July 2020

Private Company Governance 2020: A Closer Look

Rotman | The David and Sharon Johnston Centre for Corporate Governance Innovation

KPMG

Insights on 370 private companies from across Canada

Executive Summary

Previous research by the David and Sharon Johnston Centre for Corporate Governance and KPMG LLP showed that the governance models adopted by private companies were as diverse as the companies themselves and different governance models were possible in any situation – there were large multi-generational companies with no formal governance structures and small companies with independent boards of directors.

This study expands on this research by analyzing data on the governance profile of 370 private companies across Canada. We found that private companies tend to vary quite significantly in their approach to governance: many have no structures of governance whatsoever while others have more formalized structures such as an advisory or fiduciary board. Our findings also show that the size, age generation and disparity of ownership of the company were important predictors of board adoption.

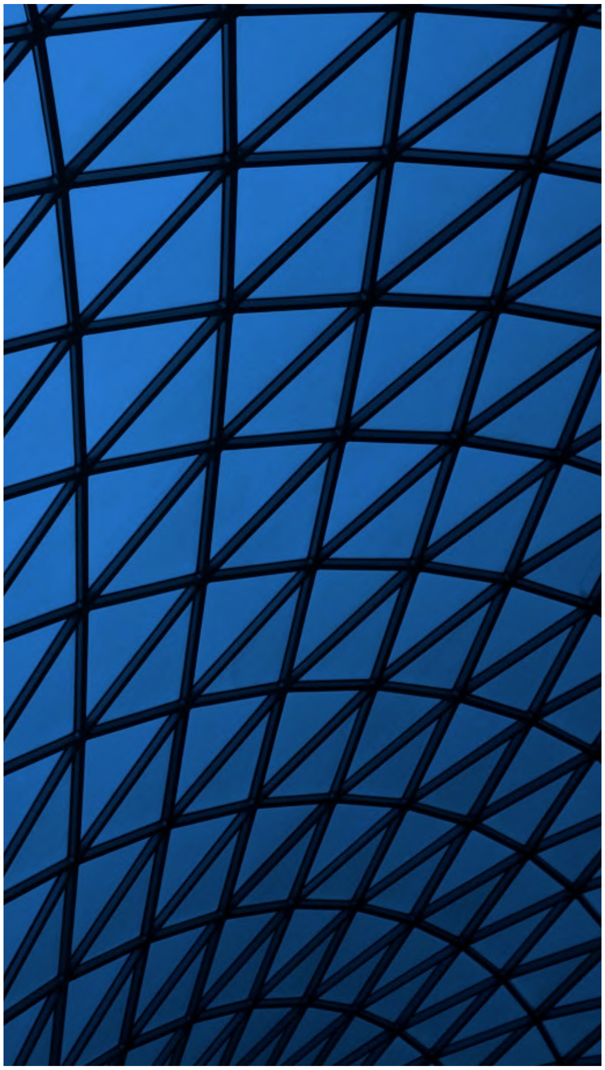
Private Company Governance 2020: A Closer Look

TABLE OF CONTENTS

Introduction

Private companies are the cornerstone of the Canadian economy, contributing up to 67% of Canada's GDP, according to the Business Development Bank of Canada. 80% of all companies are also family-owned, according to a 2019 report by the Family Enterprise Xchange and the Conference Board of Canada.

Yet we know little about what governance looks like for private companies, both family and non-family: how likely are they to make decisions informally or have formal structures such as boards and ownership councils in place? Are private companies more likely to formalize their governance apparatus as they pass through generations and as they grow in size, or if ownership becomes more diffuse? Recent research by the David and Sharon Johnston Centre for Governance (Johnston Centre) and KPMG LLP showed that the governance models adopted by private companies are as diverse as the companies themselves and different governance models were possible in any situation, e.g. we found both large multi-generational companies with no governance structures and small companies with formal boards.[1]



We expanded on this research by collecting data on the governance profile of private companies across Canada. Though private company owners tend to be wary of the term 'governance' since it evokes ideas of bureaucracy and a loss of control, for the purposes of this paper, we pared governance back to its most basic principle: decision-making. As we argued in our previous paper, all companies make decisions, with or without formal governance structures.

For the current study, partners at KPMG completed a survey on behalf of 370 of their private company clients. The vast majority of companies in the sample (76%) were family-owned. The companies were based in ten provinces across the country, varied in age, size and ownership structures, and represented a broad spectrum of industries (for a detailed breakdown please see Appendix A).

[1] The David and Sharon Johnston Centre for Governance Innovation and KPMG LLP (2020). *The critical importance of effective private company governance*. Retrieved from https://uoft.me/PrivateCorpGov

Survey Results: Adoption of Governance Structures

Companies can take different approaches to decision-making, which can range from having no formal governance structure at all, to having a semi-formalized group such as an advisory board to provide independent advice and business insights, to having a truly formalized fiduciary board with a legal standing and the authority to make binding decisions in the best interests of the company. Family-owned private companies may also adopt a family council to enable their business to have a more structured connection with the ownership base, especially as this base expands.

