



Unleashing the power of effective boards in privately held companies

August 2024



Erika Whitmore:

Steven, I am so excited to have you here today for the Privately Speaking podcast. You and I have worked together. It's been a little while, but really, really excited to have you here today and share your expertise with this great audience. If you want to give just a really brief overview of your tremendous experience, part of which is with our Board Leadership Center.

Stephen Brown:

And thank you very much. I'm so happy to be here, Erica. And why don't I just start with the Board Leadership Center, which is our group at KPMG that works with our client boardrooms and C-Suites, those who work with boards on thinking through a number of corporate governance issues and how to promote continuous improvement around their corporate governance. And we do that by having a group of corporate governance experts who have the experiences and the combined experiences of being corporate securities lawyers, former general counsels, academics who have studied and taught corporate governance to students at law schools, undergrads, business schools, all of the above. And I've done all of the above, including that academic part, which I and my other colleagues still do part-time now with the addition of also leading a corporate governance group at a very large, trillion dollar asset manager. And we bring all that experience to help our client boardrooms through a number of corporate governance issues. So with that, that is what I lend with my colleagues at the Board Leadership Center, which we are very happy to work with you and other folks inside of KPMG helping our client boardrooms and C-suites.

Erika Whitmore:

Which is awesome. And your experience is just super, super helpful. And I think for our audience, the two topics that we're going to broadly focus on today is number one, thinking like an activist. While some might think that that's more of a public company board scenario, I think we can speak a lot about what boards and companies should be thinking about when it comes to activist shareholders. But then also the second topic we're going to cover is board effectiveness. So with that, if I take a step back and we start with the activist topic, when we were talking just a few minutes ago, you thought it was very important to lay the foundation for that, which I also agree with. So maybe we can start there.

Stephen Brown:

Sure. Yeah. In this phrase, "think like an activist," I'm going to take a stab at this, that it's probably about five years old or so. It is a fashionable thing to say, not at activist investors. If we think about the hedge fund activists that get the headlines in the Wall Street Journal and New York Times, really if we go back to the corporate governance

timeline, 2010, 2012, they really came into prominence. By the way, we go back to 1980, which I will not bore you with. And I bore my law students with thinking about the activist hedge funds - we call them corporate raiders back in eighties were around, but really in 2010. And so they've really had a great success and continue with great success till today. And so this phrase came about to try to teach folks inside the boardroom, sitting on boards and management teams to think like an activist.

And really what that phrase sort of colloquially means is that, get out of your bubble and think like an outsider who comes in, to really have an agenda that is a value play and to make you operate better, But to do that, they may have to remove some or all of the board, which also may include removing the current management team. So it is partly a good thing. It is partly also for job security. If you don't think like an activist, don't worry particularly for a publicly traded company, an activist will think for you and you're going to lose your job. So it's sort of a wake up call to get out of the bubble. So I like the phrase. I do it like "think an activist" , I have come in recent years just to add, and I'll finish the definition with this sort of second or third sentence, which is, periodically think like an activist.

And I say that because an activist, is constantly thinking about the value play and what he or she can do and how do they win at it and then move on. Which if you're running a company, you're long-term oriented. And so there are things that you need to think about that activists aren't thinking about. And so I don't want people thinking that 24/7, I must think exactly like an activists. I like to say periodically get out of the bubble, periodically think like an activist. And that helps you think about all your business operations and your board composition. We'll go through all that. And that's a good practice to get involved in.

Erika Whitmore:

Kind of like a mental reset and really trying to challenge yourself in terms of what should you be thinking about that, if you're solely focused on long-term investing and growing your company without stepping outside of that realm, you might not challenge yourself in ways that, to your point, an "activist" would.

Stephen Brown:

Absolutely. And I will say this many times, and this is an uncomfortable conversation sometimes I have with board members who are in an activist situation.—so think about a publicly traded company that is an activist situation where they say, well, it will disrupt the board work together. And I have to stop them saying, look, the company has very good bones. This company is going to be a going concern and it will continue tomorrow. It just might not continue with you. So I have to remind them, right? Because we all take it personally sometimes, which we've got to depersonalize this and think about what's good for the business, which may or may not be that you stay. I think we're all on board in the general concept, but being able to step out of our bubble and think a little bit differently about how we're running the business.

Erika Whitmore:

So if you are part of, whether it's a CEO or a COO of a privately held company, maybe the board at this point is mostly shareholders that have an investment, that have a sizable investment, thinking like an activist in that CEO/COO role. What are some of the things that they could be thinking about in terms of their board specifically? And I know we're getting a little bit into the next topic, but I think that's okay. What are some things they should be thinking about from a board perspective?

