

# Ten Common Mistakes Of Company Boards

*How to identify when corrective action will maximize value*

Now more so than ever, private company Board of Directors are being called upon to provide leadership and skills that go beyond traditional governance activities. Boards and individual directors are becoming “activists” with involvement in strategic leadership, organizational leadership, interim management, and industry support in addition to classic governance activities.

According to a 2009 *McKinsey Quarterly* survey<sup>1</sup> seventy percent of privately held company boards are involved in core performance and value creating activities (an increase from 59% in 2006). However, only 43 percent of respondents said their boards are effective in the creation of corporate value.

When operational efficiency, scalability, innovation, and exit planning all become focus areas of the “partnership” between boards and management; the long-term wealth generating probability for the enterprise drastically increases.

Company Boards are ultimately responsible for maximizing shareholder value, not performing the day to day activities of the company’s operations. But with every opportunity there are roadblocks that can overshadow the role of the board and its ability to effectively oversee the business.

This article serves as a set of guidelines for directors, including highlighting the most common mistakes made by board leadership that reduce a board’s effectiveness and hinder the company’s success.

**Garry Meier**

Ephor Group Chairman and Founder

solving the value equation





## Directors Audit Checklist: How to identify when corrective actions are required to maximize value

While it is obvious that the position of a business in its lifecycle will have a significant impact on the type and nature of the governance required: every business, whether in the development, growth, or mature phase, faces numerous challenges.

Companies often lack “holistic” insight into the issues facing the business. Too often, when management does seek assistance, consultants are hired to solve a specific leadership or functional problem. However, solving singular functional problems commonly provides only temporary performance improvement. Ninety percent of the companies we work with have at least one significant operational issue plus a major strategic and management deficiency. Value creation arises from solving both the operational and strategic issues, as well as aligning and balancing stakeholder interests. A holistic approach that directly impacts both near and long-term performance and strategic positioning is therefore imperative.

“Value creation stems from solving both the operational and strategic issues in a holistic manner, as well as aligning and balancing ALL stakeholder’s interests.”

Because early stage and mid market companies generally have the opportunity to grow rapidly, they provide excellent possibilities for increased returns on invested capital. However, non-asset intensive businesses can be tricky to operate effectively because they are “perform” businesses. Generally speaking, they are people and process intensive; therefore how well the people perform in sales and delivery of service, has a direct impact on how well the company performs.

Even though there may be a great market opportunity; the challenges people intensive businesses face, whether in bear or bull economic conditions, are complex. A company can have the best product/service in the marketplace and still not succeed if effective corporate governance does not “synergize” the company. An effective Board is required to overcome these complex challenges:

- Vague value-propositions which generally are difficult to “message”
- Shortage of management talent and leadership
- Higher investment return expectations, generally due to institutional funding
- Emphasis on short-term results
- Cut-throat competition
- Chronic change in direction and/or the lack of ineffective Board Governance





Let us be clear: it is NOT the Board of Directors duty or responsibility to handle or “meddle” in the day-to-day activities of the business. Those responsibilities belong to the operating officers and management of the company. However, it is the role of directors to support, augment, and enhance the capabilities of management, not “BE” management!

## The Ten Most Detrimental Mistakes in Private Company Boards

### Mistake #1: Complacency: Lack of Timely & Decisive Action

The number one mistake made by Board of Directors is complacency. Time is rarely an ally in today’s business world and complacent boards often lose sight of their role as change agents, preferring instead to hold on to the status quo, due to the concept of hope: We must remind ourselves that: “Hope is not a strategy!!”

Symptoms of complacency come in the form of general underperformance to expectations. Business is good, but the company just plods along and never seems to take off. Operating metrics and profits are at less than acceptable levels, but the sales staff is optimistic. The business provides a great service that customers should buy, but for some unknown reason it has not really caught on? Simply said the company is not “fulfilling the market opportunity”!

In examining whether performance is up to par, ask the following questions:

- Are milestones being missed?
- Are financial and business targets being met?
- Is the competition gaining market share and brand equities?
- Is there a technology substitution threat on the horizon?
- Is there consolidation activity and why are we not being approached?
- Has growth stagnated?
- Does management really have the skill set necessary for consistent and defined success?

“Research of private company investment returns further indicates that privately boards exponentially increase the probability of success when the roles and agendas of the Directors are highly structured, and managed by an effective leader or Chairman.”

With today’s unfavorable economic conditions and regardless of the governess process or member capabilities, identifying the barriers to success and assertively developing and implementing improvement processes and programs is required. Waiting too long to take decisive corrective action is inexcusable, and too often the root cause of company turnarounds and restructurings.





