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SMALLER BUSINESSES NEED OUTSIDE DIRECTORS

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Smaller Businesses Need Outside Directors

A few good friends and family members may not be enough to make the most effective board for smaller companies. Give serious thought to retaining (and paying) outside directors

William E. Thomson

A FEW YEARS AGO, when discussing an assignment with a potential client, who was the sole owner and operator of a substantial firm in a small Ontario city, I asked for a list of his company's directors. Although, he "couldn't quite remember because there are many subsidiary and related companies," he thought that, together with himself, his wife, his son and perhaps his vice president of finance fulfilled these functions.

Having identified the company as a proprietorship, I requested the names of the company's solicitor and accounting partner. The owner answered that in 40 years of operation he had no reason to know them because, as service providers, they dealt with the appropriate functional manager.

I persevered, asking for the names of his business friends, those whom he could approach for advice or whom he could count on for support when business issues presented him with challenges beyond his personal experience. After pondering the question for a while, he finally suggested that the only person he might include would be his bank manager.

My client was not a typical loner, but an outgoing, friendly person whose business required continuous interface with all manner of customers, suppliers and lenders. He also played a prominent role in community affairs.

Within 16 months of our conversation, the bank manager had transferred my client's corporate loans to the bank's special loans squad and a receiver had been appointed.

MANY BOARDS COMPRISED OF "WRONG" PEOPLE

This is not an isolated case. In small- to medium-sized businesses (sales less than $100 million), one seldom finds a board with members who can perform the traditional role of director. When a board exists, at best it includes family, employees (whose advice is somehow supposed to improve when they are elevated to a directorship), the company lawyer (whose business experience is confined to the commercial endeavors of his or her law firm), and one or two old friends retained for their conviviality, lack of opposition to the owner's policies or long association.

When this "makeshift" board faces an unusual occurrence in the business' operation, a great feeding ground for the consulting community is created. This is particularly true of accounting firms, which constantly attempt to promote competencies beyond their historically narrow focus and, accordingly, fail to help with predictable regularity. Perhaps the compensating factor of consultants is that the company's inexperience causes a poorly defined and administered assignment so nobody wins.

"Outside directors should be used by smaller companies to the fullest extent possible."

PAYING FEES IS NO FRILL

The only substantive reason for the shortage of competent outside directors seems to be the reluctance of smaller companies to pay them. Once directors are appointed, there is no hesitancy in causing them to perform the purpose for which they are present. But, paying fees to directors seems to be viewed as a frill that can be summarily deferred or cancelled when a smaller company experiences bad times. Perhaps that is acceptable for large, public companies, where directors are perceived to be more affluent or exposed to public scrutiny. In most businesses, when trouble or change looms, a board becomes more active and attentive to management's actions. Rather than having fees reduced, it may be more appropriate that they be increased to reflect the greater amount of work done by directors.

Directors should be adequately paid, preferably using an annual retainer rather than meeting fees, since in today's reality directors are more regularly called upon for purposes other than just attending formal meetings. In most situations, enjoining the director in the company's success by paying a contingent amount, either through share options or participation in profit share arrangements, is also useful.

NEED FOR OUTSIDE DIRECTORS

Outside directors should be used by smaller companies to the fullest extent possible. They should fulfil the standard roles imposed by corporate rules and convention. But, where outside experience with the business community is required or desirable, they should also be the first line of access for management. Access to people, methods and experience are the natural benefits an outside director can provide. In most cases, provided competency is proven, companies with which the director is associated should be permitted to serve the subject firm without undue preoccupation with perceived conflicts. Costs should be much lower and the quality of the service is normally better because of the director's involvement.

Finding suitable candidates for boards is relatively easy. After considering the type of business, together with the attitudes and competencies of management and of existing directors and shareholders, a profile should be developed of the qualities sought in the new director. Current stakeholders are canvassed and a list developed.

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DIRECTORSHIP BEING THWARTED

We are inundated with articles and periodicals warning of the danger of becoming a director. Many law firms now advocate the formation of advisory boards in order to shield individuals from the risk of being a board member. We seem to have lost the point. There is a real need for companies to have access to an experienced group of businesspeople to assist in the decision-making process and to monitor operations and management performance. The articles emphasize the reasons for refusing board membership, such as the financial risk involved. Adding to this mix is a succession of overzealous civil servants drafting rules to penalize the corporate elite. The accounting and legal fraternities have made a business out of advising on the various pieces of legislation and practice. The ignorant postulate and the "professionals" opine.

The business community's members spent years learning about their companies and industries and developing a background of experience that is useful to others. This knowledge and experience are recognized when one is asked to join a board of directors. Presumably, beyond wishing to have financial security, this recognition is what we strive toward, and represents the fulfilment of many of our aspirations. To be thwarted by government and given shrill warning by system feeders is unacceptable.

However, until the regulatory environment is changed, companies and their influential shareholders must be prepared to provide reasonable indemnities to outside directors to protect them against risks inappropriate to their situation.

BEWARE!

So, if you're running a smaller company beware the trap of appointing co-workers and family as directors; they may have other agendas or be fee hungry. Your board should include outside directors, who you should compensate adequately. You will benefit from their experience and alternative view of your situation. BQ

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