

NAVIGATING PRIVATE COMPANY GOVERNANCE

The Savvy Business Owner's Guide
To Developing An Effective Board

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The Savvy Business Owner's Guide To Developing An Effective Board

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Preface

It's not about finding the right answers in life, it's about asking the right questions.

Having sat on boards for over thirty years, the right question to ask is “why?”—as in, “Why should I have a board?” Another important question to ask—“How does it help my business?”—is easier to answer. There are many books on how to organize and run a board.

My observation is that most private company owners don't think about what is outside their field of view, and that is where a strong board makes a difference. Owners with boards also tend not to think about how to get the most from their boards, and that is a lost opportunity.

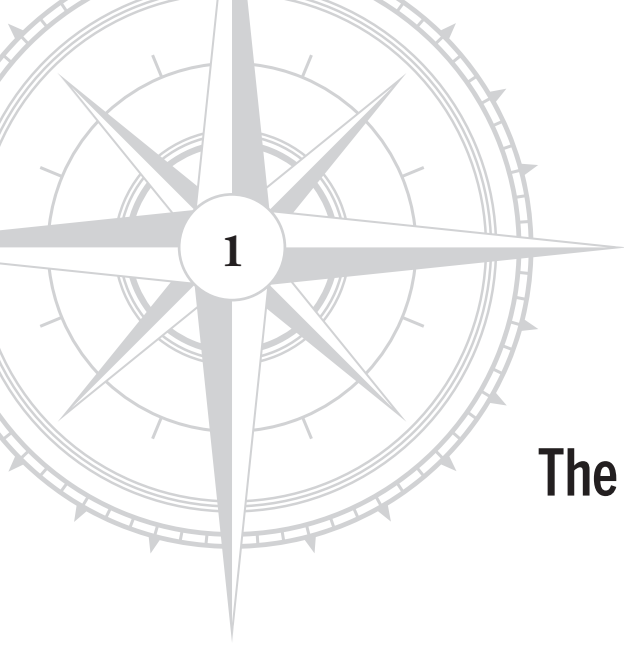
Why have a board? The conversation usually starts when the owners realize that they and their team lack the experience and knowledge needed to address future challenges. They realize they need help, and project-oriented consultants don't seem to be the right answer. This usually starts when the business is in the \$25 million to \$30 million revenue range because that is when their needs exceed the span of control of the leadership team. There are numerous exceptions to this, but it all hinges on the experience and judgment of the leadership compared to their future challenges.

Strong board members should be able to ask questions that stop the conversation, cause everyone to pause and reconsider the issues, and then create a new and better outcome from where they were. They should be measured by their ability to add a new dimension that was not considered or thought possible previously. This is the benefit of bringing in outside experience and judgment.

Business owners should be thinking about how a board can create true value, and hedge against downside risk. I wrote this book so owners can have greater business success with less risk and less stress. My focus is on getting better outcomes.

Bruce Werner

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The Ownership Journey And Governance

There is an old joke that people who start businesses will work eighty hours a week for themselves so they do not have to work forty hours a week for someone else.

In my experience, the people who own and manage private companies do not like being told what to do by someone else. The favorite motto of the private business owner is, “You are not the boss of me”—so the idea of private company governance might be an uncomfortable concept.

Sure, these owners understand why governance is needed by law for public companies like Apple, Exxon, and Google. As investors in public companies, most concur with this opinion from Investopedia:

Corporate governance essentially involves balancing the interests of a company’s many stakeholders, such as shareholders, senior management executives, customers, suppliers, financiers, the government, and the community.¹

Since governance provides the framework for attaining a company’s objectives, does it also make sense for private companies to use similar rules and processes to succeed?

What's The Preamble To Your Business Constitution?

Let's go back in time to civics class in high school when you studied something called the Preamble, which is the first fifty-two words of the U.S. Constitution.

No doubt your teacher explained that the Preamble contents can be summarized as a list of goals by which the United States would be governed.

Four main ideas are presented within these fifty-two words:

- Who is enacting the Constitution? “We the People of the United States”—the owners of this enterprise.
- Why is the Constitution being adopted? “In order to form a more perfect Union”—to have a successful enterprise.
- What exactly is being adopted? “This Constitution for the United States of America”—rules and principles according to which an organization is acknowledged to be governed.
- What goals are established by the Constitution? “Establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity”—five ideals to strive for.

These are the rules of the road for the ownership journey of the United States. Let's put political opinions aside for one moment. There is great evidence that effective governance has been key to the success of the United States as a nation for almost 250 years.

