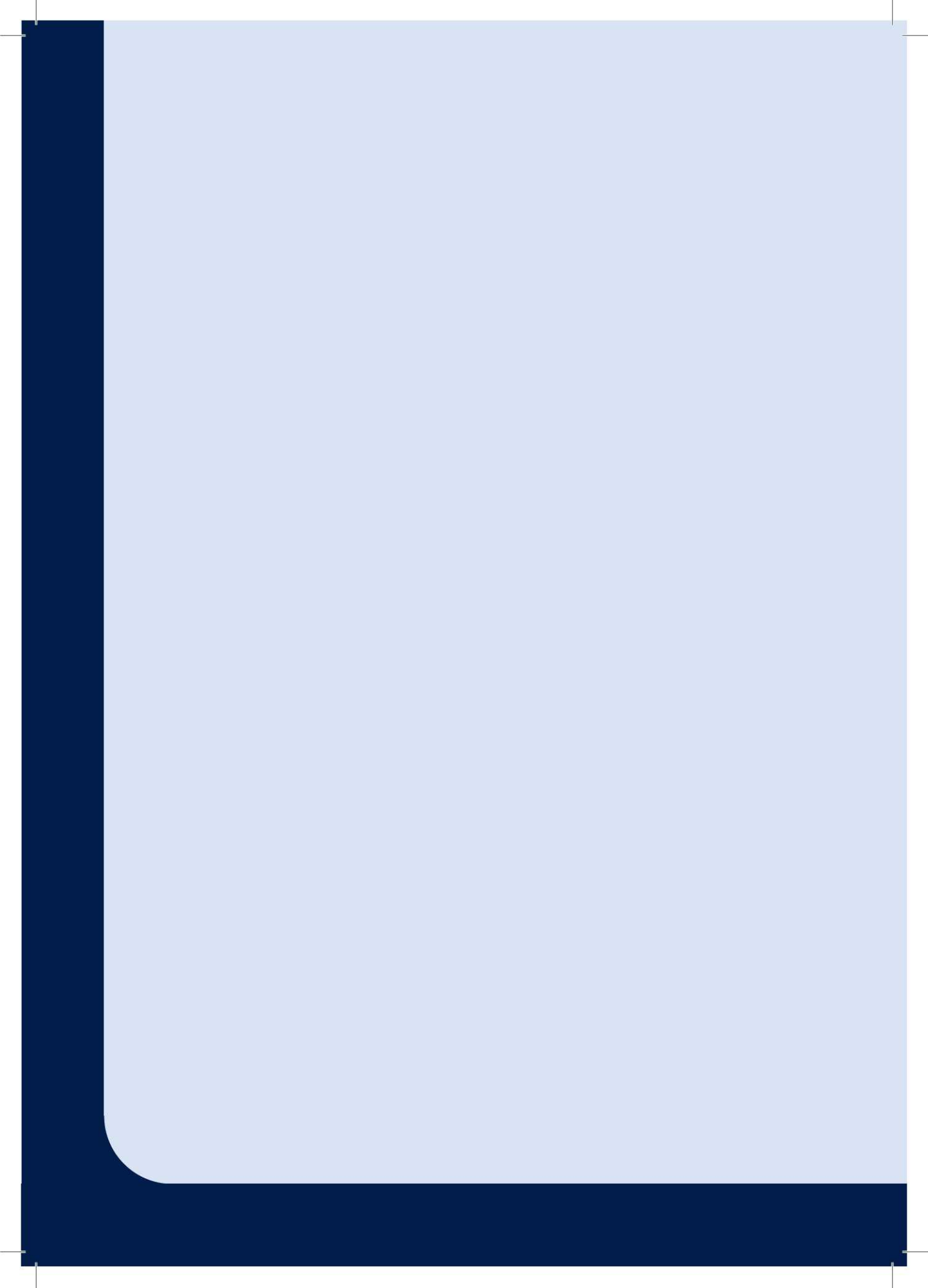


# THE PRIVATE EQUITY CHAIRMAN CHALLENGE

equity**CHAIR**



Catalysis  
Advisory



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## Making appointments and post-deal interactions more successful

### WHAT'S THE ISSUE?

From the work of our two businesses pre- and post-deal with many mid-sized companies and their investors, we observe that:

- The role of chairman in PE-backed businesses is relied upon by investors to increase their confidence that their relations with management teams are well governed, and by both investors and management teams to gain value-add from the experience and judgement of a third party.
- There are too many situations where the fit between investees' situations and the chairman is not quite right, and management, investors and chairmen feel that the three-way relationship could have worked significantly better.

