



Family Business Governance and Outside Directors—Expectations from an Independent Director

Miguel Ángel Gallo*

IESE Business School, Spain

Commentary. Received: 2022-09-19; accepted: 2023-03-21

JEL CODES L20, L29

KEYWORDS

Board, Consensus, External director, Family business, Independent director, Harmony

Abstract Based on the author's own experience as an external and independent director of several boards of directors of family-owned companies, the objective of this paper is to show the responsibilities that these directors must assume and how they should preserve their qualities as "external" and "independent" directors. In this way, it is expected that this commentary can help to shape the procedure of incorporation and evaluation of external and independent directors.

CÓDIGOS JEL L20, L29

PALABRAS CLAVE

Consejo de administración, Consenso, Consejero/a externo/a, Empresa familiar, Consejero/a independiente, Armonía

Gobierno de la empresa familiar y directores externos-Expectativas de un director independiente

Resumen A partir de la propia experiencia del autor como consejero externo e independiente de varios consejos de administración de empresas familiares, el objetivo de este trabajo es mostrar las responsabilidades y obligaciones que deben asumir estos consejeros y cómo deben preservar sus cualidades de consejero "externo" e "independiente". De este modo, se espera que este comentario pueda ayudar a configurar el procedimiento de incorporación y evaluación de consejeros externos e independientes.

<https://doi.org/10.24310/ejfb.ejfb.vi.15377>

Copyright 2023: Miguel Ángel Gallo

European Journal of Family Business is a fully open access journal published in Malaga by UMA Editorial. ISSN 2444-8788 ISSN-e 2444-877X

This work is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License (CC BY-NC-SA 4.0).

*Corresponding author:

E-mail: MGallo@iese.edu

1. Introduction

Many years have passed since I was invited to join the board of directors of a family-owned business. By that time, I had already served as a director on the boards of several companies. Today, at the age of 89, I am on the board of directors of four companies. They are all medium-sized family businesses, 100% owned by a single family and with a profit after-tax of more than one million euros; two of them are recognized as leaders in their respective sectors.

The size of the board ranges from four to eight members. In three of them, there are non-family managers who are directors: in one of them, I am among the two independent external directors; in the other three, I am the only external and independent director.

Encouraged by the editor-in-chief of the *European Journal of Family Business*, Dr. Amaia Maseda, I will, in the following paragraphs, share my thoughts, based on my personal experiences, regarding what these companies expect from an external and independent director in terms of company harmony, her/his responsibilities as a director, and how they must preserve their qualities as an “external” and “independent” director.

2. Expectations from an External and Independent Director on the Board of a Family Business – Unity and Harmony

In a previous article (Gallo, 2021), I insisted upon the difficulty of achieving harmony in a family-owned business if there was no broad and permanent basis of unity to which its board of directors must adhere. It is natural for people in positions of power to want to retain it (Alvira, 2005, p. 71), which explains the infrequent changes to the composition of a family-run business’s board of directors. Even when they occur, they are usually because of special circumstances such as illness, disability, substitution of some owners by others, death, etc. These circumstances can incite an erosion in the unit.

In my experience over the last five years, unity in such boards has been paramount to handle the lack of success of certain directives to attain the expected strategic or organizational success or to manage a strong demand for strategic change because of evolution of the business environment – something that is currently occurring in many family businesses. These are complicated situations, requiring rapid adaptation to new technologies. There are also other complex situations, such as the

succession of owned directors (owners of the family business) by one of their children or by a non-family member, or the incorporation of new directors that bring knowledge of new fields of action. Then there are other circumstances, quite different from those just mentioned, but also very common—for example, problematic marital separations.

Additionally, the board of a family business must be among its main engines to achieve professional excellence through a balance of *potestas* as socially recognized “force”—that is, recognized “power”—and *auctoritas* as socially recognized “truth”—that is, recognized “knowledge” (Álvaro D’Ors, quoted in Domingo, 1987). Balance must be established, first, among the board members and, then, among the principal managers of the family business.

The external and independent board member—formed by one person or several—must be especially careful, first of all, to ensure that necessary balance between *potestas* and *auctoritas* is achieved in the board itself, and then, that this balance is achieved between each of the directors. This is a crucial aspect of the duty of diligence and loyalty, which the legislation usually establishes among the basic responsibilities of the director.

The meetings of a family business’s board are significant events to ensure congenial coexistence in the company and in the family. The board of a family business signifies—in a powerful manner—positive or negative coexistence in the company and in the owner family. Naturally, the external and independent board member is expected to positively coexist with each board member.

The board is not, by law, obliged to collegiate its decisions, that is, take them by consensus. Sometimes it is even desirable that this consensus is not reached, so that the different positions on how to govern the company are clearly distinguished and, if necessary, decided by the shareholders meeting, the company’s supreme governing body. However, when voting becomes common in the decision-making of the board of a family business, it signifies lack of consensus, which can potentially precipitate disunity.

