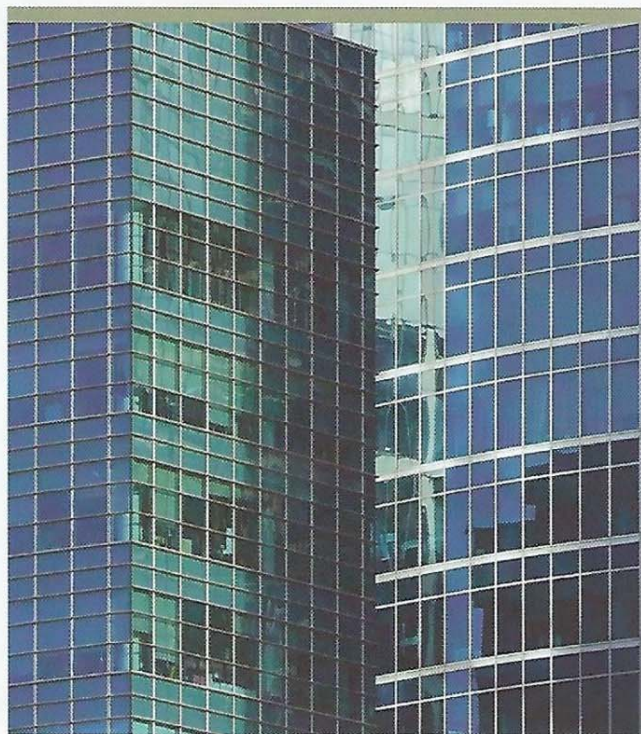


THE JOURNAL OF PRIVATE EQUITY



“US Venture Capital and Private Equity momentum remains relatively strong with growing uncertainty about the economy and financial volatility risks.”

F. John Mathis, Editor



Why Hire Outside Directors When Private Companies Don't Have To? *Change! Break the Status Quo. Rejuvenate.*

Abstract

John M. Collard

You need these guys — to increase cash flow and provide valuable guidance, contacts, growth, and credibility.

Outside directors are generally hired based on their experience, effectiveness, connections, and access to capital, which can be very beneficial to a company. Companies that are committed to going through significant business change (turnaround, transition into new markets, increased cash flow and corporate growth, generational ownership transfer), are anticipating a major liquidity event, or have shareholders who are not active or business savvy need guidance. An outside director is a member of the board of directors or advisors who is not part of the executive team. Outside directors are advantageous because they are experienced experts who rarely have conflict of interest and they often see the big picture differently than insiders.

Traditionally, companies invited friendly advisors to join their board. Now, there is more risk to directors as a result of legislation (Sarbanes-Oxley). Whereas there is formality (reporting, responsibility, risk), liability, and more expense (e.g. D&O insurance) to a board of directors, there is a budget-friendly alternative in the form of a “board of advisors” that is beholden only to management. The main difference is in where the fiduciary duty lies: to the shareholders or to management. Trusted outside directors can provide guidance for the business to produce value — for the business.

WHY ADD OUTSIDERS ?

1. Outside directors increase cash flow/business growth. A Forbes/Lodestone Global survey shows 97% companies reporting increased revenues and earnings, with increases of 56% since adding a board with outside directors.
2. Outside directors can be a valuable resource. They bring a new set of skills and ideas, while you maintain control.
3. Outside directors provide an external source of accountability, which is key for businesses to move forward.
4. Outside directors are on the side of owners, shareholders, and managers, these advisors answer only to you.
5. Outside directors add credibility. When it comes time for a liquidity-seeking event, they send a message that your company has leadership and guidance.

With a board of directors, your company immediately gains legitimacy and a panel with expertise that you probably do not have in house. Although the role of board members is to direct accountability, develop strategy, protect assets, and oversee implementation, they are often adept at guiding major decisions, serving as a resource, and being a confidant to the CEO.

Benjamin Zander, conductor of the Boston Philharmonic Orchestra, discovered that he was the only person on stage that didn't make a sound. He realized that his job was to create great things out of the individual talents of the musicians in front of him. This is very much like the role of an outside director: to bring out the very best in the company's inside talent, to guide the company to meet its goals. Management makes decisions and maintains control, based on guidance and information.

Outside directors bring an independent perspective, develop strategic thinking and planning, use their experience and objectivity, provide their Rolodex of contacts, find capital, and guide transaction activity (Exhibit 1). Many of these benefits are absent in companies, so outside influence should be used to your benefit. After all, you have nothing to lose and everything to gain by considering their advice when you make decisions.

EXHIBIT 1 Benefits of Outside Directors

Action/Skill	Benefit
Independent perspective Unbiased advice	Challenge management Sounding board for CEO Objective, Mediate conflicts
Strategic thinking and planning	New directions, Transitions Incentive-based compensation
Experience and objectivity New knowledge	Been there, done that Oversee performance and risk Accountability, Credibility
Contacts Networks	Investors, Lenders, Resources Partners, Customers, Suppliers
Capital infusion	Raise Money, Restructure Guide offering process Find capital
Transactions	Prepare company for sale Locate interested parties Negotiate a deal

Create a culture and structure that will withstand third-party accountability to add value to your business. Start thinking as a serious, growing company and prepare for a future life as a public company or for increased scrutiny of investors.

INDEPENDENT PERSPECTIVE

The CEO needs unbiased advice and diversity of opinion from outside directors who care about the company's success, but who can view things from a distance and a different perspective. CEOs will be well served by adding board members who can challenge them and decisions they are about to make.

STRATEGIC THINKING & PLANNING

Outside directors should constructively challenge and contribute to strategy development, implementation, and infrastructure. Outside directors can be particularly adept at guiding the company into new markets or changing direction when trouble occurs. Because these outsiders have experienced these situations and guided other companies through the pitfalls, they can certainly guide you to success with less trepidation.

EXPERIENCE & OBJECTIVITY

The very nature of growth implies that a company is going to new opportunities. It is refreshing to make that journey with the help of an advisor who has been there, and done that, before. This objectivity can help you through the obstacles.

CONTACTS

Every company needs help when it wants to grow, prosper, or turn around. Outside directors can extend the company's reach by using their own contact network, including colleagues that can get involved to provide guidance and resources.

CAPITAL INFUSION

Outside directors often have a database of contacts who can supply capital, both in the form of equity (investors) and debt (lenders). Some have more extensive and higher quality databases than others. This means that you can get in front of many financing resources quickly once an expression of interest package is ready. Present your opportunity in terms the investor or lender wants to see. Your company is the product.

TRANSACTIONS

Prepare for that liquidity event. The best time to sell a company is when a buyer wants to buy and has cash, which could come when you least expect it. Be prepared and work toward ultimate valuation throughout the process of growth.

Do not be surprised when you come to the realization that the company is not attractive to investors or lenders. This means that you have the opportunity to rebuild the company, or parts of it, so that it can be considered a good deal. Build a company in which investors want to invest.

WHAT BUYERS AND INVESTORS LOOK FOR

- *Businesses that create value:* Consistency.
- *High probability of future cash flows:* Promise of cash.
- *Market-oriented management team:* Generate revenue.
- *Ability to sell and compete; develop, produce, and distribute products; and thrive and grow:* Track record.
- *Fair entry valuation:* Realistic return potential.
- *Exit options:* Investors want ROI multiples.

Outside directors are adept at negotiating deals. They elevate you (management/board) to the decision-making role.

Hire that outside director. They bring about change.

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