Strengthening Governance from Within: The Role of Executive and Non-Executive Directors in Family Businesses

Family businesses are driven by deep-rooted values and long-term vision, but they often struggle with one silent threat: weak internal governance. When left unaddressed, this can undermine even the most profitable enterprises. Fortunately, much of this risk can be mitigated through internal governance reforms, especially through the introduction of well-defined executive and non-executive roles within the board of directors.

Why Internal Governance Matters

In many Maltese family businesses, the board of directors is made up exclusively of family members. While this may initially seem practical, it often leads to concentration of power, conflicting interests, and limited strategic oversight. Family members wearing multiple hats; owner, manager, sibling, parent, etc., blurs boundaries and can compromise both objectivity and accountability.

Introducing a well-defined governance structure ensures that decision-making processes are not concentrated within a single individual or a small group but are instead supported by a balanced system of oversight and strategic planning.

The board of directors can be made up of both executive and non-executive directors. Clarifying the roles of executive and non-executive directors is essential to improving governance in family businesses, regardless of their size.

The Role of Executive Directors (EDs)

Executive directors (EDs) are responsible for executing the company's strategy and are actively involved in the day-to-day running of the business. Typically drawn from the family, they bring hands-on experience and in-depth knowledge of the company's operations. Their main responsibilities include:

- Implementing strategic decisions.
- Overseeing operational performance.
- Leading teams and managing internal resources.

However, when executive directors dominate the board without checks and balances, their strategic decisions may become reactive rather than visionary, meaning that they are focused on immediate operational concerns rather than long-term growth and sustainability.

Example:

A well-established, second-generation family business in Malta operates a chain of retail outlets. The business was started by the parents and is now primarily managed by their two adult children.

The two siblings currently serve as executive directors. One is responsible for operational matters such as stock management, supplier relationships, and logistics. The other focuses on marketing, customer experience, and sales strategy. Both are deeply involved in the day-to-day running of the business and lead separate internal teams.

Despite their commitment, decision-making is sometimes hindered by differing priorities, one pushes for further physical expansion, while the other advocates for more investment in digital platforms. Since both are equally involved and emotionally invested, tensions occasionally surface when strategic directions clash.

The Value of Non-Executive Directors (NEDs)

Non-executive directors (NEDs) can be a combination of family and independent members. Even if they are family members, they should not be involved in daily operations. Their main role is to bring objectivity to the boardroom, offering strategic insight and holding the executive team accountable.

They can be the voice of reason when family members disagree, bring in new ideas, especially if they were brought on board for that reason, to avoid everyone thinking the same way, and share useful experience from their own work in the industry.

Benefits of appointing non-executive directors internally include:

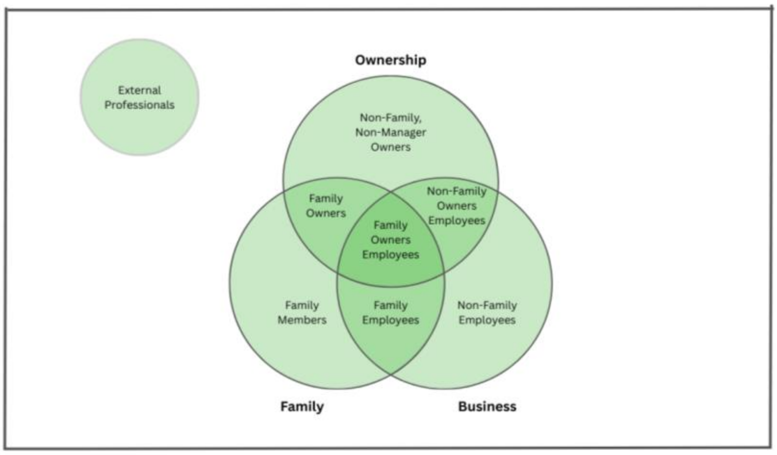
- Independent Oversight: They assess decisions without being influenced by day-to-day pressures.
- Conflict Resolution: NEDs can act as mediators in family disagreements, especially when impartiality is needed.
- Strategic Focus: They help shift the board’s attention from immediate operations to long-term vision, risk management, and succession planning.

Example continued:

To bring balance and improve governance, the board now includes two additional family members who are not involved in daily operations. These individuals may be part of the older generation or extended family, for instance, retired family members or next-generation stakeholders with a long-term interest in the business but no operational role.

This diagram outlines the various roles within a family business, which can be categorised as either executive or non-executive directorships.

Where Executive and Non-Executive Directors Come From



From this diagram, the executive directors usually come from the Business circle (from the above diagram), especially where it overlaps with Ownership and/or Family. These can be:

- **Family Owners Employees –** These are family members who both own part of the business and work in it actively.
- **Non-Family Owners Employees –** These individuals are not part of the family but have become owners, perhaps through investment or long-term involvement, and work in the business.
- **Family Employees –** Family members who work in the business but do not hold any ownership stake.
- **Non-Family Employees –** Employees who work in the business but have no family ties or ownership.

With regards to the non-executive directors, these individuals sit on the board but are not involved in daily operations. These can be:

- **Family Members –** These are relatives who may not be directly involved in the business but may still have a vested interest.
- **Family Owners –** These are family members who own part of the business but are not involved in its daily management.
- **Non-Family, Non-Manager Owners –** These are external individuals who have invested in the business but do not work there or participate in day-to-day management.
- **External Professionals –** These are independent experts, such as lawyers, accountants, or consultants, who are brought in to give professional advice and help guide strategic decisions.

Family dynamics, emotional ties, and legacy concerns can still influence decision-making, even in the most well-intentioned boards. While restructuring the board internally, including both family and non-family members, and distinguishing between executive and non-executive roles, can significantly enhance governance within family businesses, it is only part of the solution. For this reason, many family businesses eventually find value in involving external professionals. In the next article, we will explore how external professionals can complement internal reforms, strengthen governance further, and support long-term sustainability without undermining family control.

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