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PERCEPTIONS ABOUT BOARDS IN SME SIZED FAMILY BUSINESSES

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Abstract

This paper reports on a study of the attitudes to the formation and roles of formalised active boards in Australian small to medium sized (SME) family businesses. While the literature on governance includes guidelines for effective boards, many family owned businesses perceive they are functioning adequately without formalising a board structure. This study employed a qualitative approach and explored the board functions of nine family business cases drawing on the Hilmer and Tricker (1994) framework. This framework summarises the roles of boards as: formulating strategy, setting policies, supervising executive management and providing accountability. Cases included those with and without active boards, some of which comprised solely non-independent (family) directors and others which included independent (non-family) membership. A review of the case studies identified perceived long-term advantages in formalising boards in the small to medium sized family businesses, as well as some perceived disadvantages by those SME family businesses which were reluctant to adopt active boards. Overall, the case studies suggest that active boards of directors with a mix of family and outside directors can bring a wide range of benefits to SME family businesses including improving strategy, managing family emotional and loyalty stresses, and providing expertise that would otherwise be unavailable or expensive.

Key words: family business governance, board structure and composition, small to medium enterprise sector.

Note: An earlier version of this paper was presented at the 2006 FERC roundtable in Niagara Falls.

INTRODUCTION

Corporate governance is an important characteristic of business entities because it involves the protection and enhancement of the wealth of shareholders by ensuring the accountability of management and the board. Over time, various corporate scandals around the world such as Enron and WorldCom in the USA, Parmalat in Italy, and HIH in Australia (to name a few) have prompted further reforms of the boards of directors of corporate entities. Some of these reforms have been legislative; for example, the Sarbanes-Oxley Act in the USA (AARW, 2007) and the Corporate Law Economic Reform Program in Australia. Other calls for improvements in corporate boards have been voluntary in nature; for instance, in the UK, the Cadbury Commission (1992) had developed a code of best practice for board directors as well as suggesting that boards contain a majority of independent directors and that the positions of Chairman and CEO be held by different people. In Australia, the Australian Stock Exchange has published a set of voluntary guidelines for corporate boards (ASX Corporate Governance Council, 2003) which contains 10 best practice principles and a series of corollary recommendations.

Research about large organisations' governance has focused on the composition and performance of boards with mixed support being found for a causal link between good company performance and board composition (Huse, 2000). According to Pettigrew (1992), prevalent studies of board composition need to be complemented by studies of processes inside and outside the board room. In general, large corporations have been encouraged to establish their boards with a majority of outside (i.e., independent non executive) directors (e.g., Zahra and Pearce, 1989), with the argument being that such composition will 'more effectively control the potential opportunism of executives, connect the firm with external constituencies and resources, and provide advice and counsel to top management.' (Fiegener et al., 2000a, p. 291).

Contrary to others' views (e.g., Bennett and Robson, 2004), Huse (2000) finds that there has also been considerable research on boards of small to medium enterprises (SMEs), with more than half of such studies using agency theory to model SME board structure. Most of the prior research has used surveys to collect data as the secondary data available for studying large organisations is not generally available for SMEs. The interest of researchers in boards in SMEs has been concentrated on the need to ensure that effective boards are in place to support the growth and professionalisation of the business (Dyer, 1986).

In the Australian legal system, similar to that of the USA, the UK, and other western systems, each incorporated entity is required to have a board of directors. Under corporate law and the constitution of the company, the board of directors is accountable for the operation of the company and it possesses the powers and authority to make decisions and run the organisation. While such legal requirements have been less stringent for SMEs, they have the potential to contribute to equally effective outcomes for such enterprises (Zahra and Pearce, 1989; Lorsch, 1995). This paper focuses on a major sector of SMEs, namely, family owned businesses. Data is gathered from case studies of nine SME family businesses to report upon the attitudes of these family businesses towards their experience with the board of directors that have existed in their own entity. The case studies review the roles the boards play, and their membership, in an effort to understand why some family owned SMEs do not choose to formalise their boards in terms of composition, reporting mechanisms, and meetings. Family owned SMEs that have an 'active' board are studied here along with those entities which did not have 'active' boards. The evidence obtained from these case studies suggests that although all of family owned SMEs reviewed here believed that they were 'successful', significant advantages were identified by those family owned SMEs that had adopted 'active' boards of governance. It is hoped that experiences of those family SMEs with boards will be useful in encouraging those without boards to formalise them.

BACKGROUND TO THE STUDY

Although there is no single agreed definition of a family business, there has been broad agreement that a business owned and managed by a family unit or their descendents is a family business (Chua et al., 1999). This study has used the following definition as it is recognised that in some family business cases, there may be no family member in a management role and yet there is considerable family control of the business:

> 'The family business is a business governed by and/or managed with the intention to shape and pursue the vision of the business held by a dominant coalition controlled by members of the same family or a small number of families in a manner that is potentially sustainable across generations of the family or families.' (Chua et al., 1999, p. 25).