Boards

However, there is no one-size-fits-all structure or set of policies that works best for all companies, and the most appropriate governance model might depend on the current needs of the company and its stage of evolution.

Among the private companies surveyed, half had adopted a fiduciary or advisory board, or both (see Figure 1). Interestingly, non-family companies were far more likely to have some formal governance structure in place (71%) than family companies (44%).

Family companies that had some formal governance structure in place were as likely to have an advisory as they are to have a fiduciary board. On the other hand, non-family companies were far more likely to adopt a fiduciary board than an advisory board. The greater prevalence of advisory boards among family firms could suggest that family company owners are using advisory boards to access independent advice while maintaining control and limiting the bureaucratic burden incumbent in setting up a fully formalized fiduciary board. Our previous research showed that a loss of control and unnecessary bureaucracy are two of the most common objections raised to board adoption. Our findings confirm this: over 80% of family companies that had an advisory board had at least one 'outsider' on it who could provide independent advice (see Figure 2).

Figure 1:
Board Adoption (n=370)

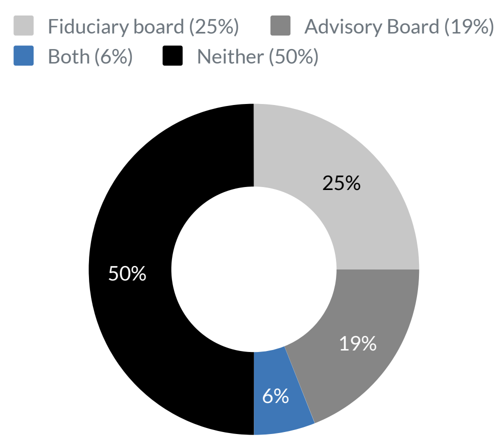
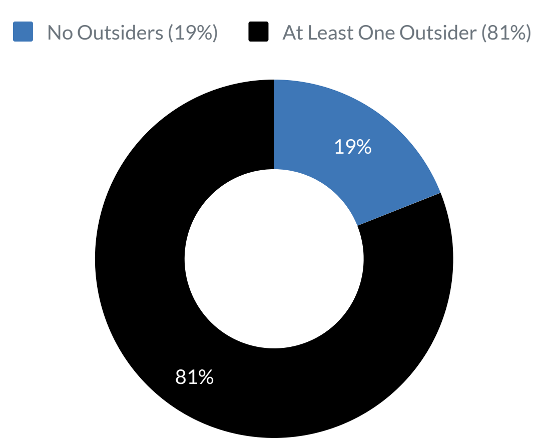


Figure 2:
Advisory Boards typically include outsiders.



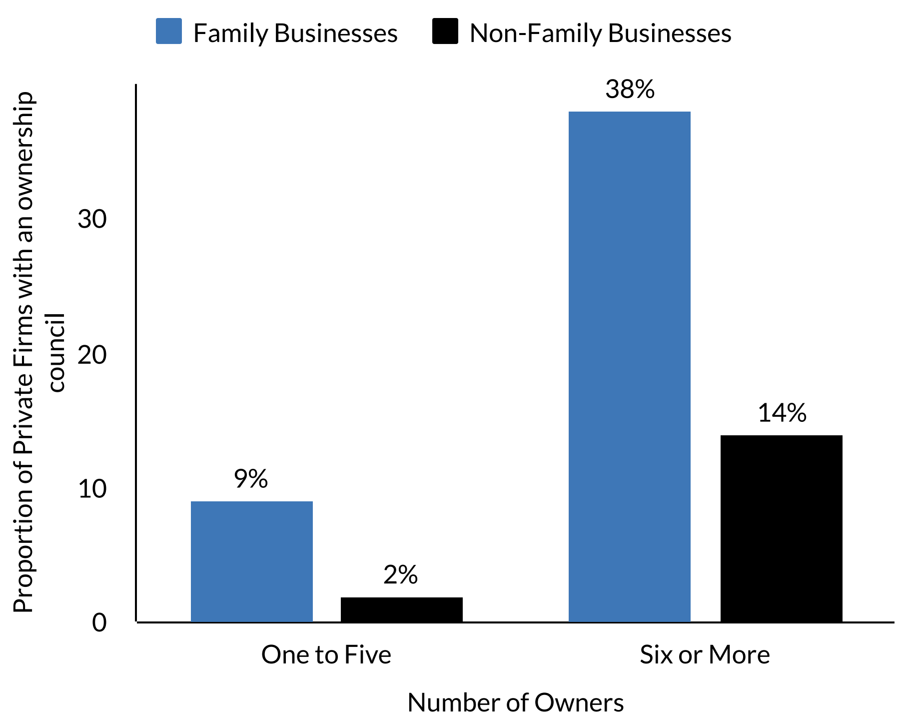
Survey Results: Adoption of Governance Structures

Ownership Councils

Ownership councils are formal governing bodies where decisions can be made among groups of owners. In our sample, ownership councils were very rare regardless of age, stage or governance structure – for example, only 11% of family-owned companies surveyed had a family council. Moreover, organizations with boards were not more likely to have an ownership council than those without boards.

