KPMG

Unleashing the power of effective boards at privately held companies

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Erika Whitmore:

All right. Well, I'm really excited for today's session. Thank you everyone for listening. I'm very excited about our speaker today who's going to be on this podcast with me. Claudia Allen is with the KPMG Board Leadership Center. But she has a very interesting background and I want to make sure, Claudia, that I give you time to share that. So, Claudia, why don't you tell the listeners a little bit about yourself?

Claudia Allen:

Well, thanks Erika. It's great to be here. As Erika mentioned, I'm a senior advisor with the KPMG Board Leadership Center, which is essentially our think tank on corporate governance, and we work with both public companies and private companies. For example, we work with the Private Directors Association—I'm a founder of that—various directors, and various private companies. By background, I'm a corporate lawyer. I was a partner and cochair of the corporate governance practice at a national law firm.

Erika Whitmore:

Awesome. Thank you, Claudia. So, much experience when it comes to boards, which is outstanding. So, we recently did a survey, and if you don't mind, Claudia, if you could explain what the survey was and why we did it.

Claudia Allen:

When you look in the private company space, there really is not a lot of good data on private companies. And, also, private companies have so many different ownership structures, so sometimes you're comparing apples and oranges. So, we were able to survey about 600 directors from a variety of company types, from private equity to family-owned companies to nonprofits. And some of the interesting findings were that for those who responded, almost 90 percent of their companies had at least one independent director. And that percentage held true if you separated out, for example, PE or VC-led companies. Interestingly, the lowest percentage of independent directors was at founder-led companies. And that may in part reflect a desire from some founders to retain more control. And one of the interesting things we found in the survey and in subsequent discussions is, particularly at family-led companies, a number of directors commented that their CEOs really didn't know how best to use their experience and skills. So, I think that can be a very helpful area for our discussion.

Erika Whitmore:

Hey Claudia, real quick, and I'm going off script here a little bit like I told you, what you just said in terms of board members maybe feeling like their CEOs aren't effectively utilizing them. I'm a founder or a CEO and I just heard that, I would think, well, wait a minute, that might be me. What are some suggestions that we would have that they could do to become more educated in terms of how they could effectively use their board members?

Claudia Allen:

Well, I think you have to think about why are you bringing on the independent board members. And typically it's, among other things, you want an outside perspective. You may be looking for somebody with industry expertise, or you're a growing company and you need help with M&A, so you bring somebody who has M&A expertise. I think you want to take advantage of that. And really the only way to do that is if there's a level of trust and understanding between management and the directors. There can be constructive questions from the board and there should be, but you need that level of trust to be able to push and pull. For example, an area where many directors think that they're not doing the best job is with oversight of strategy.

Erika Whitmore:

That's a tough area too, right?

Claudia Allen:

It is. And if I were the CEO of a company, I would bring the strategy to the board before it was fully baked, when I probably had decided or thought I had a good direction as to where I was headed. And then I would sit with the board. And they should be asking, for example, about what are the other alternatives you considered and why didn't you pursue those? What are your assumptions? In other words, have a robust dialogue so that you can really improve the strategy. The board is not very helpful when it's only used as a rubber stamp. You really are undercutting the ability to take advantage of the skills that the board brings to bear.

Erika Whitmore:

Another thing that I'll just pick apart just a little bit in terms of what you said or maybe just give you my thoughts for what it's worth. I'd love to hear what you think in terms of that building trust and building a relationship. I love that. I think that that's with any relationship, but especially important between the independent board and/or committee of members and the CEO. And if the CEO has brought in somebody who they think is very qualified but maybe doesn't have necessarily that relationship. Some of the things that I've seen CEOs do is, obviously, you maybe have your quarterly, whatever cadence it is, but hopefully at least quarterly that you're meeting with your board and having those dinners and those other opportunities—where you're not necessarily in a formal setting, but you're getting together. Maybe it's lunch, whatever it is, and you're building those relationships.

Claudia Allen:

I agree. And I think another important area is onboarding of directors. There tend to be more formal procedures at public companies, but less so at private companies. So public companies typically have a book of information they present, and the director meets with all the executives. So, I think if you're talking about a private company, many times management just simply hasn't thought about the need for this, and that's something I've heard about a fair amount. So go ahead and create a program to onboard your new directors. And it should have some key components. You should be briefing new directors on key challenges, the financials, the strategy. You should be giving them basic documents, not a flood of documents, but basic documents, the certificate of incorporation, the bylaws, the strategy. And then you should also have one-on-one briefings with the CEO, the CFO, maybe the chief risk officer if you have one.