Consistent with the USA and Europe, Australian family-owned businesses are a significant proportion of the economy. It is estimated that they make up approximately two thirds of private companies, employ about half of the private sector workforce, and represent a wealth of approximately $A4.3 trillion (Smyrnios and Dana, 2006). The economic significance of SMEs suggests that an interest in the role of boards in larger corporations should be complemented by a similar investigation into the role of boards in SMEs and particularly family owned SMEs.

Board roles

There are many views about the roles of boards of directors and their contribution to the governance of organisations. For example, Huse (2005) summarised board roles and theories that reflected both the external perspective (control roles) and the internal perspective (service roles). He found there to be six distinct board roles: behavioural control, advice/counsel, output control, networking/communication, strategic control, and strategic participation. The board's service provider role includes giving valuable advice and networking opportunities for the management team through its accumulated knowledge and skills. Board roles have also been described as ensuring legal and ethical conduct by the business and its employees (Lorsch, 1995; Conger et al., 1998) as well as the importance of ratification and monitoring of decisions (Gabrielsson and Winlund, 2000).

In their recent work about boards' crucial contribution to governance, LeBlanc and Gillies (2005) stress that the effectiveness of a board in carrying out the roles described above will depend on the integration of three factors: board structure, board membership and board process. They emphasise the need for boards to pay attention

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to aspects such as 'the leadership qualities of the chair of the board, the nature of the relationship between the board and management, the operation of the board and its decision-making process, the "human factors" in board decision-making, and the "fit" among individual directors and how they relate to one another as a decision-making team.' (LeBlanc and Gillies, 2005, pp.138-139).

In this study, we have used the framework of board roles of Hilmer and Tricker (1994), who conceptualised boards as having four components: formulating strategy, setting policies, supervising executive management, and providing accountability. Figure 1 depicts these roles across two dimensions: a long term/short term focus and internal/external focus (the latter differentiating between a focus on internal operations and on the external influences from the environment in which the firm exists). This framework also enables the board's contribution to the company's performance through strategy formulation and policy making to be grouped on the right hand side, and its responsibility to ensure conformance to required results and maintenance of accountability to the shareholders and other interested parties, to be grouped on the left hand side. While these dimensions were not specifically developed for the SME sized business or for the family owned business, they provide a useful framework for this current study to explore how board roles are conceptualised in the family owned SME.

External	**Accountability** • Reporting to shareholders • Ensuring regulatory compliance • Reviewing audit reports	**Strategic thinking** • Reviewing and initiating strategic analysis • Formulating strategy • Setting corporate direction
Internal	**Supervision** • Reviewing key executive performance • Reviewing business results • Monitoring budgetary control and corrective actions	**Corporate policy** • Approving budgets • Determining compensation policy for senior executives • Creating corporate culture
	Short term	**Long term**

Figure 1: Range of Board Roles (Source: Adapted from Hilmer and Tricker, 1994, p. 28).

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Boards in family owned SMEs

Drawing on agency theory, it has been suggested that for the SME sized family business, the board may make an even more important contribution than in larger businesses due to the wider information gap often prevalent between the owner/manager and other business stakeholders (Johannisson and Huse, 2000). This information asymmetry arises, for example, because there are less publicly available information sources about SME sized family businesses than for large publicly listed corporations. In addition, the board can be particularly useful in facilitating generational transitions in the family business: a time when the distribution of power needs clarifying and problem solving for the different generational groups is emotionally charged (Dyer, 1986).

Another view has been expressed by Salvato (1999) that in family firms two 'practices' have prevailed (i) the absence of a board and (ii) the formal board consisting of insiders and family. Hoy and Verser (1994) claim that while there is a case against having boards, there is more support in favour of formalised boards with two issues dominating the research studies: firstly, whether to include outside directors; and secondly, the scope of board authority.

The focus of research on boards in family businesses has been on the prevention of negative consequences of family ownership on business performance. Whether a family business is publicly listed or not, the complexities of the overlap between the family, ownership and the business inherent in the 'family business' entity, will be managed more effectively with a structured approach to governance, including the formation of a functioning board of directors. To optimise the performance of the family business, Dyer (1986) highlighted the need for effective boards as did Ward (1988). The effective family business board was viewed as one in which the advantages of family ownership were balanced with the development of independent and professional governance practices. Not surprisingly, the composition of the family business board has been viewed as crucial:

> "The (family business) board is elected by the shareholders and legally represents them in directing (the business). It typically comprises top management, family members, and, in the best cases, experienced business people from outside the company. Ideally, a board will have a majority of independent, outside directors and will elect its own chairperson." (Ward, 1988, p. 8).

