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How to Create a Future-Ready Board of Directors

By Michael Mangum and Ed Rowell

A simple shift in perspective regarding boards of directors can lead to a cascade of the best decisions an E&C industry owner will ever make.

Sometimes it's hard to tell the difference between a threat and an opportunity.

One electrical contractor sees a clear trajectory in the growth of clean energy and complains that tax policy and governmental meddling give wind and solar an unfair edge. Meanwhile, a competitor across town is already building a strategy and positioning its business to dominate that emerging sector for years to come. Or consider the small to midsized heavy civil contractor that sees the nature of public infrastructure projects shifting dramatically—both in increasing job size and alternative delivery methods—and starts planning for an accelerated retirement. Another contractor sees those same trends and begins overhauling its business by forging new relationships with potential design-build and public-private partners.

Some of this difference in response is simply a matter of personality. For many, it's about not knowing how to anticipate and take advantage of these disruptions to the status quo. In most cases, companies lack the internal talent to make what feel like seismic shifts in focus, because they've hired to meet the needs of their current reality.

Those who can't answer the question "what's next?" often find themselves stalling, hoping that clarity will miraculously show up like a sign from heaven. To quote former New York City mayor Rudy Giuliani, "…hope is not a strategy."

One frequently overlooked means of preparing for the future is through a high-performing, strategically focused board of directors (BOD). Most FMI clients don't utilize a true, functioning BOD beyond the minimum statutory requirements, and those that do have a functioning BOD often lack directors whose competencies and experiences are well-aligned to anticipate and execute on potential future opportunities. In both instances, the business lacks the right people in the right place to see beyond the day to day and craft a winning vision of the future.

Five Signs Your Board Needs an Overhaul

In FMI's work with CEOs and owners across the industry, we frequently see evidence of BODs in need of a fresh infusion of energy and vision. Do these characteristics ring true for your board?

Any combination of these five factors can significantly hamper an organization's ability to anticipate future trends and position itself for success. Even worse, without directors who can anticipate and respond, a company is at significant risk and may be left behind.

Identifying the Distance From Here to There

We encourage companies to start by assessing the competencies and experience of both management and directors compared to overall business needs in order to accomplish long-term strategic objectives. This comparison should span all major business functions (technology, people practices, market segment focus, operational excellence, etc.) as well as its characteristics (insiders vs. independents, degree of diversity, strategic thinking capacity, etc.) This process is commonly called a "gap analysis." From this exercise will emerge substantial new information that helps a business owner or leader make decisions to close (and even eliminate) those gaps.

Next, ponder these critical questions relative to your business's future and the BOD's role:

- Does the organization currently have the necessary resources to achieve its long-term objectives?
- Conversely, do we have directors who are not adding substantial value toward the goal of building an exciting future for the business?
- What types of directors are needed to close the critical gaps identified?

Finding the Right Balance

Determining the optimal ratio of independent, outside directors and inside directors can be a challenge for any organization. For example, it's difficult for people who work full time in the business to distance themselves from its politics and dynamics. Consequently, they may provide skewed evaluations that are motivated by purposes other than the accurate assessment of executive or organizational performance. A wealth of current research supports the inclusion of outside directors. Their valuable contributions include:

- With independence, the freedom to more effectively monitor the organization and deliver more objective decisions and recommendations
- More likely to ask objective questions, evaluating management and assessing firm performance
- More likely to exercise appropriate checks and balances with management
- Valuable in securing additional resources
- Bring new perspectives and ideas

Along with added value, there are potential challenges as well. Having a greater proportion of outside directors may also lead to:

- Increased conflict
- Reduced firm-specific knowledge, skills and information
- Lower group cohesiveness

Hence, while outside directors can greatly contribute to the BOD, there are strong reasons to include internal directors. Perhaps the most important reason to have director insiders is to prepare them for future leadership roles. By stepping outside their normal operational or tactical role on a regular basis, internal directors can learn strategic thinking skills, gain a broader sense of perspective and build relationships with other leaders.

Overall, it seems that a high-functioning BOD benefits from the right mix of independent directors and organizational directors.

Factors That Matter

Regardless of inside versus outside status, it is important to remember that subject matter expertise alone does not make someone a great director. In addition to having a reservoir of relevant knowledge, a strong advisor must:

- Model proactivity, offering ideas and information readily
- Display excellent listening, diplomacy, negotiation and communication skills
- Demonstrate both functional/general and firm-specific knowledge and skills

A Case in Point

Consider this real-life scenario: The CEO and independent directors of a regional electrical/energy services contractor approached FMI for advice on shaping the board's future to better address the compelling challenges facing the business. The company generated approximately $250 million a year in revenue, with just over 800 employees and a strong presence in the Southern U.S. Performance was good: $15 million NIBT (6% net pre-tax) and a three-year trailing average annual growth rate of 7.5%. The BOD had set strategic goals of 10% compounded growth, primarily through expansion into the Northeastern U.S. markets. The key business risks were succession and commodity price fluctuation.

