Boards of Directors

<u>The Need for Boards of Directors</u> (Back to **[Table of Contents]**)

Two Hats Are Better Than One - But a Smart Owner Will Wear Only One at a Time.
Why it's critical to separate the roles of owner and manager in the closely held business.

Introduction
Closely held or family businesses have some unique problems that do not seem to affect businesses in which the owner and top management are separate or where top management does not own a controlling interest in the company. The roles of a business owner and the management of a business are separate and distinct and equally significant to the success of the enterprise. In the closely held of family business, the roles are usually performed by the same people.

Manager and Owner
While it is possible to wear both hats, few business owners seem to realize that they simply cannot wear both at the same time. The role of owner and role of manager are different enough that critical decisions by management for short-range gain are often opposed to the long-range interest of the owners. As a result, many closely held businesses suffer from a clack of clearly defined objectives or from no long range strategy at all. They tend to be forced in whichever direction their management decisions take them.

It is the responsibility of the business owner to establish goals and objectives for the company and to discipline the performance of the management of the enterprise toward attainment of those goals. A critical ingredient in the formula for success of any size company is measurement of the performance of the management of that business. A critical analysis of the efforts of management toward the achievement of predetermined attainable goals is sadly lacking in most closely held businesses. Many owners believe that as long as everyone works hard, puts in the long hours, and seems really to care about the success of the business, things are fine and management is doing its job. Loosely translated, this means that management "job" is to work long hours and to care, which is not the case.

Management Organizes
Management is supposed to organize the resources of the organization to achieve attainable goals and objectives as set out by the owners or stockholders of the company and be prepared to explain in factual detail why that cannot or has not been done.
When the owner and management are the same people, realistic goal-setting is often supplanted with "we'll push as hard as we can and then measure the effort," which, of course, is impossible because it becomes, "This is where we are at, so it's where we should be."
Many owners of closely held businesses refuse to have their performance measured, contending it is nobody's business how they run their business. Few who feel that way realize that a fundamental definition of "running a business" includes setting objectives and measuring the performance of those charged with attaining the objectives. To so less is to invite disaster by simply continuing to work hard until something goes wrong or by allowing a business to grow until it self-destructs from its own lack of direction.

Owners Direct
The problem is easily corrected. Once the differences I the roles of the owner and manager are recognized, and the fact that you can't wear both hats at the same time is accepted, the rest is easy!

Owners of closely held businesses need to set aside time at least three or four times a year to take off the "management" hat and perform the important functions of a business owner:

- Establishing and updating the short-and long-range goals and objectives of the organization.
- Reviewing and recommending policies for the enterprise, and
- Objectively measuring the performance of management (i.e., themselves) in accomplishing clearly defined milestones and objectives.

Where the Rubber Meets the Road
All knowledgeable parties with an ownership interest, whether active in the business or not should be restricted to owner concerns and not to the everyday management issues of running the business. To avoid mixing the two, these periodic sessions should be isolated from the daily business concerns by taking place away from the office. The can take place in the office after hours, or when no interruptions are likely, because that helps facilitate objectivity and neutralize rank and title difference among owners.
When there is only one owner, the process is more difficult, if not impossible. An alternative here is to develop a planning committee and recruit knowledgeable, trusted people from within the company. The committee can help establish what is right for the company in attainable goals and develop ways to measure the performance.

A planning group can include top management only but you will have better results in most organizations if middle management and even field management and labor are represented. Top managers are beginning to include labor and first line supervisors in business planning. With exciting results. The people who do the work often know a lot more about the strengths and weaknesses of manpower resources, the potential of field organizations, the quality of technology and what's right for the company than they are given credit for. Whether you choose a few trusted senior managers or include others from within the organization, the group should develop – and long-range goals for the enterprise completely independent from their day-to-day roles within the organization. Establishing even a fundamental business planning process has had a profound effect on owners and employees of closely held businesses. It gets people excited about what is right for the company and how to achieve it.

A Board of Directors Can be an Important even Critical Business Tool
Perhaps the best way to correct the unique problems of the closely held business is to establish an active, independent board of directors. The board of directors takes the owners' role as the representatives of the stockholders. Some closely held businesses have active boards, but many are not effective because they are not independent of management. Boards made up only of insiders-managers of the company; family members; or people closely associated with the business, like the company accountant, lawyer, or banker-are usually too close to the everyday

operations of the company and not objective enough to accomplish the tasks of setting attainable goals and measuring and disciplining management's performance in the pursuit of them.
THz most effective board for a closely held or family business would have several truly independent outsiders is preferred for a truly independent board, but two or more can be extremely helpful to owner who is not ready for that much "outside help."

How to Choose Board Members
Selecting outside board members is not difficult. Any person who is, or has been, successful in business is an appropriate candidate and need not know anything about your type of business. In fact, that may be preferable, as the role off the board is not to interfere in the running of the business. They expect management to do that. It is usually not hard to find successful people in your business community who would be flattered to be considered to serve on your board in this capacity.

You can seek nominations from your managers, associates, and friends. You should interview candidate without obligation to find people you trust, and with whom you would be comfortable working. They should be owners or senior managers of successful businesses who have had profit and loss responsibilities. Preferably they have been responsible for making payroll at some point in their careers.
The size of the candidate's business is not critical; but if it is too much larger than yours, they may not consider their appointment as important as you do. The owner of a growing printing business or successful service station may be an ideal candidate. Bankers with whom you are not doing business make good board members. If you are weak in marketing, an advertising or public relations executive would be a good addition to our board.

What to Pay Them; When to Meet
Outside board members are paid for their efforts and the compensation will depend upon the size of your company. For small companies there needs to be some compensation to establish the professional nature of the relationship. For firms up to about $10 million in sales a nominal amount of a several hundred dollars per meeting may be acceptable. For companies between $10 and $50 million, $1,000-$1,500 per meeting might be appropriate. Some larger companies pay an annual board fee of $10,000 and more plus an additional amount per meeting. A board should meet no less than two time per year or it becomes too far removed from the business to be effective. It should meet no more than six times per year or the members almost become insiders and lose objectivity. Three to four times per year is effective, unless there are numerous changes going on within the organization or its environment. Five to seven members for companies of $10 million or more is a common board. Some prefer to start with fewer until they see how it works. Three members works as long as two are outside independent board members which means not employees or service providers to the firm. While an odd number of members is standard, there is more discussion than voting on the boards of closely held companies, so an odd number is not imperative.

An active, independent board of directors may be the single most important choice the owners of a closely held or family business can make in ensuring their future prosperity, managing their business risks, and gaining control of their two-hat responsibilities. It also brings in the independence and objectivity so vital to the leadership of the closely held business.

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