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Family Business

THE GUIDE FOR FAMILY COMPANIES

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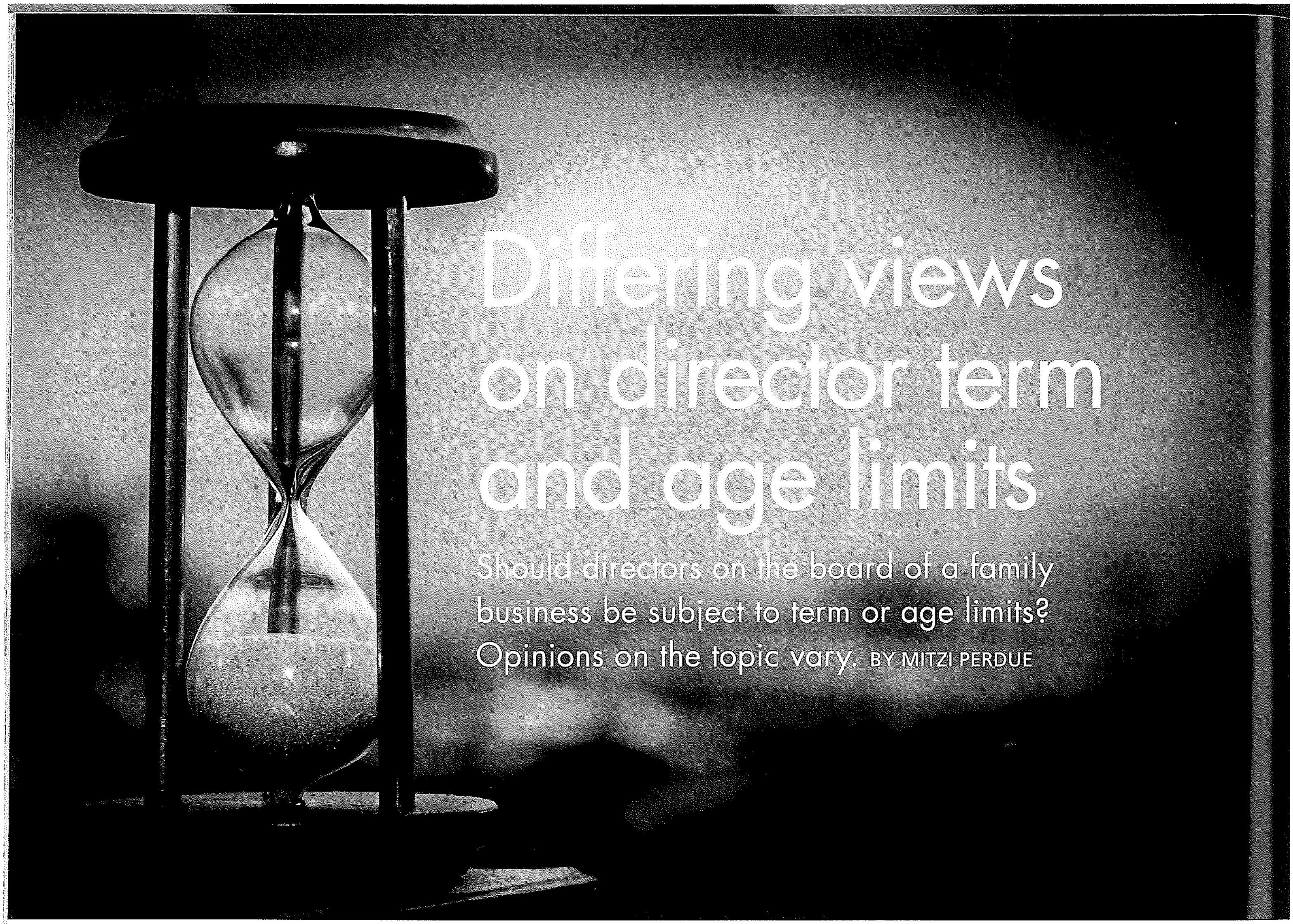
From bottom up: Guy Cecala, Martha Huber, Molly Heaney, Peter Francis and Evan Seely.

