



Fiduciary Guaranty *Smart Governance*TM Program

To the typical challenges that all commercial enterprises face, there are a few additional ones that accrue to closely held corporations and family owned businesses. Most of these challenges derive directly from the market perception that the quality of corporate governance is compromised in the closely held corporation. Notice our invocation of the term “market perception.” Sometimes “perceptions are reality” in the minds of investors, regulators and the pesky plaintiff’s bar.

Access to capital – either debt or equity issues – can be restricted because of the widely held belief that the directors are less likely to think independently of management and to hold management accountable to “best practice” standards. This is especially troublesome when the board IS management. The need for either outside directors OR a third party-monitored decision making process ... becomes imperative to open the money spickets for debt and equity capital.

Pressing the firm’s competitive advantage in the marketplace depends on capably prosecuting a portfolio of complex, interrelated value-creation and risk-attenuation tasks. The judgemental component of these decision tasks is very demanding. Without the Board having been conferred with a superior decision making capability – it is unlikely that the firm can optimize its competitive positioning. This is a serious matter ... because of an immutable central reality: revenue growth and earnings growth derive from the magnitude of the firm’s competitive advantage and its sustainability. Boards that fail to perform independently of management’s preferences and biases - rarely achieve superior decision making capability.

And, finally – the absence of outside or independent directors tends to elicit greater fiduciary liability. This factor derives from both the market perception of fallible judgement that derives from non-independent boards – and from the reality that non-independent boards are rarely able to “challenge the boss” and thereby widen the domain of alternative courses of action. A long-standing principle of complex decision making under conditions of risk and uncertainty ... is that quality decision making is facilitated by driving an exhaustive search for alternative courses of action. Failure to do so ... truncates the range of alternatives and elicits faulty decision making. Adversarial constituencies don’t need much of an excuse to litigate against a board for alleged violations of the duty of care or the duty of loyalty.

FIG Product Offerings for Closely Held Corporations

Board Incubator™ Program

When a Board makes a decision to add more outside directors – two challenges are immediately apparent: 1) time and resources are required to find competent board candidates – a problem if “time is of the essence” and, 2) by what evaluative procedure can a board determine the suitability of candidate qualifications?

The FIG Board Incubator Program addresses these two issues – shortening the time requirement and vetting the candidate qualifications for board service.

By this program FIG can provide two-to-four qualified directors immediately (within thirty days). These directors will be temporary and will typically serve for one year or less – contingent upon permanent directors having been sourced, trained and placed.

Following placement of the temporary directors, FIG will conduct a search, selection and training of directors who can serve on a permanent term basis. The training conferred by FIG’s Smart Governance Team will be specific to the dynamics of complex futurity decision making and the Decision Audit and Smart Governance Audit principles embedded in these FIG board services. In other words, this is not yesterday’s legacy training regimen.

Smart Governance Audit™

The purpose of the **Smart Governance Audit** is to identify how a board makes its most important decisions. This task requires understanding how information (including decisions made elsewhere in the organization) flows to the management team before it is presented to the board in the form of a proposal, feasibility study or recommended course of action. And, importantly, it includes how the board interacts with management in making decisions specific to management’s recommendations.

A generic *decision topography map* is developed to portray these decision-and-information flows.

The value of the **Smart Governance Audit** is its demarcation of the most significant decision process errors and sub-optimalties that characterize the board’s and the organization’s routine decisional performance.

By providing an informed basis for addressing systemic underperformance – the board can hold the organization accountable for upstream decisional deficits that would otherwise introduce incumbent error into the boardroom decision making process. Specific benefits include:

- The board’s ability to discharge its duty of care in holding management accountable is enhanced

- The board is empowered to be adopt a healthy skepticism about claims made in any management recommendation - which is the proper supervisory attitude required to fulfill the fiduciary oversight role
- The board demonstrates its interest in and commitment to superior decision making within the corporation – an action oriented posture that serves the best interest of the shareholders

Ad hoc Decision Audit

Fiduciary Guaranty (FIG) presents a remediation methodology for boardroom decision making that elicits a threshold of fiduciary decision making performance that is difficult for aggrieved stakeholders, including dissident shareholders or politically motivated regulators, to challenge. This means that – aside from the occasional manifestation of Murphy’s Law - the directors, officers and other corporate fiduciaries participating in the decision making process will never lose a fiduciary lawsuit brought against them for alleged violation of their fiduciary *duty of care*. This is achieved by establishing a *refereed decision environment* in which the decision making process is monitored and groomed in real time - inside the boardroom - by independent, third party experts.

