

COVER STORY

Helping Hands

By Lynn Wasnak

It's less lonely at the top if you have a good board of directors—and it's even better for the boss if those directors are outsiders looking in.

Perhaps you are, or would like to be, chief executive officer of your own closely held corporation. You bought it, you built it, or maybe you inherited it. Regardless, you're in charge, the "master of all you survey."

But to help keep things running—and growing—a number of private-company leaders have created either legally constituted boards of directors or more informal "advisory boards" with outside members. They say that boards help them grapple with big issues such as long-term strategy, launching new product lines, finding financing, and big decisions, such as whether to acquire a particular company, or dispense with the services of a listless nephew. Boards also come to grips with the most avoided subject of all: "Who will lead this company when I die?"

Dale C. Eisenman, president of Zee Medical Service Inc. and Medcor Inc., Columbus, says he had never planned to run a business at all. He was a Cleveland attorney when he acquired the license to run Zee Medical, a first-aid supply replenishment business, in central and southern Ohio. "It was going to be a private investment. But I learned that if you aren't actively involved in your new business it won't do very well. And it didn't for the first four years," he says.

To turn it around, Eisenman moved to Columbus. His banker was the first to suggest a board of advisors. "I didn't pursue the idea at first, because I didn't want someone telling me how to run my business," he says candidly. He liked decision-making. But as the company grew and faced more challenges, he realized he needed third-party advice. "My board was formed with the primary purpose of assisting me in strategic planning. Others use them for operations, but I wanted my board to help me decide 'Where do we go from here?'"

Eisenman's board consists of Donald Freytag, former president of Beverage Management Inc., Columbus, and now president of Freytag Investment and Management Co.; Richard Burrell, chief financial officer at R.G. Berry Corp., Columbus; and Thomas Gerlacher, former vice president of budget and planning for Chemlawn Services Corp., and now president of CFO Resource Network Inc., Columbus. Freytag brings marketing expertise, while Burrell and Gerlacher offer financial and service-business experience.

He credits the board for giving him focus and clarifying his priorities. He knew the growth of Zee Medical would eventually be slowed due to geographic licensing limitations. The board helped him develop the concept of Medcor Inc., to supply wellness programs and provide medical supplies for employers that do their own replenishment. "The board has been of great assistance in giving me direction, and market-testing advice, and explaining what to do with the information once we get it," says Eisenman.

"All of our directors are outsiders," says William Crotty, president of VanDyne-Crotty Inc., Dayton. "I'm the only corporate officer who sits on the board. Our financial officer reports to the board and sits in on deliberations. But when the votes are cast, it's strictly the outside directors who are involved."

Although his uniform sales and service business is family-owned, "We didn't want aunts and uncles on the board," says Crotty. "Years ago we determined that to avoid the usual pitfalls of a family-held firm, a vital ingredient was to manage VanDyne-Crotty as though we had 10,000 shareholders out there to be satisfied. Since we don't have the shareholders, we wanted to have their "representatives", or the outside directors, on our board, to make sure that the president-myself-feels the heat of pragmatic questioning that pulls the best thinking out of me. Outside directors make sure that Bill Crotty doesn't get carried away with his ego or emotions."

But a recent study of *Inc. Magazine* 500 firms conducted by Dr. Roger H. Ford, director of James Madison University's Center for Entrepreneurship in Harrisburg, Virginia, appears to show that outsiders may not be as useful as claimed by business consultants, seminars, and renowned universities, including Harvard.

Ford says that the belief that outside board members benefit private companies has not been properly tested.

His study showed that boards composed of inside members were more influential on the surveyed businesses than mixed boards, or those composed of all outside directors.

"In general, my findings cast serious doubt on the value and contributions of outside directors. For the majority of board functions examined, it appears that outsiders and outside boards may actually be more of a burden than a contributing asset," Ford maintains.

The biggest complaints of the CEOs Ford surveyed were that outside board members lacked adequate knowledge of their firm and its environment and were not readily available for meetings. They especially cited a "30-day notification" for board meetings, saying that outsiders could not respond quickly in a crisis.

In contrast, insiders, with day-to-day company involvement, were automatically informed on business activities, and were always available.

"I don't want to be depicted as a 'board basher,'" says Ford. "But my concern is, what are the odds of making an outside board work? I believe the study's findings prove the odds are very small. Outside boards are not the panacea they've been purported to be. The CEOs of these more dynamic, fast-growing companies will get more bang for their buck by spending their time, energy, and money concentrating on internal management, rather than boards."

However, Leon Danco, president of the Center for Family Business, Cleveland, took exception to Ford's sample, claiming the *Inc. Magazine* 500 group, which is selected on the basis of rapid growth, is hardly typical of privately held businesses. "For the most part, [the *Inc. 500*] are very small, and are very young. And they are not long-lasting. In my opinion, the view of the *Inc. 500* [members] is not a valid index of anything other than that particular group."