SUSTAINABLE GOVERNANCE at J.M. Huber Corporation

The forward-thinking Huber family established solid governance structures in the third generation and built on this foundation in G4 and G5.

PLUS

- How family offices can help with NextGen education
- Board term and age limits: Pros and cons
- Family Leaders to Watch



Differing views on director term and age limits

Should directors on the board of a family business be subject to term or age limits? Opinions on the topic vary. BY MITZI PERDUE

Instituting term or age limits for directors is a way to ensure you have the right board members to help your family business grow and thrive in today's competitive marketplace. Requiring directors to step down once they have served a predetermined number of terms or reached a certain age takes emotions out of the equation because the board members know in advance when they'll need to step down.

A recent study reported that in public companies, age limits are more prevalent than term limits. Deloitte's 2016 Board Practices Report, which queried 189 public company members of the Society for Corporate Governance, found that while 81% of the respondents from large-cap companies and 74% of those from mid-cap companies imposed age limits on their directors, only 5% and 6%, respectively, used term limits.

In family-owned private companies, the interpersonal issues are more intense because family members serve on the board. Here are some real-world examples from family business members, along with recommendations from advisers to family firms.

Steve Walker: Use evaluations as an alternative

"Rather than instituting a formal term limit or age limit, we recommend that at least once a year, a board assess how well the skills of the board members align with the current strategy of the company," says Steve Walker, managing director and general counsel at the National Association of Corporate Directors (NACD).

"While age limits and term limits have been used by many successful companies, NACD recommends annual assessment of board composition as the best way for board leaders to ensure that the C suite has a 'strategic asset board' that provides sound advice and counsel in this highly competitive and innovative marketplace.

"A business needs to be checking constantly if the board has both the soft skills and hard skills the company needs to remain competitive."

A tool for assessing directors' skills. Walker recommends using a skills assessment matrix to gain insights on your board members' strengths and to identify gaps you need to fill.

To create a matrix, list the skills your company needs most on a sheet of paper. These skills might include financial acumen, supply chain expertise, a track record in M&A or boots-on-the-ground experience in China. The critical skills list typically ranges from 10 to 15 top priorities, Walker says.

Now, create a grid by listing the current directors across the top of the page. Board members then confidentially self-assess their level of expertise for each of the skills and also rate their fellow directors.

"It is critical to understand that this is not a report card," Walker points out. "Rather, it is designed as a team exercise to monitor skills gaps based upon the current strategy. Leadership does not share the individual results with the board."

A high-functioning board would have at least one person who receives a high rating for each skill listed on the matrix that emerges from this exercise. If the assessment reveals a skills gap, the board should find a new member to fill that gap.

"However," Walker is careful to mention, "no matter how technically aligned an individual board candidate may be, soft skills and cultural fit may trump hard skills."

In addition to evaluating individual directors' skills, the board should examine their level of engagement and preparation. Those who aren't adding value should be replaced.

The skills assessment matrix may also reveal redundancies. In Walker's experience, redundancies aren't always a negative. "Having institutional knowledge and wisdom are critical assets, as long as the director is still actively engaged and prepared for meetings," he says.

"Many boards choose to expand the board size to accommodate a new board member" rather than replacing one director with another, Walker notes.

Onboarding strategies. The company should clarify what's expected of directors when they first join the board, Walker advises. "There should be an onboarding letter managing the new member's expectations and spelling out his or her responsibilities," he says.

The onboarding process should include an explanation of the role of director evaluations in ensuring that board members have the skills the company needs. As Walker puts it, "When a new member is onboarded, he or she needs to understand that this is not an appointment to the Supreme Court. It's not for life!

"The individual needs to understand that board members serve at the pleasure of the CEO or chair of the board, and then only as long as the individual's skills are aligned with the company's needs and strategy."

THE BOARD SHOULD EVALUATE INDIVIDUAL DIRECTORS' SKILLS AND EXAMINE THEIR LEVEL OF ENGAGEMENT AND PREPARATION. THOSE WHO AREN'T ADDING VALUE SHOULD BE REPLACED.