## Mistake #2: Strategic Market Positioning Misaligned

Quite often a company can have great technology, people or operating history, but still fail to produce expected results.

This is a typical problem where in generally the financials will not expose the issues, because the problem is not in the execution of the business so much as in the firm's strategic and product positioning.

Often the problem is the board's perception of the marketplace, which can be overly influenced by management or the board members are "just too busy" or simply lack the skill necessary to effectively evaluate the market dynamics. Since customer requirements shift and change, the niche a company occupies needs to be refined or even redefined in order to create sustainable and long-term value. This happens frequently in mid-market service businesses where it is not unusual for customer needs to change as their markets change, thus resulting in their own business model being altered in response to market conditions.

An additional issue arises when the competition begins to consolidate and these newly formed, larger players begin taking market share due to their enhanced capabilities.

When key operational and financial measurements do indicate that performance is falling short of the internal and industry expectations, it is time to evaluate an organization's strategic positioning in an aggressive manner, and insure that the organization has access to the required skilled resources, to execute on the positioning changes.

### Optimally Sizing Your Business for Maximum Value Creation: Sun Tzu on Strategic Positioning

Fighting the wrong fight is one of the most common board management mistakes today.

Sun-Tzu in "*The Art of War*" teaches key lessons about when to fight, such as knowing how to employ large and small numbers.

If you are:

- 10 Times bigger, then surround
- 5 Times bigger, then attack
- 2 Times bigger, then divide your force
- 1 Time bigger, then engage
- If Fewer, then circumvent
- If Outmatched, then avoid

It is obvious what Sun-Tzu, one of the greatest strategist of all time, thinks - size matters.

Many companies lack the experience to grow effectively either through alliances or acquisition, but failure to do so is also the failure of the firm.





## Mistake #3: Lack of a Highly Defined Business Model

A business model by definition provides a blueprint that defines how a firm translates their ideas into services or products to create shareholder value. A valid business model delivers utility, and brand equities to the customer, while a refined business model provides a sustainable competitive advantage. The more defined the business model is, the easier it is to manage, govern and execute.

Many business models have been developed over time and continue to evolve, for example:

- The “shop keeper model,” which started in ancient times, evolved into FW Woolworth, Sears, and Wal-Mart; more recently morphing into today’s present world of Dell Computer, Netflix, eBay, and Amazon.com;
- Gillette’s “razor and blades” business model has been followed by Hewlett-Packard (computers, laptops, printers and ink) and Adobe (free word processor reader, expensive word processor writer);
- Business service models based on transaction processing first used by companies like American Express are now used by Kinko’s, ADP, and Latin American Card Services;
- The “hub and spoke” delivery model pioneered by FedEx has been used to upgrade and revitalize the service of mature companies like UPS; and
- Community models such as Starbuck’s have been picked up by social nets such as Facebook, YouTube, eHarmony, and LinkedIn.

New business models are continually being created: for example, Salesforce.com, Google and Zoho.com: who exponential grow and build brands, while others languish by the wayside. It is well known and understood that faulty and poorly defined business models grow up to be bad businesses (for example, the dot-com bust was a result of poorly thought out business models).

Does your business model provide customer utility, brand equities and competitive advantage for your company? Will it survive the long-term test of time? It is the board’s responsibility to insure that the answers to these questions is “YES.”





## Mistake #4: Low Reliance on the Need for Processes & Measurements

With business, as in sports, the difference between mediocrity and greatness is a matter of inches. Daily execution and refinement of the business processes must become a perpetual activity to achieve consistent performance. Incorrect or insufficient measurements and inadequate process definitions are the primary causes of poor execution.

Board's must insist that management create and implement an effective measurement and metric system around defined, effective business processes. When measurement and metrics drive the organization, decision making is decentralized, communication permeates bottom-up and top-down and performance is transparent. Defined processes not only ensure quality, productivity and cost containment, but are critical components in the valuation of the business.

Measurement and metrics can also serve as an early warning indicator of changes in customer satisfaction or market forces. By pinpointing issues before they become viability issues: Board's have time to take decisive corrective action before it is too late.

*“Corporate directors that spend resources on forward-looking strategies and take tactical action initiatives, achieve increasing value.”*

## Mistake #5: Excessive Focus on Revenue Generation

One of the most costly mistakes a company can make is adding revenue without a client “retention metric” and scalable business processes and technology to handle the increased volumes of activities. Revenue for “revenue’s sake” without strategic and tactical clarity has failed many times, and is the most common mistake we observe from venture funded companies and venture professional oriented boards.