And the other part of it is individual directors really need to take ownership of their own onboarding. If there's something they want to learn more about, they should ask for it, take ownership there. And then an interesting thing some companies do is they have effectively a reboarding after 12 or 18 months, during which the director then is sort of steeped in the company and can ask more questions. Other directors, if they want to attend, will be invited to attend as well. So, you want to give somebody the ability to contribute—because if they just show up at the first meeting, they're not going to understand the culture of the board, most likely, they're not going to be the most effective contributor. And one of the other things you can do is, given the term "board buddy," team up a new director with a director who has some tenure on the board who can provide some insights into the culture of the board and also can give some candid feedback to the new director at the end of each meeting.

I think it really is important for somebody who joins the board to understand why they're being asked to serve, what skills they have that the company is looking for, and to be comfortable with the culture of the board. You really have to look at it. Sometimes there can be a temptation if you get an invitation, I'll immediately serve, but it's a two-way street. You have to make sure that it both suits you and suits the company. And then you really have to read up like crazy, read everything you can about the company and the industry. And one thing that is difficult for directors is there is an inherent information asymmetry—management always has more information, and there's some filtering. It's just natural. So, get some information from outside. So read trade publications, go to a trade show. If it's somebody that sells a retail product, go to the stores. Help yourself learn more about the industry, its competitors, what's on the horizon. It really will help make you a better director and more effective.

Erika Whitmore:

Yeah, absolutely. Now I also know Claudia, because I think you're doing a round table in Salt Lake City, I think here soon, which I'm super excited about. So, thank you in advance for doing that, but I know you've done many of these in the past, and so I'd love to hear some of the key themes that you hear when you're part of these roundtables and maybe, for the benefit of the audience, this happens throughout the United States, probably outside of the United States even, where we get together with directors and basically have a conversation. Sometimes there's an agenda and sometimes there's not, but there's a lot of sharing among different board members from all over the US. But we'd love to hear some of the highlights from those roundtables.

Claudia Allen:

Sure. I mean, in terms of private company directors, a lot of the discussion of late has been about what attributes do you look for in a director. And I think part of the exercise is looking at the company and its strategy, identifying the skills the board has, and then looking for the gaps and figuring out what skills you really want and need. So, the skills first, then you think about the people. And then part of that depends upon the type of company. So, for example, a family-led company may be looking to professionalize governance. Some have had a meeting once a year, and that's kind of it. And there's a need to really make sure that directors are in a position to exercise oversight. Or a PE or VC company may be looking for somebody who has industry expertise. Of course, if it's a high-growth area, a new industry, you're not going to find somebody with industry expertise, but maybe you'll find somebody or be looking for somebody with experience with innovative type companies who's helped a company like that grow.

And it also depends on the stage of the company. So, if you're thinking about going public, probably looking for somebody who's been through that as a director before. So who understands, for example, if you're looking for an audit committee member, somebody who understands what a public company audit committee does, what the finance group of a public company is required to do. And then you also may be looking for specific skills. I think I mentioned this before, as companies mature, you may be looking for M&A expertise. You may be looking for digital transformation expertise. And then some companies are just also simply looking for additional perspectives as they think about their strategy. So, somebody who can bring that type of influence to bear, get the company thinking more about the future rather than so much on the past.

Erika Whitmore:

Do you see a lot of cybersecurity experts or individuals like what I've seen on a lot of my high-growth companies? They'll add individuals to the board that were maybe part of a CTO organization in a larger, more established company. Is that something that you see as well?

Claudia Allen:

I think for all types of companies, whether they're public or private, I think there's obviously a realization that tech/cyber are both enabling and pose potentially existential risks to companies. It's really important to evaluate how central tech issues are to a company and then to decide whether you want that level of expertise on the board or whether you want to get it through consultants, an advisory board, or other. I think that the one thing companies generally try to avoid is getting a director who maybe has current expertise in an area but does not yet have the breadth to be a good director, generally—just doesn't have that level of business experience because companies change, issues change. So, you want somebody who's a great director who also has some domain expertise. So, I think we see more desire for expertise or experience in that area. I think at the same time, a lot of private companies, probably, their boards are further behind in thinking about this than public companies.