Likewise, effective private company governance can be critical to personal and business success.

The Ownership Journey: Secrets For Personal And Business Success

One of the key issues to understand when you own and manage a business is the difference between working *on* the business versus working *in* the business.

While most of your time is spent working *in* the business, working *on* the business is where the high-impact decisions are made. Oddly, the time spent on these decisions is typically inverse to their importance.

To reinforce this point, consider the most important question: “Why are you in business?” Most owners don’t stop to dissect the question into its parts. The questions are: What are your life goals? How does the business help you to achieve those goals: financial security, happiness, family harmony, enjoyment of time well spent? You can make more money, but you can’t make more time.

Additionally, how does your business strategy enable you to achieve your life goals? The business is an asset, and it should be used to help you achieve your life goals.

From that perspective, it is easier to define a process to help you as the owner achieve your life and business goals. Where you and your business are today is Point A. Where you want to get to is Point B.

Once the two endpoints are defined, it is more straightforward to construct a road from A to B. Success is about perseverance and adapting to changes beyond your control on that highway.

Eight Steps For Your Highway To Success

Here are eight steps for a business owner to build a solid foundation for your highway to success:

Step one: Create an ownership strategy. Develop a statement of life goals and decide how the asset must perform so you can achieve your goals. These goals usually focus on financial security, happiness, ownership succession, management succession, and family issues.

Step two: Create a business strategy. Once you set performance metrics for the asset, you should flush out the business goals and strategies that will produce winning metrics. This is usually something like: I need to get the business to \$X EBITDA (earnings before interest, taxes, depreciation, and amortization) and sell it to achieve financial security. So how do we get to \$X?

Step three: Use capital and talent to drive the business strategy. All businesses need capital and talent to succeed. Private businesses are constrained in both areas. How much capital, and in what structure, do you need to fund the strategy? What talent is needed to execute the strategy?

Step four: Execute organic growth and mergers and acquisitions to fulfill the strategy. It usually all comes down to how to grow the business. How much future growth will be organic, and what is needed to make it happen? If organic growth is not enough, acquisitions need to be considered. If you need to make acquisitions, who are the targets, and how will you successfully acquire and integrate them?

Step five: Think about governance needs. While the focus needs to be on growing value, risk management cannot be ignored. What governance structures are needed to provide oversight and perspective along the way? How will outside perspective benefit the business strategy? What is the system of controls being used? If the intention is to own but not run the business in the future, who is protecting the shareholders? If you need to develop a board, how do you define its mandate, select directors, and run it to add value to the business?

Step six: Take advantage of conflict resolution and mediation. This aspect of running a business is too often overlooked until major problems arise—yet conflict is inevitable in business. It is how you handle it that counts. So what to do when people don't agree? The biggest issues occur within the ownership group, then within management. If your governance system does not have these mechanisms now, you will need to figure them out when conflicts arise. Perseverance and determination have always been requirements for success, although they alone are not sufficient. A good plan, adequate resources, and adaptability are required for success since the market is fluid and dynamic. A little luck never hurts either.

Step seven: Plan for management succession. Continuity of management is considered the biggest risk in business, but it can be managed successfully with effort. This requires looking ahead to anticipate the future needs of the business and securing the talent best suited to meet those needs.

Step eight: Manage the exit process successfully. Building a great business often seems like the hard part, but it is really the preamble. A successful exit of choice is the capstone of a great career. For many owners, it is also the starting point for the next stage of life. The goal is to have no

regrets when you no longer own the business. So how do you get there? Understand that the decisions you make on the business are the ones that matter, and then drive the other decisions to make sure you get there. It can take time to develop this perspective. But if you talk to enough people who have sold their businesses, this theme comes out time and again.

With these eight steps in mind, let's consider the critical behaviors for success in a private company.

Critical Behaviors Of Successful Private Company Owners

There is a benefit to being in the right place at the right time, as well as being blessed with the skills, intelligence, and connections to achieve business success.

From my perspective, the robber barons, oil barons, and software moguls of the past were in the right place, at the right time, and had what was needed to take advantage of their once-in-a-century opportunities.

But that is not what happens to most private business owners. The rest of us need to play the cards we were dealt as best as possible. As they say, hope is not a plan. So what are the few critical behaviors that define successful owners of private companies? After analyzing dozens of case studies, I've found a few behaviors are consistently demonstrated by successful owners:

Maintain focus. Many entrepreneurs are known for having the high energy level that is important for reaching results. However, without focus, it is meaningless. You can run in circles quickly and still get nowhere. The simplest way to stay focused is to revisit your mission statement and key strategy documents when things get fuzzy. The reason to invest time in developing these thought pieces is so they become your compass when you wander off course.