Stephen Brown:

And I think the phrase "think an activist" really works well with private companies because we're not thinking about that Wall Street Journal front page of an activist investor coming in, trying to take over a very large publicly traded company. But it does stand for, let's think outside the box and let us as a management team think about if we were being attacked by an activist, what would be our defenses and how will we act. And the reason I like that concept is that it does depersonalized and allow for a conversation. You can sort of have this conversation about, well, what if it's not me,

CEO saying that these are issues when I'm taking a third party approach. And a lot of times that's helpful if everyone's sitting in the boardroom is having this hypothetical conversation, you can bring up issues that might be hard to bring up.

And thinking like an activist would mean thinking about, one, activists go after companies that they think are a value play, but there's a lot more value that's not being mined. Whether they have compared to competitors and peers, they haven't seen their growth potential from an operation standpoint. There is something happening that is not optimal or from a financial engineering standpoint that if they did something differently, it would bring more value. So it's thinking about how you line up. And so if you're a private company thinking about how you line up to your competitors and peers and how would an outside investor, who's not yet invested in you, sort of think through those issues about what's going well and what's not going well. And by the way, activists only go after companies who they think there's value in it, they have to see the value in it.

And they also, by the way, have to see something we call campaign vulnerability, which is that, can we win? And the way activists think about can we win is essentially, can we take the existing shareholders and they vote for us? And that's thinking deeply about, and by the way, a good exercise in a private company because you have investors, whoever they might be, whether they're family owned or you have large institutional PE funds or labor or state funds who are invested in you privately, think about how they see you as the management team and would they go with a third party that jumped in and said, we want to run the show because the current c-suite is not doing the job. And so that, again, having that articulation allows you sort of run through scenarios. And by the way, that really helps when you think about board quality and maybe you know that you have a board member or two board members who have really not up the snuff.

It gives you that opportunity to walk through how they would attack you and the way you attack. Just like I always think of the analogy to the Serengeti and the absolute humanity and the cruel humanity of how animals and the Serengeti operate, which is that they go after the weakest of the herd and they don't go after the strong ones, and it's not efficient or effective. And so it allows you to start having that conversation about what the value of all your board members and sort of talk through what possible weaknesses is. And maybe that ends with a conversation that Johnny's sitting on the board, maybe Johnny, you have three more months or a year because we need to get another skillset on that board that makes sense. It can make us stronger.

Erika Whitmore:

In terms of private boards, sometimes depending on how the preferred stock agreements are written, et cetera, there's going to be certain investment companies or firms that are going to have one or more seats. But in an instance where you've got those set seats you could expand, right, Steven, so expand and add the expertise you're missing, or is that something that you sometimes see with private company boards?

Stephen Brown:

Yes, yes. And again, thinking of what's really optimal, and that's sort of thing that I guess is the discipline nature of the public markets, if you will. We could do a pro and con list of going public or staying private, but one of the great things about being private is that you don't have that public market pressure and you don't have the noise of the market. But one of the small downsides is that the market can be a disciplining factor. You may have heard this, I'm fond of saying it. Oh wow. If you are a public company, you wouldn't be here right now because the discipline factors of having public investors and the ability to have active investors, they would've come in right now and sort of wiped out the management team. You're not doing X, Y, Z. So again, it is that opportunity to be self-critical of how you're operating. And yes, there are opportunities in the private board to change out directors and to add directors who you believe will bring the value that you need.

Erika Whitmore:

So we're going to switch topics here, but I think just to kind of close the loop on the activists, we could do a whole podcast on this one, but we're choosing to do kind of the two topics. But I think in terms of benefit to a privately held company/board, really having that mindset shift and thinking about what do I need to do with the business? What can I do with my board seats to really think outside the box and think like an activist shareholder who would be, to your earlier point, trying to get more value out of the business. Switching over to our second topic of board effectiveness, what does board effectiveness mean to you and why focus on it, especially if you're a privately held company?

Stephen Brown:

Sure, sure. And especially if you're a privately held company, so complying with SEC, New York Stock Exchange, Nasdaq, all the exchange rules and some rules, which really may not be material to you, but you have to do it because a publicly traded company, you just don't have those issues in a private company. That's one of the great good sides of it. But the idea of thinking about board effectiveness is just simply making sure that if you focus on the several aspects of board processes to ensure that you have effective oversight and leadership, and those aspects could be board composition, the quality of board discussion and information flow, to the culture inside the boardroom, to ensuring that there's a board feedback loop, board evaluations.

Erika Whitmore:

So in terms of board composition, so we touched on this a little bit in terms of potentially adding expertise/ individuals to the board to help you think outside the box or get expertise, what are your thoughts there in terms of if a company's earlier on in that process, what should they be thinking about in terms of board composition?

