One family business's governance journey

Daniel B Hatzenbuehler
E Ritter & Company

Our family and our business have been on the family business governance journey for approximately nine years. In retrospect, it has been a journey both eventful and smooth, but a journey nonetheless. And it is a journey that in certain respects never has a destination, especially if the family and the business are to remain vibrant and effective for the long haul. There are plenty of milestones along the way and sometimes it is helpful to look back over those markers and reflect on some of these experiences. As the adage goes, 'One can't understand where one is heading unless one understands where one has been'. So, to understand our governance journey and the lessons learned, it is necessary to appreciate where both the family and the business were when the journey began in 2005.[1]

1. "Because we've always done it that way" is not good governance

E Ritter & Company was, and is, a classic fifth-generation cousin consortium, a mature business with a large and geographically dispersed group of third, fourth and fifth-generation owners, only two of whom were working in the business. Additionally, especially at the fifth-generation level, in 2005 the family owners among the three family branches did not know each other well or even at all, nor did they have a deep understanding or appreciation of the business or its family history. Since the company's inception in 1886, the leader of the business had been either a direct lineal descendant or an in-law (in my case) of the founder. The great-grandson of the founder was president of the agribusiness division and I served as chair of the board and chief executive officer (CEO). Additionally, approximately 95% of the stock was either owned or represented by the board of directors. The family, while very cohesive and supportive of management, could best be described as passive family owners. Few, especially from the fourth and fifth generations, attended the annual shareholder meetings.

The company is engaged primarily in two disparate business lines – agriculture and rural communications. With the exception of the president of the communications division, who had significant industry experience with a number of telecommunications operations in the southeastern United States, and the director of human relations, who had significant work experience in national and international

1 For a much-abbreviated version of this and other family business governance journeys that we have been on at E Ritter & Company since 2005, see the article by Stan Luxenburg, "E. Ritter & Co.'s governance journey", in the Winter 2012 issue of *Family Business Magazine* (www.familybusinessmagazine.com).

operations, upper management was home grown. The company had long relied on the local talent market to fill most of its managerial needs, especially in the agribusiness operations, so management consisted of long-tenured, extremely loyal employees who had limited work experience in other organisations or geographies.

Some of the seeds for change in the governance structure were planted in 2001 when the company embarked on a wide-ranging culture change project that sought to bring best practices to organisational and employee development, and strategic planning. As the company began its efforts to 'honour the past but prepare for the future' in the 21st Century, by 2005 it was becoming apparent that something was still missing.

In terms of governance, the board of directors consisted of eight persons, six of whom were family members who more or less continued to represent the three family branches, and two who were outside (as opposed to independent) directors. All of the family board members had served continuously for several decades, so there had been no opportunity for the younger generations to become involved in board leadership. Over the years, however, the board had worked steadily at professionalising the governance of the company. It had, among other things, expanded the board in the early 1980s to add the first outside board member, instituted written quarterly financial reporting and operational updates to shareholders, implemented a shareholder agreement that restricted ownership to family members but gave shareholders annual opportunities to redeem shares at an independently determined valuation, instituted modest quarterly dividends to provide some current return to the family, and implemented both annual and long-term compensation plans to reward and align management with the success of the company.

However, the communications division had grown beyond the capabilities of the family-dominated board, which admittedly found it increasingly hard to keep up with technology and deregulation, as well as the convergence of the voice, video and broadband product lines. In short, the board was finding it more and more difficult to be of guidance to management or to assess effectively the opportunities for change and growth that were being presented to it. A similar phenomenon existed on the agribusiness front as well: agriculture had become a global business with forces around the world having a greater impact on local agricultural decision making. The president of the agribusiness division summed up the overall situation within the company succinctly: "The good news is that we're a 120-year old business; the bad news is that we're a 120-year old business."

2. Bodies at rest tend to stay at rest

For many years the attendance of the family owners at the annual shareholder meetings had been sparse, most often limited to the family board members and local family owners. All family owners had inherited their stock from prior generations and viewed themselves as merely the custodians of the stock until it was time to transfer their shares to the next generation. This had not raised any concerns on the part of family management and the board. Rather, they interpreted the lack of family participation to mean that the family was satisfied with their investment and how the company was being managed. In fairness, management had not taken any extraordinary efforts to encourage greater attendance and participation other than the annual letter of notification of the meeting and request to attend.

