



CLARKSON
Centre for Board Effectiveness

Clarkson Centre SME Toolkit #1: Optimizing Board Skills and Meeting Effectiveness

By Matt Fullbrook

In 2006, the Clarkson Centre for Board Effectiveness (CCBE) began a multi-year study of corporate governance in Canadian Small- and Medium-Sized Enterprises (SMEs). This initiative included nearly 100 interviews with SME board members and extensive data collection from public filings of publicly-traded Canadian SMEs. The outputs from our efforts include four years of comprehensive governance ratings for Canadian public SMEs, contributions to the development of the structure and content of the SME Board Effectiveness Program offered by the Rotman School of Management, and a series of practical toolkits for SME boards, of which *Optimizing Board Skills and Meeting Effectiveness* is the first.

From our interviews, the most common recommendation long-standing SME board members and executives have for their peers is to *start behaving like a large company as soon as possible*. In other words, SME boards benefit from implementing formal processes and structures early in their life cycles. Throughout our SME Toolkit Series, we will provide guidance to SME boards on topics that are important to directors, managers and investors, and also recommend resources that we believe will help boards design, implement and execute formal processes in key governance areas. We also offer descriptions of valuable governance structures that are common among larger companies, and explain why and how SME boards might consider applying them in their own organizations.

Optimizing Board Skills and Meeting Effectiveness focuses on common characteristics of SME boards and the challenges they face. This report includes insights as to how SME boards commonly evolve, and suggests processes, structures and tools that can help ensure ongoing effectiveness through periods of concentrated change.

CCBE recognizes the generous support of the Ontario Ministry of Training, Colleges and Universities throughout this research initiative.



Rotman
a new way to think

Optimizing SME Board Skills and Meeting Effectiveness

How Are SME Boards Different?

Throughout a business' life cycle, the responsibilities of the board shift to compensate for changes in strategy, leadership and regulations. As SMEs focus on achieving sustainable growth and settling into a long-term strategy, the ideal board is often one comprising a very high level of specialized industry expertise. This assessment is supported by The *Clarkson Centre - PricewaterhouseCoopers Director Survey in Partnership with the Institute of Corporate Directors* (CCBE, 2009), which showed that 74% of private SMEs and 69% of public SMEs prioritize industry expertise on the board compared to a 54% average for all other boards. Deep industry knowledge allows SME boards to provide close hands-on guidance on an ongoing basis through periods of high risk and rapid growth. In contrast, boards of most large organizations prize specialized professional expertise (legal, finance, etc.) and executive experience. As organizations mature, the role of the board becomes less hands-on and their focus shifts to higher level strategic guidance. Our interviews suggested that boards comprising strong industry expertise provide the added benefit to SMEs of requiring managers to make more compelling arguments for strategic decisions, as the board is often nearly as expert as managers.

Boards of growing organizations face evolving expectations and often require access to new skills. Further, if an organization is publicly traded in Canada, its board must comprise a majority of independent board members. As a result, SME boards must be prepared for ongoing renewal.

Key Challenges

Access to board candidates with varied backgrounds and expertise can be elusive for many SMEs. Our interviews suggested that SME directorships are often seen as 'high-risk, low-reward', and as such can be unappealing compared to appointments on the boards of larger organizations or not-for-profits. Additionally, SME managers often have social networks that are limited to a specific industry and/or geography, and absent assistance from outside advisors can struggle to build diverse and independent-minded boards. Making matters worse, the abundance of industry expertise that is so helpful to emerging organizations can quickly become a burden as the board's role becomes more sophisticated and the need for complementary, rather than redundant, skills increases.

Shareholder and/or lender influence on the board can also have a significant effect on composition. In many cases, investors open the door to a broader diversity of potential director candidates. Our interview participants suggested that, while sometimes difficult to achieve, actively seeking a balance of investor, board, and management insights in the boardroom can

yield highly effective results. Clarysse, et al. (2007) found that board composition in start-ups is heavily influenced by the type of external shareholder (venture capital, academic, or other), and further that boards gain access to human capital as well as social capital through investors, providing them with access to a greater diversity of candidates. However, our interview participants cautioned that an imbalance of investor influence on the board can create a highly challenging decision-making environment.

Finally, since SME director candidates are most frequently identified through social networks (via managers, investors and board members), it can be very difficult to identify truly independent candidates. While director independence is mandatory for publicly-traded organizations, our interview participants indicated that the benefit of independent guidance is equally valuable for private firms. In addition, Brunninge, et al. (2007) argue that expanding the diversity of points of view by increasing board independence can greatly enhance strategic decision-making in SMEs, regardless of ownership structure. Many SMEs, however, face reluctance from owners and managers, as well as a lack of options, when seeking truly independent board members.