To throw light on this state of affairs, and to offer some pragmatic guidelines, we used an on-line questionnaire and a round of telephone interviews involving a total of 50 chairmen and 30 investors who are experienced in situations both successful and less so. We gathered a great deal of data and views and, rather than trying to reduce what we learned to statistics, we have structured the following pages around answers to questions under two main headings.

### GETTING THE INITIAL CHAIRMAN APPOINTMENT RIGHT

#### 1. Can the chairman role be usefully defined by investors?

Chairmen views were divided on this topic: significant numbers felt that investors shouldn't try to define it because:

- There is no one-size fits all – the business and management context varies too much
- The difficult thing to define is not what investors want, but what the company and its team need
- Investors aren't great at understanding the chairman job, so better let the chairman specify it

Others argued that investors should make that effort because:

- CEOs often aren't given a proper rationale for the appointment of the chairmen
- Divergent expectations can make life difficult for everyone
- Without a clear definition you can make a random choice of chairman



Our suggestion to reconcile these considerations is that investors should identify:

- Overall objectives for the role.
- Any specific expectations/concerns which need chairman attention.
- The rationale of the chairman to discuss with the CEO.

However, chairmen should be left to lead in the board on:

- Shaping business strategy
- Approaching key business and people issues
- Building trust between stakeholders

## **2. What should investors consider when outlining the role of the Chairman in a PE backed business?**

- Industry sector experience can be helpful, but many other factors can be just as important. As one Chairman noted: Industry experience was far less the issue than the predictable growing pains that come from a move to a less entrepreneurial, more professional business.
- What does the business do? Where is it selling into? What might be the other markets?
- Where is the growth going to come from? Will it be domestic or international? What is likely to be the major challenge to growth? What makes this an interesting investment proposition?
- What is the current management structure/experience? Do the management team have previous PE experience? Are they the original founders?
- How much need is there for a Chairman who can introduce rigorous board processes and good governance?
- Is this appointment being made pre-deal i.e. able to benefit from the Chairman's input to pre-deal DD?
- Will management take an active role in the hire (there is far greater chance of buy-in from management if they are involved)? Do they understand the role and value-add of the Chairman?
- One of the Investors we spoke to said: "The Chairman was seen from the start as the Investor's choice - management was suspicious and that took time to overcome...It was a long-standing issue for the management."
- Is exit already on the agenda?
- The size of the business.
- It is hard to characterize PE chairman roles as non-executive in the traditional sense. The quantum of commitment needs to be considered with some care.



The answers to these questions can provide the criteria for a search and selection process.

### **3. What should investors be asking potential Chairmen as part of the selection process?**

- What do you see as the challenges for this business? How would you propose overcoming these challenges?
- Can you give me an example of where you have managed periods of high growth within a business, either as a Chairman or as an executive? How have you preserved the core values of the business during these periods?
- How have you built successful management teams during these periods of high growth?
- What do you do to build good governance within the business?
- Can you give me an example of a PE-backed businesses you have chaired where there have been disagreements between the investors and the management over issues of growth, strategy, exit. How have you resolved these differences? What were the outcomes?
- How important has sector been to your success as a Chairman in previous businesses?
- How often have you needed to change the CEO/CFO/CXO after becoming Chairman? How quickly can you act?
- When do you start preparing for exit? What does this entail?
- How much capacity do you have to step up your involvement in the business at particular time? e.g. M&A, change of management, exit.

### **4. What should Chairmen be asking investors as part of the selection process?**

Where are you in your fund cycle?

Why do you see this as an interesting investment proposal?

Why do you think you are the right investment partner for this business? What are you going to bring to the deal?

What is your assessment of the current management team? Would you be supportive of management additions/change?

Do you have a war-chest available for additional capex, working capital, bolt-on acquisitions?

