

PUTTING THE LENS ON PRIVATE EQUITY-OWNED COMPANIES AND DIRECTOR EFFECTIVENESS

On February 8th, NACD Chicago members and guests were treated to a lively discussion on the differences and similarities between public company and private-equity owned company boards. The panel was expertly moderated by Chris Abbinante, a partner with Sidley Austin, LLP. For over 20 years, Chris has represented private equity sponsors and corporate clients on complex transactions, including leveraged buyouts, mergers, acquisitions, divestitures, investments, joint ventures and other corporate matters.

Panel participants included:

- TJ Chung, a partner at Core Industrial Partners, LLC, a Chicago-based private equity firm investing in North American lower middle-market industrial and manufacturing businesses. TJ was previously the CEO of Teletrac Navman, and currently serves on the boards of two publicly traded companies, Littelfuse, Mastercraft, in addition to several privately-held technology companies.
- Dave Hawkins, co-founder and managing partner of Shorehill Capital LLC, a Chicago-based private equity firm focused on making control investments in North American precision manufacturing, value-add distribution and industrial service companies. Dave currently serves on the boards of Belt Power Holdings, LLC, Tribus Aerospace LLC, Power Grid Holdings, Inc. and Jasper Engine Exchange, Inc.
- Chris Killackey, a partner at Prairie Capital, a private equity firm investing in lower middle-market companies. Chris is responsible for investment origination, due diligence, deal structuring, and negotiation, along with fundraising and investor relations. Chris is currently a board member of four portfolio companies including Architectural Lighting Works, Industrial Water Treatment Solutions, Premier Dealer Services and ProVest.
- Tim Vargo, a retired President and CEO of Kele Incorporated. Tim has over 40 years of leadership and managerial experience in capital allocation and restructuring, automotive supply chain and process improvement. He currently services on the boards of Exide Technologies and Motorcar Parts of America.

Differences and Similarities of Public and Private Boards: The panel compared and contrasted their experiences on public versus privately held company boards. It became clear, very quickly, that one key difference is that time commitment and level of engagement are typically much greater with private boards. In general, public board responsibility is very structured and focused on governance. Meetings are scheduled in advance, and while a lot of prep work is required before each meeting, there isn't much engagement between meetings, unless there is a pressing need. Private board directors, on the other hand, must be prepared to roll up their sleeves and get involved heavily in the strategy and operations of the business, particularly in the first couple of years following a private-equity investment. While the panelists agreed on the huge commitment required, they also found board engagement in private companies more rewarding and even fun!

Human Capital: Given the greater level of their involvement on private boards, the panel discussed the need to balance the relationship between the directors and management so that the management team has the ability to make informed yet final decisions. One panelist indicated that in his experience, setting the proper expectations up front was key to success. Others felt it was critical to build a strong relationship that establishes trust with the CEO and the executive team, so they can work together as partners. Clearly this relationship can be tricky as the board is responsible for hiring and firing the CEO, and turnover is generally higher at private firms. And while this is statistically true, our panel members expressed that enlightened PE firms realize that their interests are best served when management teams are given the resources to thrive. One panelist indicated they retain coaches to work with the senior leaders as a way to provide the tools necessary to succeed. The panel agreed that trust on both sides is critical, particularly when there is disagreement.

Strategy versus Operations: There was definitely a consensus that the board for a privately-held company is very involved in setting and agreeing on the strategic plan in collaboration with the CEO and executive team. From a process perspective, it was agreed that a company's vision, strategy and tactics should be agreed upon once a year. Once the strategic direction is determined, Board discussions then revolve around tactics and execution. One panelist shared that they determine their "Fab 5" or "Super 7" tactics for the year and then at each board meeting, they discuss the resources needed to execute on those objectives. Another panelist indicated that as CEO, he then shared the objectives with various layers of management, so the teams were engaged and accountable. The panel agreed that each year it was important to evaluate where they are relative to the strategy, acknowledging that the markets they are addressing will dictate when there needs to be a course correction.

Exit strategy: A private equity firm invests in a company to make a profit by exiting – but when and how? Shorehill shared that their firm comes in with a 100-day plan and the first stage is to first and foremost get to know the players really well – including their hobbies and kids, etc. before they start developing the operational plan. Based on this intense evaluation, they can better determine the resources the company will need to execute on strategy. The ultimate goal is to make the firm more valuable before a liquidity event--either sell or take it public. While the exit decision is ultimately up to the majority shareholder, it was made clear that all parties need to be aligned and motivated toward the same goal. While one might think that a PE firm would sell to the highest bidder regardless of circumstance, the panelists emphatically made the point that their industry is small, and their reputation is critical to deal making. The ideal outcome is that the management team is happy to stay on and motivated to keep the company successful long after the PE firm exits.

Using our panel as a proxy for best practices in private equity boards, they have done multiple deals with one other and achieved win-win outcomes for the private equity firms and the companies-- so mission accomplished!