NACD Directorship

Risk Mitigation on a Budget

Directors have multiple opportunities for risk management education, from formal classes to casual networking.

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It is poignant to speculate that if the largest financial institutions in the U.S. had simply spent more of their extensive budgets on better board education with respect to complex financial instruments that a $15+ trillion mess could have been avoided. During a recent board meeting I attended where this subject was being discussed though, one director instructively commented that "effectively managing risk isn't a function of expenditures for director education, because thousands of small public company boards expertly manage risk on a daily basis, where the budget for director education isn't large enough to buy a cup of coffee!"

Especially since so much of the discourse in corporate governance focuses upon large-cap, headline-making events (e.g., Enron, Lehman, etc.), it's easy to overlook that in excess of seven out of every ten public companies in the U.S. have a $500 million market capitalization or below. At many of these companies, boards are not only leanly-staffed, but the annual budgetary expense for the entire board can be less than the amount a large-cap company expends on just a couple of directors. When taken together with the fact that small-cap companies have demonstrably smaller margins of error in managing risk, what can the governance community at large learn from the way risks are managed at the smallest of public companies?

1. Risk is relative. Small-cap companies are immune suppressed versions of large-cap companies; a poorly mitigated risk that gives a large-cap company a "cold" will kill most small-cap companies. Accordingly, small-cap companies are uniquely attuned to survivalist risk mitigation; whether a risk is simple or complex is neither here nor there, rather risks that have serious corporate consequences require serious oversight.

2. The answers are not in the boardroom. The first step in managing risks is to identify them. But the majority of small-cap companies can't afford to retain board consultants to identify and confirm risks. Instead, financial restraints compel small-cap directors to be more hands-on—speaking with employees, customers, and suppliers in the field. As Laban Jackson and Suzanne Hopgood so eloquently stated to a room full of directors at the Directors Forum in January, the answers to most governance questions are not in the boardroom.

3. Read trade publications. Small-cap companies can rarely afford to purchase proprietary third-party industry reports. Accordingly, many directors of small-cap companies develop the requisite

industry expertise by reading relevant industry publications, which are often compelling sources of statistics, trends, and analyses.

4. Take advantage of publicly-available information. The public filings and quarterly earnings calls of publicly-traded competitors are treasure troves of information about macro and micro risks, and the steps taken to mitigate them. For example, are there risks which similarly situated companies seem to be more (or less) concerned about than your company? Does your company seem to be facing risks that your competitors are not? Do your competitors have creative ways of managing some risks which your board hasn't entertained?

5. Ongoing dialogue with other directors. Because the process of identifying and managing risk is more the same than it is different, industry notwithstanding, having an ongoing dialogue with other directors outside of your company is always time well spent. Local NACD chapter meetings and director education forums are great venues for such interaction.

Whether it's a visit with a large customer that gives rise to material doubts about the scalability of your legacy ERP system, a passage in an industry trade publication that identifies a new, well-funded Brazilian competitor, a comment from another company's CFO during their earning call about a creative new way they found to hedge currency risk, or a conversation with another director over coffee wherein you learn about a problem they found with their existing insider trading policy, all of these risk mitigation tools have one thing in common – they fit any budget.

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