How Large Organizations Do It

Most large-cap boards are strongly focused on strategic guidance and independent oversight. As a result, compared to SME boards, larger firms have less need for industry expertise at the board level. Instead, they prize practical professional backgrounds and executive experience.¹ Moreover, CCBE (2009) found that SME directors feel they would benefit from greater strategic focus at board meetings (see Figures 1 and 2 below). If achieved, this shift would align the focus of SME boards more closely with larger firms.

Additionally, large private and large public corporations place a much lower value on directors' social networks than other firms. Only 5% and 6% of large private and public firms respectively indicated that directors' networks were an important factor in board member selection, compared to 28% of all other firms. As firms grow, so do their connections to potential board members, thus reducing the reliance on directors themselves to identify new candidates from their own networks. This shift also helps to increase director independence as access to outside candidates increases.

¹ CCBE (2009) found that 81% of large public firms and 72% of large private firms prioritized executive experience on their boards, compared to 53% of all other boards.

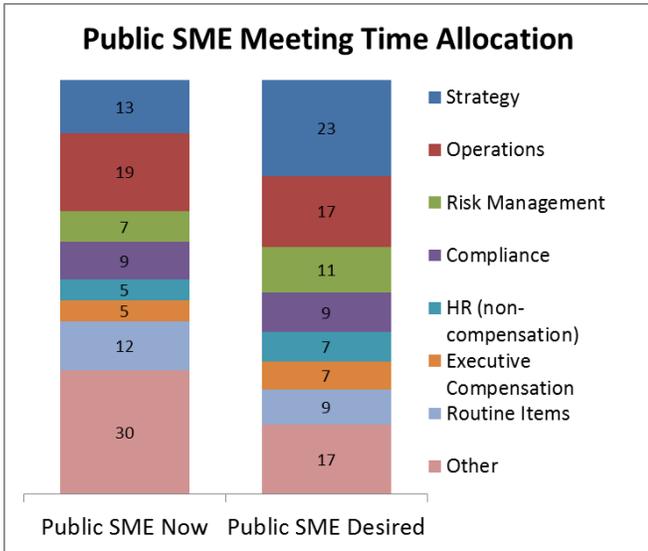


Figure 1 – Source: [2009 CCBE/PwC survey](#)

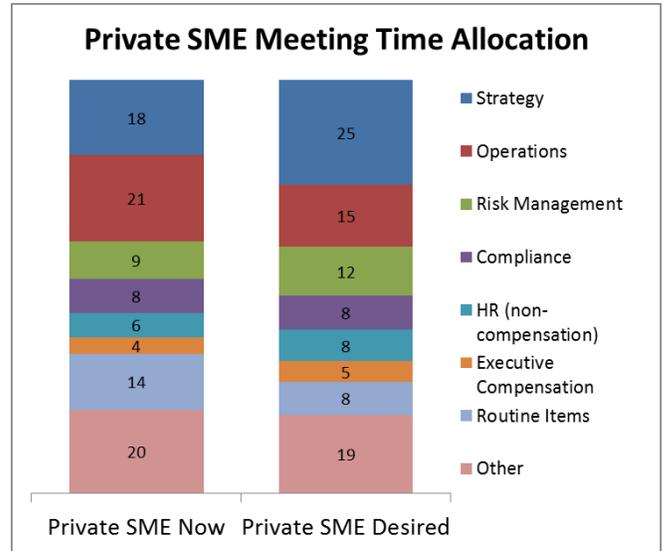


Figure 2 – Source: [2009 CCBE/PwC survey](#)

Our interview participants indicated that SMEs can greatly benefit from increasing board independence as early as possible in their growth process in order to optimize decision-making effectiveness and oversight, as well as to be well-prepared for potential public listing and increased strategic sophistication. CCBE’s first SME board ratings² in 2006 found that less than half of Canadian public SME boards had a best-practice level of director independence (two thirds or more independent directors). In contrast, 71% of larger firms – those listed on the S&P/TSX Composite Index – had best practice director independence. The negative side of this trend tells a similar story: 12% of SME boards comprise *fewer* than 50% independent directors, compared to 3% of large firms. By 2010, the landscape had not changed dramatically, as only 55% of the SMEs we scored had highly independent boards.

In order to ensure ongoing optimization of board composition, boards of large firms use various formal processes. Large firms are much more likely than others to maintain an evergreen list of potential directors, ensuring that unexpected gaps can be filled quickly. In addition, many large firms retain expert advisors to help identify potential board members. While this is a luxury that some SMEs cannot afford, ongoing processes such as evergreen lists, skills matrices and board effectiveness evaluations can help to monitor strengths and weaknesses as well as planning for eventual director turnover.

