More blue collar than blue chip

Building a small-cap board? It takes a different mindset and different skill sets than what big-cap companies face. Here, several experts explain how the challenges compare

By Ken Mark

While most corporate governance duties appear to be etched in stone, company size matters because small-cap and large-cap boards diverge on how they carry out such tasks as representing shareholders' interests, identifying and managing risk, setting executive pay, ensuring financial statements, and affirming legal and regulatory compliance.

Essentially, the two play in different leagues. "As for board composition, resource constraints and austere enterprise risk conspire to mandate simplicity [for small-cap boards]," says Adam Epstein, a governance consultant and author who spoke to *Listed* shortly before he was to appear as a feature speaker on small-cap governance at the National Association of Corporate Directors' annual Small-Cap Forum. Epstein's 2012 book, *The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies*, gets a lot of love at such events.

"Small-cap companies often can't afford the time or expense of large boards, so they tend to have boards with seven or fewer directors," says Epstein, who is based in Danville, Calif. "More important, thriving is a luxury not in evidence for many small-cap companies, so board members are focused more on surviving—revenue growth, innovation and material risks. Finally, there is a premium on prospective directors who can begin contributing early and often."

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So, when it comes to board building, small-cap firms (and large caps, too, for that matter) need to choose directors best suited to meeting their specific needs. "Since small-cap CEOs may be founders playing a significant management role and be significant shareholders, they are after candidates who can play a large mentoring role, help develop the company's overall strategy and bring in others who can offer assistance," says Liz Watson, Vancouver-based founder and president of Watson Advisors Inc.

Ideal candidates are experienced business veterans who have "seen it all before," enabling them to spot red flags early and propose proper solutions, especially financial issues such as raising capital and dealing with lenders and investors. Says Tim Jackson, senior adviser, capital solutions at The MaRS Centre for Impact Investing in Toronto. "For small firms cash flow is crucial. And that includes monitoring sales revenue over which they have more control. But that's often overlooked."

As well, Epstein states that most small-cap companies can't afford to pay generous stipends, so they must search for directors who are passionate about the business rather than about the stipend. According to Jackson, many suitable small-cap board candidates are willing to serve as a way of giving back to the communities or business sectors in which they grew up. Others are attracted because of the dynamic, entrepreneurial needs of a small-cap companies compared with the more compliance-focused concerns of larger firms.

And yet, Watson contends that despite the glamour, glory and higher remuneration, would-be large-cap directors face their own challenges. These include learning more about the corporate culture, executives, and operations, especially for huge, diverse multinationals. This requires setting up a suitable approach and timetable for getting up to speed quickly so they can perform their duties properly.

In terms of board functions, enterprise risk management has quickly moved up the priority list. In Epstein's view, small-cap board members must each "own" risk assessment and mitigation since the firm cannot afford to hire outside consultants.

However, large-cap firms have the means to put together a "dream team" of financial, accounting, compliance, legal and other experts. Still, he cautions such firms to focus more on skill sets rather than reputations to ensure that board members can keep a closer eye on risk management rather than simply outsourcing the task. "Just think, if Lehman Brothers had put a derivatives trader on their board, and then listened to what that person had to say," says Epstein.

The importance of the board chair is perhaps the one area where large- and small-cap boards want the same thing. The role demands more than a titular leader. When explaining the difference between Canadian and U.S. boards, Liz Watson concludes that generally, in Canada, the atmosphere around the table is too collegial, weakening boards' potential contributions to their companies. She proposes that board chairs introduce new approaches to maximize the board's value. One way to liven up proceedings would be to stimulate greater debate and discussion regarding relevant but controversial issues. Here the board chair needs to ensure that this becomes a forum for constructive debate in which members enjoy the freedom to disagree with one another.

Another emerging trend for small-cap firms is board member succession planning. On the large-cap front it is already happening, with various Canadian banks imposing term limits, for example. For small caps, it becomes an "age-and-stage" concern. After a firm has enjoyed substantial prosperity and growth, it may need "fresh blood and fresh thinking," which today might loosely translate into new board members with wider board experience including compliance and regulatory matters to deal with bureaucrats as well as more sophisticated lenders and shareholder groups.

Such a talent pool exists. Says Liz Watson: "I have received calls from large-cap board members asking me to suggest a smaller-firm board they could serve on. They want to make a more hands-on contribution to help build a company rather than deal with the compliance and bureaucratic focus of a large-cap board."

For them, it's the challenge—not company size—that matters.