



**Can the  
empty seats  
in your organization  
make effective  
decisions?**

## **Guide to Forming an Advisory Board**

**presented by:**



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For the past 65 years, Apple Growth Partners has committed itself to one unwavering goal - helping private companies grow their business. We have contributed with accounting, tax and general business advice. Recently, the concept of Advisory Boards has become a hot topic.

We have assembled this material to serve our clients and friends interested in using Advisory Boards to support strategic business planning. Our experience shows that such boards of advisors can facilitate the decision making process of almost any company, big or small.

This book will walk you through the concept, show you the steps and estimated costs to launching a board, and provide some materials that discuss critical issues of business growth. You'll learn how valuable an advisory board can be in addressing the decisions your company faces.

Let's start with some basics:

- ⊗ Advisory boards, by definition, are not boards of directors and as such, do not have a vote, legal say or other control over your business decisions. Their input purely is advisory and for your consideration.
- ⊗ The best boards are comprised of talents that cross the classic business spectrum of human resources, marketing, operations, administration, legal, finance and in some cases, technology. The selection of advisory board members, then, should be done in such a way as to fill the areas of greatest need, i.e., to supplement the skills of the management team. For instance, if the management team is strong in sales and production, you might look to fill the board with human resources, administrative technology and marketing backgrounds. Often times, owners enjoy having a business peer in a non-competing industry serve to provide the “pragmatic” or “sage” point of view.
- ⊗ Boards of this nature generally are most effective if they meet with some frequency, such as quarterly or triannually. They typically do not have significant work expectations in between meetings. Compensation for advisory board members generally is structured in the range of \$150 to \$200 per hour for meeting time.
- ⊗ One of the best outcomes experienced has been the impact the advisory board meeting has on a Company's management team. The impending meeting often serves as a rallying point to bring the management team's planning efforts up a notch, as the various members of the management team will be called upon to report, not just to the same old face, i.e. the owner, but a formal Board of Advisors.
- ⊗ The Board of Advisors does not replace the formal board of directors, which typically is composed of business owners, and often, their corporate attorney. The Board of Director's agenda typically deals with the more formal corporate matters and does not often get into sales, marketing, operational or manufacturing details.

The following outlines the typical steps and costs in forming an Outside Board of Advisors.

Part I	Estimated Time	Estimated Cost
Formation and planning for an Outside Board of Advisors	8 to 16 hours	\$ 1,200 - 2,400
Part II		
Participation of the Board of Advisors for the initial one year term	4 meetings x 3 advisors at \$400 per meeting	\$ 4,800 total or \$1,600 per advisor

Steps to Form an Advisory Board:

**Step One:** An Apple Growth Partners representative would meet with you to prepare a preliminary agenda for the initial four meetings. We could assist in contacting and handling the arrangements for the initial meeting.

**Step Two:** We would help conduct the first meeting, which would be viewed as a developmental meeting. The initial participants are typically the owner(s), a facilitator from Apple Growth Partners, and selected board members. Typically, three outside advisors are appropriate to initiate a balanced board of advisors.

At this developmental meeting, we would plan out the first four meetings of the Board, which should take place on a quarterly or triannual basis. Each meeting would focus on a theme, such as finance, marketing, systems, strategic planning. Once the theme was set for each meeting, based upon the relative order of importance, we would then work out a specific agenda, wherein members of your management team would present their particular department or area.

We would also reserve time at each meeting for special issues. These would be the more immediate concerns that you would like to discuss and receive feedback on. I would also suggest that we reserve some time for one long-range issue at each meeting.

**Step Three:** This initial or core Board of Advisors would then assist you in developing the long-range plan, by suggesting additional candidates and/or positions, based upon what we learned during the developmental meeting(s) above.

**Step Four:** Communications are critical and are an ongoing step. We would prepare a communication piece during the initial developmental meetings, to facilitate your internal communications as to the purpose and goal of the Outside Board of Advisors. As the board matures, annual updates are usually sufficient.

This guide includes articles that clients have found helpful when contemplating the formation of an Advisory Board. Our experience has been that forming these boards has offered clients tremendous value when they are structured with the right mix of talents, are well organized and planned, and are followed up with timely communications.

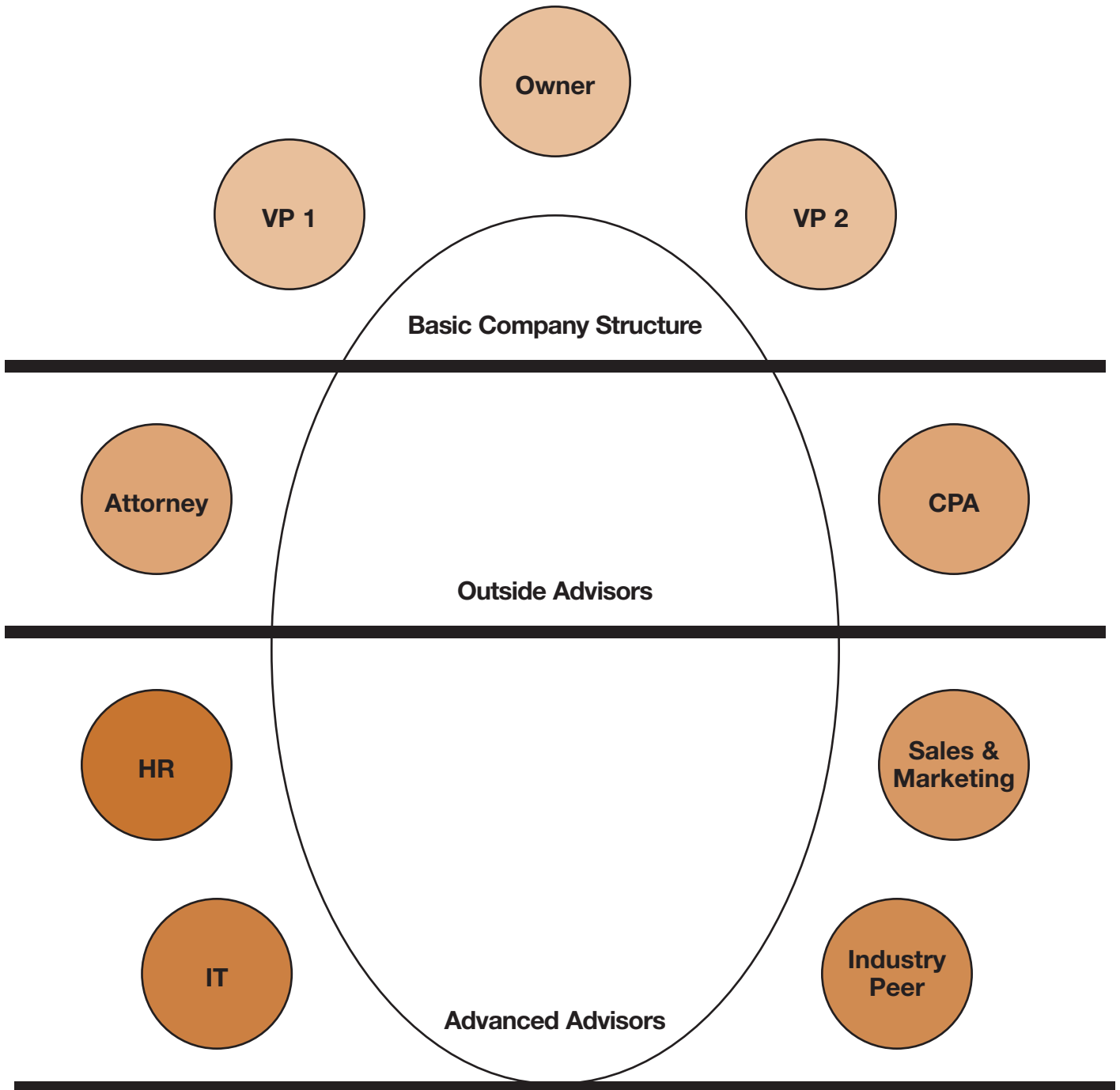
We would be thrilled to have the opportunity to discuss this concept for growth with you.