² CCBE undertook an initial SME board effectiveness study in 2007. We scored a random sample of 108 Canadian SMEs (market cap from \$0 to \$400m), weighted by size and industry, against our 2007 Board Shareholder Confidence Index scoring criteria (<http://www.rotman.utoronto.ca/ccbe/2007glossary.pdf>). Subsequent SME scores (2008-2010) were based on a customized SME scoring scheme ([click here](#) for full SME scoring criteria)

Useful Tools for SMEs

There are useful tools available to help SME boards enhance the effectiveness of their boards and directors. Below we have provided links to online examples of resources designed to help boards overcome challenges in optimizing board skills as they progress through the phases of their organizational life cycle. If you choose to make use of any of these tools for your board, the contents can be amended to suit your organization's specific needs. Where applicable, please respect any outstanding copyright.

1. *Board Skills Matrix*: This tool helps boards to identify gaps and redundancies in their current skills profile. The purpose of a skills matrix is to concretely measure where to focus future appointments and turnover. Examples of generic and detailed skills matrix templates can be found [here](#) (Independent Schools Victoria - Australia), [here](#) (Saskatchewan Trade and Export Partnership), and [here](#) (Columbia Basin Trust - British Columbia).
2. *Board Effectiveness Evaluation Survey*: Most boards complete some form of formal self-evaluation on a regular basis. Using confidential surveys allows board members to provide anonymous feedback, and provides the board with concrete data that can be tracked year-by-year to monitor improvement and gaps. Examples of board evaluation surveys can be found [here](#) (Health Association Nova Scotia), [here](#) (Legal Aid of Napa Valley) and [here](#) (Free Management Library).
3. *Director Effectiveness Survey / Peer Assessment*: Although peer assessment can be a sensitive process, many boards have benefitted from incorporating a regular peer survey into their board's routine. Results from peer evaluations can provide guidance to individuals as to how they can create more value for their board, as well as illuminate opportunities to leverage specific individuals' skills in the decision-making process. Robert Muschewske (2006) and Beverley Behan (2010) both describe several valuable approaches to the peer evaluation process. A comprehensive sample peer survey can be found [here](#) (Law Society of Upper Canada).
4. *Consent Agendas and Tracking Time Spent at Meetings*: When boards are struggling to optimize time allocation at meetings, it can help to formalize the agenda-creation process, as well as to track time spent over a span of several meetings. Consent agendas allow boards greater democratic control over the content and flow of meetings, and can help to improve or validate the effectiveness of the little time they spend together. *The Consent Agenda: A Tool for Improving Governance* is a report published by Boardsource that, while targeted to not-for-profit boards, has many useful insights that are broadly applicable ([click here](#) for download). Additionally, diligently tracking the time your board actually spends on each agenda item over several meetings can help to illuminate if and when time allocation is not going as planned.

Recommended Reading

- Malizia, D. J. (2008). Big fish, little pond: How large-company execs best fit into smaller businesses...and their boardrooms. *Directors & Boards*, (Q1).
- Gabrielsson, J., & Huse, M. (2005). "Outside" Directors in SME Boards: A Call for Theoretical Reflections. *Corporate Board: role, duties & composition*, 1(1).
- Prestney, S. (2008). SMEs need governance carrot. *Charter*, 79(5), 44.
- Crauford, Nicki. (2010, March 1). Small companies could gain a lot by adopting formal governance. *Dominion Post*, C.2.
- MaRS. (n.d.). Different board models for different ventures. *Entrepreneur's Toolkit*. Retrieved from <http://www.marsdd.com/entrepreneurs-toolkit/articles/different-board-models-for-different-ventures>.
- MaRS. (n.d.). Creating your initial board of directors. *Entrepreneur's Toolkit*. Retrieved from <http://www.marsdd.com/entrepreneurs-toolkit/articles/creating-your-initial-board-of-directors>.

Bibliography

- Behan, B. (2010, June). How to Conduct the Director Evaluation Process. *Businessweek*.
- Brunninge, O., Nordqvist, M., & Wiklund, J. (2007, January 24). Corporate Governance and Strategic Change in SMEs: The Effects of Ownership, Board Composition and Top Management Teams. *Small Business Economics*. doi: 10.1007/s11187-006-9021-2.
- CCBE. (2009). *Clarkson Centre-PricewaterhouseCoopers 2009 Directors Survey in collaboration with the Institute of Corporate Directors* (pp. 1-14). Toronto.
- Clarysse, B., Knockaert, M., & Lockett, A. (2007). Outside Board Members in High Tech Start-ups. *Small Business Economics*, 29(3), 243-259. doi: 10.1007/s11187-006-9033-y.
- Muschewske, R. C. (2006). Peer evaluation: take the plunge. *Directors & Boards*, (Spring).

© 2011 Clarkson Centre for Business Ethics and Board Effectiveness. All rights reserved.