

Investor Relations for Private Companies

A Board of Directors Engaged as an Asset and Not an Obstacle is Vital to Maximizing the Success of an Emerging Company

Prior to obtaining venture capital, most emerging companies do not place emphasis on recruiting or properly using a board of directors. Entrepreneur-controlled, there is generally no pressing need for a board elected by and representing the interests of the stockholders.

Formal board representation, however, is a condition of obtaining private equity. To the entrepreneur CEO, this is a major new dynamic holding unique challenges and opportunities that differ from any previous business relationship. Investor board members should be viewed as valuable assets, bringing industry expertise, technical skill, customer access, objectivity, and more. And, as with any asset, investor board members need to be engaged to produce benefits.

An important part of the CEO's role in a venture-funded company is to get the most from the board, and to work with the chairman or lead director to ensure that the board is using best practices and best efforts to further the interests of the company.

Before discussing specific principles and practices, let's first consider the investment landscape. In some cases, a company seeking venture capital under-promises results and achievements during the investment cycle and over-delivers post investment. Unfortunately, this is not the most common situation, in part because the playing field is not level. More typically, to attract venture capital a company develops overly-optimistic revenue and profit projections which VCs discount in their internal models but nonetheless make the company abide – often by stipulating the achievement of “milestones” in stock purchase agreements as conditions for providing additional capital at agreed valuations. This optimistic planning, coupled with the ownership dilution concerns of the founders and inside stockholders, tends to reduce the amount of VC equity investment requested by the company.

For their part, to reduce risk and increase potential ownership stakes, VCs are motivated to minimize early investments in favor of follow-on rounds. Thus, the more common scenario sees the company under-delivering against plan, failing to achieve their milestones, and soon seeking more capital from existing or new investors under adverse circumstances. But it doesn't need to be this way. Proactive board relations can produce tighter partnerships, unified decisions, and avoid many of the problems that arise from a company's performance that is below expectations.

Corporate scandal and fraud, prison terms for convicted executives, and directors' personal liability for lapses, have made Sarbanes-Oxley compliance, corporate governance, and board composition hot topics. Much has been written in recent years about directors' roles on the board as well as board committees of public companies. Privately-held, venture-funded companies can learn from studying the actions of publicly-traded companies regarding best practices for entrepreneur CEOs and board members.

Entrepreneurs generally have limited previous experience in working with investors in a formal board of directors setting. This is often the only forum where CEOs have their vision and judgment aggressively questioned, and where the possibility of investors withholding further financial support can be wielded as a sword or a shield by the investor representatives on a board.

Regardless of whether the entrepreneur CEO is chairman of the board – and best practice suggests he/she should not be the chairman – the CEO, as the company leader, is the focal point of board meetings and can exercise great control over the direction and tenor of board interaction. This is where sharing strategies and ideas and building consensus happens.

CEOs should view the skills and experience needed on the board in the same ways they would in determining the capabilities of executives or consultants needed by their business. Establishing a proactive working relationship with each individual director is crucial. CEOs should strive to establish and formalize each director's level of activity and attention and, if the "job description" includes it, interactions outside of the board room.

The following are some ideas about how entrepreneur CEOs can maximize their relationships with venture representative-dominated boards, as well as some of the principles and practices that should be embraced:

- **Communication Factors** – Like “location” in real estate, communication is paramount in investor relations. Honest, open, hard-hitting, and polite communication is essential.
 - Keep the board informed about industry and company issues in real time as well as at scheduled meetings.
 - Listen respectfully to your board members and appreciate that their wisdom is often the result of having lived through pain and suffering they hope you can avoid and they won't repeat.
 - Although the relationship between CEOs and investors can be fairly adversarial during the investment cycle, post-closing everyone should have the same interests – maximizing the satisfaction and rewards of running and growing a successful company.

- **Investor Motivation Factors** – Learn whether the investment has broad support within the VC firm or mostly the support of the “sponsoring” partner who is on your board.
 - Reach out to and get to know the other partners at the fund, as well as the senior management at other companies funded by your VCs.
 - Become familiar with the criteria for follow-on investments, exit timing, and realistic target valuations.
 - Understand whether your investors truly have the ability and inclination to spend time and political capital helping your company in sales, marketing, product development, etc. If they do, drive them to perform to your high standards.