Furthermore, Fiegener et al. (2000b) found that the balance of CEO-board power favoured the CEO in smaller family businesses as there was usually a concentration of ownership with the CEOs; hence they were able to recruit directors of their choice and overrule decisions if they wished. In another study, the same authors concluded that:

> "If outside boards are indeed beneficial to small private firms, as many advocates contend, then understanding the conditions under which firms do or do not adopt that board composition may eventually help to improve the practice of governance in small firms." (Fiegener et al., 2000a, p. 306).

According to these authors, the strongest of such conditions was that the ownership stake held by non related individuals influenced recruitment of independent directors;

followed by older CEOs presumably because their boards were perceived to be valuable in discussions of imminent successions; and finally that CEOs who intended to transfer the business to someone outside the family were more likely to have outside boards.

Johannisson and Huse (2000), similarly argue that the family business will be better served by incorporating external (non-family) members on their boards as they will facilitate awareness of a wider range of managerial issues. However, they take this further by exploring the challenges of the *family owned* SME to attract and select the 'right' outside appointee/s for the board (Johannisson and Huse, 2000). In their view the emotions and politics of the family business may cause some degree of irrationality which may adversely influence the nature of board member selection in these businesses. They surmised that traditional defensive family businesses might be hesitant to invite external members onto a board whereas genuinely entrepreneurial firms may consider access to governance competencies as just another resource to exploit when growth is aggressively promoted.

Effective family business boards have been viewed as those where directors, both family and non-family, have been appropriately prepared for the director roles (Ward, 2001). This will mean that family member shareholders, even though their ownership stakes may be inherited, need to pay attention to educating some of their group for director roles and responsibilities. Such education will usefully include mentoring and counselling those who may not have prior experience of board issues, including the family member CEO, senior family and non-family management, family employees and other family shareholders not involved in the day-to-day management of the business.

While board size, board activity, and the inclusion of independent directors has been suggested to lead to increased board performance in businesses generally, Corbetta and Salvato (2004a) take a contingency perspective and warn that boards in the family business will not lead to improved performance under all conditions because of the contingent situation created by various aspects of family involvement. In their view:

> "Family firms that explicitly take the extent and the quality of such involvement into consideration will develop boards of directors through which they will reap rewards by improving its effectiveness in providing both control and accountability, and resources which are vital to the firm's prospects for success and survival." (Corbetta and Salvato, 2004a, p. 6).

In summary, while there seems to be general agreement that formalising boards of directors rather than relying on kitchen table ad hoc discussions, will be helpful in some ways to SME family businesses, there is no single recommended composition, or agreement as to how boards will influence performance (including conformance) of the business. If research generally supports active board formation, why is it that not all family SMEs whole-heartedly embrace the notion of a formalised board? As noted previously, this paper addresses that question by exploring why some family SMEs do formalise their boards, what challenges have they experienced and what advantages do they perceive in having done so. Where boards had not been formalised, the means of undertaking the usual governance responsibilities were also explored. This study elicited from directors who participated on such boards, why they formalised the

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boards and what value they perceive from having them. In addition, two CEO/directors of two businesses who had not formalised their boards were interviewed to ascertain their rationale for not doing so.

RESEARCH DESIGN

The study was qualitative, as the focus was on why (or why not) and how family businesses established and maintained formalised boards, i.e., functioning active boards of directors, rather than non-functioning entities which merely satisfied legal governance requirements.

A series of case studies was undertaken where the emphasis was on the family business participants' attitudes to board formation and their perception of how board roles were carried out in the business. The study was based on interviews with family executive and non-executive directors in SME sized family businesses. Family directors - executive or non-executive - are referred to as non-independent directors, while non-family directors are referred to as independent directors - again irrespective of whether they are executive or non-executive. A semi-structured interview guide was prepared to ensure interviews were consistent and yet flexible enough to probe specific aspects in the different cases. Interviews were transcribed and qualitative software was used to organise the data. Consistency of analysis was ensured by co-authors evaluating interviewees' responses and comparing interpretations.

Research sample

Data was collected through in-depth one-to-one interviews of family business directors in nine small to medium sized Australian family business cases (i.e., businesses with up to 200 employees) ranging from the first to the fifth generation of ownership and management (see Table 1). A range of sampling strategies was considered in selecting the cases for the study namely, opportunistic, convenience, snowballing, theoretical, and extreme case selection methods (Miles and Huberman, 1994, p. 28). All involve an initial selection, then adding or modifying as opportunities arise. The cases for this study were identified through a combination of opportunistic and convenience sampling techniques, and recruited through direct contact with the researchers which was considered suitable as the study was exploratory in nature. This careful approach facilitated the development of the relationship of trust and confidentiality between the researchers and the interviewees.