Crotty says that Ford's scenario is probably correct if the owner-CEO does not acknowledge the proper authority of the board, listen very carefully, and enter into serious discourse when there's a difference of opinion as to the direction of the company. "But I think that's a fatal error I've seen too many people in my situation make, to the detriment of their companies," says Crotty. "Normally, privately held companies are being managed by two or three people. If anything happens to them, where's the line of succession? Where's the continuity? I'm at the point now where I take [the board] so much for granted that I can't imagine any privately held company of any size, that has any ambition and desire for continuity, not having such a board."

And Freytag scoffs at the "30-day notice" rule. "If someone needs advice, I don't wait 30 days to give it. That's an artificial restriction. There are ways around it. Use the telephone. Buy a lunch."

Regardless of which opinion you side with, it seems clear that not every private company benefits from a board with outsiders. Danco says the company already must be successful and have a relatively stable and competent management structure. And directors are only effective if the owner wants to accept and act on the board's suggestions and advice. "Boards should not be created to perform crisis surgery on premature ventures," he cautions.

"As CEO you've got to be able to back away from the business and have an objective view. If you're working 16 hours a day trying to keep the alligators at bay, you're just

not going to have time to use the board," says Freytag. He believes a person in that situation is better off hiring a consultant for periodic meetings without a formal structure, until the business has matured enough to utilize a board.

There's also no reason to get involved with a board if the company is not growth-oriented. "It's only when CEOs have plans to grow, expand, and do the job better that they're going to want to have other people challenging them, and trying to help by pointing them in profitable directions," Freytag adds.

"Bury your ego!" advises Clay Mathile, president of The Iams Co., Dayton pet food manufacturer. "I need help" is the hardest thing for a CEO/ entrepreneur to say," he claims, and those who can't say it should probably forget about a board.

"If I had the opinion that I own the thing and I'll run it the way I want to, then an outside board of directors is obviously a waste of time," adds Leo Hawk, president of Superior Metal Products Inc., a Lima-based manufacturer of decorative hardware for the appliance and office furniture markets.

"It's a question of whether a person really wants critiquing. Most CEOs of tightly controlled businesses don't want that pressure of being critiqued by somebody they don't know. Obviously, if a person is an egomaniac, he doesn't need a board of directors. He thinks he's got all the answers."

SELECT CAREFULLY

Each CEO must think long and hard about what his or her company needs from board members. Says Mathile, "I wanted my directors to be risk-taking peers, with a high degree of honesty and integrity." He also wanted directors to possess functional strengths consistent with the company's key business strategies. In Iams's case, that meant extra marketing and human-resource strength. He also wanted directors he could like personally—those who had compassion and treated their own subordinates with respect.

"A director should not be afraid of seven-digit decisions," he adds. And due to the nature of its business, Iams has a rather unique criteria for its potential directors: they must own a dog or a cat.

"Board members should be directors of the whole," says Danco, "not directors representative of a sister or a brother. That's like getting my gladiator to take on your gladiator," he says.

Those with even a trace of self-interest should be excluded, Danco adds—no accountants, attorneys, consultants, salesmen, or employees."

VanDyne-Crotty's board members are chosen for their specialized strengths and integrity. The oldest member, Robert Fahrendorf, has been on the board for 34 years. He offers expertise in commercial/industrial real estate. John Torley was formerly CEO of Amcast Industrial Corp., Dayton, and has an engineering background. Dudley Kircher is currently vice president of community relations for Mead Corp. Vic Cassano is an entrepreneur who developed and eventually sold a successful chain of pizza restaurants. And Ben Scott, the newest member, owns several McDonald franchises. Scott is also in his late 30s, to help balance the board's age range. Crotty's board members all live in the Dayton area.

Taking a different tack is Bill Ivers, president of Software Clearing House Inc., Cincinnati, which telemarkets mainframe software worldwide. He created an advisory board with members of the class he took at Harvard for company owners and presidents. His board members fly in for quarterly meetings from North Carolina, Oklahoma City, and Minneapolis. "The things I find most valuable about my board are that the [members] come up with ideas I wouldn't have thought of, and they look out for me. There is no one else I deal with who really looks out for me."

Freytag recommends a board of three to five members for a small company, and seven to nine for a large company.

Interlocking directorships, where CEOs serve on each others' boards, reduce the opportunity for a fresh viewpoint. "Also make sure you don't have people who don't have the time or commitment," says Freytag. "Everybody wants to have a big-deal CEO on the board, but big-deal CEOs have their own fires to fight."

Just what is this board, with outside members, going to do for the business owner that he or she can't do alone?

Mathile says that the value of a board depends on how a CEO uses it. "Too many discuss operating problems in board meetings. That's a mistake. The board should work with strategic issues. The advisory function does not replace competent operating management."

In addition to assisting with strategic plans and supplying professional contacts, Crotty says his board is a very effective buffer in matters of compensation. "Any increases, adjustments, or bonuses for officers and top management have to clear the compensation committee.

Board approval removes me from the direct line of fire," he explains.