Internally, the company wanted to begin transitioning from a third-generation CEO to the fourth generation. The internal candidate was in his early 30s and unprepared to lead the business. The BOD wanted to hire a nonfamily CEO, most likely an external candidate.

Externally, more than 75% of the firm's revenue was linked to the relationship of crude oil versus natural gas prices. When the spread of oil to gas was greater than a ratio of 20-to-1, the company couldn't keep up with all of the work opportunities. Yet when it fell to a ratio of less than 10-to-1, there was little to no work. The midterm outlook was for a large spread, but rapid growth in the energy complex had resulted in a severe shortage of engineers and designers. As a result, the buyers of construction services began shifting the delivery method from a traditional GC to a more integrated EPC model. Thus, the availability of internal engineering resources became critical.

The firm's BOD makeup was fairly typical in that the average director age was over 67, with board tenure being about 13 years, and all were Caucasian males. There were four internal directors (CEO, CFO and two next-generation family members) and three independent directors (a retired CPA—former managing partner of current auditors; an attorney—current corporate counsel; and a retired banker—former market president of the company's current primary lender).

At this particular firm, BOD meetings were arranged around a single-page agenda prepared by the CEO with no input from other directors. There was no meeting calendar or predetermined rhythm of meetings over the year. Materials were distributed at the meeting—so there wasn't time for advance preparation. The primary functions of the BOD were twofold: first, to approve dividends to shareholders and, second, to listen attentively as the CEO "pontificated" about current quarterly results.

These independent directors could see out far enough to anticipate some big challenges. They knew they had more to offer and were frustrated by the lack of opportunity to provide input.

Taking Action

After FMI's assessment and recommendations, the following steps were taken over the next 18 months. Key changes involved BOD composition, which was modified extensively, with one replacement and two additional directors appointed:

- An internal director (the current CFO) was removed/resigned from the BOD. He was then replaced with an outside director who was a 30-plus-year retired COO from a similar business. The CFO continues to participate in BOD meetings as a member of management and as an observer, yet he has no vote.
- One additional fourth-generation director was added: the daughter of the current CEO who holds a Master of Business Administration from Wharton, and who is currently CIO of an international software company based in New York.
- One new independent director was added: an energy complex consultant with extensive knowledge of commodity price fluctuations and hedging strategies, who is also currently a director on the board of a publicly traded oil and gas master limited partnership. He was also the former owner/CEO of a Pennsylvania-based oilfield services construction company.

*Note: This maintains internal director control of board (five internal directors).

The following BOD roles were also modified:

- One of the current independent directors (corporate counsel) was named lead director to partner with the CEO in setting the agenda and facilitating meetings.
- A new succession committee was formed and chaired by the retired banker (who still has access to the bank's HR team and consultants) with the initial charter to launch the management succession and ownership transfer process, while doubling down on the inexperienced fourth-generation family member's professional development.
- A new audit committee was also formed, chaired by the retired CPA, with the initial charter to develop strategies to lower commodity price fluctuation risk to the business.

Measuring the Results

By honestly facing the cold, hard facts around the gaps they saw, the gutsy leaders in the above example delivered immeasurable influence to bear on the future of this company. By making a few needed changes and a few key additions to the BOD, they found clarity around their challenges and took intentional deliberate steps toward their preferred future. Through it all they maintained a strategic focus, refusing to delve into operational issues in their quest for solutions.

For an owner/CEO, it takes significant ego strength not only to bring in outside directors with specific expertise aimed at the future, but also to actually empower those directors to affect change. For those individuals with the courage to share the strategic leadership platform, those dark clouds on the horizon that once looked like a vicious storm now begin to look like unprecedented opportunities. Rather than focus on a perceived loss of control or feelings of being accountable to others, a simple shift in perspective can lead to a cascade of the best decisions an E&C industry owner will ever make.

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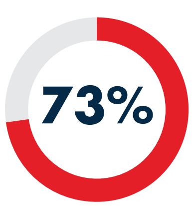

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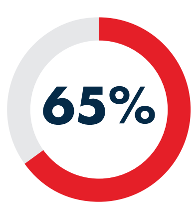

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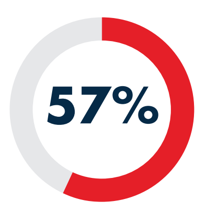

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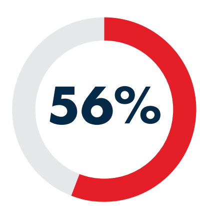

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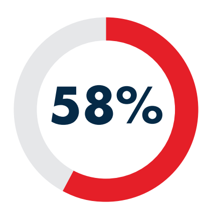

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