However, another equally possible interpretation became more plausible: the lack of involvement was due to a lack of emotional, financial or informed engagement caused by the lack of opportunities for younger family members to get involved with the company in any meaningful way. No one had really focused on the fact that such lack of involvement could, over time, foster apathy or even worse, discontent, as future generations became less and less attached to the business and the family's historic roots.

Consequently, both the family and the business had something of a perfect storm brewing: an aging, non-business focused board of directors and a younger, uninformed group of family members who were geographically dispersed and lacking the emotional ties to the family and/or the business that the older generations had. That was the bad news; the good news was that through a lot of education, conversation and collaboration, there emerged in the following years a way of addressing these concerns that could both strengthen the family and enable the company to grow and revitalise itself for as long as the shareholders desired it to remain a family business.

3. It takes a lot of work to convert passive family owners to active and engaged owners

Beginning with the 2006 annual shareholder meeting, management actively encouraged (some would say cajoled and threatened) the fourth-generation family members to attend the shareholder meetings and to bring with them their fifth-generation young adults. For their part, management started using these meetings to educate the family on not only business operations, but also what it meant to be an informed and engaged owner of a family business. The fifth-generation attendees began to see the company and their connections to the family in a whole new light. From the feedback received from directors and family members alike, there began to develop a lot of interest and enthusiasm about the changes and opportunities that were taking place in the company and about its future. Yet, with this interest and enthusiasm there also came questions, differing viewpoints and varying levels of desired participation and also some concerns.

So 2006 was when the company embarked in earnest on its family business governance journey. During that year, the family executives became students of family business governance to learn as much as possible about the importance of strong governance structures, and how to create them for both the business and the family. Additionally, family board members were encouraged to attend family business conferences to learn for themselves the importance of both corporate and family governance.

The interactions with academics, family business consultants and successful families in other businesses were eye opening for all those who participated. We learned that a family cannot take past success in business or past family unity for granted, and that it must anticipate and prepare both the family and the business for future survival. It helped us to understand that we had to develop better organisational structures for both family and board to meet the new realities that were ahead for both. What we did (or did not) do in the near term would directly impact the cohesion of both the family and the business over the next generation.

4. The business of the business and the business of the family both need a lot of attention

At both the board and the family levels, we were facing new realities that created new challenges and required much more informed decision making for the company to remain competitive. The company was engaged in two very different and complex business segments within one entity. The transitions from wireline to broadband networks and business strategies, as well as the globalisation of agribusiness, significantly increased the need for more frequent access to expertise in areas such as marketing, international trade, technology, strategy and customer service. Leadership succession, at all levels within the company, was a huge looming issue that deserved greater separate focus. In short, the company depended on how the board and the family addressed these issues, not to mention the implications from not addressing them.

The same sort of new realities existed in the family. The new realities of the next generation required much more informed and unified decision making in order for the family to continue as an important contributor to the future success of the company. Fifth and sixth-generation family members, geographically dispersed with diminishing ties to the family, the business and the local community, were already on the scene. More importantly, as the board and management grappled with the issues facing the business, they would need unified input from the family on matters such as acceptable rates of growth, debt levels, access to capital and dividends; the family would need to consider issues such as qualifications for participation as a family board member, an employee or both, since these issues have long-term implications for both the family and the business.

Yet, we had no organised means to educate the family on these issues or for them to formulate responses to inform and support what the board was doing on their behalf. Organising and educating family members takes time, and the time to begin to address those issues was now – when the family had no divisions of opinion or dissatisfaction, leadership vacuums or generational transitions that could strain relations. There was an opportunity to capitalise on the spirit of goodwill and cohesion that had been one of the family's strengths, as well as a real sense of excitement about the company's future. It was time to use this momentum to build on what the family and the business had for the benefit of both.

To address the needs of the business and the family, two matters needed to be faced, and quickly: transitioning the board of directors from a family-controlled board to a true fiduciary board made up of a majority of independent directors, and organising the family to enable it to become an effective, educated and engaged group of family owners. Therefore, I began a crash course on how an independent board of directors could be good for the business of the business and a family council could be an effective counterbalancing governance mechanism for the business of the family.

5. "Structure is your friend"[2]

In July 2007 I proposed to the board of directors that it form and support a committee of family members and family directors to investigate, and then report to the family on, the advisability of forming the Ritter Family Council – a forum to reinforce unity and commitment to responsible ownership among the individual owners and their families. The primary purposes of a family council are to promote family ownership education, encourage the development of long-range family goals, enhance social bonding among family members, provide a representative forum for developing family policies and opinions, and become a means for the family to develop a unified voice in communicating with the board of directors on issues of importance to the business.

