# Best practices from boards of public companies

BY MARGARET PEDERSON

Family businesses have become increasingly sophisticated over the last few years and are embracing best practices of other companies, both private and public. One way for family companies to add value is by incorporating best practices of public company boards. Public companies have improved many of their processes and procedures, partially in response to new regulations. Many of these practices can benefit privately held family businesses. Even though private companies are not bound by the new regulations, there are benefits to applying these practices, as they can improve financial performance, reduce risk and enhance business opportunities.

Two areas form the foundation for these best practices: diversity of thought and expertise, and an engaged board. A diverse group of engaged directors can help improve financial results, grow the business, spark innovation and minimize risks.

## Fill talent gaps

Some public boards require a gap analysis, which confirms board members' strengths and identifies missing industry expertise or functional skills. A job description for incoming board members is then written that outlines needed skills and expertise. Today, for example, many boards are seeking directors with IT skills, social media expertise and global experience.

There can be two challenges here: bringing in a non-family member and adjusting the composition of the board, which may require a reduction in the number of family directors. Adding a director(s) who is part of a family business or who serves on a public company board as well as on a private board may help build credibility and empathy. It is preferable to add (at least) two independent members at the start to avoid isolating—and therefore marginalizing—a lone outside director.

Another important topic for family companies to consider when adding non-family directors is how the board members will be compensated. Will they receive shares? If so, how can the shares be cashed out once the directors leave the board? If not, how will the directors be made to feel connected and committed to the company?

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## Appreciate independence

Public company boards historically were composed of several management personnel and members recommended by the CEO with a limited number of truly independent directors. Increasing the number of independent directors has become a priority for public companies. Today, in most public companies all directors are independent except the CEO, and the characteristics of independence are legally defined. Splitting the chairman and CEO roles (so that one person does not hold both titles and thus serve as his own boss) is also becoming more prevalent. Some shareholders have staged proxy fights to advocate for this change. Institutional Shareholder Services, a proxy advisory firm, advises companies to divide the chairman and CEO roles.

Some family company boards, like the public boards of old, have a reputation—sometimes deserved—of being created or strongly influenced by the CEO, especially if the CEO is the founder. Directors are often the founder's golfing buddies, school friends, neighbors or friends-of-friends. When they are recruited by the CEO and owe their initial and ongoing board membership to that relationship, their independence can be compromised. This may be beneficial to the personal agenda of the CEO and the family, but it may not be in the best interest of the company in terms of either the short-term financial results or longer-term strategic positioning.

Truly independent board members can bring added expertise, related to the industry as well as to

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specific functions. They also broaden contacts, which can be valuable as the company expands into new products or services and additional geographic zones.

### Engage with the board

Engaged board members bring their experience and expertise to the discussion and are often more intent on a meaningful dialogue than on concurring with the CEO or family members. The difference leads to longer board meetings with informed discussion rather than quick approval of a motion based on family or management presentations.

Candid dialogue is important in assessing risks, unearthing competitive threats and preventing technological disruption. This can lead to more comprehensive development and review of company strategic plans, identification of risks before they become apparent and uncovering new business opportunities. An engaged and independent board can also provide an objective assessment of family managers.

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However, candid board discussions can be disconcerting to family members, especially if they are accustomed to proceeding on their own; they may not welcome meaningful dialogue, especially initially. Keeping the dialogue objective, based on facts and analysis, can reduce the emotional component. A professional and non-adversarial approach should be maintained at all times. Adding directors who have owned their own businesses or been involved in family-owned or private companies can increase empathy.

### Share information and access

An informed board provides intelligent input. Experienced board members know their job is oversight and guidance—as the saying goes, they should keep their "eyes in, hands out." However, to provide the most valuable input, they need access to appropriate information and personnel, not just what is often presented in the family or management overview. Providing this access may seem invasive to the family, especially at the start, but it yields more accurate advice. In order to properly focus on areas where improved performance is needed, directors must communicate with managers.