David J. Gaino, Chairman  
Apple Growth Partners



**Fill them with industry experts with whom you can “sound out” your ideas.**

# Advisory Board: Sample Structure





## **Determining if your business is ready.**

We often hear a client question, “Is my company really ready for an Advisory Board?” The truth is, a board of advisors can be a critical piece of the growth strategy of any business. Certainly, the cost may be a deterrent for the smallest of companies.

The following pages, reprinted with the permission of Beale International, reflect the stages of evolution through which every business goes. The survey may help you decide these questions:

- ☉ Where is my company at in its phases of business evolution?
- ☉ What are our strengths? Weaknesses?
- ☉ Am I ready to assemble a team of advisors to facilitate growth to the next level?

## Ask Yourself.

Do you have the qualities of a mature, financially stable, professionally managed business?

### Organization and People

#### CEO

\_\_\_\_ Does the company have a well defined leadership (CEO) role?  
Yes      No

\_\_\_\_ Does the company have an effective leader?  
Yes      No

\_\_\_\_ Does the leader understand his/her talents and blind spots?  
Yes      No

#### Management

\_\_\_\_ Are the key management positions right for the company's size and growth rate?  
Yes      No

\_\_\_\_ Are all the right people in key positions — management and technical?  
Yes      No

\_\_\_\_ Are the managers systems oriented?  
Yes      No

#### Communication

\_\_\_\_ Are meetings productive and efficient?  
Yes      No

\_\_\_\_ Do managers receive productive feedback, coaching and training?  
Yes      No

\_\_\_\_ Are leaders and managers available to employees and customers?  
Yes      No

### Systems and Information

#### Accounting

\_\_\_\_ Are accounting, financial performance reporting and control systems in place and working?  
Yes      No

\_\_\_\_ Are financial and non-financial performance information reports produced and used by key employees?  
Yes      No

#### Work Process Systems

\_\_\_\_ Are work process systems efficient and producing quality end products?  
Yes      No

\_\_\_\_ Is the difference between marketing and sales understood, and are the systems for both in place and successfully working?  
Yes      No

## Ask Yourself.

Do you have the qualities of a mature, financially stable, professionally managed business?

### Market Niche and Product

#### Business Niche

- Is the company focused in a well defined business niche?  
Yes No
- Do products and services fit the company's business niche?  
Yes No
- Has diversification into unrelated businesses been avoided?  
Yes No
- Are the leader and key managers externalized in their industry?  
Yes No

#### Customer Service

- Is product and service quality continually evaluated and improved?  
Yes No
- Is what constitutes superior customer service clearly defined?  
Yes No
- Is superior customer service continually practiced throughout the company?  
Yes No

### Money and Finance

#### Controllership

- Does the company have the effect of a strong controllership department?  
Yes No
- Is the controller an integral part of the management team?  
Yes No

#### Expense Control

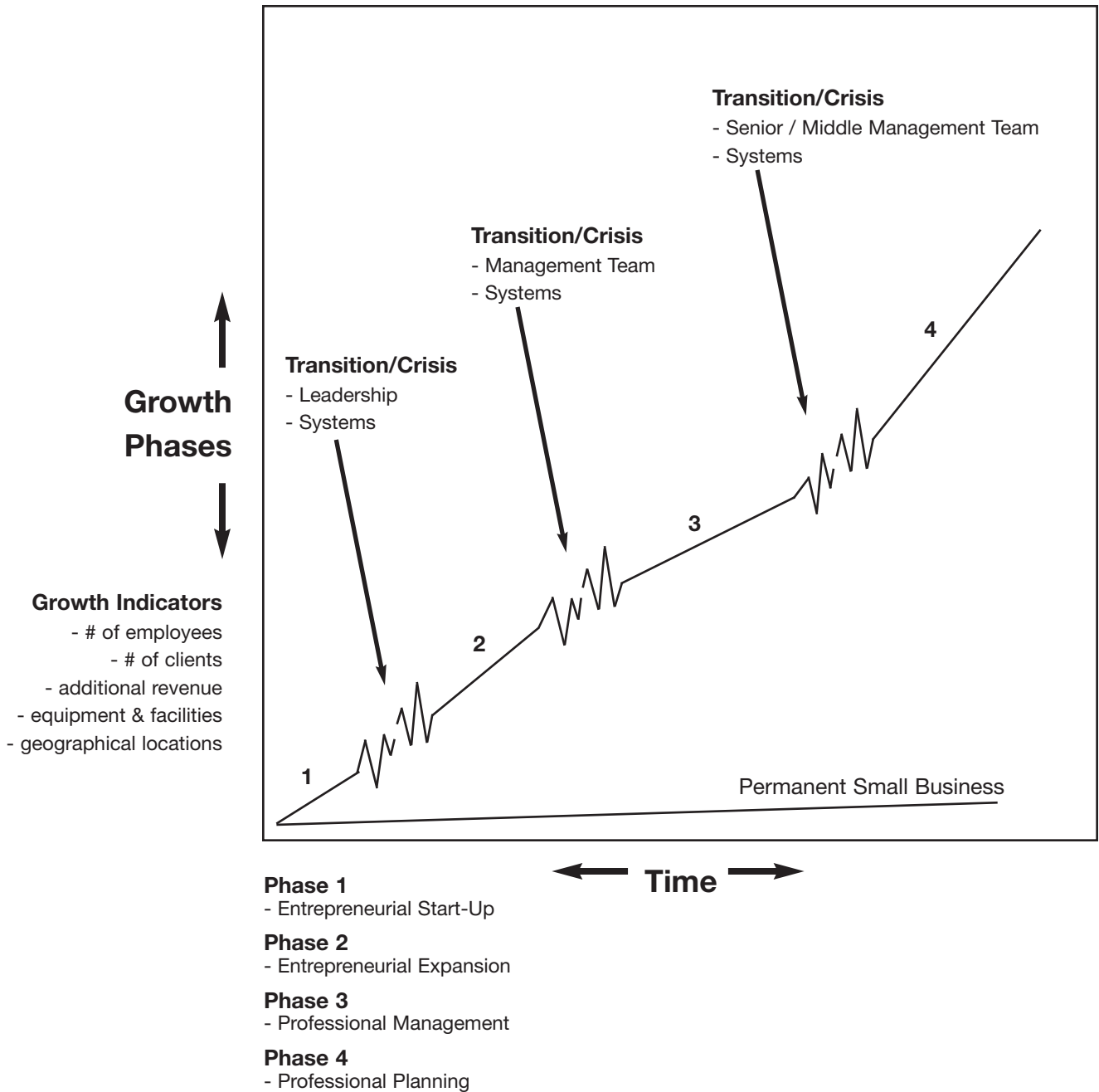
- Are financial forecasts prepared on a timely basis?  
Yes No
- Are expenses closely monitored and controlled?  
Yes No
- Are key performance measures established and monitored?  
Yes No