Family-owned companies with at least six owners are more than four times as likely to have a family council than those with fewer owners. For these families, formal family councils provide an opportunity for diffuse groups to make ownership-level decisions that are communicated to the company and family with a single voice (see Figure 3).

Figure 3:
Private companies are more likely to have ownership councils in place when more owners are involved. (n=358)



Survey Results: Adoption of Governance Structures

Ownership Generation Matters

Previous research by the Clarkson Centre for Board Effectiveness showed that family companies tend to formalize their governance structures and processes as they pass from one generation to the next. Advisory boards were often implemented as the first step in transitioning towards formal governance, with many companies often retaining both an advisory and fiduciary board.[2] The same study also found that companies in the first generation are most concerned with building and growing the enterprise, while the second and third generations are focused on succession planning and establishing the structures, practices and policies to ensure the long-term survival of the company.[3]

Our analysis confirms that family companies tend to adopt formalized governance structures as they pass through generations – family companies were much more likely to have a fiduciary and advisory board in place after the 1st generation (see Figure 4).

Figure 4:
Formal governance structures are much more common after the first family generation (n=281)

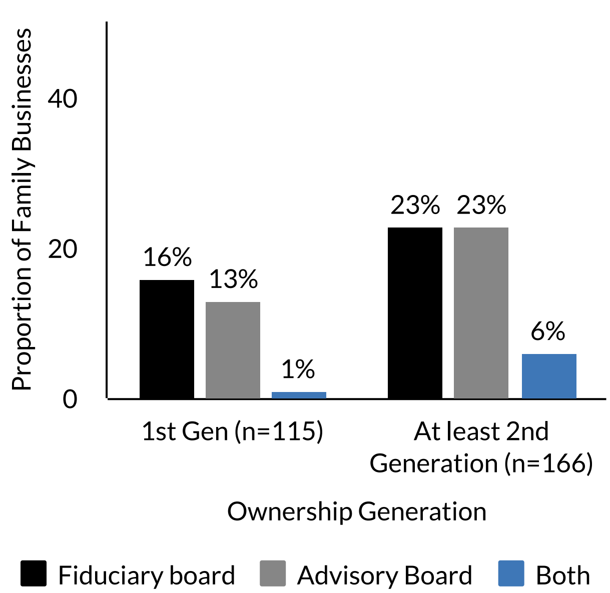
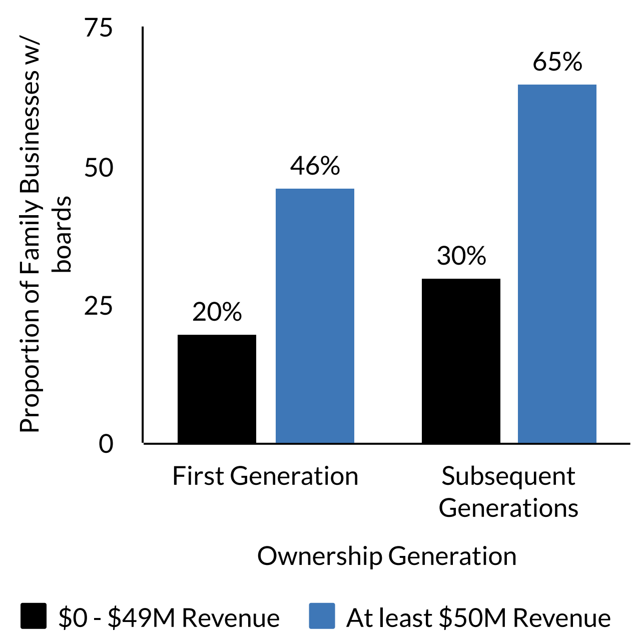


Figure 5:
Revenue drives board adoption more so than family ownership generation.



[2] Clarkson Centre for Board Effectiveness and the Institute of Corporate Directors (2016). *Why Family Business Success Matters for Canada*. Retrieved from https://www.icd.ca/getmedia/bd077e87-14a0-4707-baf0-168e1de38cff/Private-Family-Business-Governance-Survey.aspx

[3] Ibid

Survey Results: Adoption of Governance Structures

Company Size Matters

While generational transfer is clearly associated with increased governance formality, company size seems to be an even more important factor. We found that only 20% of companies with revenues below 50 million were likely to have either a fiduciary or advisory board in the first generation, compared to 46% of companies with revenues above 50 million. In subsequent generations, the smallest companies (with a revenue below $50 million) were only 10% more likely than the previous generation to have a board while 65% of subsequent generation companies with revenues above 50 million had one in place. Thus, while the generation of the company matters, the size of the company seems to be far more important factor driving board adoption (see Figure 5).

Size seems to be a much greater predictor of board adoption among family enterprises. While a meager 25% of family-companies with a revenue of twenty million or below had adopted a formal governance structure of some kind, close to 70% of family-companies with revenues over hundred million had adopted some governance structure. Non-family companies are more likely to have a board in all size categories.

