Why Outside Board Members are Good for Insiders

James McTevia
November 12, 2015

Many privately held companies have not yet discovered that a diversified board of directors that includes at least one independent director is good for shareholders, management, employees, and the firm's legacy. Nominating, electing, and listening to advice from independent outside directors sounds counter-intuitive to small and medium-sized companies that chose to remain closely held precisely because they wish to be insular.

This message is about why that choice is a bad one. Truth is, knowledgeable and experienced boards of directors are good business.

The counterintuitive strain is easy to understand. Large public corporations undergo intense scrutiny from Wall Street, from the SEC, and financial media outlets. A single share of publicly traded stock is enough to attract a persistent and very public corporate gadfly. Besides, creating and sustaining a meaningful board of directors takes some effort. Busy principals of many privately held, less complicated companies watch this and say: "Who needs it?"

My response? Almost every company needs it.

"It" means a board of directors that meets at least quarterly, preferably monthly. It means an outside director or two, with appropriate expertise and with no connection to the company (not even a regular golf date with the principals), should be elected by shareholders—even if every shareholder's last name is the same. It means meetings should reveal a well-focused window into the company's operations.

Accurate minutes of forthright discussions should be kept and maintained in the corporate record book to protect the corporate shell. If that sounds like culture shock and a waste of time and money, please keep reading.

Here's one vantage point. The auto industry, as an example in the past decade, has been hit by enormous pressures that include breath-taking technological change, globalization, and rapidly evolving consumer profiles. It has been a grim decade. The major manufacturers nevertheless survived. Countless automotive suppliers did not.

How many of these vaporized companies would still be here if they were monitored by experienced boards with independent outside members who would not have been reluctant to focus on bad times and advocate accordingly—especially from their standing as experts in, say, transitional management, or mergers, or crisis management? No one can answer precisely. But I know which set of companies—those with such governance or those without it—would be best positioned to weather the storm and perhaps even sail toward prosperity.

From a personal perspective, it would be a lot less expensive to compensate a professional for expertise in the boardroom, and act on it, than to wait until it is too late and engage someone like me to come in and try to put Humpty Dumpty together again. I speak both as someone who has more than half a century dealing with companies in transition and overseeing the messy and often tragic results of bad corporate stewardship. Restructuring consultants and insolvency professionals are usually sought as the last recourse and only after a company's leadership fails its fiduciary responsibility.

In recent years I have been approached from time to time to join one board or another as an independent director. I much prefer a boardroom role helping to guide a profitable, growing, and solvent company than being engaged to wind down a company and dispose of whatever assets remain after a disastrous year that someone should have seen coming and should have acted upon.

Smaller, privately held companies have few shareholders, tending toward family ownership and interlocking old-boy directorships. Ownership might be into its second or third generation, operating on somewhat of an autopilot mentality, a mistaken sense that any clock once wound will never stop ticking. More important, these folks need someone who will think on their fiduciary behalf, who will not vote for unwarranted bonuses or dividends—and even if outvoted will say so and have their vote recorded in the company's minutes.

This sort of vigilance, I must repeat, is for the benefit of the principals, their company and its legacy. By "legacy" I mean several things. First, and of course, the good name and reputation associated with the company and everyone connected to it. Second, the company's sustainability—its very survival in the demanding and often unpredictable world of commerce. And third, a clear culture of bona fide fiduciary and operating standards—something that resonates in legal proceedings that almost certainly arise any time a company is overcome by events. It happens. And therein lies the core of my assertion that an experienced board taken seriously is the best insurance policy your company can buy.

Meanwhile, a company will perform better— and be a betterbusiness—by availing itself of the expertise and ears to the ground that independent directors can provide. Through my career, which spans more than 50 years, working with a diverse cross section of businesses in a variety of industries, I have found that certain truths apply to all businesses. All boards should strive to focus on the words "fiduciary," and "trust," and avoid even the appearance of impropriety.

All board members, voting individually, are empowered, sometimes more and sometimes less, to weigh in on business strategy and the hiring and firing of top management. Boards are not cookie-cutter agencies. But always, every board member's fiduciary responsibility demands he or she intercept fiscal imprudence or sloppiness. That's an ethical duty, obviously. It is also—and this is the part that seems too often not understood—good business.

James McTevia
November 12, 2015
Consultant

James V. McTevia is a nationally respected expert in advising clients in transition. A pioneer in crisis management, he has more than fifty years' experience as a consultant and advisor to government agencies and private sector businesses. He is the author of "The Culture of Debt" published in 2010. He can be reached at 586-764-4500.

https://www.corpmagazine.com/executives-entrepreneurs/expert-advice/outside-board-members-good-insiders/3/