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EDITOR: NICHOLAS KING

Hiring Outside Directors When Private Companies Don't Have To: They Bring Change

BY JOHN M. COLLARD

John M. Collard is chairman of Annapolis, Maryland,-based Strategic Management Partners. In this article, he discusses the ins and outs of bringing in outside directors to help guide decision-making and bring fresh perspectives.

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

Companies committed to going through significant business change (turnaround, transition, generational ownership transfer), anticipating a major liquidity event, need guidance.

Why add outsiders to your board of directors or advisers?

- Outside directors often increase cash flow and business growth. According to a Forbes/Lodestone Global survey, 97% of companies reported increased revenues and EBITDA, since adding a board with outside directors.
- Outside directors can be a low-risk, low-cost resource. They bring a new set of skills and ideas to produce benefits, while you maintain control.
- Outside directors provide an external source of accountability.
- Outside directors are on your side. These advisors answer only to you.
- Outside directors add credibility. When it comes time for a liquidity-seeking event, outside directors send the message that you are an organization with leadership and guidance.
- Outside directors bring an independent perspective, develop strategic thinking and planning, utilize their experience and objectivity, provide their contacts Rolodex, find capital to finance the company, and guide transaction activity. Many of these benefits are absent in companies, so outside influence should be used to your benefit. Remember, the key is for the CEO and management team to listen to the advice given and factor these inputs into their thinking, then make decisions.

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 Finders of 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 future life as a public company or for increased scrutiny of investors.

Independent Perspective

Day-to-day events often distract a CEO. An outside adviser provides a sounding board to ground the CEO in real leadership duties. Typically, a board will focus on protecting the unique value of the company, but they often add much more.

The CEO needs unbiased advice and diversity of opinions from outside directors who can view things from a distance and a different perspective. The CEO will be well served by adding board members who can challenge the decisions that they are about to make. You want board members who are not afraid to offer advice, guidance, feedback, and argument on issues, while employee board members may be in fear of speaking up. Board members can mediate disputes.

Strategic Thinking and Planning

Outside directors should challenge and contribute to strategy development and implementation. They can be particularly adept at guiding the company into new markets, or changing directions when trouble occurs. Because these outsiders have experienced these situations before, they can certainly guide you to success with less trepidation.

Once strategy is set, communicate that message for all stakeholders to understand. Provide guidance. Which generic customer needs will be satisfied? Why will they buy? Why will they buy from you? Differentiate yourself from your competition. There is nothing quite so effective as designing compensation and incentive plans that are paid out when goals are met, but, don't pay for nonperformance. Incentive-based management is extremely effective.

Experience and Objectivity

The very nature of growth implies that a company is going where it has not been before. It is refreshing to make that journey to new opportunities with the help of an objective adviser who has been there, and done that before. Understand the idiosyncrasies of the new market: doing business with the federal government is quite different from doing business in commercial and international markets. Sell products and services to customers in the way that they want to be sold to.

When independent observers scrutinize management performance meeting goals and objectives, and monitoring results compared to long-term valuation goals, there is real value in their participation.

Contacts

Your contact book can't include everyone. 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, colleagues who can get involved to provide guidance and resources. Some outside directors have more quality contacts than others.

Rely on these introductions to bring in new capital, customers, and suppliers. Strive for strategic teaming relationships to promote growth. Contacts can be influential in bringing resources not previously available.

Capital Infusion

Outside directors often have a database of contacts who can supply capital, in the form of equity and/or debt. 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 or offering package is ready. The key is to document the plan describing where you want to go and why you will succeed, put that in summary and detail form, describe assumptions and risks, and present rate of return projections. Present your opportunity in terms the investor or lender wants to see —your company is the product. Investors are in this for returns on their investment.

Prepare for the stringent criteria of financing sources. Begin this process early so that you are prepared when the time comes. Consider a 2-page (executive introduction), 10-page (present the deal opportunity), list of due diligence (details) available, and operating plan approach, to step potential interested parties through the process. Send the introduction to 100s or 1,000s of potential investors.

An outside director, as part of the company, can be a finder to introduce you to investors and/or lenders and guide the process—you then negotiate a deal that you can live with. The key is to prioritize the flow of introductions and manage the diligence process. There is money available, just be the "good deal."

Transactions

Outside directors also often have a database of investor contacts who have deals for acquisition and who are looking for opportunities to buy. You can get in front of M&A dealmakers quickly once an offering package is ready. Use a similar approach as described earlier.

Prepare for that future 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. Privately held and family-owned companies should demonstrate that they can be run independently, without the owner, to maximize their valuation. Buyers don't pay for past sins, and they don't pay much for companies who are heavily reliant on the owner. There is much more value in the company when the management team (without owner), processes, and procedures control the company to produce results.

Outside directors are often adept at introductions or negotiating deals. They then elevate you (management and the board) to the decision-making role.

Hire that outside director. ■

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John M. Collard

is chairman of Annapolis, Md-based Strategic Management Partners, Inc. a turnaround management firm specializing in investing in and rebuilding underperforming companies, asset and investment recovery, outside director governance, and raising capital. He is a Certified Turnaround Professional, Certified International Turnaround Manager, past chairman of Turnaround Management Association, past chairman of Association of Interim Executives, senior fellow at Turnaround Management Society, and serves on public and private boards of directors. He is an adviser to company owners, investors, and private equity investors, and has participated in over 45 transactions worth $1.2B. He has been inducted into the Turnaround Management, Restructuring, Distressed Investing Industry Hall of Fame. He received the Interim Management Lifetime Achievement Award from the Association of Interim Executives, SmartCEO Distinguished Leadership Award, Prince Georges Business Leader of the Year, and Most Admired CEO Award from the Maryland Daily Record. He can be reached at (410) 263-9100 or www.StrategicMgtPartners.com