#### Debt/Equity Management

- Are debt/equity objectives established and monitored?  
Yes No
- Is the company committed to minimizing, if not eliminating, debt capital in relation to equity capital?  
Yes No

# Business Evolution

## The Phases of Business Growth



**As small companies grow and mature, the need for radically different management practices increases.**

# Business Evolution

## Phase 1 - Entrepreneurial Start-Up

### Characteristics

- ⊗ The founders are usually actively involved in running the company
- ⊗ The primary emphasis is on producing products or services and selling them
- ⊗ Management, systems and planning receive minimal emphasis
- ⊗ Communication is informal
- ⊗ Employees work long hours and are paid modest salaries
- ⊗ Management reacts more to customer needs than to employee needs
- ⊗ The founders are either technically oriented or market builders and are not skilled managers
- ⊗ The growth is greater than inflation, but usually slow to moderate

### Problem Areas

- ⊗ When there are two or more founders or partners in the business, it is not clear who is in charge
- ⊗ Conflicts between founders or partners often arise and remain unresolved
- ⊗ New employees are less motivated by dedication and more motivated by money and status
- ⊗ Budgeting and cash control are often insufficient
- ⊗ There are often working capital shortages due to minimal planning
- ⊗ Entrepreneurial founders are often tempted to diversify into unrelated businesses

### Crisis

- ⊗ Leadership and Systems

# Business Evolution

## Phase 2 - Entrepreneurial Expansion

### Characteristics

- ⊗ A capable leader is at the helm - Phase 1 crisis is resolved
- ⊗ The business often has multiple locations: sales offices, branch offices, warehouses
- ⊗ Attention is given to areas beyond production and fulfillment
  - marketing and sales
  - inventory management
  - personnel
  - accounting, budgeting and finance
  - systems support
- ⊗ Employee jobs are more specialized
- ⊗ Company becomes more impersonal due to having more employees
- ⊗ Growth rate is faster than in phase 1, sometimes accelerating at a very fast rate

### Problem Areas

- ⊗ Delegation becomes increasingly difficult for the leader/CEO
- ⊗ Access to the leader/CEO becomes difficult for managers and employees
- ⊗ Managers feel better qualified than the leader to make decisions in their technical areas, but are not permitted to make them
- ⊗ Managers are technically oriented and therefore not skilled at making their own decisions
- ⊗ Poor decisions are often made in areas of systems improvement, facilities expansion and purchase, recruiting and hiring key employees, use of cash, and commitment to new products
- ⊗ Problem solving meetings and processes can be awkward, time consuming and often ineffective
- ⊗ Some key employees become disenchanted and leave
- ⊗ Financial performance reporting and control systems are often inadequate for sales volume
- ⊗ Major shortages of management time and cash often occur
- ⊗ Entrepreneurial owners are often tempted to sustain faster growth indefinitely and are simultaneously tempted to diversify into unrelated businesses

### Crisis

- ⊗ Management Team and Systems

# Business Evolution

## Phase 3 - Professional Management

### Characteristics

- ⊗ The company's business niche is clearly defined and its products and services fit the niche
- ⊗ An aligned management team is in place (Phase II crisis is resolved)
- ⊗ The company has an identity beyond the founder(s) and the current leader/CEO
- ⊗ Efficient financial controls and work process systems that produce quality end products are in place
- ⊗ Short and intermediate term plans to focus the company are in place
- ⊗ Managers are doing more managing than technical work
- ⊗ Profits centers are established
- ⊗ Growth has slowed to a more moderate rate
- ⊗ Profitability is strong
- ⊗ Cash flow works well
- ⊗ Equity capitalization is sufficient for the company's size

### Problem Areas

- ⊗ Time needed to react to change increases due to company size
- ⊗ Senior management feels it is losing control from having less day-to-day contact with operations
- ⊗ Increased vulnerability to external factors: government, union, competition
- ⊗ Increased vulnerability to internal factors: politics, outdated corporate culture, bureaucracy
- ⊗ New business opportunities are continually identified, but reaction to them is cumbersome
- ⊗ There is less communication from the top
- ⊗ Managers are tempted to grow the company at a faster rate than the company can absorb and stay in control

### Crisis

- ⊗ Senior Management and Middle Management Systems

# Business Evolution

## Survival, Growth and Profitability Strategies

Phase	I	II	III
Emphasis	Survival - Growth - Profitability	Growth - Survival - Profitability	Profitability - Growth - Survival
<b>Survival</b>	<ul style="list-style-type: none"> <li>☉ Emphasize cash flow</li> <li>☉ Create viable products and/or services</li> <li>☉ Develop strong basic accounting:               <ul style="list-style-type: none"> <li>- monthly financial statements</li> <li>- cash flow projections</li> <li>- operating budget</li> </ul> </li> <li>☉ Develop short term business plan</li> </ul>	<ul style="list-style-type: none"> <li>☉ Emphasize cash flow</li> <li>☉ Emphasize building an asset base</li> <li>☉ Create a strong management team</li> <li>☉ Expand and improve accounting systems to include return on asset accounting</li> <li>☉ Externalize               <ul style="list-style-type: none"> <li>- knowledge of economy</li> <li>- knowledge of own and related industries</li> <li>- knowledge about competition</li> </ul> </li> <li>☉ Develop intermediate business plan</li> </ul>	<ul style="list-style-type: none"> <li>☉ Emphasize cash flow</li> <li>☉ Emphasize building an asset base</li> <li>☉ Emphasize management development</li> <li>☉ Create strong accounting, financial control and financial performance reporting systems</li> <li>☉ Create strong work process systems</li> <li>☉ Create strong employee support systems</li> <li>☉ Expand externalization</li> <li>☉ Develop longer term business plan</li> </ul>
<b>Growth</b>	<ul style="list-style-type: none"> <li>☉ Develop customer and revenue base that will survive indefinitely and can be built upon</li> <li>☉ Define and cultivate the most viable markets within limits of financial resources, size management ability, distribution capacity, etc.</li> <li>☉ Do not diversify into other businesses</li> </ul>	<ul style="list-style-type: none"> <li>☉ Expand market base and product line by plan, not by whim</li> <li>☉ Capitalize on product and market knowledge and technical skills acquired in Phase I</li> <li>☉ Do not diversify into other businesses</li> <li>☉ Emphasize acquiring and developing key personnel</li> </ul>	<ul style="list-style-type: none"> <li>☉ Expand into other market segments by plan</li> <li>☉ Emphasize new product development and old product discontinuation</li> <li>☉ If diversification is a must, expand only into very closely related businesses which can capitalize on parent company's management, marketing and technical strengths</li> </ul>
<b>Profitability</b>	<ul style="list-style-type: none"> <li>☉ Owners must be committed to building a company rather than high personal income and free time</li> <li>☉ Make cash flow and some growth more important than high profitability</li> </ul>	<ul style="list-style-type: none"> <li>☉ Increase profit rate, but plan to invest in longer term product and market development</li> <li>☉ Achieve adequate return on assets</li> <li>☉ Make building a viable organization more important than high profitability</li> </ul>	<ul style="list-style-type: none"> <li>☉ Achieve consistently strong profitability and return on assets</li> <li>☉ Strive to make company financially balanced to retain and attract outstanding middle and executive management and technicians</li> </ul>

