PRIVATE DIRECTORS ASSOCIATION®
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Board Director Committee

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Special Edition Newsletter

Board Director Focus: Board Recruitment for Special Circumstances

Mark Richards is the President of Meade Street Advisors, LLC a business he founded to assist private and family-owned businesses seeking to establish a professional board of directors, implement best practice corporate governance and strategic planning processes, and mentor executives. Mark is a seasoned executive with over 20 years in the C-Suite running middle-market publicly-traded, private and ESOP-owned businesses. Mark has 15 years of board experience, including 10 years as board chair, and has served on all standing committees. Mark can be reached at ***mark@meadestreetadvisors.com.***

Board Retention and Recruitment During Challenging Times

By Mark Richards

A successful Board of Directors is a stable group with little turnover from year to year. However, there are some board governance scenarios where its composition can be aggressively redefined, including removing the entire board of directors. We all know a story, where through no fault of their own, a company enters into distress from some sort of *black swan* event. Of course, not every reason for distress is some sort of paradigm change. For example, a Federal ERISA, DOL, IRS, FDA, or DOJ Foreign Corrupt Practices Act (FCPA) investigation can quickly overwhelm a business and its board of directors. The unplanned death of the business owner, a major customer or supplier default, or a disaster like a fire or tornado that destroys the business facility are further examples of very challenging situations, which will create financial and organizational distress. No matter the cause, what is important is how well a board of directors has planned and responds to such events. Director retention and recruitment during challenging times is an enterprise risk that merits advanced and periodic consideration by the board.

Director retention under normal circumstances is generally planned and predictable. When the business is unexpectedly impacted by a negative scenario, retention will become an issue despite what board members tell you in advance. Directors carry varying tolerance for and exposure to risk. As uncertainty rises in the business directors will step down. Typical reasons include legal concerns especially for personal liability. Despite volumes of case law supporting the board of directors' who follow good corporate governance practices, directors will still seek to remove themselves from situations they deem risky. Reputational risk is another reason directors will step down, though, few directors will use this reason overtly given its selfish perception. More likely and in my experience, directors will cite a lack of time or skillset to address the matter, and suggest the board find a more suitable person. In these situations, seek to extend the departure-transition time period especially if the board of directors has not managed a robust board succession planning process with a short-list of "ready now" candidates. This may appear counterintuitive given the director wants to leave, so let me elaborate.

During challenging business conditions, sudden director and executive turnover exacerbates an already tenuous situation. Key stakeholders will view the unexpected loss of talent as a sign of further weakness, which aggravates the situation. Even with a well-designed public relations plan, rapid director defections negatively impact employee morale and undermine credibility with customers, suppliers and financing sources, and open up

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the company to competitor attacks. It is in the best interest of the company to carefully manage director turnover during times of uncertainty.

According to the October 2020 *Harvard Law School Forum on Corporate Governance*, the average tenure for a seated director is 9-10 years, so it is more than likely the director seeking an exit has longer service and institutional knowledge, which is especially valuable during periods of distress. An extended transition enables the director search committee time to do their work. Equally important, it gives the business time to stabilize the situation. In my experience, most sitting board members seeking an exit will continue to serve provided they know a good faith effort is underway to find a replacement.

Board of director recruitment during a time of business uncertainty significantly complicates the task. The circumstances surrounding the business situation may demand recruiting new directors to regain credibility with key stakeholders and even regulators -- further increasing the importance of the process. In these situations, the first thing a company must do is make sure strong, respected executives fill the board leadership roles for all standing committees (audit, compensation and nominating/governance), including a nonexecutive chair. Once these positions are anchored, it will be easier to recruit others to serve on the board. Subsequent candidates will have more confidence that the board will be well run, and they will be less concerned that serving on the board will expose them to significant risk.

A strong nonexecutive chair to lead the board should be considered if the currently sitting CEO is also board chair. From my experience, the CEO will be consumed by the business crisis, so naming a non-executive chair provides the CEO leverage. It also sends a message of confidence to stakeholders. Adding executive resources during times of uncertainty calms customers, suppliers and financing sources because it shows the company is being prudent, thoughtful and has bench strength. The non-executive chair will also serve as an independent voice to stakeholders.

When recruiting new board members during a period of business distress, the board search matrix should be revised to focus on candidates with the right temperament. Given the increase in risk, complexity and time commitment, and in the special case where the business may elect to restructure under the protection of US Bankruptcy law, the board of directors will work through countless challenges and need to augment its existing skillset. Russell Reynolds Associates, a leading US executive search firm, researched the profiles of board members who thrive during times of business distress and found they shared a mix of these key qualities: financial expertise, prior experience with distressed assets, time to dedicate to the board's work, poised under pressure, diplomatic, curious and determined. Finding board candidates with these attributes and attracting them to a distressed business requires specialized expertise often found within boutique executive search, as well as in turnaround and bankruptcy advisory consulting firms. The leading international executive search firms will have a partner that specializes in these sectors too. These are expensive resources to retain, but given the situation they represent a wise investment to attract and retain the right board talent on a timely basis.

A company and its board of directors finding itself in a challenging business situation needs to understand that conditions have changed and a board recalibration exercise is needed. The speed with which the board pivots will often determine whether the business survives or fails. When business conditions significantly worsen, a planful board should consider the possibility that long-serving board members may ask to resign. They'll also want to anticipate that if conditions have sufficiently deteriorated, some board members may need to be asked to resign.

The existing board skills matrix must be revised to prioritize the temperament and skill-set needed to successfully address the current situation. The ability to attract the right talent requires highly-respected executives anchor the key board leadership roles, and warrants serious consideration to naming a non-executive chair to serve as an independent voice. The non-executive chair plays an especially important role during a period of business distress, as they bring everyone together and get the very best out of the new board while the CEO focuses on stabilizing the business.

Even with thoughtful structural preparation and candid assessment of sitting board members, don't be surprised when director candidates reject the board role for the same reasons sitting board members request to resign. Executives who are adept with distressed situations bring unique experiences and special attributes that may not be present in the current board members. Serving on a board of directors for a business working through a distressed situation is intense. Companies that have invested the time to design, implement and refine good corporate governance practices and include distressed business scenario preparations in the annual strategic planning process, are best positioned to successfully work through the challenging situation.

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