

# Soliciting Initial Outside Directors for Private Companies

BY BRUCE WERNER

Private and family-owned companies with tenured outside directors have learned how to attract, evaluate and retain other outsider directors. Experienced directors create value by leveraging their knowledge and well-established relationships to effect change. But where does this start? A critical step to recruiting initial directors is to understand that candidates likely lack institutional knowledge, and have no meaningful relationships with current directors or the company.

Private companies seeking their initial outside directors are typically mature businesses in their second or third generation of leadership. They have experienced multiple business cycles and the leadership is self-aware. They are looking for outsiders to fill specific needs. Often they engage consultant to lead them through this process.

The consultants help the owners design the new board (how many directors, insiders/outside, candidate criteria, compensation, nominating process) and manage the selection process. The first request for resumes is typically described in a one page anonymous summary. Once an initial phone interview is scheduled, candidates receive a 2-3 page description of the business. Sometimes they receive a marketing/sales presentation from a recent sales meeting. While useful, these documents lack context.

While this practice is sufficient to run the process, it is also one-sided. The consultants are properly focused on the needs of the owners, not the needs of the candidates. The candidates may experience a series of surprises as the discussion unfolds. How does that help to expedite the best matches? While a partner in a private equity fund, we would receive hundreds of investment summaries each year, before signing non-disclosure agreements. These teasers were usually two pages in length, and told our firm what we needed to determine if we should commit resources to a

project. The company summaries I have seen as a board candidate have a fraction of the content the typical investment summary.

Candidates are deciding if they should invest a significant amount of personal time and if they should accept reputational risk when they evaluate joining a new board. My experience suggests that the selection process would be improved if it were less opaque.

## Key Questions to Consider

The critical point to consider is that outside candidates for director seats frequently have little or no institutional knowledge, no sense of the company's culture, and little or no critical business data when they submit their resume to the search committee. While the current Board, owners and their consultants are intrinsically in tune with these issues, the candidates are not. They are often recruited from different industries. Professionals seeking board seats will "opt in" until they have a reason to leave the process. Better information will accelerate the weaning process.

After reviewing a dozen searches that I have been involved in, I have concluded that these four questions need to be considered when designing the search:

- *What non-public data do we provide to the candidates, and when do we provide it?*

This is the most difficult of the four questions, since there may not be much precedent to provide guidance. Other than its bank, the company likely has not shared critical information with any outsider. The best first step is to consider "what would I want to know if it were me" but remember that the incentives are not the same.

- *How do we build and test relationships through the process?*

Phone interviews are an effective first screen, but good relationships grow through mutual shared experiences. A good process usually includes an opening dinner, with a full day of meetings the next day, including factory tours. These tours should highlight major product lines and capabilities, and a chance to socialize with the full management team. The more time spent together, the better.

- *If the company is looking for multiple initial outside directors, what can it do to test the compatibility between candidates?*

Since the outside seats are typically slotted for specific skills, consider scheduling non-competing candidates (e.g. a finance person and a marketing person) together for on-site interviews

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Kona Advisors LLC provides advisory services to the owners, investors and CEOs of private and family-owned businesses. Our deep experience with private company governance, capital structure, strategy and management issues positions Kona Advisors to bring a broader perspective to understanding clients' needs, quickly develop meaningful solutions, and delivering results.

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to create interactions you can observe. I participated in this once and found it very beneficial. Meeting other candidates allows them to gauge the talent pool, and get a sense of where the process is headed. I have been on boards where the initial outsiders learn of each other when they shake hands at the first meeting. That approach extends the time needed to build effective relationships.

• *How do we structure the recruitment process to dovetail into the on boarding process?*

Plan the on boarding process first and work backwards! Part of this depends on the committee structure, and the interviewing that deals with committee needs. (e.g. Audit, Compensation, Nominating) Matching people for committee discussions, separate from the full Board, will expedite on boarding.

It is important to remember why outsiders serve on private boards. The reasons to serve as an outside director for a private company are (1) to have a meaningful impact on the organization, (2) to expand their network, (3) for professional growth, and for those who are at or near retirement, (4) to stay engaged. While the compensation provides respect for the time spent at meetings, it is usually not the prime motivation. Successful professionals serve as outside directors because they want to. Over the course of a typical three-year term, there will be enough late flights, early wake-ups, difficult conversations and calendar conflicts to demotivate the candidates who are incented only by money. Better data will allow outsiders to understand their ability to have an impact, and stronger relationships will motivate them to act.

**Summary**

The typical Board meets quarterly, with a few calls between meetings. Many private boards do not have formal Audit, Compensation and Governance subcommittees. This reduces the opportunities to work together. I have found that in these situations, newcomers may need a full year to become integrated.

When soliciting candidates for initial outsider director positions, consider providing more than a few descriptive pages to brief the candidates. (Chart 1) Most, if not all, of this will be revealed not later than their first Board meeting. In addition to improving the interview process, you will likely receive fresh ideas to improve your business.

Once directors know each other, they will naturally start talking offline, which is the best way to build good working relationships. The goal is to have a strong, collegial environment that welcomes constructive dissent, fosters resolution, and promotes good governance. While cost is always a concern, consider inviting candidates to a few more meetings, plant tours or sales events early in their terms. Since the expected term is measured in years, amortizing these travel costs over 24-36 months may make it an easy decision.

Chart 1
<u>Data to Understand the Business</u>
Strategic Plan
3 yr audited financial statements
Pro-forma forward budget
Summary of credit facilities
Organization chart
Status of Management succession plans
Executive appraisal/incentive systems
Union/Labor history

Chart 2
<u>Data to Assess Director Risk</u>
History of communications to outside and family shareholders
By-Laws with Indemnification
Domicile-specific director obligations
Minutes of past Board meetings
Insurance summary - all lines
Summary of claims, settlements, judgements
Dividend policy
Audit Committee Reports
Compliance manual
HR Policy manual
Special directives from owners
History of communications to outside and family shareholders
Contact list of professionals: Attorneys, Bankers, Accountants, Auditors, consultants

As the process moves forward, the best candidates will want to understand the risk of being a Director. Chart 2 provides a list of information that good candidates will inquire about. As a fiduciary, they will both want and need this information.

Electing outside directors is a commitment measured in years. Many companies purposely limit the information they provide to candidates, either from habit or due to competitive fear. The habit will need to disappear when the outsiders are elected, and the fear is often not justified. Providing timely, critical datasets, and multiple opportunities to build personal relationships is critical to selecting and on boarding the best outside directors. It is a learning process for the owners, frequently more so than for the candidates. ■