Where do you see the exit? Trade sale, other PE? In what time frame?

What does the Financial DD look like? What concerns has this raised?

What is your likely investment hold?

How interventionist are you typically with investees?



## SETTING THINGS UP FOR A POSITIVE POST-DEAL PROCESS

### 1. How aligned are chairman and investor views across the investment lifecycle?

Charts 4 to 6 in the annex below suggest that:

- Investors are more optimistic about the coherence and usefulness of due diligence outputs post-deal than chairmen.
- Investors and chairman share a similar (generally sceptical) perspective on the quality of strategy, organisation, management practices and people capabilities at the time of investment – and a much more positive view by the time of exit.
- Where they diverge again is in their views of how well investments perform overall: chairmen are much more positive about performance across various criteria compared with criteria when contrasted with investors' more sceptical views.

### 2. What is the 100-day plan (or equivalent) supposed to achieve?

Both chairmen and investors had notably diverse views regarding the purpose of the early post-deal period. Three variants were typically mentioned (along with some hybrids):

- a) A snagging list of financial/legal points the FD needs to tidy up
- b) A process to clarify and prioritise the objectives and strategies for the next 3-5 years
- c) A fertile period to get momentum on substantive business change

(a) is probably inevitable in any variant but some respondents saw (b) or (c) happening only once the dust had settled from (a). Others saw (b) starting even during the transaction preparation period.

Our view is that in the majority of cases, the high-level investment thesis needs revisiting – with a strategy workshop or two – in the light of due diligence findings so that (c) is both appropriately directed and fits the available management bandwidth.

### 3. What are the relative strengths of the chairmen and investor directors in the investee boards?

When investors are asked about their view of chairman value-added, they highlight:

- Moral support to the management team and influencing the CEO.
- Experience of businesses from similar sectors, size and growth characteristics and understanding of similar strategic/change initiatives.



- Providing good governance: overseeing standards, ensuring board effectiveness and meetings.
- Developing strategy and keeping an eye on the big picture.

None of this is especially surprising and nor are the areas of perceived lower value-add: supporting acquisitions, dealing with potential acquirers and exit and knowledge of private equity – all of which can fit under the broad umbrella of corporate finance skills. Chairmen believe that they bring more exit preparation and private equity understanding than investors give them credit for.

When chairmen are asked about investor contributions they are more generous in their views than investors about chairmen or, curiously, investor views of themselves. Again, there are few surprises in the main perceived value-adding areas:

- Developing strategy and keeping an eye on the big picture;
- Providing business/finance advice to management;
- Experience of businesses of similar size, growth and change initiatives;
- Dealing with potential acquirers and exits in general.
- Neither chairmen nor (especially) investors) rated their sector knowledge very highly.

What is more striking are two areas where investors and chairmen score themselves and each other generally quite low:

- Bringing commercial introductions and value-adding colleagues/advisers.
- Dealing with under-performance.

#### **4. How might chairmen and investor value-add be enhanced post-deal?**

When asked about ways to improve the effectiveness of the chairman-investor relationship, respondents offered relatively few actionable ideas.

Both chairs and investors thought chairs could be more effective if they went about management change earlier, were closer to the team – while chairs wanted better support from investors, especially when change was needed. Investors wanted chairs to have a better connection to them and less risk of chairs ‘going native’.

In terms of the investor role, respondents pointed to a firmer stance in management change and greater closeness to the business.

There is a risk, however, that this emphasis on management change makes more sense in hindsight than in real-time because under-performance is identified through deviance from budgeted numbers – whose cause is often open to interpretation – whereas earlier warning signals (like vague strategy, weak



prioritisation, lack of alignment on execution) are more directly attributable to the top team, but less frequently identified and discussed.

In this context, it can be helpful for chairs and investors to ask higher level questions about various kinds of alignment periodically:

- Are strategic priorities being translated into organisation and people actions fast enough?
- Is the level of challenge facing the business matched by the requisite management and organisation 'horsepower'?
- Is what we are working on as a board laying the right path to exit?
- Are management, investors and chairman all aligned on priorities and pacing. If not, why not?