Figure 6:
Non-Family Companies Typically Have a Board

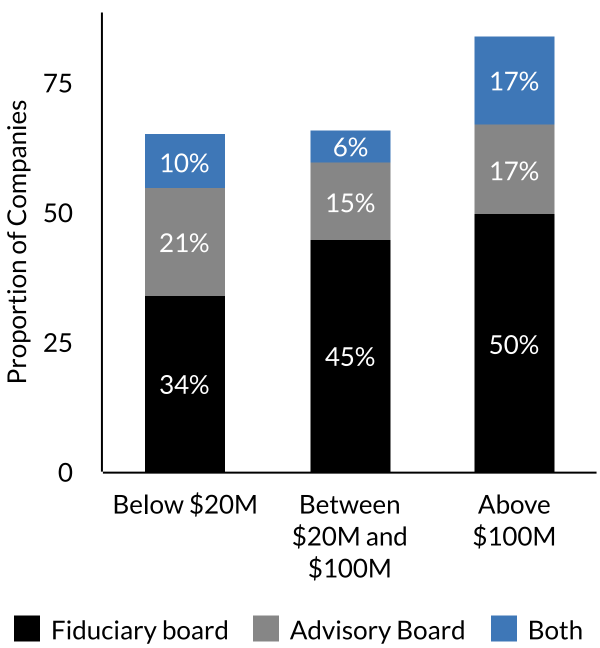
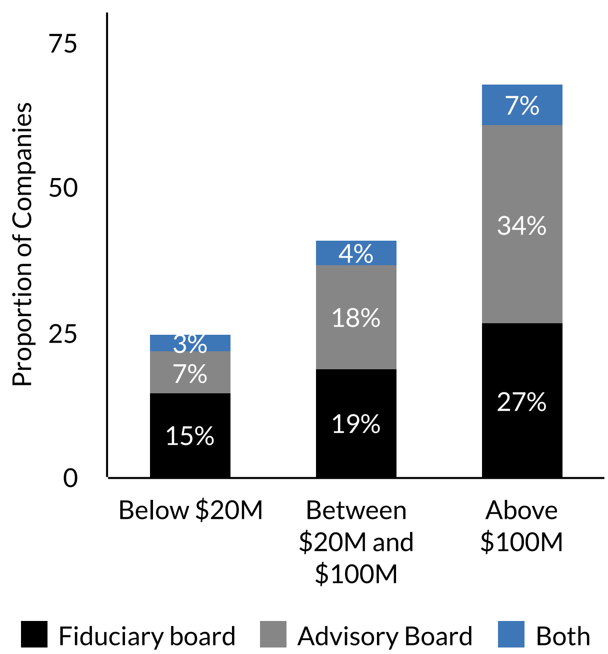


Figure 7:
Revenue is a Major Driver of Board Adoption at Family Companies

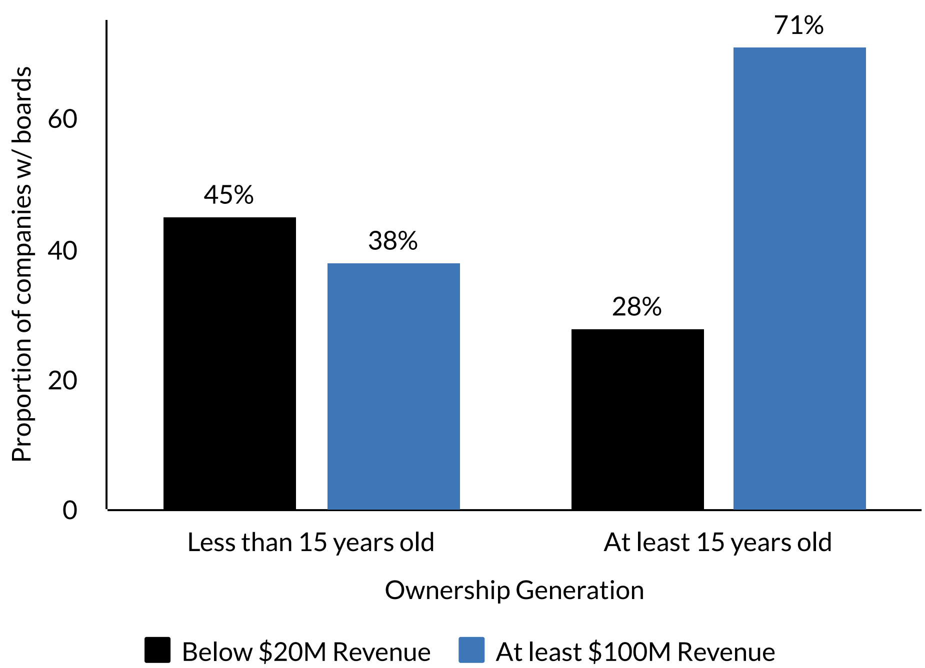


Survey Results: Adoption of Governance Structures

Company Age Matters

While the size of the company is an important predictor of a company adopting either a fiduciary or advisory board, it is clear that age of the company is also an important factor. We found that most younger companies (that were less than fifteen years of age) did not have a board regardless of revenue. On the other hand, we found older companies (that were at least fifteen years of age or older) were much more likely to have a board in the highest revenue bracket ($100 million and above). Over 70% of private companies that were both large in size and over 15 years old had a board.

