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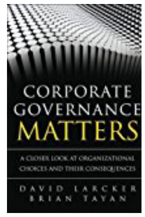

Private Directors Association™
Recommended Reading:
Corporate Governance Matters: A Closer Look at Organizational Choices and Their Consequences 1st Edition
by David Larcker and Brian Tayan
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PDA Newsletter October 2016
Improving Information Flow to The Board

Upcoming Events

The Value of a Board of Directors in Helping Companies Fulfill Their Fiduciary Responsibilities

October 19, 2016

Starts 5:30 PM

Katten Muchin Rosenman LLP
525 West Monroe Street
Chicago, Illinois 60661

How a Board Helps or Hinders the CEO in Growth Periods

November 16, 2016

Starts 5:30 PM

The Northern Trust Company
50 S La Salle Street
Chicago, Illinois 60603

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Contributing Editor: *Tony Natale is an early member of the Private Directors Association. He is well recognized for his leadership roles as Chief Executive Officer and Financial Advisor. He founded and manages Shepherd Partners, Inc., a consulting firm dedicated to helping middle market or family-run companies in transition. To reach Tony: Tony@Shepcorp.com 312-543-4493*

SHEPHERD PARTNERS
Advisors to Companies in Transition

CEO's have profound control over the material that gets presented to a company's board of directors. At times there may be issues with the adequacy, accuracy and timeliness of what the board sees. The point of this article is to sensitize the board to what it should be seeing and how to improve the quality of that information flow.

Minimum Requirements:

The monthly, quarterly and annual financial packages should include a set of consolidated and unit level income statements, balance sheets and cash flows. The P&L should compare actuals to budget and prior year and show variances as Favorable/(U)nfavorable. These statements should be accompanied by a Management Discussion and Analysis (MD&A) that strikes a balance between too little and too much information. This analysis should avoid what I call the 'elevator analysis' where the writer states this went up and that went down. What's important is to key on exceptions and their cause. And, in my CEO role, I like to have the board see the period summary of a Balanced Scorecard or Flash Report; whatever one-page document my direct reports and I see daily to keep on the pulse of leading performance indicators such as a sales pipeline, customer service metrics, key commodity prices, people counts/open positions, etc. Nowadays this information needs to be accessible in the cloud using secure services like DropBox or SmartRoom. Additionally, there should be an automatic digital feed of press releases. This digital feed could be supplemented by a 'clipping service' covering the company and one or two top competitors.

Governance and the CEO Gatekeeper:

The CEO and CFO are gatekeepers to what the board sees. Much of the vital information seen by the board is financial in nature. And while accounting should be precise, interpretation of accounting rules allows for wide latitude in how those numbers are reported. While I view the CFO as the financial conscious of the organization, it is unrealistic to expect complete transparency from this direct report to the CEO whose job and financial success are determined in no small part by his boss. Assuming the CFO is present at each meeting, boards should be prepared with open-ended qualitative questions to ask. For example, "What other information should the board be seeing to understand the company's performance?" Or, "What do the financials not reveal or potentially mislead the reader about?" And, "What concerns do you have that haven't been covered in the MD&A?" Seeing the officer's response to this and eyeballing the dynamic between the CEO and CFO will tell the board important intangibles that may indicate developmental needs, highlight leadership gaps or point to potential trouble.

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The Agenda:

Most private company boards are run by the CEO so the agenda is driven by him. This important control element wouldn't be a factor if there was a non-executive chairman but that is rare especially in non-public companies. And while there is usually a catch-all item for "Other Business", controlling the agenda and the time allocated to topics can lead to inadequate treatment of certain topics (I suspect the Wells Fargo board now wishes it had paid more attention sooner to the credit card scandal under its CEO!). Boards and their companies would be well served by helping the CEO craft a template for the agenda, the time allocation for each item and the spacing throughout the year of topics such as strategy, capital spending, finance, etc. Standing committees can also shape the agenda. It is incumbent on the board to see that questions it posed in prior meetings are addressed adequately. One agenda item good boards and leadership will benefit from is a discussion of threats or weaknesses as this will help focus the management on risk management and the future.

Management Presentations:

A board's ability to gauge the CEO is enhanced through exposure to others in the organization such as functional, geographic or division leadership. Throughout the year, a confident secure CEO would have these team members make presentations to the board and have unimpeded board Q&A. Not only does this better inform the board, but it gives it a chance to see company talent first-hand and observe the CEO's dynamics with his team.

A Word to Private Equity Professionals:

Private Equity Group (PEG) investors agree, almost universally, one thing they all could do better is replace under-performing leaders sooner. This is driven in part by the dynamic of the entrepreneur and the investor. First off, the private equity sponsors are aligned with and literally invested in management so it is harder for these professional investors to be even-handed and dispassionate about their CEO partners. And because the CEO often views, wrongly, that he needs to be in a selling mode to the investors (after all they are investing in him and his ideas) this role can lead to him hiding or downplaying bad news or conflicting views. Consequently, he is missing out on a prime benefit of having a knowledgeable board; the ability to test ideas and manage risks. Nobody likes to look uniformed or wrong; especially executives. So, PEGs should consider their tendency to be over-committed to their portfolio CEOs and for these CEOs to continually over-promote positives and hide or dismiss negatives.

Conclusion:

There is a certain tension between how much information the CEO gives the board and what the board needs to stay atop its governance and advisory duties. Establishing the template for a robust board information packet is a solid first step. Supplementing that by open-ended qualitative questions directed towards the CFO, plus assuring that open items from prior meetings have been addressed fully, and a scheduled discussion of threats and weaknesses, are all valuable additional steps for a board. Presentations by functional or other unit leaders will deepen the board's understanding of the company, management talent and its leadership dynamics. And professional investors benefit by maintaining a healthy recognition of CEO's tendency to be in selling mode and how this can skew what the PEG sees and how it evaluates this information.