### **Conclusion**

We hope you find this report a useful aide memoire whether you are an investor selecting a Chairman to work alongside you on a PE backed deal or a Chairman looking at PE backed opportunities. Our discussions strongly supported the value a Chairman can bring to both investor and management to deliver a successful investment. However, sufficient time needs to be spent understanding the longer-term requirements of the Chairman, following the initial deal phase. This can help management view the introduction of a Chairman positively, as someone to help them deliver real growth and create real value.

It was encouraging to see so much agreement between the Chairmen and the investors as to their respective roles within the investment cycle, with (generally) a good understanding of where they can work together and where they should be left to take the lead. So often the success of these relationships boil down to mutual respect and communication.

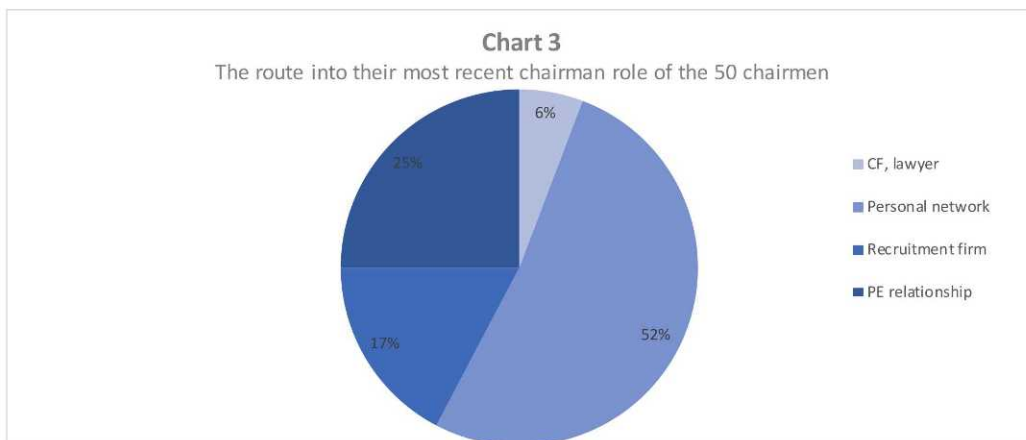
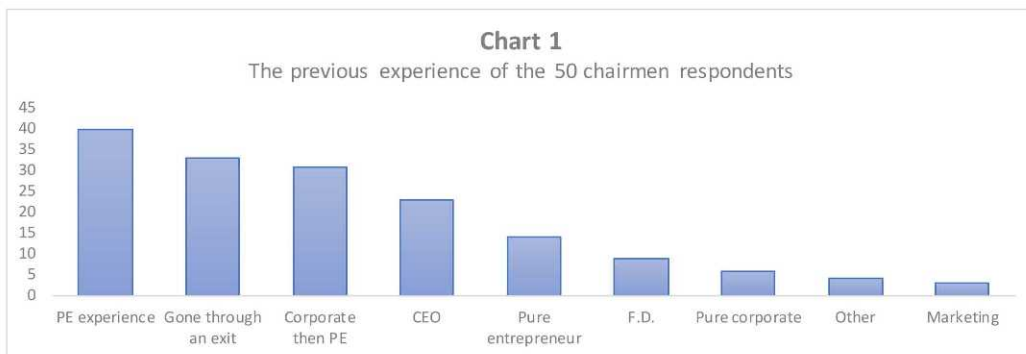
Finally, we would like to thank all of those Chairmen and investors who gave their time so generously to complete the questionnaire and to speak to us.

