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Steering Head-on Into Accountability

WHY AND WHEN PRIVATE COMPANY FOUNDERS SHOULD FORM AN INDEPENDENT BOARD

By G. Bradford Bulkley

This accountability thing is really hard. Could that be why so many private and closely held companies don't have independent boards? After all, holding ourselves as business founders and owners or our people accountable isn't always pleasant. Accountability involves tough choices, sometimes ranging on the spectrum from grim to catastrophic. Then there are the difficult conversations and the soul-searching. Oh, the soul-searching!

Like it or not, accountability comes with the dream of owning and operating a business. Still, what exactly does accountability look like in the private-company world where you—and maybe you alone as majority shareholder—are lord and master?

Public Vs. Private Accountability

Federal law defines the fiduciary responsibility that public-company boards have to their shareholders. Equally important is their responsibility as strategic advisors to management. What accountability requirements do private companies technically have? In a word, none.

Sure, a lack of requirements suggests a degree of freedom, but I continue to be astounded by the many private companies—some quite large—whose owners choose not to be accountable to anyone, and certainly not to an independent board.

If there's one thing I've learned in more than three decades of counseling privately owned companies, it's that the companies that exercise strong corporate governance through organized, independent boards with well-defined responsibilities and real authority exhibit the best long-term financial performance. The CEOs and management teams of these companies don't fear independent governance. In fact, they thrive under accountability because they see the direct correlation between good governance and strong financial performance. **Private companies need independent boards every bit as much as public companie**s.

The Challenge: Allowing Others In

It's difficult for private-company owners, especially founders, to cede any power to a board. To some, it's simply anathema. They fear losing control of the company they worked so hard to build and, in some cases, being forced to make uncomfortable decisions.

Properly structured private-company boards should operate according to a well-defined charter that is developed by ownership with a lead director's input. This charter should also prescribe directors' responsibilities, which should emphasize evaluation and assessment, measurement and guidance. Having this in place should assuage most fears about losing control. Independent boards work to ensure the vitality and growth of the entity and, therefore, the interests of all shareholders. **Make no mistake: A good board is not there to answer management's questions, but instead to question management's answers.**

The Risks of Insular Boards

In too many cases, when private-company owners or CEOs take the initiative to form a board, they surround themselves with golf buddies, old college pals, and others who tend to look and sound just like they do.

These boards offer only a veneer of governance that disguises a coarse underlayer of collegial comfort, passive agreement, and resistance to change. At their worst, they perform only perfunctory duties and, due to the absence of diversity, are characterized by lack of substantive debate that could benefit the company, shying away from tough issues and incisive strategic planning. **It's often said that good is the obstacle to great. Insular or legacy boards are neither.**

Duties and Benefits

A board's primary responsibility is CEO accountability, even when the CEO is the owner and board chair. Some senior managers hesitate to challenge their CEO for fear that their candor might be—to put it charitably—unwelcome. Conversely, strong independent boards can demand accountability and speak candidly without fear of retribution.

Another critical responsibility is CEO succession, which is, perhaps, the most difficult issue faced by private companies, particularly family-owned companies. Despite his oft-stated intention to live forever and remain the chair of National Amusements (parent of CBS/Viacom), Sumner Redstone eventually did succumb to failing health last year at age 97. Clearly, he had difficulty addressing succession.

Independent boards can and should be completely honest in assessing the talents of all potential successors and provide an important buffer for founders, especially in contentious environments with an heir apparent. An honest, unbiased viewpoint—in this and all areas—is the most prominent benefit that independent boards provide.

Other critical duties involve assessing the entity's management, legal, and tax structures; understanding and evaluating both operating and financial risk; measuring progress against industry benchmarks; and advising on annual plans and M&A opportunities.

Boards are all about creating strategies without getting involved in daily operations.

So, When and How?

First and foremost, if you think you might need a board of directors, you likely do. It's a genuine and admirable call for support. Embrace it, and the results will follow.

For established entities, creating an independent board is less about size and revenue level than it is about complexity, operational scale, and growth needs. Certain seminal events in a company's life cycle—scaling operations, product line or brand extensions, acquisitions, raising capital, introduction of third-party shareholders—can give rise to issues that fall outside a founder's expertise. An independent board with the addressable experience and skills can provide critical guidance.

Even leaders of early-stage companies should consider forming an independent board. Some companies launch with existing business or scale, whereas others are founded based on marketable skills or interests. The former should have an independent board at launch. The latter should contemplate the idea but likely can afford to wait until the need to scale operations or another life-cycle event surfaces.

Another crucially important factor is comfort. When business becomes too comfortable, when running the enterprise seems rote and provides little challenge—when you're playing too much golf—an independent board is an appropriate way to recapture value that is likely being lost because the magic and intrigue are gone.

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It's never too early—but it can be too late—to have an independent board.

In order to govern effectively, a board must understand its mission and responsibilities—the bounds of its governance—and ownership's purpose and expectations.

A strong board is well-structured and led by a lead director, preferably an outsider. The lead director's responsibilities should be documented. These responsibilities generally include determining required board member skill sets, recruiting other members based on a qualification matrix, conducting annual board evaluations, and setting board meeting agendas with the CEO.

Other key considerations include director compensation, committee structure, and, of course, culture. And culture is king. Companies with strong cultures breed employee satisfaction, which increasingly is the difference between success and failure. The same notion extends to boards.

Board members are people, and to be enthusiastic and productive contributors, they must be engaged. Strong boards promote engagement by addressing substantive issues and encouraging healthy debate. They serve as sounding boards for their CEOs, and their toolbox includes much more than a rubber stamp.

Your directors are like the Knights of the Round Table, there to protect ownership's interests and ensure that growth benefits the entire enterprise.

Be Strong

Forming an independent board takes courage. The CEOs who have installed successful, independent boards steered deliberately and methodically into their fears. They were comfortable with the notion that outside perspectives could challenge their ideas—and their authority—in ways that wouldn't dilute their influence. Instead, those outside voices serve to strengthen the owner's ability to continue building an organization with a sense of purpose and permanence into something that would outlive even them.

After all, isn't that the ultimate goal?

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