How Independent Directors Add Value

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When considering the addition of outside directors to their boards, many bottom-line-oriented family business owners want to know how independent directors add value to the business. Since the role of an effective director does not include the day-to-day management of any operating functions, the answer may be difficult to come by.

Of course, much will depend on what each director brings to the board table. In my experience, perhaps the most discernible benefits come from individuals who can offer a network of contacts that may directly affect the company’s revenues or profits. In one such instance, an advisory director has not only provided introductions to potentially valuable customers, but he has also offered professional advice on development of new products and markets that should prove very profitable to the company in the future.

What can a director who does not have industry or customer contacts contribute to the success of the company? Other forms of networking also add value, however difficult to measure. One of my fellow board members has provided numerous contacts from his PDA during board meetings. Whether providing a resource for legal work or a contact for finding managerial talent, this director would be an asset to any board.

Networking is not the only benefit from a well organized outside board. During periods of ownership and management transition, an experienced executive board can be invaluable. When inexperienced owners find themselves in charge, an outside board can be extremely helpful in overseeing executive management. This is particularly helpful in family businesses where the CEO is relatively new and ownership is vulnerable. An example of the board’s value in such a situation occurred when a very capable CEO was hired by the board to turn the business around. The board was routinely challenged by the CEO to let him run the show with little accountability or oversight. After a few moments of conflict between the outside board and the CEO, the CEO accepted accountability, not only was the company turned around, but the inexperienced shareholders were the beneficiaries of a tenfold increase in the value of their business in less than three years. In this instance, the CEO also benefited significantly because the outside board was willing to compensate him for his performance to an extent that the family shareholders would not have, were it left to their initiative alone.

In addition to accountability of management, a professional board offers an element of discipline not often found in situations where the board is composed entirely of insiders. Entrepreneurs who are willing to accept such accountability are at the top of their class. It is much easier to do what you think is best for the business without having a board second-guessing you or challenge your thinking. The devil’s advocate role of
an independent board can be challenging, but as Peter Drucker once said, if everyone agrees with a decision without challenge, it probably is the wrong decision.

The value of constructive challenge by an independent board is often hard to measure, and can sometimes be best measured by loss avoidance as opposed to added profits. Perhaps one of the most difficult decisions an outside board is faced with is one in which the managing owner is passionate about a new venture, that from a business perspective, does not fit the risk profile of the overall ownership. In one such case, the majority owner and chairman, wanting to make an acquisition that was turned down by the outside directors, disbanded the board rather than accept their counsel. As a result, the acquisition was made and caused several years of losses for the consolidated entity.

Another, more difficult challenge facing independent directors occurs when a family manager is in need of significant disciplinary action. In such instances, what is best for the business comes into direct conflict with what is best for the family. Truly independent directors are often faced with unsavory alternatives in such circumstances, but their fiduciary responsibility to all stakeholders should prevail. This is particularly true where there are non-family minority shareholders, however small the minority.

A final value of an effective outside board is even more difficult to measure in terms of bottom-line profitability. An effective board will bring management out of its operational orientation periodically and focus them on key strategic imperatives. Outside directors with senior executive experience in successful companies are uniquely qualified to challenge and expand strategic perspectives on the business. Such seagull thinking can keep management’s eyes on the critical factors that will account for the vast majority of the company’s success and profitability.

Yes, it is difficult to measure the value of an outside board in terms of dollars. However, such a board’s contribution to a better-performing management/ownership/board team can add significantly to the value of the family business over time. In order to add that value, there must be a confirmed partnership among ownership, management and the board.