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Search Fund Company Boards

How CEOs Can Build Boards to Help Them Thrive

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Search funds often catapult young, first-time entrepreneurs into the CEO position of an ongoing concern of some size. As talented and ambitious as these young CEOs are, they, nonetheless, generally lack executive experience. If rookie CEOs properly constitute and consult the company's board, however, they will find that the board can provide valuable guidance and oversight.

Search Fund Boards are Different

The structure and process of search funds creates a very different dynamic between a CEO and her board than those found at other companies.

Search funds, typically, are created by an aspiring CEO. The CEO raises a small pool of capital from about a dozen investors, usually about $400,000. The money funds a search for a business to acquire. The CEO spends about two years in a broad solicitation process, focusing on a subset of likely and desirable prospects, making an offer, executing diligence, arranging financing, and, if successful, closing.

On closing, the search fund CEO takes the reins of an existing, small-to-medium sized company (typically one with $1 million to $4 million in EBITDA). CEOs are frequently very talented and ambitious MBAs, but often without prior executive experience. Some of these search fund CEOs will have come from other operating companies, private equity, banking, or consulting firms, but even so, the CEO may never have run an enterprise or had complete responsibility for a profit and loss statement.

This means that a search fund CEO is in a very different position than a CEO installed by a private equity firm. Typically, the CEO appointed by a private equity firm to a portfolio company is a seasoned executive with experience running an enterprise or domain expertise in the industry. Additionally, the PE firm usually has complete control of the equity, acting as an agent for the PE fund's investors who are limited partners. Search fund transactions, however, generally do not rely on a control investor and most of the money to acquire the target firm will come from a fragmented group of private investors, using their own capital, or in some cases, institutional search fund investors who operate in a fund structure with limited partners. The search fund CEO and her board, therefore, have a different relationship than the dynamic experienced between a PE firm and the CEOs of portfolio companies.

While many families run small to medium sized firms, family-run businesses also differ from search fund companies. In a family based business, the organization and the board often have non-economic objectives like the family's reputation. Some families employ a professional, non-family member as CEO, but many put family members into leading positions. Additionally, family based businesses might have different hold horizons for an asset; they often see their investment periods as generational while a search fund will typically exit after five to ten years. Accordingly, the board of a family-based business focusses on serving the needs of the family. Indeed, the board may consist predominantly of family members.

Public company boards also have different obligations from search fund boards. Public boards interact with professional managers and focus on compliance and regulations; duties search fund boards do not face. Besides compliance, the primary responsibility of public boards is to hold the CEO accountable. The board plays a key role in deciding on whether to retain a CEO, negotiating the CEO's compensation, and finding a new CEO, if necessary. And while these concerns about the CEO are a backdrop for search fund boards, they are not its primary concern.

A key role search fund boards play, which is typically not present in PE, family and public boards, is to help and support the first time CEO. This is the single most important function for the search fund board and where the most value will be added. Typically, in other board venues the governance function centers on retaining and monitoring the CEO as compared to supporting and coaching the CEO. In all board contexts, directors have a responsibility to represent all shareholders, but in search fund boards, the directors must also embrace coaching, mentoring and developing the CEO.

Constituting the Board

After closing an acquisition, one of the very first activities a new search fund CEO will engage in is forming a board of directors. At this point, the CEO has a great deal of influence over the board. She chooses who serves and determines the nature of the interactions. However, as soon as the board is established, the dynamic switches. The CEO will have little ability to change the board, but the board will have the power to change the CEO - a key concept to comprehend.

A search fund company's board should consist of at least three members and no more than eight. This size will allow for vibrant and productive conversations. A board of less than three will not have the diversity of opinions and experiences necessary to stimulate robust dialog. A board of more than eight is too large and will inhibit dynamic interaction; meetings will feel like a presentation from the CEO rather than a conversation.

If it is possible, the CEO should consider determining predefined terms for board service. Although this is rare in search fund boards, it could allow for graceful entry and exit of old and new board members without unnecessary emotion and drama. It will also allow the CEO to morph the board as the needs of the CEO and company change over the holding period. Additionally, it will allow board members to move off the board without an awkward resignation.

