INSEAD

Alumni Association Belgium

IN-Board Academy

WILL INDEPENDENT BOARD MEMBERS BRING VALUE TO YOUR COMPANY?

Is your company ready for independent board members?

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Content

Introduction

Every year the INSEAD IN-Board Academy programme participants prepare a viewpoint based on their personal and course experience, which addresses a practical challenge on the way to Board Excellence. The IN-Board Academy programme is meant for senior INSEAD alumni and focusses on the aspects of the role of a non-executive director and aiming at developing their board skills in a tailor-made programme (modules), using the format "for alumni by alumni".

The participants in the 2015 IN-Board Academy programme and hence the authors of this document are: Karsten De Clerck, Marc Czarka, Baudouin Deschamps, Frédéric Genin, Werner Jacobs, Guus Keder, Jan Laga, Diego Lanckisweert, Stéphane Leclef, Christel Musset, Michael Pinto, Erik Vanderhaegen, Johan Van Genechten, Louis Versele and Frederik van Oene.

This year the IN-Board Academy participants decided to focus on an essential question for small or medium-sized companies: **"Will independent board members bring value to your company?"**

When we refer to companies in this viewpoint we mean all types of small and medium-sized companies and organisations, such as family-owned companies, start-ups, associations as well as listed companies.

The relevance of this topic can be illustrated by a few statistics and examples of frequently occurring problems or missed opportunities:

- In Belgium only 22% of family-owned companies have active boards. **Only 11% have boards with independent directors[1]!**
- Whenever a company goes through an important transition, such as a change of ownership, a succession process, an internationalisation process etc., it is fundamental to get multiple viewpoints on this transition at both management and board level;

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[1] Source : Jozef Lievens, Institute for Family owned companies (www.familiebedrijf.be)

- Whenever a company or organisation has a board with potentially important conflicts of interest, an independent board member can help address the issue and eventually mediate. This could for instance happen in a self-governing industry body or in an early stage company where different shareholders may have diverging shareholder rights and interests;
- The introduction of independent directors results in an increase of corporate transparency; independent directors require transparency to perform their monitoring and advising roles, and that both management and independent directors are expected to take actions necessary to ensure they have the information necessary to carry out their tasks;
- Independent directors can bring an external view on good practices from outside the company's industry and bring new ideas in the context of market and technological evolutions.

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Checklist

This guide shows you how to evaluate whether independent board members are likely to bring real value to your company. For this, we suggest you reflect on two sub-questions:

1. **Do we need independent directors?**
2. **Are we ready for an independent director?**

To help you in your decision making we have created, based on our experience, a **s**imple checklist highlighting for each topic the essential questions that could guide you to a recommended way forward. They are the following:

1. Do we need independent directors?

	Essential questions	Yes	No
a	Will you be confronted with succession issues in the medium term future?		
b	Are there regularly conflicts in your board that do not get properly resolved?		
c	Is your organisation in need of a director who is fully aligned with the best interests of your company or start-up?		
d	Do you estimate that your board is lacking diversity?		
e	Is your organisation more or less at a stand-still and do you wonder how your board can create a spark to initiate growth or needed change?		

If you score one clear “Yes”, this topic will need your full attention. If you score Yes on several questions, there is real urgency to consider action.

2. Are we ready for independent directors?

	Essential questions	Yes	No
a	Is your organisation open to governance through a properly functioning board? - Are you open to external advice? - Are you prepared to share decision-making power? - Are you applying good governance codes?		
b	Do you typically use a sound, fact-based and balanced way for making important decisions in your organisation and your board?		
c	Are you open for an independent board member to have a potentially important impact on the discussion about the future course of your company?		
d	Could you accept that with independent board members more differing views would be present in the board, creating different board dynamics?		
e	Could you draft the profile of an independent board member who would be a real added value for your board?		
f	Would your organisation benefit from having a sharp, well-articulated vision of what and where it wants to be in the medium term future?		

If you score one or more clear “No’s”, you are likely to undermine the option for independent board members to fully contribute and make a difference to your company. In this case the next key question to be raised is whether you wish to make any changes or whether there is a real need to make changes?

Case studies

To verify the usefulness of our checklist we applied it, with the benefit of hindsight, on three real life examples that we would like to share with you. The identities of the organisations have been anonymised.

Case Study 1

Profile

Capital intensive industry, CEO/founder/shareholder with private equity co-investor. Financial situation precarious due to over-investment.

Board

Composed of CEO/founder/shareholder and wife, two independent board members and two representatives of the private equity investor.

Issue

Desperate need for additional equity in order to survive. M&A boutique appointed, business plan sent to investors. However the CEO has a conflict of interest and sends his own business plan, sometimes even to the same parties, valuing the company much higher. The CEO also keeps information hidden from the board and continues to make additional capital expenditures (capex) before informing the board on the pretext that it was necessary to gain a contract (even though the capex is more than twice the contract price).

Outcome

Some board members resign, and later the potential investors retracted, leaving the company with no other option than to file for bankruptcy.

Lessons learned

- If a founder/CEO is not convinced that the board can add value and continues the way he operated in the past, ignoring the reality of the situation and the voice of the board, the board indeed has no added value and should resign;
- If the independent members of the board are convinced that the entrepreneur should be unconditionally supported and tolerate that the information is not adequately shared in the board, they also do not add value.

Conclusion

Entrepreneur: do not start a board if you are not ready to be challenged and to be fully transparent!

First-time board members : be diplomatic but firm on the role of the board and do not tolerate this behaviour. You probably arrived too early!

Case Study 2

Profile

The company was set up by experienced entrepreneurs in the financial sector. The ambitious business case was based on the success of a specific product and the probability of subsequent mass market strong demand. This never materialised. And most of the capital went into non effective advertising campaigns.