Stephen Brown:

Sure, yeah, you want to have people who automatically add value on day one. And you want to think about, first of all, what are your issues? So when we think about private companies, family owned companies for instance, may reach the point where, and we hear this term all time now, we want to profess "professionalize the board," which they have no intention of going public, but they look, they think are at a maturity cycle where they need a more professionalized board or more professionalized governance structure. Or it could be if they're heavy institutional ownership where the PE companies, or VC companies sort of ask for that, a professionalization of the board, or perhaps they see that the management team can really use some folks on the board for oversight that have particular skillsets that are not necessarily found in the c-suite who can help give guidance. And one of the biggest things, I'll say, one of the biggest things that board members have come back and said is that particularly is hiring, having independent directors on the board, and using those directors to have a feedback loop with the CEO and to bounce off information with the CEO, which one of the big things that CEOs really enjoy and the board members really enjoy doing also.

Erika Whitmore:

That makes a lot of sense. One thing I have seen a lot of boards adding in terms of expertise, I love your thoughts on this, is AI, cyber, I mean cyber, nobody should not be thinking about cyber and cybersecurity risk. What are your thoughts on that and what are you seeing companies do?

Stephen Brown:

Yeah, that's a really big issue these days with private and public companies, which is the thought of, okay, I need that single issue focus expert. So that cyber expert, AI expert, climate change expert, and many of the rules that you've seen bantered about from a public company standpoint, and some of them went effective, some of them are not, but most of them have sort of scratch this idea that you must have a particular expert. Actually, you think about, and forgive me, I'm just going back to the public realm, but I think there's a lot of implications for a private realm. Really the only expertise that's required from a public realm, public company realm, is that audit committee expertise, that you have someone who has an accounting degree or was an accountant or had accountants reporting to them or the committee financial expert. And we can walk through, although I think it's obvious about why you would want that.

And by the way, we see that in private companies too. Wanting to have someone who has that experience who understands accounting and has that background is important. Well, the same thing we sort of looking at, do we need these other expertise? And I think the answer is it depends and yes, and what it depends is that out of a board member, I want everything. I want them to have the judgment and the gravitas that a senior member of the corporate space has that could look at P&Lp because they've done it before, could look at talent because they've done it before, and help make those judgements. And by the way, I want that. And then if they have this expertise in climate change because climate change, if I'm in a business that's really matters to me material, I want that too. If it's AI focus or technology focus, I want that too. So I look for board members who have the full package already and then build a skillset that says just like building a football, soccer, baseball team, you name it, that you have people with different skills, but they all know how to play the game.

Erika Whitmore:

That makes a lot of sense. So we've talked a lot about independent directors. What skills and backgrounds should a company that's looking to expand their board, to your point, maybe professionalize the board a bit, what should they be looking for in an independent director?

Stephen Brown:

And this is the lawyer in me. It always depends, right? Depends on what your issues are right there. But generally at a baseline, you need people who want to be there, want to delve into what private companies delve into or are comfortable with that, have a good relationship and a good vibe with the CEO. They don't have to be the CEO's best friend, which by the way, we historically many times it is putting the CEO's best friend on the board. And my response to that is that, well, as long as the best friend has all these different qualities and it can remain independent and have independent view point, But really I'm looking for, and again, I'd love for them to bring a particular viewpoint in that issue which you just cannot buy, which is judgment, the ability to sort of think through and know whether to go right or left and provide that advice and provide that feedback and if necessary, to really push back on management because it is judgment, wisdom and a gravitas to sort of push back at a board meeting and knowing when to do that and how to do that on something that management is doing.

And so there are a lot of different things you want, but at the base, you want very seasoned business folks who have, one of the most important qualities, and I'll sum it up with this, is pattern recognition. You want the ability, the c-suite to go to management and say, here's the problem that's before us and the board member to say, I've seen that before, or I've seen something like this. Here's how I dealt with it, and here are your three options. You want pattern recognition, you just can't buy that off the rack.

Erika Whitmore:

I love that because I think to your point, the experience, and it doesn't necessarily mean experience all within, say your industry, you can add someone to the board for that, but somebody who has been

involved in enough transactions that would be along the lines of transactions that you'll enter into or if they have been there, done that in terms of the strategic direction that you'd like to take your board. That makes a lot of sense. In terms of rounding this out, and you mentioned this a couple times, board evaluations, so now you've hopefully got your board in place, you've got experts where you think that they should be. You've also got your investor board seats. How do you evaluate the board?