## Benefits of Becoming a Phase Three Business

- ⊗ Survival and continued development of the company are not dependent on one or a few people
- ⊗ Management and ownership succession are more assured
- ⊗ More capable employees can be hired and retained
- ⊗ Existence of a strong middle management team frees ownership/executive management to plan, pursue additional markets, and react to major opportunities and problems
- ⊗ The company can more effectively expand product lines and markets
- ⊗ The company is more able to react to an adverse economy or market
- ⊗ Profitability is usually sustained
- ⊗ The increased flexibility and stability usually makes the business more enjoyable for the owners/managers and key employees
- ⊗ The owners can spend more time away from the business if desired
- ⊗ The business is more marketable at a premium price if the owners desire to sell
- ⊗ Smaller companies in the same industry can be successfully acquired

# Beale International

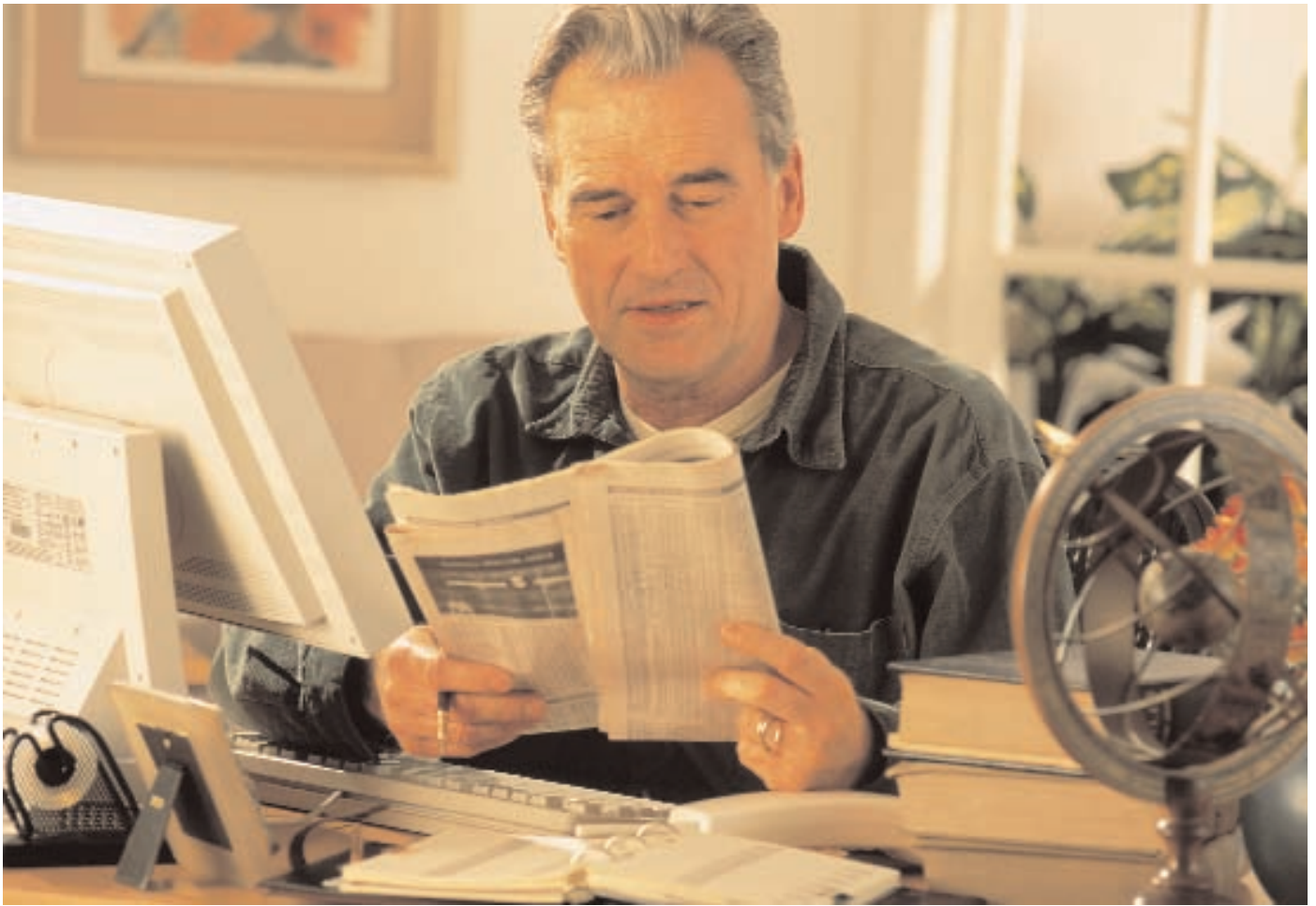
**Beale International is a Management Consulting firm serving mid-sized business across the United States. Many client companies operate in multiple locations - some in foreign countries. Our clients typically fall into one of three categories:**

- ☉ Family businesses - closely held, multiple generations in the business
- ☉ Fast growing entrepreneurial companies - often a marketing-skilled founder at the helm
- ☉ NASDAQ companies - successfully completed an IPO, formal board of directors in place

**Our purpose is to facilitate movement to the company's next level of performance. Client companies are usually at a strategic and/or organizational crossroads due to fast growth, market changes, or ownership and/or management changes.**

**Consulting services provided by Beale International are as follows:**

- ☉ Strategic Planning
  - Redirecting and focusing talents and energies
  - Releasing inappropriate products, services or markets
  - Aligning company strategy with owner objectives
- ☉ Organizational Planning and Design
  - Developing an organizational structure that will enable the company to achieve its strategic goals
  - Creating senior and middle management teams appropriate for the company's size, market and strategy
  - Assessing skills and abilities of all key management and technical people
  - Building a productive board of directors
- ☉ Executive and Management Recruiting
  - Sourcing qualified, loyal people for senior and middle management positions who are compatible with the company's culture, size and strategy
  - Helping companies avoid the trap of hiring people who better fit much bigger companies and are "building a resume"
  - Recruiting is done for consulting clients, giving us intimate knowledge of staffing needs and qualifications and make up of people who fit
- ☉ Executive Coaching
  - Giving directional, confidential support to help prepare executives and managers succeed in their current role and/or prepare for their next level of responsibility
  - Coach key people to see themselves more accurately and thus help them select responsibilities that are appropriate
- ☉ Management Training
  - A five day management training program done one day per month so participants can get practical experience between sessions



## **Supporting Articles for Family Owned Businesses**

# Outside Review in a Wider Context: An Alternative to the Classic Board

Donald J. Jonovic, President  
**Family Business Management Services**  
Cleveland, Ohio

Family businesses have special and urgent needs for outside review. The most common model suggested for achieving this is the working board of outside directors. While such boards can be effective, there are reasons why they may be inadequate to the task in family companies. An alternative to the classic board model, a review council, with broader membership and mandate, may solve the outside review problem for the majority of family companies.

If the existence of a professional journal can be considered the sine qua non of an academic specialty, the field of "family business management" is only two years old. Clearly, researchers and writers have been working in the area for many years, but the appearance of Family Business Review in the Spring of 1988 was a significant milestone. It represented the beginning of a new body of literature, and a specialized theoretical stream. Every new field must start from a theoretical base, however, and this one quite naturally drew heavily from the wide experience and vast management literature devoted to the non-family company. Nowhere are these public-company roots more obvious than on the subject of the family business board of directors.