However, with the years the company had gained significant expertise in its sector. It had developed a specialist know-how which was saleable as consulting activity. Turnover volumes however, would remain extremely low when compared with the original plan.

Issue

The board held several meetings in the context of Article 633 of the Belgian Company Code (net assets falling below the threshold of 50% of the company's capital).

Meanwhile, the founders acknowledged the failure of their business model.

They presented the investors with the choice of either selling their shares back to them at net asset value or to put the company into liquidation. Their argument was that since the business model was no longer valid they had played and lost, despite the possibility to develop a business model based on consultancy.

The Federal Fund accepted, took the loss and exited. Not the other external investors. Liquidation was then the only option.

The tension gained intensity and a court case was unavoidable.

The board was composed of an independent Chairman, the founders/shareholders, four business angels, one representative of a Federal Investment Institution and one representative of a creditor organisation.

Outcome

Under the leadership of the independent Chairman, the board managed to restore trust and worked constructively with the founders. They understood the potential value of the consulting business model. And they also saw the value in keeping alive a company that had started to establish a name in the market. Together they produced a viable new business plan around the consulting activity. The revenues of that activity were projected as sufficient to ensure profitability and more importantly to keep the 10 employees.

Even though the company is far from the originally projected numbers, the activity is growing steadily and now generates good profits for its shareholders and founders. All clients are well known large and medium sized companies.

A few years later the founders were able to acquire back all the shares from the external investors, even at a small premium. At the end no (or very limited) value was destroyed and the company now employs 30 people.

Lessons learned

- The external board members and the independent Chairman played a significant role in re-energising the founders around a new start, building on core specialist knowledge that until then was underestimated;
- The board members also helped introducing leads for the consultancy business;
- This story tells us about the importance for a company (start-up in this case) to accept having and working with a board from the very early stage;
- It also emphasises the importance of having at least one independent director, without whom an objective assessment of the situation would have been practically impossible.

Case Study 3

Setting

An independent director joined the board of a small company, which had recently been taken over by a holding with two shareholders. One of the shareholders became the CEO of the company and the other became the Chairman. The holding held 75,01% of the shares and the remaining part was held by the previous owner, who still had a board seat.

The appointment of the independent board member was recommended by the CEO.

Three months after the director joined, the Chairman called him to say there was a consensus to fire the CEO, who had been there for one year, during which time results had slipped. It was a first test of independence.

The second test of independence came when the owners asked the independent director to find a replacement for the CEO, against payment of a fee. The director decided against this but agreed to supervise a search firm in collaboration with another board member.

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The third test of independence was when the director had to disagree with the minority shareholder who had proposed that a family member of the Chairman would take over as CEO.

Meanwhile results were suffering and the board, under influence of the previous owner, stopped many of the new initiatives taken by the new CEO.

Outcome

Results of the company went further down and the company required additional funding. The new owners increased the capital and diluted the previous owner to 15%. The previous owner remained on the board.

One year later, the previous owner bought back the company at a valuation which was about 40% less than what he had sold it for.

Lessons learned

- An independent board member is of great value in smaller companies;
- An independent board member can influence but in the end the shareholders decide as they see fit;
- Consider not having minority shareholders in the board;
- Consider not having previous owners in the board.

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Conclusions

Our checklist aims at helping you to reflect on the essential question **"Will independent board members bring value to our company?"**

Based on your answers, the situation of your organisation can be positioned in one of the four squares in the matrix below, each with a recommended way forward.

Need for independent board members		Readiness for independent board members: Yes	Readiness for independent board members: No
	Yes	**I. Appoint an independent board member**	**II. Quickly build readiness for an independent board member**
	No	**III. Stay as you are**	**IV. Consider getting ready for an independent board member**

Recommended actions by matrix position

I. If you need one and are ready, consider appointing an independent director to your board;

II. If you need one, but are not ready, you have a strong interest in quickly building readiness;

III. If you are ready but have no real need, just keep going as you do now;

IV. If you do not need one (yet?), you may do well by reflecting on building readiness for the eventuality that your readiness level changes in the future. Re-evaluate the checklist regularly.

Annex

IN-Board Academy 2015 Modules : Content providers, hosts & keynote speakers:

LEGAL AND CORPORATE FRAMEWORK: GOVERNANCE, RESPONSIBILITY AND LIABILITY - **Philippe Lambrecht**, Host & Moderator, Secretary General, FEB-VBO, **Jean-Pierre Blumberg**, Partner, Co-Head of Global M&A, Linklaters, **André Bergen**, Chairman Cofinimmo, **Dirk Lybaert**, Chief Corporate Affairs Officer, Proximus

CONTROL, AUDIT & RISK MANAGEMENT - **Eric Van Hoof**, Host & Moderator, Partner EY, **Christian Jourquin**, Board Member ING, **Diego du Monceau**, Chairman Audit Committee ING, **Xavier Bedoret,** Director Internal Audit, Engie

BOARDS IN TIMES OF CRISIS OF THE COMPANY - **Olivier Hamoir**, Host & Moderator, Director McKinsey & Company, **Pierre-Alain De Smedt**, Chairman Deceuninck Plastics, **Vincent Doumier**, Board Member Cofinimmo

DECISION MAKING & BOARD DYNAMICS - **Jean-Charles Uyttenhove**, Moderator, Partner Accord Group, **Herman Daems,** Host, Chairman BNP Paribas Fortis, **Michel Delloye**, Board Member Vandemoortele

FAMILY GOVERNANCE & FAMILY BUSINESS BOARDS - **Jozef Lievens**, Host & Moderator, Chairman Eubelius & Managing Director Instituut voor het Familiebedrijf, **Nicolas Boël**, Chairman Solvay**, Martine Reynaers**, CEO Reynaers Aluminium

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