Stephen Brown:

This is the part where a lot of boards fall short, particularly private boards, but in general because they give it short shrift, it could be a little bit personal, it can be, it's a waste of time. But I can tell you board members really, really appreciate it. And by the way, when we look at the academic evidence, so surveys that we've done here at the Board Leadership Center, other folks have done, some of the big academic schools have done these surveys over the year. And it's fascinating because what they show is that when they ask sitting directors, is there someone sitting on your board who probably shouldn't be there? Overwhelming, they come up with, yeah, there's at least one person that shouldn't be there. And I call that the full employment act for activists and investors, they read this stuff too, and they say, well, I'll get the guy off the board. Matter of fact, I'll get four of you off. So I gave four seats. But what it shows is that board members want to be part of an effective board and they know when someone's not effective, it may be hard to get them off. And so the evaluation process can sort of help with that. And again, it doesn't have to be a very intricate and deep process, but it has to be a way to give for the board to think through feedback and think about what's going to change and really having the opportunity, really having the opportunity to be able to express your opinions. And by the way, using a third party that comes in and does that, doesn't have to be every year, sometimes many boards do it every three years or even every five years, but in between they'll have someone locally in management run a board evaluation process. But it's really important to allow board members to give that feedback and that you can get that 1% better every time you do it.

Erika Whitmore:

It is kind of back to the earlier discussion in terms of thinking about the business and the strategic direction of the business and thinking like an activist, right? You want to continuously improve and make sure that you have the right pieces in place on your board to effectively help management do that. In terms of board agendas and quality of board discussions. You touched on this a little bit, but I do think our audience would be very interested in your thoughts on that.

Stephen Brown:

And this is what I think is the biggest part of a board evaluation that I focus on when I do board evaluations, is do you have the right agendas and are you having the right type of conversation? And so important in that when the board meets for one, I remind board members, and some of you don't have to remind that it's a board meeting, not a management meeting. It's a boards meeting, not a management meeting. There are many times these board meetings, particularly when you have a lot of inside directors, so you have c-suite and management folks from the company sitting on the board, and maybe you have two outside directors or three outside directors. It can become a management meeting where one, they're all using acronyms and jargons, and so they're not giving a full explanation because everyone works there 24/7, as opposed, but I have to remind people, not to two or three independent board members there, so stop using jargon. Because

I can tell you, they won't tell you, but I could tell you, they have no idea what you're talking about. But more so, they lose the opportunity at a board meeting, to really think at a much higher level, Think at a higher level about oversight and think at a higher level about where they want to go. And it become really an operational short-term focus. And that's when independent board members sitting on private companies have to ensure, that's their role. Their role is when that starts to happen to say, excuse me, ladies and gentlemen, I want to lift the conversation to X. And by the way, a lot of that is done before that meeting starts, looking at the agenda and going back to the CEO saying, I want to add this to the agenda, or I know what the numbers are, I can read them. You're going to send me the numbers. So I don't want a

presentation about the numbers. I can read the numbers. That's what you're going to give to me.

I want to dynamically think about what are you going to do about these numbers for next quarter? I want to hear from management is about how you're going to affect those numbers. I don't need you to be descriptive. I got that in the papers. I need you to be forward looking. And that's what's really important and that's the value to the company that you're using, the independent directors wisely, that you're getting their strategy from them. And I'll end with this that, and it's very hard to do, but it's hard to do because you have management team needs to have great comfort in directors and have an honesty where you put something in front of directors saying, here's my issue, here's what I'm facing, we're facing extreme competition from these three competitors, and I want to put on the table that I think we have two options and here's what they look like, and I'd like to hear your opinion. It takes a really bold and confident CEO and management team to say, I want to hear your opinion. I think I have the answers. Here are these two options, but I'm open to you changing my mind here because you're going to do so with the wisdom and the pattern recognition that maybe my mind gets changed about where to go with this.

Erika Whitmore:

A hundred percent. That makes a lot of sense. Well, Steven, I can't believe it. It went by so fast, but I'm down to our final question. Anything else you would like to leave the audience with in terms of private companies and what they should think about when it comes to board effectiveness or thinking like an activist?

Stephen Brown:

Sure. Well, and that's just as simply, is that look over the years, over the last 15 to 20 years really, but if we think about the last 10 years, private companies are just so important to total the global economy, but certainly the US economy, that there's a tremendous amount of power in private equity that's doing a fair amount of backing. And it used to be 20 years ago we would be talking about publicly traded companies, but there's a lot of power in the private space. And so it is really important to think through how do we govern ourselves well. And it's been, if we think about the last, certainly the last 30 years, the last generation or so, and again, I sort of teach this stuff in law school, corporate governance. The focus really is on public companies. But if you look at the numbers of how many private companies are out there and how strategically important they are to our economy, it's really important that we have great governance at private companies.

Erika Whitmore:

Absolutely. I totally agree. Well, Steven, I thank you so much for your time. I knew we would learn a lot from you today. I do, every single time I spend time with you, so appreciate your time and we look forward to having you on a future episode.

Stephen Brown:

It's always a pleasure. Always.

Erika Whitmore:

Awesome. Thank you.

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