Operational effectiveness commands that revenue growth comes with a focus on implementing efficient business processes and monitoring quality. Defining and measuring these processes will indicate where efficiencies can be gained, costs reduced, and quality improved.

Toward these goals, metrics, key performance indicators (KPIs), can be used to identify the twenty percent of customers that are driving eighty percent of the profits. By focusing on providing better service to these customers, the customer relationship can produce better returns, and lead to more referrals, thus more revenue and lower customer acquisition costs.





Increasing revenue is the answer *only* when all functions are aligned and management has the people, processes and systems in place to effectively grow; otherwise more revenue is likely to cause more harm than good, and potentially put the “invested” capital at great risk. Therefore it is the Boards’ role to insure “no harm is done”!

## **Mistake #6: Exiting for the Wrong Reasons or Wrong Time**

Knowing when to exit is the most misunderstood issue facing Board’s and/or their institutional investment partners today. An exit should be the result of a strategic initiative to seek a realization that is planned, process driven, and is effectively managed by the board, and not the result of factors that make an exit imperative. Further, if an exogenous opportunity to exit materializes, the rush to close often becomes the overriding interest. However, as research reveals, companies that spend six to twelve months optimizing their business model as part of an orderly disposition, create enhanced shareholder value.

While waiting for market timing or a trigger event is the norm, it is generally not the appropriate answer. What is needed is to manufacture the outcome through planning and execution governed by the board. It is a priority of every Board to manufacture the exit outcome by positioning the company to be strategically valuable for the right reasons, to the right buyers, at the right time, at the right valuation.

## **Mistake #7: Misaligned Board Membership to Situational Requirements**

Too often the Board of Directors lacks an appropriate mix of strategic, product, domain and operational experience. An effective Board must illustrate the experiences and professional ability to understand the business, create a platform based on a sound business model, evaluate and hire suitable executive management, ensure that effective execution occurs and provide the company with prudent resources to implement its’ objectives.

The worst misalignment of member skills to board requirements, occurs when too much reliance is placed on members with finance backgrounds. While finance experience is a critical expertise for any board; boards that are heavy in financial expertise are often deficient in operational expertise, specific customer or industry knowledge or some other critical requirement.





Because the Board of Directors is ultimately responsible the success or failure of the company, it is important that members have a mix of backgrounds and skills. Boards that do not have a well balanced mix of expertise, miss the depth of insight and leadership that such wide-ranging experience can bring. We at the Epor Group strongly suggest “some grey-haired” experience on every board. Experience consistently outperforms intelligence!

## **Mistake #8: Lack of Company Leadership by the Board Members**

In some companies, the Board of Directors' role in developing strategy or evaluating company management is insignificant. When this happens, it is often because the Board members do not have the operating experience, industry knowledge or the leadership characteristics required to play a strong role in the leadership and direction of the business.

Traditionally, leadership planning and development at the company level is left up to the CEO and Human Resource department. There is however little leadership planning and development for board members who must acclimate to these responsibilities without the same level of attention, guidance and development given to operating constituencies.

It has been proven repeatedly that effective and appropriate governance leads to higher valuations<sup>1</sup>. Evaluating management, driving corporate culture and setting strategic direction are all board responsibilities and are critical to maximizing shareholder wealth. Therefore Board membership is a responsibility that goes beyond the bounds set by listening to management presentations and routinely getting thru board meeting agendas. Effective Board Directors are all about Leadership and Stewardship!

Additionally, effective Directors mitigate risks. Supervising

**“Effective Boards work differently; they rely on defined measurements and milestones, constantly re-challenge industry and company assumptions, and take action and initiatives that drive increased value.”**

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<sup>1</sup> In a paper prepared for the Forum by ATKearney by Rand Garbacz reported that a strong and positive link between quality governance and company performance and shareholder value. Specifically, he noted that firms that had very high GMI (Governance Metrics International) scores tended also to show very high total shareholder returns. These included firms such as Coventry Health, Sunoco, ITT, 3-M and Harley Davidson. On the other hand, companies that demonstrated very low GMI scores also tended to show quite low total shareholder returns. These corporations included such firms as Lucent, Qwest, Xerox and Williams. Mr. Garbacz also noted that “culture impacts the interests of all other stakeholders, and thus derivatively has a direct, measurable impact on shareholder wealth” and “Corporate culture starts with the board and identified a number of board issues that significantly influence corporate culture.”





enterprise risk management (ERM) includes:

- monitoring the impact of the significant changes that the Obama administration has had on American businesses,
- preparing for increasing litigation and governance requirements,
- implementing variable compensation or taking corrective action on misaligned pay practices,
- mitigating reputational risks, while increasing brand equities, and
- continuously assessing both upside and downside risks.