Boards of outside directors have been recommended to family and closely held companies for many years, the justification generally being the need to improve strategic direction by creating a closely held board similar to the public company board (Danco and Jonovic, 1981). But, while the basic rationale for installing outside directors (the need for outside review) remains valid for public as well as private companies, this field has matured enough to reexamine the traditional concept of the outside board from its own specialized perspective. Is the outside board, in fact, the most effective source of outside review for most family companies?

This paper proposes taking a fresh look at the family company's need for outside review, proposing that the need for outside review varies along a continuum of form and intensity depending on the age, size, and complexity of the business involved. The existence of such a continuum would imply that classic, outside boards may be appropriate only for a relatively small subset of family and closely held businesses, specifically, businesses at the more complex end of this spectrum, the companies with professional management teams, effective financial systems, and at least rudimentary strategic planning.

For organizations lacking one, some, or all of these organizational features, this paper suggests that an outside board could at best be a distraction, and at worst, a danger. Given that outside review is an important requirement for most closely held and family companies, however, a "polar" alternative to the outside board, a review council, is proposed here as a source of this review in younger, less managerially elaborated companies - a class of organizations which contains the majority of family businesses.



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## The Varying Importance of Outside Review

The term "closely held" is often as descriptive of management style as it is of the ownership structure. The combination of the business owner's instinctive secrecy with the naturally private interrelationships within families can lead to organizations and families in business that are relatively isolated from significant professional contact with the outside world. Business decisions are made, and actions taken within a closed and recycled cognitive and cultural atmosphere.

This spaceship-like self-containment may, in fact, be useful, even essential, for the new, entrepreneurial venture. But as the organization succeeds and expands, the complexities of managing growth and adapting to change multiply (Davis and Stern, 1988; Dyer, 1988), and typically outstrip available internal resources and experience. Hence, with success, the need for information and help from outside the family and the business in a wide range of areas becomes greater (Lansberg, 1988).

In short, as family companies grow and age, the need for objective, informed critique and advice on strategic and organizational assumptions and decisions-outside review-also grows.

One consistently applied model for achieving this outside review on a long-term basis in the family company has been the outside board. In fact, the assumption that working boards in family companies (consisting of a few to a majority of outside directors) are necessary and beneficial is so widespread among consultants, researchers and writers in the field that it is difficult to find committed critics of the concept (Ward, 1988).

A wide range of necessary and important outside review functions has been suggested for outside directors: involvement in policy and strategy setting (Nash 1988) , providing owner managers with objective help (Danco and Jonovic, 1981), and acting as the CEO's sounding board or "sparring partner" (Mathile, 1988). Other writers have described roles for outside directors in managing important life cycle changes within a closely held company (Whisler, 1988), helping to arbitrate inevitable family disagreements that emerge during such changes (Alderfer, 1988; Whisler, 1988), and as "overseers" (Dyer, 1986) of such transitions. Further, the outside director has been described as bringing crucial objectivity to important decisions (Mueller, 1988) and helping to monitor the succession plan in a disinterested manner (Jonovic, 1982).

## Good Reviews - Poor Box Office

The general assumption of benefit does not mean outside boards are viewed as a panacea. Potential problems have been recognized. The most widely discussed of these is director liability (Shipani, 1988; Tillman, 1988), although other, more prosaic difficulties, such as the difficulty of managing a board, inappropriate involvement in operating decisions, inadequate preparation, and so forth, have been listed (Jonovic, 1984). Further, not all analysts consider a working board essential to the success and/or succession of a family company.

Succession, growth, and strategic change models have been developed that do not even mention an outside board as a component (Flamholtz, 1986; Rosenblatt, 1985), while others find it sufficient to touch on the concept only in passing (Ward, 1987; Jonovic and Messick, 1986).



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More significant than the occasional mixed reviews from specialists, however, is the general failure of this concept to "sell" in the real world of the end user. Consultants and others who have worked closely with business owners over the years have noted their lack of enthusiasm for the outside board (Danco and Jonovic, 1981). John Nance, Director of the National Association of Corporate Directors, has estimated that fewer than 10% of closely held businesses have outsiders on their boards (Ward, 1988).

Whatever benefits might be promised, it seems the broad plurality of business owners, urban and rural, simply do not buy the concept of the outside board. Personal experience bears this out. It is not unusual for two or three years to pass in a consulting relationship before the concept of an outside board can survive even as a trial balloon. Even when boards are finally created, they are created hesitantly. New boards are likely to include only one or two outsiders, who are, therefore, outnumbered by the incumbent insiders (Ward and Handy, 1988).

This is somewhat a problem of education. Many business owners have not been exposed to board models specifically tailored to closely held companies, and their companies in particular. But lack of understanding cannot account for the evident resistance among even those business owners who have been exposed, in detail, to the idea.

In 16 years of work with business owners, I believe I have heard and discussed just about every sensible objection to the creation of a real board. In an early book on the subject (Danco and Jonovic, 1981), many of these objections were discussed. But the intervening eight years, during which I have been involved on a long-term basis with a number of working boards, both as a consultant and as a director, it has become clear to me that many of these objections (and others which have not been considered) cannot be lightly set aside. Many of them are valid. While I remain firmly committed to the necessity of outside review in the family company, I believe it is necessary to take a few steps back from the concept of the outside board, both to reexamine the board's mandate in a family company and, possibly, to refine and/ or reshape the implementation of outside review.

The purpose, here, is to examine some of the more fundamental pitfalls, traps, and dangers into which outside boards can stumble once they are in operation. Some of the key requirements for long-term succession and success in the family company will then be translated into implications for an expanded model for outside review.

### **Why Boards Can Fail in Practice**

Boards of directors are a legal requirement for corporations. The concept evolved out of a long history of business experience and common law, and requires, in essence:

(1) individuals formally appointed to the corporate hierarchy, who (2) operate with authority as a voting body to (3) oversee management performance and the commitment of company resources, (4) acting in the interest of the shareholders.

These characteristics are time-honored, and a great deal of tradition and practice has grown up around them. The appropriateness of such responsibilities in an overseeing



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body is difficult to dispute, and boards, properly constituted and operating under these mandates, have accomplished a great deal of good in companies public and private. The question is not so much whether the outside board is useful. The question is whether or not the classic model of the outside board is adequate to the task of outside review in the growing family company.

An obvious inadequacy of the legal concept of the board, from the perspective of achieving outside review, at least, is the lack of a requirement that a director be an "outsider," however we may define that term for our purposes. The only requirement, in general, is that the person chosen act responsibly and in a fiduciary capacity, according to law and the corporate bylaws. In fact, there is no reason why the legal duties of a director couldn't be filled effectively by "insiders." Ward's (1987) "family council," for example, could function as a board (as is often the case in practice).

This inadequacy has been addressed by defining an "ideal" board as one consisting of a majority of independent outsiders (Ward and Handy, 1988) or a working board of outside directors, consisting of a majority of independent, risk-taking peers of the owner-manager (Danco and Jonovic, 1981). These models of outside boards will be referred to, collectively, as the "classic" model or "classic" board. For achieving outside review, the classic board is a vast improvement over the typical inside board found in most family corporations, but, in practice, even outside directors can run into severe and often insurmountable roadblocks which deflect them from their course and prevent completion of their mission.

Two key differences between outside boards in public companies (regulated boards) and those in closely held companies (private boards) provide the foundation for these barriers: Lack of Authority. Outside directors on private boards do not, generally, operate with authority. While it is true that such directors do have voting power in board decision making, the relative smallness of the shareholder group gives a sobering reality to share holder "veto" power over board decisions.

