

DIRECTORBANK.

THE ROLE OF THE PRIVATE EQUITY CHAIRMAN

Part 6.

The **challenges of chairing
a PE-backed business.**

A series of short reports encompassing the views of 240 experienced Chairmen.

THE CHALLENGES OF CHAIRING A PE-BACKED BUSINESS?

In a series of mini reports, Directorbank explores the role of the PE Chairman – the draw, the required skill set, the opportunities and the challenges, particularly concerning the relationship with the CEO, the wider management team and the backers.

This report explores the challenges of the PE Chairman role and encompasses feedback and insight from a recent survey of 240 experienced Chairmen from our network.

5 KEY AREAS WHERE CHALLENGE IS LIKELY TO ARISE:

1.

A BREAKDOWN IN THE PE INVESTOR AND MANAGEMENT TEAM RELATIONSHIP

The main challenge cited by **46%** of the Chairmen surveyed is keeping the interests and agendas of the shareholders aligned throughout the investment period. This is particularly testing when management has a mistrust of the investors or they are reluctant to accept PE's views. Conversely, tensions can rise when a PE house is unwilling to understand, or is unsympathetic towards, the motivations and aspirations of the executive team.

To reconcile entrenched positions, the Chairman must come from a position of trust and mediate discussions, ensuring the interests of the different shareholder groups are acknowledged and respected. On one side, he must build and maintain a good relationship with the CEO and the Management Team, and on the other, the PE house and the non-executive directors. He must act as a communication filter ensuring that all sides have a clear understanding of the realities of the situation and the required actions.

“You need to stay close to the business, to the Management Team and to the PE firm to ensure you are all in it for the same end result, albeit with different flavours.”

“The Chairman has to be a politician in ensuring that good relations are restored.”

“You need to get the issues out in the open and have an explicit understanding of what can and can't be resolved. You must help each side to see the others point of view.”

“It requires subtle diplomacy, careful listening and persuasion.”

“If issues arise between parties, get them to talk to each other and work it out, but not at a board meeting.”

“You must communicate very often with both Management and the PE house, openly and fairly, on all strategic and personnel issues around the Board. You need to make sure the CEO, Chairman and investment leader from the PE house have a Troika every 2 months – there is no agenda, but anyone can put up what they want to talk about. It makes sense to be aligned over difficult decisions.”

“Seek resolution through listening and talking. Be prepared to take tough decisions, but at all times be fair. It may not seem fair to everyone, but if you have listened and thought carefully, the Chairman is beyond reproach.”

“Keeping the interests of the investors and managers aligned, both in good times and bad, is essential. The only way to do this is through close dialogue at all times during the life of the project from even before the investment has been made right through to exit. Even then, it can be difficult, especially if the people involved change.”

2. AN UNDERPERFORMING MANAGEMENT TEAM

Management’s failure to hit agreed milestones was noted by **29%** of Chairmen as the main challenge they have faced in the role. Often this situation is exacerbated by considerable pressure from the PE house who demands swift improvement.

In such circumstances, respondents agreed that one must ascertain quickly where fault lies. The Chairman should consider the situation carefully and calmly. He must look at the factors at play and make sound and well considered decisions based on fact, common sense and experience. If members of the executive team are at fault, often the CEO or FD, he should consider replacing them. Importantly, the Chairman must keep the PE backer aligned with the agreed course of action.

“A successful business can breed complacency and cause a reluctance to adapt or step up a gear. A combination of patience, listening to people, tact, humour and persuasiveness have worked best.”

“The main challenge almost always starts with the business not performing in line with the business plan, or in line with the expectations of PE. The solution varies enormously depending on what has driven the underperformance, and the time and capital it will take to correct it. You also have to look if the management team have the right competencies to cope with the new set of circumstances.”

“You must coach executives who have strengths critical to the business, but lack leadership skills.”

“If management cannot make it work, the Chairman needs to change them. If management struggles to make it work, the Chairman needs to help them.”

“You may need to replace senior members of the management team who were ok at the early stages, but did not grow with the company.”

“The balance between the non-executive and the executive is difficult when performance is below expectations. It is important to stay balanced, understand the real and root causes, and then take appropriate and calm action.”