Each of the participating cases had a board, as per legal requirements, with that board having the power and authority to make decisions and run the company. However, we wished to find out whether that board actually exercised those powers and decision-making capacities and if so, how this occurred, and if not, who undertook these roles in the company. Further, if the governance roles were *not* undertaken by an active formalised board, we were interested to know whether the approach adopted by the company was nevertheless perceived as effective.

The interviewees included eight family members who were the current CEOs of their related business and who were also directors and so they are classified as non-independent directors. The remaining interviewee was a non-independent, non-executive director (the Paul case).

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The family ownership stake for the cases in this study was almost 100%; in all but one case there were family members in some of the key management positions and, in all but two cases, there were two generations involved in the business. These characteristics suggest there will be strong family influence in the governance and the management of the businesses reviewed in these cases (Shanker and Astrachan, 1996).

Of the nine cases, seven had formalised active boards of directors and all except one of these included independent non-executive directors. Of the formalised boards, all except one had an independent chairman of the board. Two cases did not have active, functioning boards; one which was owned and managed by an owner/founder/sole director (the Taylor case), and the other largely because of the third generation former CEO's refusal to contemplate formalisation of an active board: 'Dad's the majority shareholder and doesn't sort of believe in boards and meetings and having outside people involved in the company' (the Dawson case).

Table 1: Profile of cases

Case Company	*Type of Business*	*Generation of ownership/ Generations working in the business*	*Employee size (Full-time Equivalent)*
Anderson	Food and Beverage Production/Retailing	4&5 / 5	110
Boyd*	Printing	2&3 / 3&4	140
Conlon	Retailing and Distribution	3 / 3&4	200
Dawson**	Food Production and Retailing	3&4 / 4	120
Howson	Financial Services	2 / 2	170
Kleeman	Sales and Distribution (white goods)	2&3 / 3	45
Paul	Food & Beverage Production/Retailing	3&4 / 3&4	70
Smart	Media	1 1	4
Taylor**	PR and Marketing	1 / 1&2	12

Notes: * indicates that there was no independent director on board

** indicates that there was no formalised active board

FINDINGS AND DISCUSSION

From an analysis and evaluation of the interview transcripts, several themes emerged which portray the key challenges experienced in the family business cases: motivations for formalising active boards; roles undertaken by the boards; and perceptions of contributions to the board's effectiveness, including membership and structure.

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1 Motivation for establishing formalised (active) boards in the small to medium sized family business.

While the need for family business boards to undertake roles such as those articulated by Hilmer and Tricker (see Figure 1) was generally recognised and appreciated by interviewees, several reasons were articulated for the board's existence other than carrying out those roles. These reasons were seen as particular foci for these family business boards, which are not identified in the literature as being significant for boards generally. The reasons included: the need to reassure shareholders and other stakeholders (e.g., future buyers) that the business was solid; to cope with a particular crisis (including external crises and internal issues relating to family dynamics); and to help alleviate risks associated with the business that come with succession considerations, particularly if that succession might involve a family member.

For example, in one case, the third generation interviewee commented that the motivation to form the board was when her sibling resigned from the business and took much business knowledge with him. To avoid similar gaps in experience and competency, the third generation CEO formed a board with an independent chairman and commented that the arrangement was working very well: 'Before we had a board we relied heavily on our external accountant to advise us to 'comply with what we had to comply with and that was it'' (the Kleeman case). In another case (Paul), several branches of family owners sought representation in key discussions and so the board was 'formalised' to give these stakeholders a voice.

On the more positive side of motivation for a board, the third-generation Conlon's CEO commented that his grandfather had established an active board - with outside membership - within several years of setting up the family business. In his view this set the pattern of operating a professional business and emulating larger business practice. In another case, an interviewee admitted that his motivation for forming the board was sparked by legal advisors who suggested that to comply with various corporate regulations, a committee be formed for this relatively new business. He went further than a 'committee' and formalised an active board with an independent chairman and he attributes the business's success largely to the board's input and decision making process.

Reasons given for not setting up boards, or expressed disadvantages in their operation included: that they would be (or were) costly in time and money; that they would create additional work; that family owner/managers (and simultaneously, non-independent directors) were fearful of being judged naïve or ignorant – either by the other directors or by shareholders – and that family owner/managers feared becoming bogged down in bureaucracy and losing the ability to respond quickly. In one case, while the CEO was cognisant of the advantages of a board of directors, and considered directors could augment the range of expertise available to him in running the business, he commented that 'as sole owner/director, I see no immediate need but with growth I think it will be essential' (the Taylor case).

Some interviewees expressed uncertainty about how to attract suitable (and willing) directors and were fearful of making a poor selection and of not knowing what capa-

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bilities to look for or how to assess those capabilities. Fear was also expressed that independent directors might misuse sensitive company information.

