Steer towards success: What very successful portfolio company boards do

In our previous edition, we began to look at how you can design and fill the boards of your companies so they will be more effective. This edition shifts attention to board processes. Board processes exist to help the company reach its goals. First, we'll examine how boards organize their activities. Then we'll look at how board members actually behave in and between board meetings to support the company's achieving its goals, and how to build the trust that facilitates good interactions between the board and management. The purpose of board processes is to encourage good board behavior to happen, but sometimes bad behavior still happens, and drastic action may be required.

STRUCTURED BOARD ACTIVITIES

Good boards have thoughtful structures for their activities.

Clear communication and shared understanding of value creation plan. Because aligning goals is imperative, a very clear and direct communication between the owner and the CEO regarding the owner's goals, expectations, and priorities must occur on a regular basis. From the outset, it is important for the CEO to understand how value is determined and created, and the strategic priorities for the company. Many investors make the CEO explicitly focus on evaluating his/her direct reports, objectively, to ensure the company has the bench strength to meet investors' goals for the company. Successful investors focus regularly and repeatedly in these conversations on these topics.

Financial	Strategies	Talent
Summary of the company today Ideal summary profile at exit Value to management today and value to management at exit if expectations are met	Key high-level strategies to achieve the sought-after outcome at exit	High-level summary grades Strengths and weaknesses of the CEO's direct reports

Meeting schedules and meetings**.** The board decides when it will meet and what will be discussed in each meeting. The chairman and the CEO usually agree on an annual program of issues to be brought to the board, and boards usually meet four times a year. The four meetings follow a rhythm, addressing different areas necessary to the company's success. Typically, an annual cycle includes a strategic planning meeting, an operating planning meeting, a human capital planning review, and an execution-focused meeting. Whatever the particular focus, at all meetings the board also:

1. Examines progress on the executional tasks of the business
2. Takes a look forward at potential market and competitive factors that could affect strategic, financial and operating results.
3. Closely reviews initiatives that are crucial or behind, and also initiatives that are progressing nicely and where the board may be able to provide assistance or advice.
4. Reserves time every board meeting to step back from that day's agenda to look at the horizon. The willingness and ability of management to admit and learn from mistakes emerges when a collaborative, trusting relationship between the management team and the board has been built. Allowing some time in each meeting for free discussion or new ideas enables the CEO to mention something off the agenda that may or may not be worth exploring. When the board and management perceive and explore unexpected challenges, they can respond. They can also act upon unexpected opportunities, or even turn a challenge into an opportunity.

At board meetings, board members may use a table like the one above (under communication) to help them keep their minds and management's minds on the key drivers of success.

Many firms have a dinner the night before the board meeting. In that less structured setting, management and board members can brainstorm strategy. The board may also hold separate strategy sessions that do not necessarily occur every year. These sessions may include people outside the board, such as subject matter experts or other managers in the company.

***Information flow to the board*.** Most boards provide the management with a format for preparing board packs that combine elements investors need to see on regular basis with information management wants to share. Lead or controlling investors typically are able to examine the board pack before it is sent out to the board and may make changes and add material. The board chair (often the lead investor) and CEO agree to the specific meeting agenda ahead of time. Directors receive the formal board packs seven days to 10 days before the meeting.

BOARD ACTIVITIES OUTSIDE OF BOARD MEETINGS

As part of the overall governance approach, investors also have monthly two-hour financial operating calls led by the lead investor (who may be the chairman) or by the CEO. These meetings involve the whole deal team. Investors also review monthly dashboard reports or KPIs. In addition, the lead investor and/or chairman (if the lead investor isn't the chairman) interacts with the CEO several times a week.

If the CEO and chairman are in sync and in touch frequently between board meetings, it's important for the CEO and the chairman to keep the other directors informed of the outcome of those discussions.

The chairman must truly be an arbiter: eliciting the thoughts and feelings of the other directors and representing them to the CEO. The chair's ability to listen and actually represent both the board perspective as well as from the management perspective brings out the best ideas and decisions. One non-executive chairman described his interactions with other board members as follows:

> I don't just take what they say and run with that to the CEO, I will challenge them, I will say I don't quite understand that, give me a little reasoning here why this is more important than not and I think they know when they say this, I am going to say "So what?" so they really have to put together their thought process better. Then I will ask the board members "Do we have unanimity here?"