Have tenacity. President Calvin Coolidge is credited with saying, "Nothing in this world can take the place of persistence." It is not enough to work hard; you have to work on the right issues at the right time. When you reach your limit and you can't work any harder, step back and assess

how you work. Don't work harder, work smarter, and bring in help when hard work alone is not going to get the job done.

Practice adaptability. Charles Darwin's "survival of the fittest" is often misunderstood. From my perspective, what Darwin really meant was survival of the most adaptable. I believe the same is true of businesses that endure over decades. Great businesses can start to decline if they fail to adapt to changes in their markets. As owners age, start to enjoy their success, and get comfortable, they can begin to lose touch with how their market is changing. That can be the start of decline that is only seen in the rearview mirror of life. Practice adaptability to avoid this sort of decline.

Making adaptations is the result of seeing external changes and responding to them. Great business leaders build their organization to execute—while spending most of their time looking outside of it to view their world and assess the environment they are in. Get input from the external world, anticipate, and adjust your organization for what is coming. As hockey great Wayne Gretzky is oft quoted, "Skate to where the puck is going to be, not where it has been."

Set priorities. Business is not a democracy. Priorities matter because time, talent, and resources are scarce and need to be allocated to their highest and best use. That is what owners are responsible to inform their boards and management teams of. Owners, specifically, only have to make a few decisions: What business are you in? Who is running the business? What does the business need to do for you? Non-owner business leaders must understand that directive, translate it into a strategic plan, and execute it. Priorities are set by ownership and driven down through the organization.

Manage expectations. When you combine focus, adaptability, priorities, and a practical understanding of what your organization can do, it is time to manage your expectations. Be aggressive but not unrealistic. This is both for yourself, as the owner, and your management and staff. Two phrases that sum this up are stretch goals (goals that are set just beyond your known reach but not so far that they are unreasonable) and SMART goals (goals that are specific, measurable, achievable, relevant, and time-bound).

Ask for help. Don't be afraid to ask for help when you need it. This can be tough when you are firefighting, perhaps lack resources, or just having a tough go of it. Even the best athletes have coaches, as do many executives. Sometimes a few pointers are all you need for a course correction. Other times you need someone to tell you what none of your people will say. Whether it is a coach, a personal board of directors, an advisory board, or a fiduciary board, you should be thinking of your current and future needs and surround yourself with people who can keep your thinking fresh and your eyes clear as well as provide clarity of judgment for when you may become conflicted.

Hold yourself accountable. This is often the hardest task of all. Very few people do this well consistently, year in and year out for decades. Several of the boards I serve on were formed because the owners knew they needed outsiders to enforce accountability. This is a higher standard than, "Let's make some money and have some fun." This is the ownership version of the concept of continuous improvement.

There are many ways to grow a successful business, but the behaviors that create success don't vary much over time. How well are you demonstrating these behaviors?

Where Are We Headed?

What exactly is private company governance is the next topic to be examined. More importantly, why does it matter for private company success? These issues are considered in the next chapter.

Chapter 1 Takeaways

The Ownership Journey And Governance

Your ownership strategy should drive your business strategy. Develop a statement of life goals and decide how the business must perform so you can achieve them.

Manage capital and talent to drive the business strategy. All businesses need capital and talent to succeed. Private businesses tend to be constrained in both.

Think about your governance needs. While the focus needs to be on growing value, risk management cannot be ignored. What governance structures are needed to provide oversight and perspective along the way?

Plan for management succession. Continuity of management is considered the biggest risk in business. It must be managed successfully to ensure the continuity of the business.

Manage the exit process thoughtfully. Building a great business often seems like the hard part, but it is really the preamble. A successful exit of choice is the capstone of a great career.

Know how to maintain focus, demonstrate tenacity, and practice adaptability. Priorities matter because time, talent, and resources are scarce and need to be allocated to their highest and best use. When you see your situation change, assess the change, and adapt to the new reality quickly.

Manage expectations. When you combine focus, adaptability, and a practical understanding of what your organization can achieve, allow yourself to manage your own expectations.

Ask for help. Don't be afraid to ask for help when you need it. This can be tough when you are firefighting, whether due to a lack of resources or just having a tough go of it.

Hold yourself accountable. This is often the hardest task of all. Very few people do this well consistently, year in and year out for decades.