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Thought Leader Forum: Governance and Compensation

The State of Family Businesses in the Pacific Northwest

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The ongoing research from The Pacific Family Business Institute (PFBI) offers valuable data and insights to family businesses and their advisors into the challenges and opportunities facing family businesses in the Pacific Northwest. At a recent Northwest Family Business Advisors meeting in Seattle, a group of expert family business advisors shared key learnings from PFBI's recently published survey, Governance & Compensation: The State of Family Businesses in the Pacific Northwest, and discussed ways to engage family businesses on topics such as business growth opportunities, succession and governance. Participants were Dan Gaffney, CPA, partner at Moss Adams LLP; Bill Weigand, partner at Davis Wright Tremaine LLP, Christian Schiller, managing director at Cascadia Capital; and Richard Simmonds, co-director, Pacific Family Business Institute. The panel was moderated by Ron Dohr, Ph.D., co-director, Pacific Family Business Institute.

Dohr: Why did your firm choose to be a sponsor of this survey?

Gaffney: At Moss Adams, we wanted to understand the data and issues facing our clients here in the Northwest, because the world is getting more and more complicated. Taxes, regulation, financing, succession issues, block chain, AI, data security, you name it, we deal with it. As companies wrestle with these complex issues, good governance is increasingly important in order to grow and innovate their business into the future.

Weigand: We at Davis Wright Tremaine saw the survey as a way to validate the impressions we had based on our work in the marketplace. Much of our advice around governance was based on our own experience. We did not have a very good compass to confirm our impressions and guide our advice.

Schiller: At Cascadia Capital, what interested us was that this survey is the first board governance survey of its kind in the last 11 years. So, there was a huge gap in understanding and data within family business. I found the way the survey was conducted compelling; a lot of in-person meetings, very in-depth.

Dohr: What key takeaways did you find most interesting and useful for your firm?

Gaffney: I'd say the largest one was a strong correlation between having a governance structure in place, and profitability and success for the organization. It reinforces how important it is, and we hope it will lead to some good discussions with our clients about their governance structures.

Weigand: Sometimes owners say they want to bring in an outside, non-family director, but they hesitate in making that happen, not knowing where to start or whether qualified individuals will be interested in serving. First, the survey showed it was easy to attract and retain outside board members. And second - this confirmed what I thought, but it still blew me away - the average tenure for a board member is 15 1/2 years. So, if your heart's pumping, you stay on the board. I don't think that's a very good test. We should ask, "How do we refresh our board? What kind of term limits or other conditions are important to focus on?"

Schiller: The most surprising thing was the correlation between family councils and good board governance. Family businesses that had both family councils and boards had more independent board members and more robust committees. And interestingly, 100% of family businesses with family councils said they believed the board contributions were valuable, whereas the percentage finding board contributions valuable was much lower for those without a family council.

Dohr: Rich, could you describe the differences between a family council, advisory board, and a legal fiduciary board?

Simmonds: I think about it from an evolutionary standpoint. Each of these needs to fit the business and the family at that point in time. Typically, the founder/entrepreneur grows the business and it is doing well. Then he or she wants a sounding board. So, they meet with a couple of buddies over coffee, and that's the first step towards governance. The next step is typically an advisory board that looks like a normal board but doesn't vote. There's no fiduciary responsibility. Next is a legal fiduciary board, where you do have that responsibility. Then, when you get big enough - with family member shareholders - you need a mechanism to govern the family, not just the business. That's where the family council pops up. The purpose is to educate and develop family members for work in the business, as well as to potentially serve on the board.

Dohr: How do you plan to use the survey results with your clients?

Gaffney: We are taking some key talking points from the survey and intend to engage our clients in meaningful business discussions about building out their governance structures.

Weigand: The survey is a valuable tool to help us serve our clients better. We will also make the survey available to the public on our Family Business Resource Center (www.familyownedbusinessadvisors.com). It's a website with articles and other information for family-owned businesses. If an issue comes up, we can point people in that direction as a good place to start for information.

Schiller: The survey will help provide a catalyst to start that incredibly difficult conversation with a family business, - why have a board? That's going to seem scary, giving up control, things like that. It's going to be hard, but also very valuable. The survey can help bridge or open that challenging dialogue.

