Governance Issues Unique to Start-up Businesses

Ag Decision Maker
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File C5-75

Many value-added agriculture businesses are start-up businesses. A group of individuals, often called a steering committee, have gotten together to investigate and create a business. However, once the business is up and running, governance of the business is transferred to a board of directors. Making the transition from steering committee to board of directors is often a difficult transition for rural businesses.

Two issues that often emerge during this transition are:

1) The size of the board of directors often needs to be smaller than the steering committee. So, some of the individuals who have worked hard and invested a great amount of time to create the business cannot participate as a director.

2) The role of the board of directors is different than the steering committee. The steering committee and its members are often intimately involved in the activities of creating the business. However, the role of the board focuses mainly on setting policy and the activities of the business are delegated to the manager or Chief Executive Officer (CEO). Some steering committee members may make better board directors than others.

Size of Board of Directors

Many newly formed businesses start with large boards of directors. Typically the board is made up of people who participated on the steering committee that created the business. The steering committee is typically composed of industry leaders in the community that help generate support for the entity. So, it's not uncommon to find steering committees of over 20 people. These steering committee individuals often want to continue to participate in the business by being on the board of directors. So, the board of directors of a start-up business may be composed of the steering committee members and may be quite large and become unwieldy at times.

If this occurs, the board may need to downsize to a more manageable number. However, any time you have a steering committee of over 20 people and then move to a board of directors of eight people, most of these people will no longer be involved in the business. How do you make this transition without offending people who want to continue to be involved in the business?

What's the right number of board members? Research indicates that about nine individuals may be optimum in a corporate setting. The number nine is often made up of seven board members and two members of management. We know that management cannot participate on the board of directors. So the actual decision making group consists of seven individuals. Seven may be too low for many of the organizations located in rural communities. So choose a number for which you are comfortable. Nine is often used for value-added companies, but it's not uncommon to find larger boards. Just remember that, as the number of directors increases, it becomes increasingly complex and time-consuming to reach decisions.

If you have a business with a large number of directors serving on the board, you can improve its efficiency by utilizing committees. Committees allow a subset or small number of directors to conduct decision making on specific topics. This frees the board from having to deal with all of the decisions facing the company. Committees may make the actual decisions relative to their focus areas and report their decisions back to the board, or make recommendations to the board for final action by the board.

Examples of committees include the following:

Executive Committee - A large board of directors often has an executive committee. Executive committees are often composed of the officers of the company plus a couple of "at large" representative from the board. Executive

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committees often focus on areas of decision making that are relatively minor to the functioning of the business. This allows the board to focus more of its time on the major issues facing the business. An executive committee should not become a policy making committee. Policy should be made by the entire board of directors. The executive committee should not become a board within the board.

Nominating Committee - A nominating committee is usually appointed every year to go through the process of recruiting individuals to run for the board of directors.

Finance Committee - A financial committee usually deals with the on-going financial activities of the business and organizes the activities of the audit. This is a critical function and one that many directors are uncomfortable serving on.

Management Evaluation Committee - A management evaluation committee is formed to conduct the performance and compensation evaluation of the CEO or general manager. This committee reports its finding back to the board.

The larger the board, the more committees you may have. Typically, there are just the nominating, finance, and management evaluation committees with a nine member board. Larger boards may also have an executive committee. Other committees may be added to reflect the unique nature of a business.

Transition from Steering Committee to Board of Directors

Newly formed companies often struggle with the transition from a steering committee that created the business to a board of directors that oversees the operation of the business. The role of the steering committee is a hands-on investigation of a business opportunity and, if feasible, the creation of a business entity to take advantage of the opportunity. Conversely, the role of the board of directors is the hands-off oversight of the operation of the business entity where a management team has been hired to conduct the hands-on activities.

Individuals who are well suited for the steering committee may not make the best directors. This has nothing to do with their level of competence or desire. Often the steering committee members have poured their passion and soul into forming the business. In some of these situations, the steering committee has been involved in activities that employees would normally be doing. If this occurs, you may have a problem when you shift to business operations with a board of directors. The role of the board of directors is to hire a manager and have that person oversee the activities of the business. Board members should no longer be involved in the day-to-day activities of the business, as they were when they were steering committee members. This involves moving to a system of delegating responsibilities.

Some people’s talent is very well suited for a steering committee. These activities may involve promoting the business and helping provide creditability in the community. These traits are good for a steering committee member but may not be the best traits for a director. The challenge is how to move from a steering committee to a board of directors while retaining the individuals who will make good board members.

The first step is to recognize the issue and discuss it. It is okay to hire a person to manage the business and go back to your normal line of work and let the manager run the day-to-day business. Talking about this issue rationally as a steering committee often helps the committee members realize what’s happening and why it’s necessary for them to step away from the day-to-day aspects of running the business and let the manager handle these activities.

Related Ag Decision Maker Files

File C5-70, Introduction to Governance, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-70.pdf

File C5-71, The Role of the Board of Directors, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-71.pdf

File C5-72, Recruiting, Selecting and Developing Board Members and Managers, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-72.pdf

File C5-73, Board of Director Evaluations, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-73.pdf

File C5-74, Business Strategy and the Board of Directors, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-74.pdf

File C5-76, Board of Director Educational Needs, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-76.pdf

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