Figure 8:
Younger companies are less likely to adopt a board as revenue increases.



Survey Results: Adoption of Governance Structures

Ownership Concentration Matters

The likelihood of a company adopting a fiduciary board increases substantially as the number of owners grows (see Figure 9). Interestingly, the diffusion of ownership does not have a discernable impact on the likelihood of a company adopting an advisory board.

But which variable has a greater impact on the adoption of a fiduciary or advisory board – the size of the company or the number of owners? While it is hard to disentangle the relative impact of these variables on the adoption of a board it is clear that both variables matter (see Figure 10).

The likelihood of a company adopting a board increases as the revenue of the company swells, but companies with widespread ownership (six or more owners) are also far more likely to have a board regardless of revenue.

Figure 9:
As the number of company owners increases, so too does the adoption of fiduciary boards. (n=366)

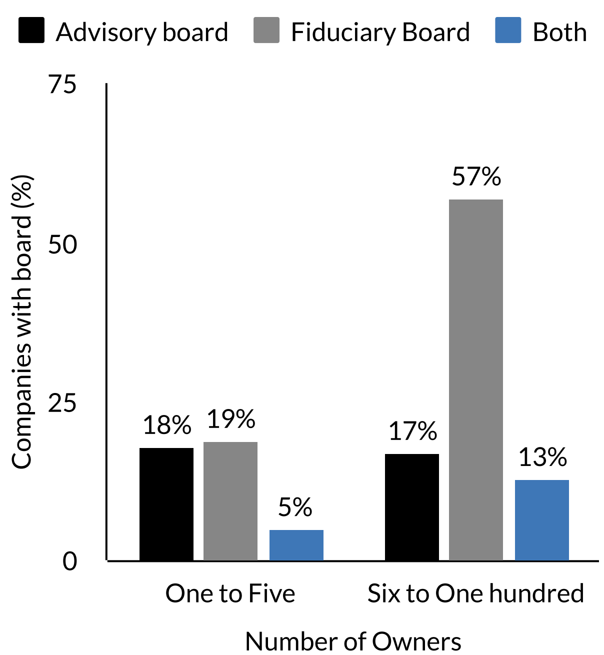
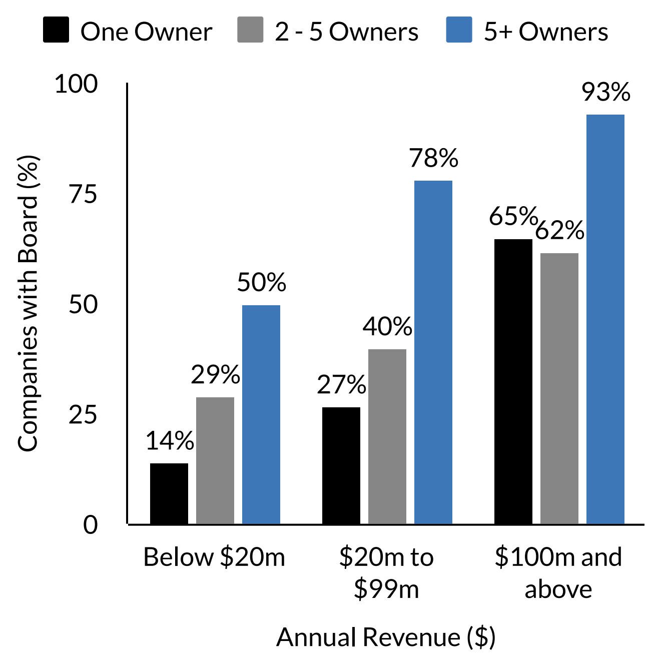


Figure 10:
All companies are more likely to adopt a formal governance structure when revenue or ownership grows.



Survey Results: Outsiders in Decision-marking Roles

Research suggests that individuals are prone to making irrational decisions and the injection of an outside perspective from both experts and non-experts can mitigate against the risks of individuals making decisions in isolation. The appointment of independent board members requires the delegation of significant authority to outsiders, but can add tremendous value to the decision making process.

We found that company size (revenue) was associated not only with the adoption of a formal board of directors, but also with the inclusion of independent directors on that board. Non-family companies with revenues exceeding 100 million were more than twice as likely to have at least one outsider on their fiduciary board than companies with revenues below 100 million (see Figure 11).

The trend for family-owned companies was even more dramatic. Those with revenues greater than 100 million were almost five times more likely to have at least one outsider on their fiduciary board compared to smaller family companies (with revenues below 100 million) (see Figure 12).

Figure 11:
Larger Family companies are almost 5x more likely to include outsiders in formal governance structures.

