

NACD Event Highlights

February 9, 2010 Breakfast Event

Outside Directors Inside the Family-Owned Business

Independent directors venturing into closely held businesses enter a world with sometimes conflicting agendas. Each Director's fiduciary duty is the same as with a public company; living up to that duty sometimes runs afoul of internal politics. How does a closely held family business with outside directors achieve good governance in times of company transition? These issues were brought to life as five expert guests portrayed a board meeting of the fictional family-owned American Electrical Products ("AEP") at NACD New England's February 9, 2010 Breakfast Event.

The plot line for the 30-minute role play focused on a meeting of the five-member AEP board, which included two sons of the founder active in the business serving as inside directors. The outside directors were an MIT professor, an investment banker and a consultant to family-owned enterprises. Moderated by NACD New England Director Stephen M. Honig, partner with the law firm of Duane Morris, LLP, the fictional board meeting focused on the key strategic issues faced by AEP: changes in its industry, increasing competition, and potential acquisition opportunities for the company.

Portraying the role of son of the founder and CEO was Roger Berkowitz, president and CEO of Legal Sea Foods. The role of the second son and CFO was played by Robert Singer, who along with his four brothers and brother-in-law serves as a director of Merchants Automotive Group. Portraying the role of the outside director and MIT professor was Lucinda Doran, Ph.D., an independent director, interim executive and consultant to middle market companies through CagSolutions, Inc. The role of AEP outside director and investment banker was played by Hugh Taylor, managing director of Newbury Piret & Company. Portraying the role of AEP outside director and consultant to family enterprises was Ira Tatelbaum, a consultant to family and closely held businesses through his company BP Solutions LLC.

The fictional scenario modeled a set of challenges that would probably be familiar to the leaders of any mid-sized family owned corporation. AEP's historically fragmented industry is changing. Consolidation among its suppliers and customers is soon to be matched by consolidation among its competitors. A private equity firm has just announced the acquisition of AEP's financially ailing but largest regional competitor, and a Netherlands-based global competitor has recently made its first American acquisition – one of AEP's peer companies owned by long-time family friends.

AEP has acquisition opportunities of its own, but whether to pursue them – and whether to take on the required debt – consumes the attention of the directors as their next quarterly

meeting approaches. The board's resolution of this issue is complicated by the contradictory strategic and personal objectives of the two sons. The CEO wants to grow by leading his own roll-up of smaller competitors, but the CFO wants to conserve cash flow for (a) distribution to the family – particularly for the care of their ailing mother – and (b) payment of the deferred portion of the redemption of their father's shares. Resolution is further frustrated by both the explosive personalities of the brothers and by their rivalry, which infect virtually every discussion at the board.

The role play and following Q&A session highlighted a number of issues frequently encountered by the boards of family and closely held companies:

1. Dealing with family dynamics:

- Maintaining family harmony while still making the tough decisions.
- Balancing risks to family relationships against risks to the business.
- The importance of directors being clear about which hat they are wearing when stating their opinions – “Am I speaking as CEO, a sibling, or the founder's son?”
- How and when to determine what the founder would do, or what he would want.

2. The outside director's role and responsibilities:

- Who do non-family board members truly represent – other family members, company employees, additional minority stockholders?
- Reconciling the different goals, interests and risk tolerances of family members, whether they serve on the board or not.
- Helping family members overcome the difficulties they may have in being objective when exercising their responsibilities as directors.
- Dealing with the tendency for family directors to feel entitled instead of privileged in their role as directors.

3. Fiduciary and governance issues:

- How to improve board performance when family dynamics are involved.
- The importance of having a strategic plan for issues such as M&A activity instead of vague statements of board philosophy.
- Dealing with inside director non-performance.
- The pros, cons and feasibility of buying out family members who are not serving effectively as directors or are repeatedly at odds with the majority of the board.
- Overcoming the inherent difficulty of selling a minority interest in a family owned business.
- Management and board succession planning.
- Legal compliance of board activity.
- The importance of considering the impact of board decisions on company employees.

4. Using outside consultants:

- How to select an outside advisor with the right skills and experience.
- Ensuring clarity as to who the advisor sees as the client – is it the board or the business itself?
- Defining the outside advisor’s role – securing the future of the business while maintaining family harmony and remaining within the risk tolerance parameters of family members both on and off the board.
- The value of bringing in an outside advisor as a transition to adding independent directors to the board of a family-owned business.
- The challenge frequently faced by outside advisors of whether to prioritize the sustainability and value of the business or the care and feeding of family relationships.

The February 9th NACD New England Breakfast Event adjourned with a reminder from chapter president Bill Earon about the next Breakfast Event, *The Gold Standard for the Risk Committee – a Red Hot Issue*, which is scheduled for Tuesday, March 9, 2010, at the Newton Marriott Hotel.