- **Competency Factors** – Objectively evaluate the competencies required on the board that will enhance CEO and senior management effectiveness.
 - Consider increasing the size of the board to accommodate the need for competencies beyond those of the investor representatives.
 - Consider creating business advisory and/or technical advisory boards to gain the desired competencies without encumbering the board which has legal fiduciary obligations.

- **Board Performance Factors** – Create written agreements for all board members identifying their roles and responsibilities to the company. For independent directors, include cash and/or equity compensation provisions in the agreements. Develop and maintain an evaluation system for the board as a whole, as well as for the individual members. The board should meet as often as required – at least quarterly, and more frequently in the period following an initial venture investment. Attendance goals should be set at 80% or higher for every meeting. Board members should:
 - Meet regularly amongst themselves, outside the presence of company senior management.
 - Actively participate in bringing new resources to the organization (customers, strategic alliances, professional services, human resources, additional investors, etc.).
 - Be prepared to identify a significant contribution made to the company within the past 60 days, and one that will be made in the upcoming 60 days.
 - Be able to identify a significant contribution that each other board member has made to the organization in the past 60 days.

- **Alignment of Interest Factors** – Objectively assess whether management and key employee interests are aligned with investor interests. Misalignment may become a source of on-going friction and may impact long-term shareholder value. This is an issue that is often unique to emerging and venture-backed companies as compared to larger more established organizations.
 - Venture-funded companies are generally cash constrained and are not able to pay fully competitive cash compensation. Furthermore, key executives believe they are integral to business performance and the creation of shareholder value.
 - Retaining and motivating valuable talent should be a top CEO priority actively supported by the board.
 - The board must ensure that the entire company clearly understands the key goals and measurements and is held accountable by human resource strategies that compensate high performance and remediate or eliminate low performing personnel.
 - CEOs, investors, and other board members need to support aligning interests of stockholders and key employees with a framework of incentives based on meeting or exceeding goals.

- **Financial Oversight Factors** – The board has fiduciary obligations to steward and safeguard corporate assets for the benefit of all stockholders. This includes authorizing major undertakings such as mergers, acquisitions, large capital expenditures, issuance of new equity or debt securities, and adding or disposing of significant lines of business.
 - The board is responsible for approval of operating plans and budgets, and on-going investigation of progress or variances against plans.
 - Each board meeting should include a review of recent financial performance and a discussion of the reasons for significant divergence from plan, changes from comparable prior periods, and comparison with the performance of competitors or other appropriate benchmarks.
 - As required, the board should meet privately with the CFO for a thorough review of financial and operating results.
 - The full board and/or the audit committee should meet at least annually with the company's independent accountants to discuss issues and recommendations.

- **CEO Performance Factors** – The board should help develop and approve of the company's strategic direction, and evaluate the CEO and senior management on the company's performance against stated goals.
 - Critical short-term and longer-term goals and the objective measurements used to assess performance must be articulated and accepted by management and the board, in writing, and communicated to the entire organization. What gets measured gets done.
 - The board should develop criteria to assess the CEO and senior management based on the critical success factors unique to the company; such as talent acquisition and development, technology development and adoption, customer acquisition and retention, and strategic alliances.

In addition to maximizing the effectiveness of a company, good corporate governance has an important related benefit. The sale of a venture-backed company to a larger, often-publicly traded organization is generally the exit strategy of choice. The attractiveness (and therefore the valuation) of a company as an acquisition target will be enhanced by its alignment with the spirit of Sarbanes-Oxley. Well documented business processes, internal controls, and performance monitoring and feedback functions – all embodiments of good governance fostered by a proactive board of directors – will ease the purchase and integration tasks of a public company.

If an initial public offering is contemplated, then obviously the company would need to be in full compliance with Sarbanes-Oxley and relevant stock exchange listing requirements. So any steps taken in that direction earlier in a company's life would aid in eventual completion of an IPO.

Successful CEOs manage their boards to their company's priorities and needs, minimizing routine items and focusing on vital issues in ways that generate debate and discussion required for good decision making. Asset or obstacle, partner or protagonist, motivated participant or disinterested caretaker: It is in the scope of the entrepreneur CEO's role to get the best from their boards, with the knowledge that investor board members of emerging companies can be critical to a company's direction, execution, and success.

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