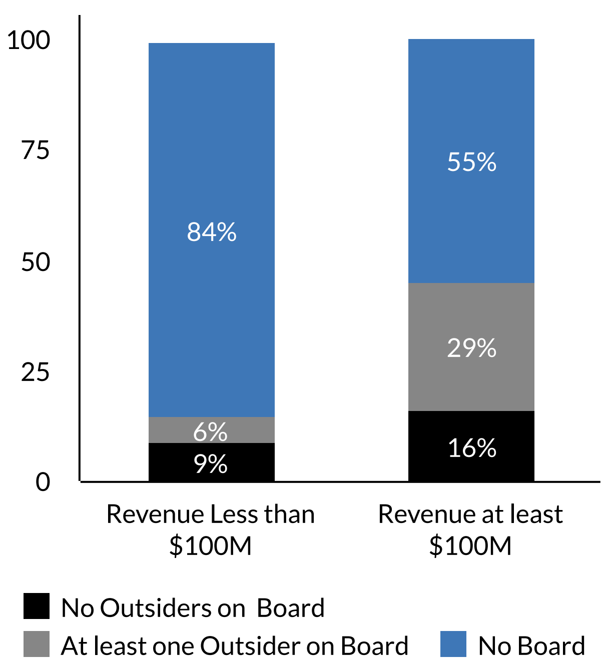
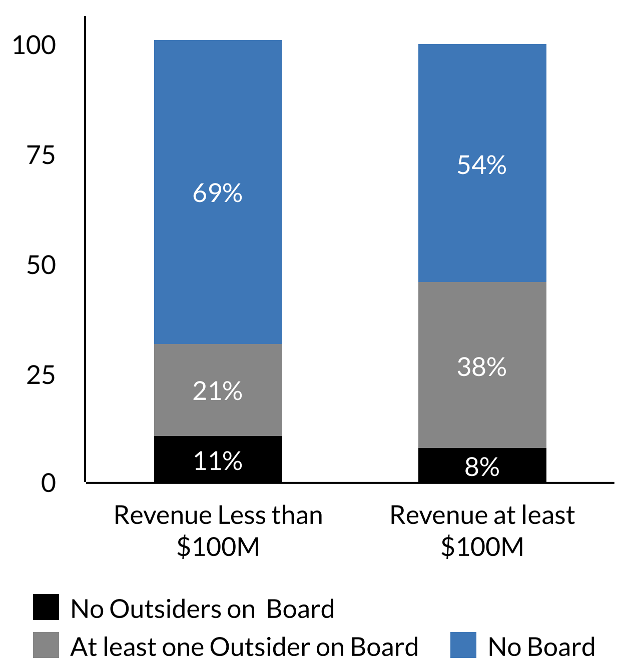


Figure 12:
Larger non-family companies are much more likely to have independent directors on their fiduciary boards



"Every decision can profit from the injection of an outside perspective"

Conclusion

A recent report authored by the Johnston Centre using data from KPMG, *The Critical Importance of Effective Private Company Governance*, showed that the governance models adopted by private companies were as diverse as the companies themselves. Although there may not be a 'one-size-fits-all' structure or set of policies that works best for all companies, every decision can nevertheless profit from the injection of an outside perspective.

We concluded our previous study with a series of important questions that would direct our ongoing research on private company governance. In this paper, our findings have begun to address two of these questions:

Question 1: What is the point of good governance?

Private company owners and managers often struggle to understand and articulate whether and why they should introduce formality to their decision-making processes by implementing a governance structure such as a fiduciary or advisory board. Is good governance just more bureaucracy or does it actually add material value to business decisions? Our findings suggest that private companies are formalizing their governance structures and adopting fiduciary and advisory boards as a decision-making tool as the complexity of the company and ownership increases. Companies are more likely to have a board of any type as they get older or bigger and when more owners are involved. These findings are consistent with previous research by the Clarkson Centre for Board Effectiveness in 2016, which found that the size, generation and age of a family company were important predictors of board adoption.

Question 2: What is the potential value of including outsiders in decision making?

Private company owners are often resistant to including outsiders in their decision-making processes. Yet we know all decisions can benefit from an external perspective and one of the primary objectives of a board is to provide independent advice. We found that as companies grow in size, they are more likely to include outsiders in their decision-making processes. Companies may recognize that the board is one way for them to formally inject an independent perspective into their decisions as they become more complex. Even family owners that are often resistant to changes that can lead to less control of the company and more bureaucracy, are highly likely to have least one outsider on the advisory board.

Appendix: Methodology

Most of companies in the dataset represented 22 discreet industries. With about half of the companies from the construction, manufacturing, agriculture, retail and food, drink and tobacco industries.