Carter Wilmot, president of Prince and Izant Co., Cleveland metals manufacturer/distributor, says: "Using advisory boards has turned my life around for the better. We're a small company, \$7 million in sales, 25 people. After attending a seminar in 1983, I vowed I'd do this thing. I'd thought about it for years, but was scared."

Wilmot says the outsiders on his board, by means of "prodding and gentle-sledgehammer tactics," gave him much-needed lessons in professionalism. "I'd never had any formal structure within the business. We had no budgeting, we had no business plan. I felt pretty stupid," he says. "But they kept reminding me not to feel stupid, because we had a very successful track record as a profitable small company, with continual growth.

"It took myself and my staff a couple years to realize that there is some value to long-range planning, to laying out an annual goal-setting procedure, and working to a financial budget," he says.

Previously, his staff just took orders and made calls, but now they study marketing and distribution of their products. "Through total honesty, and the board's direct feedback to us, we have reached a point where we better understand the business we're in. We're much better prepared to deal with unexpected changes," he says.

It's debatable whether a legally constituted board of directors is more or less desirable than an informal advisory board for privately held companies.

Those in favor of legal boards cite the higher degree of professionalism and discipline that accompany the formal structure. CEOs may take these boards more seriously. As Leon Danco, a strong advocate of legal boards, states: "Advisory directors end up as water-cooler conversationalists. Unless there's a special structural reason that prohibits the creation of a viable outside board, to me it shows a lack of real commitment [on the part of the owner] for an outside board to whom he will be responsible."

Superior Metal's Hawk says, "We set up a legal board of directors five years ago, constituted, paid, insured-the whole nine yards."

He chose three outside directors: William McCarthy, president and CEO of ABS Corp., Ashtabula; Tom Fairhurst, vice president of corporate affairs for Dana Corp., Toledo; and Larry Pomeroy, then an executive vice president for B.F. Goodrich Co., Akron, who now is retired. The trio represent both shareholders: Leo and his brother Henry J., who serves as chairman.

"It's been a...splendid experience," Hawk says, "although at times, it's taxing. It's a professional way of running things. We prepare well for board meetings. They question us in depth on subject matter. We look forward each time to giving the update, showing the plan, reviewing the shortcomings and the problems."

Prince and Izant's Wilmot says that though he started with a legal board of directors, he switched to the advisory board format when directors and officers' liability insurance premiums rose dramatically. His board members have not changed their attitude toward involvement. "We just eliminated the sticky liability issue," Wilmot says.

Liability issues are a real problem for some boards, agrees Frank Mayfield, managing director of Marsh & McLennan Inc., Cincinnati. "Insurance premiums for private company directors vary widely," he says. The fee is based on company size and risk of industry, as well as the value of coverage. A company with less than \$1 million in sales may pay \$5,000 annually for \$1 million in coverage. But a very large private company could pay an annual premium exceeding \$1 million for \$15 million coverage.

Leveraged buy-outs are not easily covered, due to debt load. Companies less than three years old rarely qualify, even if they have sufficient financing, because they don't yet have a solid reputation.

Some experts think closely-held corporations may be safe without buying directors' liability insurance for their legal boards, because there are few stockholders to file lawsuits. But that fact doesn't eliminate product liability or other claims. The lack of coverage may scare off highly qualified board members.

The informal advisory board format appears to protect members from liability problems, but experts suggest consulting an attorney before making the insurance decision.

How much should companies pay their directors or advisors? Says Danco, "It should be big enough that the business owner pays attention, because he wants to get his money's worth. And it should not be so large as to bribe. But it should be significant. What you pay your best secretary-say \$20,000-split three ways. That's a reasonable number," he states.

Lynda Walker, compensation consultant at Hewitt Associates, Lincolnshire, Illinois, says in manufacturing companies with sales under \$100 million, Hewitt found that the median annual retainer was \$6,000, with median board meeting fees of \$800, and committee meeting fees of \$750. In contrast, the average annual retainer of a *Fortune 100* company is \$22,878, with average board meeting fees of \$968 and committee meeting fees of \$840.

"You can't get rich belonging to boards. The real reward, to me, is helping the business become successful," says Freytag.

Board meetings should be scheduled at regular intervals, usually quarterly, and planned well in advance, experts say. An agenda should be prepared early and distributed so board members have time to review the documents before the meeting day.

"Sessions should not be a course in speed-reading irrelevant material," says Danco. "I've seen boards where they spend three hours reading the financial statement. That's show-and-tell. The board, in my opinion, is there to exact commitments from management on a course of action, and to measure progress along these commitments. It's not to sit there and play bookkeeper. It's not a gossip session. It's strategic planning for the future, with particular emphasis on the development of management and the development of market strategies to assure market position. The board is there to assure the successful continuity of the company."

Industry and company newsletters, and regular mailings of income statements and balance sheets, are just a few ways to educate the board.

What risk is there to add outsiders to your board?

"I've put together probably 500 boards with outsiders," says Danco. "There is *no* downside risk to it, if it's accepted philosophically by the owner or owner-group that will be judged. In my opinion, no business will long survive if it does not open itself up to the awesome changes occurring in our world," he says.