Mary Andringa: Age limits rather than term limits

Mary Andringa is chair of the board of her family-owned company, Vermeer Corporation. The company, based in Pella, Iowa, and founded in 1948, designs, manufactures and distributes large agricultural and industrial equipment.

Vermeer's board doesn't have term limits. Instead, board members stand for election each year. In addition, after shareholder directors have served three terms, they must step down from the board for at least two years.

"We do this," Andringa explains, "to give other shareholder directors a chance to serve."

As chair, she makes it a point to talk with each director long before elections are held. The board must have not only the right mix of skills and experience, but also the right chemistry, she says.

Directors must be team players and must treat other board members with respect, Andringa says. A director who dominates the conversation shouldn't be on the board, she says. She values directors who make sure everyone gets heard.

When she's talking with her directors, something she hears frequently is, "Am I still adding value? If I'm not, I'm fine with not standing for re-election."

Vermeer Corporation's board of directors. Back row, from left: Brian Gardner, Robert Hund, Scott Nelson and Cara Heiden, directors; and Jonathan Vermeer and Mindi Vanden Bosch, shareholder directors. Front row, from left: Allison Van Wyngarden, shareholder director; Jason Andringa, president/CEO and director; Mary Andringa, chair of the board and director; Derek Kaufman, director; and Robert Hardin, director.

	Director Names								
Desired/needed skills, experience, attributes	A	B	C	D	E	F	G	H	I
International expertise	X								
Technology/digital media expertise				X	X			X	
Risk management expertise			X			X		X	X
Financial expertise		X	X		X				
Marketing expertise									X
Legal expertise		X							
Human resources expertise			X			X			
Operational expertise	X	X	X			X	X		
Industry expertise		X	X		X			X	X
Gender diversity				X			X		
Racial diversity				X					X
Regulatory expertise	X		X			X	X		
Board tenure (years)	15	15	10	8	7	7	4	1	8
Age (years old)	71	74	65	62	60	67	55	47	58

Sample board composition matrix. Courtesy of PwC from the firm's report "Board composition — Key trends and developments," July 2018. Reprinted wiith the permission of PwC.

A "70-and-out" requirement. Vermeer board members cannot serve past the year in which they turn 70.

Andringa is a member of Vermeer's second generation, which instituted the 70-and-out policy. They did this because of their experience with their father, Gary Vermeer, the company's entrepreneurial founder.

The G2s loved and respected their father, but they found that in his 80s, he became more risk averse.

As a younger man, he'd see opportunity at every turn. As he aged, the family noticed that he no longer was able to strike a balance between seizing opportunities and avoiding risk. Too often, he focused exclusively on dangers instead of the myriad opportunities that were available.

After their father passed away, the G2s decided to be "thoughtful and intentional about success," Andringa says. To avoid the kind of situation they had observed with the patriarch, they decided that "having senior leaders stay around forever isn't always in the best interests of the company."

Lee Ann Howard: Manage expectations

"The question of term limits is situational; what works for one company may not be right for another," notes Lee Ann Howard, founder of Howard and O'Brien Executive Search.

Her firm recommends this approach: "Tell board members going in what to expect, including that they serve at the pleasure of the family."

In her experience, "New board members need to know such things as: that there will be yearly reviews, the amount of preparation expected, the committees they'll serve on, their compensation and the calendar dates of the meetings they are expected to attend.

"What you don't want is someone saying, 'Hey, join the board, we meet a couple of times,' and then neither side knows what they're getting into."

The yearly review can be an effective tool for maintaining a high-functioning board. "When a board member is getting a review of 2 out of a potential 5," Howard points out, "he or she is likely to self-select off."

Larry Hause: Proactively remove underforming directors

Larry Hause, an attorney and family business adviser, is squarely in the camp that opposes term limits.

"In most cases, it takes a year for a new board member to get to know the personalities and figure out what's going on in the company," Hause says.

"It takes another 12 months for the director to find his or her groove and to know how to work with both management and the family for the benefit of both. Also, it takes time to know and trust the other board members so they can function well together as a team," says Hause, who specializes in board governance and is co-author of *The Balance Point: New Ways Business Owners Can Use Boards.*

"By the third year," Hause says, "the board member is finally in a position to add value and not just mess things up. But with a three-year term limit, the member may be rotating off at exactly the time when he or she is able to add the most value."