2 Board roles

Observations about how these family businesses function according to the Hilmer/Tricker framework in Figure 1 are discussed under the four main headings: accountability, strategic thinking, supervision, and corporate policy.

Accountability

Rather than wanting accountability to stakeholders, the stated motivation for setting up boards revolved more around giving representation to stakeholders, or in some instances, preventing family dynamics from causing dysfunctionality. In this study, the formalised boards could be categorised as being more or less effective according to how they approached accountability. In the more effective boards, compliance monitoring and audit procedures were seen as being straightforward board roles. The board members were able to separate their roles from the day-to-day operating roles of the management team members. In the less effective boards, compliance monitoring was not a focus of the board. Instead there was reliance on external professional advisers (accounting, legal, OH&S) to ensure the companies operated appropriately in these areas and interaction and follow-up were otherwise dealt with by management.

Interviewees expressed some concern about enforcing the accountability of managers when they are closely related, such as an uncle who is a director, needing to encourage his nephew to be more accountable as a manager in the family business. It was thought that family dynamics were contributing to some blurring of executive management versus board of director accountabilities, which may prove to be particular to the family owned business. This is consistent with the view of Astrachan et al. (2006, p. 325) that 'accountability for the family firm involves making decisions that do not sacrifice the long term health for the short term personal or corporate gain.' They consider that much of the reluctance to formalise a board may be due to 'a desire to avoid accountability' (ibid.).

Those businesses without formal board structures were asked how they ensured that the company complied under the law (e.g., occupational health and safety, tax, and other rules and regulations applying to their industry). They responded that they trusted outside consultants and advisers to keep them compliant but agreed that there was the possibility of slippage. As Dawson's family CEO commented:

> "Up until now we basically get compliance accounting rather than advice. And because he's [the accountant] known the company for so long, he has a very good understanding of the company which helps us at least in the short-term".

This CEO recognised that outsourcing might however be costing the business as much as any additional expenses to set up a formal board structure.

Strategic thinking

One of the first generation interviewees summed up the paradoxical nature of the value of the board's strategic function when he commented that:

> "…while I recognised that the board would add to the strategic approach of the business, I'm almost sorry I did because it really is making a whole lot more work now. However, no doubt it will make for less work and less risk later." (the Smart case)

In this study, the strategic function was perceived to be the most difficult to achieve. In one firm the board was acting as a *de facto* management committee and consequently has made little inroads into strategic issues. In this case, setting up the so-called 'board' was no doubt well-intentioned, but the internal management structure and family dynamics were not suitable to support an appropriately functioning board of directors:

> "Certainly the board does deal with the basic requirements of compliance and review of financials but even that, to a degree, I believe is compromised. I think our attention to risk management, to the organisational structure, to personnel, is all compromised." (the Paul case).

In other less effective boards strategic planning was not conducted, it was really just led by the CEOs and included short term planning identified by the management teams. There was a lack of formal board policy, but the CEOs interviewed did not see this as a problem in running the businesses. They did not recognise that these boards were failing to undertake true governance roles, other than financial oversight and deliberating on some specific expenditure proposals.

One of the reasons for the lack of apparent attention to strategic issues might be that these businesses had already expressed their intention to continue for the long term, ideally as family owned and managed but at least as family owned. Their focus might therefore have been more on current operations in their competitive markets rather than the future which they assumed would be taken care of later!

Where the boards were perceived as contributing more effectively to the strategic thinking role, they were doing so both formally (through annual structured planning sessions) and informally (through the encouragement of open discussion of scenarios and alternatives). Interviewees from the Anderson, Conlon and Kleeman cases commented that external directors were recruited partly because of their ability and willingness to challenge the status quo. It was viewed, for example, that the independent directors needed to be people who could be open and honest:

> "…And that's something, a bit of a risk in a private company given that we basically own the business, so we control it. If somebody comes in and feels they're subservient somehow, well that's not really going to help us, even though it's hard when someone really quizzes you on something you believe is right and you own the company. But that's the healthy way." (the Conlon case).

Supervision

The boards in these cases varied in the degree of their monitoring of general success measures (other than financial results). The less effective boards had set little in the way of formal board policy, and generally limited their monitoring role to that of financial results. While boards rightly delegate decisions to the CEO for employee matters and for day-to-day operational issues, it appears that in two cases, delegation of board powers to the CEO may have been too great – that is, delegation may indeed have become abrogation of responsibility. In such cases, the boards did not monitor what was happening sufficiently in order to retain proper oversight and accountability of results and methods. In these cases, the board roles of the Hilmer/Tricker framework cannot be assessed as being adequately discharged.