In the family business, deciding through voting usually leads to the separation of family members who initially wanted unity. Hence, it is crucial for board members to learn about the necessary conditions to collegiate, that is, to reach a consensus on decisions.

Therefore, it is usually expected of an external and independent board member to act as a “master of consensus” to set the example in respecting the conditions that are necessary for collegial decision-making:

- Listen to others with the intention of understanding the basic reasons for their expressed opinion, and question – in a positive manner – their opinions, instead of merely arguing-to-win in the ensuing discussion.
- Express your opinion truthfully and completely, without repetition of the reasons on which it is based, and without constantly referring to past events.
- Be truly willing to change your mind.
- Accept the decision taken by all in a collegial manner, even if it is different from the one previously suggested and maintained, loyally supporting it.
- Do not necessarily withhold matters to be dealt with later in time, but deal with them diligently. Do not delay their consideration, thinking that the passage of time will prove you right or will cause such matters to be forgotten.

The external and independent board member is not only expected to exhibit an exemplary character, but they are also expected to disseminate and promote such qualities as discussed above. This is required so that consensus among board members can be achieved so as to ensure the best possible performance of the family business.

The responsibilities of the external and independent board member do not apply only to board meetings, as they are often required to hold individual conversations with certain directors. Conversations are not kept secret because they are known to others; however, a part of their content is treated with necessary discretion. Similarly, these conversations should not be interpreted as the intention of the external and independent board members, or other directors, to take the limelight away from the board, inducing others to think that they are attending a sham meeting while the decision has already been made.

Usually, in these conversations, the most important thing is to understand the personal preferences of other board members; rarely will it be an attempt to broaden their strategic or organizational knowledge. The external and independent board member cannot afford to forget that intelligence, will, and feelings are the three natural qualities of all humans (Zubiri, 1985, p. 124), and that personal preferences, as part of a person's feelings, have a substantial role in decision-making. The external and independent board member should be able to identify these personal preferences and direct them toward the achievement of the common goal, helping the person to use their "particular skills" for the benefit of the company.

Just as it is clear that the external and independent board member must do everything, it can achieve consensus and harmony, it must also

be clear that this does not release them in any way from their responsibility as board members. That is, the responsibility to perform adequately in each board meeting, having studied the issues and reached the *autoritas* that corresponds to their *potestas* as board members.

Thus, the core responsibilities expected of an external independent board member in most family-owned businesses include collaborating with the members of the family board, helping to build consensus, and supporting their personal preparation to professionally contribute to decision-making at every board meeting. However, it should be highlighted that directors are often asked, precisely because of their independent status, to comment on and explain certain decisions taken by the board of directors to the other owners, and even to other members of the "extended" family (spouses, children, etc.) in certain circumstances. Sometimes their support is also requested so that these decisions are better known by the managers.

3. Being an "External" Director

It is not difficult to reunite the qualities necessary to be considered an external director, in line with what has been mentioned so far, and even less so when, as it is usually the case, the quality of the external director is equated to that of not being a supplier or client of the family business.

A very different situation is when a significant part of the quality of being external consists of having knowledge of aspects external to the company. That is, to understand well the elements of the political and social environment that can have an influence on the business and, of course, its own competitive environment.

In many cases, one of the main reasons to appoint a person as an external company director is that they possess this external knowledge, or because they possess the skills to attain it. In any case, the external advisor must be aware of their obligation to keep their knowledge up to date and to expand it in those areas that are most necessary for their company.

In my experience, given my age, perhaps the most difficult skill to acquire and maintain is related to digital technology—also called "IT" (Information Technology)—as well as understanding the changes, dangers, and opportunities it brings. New computer programs offer extraordinary value to family businesses—it can be said that in the future, companies will not be able to survive without them. Therefore, if the external director is not "sufficiently up to date," it will be increasingly difficult for her/him to add value at board meetings.

Owing to their external and independent status, these directors tend to have “contacts” with the outside world that prove useful for the family business. They are often obliged to exploit these connections to benefit the company, and sometimes to even help a member of the family who is not part of the business. When “helping” the company through these external contacts, the external and independent director must carefully gauge the nature of the commitment that they will have to make.

4. Being an “Independent” Director

Independence, in this context, refers to the director’s participation in the board’s decision-making with no other commitment than that of seeking the best outcome for the company they advise, although having the freedom to resign when the common good of the family business has not been achieved. This resignation cannot be viewed as a positive outcome, because the real goal is to reach consensus on the best decision. However, the external and independent board member is not obliged to agree with all decisions, and sometimes resignation is the appropriate option to express disagreement.

The mission of an external and independent director is neither to resign, nor to be an easy subject of resignation. However, if their *curriculum vitae* refers to many years of experience without any resignation, withdrawal, etc., this may raise doubts about their independence.

An important element of being an independent director is financial independence. That is to say, they should not be concerned if they no longer receive their remuneration as a director of the board. This is so important that, in the process of appointing the person to the board of directors, this aspect should be fully clear to the members of the board who make the decision to incorporate them.

