Board best practices for a company partnering with a Private Equity firm

For many board and executive teams taking on investment from a private equity (PE) firm, the board represents one of the biggest areas of change and in some cases challenge & anxiety. In my experience of supporting company board teams and PE firms over recent years in the board effectiveness & performance area, getting the new board team off to a strong start represents a critical foundation of a successful partnership with your new PE investors. Research by McKinsey has shown a strong correlation between high-performing PE portfolio board teams and out-performance of PE portfolio companies at the exit stage. The board of directors represents the critical formal interface through which a PE team partners with a company and the successful performance of a highly effective board team is a cornerstone of the PE model.

In practice, many CEOs, executive teams and existing board teams find the transition to a private equity portfolio board paradigm quite daunting and CEOs ,in particular, have often found the first board meeting post investment to be one of those "the honeymoon is over" moments after the highs of closing the deal and in many cases taking some money off the table. This is understandable because in practice many companies' board maturity level prior to private equity investment is not very high and would have a significant gap to bridge to the level of board effectiveness and performance that a PE firm would require. The key areas that would comprise this gap consist of the level of formal target setting & performance reporting, sophistication of financial reporting, level of debate and challenge by the non-exec board members as well as the overall formality of the board.

Prior to taking on PE investment, many company boards, particularly those with CEO founders still in place, would have had executive-centric boards where the chairs and independent non-executive directors would very often be reluctant to challenge the CEO & executive team, hold their feet to the fire in terms of formal performance reporting and partner with the executive team in the strategy area.

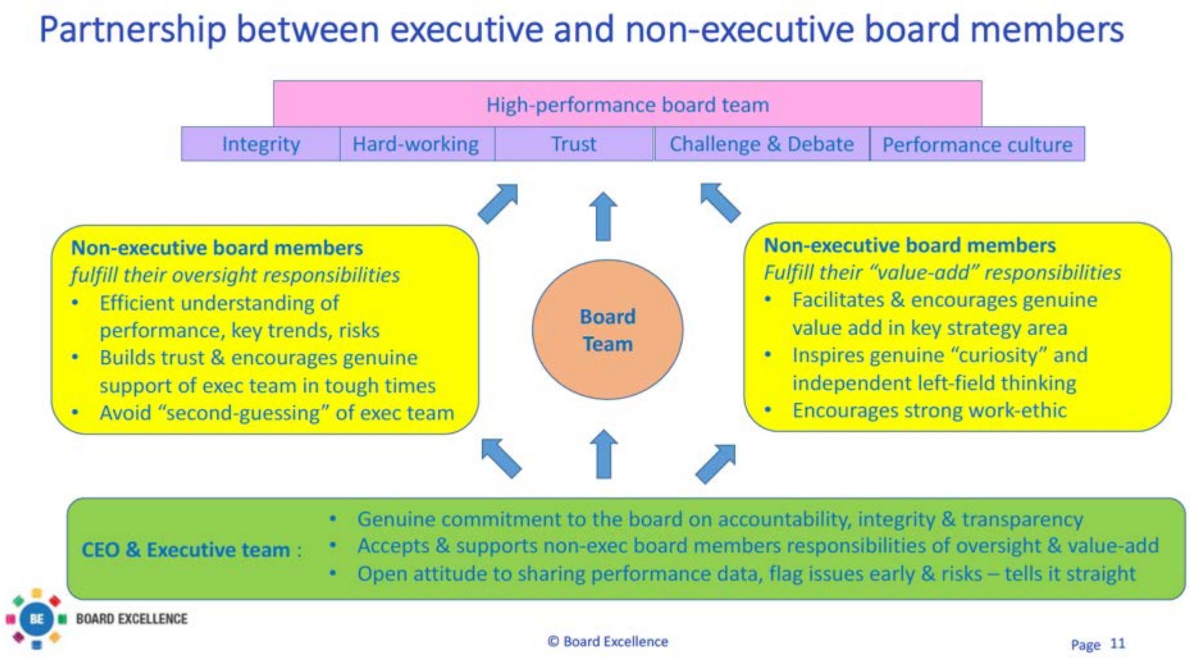
I have outlined below some key best practices that I have seen work well and really help the CEO, executive and existing board team to embrace the value the PE firm are bringing and make a strong start to establishing a genuine high-performing and effective board team from the outset that will lay the foundation for the journey ahead. While these recommendations are primarily geared towards majority PE ownership scenarios, the vast majority of the best practice recommendations apply equally well in PE-minority and venture capital investment scenarios.