## Mistake #9: Self-Focus Blinders

Boards are often composed of Investment Professionals with their own individual investment timelines, equity requirements and constraints. This dual role as an investor responsible to fund participants and board member responsible for company' equity value is at times in conflict. This is most frequently evident in second, third and later stage growth financings where institutional investor/board members "wire in" put rights and other equity protections that can be severely burdensome to the company, particularly at a later stage if additional capital is needed. While these protections are often rewarded at the fund level as prudent, from a company, management and board perspective they can often be disastrous if they create circumstances where additional capital is blocked by liquidation rights or other provisions that make new investment unattractive.

From the company perspective, board members (who represent institutional funds) often cannot objectively separate their fund responsibilities from their board responsibilities, bring an unproductive bias to their board level decision-making, and potentially may naively suppress opportunity and value.

## Mistake #10: Lack of a Governness Process & "Outsider" Perspectives

Most private companies lack independent or true "outside directors." We at the Epor Group strongly suggest that in most situations, the Board hire an effective Chairman who is empowered, experienced, has a proven governance process that creates accountability in Board members, and the knowledge and experiences to govern the company. We also strongly





recommend “outsiders”, or independents, as directors who can prevail with unbiased perspectives, create new insights and facilitate among multiple constituencies.

Independent board members are harder for operating executives to “manage upwards” and are quicker to recognize management deficiencies and strategic misdirection precisely because they lack preconceived notions of how the business should operate, and know when to seek required outside help. Experience, and unbiased perspectives, married with a solid governance process always improves the probability of success!

## Conclusion

The Board of Directors role is drastically changing and becoming more demanding as our country and its economic infrastructure is altered. All directors and shareholders must make the changes necessary to insure that their organizations prosper in these challenging times.

Moving beyond traditional governance activities is “uncertain ground” for many boards and board members. By understanding the common mistakes made by boards and their directors, it is possible to identify them, correct them, or avoid them altogether; thus creating a proactive response and set of positive actions to these ever prevalent demands.

*Did you enjoy this article? Drop us a line and let us know your thoughts on solving the value equation at [ephor@ephorgroup.com](mailto:ephor@ephorgroup.com).*

## About Ephor Group

Our methodology is proven, pragmatic, and performance oriented. This methodology; the Perform Business Process™ fills in the gaps where functional and domain expertise are constraining the business. Ephor Group has a deep track record for creating and enhancing equity valuation for founders and shareholders.





## About the Founder: Garry Meier

Garry Meier founded the Ephor Group to apply the performance improvement methodologies and shareholder value enhancement processes he and his associates developed over his thirty-four year career.



Mr. Meier is highly recognized as a business services thought leader. He is a noted speaker on strategic effectiveness, value creation, industry trends, capital appreciation, performance improvement, outsourcing, and customer satisfaction. Recently he advised the US Senate, Business Council, on the “economic stimulus legislation” on the many issues affecting small businesses.

Additionally, Garry is an advisor to private equity and venture firms on their investment strategies, portfolio companies, marketplace trends and industry forecasting.

Currently he focuses on providing board, institutional investment, and C-level guidance to maximize strategic, marketing and operational effectiveness.

### Garry Meier Background

Thirty-four plus years of strategic management, P&L management, investment banking, institutional investing, and operating company experience with broad depth of knowledge, and expertise in technology & service companies including:

#### Operational & Executive Assignments

- Achilles Group, Interim CEO
- SmartTime Inc., CEO
- Outsource International Inc, CEO
- Medaphis Physician Services, COO
- Global Integrity Outsourcing, President/CEO
- Automated Information, President/CEO
- FFMC, EVP Corporate Development
- Edward Jones & Company, Partner
- IBM Corporate Development Associate

#### Board of Director & Advisory Assignments

- Achilles Group, Chairman
- Certus Corporation, Director
- CentriconHRA, Chairman/Director
- Latin American Card Services, Chairman
- Global Integrity Outsourcing, Director
- Outsource International, Chairman
- Personalogy, Chairman
- Workplace Solutions, Chairman
- TalentTree, Chairman
- SmartTime Inc., Chairman
- The Capstreet Group, Advisor
- Economic Development Authority Board, State of Missouri, Director
- Baird Capital Partners, Advisory Board