Simmonds: We create curricula and events for advisors to family business, so we're all growing together. That's how we will use the survey results.

Dohr: As thought leaders in the realm of family business advice, for governance, compensation, business development, board structure, leadership, etc. What best practices do you recommend?

Gaffney: We need to think of succession not just in terms of what's next with the company or the exit strategy, but of management leadership and not just the family positions, but all positions in the firm. Family businesses are no longer simple in what they do, make, sell, where they sell it and to whom, and how they're structured. The world around them is complicated, and so they're challenged by all kinds of issues from personnel to technology to financing and legal structures, etc. Building a good governance structure with your succession strategy outlined early is increasingly important.

Weigand: In addition to succession planning, family-owned businesses need to innovate, change and grow. Stagnant businesses do not stick around very long. The board, especially if it's built out with independent directors, helps with succession planning and innovation, because you've got outside perspectives coming in and outsiders holding people accountable. One of the difficult things within a family business is, "Yeah, we know we need to do it, but who's going to make Dad or Mom make a decision?" Independent directors will keep that process on track.

Schiller: A couple numbers from the survey come to mind; one is that 40% of family business respondents had no independent board members, but the flip side of that is 60% do. This surprised me. Scale factored in as well. So, the best practice advice is: The larger a company becomes, the more sophisticated they get. Extrapolating that to the companies we all work with in the lower middle market, can be an interesting challenge. In the same vein, 90% of CEOs of these family companies were also the board chair. That's interesting in the age of Elon Musk and Tesla splitting those roles and other public companies seeing this separation widely as a best practice, so family companies should explore a separate Chairperson and CEO role as a best practice.

Dohr: Rich, what are the key ingredients to governance? What comes to mind when you think of family business having good governance?

Simmonds: It's important to think about the board's purpose, and family expectations, and also have written job descriptions. The survey showed that few respondents had written purposes or job descriptions, but that's really important. Someone talked about roles that were confusing between board members, family members, and people who work in the business. Job descriptions help that.

Also, regularly ask questions like, “What’s the business going to look like in 15 years?” Develop a simple grid of current board members and family members, and their strengths and weaknesses. Think intentionally about what you’re going to need, and where the gaps are. If you want to bring in an outsider, find someone who has been a CEO for a business that’s maybe three times as large as yours. Or look for someone who’s been through a family transition. In terms of determining compensation for family members and performance reviews, outside board members are better able to do that.

Dohr: We have talked about the value of having a governance conversation with clients, but who is that? The CEO? The board? The family shareholder?

Gaffney: We feel that governance conversations should be had with all levels of leadership in a family business. From the C-suite to the board, to the family shareholders. It’s important for organizations to bring together their leadership with their key advisors to discuss the governance structure and needs of the organization.

Weigand: Remember, governance is a process, not a project. You’re not going to get to the “done” spot. You may hit a plateau, take a breather, and then move on, but it’s a process that continues and evolves. The governance process should change, as the company changes, as the ownership group changes and the like. Also, to keep things moving forward, you need to have a champion from within the organization. Ideally, this person will step forward – or as a trusted advisor you may need to nudge them along

Schiller: When you’re younger in your career, you listen to your clients’ questions and demands, and you execute them, right? You don’t want to bring up something that might be controversial. Then as you move through your career, you say, “No, actually, being a good advisor is challenging your client and bringing up the hardest topics to try to get them to think outside the box,” and then bring in the village of other advisors to the family to assist on a coordinated basis. So, it’s getting them – the board, the family, and key advisors - to all talk to each other and work together that will drive the best results.

Schiller: If you can get those challenging conversations going within the family, and then between various levels of management and the board, that’s best practice as advisors. And this circles back to, “Yes, who’s the client, but what are you doing and how to really make change?” Which might take years, but it’s a good thing.

Dohr: We haven’t talked yet about compensation. The survey showed a lot of revealing facts about how we compensate boards. What’s the big picture, Rich?