Understanding, valuing and respecting the role of the board

Prior to taking on a PE investor, many CEOs and executive teams do not fully understand the role of the board. While this might sound strange for companies who have built substantial businesses to a level where they attract PE investment, it is surprisingly quite common. Particularly in those cases where you have a CEO and founders retaining a significant shareholding, board meetings often resemble executive meetings and in many cases the CEO and executive teams are not used to tough constructive challenge from non-executive board members. They also in many cases are not used to those same non-exec directors who bring tough oversight also bringing significant independent thinking to the table. The diagram below from our board best practices workshop illustrates the key role of a modern progressive high-performing board team which combines strong constructive oversight and significant value-add by the non-execs in key areas such as strategy and crisis management.The approach of the CEO and executive team in valuing and respecting the role of the board is the critical foundation of a high-performing PE portfolio team.

As a former CEO, I can testify to the fact that in the early stages, I was very cagey with the board, wanted to really concentrate on the good news, wanted to demonstrate that I had the strategy all figured out and slipped very easily into the pattern of "managing the board". This is a very natural understandable starting point for many CEOs. I was blessed in my own case of having an outstanding board chair who gave me a dose of salts early on and helped me understand the value of the board, my responsibilities as CEO and that to get the best from a board team, the CEO needed to genuinely open up, demonstrate the highest levels of respect and accountability to the board and in doing so would inspire the board to want to genuinely add serious value as well as discharge their oversight and stewardship responsibilities on behalf of the shareholders.

I have outlined a number of key areas in Diagram 1, an extract from our board best practices workshop, that I have found in supporting boards over the years represent best practices for a CEO and executive team in enabling high-performing board teams. These are now explored further below.



Composition of the board – key chair leadership role

The chair in any company board has a critical leadership role. PE firms place a major emphasis on the chair role in their portfolio companies and the overall dynamics between the CEO, chair and PE partner who sits on the board.During the due diligence phase, the PE firm will assess the current chair and unless they feel that the current chair is strong, ideally has PE chair experience and is prepared to genuinely embrace the new PE shareholders and PE partner as a genuine independent chair, the PE firm will look to put in place an experienced PE chair from their own chair network. I have seen a number of cases where the PE firm are genuinely prepared to work with an existing chair who while not having PE chair experience has the raw material and calibre to grow with the appropriate supports as a chair in line with the company scaling under PE ownership. For this to work, it's critical that the chair demonstrate a genuine commitment to lead the board independently on behalf of all shareholders and have a proper balanced relationship with the CEO. In a number of cases, PE firms use an executive chairman model. While this can work extremely well in certain scenarios, I believe an independent non-exec chairman, albeit with significant capacity to devote to the company and supporting the CEO & exec team, still represents a clearer and better model. In the case of a new chair being appointed, I can't stress enough the importance of the CEO investing significant time early on to understand the style of the incoming chair and build a strong partnership from the outset.

Composition of the board – independent non-exec directors

As part of the due diligence process, PE firms will assess the current non-executive directors who sit on your board. It's really important that the CEO and existing chair if going forward, ensure that the PE firm understand the value and expertise of existing non-exec directors who have made a strong contribution and will continue to make a strong contribution in the next stage of the company. Sometimes, PE firms can be too quick to parachute in non-executive directors from their own network who while in many cases are solid generalists, often do not have the deep sector expertise who could make a fundamental difference in adding value in the strategy area etc. Some PE firms have an approach of keeping the board team as small as possible and feel the PE partner and chair are sufficient in terms of non-executive directors. I believe this is a mistake and I would always encourage any PE portfolio board to have a truly independent non-exec not aligned to the major shareholders who brings deep sectoral expertise to the table and wouldn't hesitate to constructively challenge either the CEO or PE partner in key areas. Any board, irrespective of its shareholding and board team structure, is capable of a serious group think problem.

Alignment of board information model to IM targets and 100-day plan

A very important first step in preparing for the first and initial board meetings is to shape the board reporting and board information model to align with the key IM targets and the 100-day plan that is constructed with the PE firm. In preparing for the first board meeting, the CEO needs to work closely with the chair and PE partner to identify the board reporting template to ensure all of the key areas are covered. In many cases this will require a significant shift from the previous board reporting format. The new board and PE partner will always cut some initial slack to the CEO but a solid start in this area really helps get the board team off to a strong start. I find the use of smart exec-summaries for each of the key sections and very transparent traffic-light style reporting on key performance targets really helps set the tone for a high quality board information model that will evolve over time.

Building early confidence and trust

A new board team post a PE investment is no different to any other new team in terms of getting to know each other, understanding each other's working styles etc. When the CEO and executive team put a big effort in those first board meetings to helping the board understand the true progress of the business, absolute openness and honesty on key problems and truly engage the board team, there is early trust and confidence built that can enable quite a rapid transition from the former board to a highly effective PE portfolio board.