3. GETTING AGREEMENT ON THE RIGHT TIME TO EXIT

Board relations often come under increased strain in the build up to an exit as interests diverge and stress levels rise.

Delivering an exit that works for all parties was cited by **12%** of our surveyed Chairman as a major challenge of their role. Particular issues highlighted revolved around exit timing and a breakdown in communication such as the PE house excluding the CEO and Chair from exit negotiations, or not including management in the exit process early enough.

The solution proposed by the respondents was to have very open and honest dialogue with all parties regarding exit strategy, reach consensus on the proposed route, and help everyone hold their nerve along the way.

“Pressure to exit too early can cause friction. The biggest challenge is delivering an exit which works sufficiently well for all parties as interests tend to diverge at exit time.”

“The Chairman must work incredibly hard with both sides to agree on a way forward.”

“I have experienced being pushed out of exit negotiations by PE. Here, the Chairman must demonstrate that his network and negotiation experience is deeper than that of the PE house.”

“Agreement on exit timing has always been achieved through a detailed review of the options.”

“A big challenge is around exit timing. Progress usually takes longer than planned, and the Chairs job is to help everyone hold their nerve.”

4.

THE PE INVESTOR OVERWHELMS MANAGEMENT WITH UNNECESSARY INTERFERENCE

Unnecessary and distracting involvement in the business - usually due to a lack of faith in the Management Team's ability, or a lack of patience over deliverables - was deemed unhelpful and damaging behaviour by **12%** Chairmen surveyed.

To overcome this, respondents cited the need to work more closely with the PE investor, using experience and tact to educate and broker a fair compromise. Ultimately, the Chairman has to ensure that expectations are clear from the outset and fair boundaries have been established.

“PE Investors who try to micromanage the business is a challenge. This is where the Chairman has to take the investors to one side and agree the boundaries of their involvement.”

“Consistency of management in the PE house can be problematic, as can unnecessarily excessive governance which can jam momentum. There is no same answer on overcoming them. Worst case you resign, best case you can get the PE to listen.”

“A Chairman must ensure management and investor work together productively and keep focused on the main goal of achieving a good exit in due course.”

“Friction between PE house and Management Team is usually overcome by healthy debate and open sense making.”

“Achieving the right degree of involvement is a learning curve for both, but it becomes easier with time, effort and engagement.”

5.

THE PE INVESTOR MANAGES BY NUMBERS AND LACKS UNDERSTANDING OF THE BUSINESS

11% of the Chairmen surveyed have been challenged by a PE investor who dwells on historic numbers and asks the Management Team for large amounts of data without really getting to grips with the business, where it's heading and how it's going to get there.

The solution presented by several of our Chairmen is to ensure the long term interests of the business remain firmly on the Board agenda, and the strategies and initiatives for achieving such growth or change are appropriately discussed by all parties.

In some cases, respondents talked of a lack of experience amongst the PE team, often resulting in hesitant decision making and poor judgement. Here the Chairman should spend time educating them on the nuts and bolts of the business and ensure that sufficient time is allocated to the strategic planning process to compensate for this.

“There is a tendency to spend time on financial analysis at the expense of business, customer and employee development. The answer lies in developing a Board agenda that's more focused on growth strategy and the change initiatives required for successful execution.”

“A lack of understanding and inexperience in the PE team is only resolved through increased communication.”

“Getting the PE house to really understand the business and its markets versus what the model says is a challenge. For this you need lots of patience with the PE house, particularly at the beginning when strategy is being decided or agreed.”

“You must encourage the investor to spend more time in the business, and not just at board meetings.”

“Impatience, with a consequent unwillingness to understand the motivations and capabilities of the executive team can be a real issue. As they say, time spent of reconnaissance is seldom wasted!”

“I’ve been frustrated by the PE’s impatience when you know there are good reasons for the company not acting in a manner that seems obvious to the investors. Your role at that point is to ensure the investor understands why this is happening.”

ABOUT DIRECTORBANK ...

We are a specialist executive search firm that introduces entrepreneurial board-level directors to the private equity industry across the investment cycle. We also conduct board and senior level search assignments for privately-owned and AIM listed businesses.

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