Those cases without formal boards were comfortable that they are able to undertake the monitoring and supervisory roles of the board, pointing to their good performance in the market place as evidence. While it is difficult to speculate on how much better they might perform with a board, there was some evidence of things 'falling through the cracks'. For example, one interviewee commented that a board may facilitate greater understanding of perspectives of owners (who were also managers) and help separate ownership and management objectives. He said that currently the non-family members 'just see a wealthy family with bottomless pockets and everything they want, they should get' (the Dawson case). In his view, a board may provide greater objectivity and deliberation of major decisions.

Corporate policy

In the more effective boards, members tried hard to ensure that they operated at policy level rather than being bogged down with the detail. As one interviewee commented:

> "The board needs to develop so that the things that come before it are the big picture issues and that members grapple with the industry trends. Inevitably you find yourself getting into some detail and sometimes you need to because like if it was a litigation issue or something like that, well the board members will want to talk about the ins and outs of it. But generally speaking our chairman is very good and very strong on: 'Well that's a management issue. Fix it, don't come to us with your problems, come to us with solutions or suggested alternatives for debate.'" (the Conlon case).

A valued role of the effective boards was perceived as their ability to deliver objective appraisals of remuneration levels for family executives and thus avoid another potential source of conflict between family members where relations may be already strained.

In summary, effective boards were those functioning in each of the required roles: setting direction, making policy and overseeing performance, with much of the decision-making and implementation appropriately having been delegated to the CEOs and management team. Four cases were perceived as being effective in this regard: Anderson, Conlon, Kleeman and Smart. The interviewees from these cases also perceived boards to be of value and stated that they would recommend to other family businesses that the time, effort and financial costs in establishing and maintaining boards was worthwhile.

In this study, those businesses without functioning boards (Dawson and Taylor) and those with less effective boards (Boyd, Howson and Paul) could not be deemed to be satisfying the strategic role of governance, nor adequately ensuring that the management team was monitoring the compliance of the company with laws and regulations, both key responsibilities within the Hilmer and Tricker framework. In one case without an active board, the former CEO, now Chairman and majority owner, said that 'He would rather meet around the kitchen table with his son and daughter.' He feared loss of control with a formalised board and particularly doubted that any independent director would understand the business sufficiently to make a contribution that would be worth the money it would cost to recruit 'him' (sic). The current sibling partnership was keen to establish a board in due course. They perceived that they were able to undertake the monitoring and supervisory roles of the board but recognised that the business missed out on the strategic focus and discipline that might be offered by an active board.

Interestingly, none of the cases in this sample had formal family forums or family councils, although in two cases this option was being seriously explored. In one case a family 'conference' was held each year, which contributed informally to the board's strategic planning discussions.

3 Aspects contributing to the board's level of effectiveness

Several themes emerged from an analysis and evaluation of the interview transcripts about some key contributors to the level of effectiveness of the formalised boards, viz. freedom to work on the business; professionalisation of the business; board membership; and board structure.

Freedom to work on the business

Where boards were formalised, owner/managers were generally required to differentiate between their management roles and their director roles. The existence of a board was seen to provide the opportunity for them to take time out of the day-to-day operations and to take a bird's-eye-view of the business. Furthermore, the establishment of a board provided comfort or peace of mind for owner-managers that all aspects of the business were being actively addressed. Boards were seen to facilitate better decisions, because 'more heads' are thinking about and discussing the business. These activities enabled board members (who might also be executive managers) to be freed up to work on the business which in turn can be seen to contribute to a strategic orientation. However, 'strategy' was not seen as the driver.

Professionalisation of the business

Formalising family business boards was also perceived as promoting a more professional relationship between family owner-managers and non-family members of the management team - as identified in comments in relation to remuneration under the corporate policy function above.

In only one case was there mention of 'norms' of effective behaviour having emerged. As mentioned earlier, the Conlon board was formed by the owner/founder when the business was in its early stages and has been run since then almost as if it were a public company from its inception, paying attention to corporate governance requirements 'except for all the sub committees' (the Conlon case). Board membership included non-independent sibling managers, independent directors and an independent chairman, with equal numbers of non-independent and independent directors

> "This type of board brings accountability and a degree of scrutiny that I suppose a lot of family, private businesses don't have. The benefits for us in emulating the public structure include commercial benefits, because although the board is operating more rigorously than we need to be under the code we operate under, or that we could if we wanted to, as this is a family, private business. Independent directors bring a breadth of knowledge and experience. I think they help us avoid the thing we probably fear most, which is this groupthink. We [three brothers] are all pretty similar because we have a very similar value system, same upbringing, but we are totally different individuals. So having people come in with a totally different frame of mind I think gives us a bit of confidence that we won't become too parochial or too inbred." (the Conlon case).
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Recently, Conlon's board reconsidered its balance and agreed that it lacked an IT focus: it head-hunted a female director to partially re-dress the male dominance. That appointment was not successful as the appointee took too long to appreciate the particular business and industry environment to be able to make a meaningful contribution to the board's deliberations. However, the experience of that failed recruitment was significant in reviewing how the board behaved and how it approached decision-making.