The chairman has a different relationship with a CEO than other board members. If the chairman represents control, the CEO needs an excellent relationship with that individual. "If the chairman doesn't represent control, he becomes more of a conveyor of the board's view, rather than his own. In that case, the CEO needs to understand which board members exert more influence by virtue of their ability to sway other members of the board. The CEO also needs good relationships with multiple board members – not merely the chairman."

Good CEOs get permission from their chairmen to meet one-on-one with board members, and they do it on annual basis. These relationships can be built at retreats and other board social functions as well. The CEO should inform the other directors of decisions that have been taken in discussions with the chair in between board meetings. If the CEO is also the chairman, he or she should give the board the information it needs to help solve problems and make decisions.

THE IMPORTANCE OF TRUST, AND HOW IT IS CREATED

Board members who trust management can sleep more easily at night. Trust between the board members and the management team is built (or damaged) by the discipline management demonstrates between meetings. If the

management does what is says it will do, then trust will over time grown; if management doesn't do what it says it will, then trust will falter. Similarly, how the board handles difficulties can build or damage trust. Management will be more forthcoming admitting mistakes or expressing harebrained ideas if they know they will not be punished for them.

Ensuring that directors receive the board package several days before the board meeting and assuming that the board has read it helps build trust. "This leaves directors confident management is not running around putting out fires but has a discipline and a process to summarize what is going on" and address priorities.

Trust is especially important if the CEO is also the chairman, because investors tend to fear management's ability to snow them with misleading information.

DIFFERENT KINDS OF BOARD MEMBERS DON'T MAKE A FUNDAMENTAL DIFFERENCE

Because this process is designed to serve up what people need when they need it, it should not vary with different kinds of members on the board (e.g., junior private equity professionals, outside directors). To get the most out of outside board members, the board chairman should have candid, open, and honest conversations upfront about how these outside directors can be most effective and engaged. "Here's your role, here's where you can be most effective and where we would like you to spend your imagination and thought."

HOW DO YOU DEAL WITH BAD BEHAVIOR?

The problems usually occur when personalities clash. "Personalities make a big difference. No matter what the resume says, any individual can be disruptive, combative or inattentive. People like this shouldn't be directors, which requires collaboration skills above all."

Good boards address the issue of problem directors quickly and make a change. It is never easy because feelings get hurt and friendships can be strained. Usually it is apparent who is causing trouble. If the dysfunctional director is a major shareholder, it is really tricky. One approach is to try and convince the individual to put someone else on the board who can represent the shareholder's interest. Having other board members threaten to resign if the difficult person won't step off is a possible tactic. If there is a real fundamental disagreement between board members who have big stakes, and nobody will step aside, it is demoralizing to management and can damage the business. The solution is usually to sell the business or buy out one of the disagreeing directors.

If a board member does not perform his or her duties, the consequence is being asked to leave the board. The same can be true for a CEO, or a chairman, or someone who is both. A non-executive chairman described the beneficial effect of removing a CEO who also had been chairman of the board, hiring a new CEO, and separating the chairman and CEO roles:

> We have a very collegial board but a very frustrated board. The old CEO was very protective of everything, he would only let the board really know what he wanted them to know. He was not hiding; he would bring up bad things, but he would never really try to solve problems and that is what led to the problems that we had. The board was not really participating in the decisions to the point where a president was hired without the board really having the final say. We met ourselves as independent board members, agreed it was the path we have to take, then convinced the CEO it was time to leave. "The proper procedures in hiring a president were not followed; therefore, you lose your job" is effectively what was said. The board stuck together and as a result of that we made the decision to hire a new CEO. The old CEO wanted to stay on as Chairman and we didn't want that so we got the agreement of the board and the backing of a lot of the management team to say that the new CEO would be hired as CEO only and not Chairman, and ... [the incoming CEO] was very

> receptive to that. As a result, now that I've been non-exec chairman of the board for nine months, it's clear to me the independent board members are truly represented versus that CEO-chairman role where they were only given the information that he wanted them to have. The working relationship between the CEO and board is tremendously better, there's greater openness from the CEO and the management team and the board.

Conclusion

As discussed in our previous edition, the best choices about who should be on a board can vary with the characteristics of the deal and the needs of the company and the investors. As we discussed in this edition, the best ways to run the board and the interactions between the board and the management tend to not vary much across boards and using these approaches can help you achieve the goals you have set for your company and investment.