PRIVATE DIRECTORS ASSOCIATION
Creating Value Through Board Excellence
CHICAGO

PDA Newsletter March 2016
Serving on the Board of a Distressed Company

Upcoming Events

How to Get Your First Paid Director Appointment

March 16, 2016

5:30 PM to 7:30 PM

DiMeo Schneider & Associates, LLC
500 West Madison Street,
Suite 1700
Chicago, IL 60661

Register Now

Find a Director

Become a Member

Become a Sponsor

Contact PDA

PDA Website

***Shepherd G. Pryor IV** is Managing Director of Board Resources, a Division of TeamWork Technologies; Sheppryor4@aol.com*

Contributing Editor Shep Pryor** is a Founding Member of the Private Directors Association; Co-Author with William Hass: **The Private Equity Edge** and **Board Perspectives: Building Value through Strategy, Risk Assessment and Renewal

If you are looking for opportunities to serve on corporate boards, you have probably had a successful business career. During that time you have learned to plot strategy, manage people, analyze tough business problems and make decisions. Somewhere along the way, you may have worked in a business unit that had problems and things changed. The pace of activity, the intensity, the stakes of making a wrong move all became more stressful, but your learning curve became progressively steeper. Many executives who come through such experiences form a strong commitment to never go there again. However, the skills that you honed may be valuable to organizations that face dramatic change. You may find that serving on the board of a distressed company can be a challenging, but rewarding experience.

Employing a few key principles may help you navigate the perilous waters you travel as a director on the board of a distressed company.

There is only one flag to salute

All directors owe their first allegiance to their company as an entity. This principle stands in high relief when a company is in distress. If the company becomes insolvent, creditors, as well as shareholders, may have the right to criticize the board for failure to fulfill its fiduciary obligations. The best course of action for a director of a distressed company is to remember and to remind all those in the room that all are there to protect the interests of the company, and to protect it to the end. This means holding management, counsel, outside advisors and other board members to the same standard. When this is done well, it will give a company the best chance for survival, or, if that is not possible, a proper dissolution, with the best available outcomes for interested parties, such as creditors.

Analyze first; then decide

Sometimes a seemingly terrible twist of fate wounds a company beyond apparent repair. Management and the board may think on first blush that bankruptcy is the only alternative. Making a decision and then backing it up with pithy analysis does not work for corporate directors. That approach is an invitation to subsequent problems and litigation. If the board and management plan "to take the company into bankruptcy," the time between the apparent decision and the actual filing is filled with unfortunate opportunities to inadvertently misrepresent the status of the company and mislead contract parties, who are relying on good faith dealings with management.

What a board can do is analyze alternative action plans: refinance, bring in equity partners, sell the company, file a bankruptcy to reorganize, file a bankruptcy to liquidate, or continue to operate with different approaches that might solve the existing problems. At some point, one of the alternatives will be determined to be the best choice to further the best interests of the corporate entity. Then, and only then, should a board make a final decision. If that decision is to file, the filing should be as soon as practicable after the decision is made. This approach minimizes the potential for subsequent problems and maximizes the value to the company.

Say it today, read it tomorrow

Directors operate in confidence within the board room. They are also privy to the worst news and the concerns of management. Discussions may range from probing into the problems to formulating solutions and to determining how to hold people accountable. Remember that what you say or write down during such sessions, while undertaken in the confines of the board room, may become a subject of dispute and litigation at a later date. Don't say anything that you would be uncomfortable to see attributed to you on the front page of your local newspaper. Litigation has a way of exposing confidential comments made during a board meeting and shining the worst possible light of hindsight on even the most innocuous comments. Directors should make sure that discussions are conducted in a professional manner, assuming that sunlight will find its way into the conversation. Reflecting on a previous principle, when directors always keep the interests of the company in mind, they are more likely to pass the "newspaper headline" test.

Marines don't retreat

Often there are two attitudes of directors on boards of distressed companies: "I didn't sign on for this" and "I am here to help." Once the company is in distress, the mission of the board is to focus intensely on the fate of the business. The sooner all can move to the "I am here to help" mode, the better.

You must live through today to get to tomorrow

When distress hits, time compresses. Competitors and contract parties seem to speed up their activities and demands, and the company seems to operate in slow motion. The board can help management tune its activities accordingly. Strategic considerations must be set aside in favor of tactical moves to stabilize the company. Sometimes pet projects that have been championed by management must be halted in their tracks in order to focus limited resources on solving more threatening problems. Board members should use the greater level of objectivity that their position affords them (compared with management) to prompt management to properly prioritize.

Hire the right professionals: Amateur hour is for hobbyists

Most distressed companies are victims of long term trends that they have been unable or unwilling to detect or reverse. Even if distress seemingly comes as a bolt out of the blue, the first reaction may be denial, slowing the processes necessary to reach good solutions. Sometimes it is fair to say that if management and the board were that good, the company wouldn't be in distress. This is a tough criticism to accept. While directors and management teams are legally insulated from decisions that don't work out, they are not served well by making poorly informed decisions when problems arise. HIRE THE RIGHT PROFESSIONALS. Directors should recognize that they need thorough, professional analysis and recommendations, preferably conducted by third parties, to support the kinds of decisions they will face once distress has visited the company.

Don't bring a knife to a gunfight

Finally, if you choose to join the board of a distressed company, or if you find your company has become distressed, it is time to bring your full skill set to work. Get the right professionals on board, hold executive sessions with them to ensure they understand the importance of serving the corporate entity, not just management's interests. Make sure that the CEO and top management have consistent goals that do not conflict with those of the board. Be demanding. Prioritize board discussions with survival issues on top of the list. Set tight time lines and stick to them. Assume the worst, and hope for the best. However difficult the conditions, push everyone to achieve for the company something you can point to with pride.