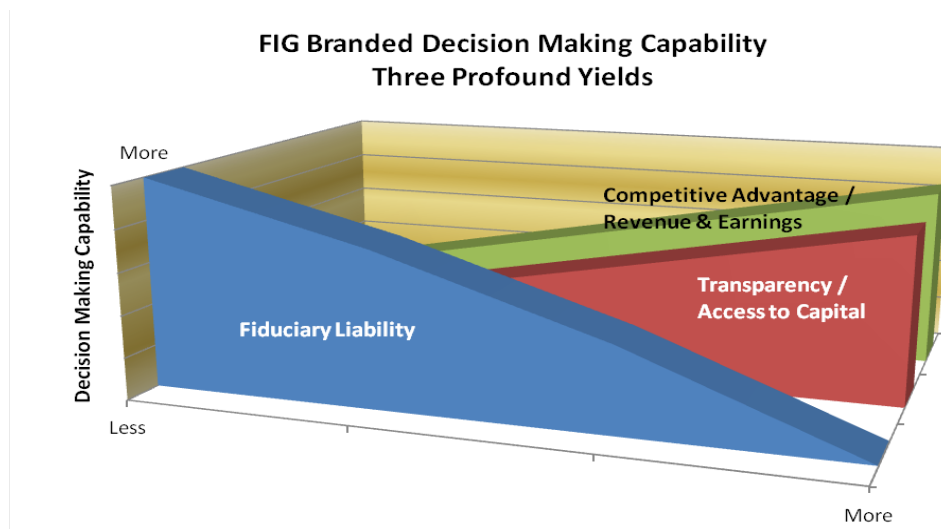
The decision audit not only protects the directors from the personal liability of fiduciary risk – but also delivers superior decision making capability to the company – which optimizes the firm’s ability to achieve and retain a significant competitive advantage in its marketplace(s). It is widely recognized that it is the magnitude of competitive advantage that drives the extent and duration of revenue growth and earnings growth. When company leadership makes better quality strategic and operating decisions – it will make more money as a commercial enterprise.

And, curiously, because the level of analysis conducted by the ad hoc Decision Audit is at the level of the judgemental activity that informs the decision making process, the Decision Audit can demonstrate a complete transparency to investors and other permitted stakeholders. Recall the decades-long quest by shareholders to extract greater transparency from the boards of their portfolio companies. Recall the resistance by boards to comply with a meaningful transparency standard because directors have always viewed board transparency as inimical to the interests of the company, viz., and transparency implies disclosure of competitive strategies, new product offerings, trade secrets and other information which would necessarily compromise the competitive advantage of the firm. By analyzing fiduciary performance at the level of judgements rendered – the Decision Auditors can certify that the complex decisions of the firm were made as well as humans can make them – and that certification does not have to be expressed in terms of any business content issues. By this protocol – investors can be provided evidence collected by outside third party experts that the Board is performing at the highest level – without disclosing proprietary information of any kind.

Specific benefits of the ad hoc Decision Audit include:

- Attenuation of board liability with a product performance indemnification feature that guarantees that the client board will never lose a duty of care lawsuit against a FIG decision audit refereed decision. This guarantee is backed by an insurance mechanism which pays for any court adjudicated settlement (up to a pre-defined amount) as well as attorneys' fees.
- Delivery of perfect transparency in the board's decision making tasks. This allows key investors and other targeted stakeholders to see exactly how well the board is performing without disclosure of any sensitive company information
- Delivery of superior decision making capability which will, over time, accelerate the company's competitive advantage in its market place(s). This will reliably elicit greater revenue growth and earnings growth.

The Centrality of Decision Making to Coveted Instrumental Outcomes



Decision making capability has been plotted in a Cartesian space against its impact on competitive advantage (and its progeny – revenue growth & earnings growth), board decision making transparency (and its progeny –

access to capital) and fiduciary liability. We have qualified the independent variable **decision making capability** by attaching a **FIG-Branded** prefix to it for the following reason: without the application of the **FIG ad hoc Decision Audit** – there is no way to confirm whether a corpus of decision makers has achieved optimality in its decisional performance. It is the decision science based algorithms inherent in the Decision Audit intervention that confers this capability. Hence, without the FIG imprimatur, there may not be a compelling way to persuade either investors or plaintiffs that superior governance practices have been achieved.

As a matter of full disclosure, the functions plotted above represent conceptual relationships between the variables. These functions are not based on data collected in a formal empirical study¹. Regardless, the functional relationships described are unassailable if the underlying assumptions are credible. There are three underlying assumptions: 1) if a board reliably and consistently makes better quality decisions – its competitive positioning will improve and that improvement, over time, will lead to enhanced revenue growth and earnings growth, 2) if a board can demonstrate to its investors *via* third-party-expert-testimony that its decision making performance is superior – those investors will experience greater confidence in the firm’s governance practices and will be more likely to assume an investment position – debt or equity, and 3) if a board can demonstrate to any aggrieved stakeholder or to a court-of-law that it has optimized its decision making process specific to its discharge of its fiduciary duties of *care* and *loyalty* - the consequent likelihood of losing a fiduciary lawsuit will approach zero as a limit.

¹One further observation: the design of an empirical study to demonstrate the validity of these functional relationships would require a multi-year longitudinal study with a level of access to the corporate participants that may not be possible to achieve on the scale required for making proper inferences from those data. Accordingly, working from plausible assumptions is a recommended approach.

Summary

Serious business observers understand the magnitude of contribution made to the American economy and the quality of life of millions of people - by closely-held corporations and family-owned businesses. Nested within that prolific value creation capability, for some of these companies, is a structural vulnerability that derives directly from governance practices that are perceived by governance ecosystem players (e.g., investors, regulators and other aggrieved stakeholders) as deficient and that, because of board independence issues – are – in fact, sometimes, deficient.

In collaboration with Dr. Steve Moyer and his colleagues at The Network of Family Businesses LLC, Fiduciary Guaranty has developed a program to address those structural vulnerabilities.