Leveraging the value of the PE partner & their supporting teams

Apart from the financing support, I believe PE partners and their supporting teams bring significant value to their portfolio boards in terms of

- Strong experience in scaling companies
- Specialist expertise in areas such as cyber-security, scaling sales organisations, business & pricing models, technology and development
- Financial expertise and support to upskill the company finance function
- M&A experience
- Support on building out the executive team through both their own extensive networks, partnerships with exec search firms etc.

Progressive open-minded CEOs recognize this value and leverage it effectively. I also see PE partners who sit on boards as a special case of a high-calibre non-exec director who bring substantial expertise to the table in their own right (many have broad experience in exec roles, other PE firms, great exit track record within their own PE firm etc.) and importantly have the bandwidth to devote to your company, to building up a detailed understanding of your market, the competitive landscape, M&A opportunities and who have a very strong alignment with you to out-perform as a very hard-working committed board team colleague. While the PE partner who sits on your board is no different than the strongest non-exec director and will not have the absolute gospel on everything, my experience has been that they are very level-headed and on the money 90% of the time in terms of understanding the current state of the business and adding serious value to critical decision-making.

Understanding the perspective of the PE partner on your board

Many CEOs and exec teams don't fully realise the significant commitment the PE partner who sits on your board has, to their own organisation and by extension their fellow partners & investor shareholders. Unlike venture capital portfolios where a partner can have a significant number of investments at any given time, PE firms often only make 5 to 6 investments a year and each PE partner normally has only one or two portfolio investments to enable them devote significant time to supporting the company. The PE partner sitting at your board table is very much invested in your success as a CEO and it's important you recognize the scrutiny they are under when they sit down at their partners meeting and the pressure they feel if the company performance struggles in any way.

PE partners hate surprises !! – flagging serious issues early

Taking into account the factors outlined above, PE partners absolutely hate negative surprises ! I can't stress enough how critical it is that when there is a genuine potential of a serious issue emerging in terms of sales/operational/financial performance or any other serious risk to the business that you

- Flag early the nature of the potential problem
- Outline the root-causes and proposed plan to mitigate this
- Engage the board for their independent expertise and support to address this

While the PE partner and board may be disappointed in terms of how this may or have arisen, they will focus all their energies on supporting you address the problem. Holding back on a serious issue and then surprising the board and PE partner when things have degraded is a recipe for disaster putting the PE partner in a very difficult position both at the board and back in their PE firm.

When serious problems arise

In many PE portfolio company journeys, there will be hiccups along the way both un-foreseen such as significant changes in the competitive landscape, regulatory environment and macro environment as well as those that are self-inflicted. My experience has been that PE partners in general are quite calm, logical in fully understanding all of the relevant factors and can help the CEO to leverage their expertise in similar previous crises in their portfolios. This in particular, is where the goodwill built up by the CEO and executive team with the board and PE partner is leveraged to get strong support from the board team and PE firm in addressing the issues.

Partnership in the strategy area

While in many cases, the core company strategy has been mapped out in the investment IM, the reality of the dynamic fast moving markets that all companies now operate in, there will be times when serious adjustment will be needed in the company strategy. The most progressive and high-performing board teams in today's environment have a very partnership-oriented approach to the exec and non-exec board members working very closely together on the strategy area. This is particularly important in a PE portfolio board. Many founder CEOs, in particular, initially find it a challenge to move away from a traditional model of bringing the strategy 90% baked to the board for sign-off. By partnering with the board team and enabling the PE partner, chair and non-execs to challenge & debate strategic options and bring their own independent thinking to the table, you end up with a company strategy well thought out and supported by the board.

Summary - a high-performing effective board team excelling post PE investment

In summary, the private equity model is ideally positioned to enable an effective high-performing board team balancing strong oversight & challenge combined with the non-execs and PE firm adding significant value to the CEO, exec team and company. A key part of the board team transition is the CEO and exec team enabling a very open culture of accountability and transparency on company performance and financial reporting to help build early confidence and trust. In return, the PE partner, chair and independent non-execs bring significant added value to the CEO & exec team in a genuine partnership model to deliver outstanding value for all shareholders and stakeholders.

Kieran Moynihan is the managing partner of **Board Excellence** (**www.board-excellence.com**) – supporting boards & directors in Ireland, the UK and internationally excel in effectiveness, performance and corporate governance.

Think your business could benefit from our services and expertise? Get in touch today to see how we can support your board excel.