Lack of Definable Shareholder "Interest." The shareholders of a closely held company, by definition relatively few in number, are not a group whose interests can be statistically distributed along a normal curve. Thus, for an outside director on a private board, acting in the shareholders' "interest" becomes almost a near impossibility, except in the most superficial and general of senses. As any experienced consultant or family business member knows, there are usually a number of powerful individual interests in a closely held company, and those interests are more likely than not to diverge widely.

Thus, the outside (and, for that matter, inside) director on a private board is likely to find himself or herself in a position where the legal definition of the director's job-acting as overseer in the shareholders' interest-is correlated with neither the realities of the responsibility nor the authority available for carrying it out.

Properly managed and implemented, a classic board should be able to turn its attention from traditional overseer functions toward a more general and advisory, outside review capacity. This metamorphosis is, in practice, very difficult to achieve, however, because of the almost inevitable overseer "aura" pervading meetings of a board.

We have to wonder whether we have inadvertently locked ourselves into attempting to graft critical responsibility (outside review), onto a body (a classic board), that was evolved for an entirely different role (that of overseer).



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## A Few Typical Failures

In fact, it is very difficult for a classic board in a family company to operate even in its natural role as overseer. Because the required authority is not there in reality (which every thinking person on the board realizes), and because of the typically powerful undercurrents and sub rosa personal agendas of the important shareholders, outside directors can fall victim to a whole range of special pressures.

Succumbing to these pressures can greatly weaken the director's ability to act as an effective overseer, not to mention cripple his or her function as a source of outside review. Misplaced "Diplomacy." Men or women typically chosen as outside directors are people who are very sensitive to power and its use. They are, consequently, exquisitely attuned to sources of influence and, yes, disruption among shareholders, family managers, and inside directors. Fully cognizant of his or her own essential lack of authority, the outside director can be placed under powerful pressure to join the emotional and political maneuverings existing in the family company boardroom.

If the business owner is stubborn, or sensitive to criticism, for example, the outsider is powerfully tempted to go a little easy. If the successor is not performing well, but the owner is blind to it out of love or hope, the outsider can become convinced that it is prudent to "give it a little more time." In one family company in a western state, two major divisions were run independently by a son of the founder and a son-in-law. While both successors worked together well enough, the organization had evolved this way more for family reasons than for business reasons. The founder was attempting to be fair and equal in his treatment of his son and his daughter (through the son-in-law), and this division seemed to give each branch of the family their own piece of the business.

A few years ago, this company created an outside board, both to help with strategic direction and to help mediate growing disagreements between the son and son-in-law. It became evident almost immediately that, although the two successors were talented and committed, neither was clearly chief executive material. This company had very poor financial reporting, and authority was fragmented haphazardly among the founder and the two successors.

The outsiders on the board realized that the company needed a controller and a chief executive officer, both of whom would have to come from outside the family and the company. But, because the founder's main agenda (over which he agonized in discussion with the outside directors) was treating his successors fairly, the outsiders did not push for reorganization immediately. They concentrated, instead, on questions of goal-setting, performance measures, and compensation.

Recently, a major reorganization was accomplished to install a chief executive and a professional controller, but this action was not precipitated by outside review so much as by two years of major operating losses and failure of a critical project.

This board eventually did its job, perhaps in the only way it was realistically possible, but we could wonder what effect real outside review—a group encouraged by mandate and qualified by experience to question the assumptions underlying this inappropriate organization—might have had on the situation.

Inappropriate "Direction." The regulated board serves as an overseer, a protector.



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Private boards in family companies, quite naturally, take on this traditional role, almost unconsciously, and often, I believe, inappropriately. I recall a meeting of an outside board during which the outside directors took on the role of advising the successor/chief operating officer on the "realities" of the marketplace. The successor/chief operating officer was young and somewhat naive, and his stubborn confidence in his own opinions was a major frustration for his father, the founder. The directors took their cue from the founder and stepped into their overseer role.

The inappropriateness of this struck me in the closing part of a meeting when the successor suggested an untested marketing idea that would require an investment of \$20,000. It was a creative, but risky idea, the sort of action entrepreneurs often implement without much analysis (essentially market research through marketing). The board, noting that the project had not been justified with detailed financial analysis, requested that the successor "run the numbers" first, and report at the next meeting.

This advice was prudent, clearly, but also had the effect of dampening the successor's enthusiasm for the project. The board delayed implementation of the project for at least six months, and set a very cautious tone - all to protect the successor and the shareholders from a minimum-risk \$20,000 investment in a very profitable, \$7 million business. Taking an "overseer" role in an essentially entrepreneurial business, this board mistook the real area of help needed-allowing the successor to take public risks and learn from the resulting success or failure.

Perhaps a group of "reviewers," created with an eye toward balancing prudence with audacity, even age with youth, might have been better able to respond to this situation, which was, after all, more about management development than it was about protecting the shareholders' interest.

Presumed "Synergy." Most gatherings of men (or women) good and true tend to wrap themselves in cloaks of collective wisdom. When such a group is defined as a board of directors, it tends to secure that cloak with a golden clasp of infallibility. A case in point is a manufacturing/distribution company that was having significant operational problems. This company had an "ideal" board composed of the owner and five outside directors. The board, recognizing the weaknesses of the owner in the area of financial management, prevailed upon the him to promote the controller to chief operating officer.

The new COO was intelligent, confident, articulate and earned the full confidence of the board. Over time, however, the owner began to have grave doubts about his COO's true performance. The board, impressed with this young man, prevailed upon the owner to ignore his doubts and continue the young man in his position to strengthen the financial performance of the company (this, after all, was a primary reason why the owner created the board in the first place).

Subsequent events demonstrated that, although the young COO did a superb job in some areas, his ability to "sell" opinions and interpretations to the board lulled the board into ignoring some major areas of evolving weakness in the company. Because board meetings proceeded professionally, and because the COO, a former auditor for a major accounting firm, was skilled at presenting operating results, the directors assumed they had made the right decision, when, in fact, the company was headed into severe trouble.

This board fulfilled every definition of the classic outside board. The directors were



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successful business owners, independent, "risk-taking peers" of the owner. Their understanding of management and organization was more than adequate. Their understanding of financial analysis, however, was weaker than the Chief Operating Officer's. One cannot help but think that a wider definition of "outsider," possibly one that included an independent professional auditor, might have saved this company, its owner, and even the COO (who was eventually discharged) a great deal of grief and money.

The argument could be made, of course, that these situations are exceptions, simply examples of outside boards operating inappropriately. We could take the position that, with proper management and definition, situations like these should not arise. Clearly, the issue should be researched and taken beyond the anecdotal evidence provided above. But lacking such empirical evidence and awaiting the reports of future researchers, I must proceed on the basis of experience. Specifically, the reality of the family company, in practice, often flatly precludes proper management and definition of a classic board. Managing a board of directors is a complex task, requiring attention, preparation, careful planning, and time. These are, generally, the commodities in shortest supply in the family business.

Properly defined and managed, classic boards can be major assets to a family company. But in many, and I believe the majority of cases, a great deal of evolution, preparation, and development is necessary before a working board of outside directors, constructed on the classic model, can be more help than hindrance. While that development is occurring (which, perhaps, never is completed), the necessary outside review might better be accomplished through a body more suited to the growing family business than a classic board.