What about the benefit people speak of most often when discussing term limits, the ability to get rid of underperforming directors? For Hause, that's one of the biggest drawbacks of term limits.

"Term limits are a convenient way of putting off dealing with a difficult director," Hause asserts. "With term limits in place, it's possible for the board chair and the other board members to wait a year or two to allow the non-performing director to rotate off."

In his view, this is an unfortunate approach. "When a board member isn't adding value, this needs to be addressed immediately. Waiting a year or two to solve this kind of problem means the board doesn't have the best team in place."

Ronda Ritter Ray: Make way for younger family directors

At E. Ritter & Company, an agribusiness and communications company founded in 1886 and based in Marked Tree, Ark., the procedure for nominating directors has evolved.

Ronda Ritter Ray, a fourth-generation member who now serves as lead family director, previously was president of the Ritter family council. "One of the topics for my first board meeting was term limits," she recalls. "The independent directors had all been there for years and, as far as the family was concerned, they were trusted friends."

As the discussion at her first board meeting continued, it emerged that nobody was in favor of term limits or age limits. "The conversation became a consensus that we could, after all, change the directors at any time.

"The conversation was easygoing and relaxed, and independent board members had the attitude, 'If we are not serving your purpose, you can simply ask us to go.' "

While the board decided against term and age limits, E. Ritter & Company formalized its director selection process in 2013. The company's first non-family CEO took office that year, and the chairman at the time, a family member, was thinking about retiring. The business needed directors with the skillsets that would help it achieve its strategic goals.

When one of the independent directors said she would be ready to step down within a year, the board began considering the kind of experience a new director should have and how to formalize director selection.

The board instituted an evaluation process after an investigation of best practices. The company also adopted a director qualification and nomination policy on Feb. 1, 2013. The policy stipulates separate sets of desired qualifications, qualities and skills for independent directors and for family directors.

"What I've learned in all of this," says Ray, "is that that attitude of, 'Just let us know when you don't require our help,' isn't as easy it sounds.

"It's hard to say to someone you've worked with on a board for 10 years, someone you like and respect, 'We're moving in a different direction, and it's time to step down.' "

Though board members aren't subject to term limits, Ray thinks it's a good idea for family directors to leave a board after 10 years. She has two reasons for this.

First, she is in favor of ensuring that younger family members have a chance to serve. "The older generation needs to enable the younger generation to assume leadership roles. The NextGen needs to know that their leadership will be required. If you wait too long, they'll lose their enthusiasm and energy."

She therefore thinks it's a good idea for older board members to make room for younger ones. For NextGen members, "Being disengaged too long guarantees continued disengagement."

She also believes that after 10 years, family members have probably made their most significant contributions to the board. "They've contributed their time and their experience," she says, "and it's time to make room for the NextGen's fresh ideas."

Keven Prather: Term limits can help manage change

Keven Prather of TransitioNext Advisors understands that even bringing up the issue of term limits can be unsettling. "I was talking recently with an attorney about term limits," Prather recalls, "and he looked as if I was stabbing him in the chest with a pitchfork."

Prather has several reasons for favoring term limits.

- All board members are not created equal. You may have some who are not firmly engaged, and it's good for everyone if they are freed to pursue other opportunities.
- Some directors may have offered the right advice when the company was small but no longer meet the needs of an expanded business in today's market.

Term limits can help manage needed change when asking people to step down is too difficult. Prather knows that this situation happens in the real world.

Find a solution that works for you

As is true of many other family business policies and structures, your family must consider as a group whether board term or age limits are the right solution for your family firm. Solutions that work for other families may not be right for you or may require modification to be workable in your family.

Your family may find that term or age limits are the most practical way to remove directors who underperform or who don't have the right skills to address the company's changing needs.

On the other hand, you may find that your senior and long-tenured directors continue to provide good counsel that translates into measurable gains for your company. If you decide not to institute term or age limits, you must commit to monitoring your board's performance — and be ready to undertake the emotionally difficult task of removing directors who no longer meet your company's needs. FB

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