The company CEO should take one of the seats on the board. The CEO then should consider investors, starting with the larger investors in the transaction. CEOs should be aware that large investors might require a board seat in conjunction with their sizable investment. If the CEO is enthusiastic about the investor who will join the board, this is a wonderful situation. But, if the CEO has qualms about the fit of the investor as a board member, they should be careful about taking on the investment to fill a capital requirement.

When selecting other board members, the CEO should consider several characteristics. Perhaps the most important consideration is availability. Can a possible board member devote the time to the CEO's company? Only board members with time will have the ability to advise a new and uncertain CEO. A potential board member with an outstanding resume who is often unavailable is of little use to a CEO.

Considering availability applies when a CEO contemplates offering a board seat to a "bold face name." Certainly, bold face names can add star power and prestige to a board. Such board members can be wonderful if they are willing to open their networks to the CEO. However, more often than not, bold face names are busy and overcommitted. While celebrity board members make for nice cocktail party chatter, a first time CEO needs a board member's attention. CEOs should be skeptical of a potential board member for whom the company will be the seventh active board seat. When talking to a potential board member, it is appropriate to inquire about existing commitments and anticipated availability.

Beyond availability, the CEO should look for board members with specific skills and traits that can contribute to the company's success. Novice CEOs can seek out board members with direct, or adjacent, domain expertise and experience who can help grapple with operational issues and offer valuable perspectives. CEOs can also look for people with functional skills. A CEO facing challenges with building out and optimizing the customer gathering function can tap a board member with sales leadership and management skills. A CEO with a company that needs to restructure its finances can use a board member who is particularly knowledgeable about debt and can assist in sourcing credit and perfecting its terms and cost.

Board members who have general experience profiles also can prove useful. For example, board members adept at deal making can advise a CEO when the initial acquisition is taking place or when the company is contemplating an exit. Executives who have scaled a small business into a larger operation can help shepherd a new CEO through the challenging process of transforming a company from adolescence to stability.

To find skills and experience, CEOs might consider individuals outside the pool of investors and other stakeholders in the business that typically make-up the board. Besides important skills, an outsider also can bring an objective perspective to conversations in board sessions.

One person a CEO should think hard before including on her board is the seller of the business. Often times in search fund deals, the previous owner rolls forward some equity. Having a seller as a passive investor is one thing, but having a seller on the board is a different level of involvement and engagement. Sellers can be extraordinarily helpful in transferring knowledge to the new CEO and helping to facilitate a productive transition - and the new CEO should do everything possible to extract as much knowledge from the seller as quickly as possible. However, if the seller is wed to the old way of doing things, having the seller on the board could be challenging. Invariably, the legacy CEO will have to watch as the new CEO criticizes, reimages, and transforms his or her baby - a difficult situation.

Certain people should not be on a search fund board. While family members and close friends sometimes invest in search fund projects, they generally do not make for good board members. Deep ties forged through personal connections create a conflict of interest and would not be fair to other shareholders. Personal relationships can also cloud judgement and prevent the direct and honest feedback that the CEO needs. Furthermore, college roommates and business school pals tend to be part of the same age cohort as the CEO so they do not add experience and perspective to the enterprise.

Having identified a pool of potential board candidates, the CEO must consider the overall composition of the board. Putting together a board means more than considering people in isolation, but requires understanding how the board member's strengths will complement one another. The board as a whole needs to represent a diversity of experiences and skills. (See Exhibit 1 for Board Composition Matrix)

Furthermore, the CEO should pursue board members who can work with one another and with whom she can work. The CEO should be able to connect with a board member and have, at minimum, a placid relationship, and hopefully an engaging association. It can be particularly helpful for the CEO to have one board member with whom she is comfortable being especially candid. A person to whom the CEO can admit being scared, confused and not having answers (all neophyte CEOs feel this way at times, at least the honest ones). While articulating these feelings in a board meeting might be inappropriate, having a confidant on the board with whom to share these thoughts can be incredibly helpful.

A CEO should not knowingly constitute a board whose members cannot get along with one another. This represents negotiating a balancing act. On one hand, it is helpful to have a broad set of differing views and experiences. But board members should be willing to be respectful of one another and able to compromise. Within the search fund community, investors and board members establish reputations for being collegial or uncooperative. CEOs should feel free to ask other search fund entrepreneurs about potential board members and the way they might interact with each other.