In two other cases, Anderson and Howson, the boards were instrumental in establishing procedures and boundaries for managerial financial decision-making; for example, that proposals for capital expenditure above $50,000 require board consideration, as would any other 'significant' proposed financial commitments. While such process management is generally considered positive and indicative of professional management practices, in one case (Howson) this boundary setting seemed to be triggered by a lack of trust in the CEO sibling by the other non-executive siblings.

Board Membership

Comments on membership focused on strategies to reduce dominance of one or more family members either by including a range of family appointees or by appointing non-family appointees to counteract the family dominance. All interviewees supported the inclusion of independent directors to ensure an external perspective is brought into the family business. However, these appointees were perceived to have other significant roles, which were necessitated because of the traditional strong family influence in decisions and direction. For example, independent directors were seen to be effective in minimising tensions between family members because in the family business many family members were appointed directors almost solely because of their (or their close relatives') shareholding and they often lacked the qualifications needed to be effective as directors.

In three of the cases there was a perceived lack of expertise in the management team which influenced potential board membership selection. For example, in one case the CEO wanted to supplement board membership with IT expertise, another CEO wanted financial expertise and another wanted legal expertise. Nevertheless each of these boards was evaluated by the authors as being valuable in challenging executive management to think about their issues and decisions, and being good at identifying and asking unexpected questions. From time to time the boards had helped a great deal in deciding what to do on the bigger issues, particularly where these related to family issues.

In addition to filling gaps in expertise for the business, independent directors were also advantageous for encouraging other board members to push the boundaries and to take greater, albeit calculated, risks. They were often recruited because the family knew them, trusted them and could therefore agree upon the appointment. In no case was a rigorous, objective selection process utilised. Most often the family members had known the appointees for some time; the *family* were comfortable with them as people and with their apparent potential to add value to the board's deliberations. Not having objective director selection processes in place at the time of a board's formalisation may be a weakness for family businesses. In particular, it could lead them into stalemates over decisions on suitable board members and fuel any existing mistrust between family board members.

Interviewees generally agreed in each case that independent directors, particularly those from outside the industry, added value (or would do so) by asking questions and forcing reflection on what might normally be taken for granted. However, several interviewees suggested that care should be taken in recruitment to ensure that appointees from outside the industry would not take too much time to 'come up to speed' with the needs of the family business and the industry in which it operates. These views are consistent with early research of Mace (1948 cited in Castaldi and Wortman, 1984), who claimed that the advice of members of boards was effective in widening the perspectives of managers of smaller firms and that outside directors with complementary experience and backgrounds could be helpful in augmenting management's business capabilities. Others have also demonstrated that the inclusion of independent directors has been important for the boards' monitoring responsibilities as they are governance bodies which need to combine the monitoring of management (which may include non-independent family members) on behalf of shareholders with the provision of various resources to the business (Corbetta and Salvato, 2004b).

Those cases without formalised boards expressed some misgivings about attracting the right external director for their business, as expressed by a third generation family CEO:

> "Well to find the right person that fits the company and the culture and the family philosophy I think is difficult - someone who doesn't want to get big for the sake of it. And also from their side of it, I'm not too sure with the responsibilities nowadays, who would want to jump on board with a company that operates semi-formally at the moment." (the Dawson case).

On further exploration of this issue, there was a clear concern that the external director might expect more formal systems and processes which the family owners perceived to be time consuming and unnecessary in what were currently good performing businesses.

Board structure

This study suggests that boards in family businesses are sometimes set up for non-business reasons, such as to provide representation for family groups or to fix family related management problems, consistent with Hoy and Verser's (1994) finding that some owners will use boards to mediate family/business relations.

While most family businesses prefer to structure their boards to give appropriate recognition to branches of the family, they need to fill those branch directorships with appropriately qualified appointees. These may be family or non-family – and therefore non-independent or independent – however, they should be equipped to make a contribution to effective governance of the business. Bringing to the board table differing views and opinions from various branches of the family was recognised to contribute to healthy debate. However, it was thought crucial that decisions were ultimately made in the best interests of the family business as a whole. In one of the cases with a less effective board – which was, in fact, 'ideally' constituted (according to the literature) – there were significant communication issues to address. The non-independent non-executive directors considered that the non-independent executive director (and CEO) chose board members to suit his needs and they were not happy about the recent recruitment of the 'independent' chairman who, in their view was a personal appointee of the CEO, and not suitably qualified for the position.