Industry	# of Companies
Construction	53
Manufacturing	52
Agriculture	33
Retail	31
Food, drink, tobacco	28
Transport	18
Wholesale distribution	17
Health services	16
Equipment manufacturing	14
Hotels, tourism, catering	13
Media, culture, graphic	12
Financial/professional services	10
Telecommunications	8
Mechanical and electrical engineering	6
Utilities	5
Mining	4
Oil & gas production, refining	3
Chemical	2
Education	1
Basic metal production	1
Commerce	1
Other	61

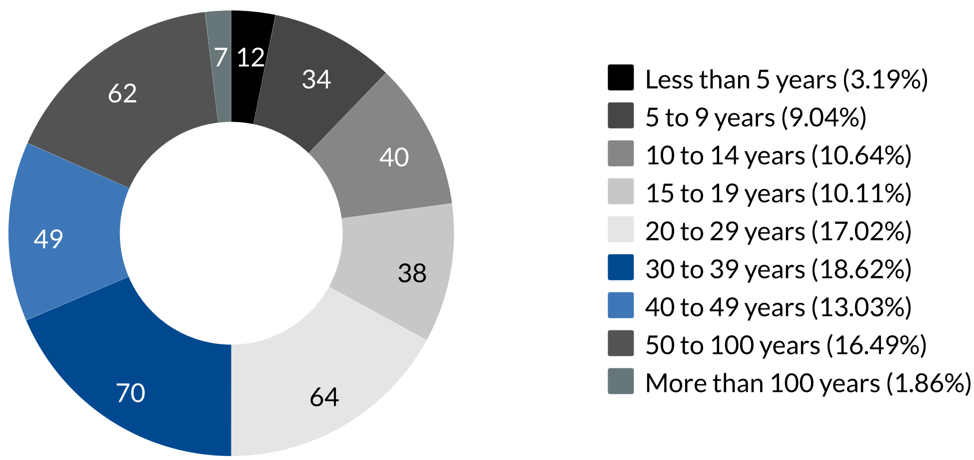
Real Estate, Forestry and Technology were the most common specific industries reported where the industry was indicated as 'other'.

Other Industry	# of Companies
Real Estate	6
Forestry	5
Technology	4
Software as a Service	2
Private Equity	2
Real Estate Development	2

Appendix: Methodology

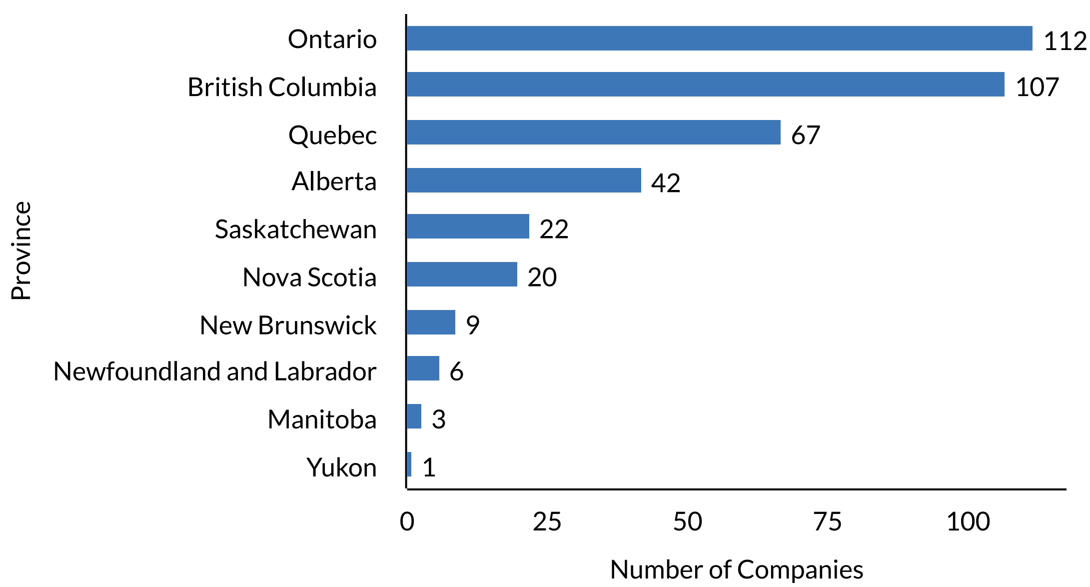
The company ages ranged from less than 5 years to more than 100 years. Of all companies, 67% of the companies are at least 20 years old.

Company Age Breakdown



Most of the companies are from Ontario and British Columbia.