### **Key Objectives?**

Family companies do, in fact, pose special problems that are not addressed by classic theories of management, as noted by Davis and Stern (1988) in their discussion of the unique problems of adaptation in family firms. Some writers have concluded, not unpersuasively, that these differences, and the seeming impossibility of adapting family culture to the outside business environment, imply that the family business is not a viable entity on a long-term basis.

The most often quoted statement of this view is Levinson's (1971, p. 98): "The wisest course for any business, family or non-family, is to move to professional management as quickly as possible."

Experience validates over and over again a conclusion that has been drawn from the growing literature in this field (Hollander and Elman, 1988): that the differences between family and more widely owned companies are rooted in the interaction between family and business "processes" within the family-owned company. Levinson is essentially correct, but assuming these interactions can be effectively managed, with the help of competent outside review, there is nothing in the concept "professional management" that precludes "family management."

As a practicing consultant, I find that most of my effort is spent finding approaches and techniques to better manage the family-business interaction, to minimize its negative effects and to maximize its potential benefits. Outside review appears to



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be a key component of increasing adaptation and growth in a family company. However, the conclusion I have reached, contrary to initial beliefs (Danco and Jonovic, 1981), is that the classic board is neither the most, nor even one of the more effective tools for achieving outside review in a majority of family companies.

As the case examples above imply, as a positive source of outside review in a family company, the independent, risk-taking peer, is, by himself or herself, inadequate to the task involved. The classic board model, which clearly evolved from the concept and practice of the regulated board, generally reserves directorships for business leaders. To be sure, many regulated boards include directors who are not business leaders, but, instead, represent various community and shareholder interest groups. Nevertheless, regulated boards and their descendent, classic boards in family companies are essentially populated by business people. Necessary as this perspective - and its concomitant skills - is to the process of outside review, it is not sufficient.

In practice, families in business face challenges in a number of areas that go beyond issues of management and strategy, specifically:

1.) Achieving Shareholder Agreement and Effective Interaction. A wide range of difficulties occur here, including finding ways for shareholders to separate their combined roles as owners, directors, employees, and family members. This separation is essential prior to any discussion of individual and communal strategic goals, and proceeds best with the help of a skilled outsider. Further, shareholders need to develop formal agreements defining their expectations of each other and outlining procedures in the event of discord or disagreement (for example, buy/sell agreements). Many of these issues are difficult or impossible to address without help by outsiders skilled in interpersonal dynamics and technical alternatives. Essential, too, can be the help of men or women who have a unique awareness of applicable shareholder perspectives (for example, the minority, non-involved shareholder).

2.) Managing a Succession Process that Is Seldom Truly Objective. Here, the family company faces questions of successor competence, relative rights and benefits of family managers, selection of future key managers, and sensible, secure retirement of the present owner(s). The existence of family cultures and blood relationships is a major factor in these decisions, probably always will be, and it must be managed in a way that is integrated with plans for evolution of the business. Again, given the convoluted individual interests involved, the outside perspective, possibly of succession specialists, successors and/or spouses, is essential to managing family business succession smoothly.

3) Achieving an Effective and Accepted Ownership Transition. This is not merely an issue of effective estate planning, although the technical implementation of transfer is essential and often very complex. There are questions to be answered here about what is fair, and how this relates (if at all) to equality of treatment. There are, also, serious questions of equity - whether ownership should be distributed or concentrated in the hands of operating managers. Seldom can these "soft" questions be decided in a technical vacuum, and the answers to ownership transition questions most often require the input of both estate planning specialists and individuals representing the perspective of important groups of heirs.



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## Expanding the Classic Model: The “Review Council”

Given the limited nature of board power and authority in a family company, vis a vis the shareholder group, and given the vastly different and much more specifically channeled long-range issues in the private versus the public company, a case can be made for bypassing the board (and the classic concept of outside directors) entirely as a tool for achieving outside review in companies unprepared to manage a classic board. Certainly, the classic board can be made to work. It has been made to work. But the argument against the concept here is based on three major limitations.

- \* First, the creation, maintenance, and management of a true classic board in a private company is a task that outstrips the resources of many companies, particularly those lacking the profile features of professional management.
- \* Second, where shareholder groups are small, such boards are inherently limited in ability, authority, and experience to address the complex issues that arise in family companies.
- \* Finally, in the entrepreneurial company, the classic board, like the low-fat diet, is just the sort of prescription the patient is least likely to accept.

As an alternative in companies not ready or not receptive to an outside board, a more broadly constructed advisory body can be created with one specific mandate: to review family business decisions and directions. Such a body could be called a review council, and could report to the shareholders with both general and specific recommendations on issues raised by the council, the shareholders, or in discussions between the two groups.

The board of directors could remain an inside board as most are now, primarily fulfilling statutory requirements, possibly reorganized somewhat to act as the representative of the shareholders as a group in meetings with the review council.

Place in the Hierarchy. The review council and its committees could work directly with the board in joint meetings held at least semi-annually, and more frequently as the situation dictated. Reports, as appropriate, would be submitted in writing to the board of directors for discussion. This relationship of the review council to the board is similar to that of the advisory council suggested by Tillman (1988) to minimize the director liability issue.

The mandate of the council would not be to function primarily as an advisor to the board, although that role could emerge and grow over time. The mission would, instead, be more one of broadening the width and depth of ideas available to the board, lending perspective to pending decisions, exploring weaknesses, disclosing failures of action, and, generally, dispassionately and skillfully examining every sacred cow.

Membership Structure. Given that the review council will be dealing with issues of shareholder consensus, succession planning, ownership transition as well as management performance and strategic planning, its membership definition should be much broader than that of the classic board. A membership with backgrounds



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varying from business owner, to professional advisor, to successor's spouse allows for greater flexibility in the creation of the review council, thus providing an opportunity for the shareholders (and stakeholders, for that matter) to gain representation of points of view as well as specific experience and competence.

Actual membership of a council, composed entirely of men and women from outside the business being reviewed, could be selected from groups represented in the following list. Specific selection would depend on the particular needs of the individual company.

- 1) Family Business Management and/or Succession Specialist. The field of individuals qualified by background and experience to work in a systematic way with families in business is expanding, so such expertise should become increasingly available. This individual can serve as the chair of the review council, a coordinator helping to facilitate communication as well as the review process. This "planning coordinator" role would probably be appropriate for most companies using the review council.
- 2) Attorney or Estate Planning Specialist. While the regular advisors to the company and the shareholders would, as always, carry out their technical roles, an independent planning specialist could have a seat on the council. This specialist, who, by agreement, would not be involved in implementation of planning strategies (for example, drawing up buy/sell agreements, providing insurance products), would provide independent technical perspective to discussions of estate planning. This role would be most appropriate on councils serving businesses beginning or undergoing development of relatively complex ownership transition plans.
- 3) Experienced Auditor or Financial Manager. Judging the quality of financial management and reporting, and interpreting financial results is complex, even for specialists. This individual could provide independent review in this complex area for companies undergoing or having completed the transition to an internal professional controller. While the organization's retained accountant would continue with its traditional compilation, review, or auditing function, this member of the review council would serve to "encourage" appropriate ongoing attention to the client, a service all too many busy accounting firms have a tendency to neglect. This person could also serve as a useful foil to the controller, whose position of relatively arcane expertise often enjoys a relative lack of questioning and review.
- 4) Risk-Taking Peer(s) of the Owner-Manager. One or more members of the council would have the background and qualification required of members of classic boards. Generally, these would be successful business owners, but capable managers with significant responsibility are also appropriate. Membership of management peers of the owner would be appropriate for most review councils.
- 5) Risk-Taking Peer(s) of the Successor-Managers. The successors' perspectives are generally vastly different from that of the owners. Membership on the council of successor(s) from other companies can give objective expression to those important views in companies where successor management is beginning to take on significant positions of authority, or where significant ownership transition planning is in progress.



