Report: Small Boards Can Be Effective

2/14/2011 By Pamela Babcock

If your company's growth hinges on moving quickly, a small board of directors might be more effective than a large one. A recent report from The Conference Board found that "a more intimate board can lead to higher flexibility and agility necessary for fast action."

But experts say that success requires more than getting the numbers right. Boards also need to have the right mix and balance of skills "to steer the company to compete in the industry, identify and exploit markets, and determine the strategy for the company," said Nancy May, president and CEO of The BoardBench Cos. in Norwalk, Conn.

"It also depends on the caliber of each board member, their motivations to contribute, and each one's ability to devote the time needed," May added. Companies that are evolving should continually assess and rebalance their boards in terms of "composite skill sets, abilities to contribute and understanding of how to overcome the next set of hurdles facing the company," May added.

Michael J. Berthelot, founder and principal of Corporate Governance Advisors Inc. in Las Vegas, said having the properly sized board is important. Large boards are more inefficient and ineffective than small boards because of scheduling problems, factionalism and members having independent agendas. "Boards also are expensive," Berthelot said, noting that public company directors are paid on average more than $100,000 a year.

"Buying" the necessary professional skills on an as-needed basis—like a legal background, marketing expertise or specific scientific knowledge—can offset the belief that a broad range of expertise must be represented through board membership, he added.

Starting the Conversation

The Conference Board raised the issue of "rightsizing" boards in one of its recent *Conversation Starters* reports, which was written by Kathleen Bui, a senior economics major at Haverford College who was a 2010 Summer Fellow with The Conference Board. Bui's assignment was to use standard databases to identify factors correlated with growth of mid-market U.S. companies.

"This was one of the more interesting findings that she came up with," said Martin Cohen, The Conference Board's director of associate services.

The Conference Board defines mid-market companies as those with annual revenues of $100 million to $1 billion, a designation that puts them below the *Fortune* 1000 but out of the startup/entrepreneurial category, Cohen noted.

The report said that numerous studies have found an inverse relationship between board size and strategic change. Some large boards suffer from a lack of motivation because of "social loafing" when a large number of members decreases the efforts of individuals. "The lack of participation may delay the decision-making process," Bui wrote.

As size increases, meaningful interactions among members decrease. Bui wrote that in another

study, researchers said exchanges of opinions and ideas “become more difficult as board size exceeds 10 members.”

“Larger boards are more inclined to develop coalitions, increasing the potential for group conflict,” Bui wrote. “The increased intricacy of coordination prolongs the execution of necessary action as decision-making becomes more deliberate and protracted. Thus a smaller board may be more effective."

Is 'Rightsizing' Already Happening?

The report noted that some “rightsizing” might have begun. The Conference Board’s *2010 U.S. Directors’ Compensation and Board Practices Report* shows a trend toward size reduction over the past decade, with small and mid-size companies reporting boards of seven or eight members.

“Considering the regulatory burdens imposed on board members today (and spanning audit, governance, risk and compensation oversight responsibilities, each requiring a standing board committee of 2-3 directors), it would be practically impossible for companies to reduce even further the size of their boards,” Bui wrote.

Matteo Tonello, The Conference Board’s director of corporate leadership, said companies have focused on board size for a number of reasons: a need to improve oversight effectiveness and board performance; a reduced pool of candidates because of increasing director responsibilities over the past decade; and board independence rules and practices that “exclude members of management from the board.”

May said that “too small a board can mean decisions are rushed through without diligent deliberation, or management is allowed too much leeway because existing board members are overwhelmed and become disengaged.” Meanwhile, she added, “Too large a board often may, depending on the complexity of the company, result in dysfunctions typified in the paper.”

May said companies in industries that are heavily regulated, that are international, or that face complex risks, competition and market pressures might need more board members “to deal with both the numbers and complexities of decisions."

Don't Get Caught Off Guard

May cautioned that she has seen companies reduce the number of directors by not replacing retiring board members, “only to get caught with not enough time and/or expertise to support their current challenges.

“Some have also been caught off guard—with a reduced-size board—when confronted with a new issue, and where they did not have the depth of experience to address a situation,” May said. “Bringing in outside support in these cases can be helpful, but final decisions fall upon the board, and they must have the confidence in their own capabilities.”

May said boards of private companies typically “have greater leeway in determining board structure and size.” And financing aside, “the private company and board can generally be more nimble in its decisions. It can, however, more easily make wrong decisions, too.”

May suggests weighing other factors. How “over-boarded” are members? Do they serve on numerous boards? How motivated are they? How often is the board and member performance appraised, by whom, and using what metrics? Does the board structure allow it to oversee the CEO and management, safeguard the company, provide sound business advice and facilitate opportunities effectively?

Another View

Berthelot said he has seen instances in which disagreements among board members have stalled management's plans for strategic change, product introduction or financial restructuring.

"The most disheartening have been where a board splits into factions with agendas that are not necessarily aimed at maximizing the enterprise's value to anyone but their constituency," Berthelot said.

In addition to the needs of meeting committee staffing, Berthelot said, every board should conduct its skills inventory and should match it to the needs of the company and its strategy.

With a seven- or eight-member board, the five or six "open" positions (if one is reserved for a financial expert and the other for the CEO) should be filled with individuals "who will provide skills, perspectives and experiences that will be valuable to the company as it implements its strategy. Personal characteristics like diversity of age, geography, experience and demographics can also be valuable additions," Berthelot said.

Some Recommendations

Marc Lewis, founder and CEO of Leadership Capital Group in Westport, Conn., said, "everybody knows what a chief financial officer, a chief sales officer or a chief HR officer does. But there's a mystery and a mystique about board executives because most people don't know what they do."

Lewis said the key is having "the right mix of board members and a board that is reflective of your constituency in terms of diversity and reflective of your business in terms of functional and industry background."

In mid-market companies, Lewis said, most boards are constructed first around industry background relevant to the company, then around functional expertise and lastly around diversity.

Other recommendations from Lewis:

- An odd number of people on your board can help avoid the "propensity to deadlock."
- Consider hiring an independent third party to help find board members.
- Institutionalize board selection and take it out of the status quo.
- Remember that it's often surprisingly difficult to reshape a board because subtle or not-so-subtle control of the board may reside with the executive chair or CEO.
- Having a governance advisor on the board can be a "tremendously powerful" resource for a mid-market company.

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