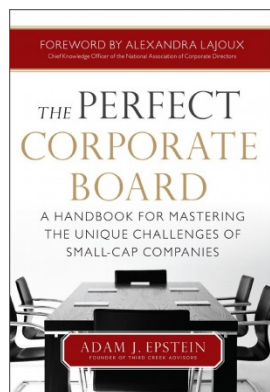


March 15, 2013 by [Brett Goetschius](#)

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Addressing the Unique Challenges of Small Cap Corporate Governance



Over the course of the decade I have spent writing about the financing of emerging growth companies I have been contacted regularly by mainstream financial news reporters working on stories involving this or that small cap management team that they suspect has engaged in accounting fraud, stock manipulation, self-dealing, or worse. Inevitably, they are looking for some confirmation of their suspicions and validation of their sense that the activities they are investigating are beyond the pale of acceptable behavior for the senior management of small public companies.

I try to be helpful, to place the situations they present in context, but often I disappoint them. “Look,” I find myself saying, “finding a small or microcap company with accounting irregularities, conflicted directors, promotional senior management, or unscrupulous investors is like shooting fish in a barrel. It’s a dog-bites-man story,” I tell them, meaning there is little that’s newsworthy in one more tale of a young public company practicing poor corporate governance, even if they’ve broken a few securities laws in the process.

“If you want to really break some news,” I tell them, “go find the small company that has resisted the temptation to cook the books, stack the board with cronies, use the treasury to feather management’s nests, or take the money from the investor who promises to bring some action to the company’s stock. One that has artfully executed on its business plan, grown and sustained the value of its shareholder equity, earned the praise of analysts and the admiration of institutional investors. Now that would be a story.”

I tell these mostly young reporters, who no doubt have never shot anything, especially fish, or covered a local news beat where they might be presented with a dog-bites-man incident to consider writing up for the police blotter, that small cap management incompetence, malfeasance, and chicanery is so common as to be unremarkable. I tell them this not to excuse or dismiss the behavior, but because I’ve come to believe that the small- and microcap ecosystem in which these companies must dwell is so bereft of support for good governance practices, shareholder-aligned capital formation, and disciplined management that underperformance is the norm, and failure, in terms of sustained growth of shareholder equity, is to be expected.

So it was with some trepidation that I picked up “The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies” by Adam Epstein, published in December by McGraw Hill. Treatises on good corporate governance, I have come to understand, are generally the province of business school professors and Fortune 500 directors who like to write off their golf retreats by mixing in a seminar or two with their tee times. Lots of high-minded ideas offered with the presumption that management teams have the time, money and professional support available to implement them, and the assumption that good governance practices are one-size-fits-all prescriptions for righteous corporate growth. All of it dispensed with the alacrity of a doctor recommending a high-fiber diet.

Mr. Epstein immediately dispels these notions, noting in the introduction, “The national corporate governance dialogue has been fixated on issues faced by large public companies.... notwithstanding the fact that small companies are routinely stymied by unique governance issues for which there is no objective, practical guidance.” Epstein then proceeds, in a crisply written 266 pages, to offer just that.

Epstein suggests that small cap companies are, “in a sense, immune-suppressed versions of their larger counterparts.... Small-cap directors frequently operate in environments in which alternatives and flexibility [presumed at large-cap companies] are replaced by a cognizance that even the most innocuous decision making can have business-ending consequences.”

“The Perfect Corporate Board” argues eloquently that good governance is not merely an ideal for an emerging growth company to strive for as it develops and matures, it is a prerequisite for survival. Epstein, a former hedge fund manager that advises small company boards, writes with the authority of an experienced investor in scores of microcap and small-cap companies, who has seen what can happen to companies with talented leadership and promising products, but which lack the kind of support from their boards that is uniquely needed by them.

Written specifically for emerging growth company officers and directors, “The Perfect Corporate Board” addresses three broad areas of corporate activities where best governance practices impact small company growth most disproportionately: corporate finance, capital markets, and the selection and reliance on service providers. In plain language, Epstein breaks down the pitfalls that await inexperienced management and boards as they

acquire and deploy capital, and nurture shareholder value. The book focuses on the activities all CEOs and CFOs must navigate whether they make software or soft drinks, and that by their nature are ill-prepared for due to the enormous experience deficit they typically bring to the table:

“When it comes to negotiating small-cap financings, it is not a level playing field for many companies – not even close. While most companies have experience transacting a handful of financings, there are institutional investors (and their hyper-specialized attorneys) who have undertaken hundreds.”

Epstein, drawing on his background as just such an institutional investor, goes on the lay out explicit advice for directors and officers considering a financing, from preparing the company to enter the capital markets, to the proper comportment of executives during investor presentations, to how to vet finance offers with varying structures and terms, and what to be vigilant about post-financing to insure that often complex compliance requirements are met and harsh penalties avoided.

Each chapter is peppered with juicy tips for negotiating with investors, communicating with shareholders, responding to critics and short-sellers, and navigating the gauntlet of investment bankers, investor relations firms, legal advisors and news media that hover around high-growth companies like groupies at a rock concert, looking for their piece of the action.

The book’s straightforward organization, which thoughtfully relegates practice tips to sidebars and comments to footnotes, keeps the pace moving, and the wisdom offered often has the whiff of secrets revealed between the investor and the invested. In one example, company managers are cautioned from offering up that tidbit of forward-looking information during an investor presentation that is not quite public but suggests a significant value-creation event in the offing: the event and its expected impact may get baked into the finance terms as the new hurdle to meet to avoid triggering penalties and defaults.

This insider’s perspective on the mind and motivations of the typical institutional investor in emerging growth companies is the true strength behind “The Perfect Corporate Board.” It is also perhaps it’s one weakness, in that investor behavior, including that of the bad, value-destroying and predatory kind all too prevalent in emerging growth company finance, is accepted at face value or given short-shrift. Any microcap company board that has watched its share price plummet while the percentage of its float in fail-to-delivers soared after it closed a no-short convertible PIPE would beg to differ with the book’s presumption that illegal and unethical behavior by investors is a nominal threat.

But this is a small omission in an otherwise thoughtful and badly needed guide for emerging growth company directors and officers seeking to successfully navigate their company through the capital markets. “The Perfect Corporate Board” is a welcome addition to the knowledge base of small cap company directors and officers seeking to improve the odds of success in building and sustaining shareholder value.



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