

“Board Stacking” – Not What They Do in Lumber Yards

CEOs, beware the perils of “board stacking.” I’m not referring to what happens in lumber yards but what some CEOs do to boards of directors in early stage or small private companies. CEOs “stack” their boards by ensuring that a majority of board members (or even the entire board) consists of the CEO’s friends and family and “company dependents.” Company dependents are typically employees, or outside consultants such as attorneys or accountants.

Friends and family are inherently predisposed to defer to the CEO’s judgment. Also, since company dependents are paid by the same people they are supposed to oversee and challenge (i.e., the CEO and management), these “bread eaters” will most likely defer to the CEO as well. “Whose bread I eat his song I sing”...goes a German proverb. In short, stacked boards are passive boards, not the independent, proactive boards that all CEOs and companies need today.

Is there something sinister going on? No, but CEOs who don’t believe having an independent board actually helps the CEO naturally prefer a passive board since they are more likely to see things from the CEO’s perspective. An independent, proactive board is more likely to see things from a different perspective - their own.

Good CEOs typically have high self-confidence and a passion to succeed and spend 20-40 times more hours working for the company than any independent board member. Therefore, since a CEO may know so much more about a company than independent board members, it’s reasonable for him to think he can do his job well without them.

However, regardless of whether the CEO thinks he is acting reasonably in stacking the board, a passive board can hurt a company. Take the example of a small, private Southern California company with a stacked board that asked my advice about restructuring their board. This company, let’s call it Smallco, had completed a painful restructuring and downsizing under a plan well devised and executed by the CEO, who we’ll call Charlie. After 18 months of losses, Smallco turned the corner and became profitable again. Unfortunately, the restructuring so consumed CEO Charlie that he failed to see that the Controller, who we’ll call Chuck, Smallco’s only financial officer and a long-time employee, had stolen over \$150,000 of Smallco’s funds during the turnaround.

Why didn’t Smallco’s board make sure, as all boards must, that Smallco’s financial controls were in place that would reduce the chances of this kind of theft? They looked at Smallco from CEO Charlie’s perspective, instead of their own. However, an independent board, seeing things from their own perspective, would have more likely recognized the need for financial controls.

Typically, a board delegates responsibility for daily operations to the CEO but continues to oversee operations. The board, freed of daily operational responsibilities, has the ideal perspective for oversight: a detached, broader view. The CEO, immersed in daily operations, especially in a small company, may have a narrower, operational view which is good while he's acting as CEO. However, a CEO acting as a board member must think like a board member by having a broader perspective and not think like a CEO who by necessity must have a narrower, operational perspective. And that failure to think like a board member is one reason why CEOs don't automatically make good board members.

From CEO Charlie's narrower perspective, he had hired Controller Chuck, had worked closely with him for a number of years, and had no reason to believe that Chuck was doing anything wrong. Naturally, since Smallco was fighting for survival, CEO Charlie relied on Chuck and focused solely on turning around the company versus overseeing Chuck or making sure that financial controls were in place to prevent Chuck from his nefarious ways.

Charlie being so close to Chuck and so consumed by executing the turnaround made it even harder for him to see operations from the broader, detached view of an independent board. At the same time, Smallco's board being so close to Charlie made it difficult for them to oversee operations from a detached view. In effect, the board saw operations through Charlie's narrower perspective. Had they been independent, they would have more likely viewed the company from a broader, detached perspective and seen the need for financial controls.

Smallco is just one example of a stacked board contributing to a company loss, but board stacking can be common, especially in small and early stage companies. CEOs, an extremely self-confident group, may not see the value of an independent, proactive board, so they stack the board and get their wish, a passive board. However, passivity destroys one of the greatest advantages that a board can give any company or CEO - a perspective, independent and detached from the CEO.

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