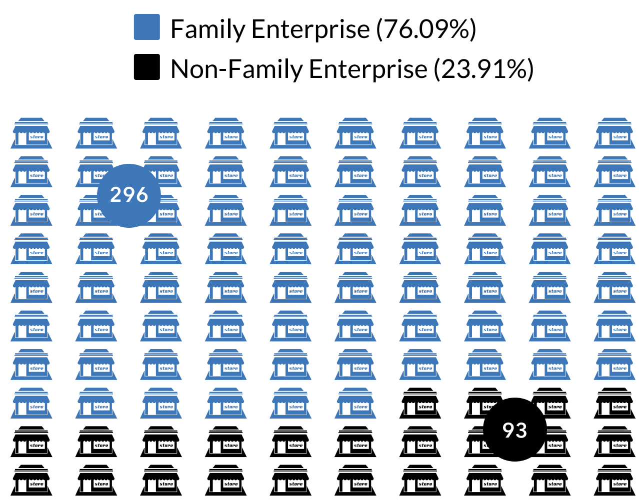
Head Office Location



Appendix: Methodology

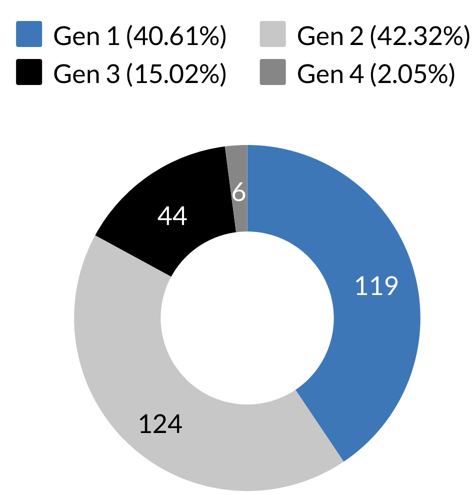
Most of the companies are family owned enterprises.

Company Ownership Type



Of the family owned enterprises, we found that just under 83% were either in generation one or two. Very few companies were in the fourth generation and we had none that were in later family generations.

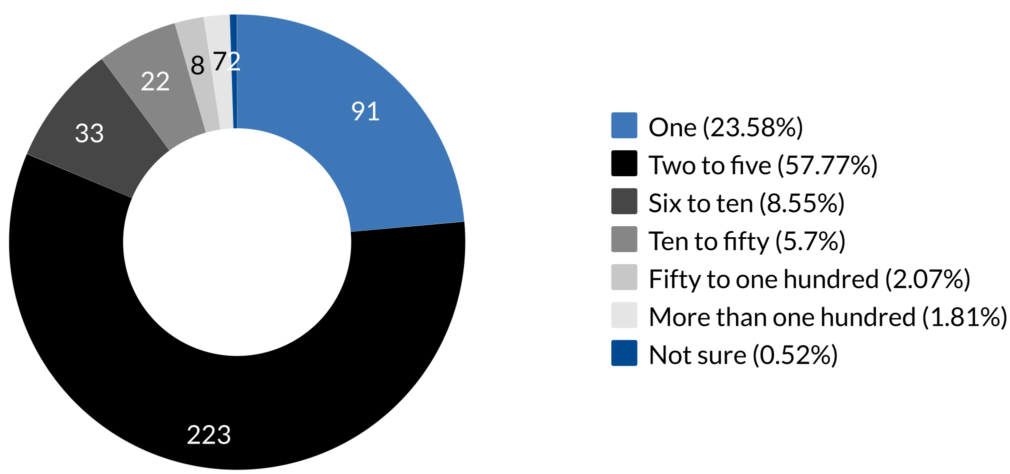
Family Ownership Generation



Appendix: Methodology

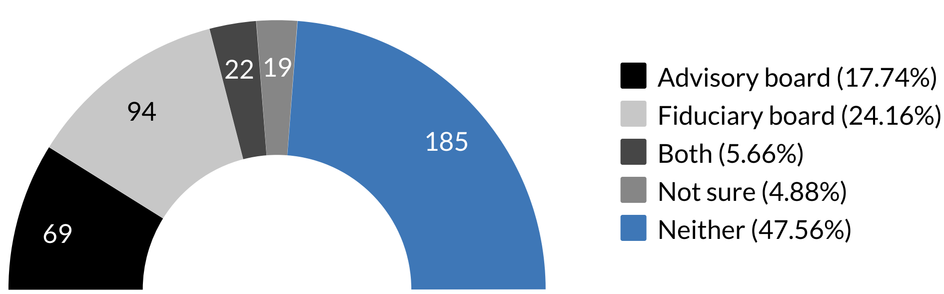
Most of the companies had one to five owners. It was uncommon for a company to have more than five owners regardless of ownership type.

Number of Company Owners



Boards were not common among the companies in our sample with about 50% reporting that they have neither an advisory nor fiduciary board. If a company had a board, a fiduciary board was the most common form of adoption.

Board Type Adoption Breakdown



Our Sponsors

The David & Sharon Johnston Centre for Corporate Governance Innovation at the Rotman School relies on the financial support of its sponsors to fund events and research. We would like to thank the following sponsors for their generous support.

Founding Partner

The Rogers Foundation
ATCO Limited
KPMG LLP
Anonymous (1)

Founding Supporter

Great-West Life Assurance Company
Mackenzie Investments
Power Corporation of Canada

Partner

Brendan Calder
Canadian Tire Corporation Ltd.
Langar Foundation in honour of Dr. Gail Regan
Robert McEwen
The Bay Tree Foundation
The Jay and Barbara Hennick Family Foundation
The Ralph M. Barford Foundation
Viewpoint Foundation

Rotman | The David and Sharon Johnston Centre for Corporate Governance Innovation

Rotman School of Management
105 St. George Street, Toronto
Ontario, Canada M5S 3E6

T 416-978-4930
E matt.fullbrook@rotman.utoronto.ca