Erika Whitmore:

I'm going to jump around just a little bit, Claudia, which you've been super great about so far. So, thank you. What are your thoughts or what have you seen in terms of how boards deal with founders/succession, which we know in public companies is super important and the company needs to have a process in place and have a plan. What do you typically see? How do boards deal with that in a private space?

Claudia Allen:

Well, ideally, a company should have a succession plan for the ordinary course as well as an emergency succession plan, because emergencies do happen. I think one of the issues with a founder-led company is do you have a founder who is introspective and self-reflective enough to be able to assess whether the company has reached a point where that individual may no longer have the skills to take the company to the next step? So, I think sometimes we see founders who really don't have the skills that are needed, and that can be unfortunate for the company. And it also depends on whether the company's a so-called "controlled company". If the founder controls the company, he or she controls the board. So, at that point you're left with, do the investors and the remaining board members have enough ability to talk to this individual to persuade him or her? So, it can be a pretty multifaceted discussion, but succession planning is a difficult issue for almost any company. It's really a discipline that's necessary because more companies that would like not to think about it have had emergencies where they've really had to change gears quickly. So, who's that going to be? Who can steady the boat and where will you look for a long-term replacement?

Erika Whitmore:

And so, best practice maybe would be that the CEO/founder comes up with a plan and then has a conversation with the board about that, right? To kind of get their thoughts, etc. Is that what you've seen?

Claudia Allen:

In more developed companies, the ideal is that succession planning should start the day a CEO is named. Now, if you're an up-and-coming company, you probably haven't had a lot of processes and procedures in place, but you have a nominating committee or another committee. There should be a discussion between the board and the CEO about what the CEO thinks, who should be a successor. It should be a board decision. But again, depending on levels of control, the decision may effectively be elsewhere. But ideally, it's a board-level decision with input from the CEO and input from others.

Erika Whitmore:

I think just with my experience with privately held companies, a lot of times it's a little closer to the vest with the founder and the CEO. But as they move along the maturity line, hopefully they'll involve their board, especially if they have an independent member to help them with that plan and help make sure it's a good one. In terms of, again, switching gears just a little bit, because I think this one's really important, and I know we're getting a little short on time, your thoughts and recommendations in terms of self-evaluations for a board. I know that we know what public companies do that's just part of the process, part of the charter, but how can privately held companies leverage that to make sure that their boards are being effective?

Claudia Allen:

You're absolutely right. On the public company level, it's part of listing standards, so they have to do it. At a public company, you would see a full board evaluation, committee evaluations, increasingly peer evaluations. But if an evaluation is done well, it can really help the board function better. Evaluations are not always a useful exercise. So, some of the things you want to think about are making sure there is buy-in from all the directors about the value of going through this exercise and then a commitment to act upon any findings. Often there'll be a finding and there'll be no action. So that's the worst of all worlds. You have some document that says you need to improve, and you haven't done it.

Peer evaluations can be helpful, but they can also be particularly tricky. There's a risk of balkanizing the board with them. I think the best way to think about them is if everybody views them as a way for each director to improve his or her performance, not as a gotcha exercise. And you would want the feedback delivered one-on-one by somebody who really has the skills to convey whatever is found and to help the director improve if there's really a problem—is able to sort of say, here's what you need to do, here's the timeframe.

And I think it's also important to think about how they're done. Most evaluations used to be done just by questionnaire. The questionnaire can be okay, not the best. Particularly if you use the same questionnaire over and over, they really lose their ability to pull out real findings. So sometimes it's helpful to use an interview, have the general counsel interview everybody, ask everybody the same questions, or use a third-party facilitator. And sometimes the most open-ended questions elicit the most helpful information, like, what are we doing really well and where could we improve? And I think those often lead to very interesting feedback and helpful discussions.

Erika Whitmore:

Well, Claudia, we are about out of time, but I would love to give you an opportunity. Any parting thoughts? What would you like to leave our audience with as kind of things that they should remember from this session?

Claudia Allen:

Well, being a director, it's a big job and there will inevitably be a crisis at a company. So, if you're choosing to be a director, make sure you understand the company, why you're serving, and make sure you have the time for that crisis because that's when your expertise is really needed. That's where you can really add some value.

Erika Whitmore:

Yeah, absolutely. Claudia, thank you so much for being on with me today. This has been great. I think our listeners will really appreciate all of your insight, and I look forward to seeing you in Salt Lake City soon.

Claudia Allen:

Thank you so much.

Erika Whitmore:

Thank you.

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