council perceive less value in Board contributions.)

Recommendation:	Family businesses and their advisors should consider adding a Family Council (or strengthening their existing Family Council) as the business and the family grow as doing so appears to be correlated with stronger industry performance.

Takeaway #3: Governance in family business is a labor of love.

The Boards of Directors for family business have much lower turnover than those for public companies, but that longevity stems from passion—not from financial compensation. Family businesses report relatively low compensation for their Directors, yet the average length of service is much longer than in public companies. Indeed, old age and retirement are the most common reason for ending service on the Board of Directors for family businesses.

Directors' commitment to the family businesses they serve is commendable. However, their longevity may actually be a weakness for the businesses. When average tenure approaches 15-20 years, Boards of Director may become stale and less able or willing to adapt to change.

Recommendation:	Family businesses must be careful when selecting new Board Members, because those individuals will likely have far-reaching influence on the business' decisions for many years. We recommend that family businesses develop and adopt clear selection criteria and performance review mechanisms for Board Members. Advisors must present the case for well-defined term limits as a best practice that will allow businesses to renew or refresh their Boards as the needs of the business change.

Areas for Additional Study

Based on the survey findings, we recommend the following areas for further study:

1. Most of the respondents believe that Board Members are satisfied with how Board Members are paid. However, the more specific question of whether Board Members would agree with that assessment remains unexplored. There may also be value in exploring specifically whether *family* members serving on a Board of Directors are receiving adequate compensation.
2. Given that more than half of respondents report that their CEO is their Board Chairperson. Future researchers may wish to focus on the advantages and disadvantages of having the CEO serve as the Board Chairperson and its effect on Board governance and business performance.

Advice for Family Businesses

After reading this report, your family business may wish to implement best practices and formalize your governance structure. Doing so may be helpful and appropriate, but we encourage you to be mindful of your business' specific needs and avoid making rash decisions. **The adoption of new governance structures and practices must be commensurate with the needs of your business and family, your mission, and your vision.**

Implementing a more formal or sophisticated structure is appropriate only if it is a good fit. The best way to make those determinations is through consultation with legal counsel, accountants, and other qualified advisors who are well versed in the specific needs of family businesses. Many family businesses also benefit from forming a peer group in which they can discuss their governance challenges and strategies with like-minded family businesses.

Please let us know how you've been able to use these survey findings to evaluate and improve your current practices. We wish all the best to your business and your family!

PART V: ABOUT THE SURVEY

The Pacific Family Business Institute's latest study, *Governance & Compensation: The State of Family Businesses in the Pacific Northwest* extends our ongoing research and offers valuable insights into the challenges, issues, and opportunities facing family businesses in the Pacific Northwest.

Methodology

The Pacific Family Business Institute has developed an extensive network of contacts with family businesses through the Pacific Northwest. Drawing on those professional contacts, the principals of the Pacific Family Business Institute identified as potential respondents approximately 140 regional businesses that met the following criteria:

- At least 90% ownership by the family
- At least $50 million in annual revenue or assets
- Based in Oregon or Washington

Of the 140 businesses meeting the aforementioned criteria, 25 (18%) reported that they did not have a Board of Directors or a Board of Advisors, so they were omitted from the study. Of the remaining 115 eligible businesses, 81 completed the entire interview and/or online survey, yielding a response rate of 71%. To encourage respondents to speak freely, all identifying information is being kept confidential. All participants will receive a copy of this report in exchange for their participation.

The survey sample is characterized as follows:

Location	75% Washington 25% Oregon
Legal Structure	64% S corporation (generally larger) 24% C corporation (generally older) 12% other
Revenues	33% $50–200 million 33% $201–400 million 14% $400–700 million 7% $1–10 billion
Company Age	Average 75 years 33% 31–60 years 33% 61–90 years 20% 120 years
Number of Employees	Average for all respondents: 685 Average for respondents with BOD: 945 Average for respondents with BOA: 242 Average for respondents in Washington: 802 Average for respondents in Oregon: 295
Role of Respondent	80% CEO, President, or Board Chairperson

The principals of the Pacific Family Business Institute personally reached out to the family business representatives through face-to-face meetings and/or by telephone to conduct interviews and gather in-depth details regarding each family business’ governance structure. The survey administrator, Riley Research, developed and hosted an online version of the questionnaire for those who preferred to complete the study online.

Please note that responses do not always add to 100% due to rounding and/or to allowing multiple responses.

Survey Research Team

Pacific Family Business Institute
www.pacificfamilybusiness.com

Founded in 2010, the Pacific Family Business Institute serves as a resource for Pacific Northwest family businesses by facilitating seminars, workshops, and affinity groups for peer-to-peer information sharing.

Co-founders Rich Simmonds, Mark T. Green and Ron Dohr are family business researchers and consultants on transitioning multigenerational family businesses; developing and preparing next-generation leaders; assisting attorneys, CPAs and other advisors who guide family-owned businesses; developing governance systems with regard to ownership, management and compensation; and assessing and evaluating family Boards of Directors.

Riley Research Associates
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Riley Research Associates provides organizations with research to help them make informed decisions. The firm work closely with a wide variety of clients across a wide range of industries to understand goals, formulate clear and attainable research objectives and identify key audiences. The Riley team brings extensive experience in both quantitative and qualitative methods of information gathering and analysis.

Additional information about *Governance & Compensation: The State of Family Businesses in the Pacific Northwest* is available at www.pacificfamilybusiness.com.

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Since we put down roots in the Pacific Northwest more than 100 years ago, we've steadily expanded to serve clients not only in the West, but also across the nation and globally. Our full range of services includes accounting (assurance and tax), consulting (IT, strategy and operations, transactions, and specialty), as well as individual and institutional wealth management.

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Davis Wright Tremaine is a full-service law firm with decades of experience serving family business clients. We help our clients through ownership and leadership transitions, corporate governance matters, estate planning, philanthropy, and growth and exit strategies. We are dedicated to supporting and advising our clients as they develop, grow, and manage their businesses for this and future generations.