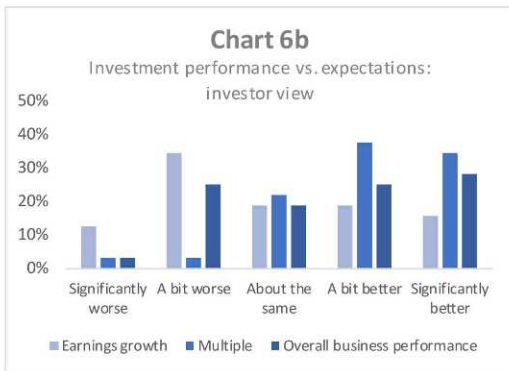
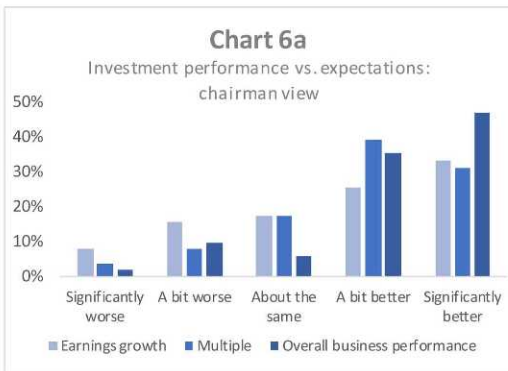
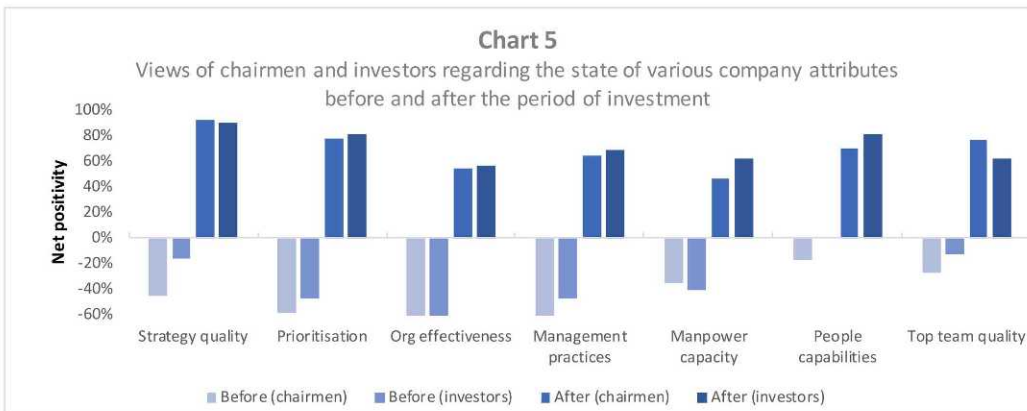
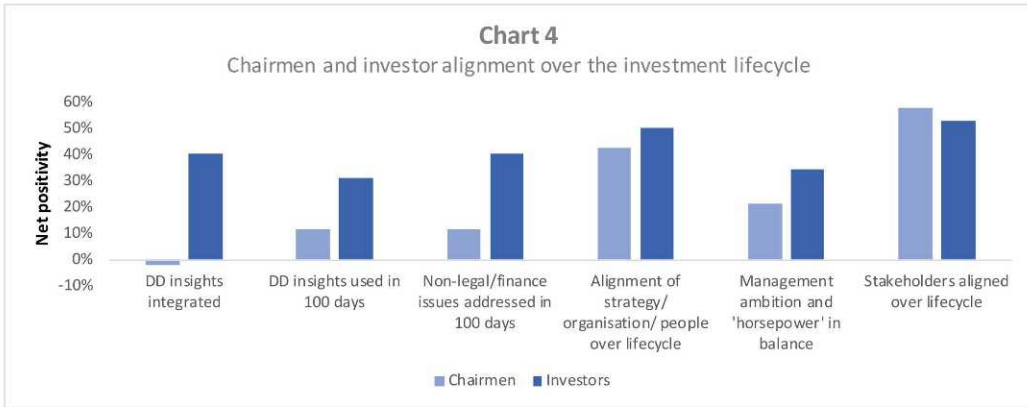




# GRAPHICAL ANNEX

## Information on Chairman contributors





## About EquityChair

Established in 2010 as part of the Equity family of businesses (EquityFD, EquityFC and EquityInterim), EquityChair focuses on the appointment of Chairmen and Non-Executive Directors to the boards of high growth businesses, often with private equity, VC or social investment funding.

## About Catalysis Advisory

Catalysis works with mid-market investors and the companies they back on strategy, organisation and people issues. It has completed 300+ assignments since 2010 across due diligence, key people assessment, strategy process and organisational effectiveness.

For more information please contact:

The logo for EquityChair, featuring the word "equity" in a lowercase, sans-serif font and "CHAIR" in a bold, uppercase, sans-serif font, both in white text on a dark blue rectangular background.

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