Thus, in August 2007 the board unanimously agreed to form a family council exploratory committee, which was charged to report its findings at a meeting of the family shareholders in February 2008, and to recommend whether it was in the best interests of the family to form a council. The committee began its work in earnest in October 2007. From its study, the committee determined that there were numerous advantages to creating a family council.

For the family, such a council would provide a structure that would give all generations a way:

- to be engaged and participate as owners;
- to understand and embrace the values and vision that have made the company successful;
- to formulate long-term goals for the family that will keep them and the company together;
- to prepare future family board members who are knowledgeable about the family and the business and who have the support of the family as a whole; and
- possibly most importantly, to gather as a family to stay connected and preserve the family history, values and relationships.

Such a council would also help the board, in that when the latter would consider strategic initiatives, it would be acting in accord with the expressed desires and goals of the family owners on issues affecting financial and business goals; it would also enable the board to take necessary risks with confidence that the family would give its support and remain united; and it would enable the company to attract independent directors with the skills and expertise needed by the company since the best directors are attracted to boards that are serving a unified family.

Similarly, great managers want to work for a company where the owners are committed long term, and who can show that they are able to make informed family decisions outside of the boardroom that support and benefit both the company and the family. Creating and using a family council is how other great 100-plus year-old family firms keep and nurture this advantage.

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2 John A Davis, "Families in Business: From Generation to Generation", Harvard Business School, November 6 – 11 2011.

At the February 2008 meeting, the committee unanimously recommended that the family form a council and create a separate working group of family members to draft a family council charter to be presented to a special meeting of the family in August 2008. Thus, with the formation of the Ritter Family Council well on its way, I was able to turn my attention to the other governance challenge still to be undertaken: converting the company's board of directors from a family-dominated board consisting of six family members and two outside directors to a nine-person board consisting of a five independent and four family directors.

6. It is impossible to over-communicate

At the February 2008 board meeting, we discussed the advantages that could be gained by making this transition, as well as some of the anxieties that such a change may cause. The discussion also gave our outside directors the opportunity to state that they really did not consider themselves to be independent because they were outnumbered; additionally, because of the great respect that they had for the family directors, they were reluctant to pound the table on any issue about which they may strongly disagree because they did not wish to inject acrimony or discord that might otherwise have adversely affected their personal relationships with the family board members. At the end of the discussion, the board agreed to take action on the following issues at their May 2008 meeting, giving them more time to consider the significant changes that were being proposed – namely, to establish the size of the board at nine persons with a majority being independent directors, to create the position of director emeritus for those family members who agreed to retire from the board in order to make room for the new independent directors, and to establish the criteria and characteristics that they desired in the independent directors to be added to the board.

7. Emotional ties are stronger than intellectual understanding

From the discussions that I had with family board members over the ensuing months, it was clear that conceptually and intellectually, few members had any real concerns with moving to a majority of independent directors. Because of the time spent involving family members in family business governance educational opportunities, everyone understood why both the company and the family needed the skills, expertise, and abilities that independent directors would bring. All had learned that both the business and the family would benefit from directors who were knowledgeable in our specific industries, with functional skills and board experience that would help the business to grow, who would challenge management in a respectful manner and ask the hard questions, who cared about the company, the owners and management, who would conduct themselves with the highest personal integrity, and who would work to build long-term value for the family owners.

However, regardless of the intellectual understanding, emotionally it was still a very difficult subject to address with the family directors, especially since it would mean that two of the family members would need to retire from the board. Some family directors feared that the family would lose control of the company if the board consisted of a majority of independent directors; others felt that if they were to retire, it would be an admission of some personal flaw or failure on their part;

lastly, some had difficulty losing the connection to their ancestors and the company were they no longer to be on the board.

Consequently, I had to be very clear on a number of points. The addition of independent directors and the retirement of family board members did not mean that the family would lose control, since the family (and largely the family board members themselves or with their family members) could easily remove any or all of the independent directors at any time, for any reason; it did not mean that there were any specific family board members who needed to be replaced due to age, infirmity, competency or any personal reason other than to make room for independent directors; it did not mean that this was the first step toward all family board members being replaced with independent directors or that there would not always be family members on the board to represent the views of the family; and it did not mean that the transition would occur overnight.

This is an extract from the chapter 'One family business's governance journey' by Daniel B Hatzenbuehler in Family Enterprises: How to Build Growth, Family Control and Family Harmony*, published by Globe Law and Business.*