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6) Peers of the Otherwise Disenfranchised Minorities. Depending on the structure of the individual family company, the review council could have as active members one or more of the following: a successor's spouse, a non-family key manager, a non-involved minority shareholder-all, of course, from other families and/or organizations. These can be powerful groups in the family business, and where their impact on the future of the business is significant, representation of their perspective on the review council is, therefore, important.

### **Council Committees**

The council would meet periodically, no less than semiannually to maintain effectiveness, to set the agenda of issues, to review changes, and to receive and discuss the reports of committees. Specific members of the council could be assigned to work on specific issues raised by the shareholders, or by the council in regular meetings.

### **Administration**

Council members could serve set terms and be expected to provide replacement for themselves, if rotation is appropriate and such a member continues to be required. Council members would receive the same periodic updates as would normally be provided to board members.

Council members who are professionals (i.e., financial planner, attorney, accountant, family business consultant) would be paid their normal fees for the time involved. Nonprofessional members would receive a council fee (similar to a director fee) for their service. These fees should be significant, a term that could be defined as enough to make the shareholders want to listen, and enough to make the council members feel their work and advice is respected.

Professional Conflict of Interest. A potential problem exists where professional advisors are placed in positions of review over colleagues who are retained by the organization.

The desire among professionals to avoid open disagreement with colleagues in the presence of the client is understandable, and could severely limit the effectiveness of a professional member of the review council. This problem can be managed, first, through a careful preliminary discussion of the professional council member's role vis a vis the company's advisors. The professional council member should serve principally as a devil's advocate, essentially providing peer review to his or her colleagues on their broad ideas, not specific directions. This would help to "institutionalize" disagreement, defining the council member's role as one of peer review rather than judgment of competence.

Second, an understanding should be reached with professional council members that accepting a position on the review council would preclude the selection of them or their firm as fee-paid advisors to the company during their membership on the council and for a reasonable period (e.g., two years) thereafter.

Given these two understandings, in the event a professional council member strongly disagrees on an advisor's approach to an issue, the company's clear procedure would be to retain a third professional to provide a "second opinion." While it is clearly impossible to eliminate completely all problems of professional



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conflict, competent advisors should be willing to accept the sort of peer review the professional council member would provide.

**Typical Meeting Scenario.** The review council would meet, conceivably under the chairmanship of the family business specialist, to consider a range of agenda items. Attending the meeting would be the company's shareholders and managers, along with their respective spouses (and, where appropriate, the spouse of a non-family key manager). The meeting could open by reviewing "old business," possibly reports of various committees of the council.

Examples:

- \* The "audit" committee, consisting of the auditor and one or more of the business owner members, discussing the adequacy of internal controls, or the accuracy of the inventory system, or an alternative interpretation of financial results.
- \* The "strategic planning" committee, consisting of the business owner and successor manager members, discussing levels of risk inherent in the current plan, or reviewing the pros and cons of a new venture proposed by a successor/manager.
- \* The "ownership transition" committee, consisting of the attorney/financial planning specialist, a successor's spouse, and possibly a minority shareholder, discussing their perception of the fairness and equality issues being faced by the business being reviewed.

The committee reports could be followed by discussion among the committee members and the company shareholders. Old business completed, the meeting could move on to new issues, either those raised in the meeting agenda (prepared by the chair-person in correspondence with council members, shareholders, and managers) or arising in the discussion of the committee reports.

Finally, company shareholders and/or managers could discuss any actions they have taken on previous council recommendations. Each meeting would be summarized in action-oriented minutes, assigning tasks and completion dates to council committees, and recommending specific actions to the company.

A review council, with its more broadly based membership structure and mandate to provide outside review on the wide range of family and business issues, could be a practical and effective tool for a successful family business. Its membership would not have to be greater than a typical classic board-five to eight members could be adequate and semiannual meetings would not be burdensome. There is cost involved with a review council, but that cost should not be significantly greater than directors fees would be. Additionally, the input from the specialists on the council could, in the long run, enable the reviewed company to maximize the return on standard professional fees.

Additionally, the review council can be a means to build the help and advice of a family business specialist into the review process in an effective and relatively low-cost manner.

Men and women who specialize in working with family companies, helping them



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recognize and work through their growth and succession problems, are, generally, highly skilled at coordinating and facilitating cooperation. A review council is a way to make maximum use of those coordinating skills with the minimum investment of time and expense.

## Conclusion

Present models for providing outside review to family companies, while logical in theory, appear inadequate in practice in many, perhaps a majority of family companies.

Classic Reprinted with permission from Family Business Review, Volume II, Number 2 boards may be appropriate only to a small percentage of family businesses, leaving far too many family companies and farms without a viable way to open the doors, in a formal way, to help and advice.

The review council could offer these companies an effective initial alternative for opening the doors to the future. As a company grows, professionalizes, and becomes accustomed to the committed review of outsiders, the council could be replaced eventually by an "advisory board," a group with all the features of a classic board, but without the formal appointment or authority as directors. Eventually, presuming success and continuing professionalization of management and the business, creation of a classic board may become appropriate.

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- The Ultimate Legacy: How Family and Closely Held Businesses Can Achieve Their Real Purpose.
- Passing Down the Farm: The OTHER Farm Crisis
- Planmakertm: A Growth and Succession Planning Workbook for Family Companies
- Someday It'll All Be ...Who's? The Lighter Side of the Family Business
- Someday It'll All Be Yours ... Or Will It? How to Survive-and Enjoy-Succession in a Family Business (Out of Print)
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Manager of a Family Business

(Out of Print)

- Outside Directors in the Family-Owned Business: Why, When, Who, and How (Out of Print)

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KAL TIRE, LTD., Vernon, BC, Canada (Wholesale/Retail-industrial, commercial, consumer tires)  
LIMA RANCH., Stockton, California (Dairy & Farming-1700-cow operation)  
LITIN PAPER CO., Minneapolis, Minnesota (Distribution/conversion-specialty paper products)  
MEDICAL SERVICES CO., Cleveland, Ohio (Healthcare-home medical services and equipment)  
PACIFIC MUTUAL DOOR CO., Kansas City, Missouri (Distribution-sash & door, real estate development)  
SANTA HOLDING CO., Bridgeport, Connecticut (Wholesale/Retail-petroleum terminals, heating oil)  
SCIOTO INDUSTRIES., Columbus, Ohio (Industrial Service-plant cleaning, outsourced assembly, distribution)  
R.W. SIDLEY, INC., Painesville, Ohio (Mining/Materials/Construction-sand, gravel, concrete)  
SIMMONS FOODS INC., Siloam Springs, Arkansas (Agribusiness-diversified poultry producer)  
SPLENDOR SHOWER DOOR CO., Toledo, Ohio (Manufacturing/Distribution-shower doors/enclosures)  
USIS/SJVE, Modesto, California (Packaging/shipping-intermodal transportation, bottling, copacking)  
YORK CONTAINER CORP., York, Pennsylvania (Paper Converting-corrugated packaging)



**FAMILY BUSINESS  
MANAGEMENT SERVICES**