Another significant element of independence is non-existence of non-professional relationships either with the management of the family business, or with members of the family. This independence will be impacted if the director seeks favors for their family or friends—favors as simple as seeking an internship position for one of their grandchildren, or supporting the incorporation of one of their children in the family business. These situations can erode independence, so much so that in the latter example, it would be reasonable for the external and independent director to resign.

However, the most difficult part of preserving independence is not so much about the capabilities and character of the external advisor, as it is to

their feelings. Every person has an “incomplete rationality” owing to lack of knowledge of reality, limitations in their reasoning, imperfections in their attitude, and biases in their feelings. In a merely conceptual framework, it is possible to split this “incomplete rationality” in “limited rationality” and “biased rationality,” knowing that this distinction is artificial. The reality of action and decision-making, in which reason serves as a faculty to discourse, feelings serve as an affective state, and will serves as the capacity to freely and consciously govern one’s own acts, is a unique reality (Gallo, 2016, p. 36). The term “limited rationality” refers to the boundaries of the external and independent director’s knowledge about the company and its competitive environment. The term “biased rationality” refers to their own personal preferences.

The effort that independent directors must make to improve their “limited rationality” has already been mentioned in previous paragraphs. The ability of independent directors to continuously learn and enhance their knowledge of the company and its competitive environment is emphasized. This ability enables them to appreciate reality as fully as possible to better serve the company. However, the effort required on part of the independent director in relation to their “biased rationality” is often greater—and more difficult—than the one previously mentioned, as it necessitates an active exercise of prudence as an inherent quality of managers. It is evident that the independent director, like any other person, is biased by their own personal preferences—both positive and negative—as to what is appropriate governance for the company. In fact, their positive personal preferences may have been a reason why they were invited to join the board in the first place. Not all personal preferences are always favorable, which necessitates their regular analysis and triage to facilitate the evolution of the family business by implementing required changes.

Good personal preferences are based on moderation or temperance in words and actions—a significant aspect of prudence; patience and grace to bear with integrity misfortunes and hardships; modesty to acknowledge and address the limitations of one’s own affirmations; generosity; and altruism. Conversely, bad personal preferences are based on pride, arrogance, conceit, and selfishness emanating from contempt for others and an inordinate desire to be preferred over others.

The independent director has feelings, and it is natural that the results of past decisions—in which they were actively involved—influence those feelings. However, the independent director must learn from both: successes and failures and

remain ever aware that the important thing is to contribute to the company's success.

The independent director is aware that the human being is a "futuristic being, that is present but projected into the future... since human life operates essentially in the anticipation of the future" (Marías, 1920, p. 23 and p. 50). Therefore, they will strive to banish negative personal attachments rooted in previous failures, which almost always have their foundation in pride and are evidenced by a non-acceptance of one's error of judgment.

An especially vulnerable aspect of the independence of the external director is the development of sentiments—positive or negative—toward other members of the board or the company's senior management. This "biased rationality" of the director will cause them to lose their independence—even if unconsciously—as they will favor those members of the board for whom they harbor positive sentiments.

5. Conclusion

Ignorance and laziness are two illnesses that may afflict the independent external director. These illnesses prevent them from overcoming their "limited rationality," which impacts their ability to effectively discharge their responsibilities as a director. Independent directors expose themselves to these maladies when they unduly delay board meetings or fail to provide required information. It is, therefore, imperative that external and independent directors, instead of becoming infected themselves, serve as an antidote to these maladies.

Two other limitations of the external and independent director include pride and loss of objectivity in judging the abilities and intentions of people with whom he/she shares responsibilities. It is his/her personal responsibility to keep both these limitations in check.

The external and independent director, like any other person in the company, needs support to improve their qualities. If this support is not available, it will be difficult for him/her to effectively perform their responsibilities. Therefore, the external and independent director, like other directors, must be open to being periodically evaluated via a positive, constructive, and dialogue-based approach.

This evaluation must be based on the clear and complete understanding of their responsibilities as external and independent directors. It is expected that this article can help shape the incorporation and evaluation procedure of the external and independent director.

References

- Alvira, R. (2005). *Filosofía de la vida cotidiana* (3th Edition). Ediciones Rialp, S.A., Madrid.
- Domingo, R. (1987). *Teoría de la "auctoritas"*. EUNSA, Ediciones Universidad de Navarra, Pamplona.
- Gallo, M. A. (2016). *El poder en la empresa*. Libros de cabecera, Barcelona-Madrid.
- Gallo, M. A. (2021). Coexistence, unity, professionalism and prudence. *European Journal of Family Business*, 11(1), 6-11. <https://doi.org/10.24310/ejfbefb.v11i1.11973>
- Marías, J. (1970). *Antropología metafísica*. Editorial Revista de Occidente, Madrid.
- Zubiri, X. (1985). *El hombre y Dios* (3th Edition). Alianza Editorial. Madrid.