Sharing information and access to management can be more traumatic for family companies than for other businesses, as family business owners are not accustomed to providing data to anyone outside the family.

### Expand the board's strategic involvement

Many public boards are becoming more involved in strategic planning. Traditionally, management developed the plan and the public board approved it annually, often in late summer. Today, more public boards expect to discuss strategy at every meeting, focusing both on high-level objectives and on tactics, and monitoring the plan's progress and results. The board's involvement in strategic planning has increased because of a greater awareness that directors can provide valuable input and feedback that result in a less insular perspective.

In family companies, non-family board members bring an outside perspective that broadens the outlook and provides strategic expertise. In public companies, the board's role is strategy oversight and approval of acquisitions. Family company boards can expand this portfolio to include working with management on strategy development and execution.

In a blog post, Marc Austin of the Corporate Executive Board (CEB) discussed an issue holding back investment decisions that stems from the boardroom: "The growing trend across boardrooms is indecision, especially when it comes to deciding on big, higher-risk growth bets." Family companies have an advantage here, as they can move more quickly and are more entrepreneurial; risks are generally taken based on family consensus. However, it is important that strategy and investments be based on analysis of company positioning, industry conditions, competition and technology—not just family members' experience and intuition with the rest of the board simply agreeing.

Public company boards are increasingly focusing on growth initiatives, as quarterly and annual growth is required by investors.

### Add financial expertise

Adding a director with financial expertise provides several growth and risk-management advantages. Public companies are required to have a financial expert on the board, and there are specific criteria defining the expertise, a condition that was added to prevent financial irregularities. The individual is usually a CPA and often is a current or former CFO (ideally in a related but not competitive field) or a recently retired accounting firm partner; these directors generally serve on the board's audit committee. Family companies can benefit from strong financial expertise, especially if family members do not have that functional skill.

### Expand competitive horizons

Many U.S.-based companies still focus on local, regional or national markets. But in today's global marketplace, it can be a wise strategic move to buy materials from abroad, outsource work overseas or sell to international customers. Adding non-family board members with experience and contacts in targeted markets can provide valuable input and reduce unnecessary risks.

Likewise, social media and mobile connections are now mainstream. Mobile devices are changing the way business is conducted: 91% of Americans have a cell phone, 56% own a smart phone, 34% have a tablet and 26% own an e-reader. This second screen is changing the way everyone receives information, enjoys entertainment and shops. Recruiting a director with expertise in technology or social media can make a substantial difference.

## Spur innovation

Innovation is becoming more of a focus for public companies; some now have an innovation committee as a subgroup of the board. Simply providing the same product or service because it has always been done leaves an organization vulnerable to disruptive competition. Industries change, new competition arrives (sometimes unseen until late in the process) and technological advances change everything. Imagine how the next iPad equivalent might impact your organization.

PricewaterhouseCoopers' (PwC) "Global Report on Innovation" (based on interviews with 1,757 C-suite and executive respondents) concludes, "Innovation is a driver for rapid and profitable revenue growth and is recognized by executives we interviewed as being integral to sustaining the long-term future of their business: 43% said innovation is a competitive necessity with that percentage increasing to 51% in five years. 93% indicated that organic growth through innovation will drive the greater proportion of their revenue growth." In another PwC study, 74% of the CEO respondents regarded innovation as just as important to the success of their company as operational effectiveness, if not more—"a first for innovation being in parity with operations." Respondents also saw a need to be more sophisticated in their approach to innovation in order to achieve these goals. This applies equally to family companies.

## Manage and minimize risks

Public companies have identified risk as an important concern. Most have created procedures to oversee risks facing existing business and new initiatives. IT risk and cyber security can affect daily operations and involve significant longer-term risk, as any organization that had its customers' accounts compromised can attest. Companies are scrambling to identify what data to collect and how to monetize the data while protecting privacy.

## The roots of board effectiveness

The starting point for a family company seeking to incorporate best public company practices is to recruit directors with diverse ideas. Once an independent and fully engaged board is in place, they must work with management to focus on enhancing performance. F