Simmonds: The survey revealed a couple of things. First, the majority of companies that have fiduciary boards pay their outside directors. Some pay their family members, but a lot of them don’t. A big takeaway for me in the survey was the number of hours put into the family council. It’s almost as big a time requirement as being a board member. A lot of us that work with family councils know that the family doesn’t always pay. They reimburse expenses, but there’s not a daily rate. So you’re asking a young person in the family to take time off from their job and come and spend a day or two at a family council meeting. You’d be surprised by how many people will pay something; maybe $1,000 a day. The survey provides summary data, but there is a lot more behind it. For example, someone I've worked with over the years called and said, "For a $500 million business, what is the range of pay for an outside board of director member?" That's data we have: by size of business and by SIC code.

Schiller: On the compensation side, what surprised me was, "You'd better be doing this for the passion," because dealing with family business is not easy, nor is being involved in the board with family business, nor board governance work. You're going to get paid a lot more on a public company board. That commitment, passion, alternative investment and ROI has to come from the impact and change you're making.

Simmonds: A family council should be the training ground for the next generation and spousal directors. They become known and so the compensation is just a little bit different than on the board of directors. In most cases, family members who work in the business, who are on a fiduciary board, are typically not paid. Family members who do not work in the business, like us, like board members, are typically paid.

Weigand: Yes, compensation is appropriate and important, but be very careful in setting it and choosing your board members. If a board member is primarily motivated by the compensation, be very careful. That's not the right motivation. The right motivation is a true desire to help a family business grow and succeed.

Dohr: Being on the board as a family member is a real labor of love. You say 50 years, but you don't make the big bucks along the way. When you have an independent board or director, then typically it's more market driven. What's the market rate to pay an outside director? The direct relationship back to the business is, it tends to do better.

Dohr: What are you as an advisor seeing relative to board governance in your clients? And what issues are they having relative to this?

Gaffney: The main thing we're seeing is around strategic planning, compensation discussions, and reviewing how businesses are structured. It's also important for businesses to invest and prepare for succession or an eventual sale a few years out at least.

Weigand: We're talking about the interaction of up to four things: the family council, governance at the shareholder level, the board of directors, and maybe an advisory board. Every family business has a governing structure, most are informal. It may just be over the kitchen table, but what the survey has confirmed is that the larger and more successful firms are being intentional about how they govern and that those efforts are being richly rewarded.

Schiller: Bringing this to life is all about doing some type of one-on-one or small group with the families, because we're all family business advisors, but what's it for? It's all for the families. Data in a vacuum is interesting, we can all look at that and learn things, but you've got to have discussions in order to bring it to life.

Dohr: Like any piece of data, "What's it say, what's it mean, and what are you going to do with it to make life different and better?" It's that third piece that is missing a lot of times. It ultimately comes down to that question, "What can we do to get the information into the hands of the people who can learn from it, so they can manage their business or family differently? That's really the bottom line. Now, let's open this up to your questions for Rich Simmonds.

Audience Question: As part of the survey, did you have any discussions on executive management's willingness to be receptive or implement the guidance of the board?

Dohr: Great question. We did ask a question that had to do with how much time the board spends on tactical or strategic matters, and the majority of respondents said it tends to be more tactically focused, although that includes how to handle strategy, policy, vision, direction of the company. It's important for them not to spend most of their time on trying to micromanage the business, but rather delegating. In larger organizations, there tends to be a lot stronger communication between the board and the executive team.

Weigand: Maybe the heart of it is, have ownership and management bought into the importance of a board and the advice it will provide? You won't have a successful board if you bring in big, high-powered outside directors, and the management says, "Thanks for the advice, even though I'm supposed to accept and implement it, I'm not going to." Then you have a fundamental disconnect.

Audience Question: Some businesses try to recruit board members with specific skill sets - somebody in manufacturing, somebody in compensation, and so on. Is this a best practice?

Simmonds: Yes, that approach makes a lot of sense. You just need to make sure they have some of the other skill sets too. Like, can they play well with others? When you are evaluating skill sets, it's important to look for more than just subject-matter expertise.

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*The Pacific Family Business Institute's Governance & Compensation survey is the product of interviews with over 80 family businesses in Washington and Oregon, and was released in October 2018. The survey was made possible by the financial support of sponsors Cascadia Capital, Moss Adams and Davis, Wright, Tremaine. To download or learn more about the PFBI survey, please visit **www.pacificfamilybusiness.com.** If you are an advisor to family businesses and would like more information about joining the Northwest Family Business Advisors group, please visit **www.nwfba.org.***