In this study, it was clear that some of the boards, although 'formalised' in terms of reporting and meetings requirements, have operated for many years without paying attention to the skill requirements of the directors. The result was that those boards acted more as management boards, mediating between family managers and/or directors in the business. For example, in one case a board was constituted by the second-generation owner who bequeathed the business to his five children. They are all still alive and attend board meetings, although in the view of the current family member CEO, '…none are very productive or have anything of value to add to board deliberations' (the Boyd case). This CEO would like to encourage these now elderly directors to nominate qualified and knowledgeable representatives so that all the board members may make a worthwhile contribution to the family business operations. In his view, the board is therefore only partly formalised and he is pushing for guidelines to be developed for 'appropriately qualified family members to be recruited to directorships'. This is consistent with Hoy and Verser's (1994) finding that boards where the family dominate, and particularly where family members are not qualified to be directors, may be detrimental to effective decision making processes.

In only two cases (Anderson and Conlon) was appropriate training as a director an expectation for ongoing board involvement. In no case was such training a formal requirement, although in two cases shareholders' agreements were being drafted to make it so.

In summary, assessments of the value of the board and its contribution to governance were not easy to ascertain. The interviewees had spent a great deal of time on board issues, debates and arguments and consequently would be loathe to comment that such time had not been valuably spent. The main value was perceived in the level of objectivity that the board added to the business' reputation. Overall, from this study, it appears that those family owned SMEs that have set up functioning active boards with appropriate practices, appointed 'qualified' independent directors, and have been serious about making the board function professionally, have found that those boards make a valuable contribution to the business. Participants in such successful boards wholeheartedly considered that the advantages outweighed any disadvantages (and costs) of establishing and maintaining the boards.

CONCLUSION

While appropriately operating boards were perceived to make a valuable contribution to the businesses, the experiences of these family businesses did not suggest any one best way to constitute the board which is consistent with Corbetta and Salvato's (2004b) claim that 'one size does not fit all'. Family members play both management and governance roles in the family business which, if not properly defined, may contribute to some blurring of governance responsibilities and relationships (Tagiuri and Davis, 1996).

In these cases, there were perceived to be long-term advantages in formalising boards in the small to medium sized family businesses similar to those articulated in the literature for the corporate sector, viz.: enhanced performance and compliance; reassurance to shareholders of an objective and professional approach to the business and their assets; and augmentation of management expertise by recruiting directors with complementary skills. Disadvantages of formalised boards in these family business cases included: that they act as *de facto* management committees and as mediating bodies to minimise tensions between family members; that owner/managers perceive that if a board exists, they will lose control of the business and flexibility of approach; and that the board function is considered a waste of time and money, especially where people – usually family members – are appointed without appropriate director skills. In cases without established functioning boards, interviewees did not perceive that there were gaps in meeting their corporate responsibilities in terms of accountability to shareholders, setting strategic direction, monitoring of results or setting policy, although observations and probing questions indicated that this perception may be incorrect.

This study was exploratory in nature, and while the small sample is not considered to have produced biased results, further research is needed before the findings can be generalised. The experiences of these cases suggest that the *motivation to creating a functional board,* the *way it operates* and how it *ensures the competence of its members* should be important foci for advisors and trainers in the corporate governance field and particularly for those advising family owned businesses. Nevertheless, several views emerged which might be used to encourage other SME family business to formalise boards including: the value from having the discipline and another layer of governance that the board provides; the value of independent director input; and the value of appropriately qualified director appointments. Setting up a board for the wrong reasons (such as to act as a mediating body for dysfunctional family dynamics), and without directors who are qualified to act as such, has generally led to unsatisfactory results.

While *formal* governance arrangements including the strategic planning, accountability, supervisory and monitoring roles undertaken by boards of directors have received considerable attention in the research literature, *informal* governance mechanisms, including social interactions, family institutions, and shared visions, have received less attention (Mustakallio et al., 2002, p. 219). As has been demonstrated in this study, it is the combination of such formal arrangements with the more informal mechanisms that are particularly important for family owned small to medium enterprises.

The effectiveness of the board in the family business largely depends on the effectiveness with which the family members are able to communicate with the business's governing body (i.e., the board). Although not explored in this study, our experience from working with family SMEs is that some family businesses – often, but not always, those with larger family shareholder numbers – have found that a separate family forum is an effective interface between the family and the business.

Further research should explore how best to encourage more family owned SMEs to establish a properly constituted effective board for the right reasons and to believe that the board will be a worthwhile investment, rather than a wasted expense. Research could usefully consider the conditions under which – and the means by which – formal (boards) and informal (family forums or councils) governance structures could add further value to the family owned SME. These conditions may include situations where trust is low between family members; the number of shareholders has increased with generational transfer; and/or information sharing is rare.

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