Once selected, board members, who agree to serve, should be compensated for their valuable time. Compensation will signal a seriousness to the relationship and expectations of engagement. In a small, search fund company a board member could be compensated anywhere from $5,000 to $20,000 per year. This can change as the company grows and the needs and demands of the board role evolve. In addition, the CEO should make sure that a Directors & Officer's insurance policy is in effect at all times and should share a copy of the policy with board members upon its renewal annually.

Preparing for Board Meetings

The CEO should take the pulse of the board to discover how frequently to hold board meetings. Typically, companies hold four meetings per year. But some companies hold as few as two, and others will schedule as many as six. Frequency will depend on the company's needs, challenges and opportunities.

Board meetings should be scheduled a year in advance to allow for busy, in demand board members to lock dates into their calendars. With the press of events, the CEO might be tempted to reschedule meetings, but this urge should be resisted. The goal is to create a rhythm for meeting dates, corresponding to the company calendar. For example, a board could always meet on the third Wednesday in the month after the quarter closes. The CEO and board chair should ensure that meetings start and end promptly to accommodate the many personal and professional obligations of board members.

Board meetings that gather members in a single physical location tend to be more focused and vibrant than having members participate by video or telephone (though remote connections might be necessary for some meetings). Companies choose a variety of locations for their board meetings, including the company's offices (headquarters or field), an investor's offices, or a neutral location. The goal is to find a location that maximizes in-person participation (though accommodations should be made to allow members to dial-in) . If the company's office proves inconvenient, CEOs should feel free to ask their accounting firm or law firm to provide free space or have the meeting in an airport conference room in a hub city.

If the meeting requires board members to travel, the company should time the meeting to minimize travel inconveniences. If board members are arriving the evening before, the CEO could host a dinner, giving her an opportunity to get to know board members a bit more personally in a casual setting. In general, board meetings for small, entrepreneurial companies do not need to be luxurious affairs - board members will respect the CEO for being parsimonious.

Preparation for the board meeting should begin well before the participants arrive. Approximately one month before the board meeting, the CEO should solicit agenda items from members. Then two weeks before the meeting, an agenda and supporting materials (the board package) should go out to allow members to prepare at their convenience.

The board package should not require much work to assemble. At a minimum, the board package will include a complete set of unaudited, GAAP financial statements with variance analysis to prior period and to plan. In addition, the board package typically will include a subset of information that the management team uses to measure and run the business.

The CEO should not prepare information for a board meeting that she does not regularly consult, unless a board member specifically requests something. Board members will periodically suggest that the CEO prepare some type of review or analysis that is not a recurring part of the board package. This might be to evaluate a new strategy, service, product, market or structure. This type of exercise can often inspire new insights. However, board members should remember to make their requests with sufficient lead-time that the exercise does not overwhelm the CEO or her staff.

After the board package is distributed, the CEO can check in with each board member to ask what the board member would like to accomplish during the meeting. The goal is to avoid any surprises. Taking the board members' temperature prior to the meeting allows the CEO to prepare to address any percolating issues of concern.

The Board Meeting

A CEO need not prepare extensively for a board meeting because the agenda should consist of topics that are being lived every day. Broadly, a meeting can be broken into three buckets: what is going well, what is not going well, and what is being done to make things better. Within these three buckets, the CEO can touch on both high level and granular topics. At times, the company may need to focus on strategic matters and in other moments, delve into very detailed tactical issues. The entire range of topics is germane to the board. (See Exhibit #2 for sample agenda)

Ideally, the board meeting is a vibrant conversation with everybody participating and without an overriding voice. To help encourage this dynamic, the CEO should frame topics as open-ended questions and seek perspectives and inputs from all board members. The CEO should expect that the board members skimmed the materials distributed in advance - there is no need to walk through the entire board package in detail. It is appropriate and helpful to highlight key issues and topics, but the CEO should resist engaging in a presentation that is a regurgitation of materials previously shared.

A typical board meeting can be three to five hours in length, a feat of endurance that will try the abilities of even the keenest board member. CEOs would be wise to front load the agenda to discuss the most important topics first. CEOs should also remember that part of each session of the board meeting should include some time, 15 to 30 minutes, where the board can speak and interact without any executives, including the CEO, present. The CEO ought to schedule a portion of the meeting to address compliance and administrative issues such as voting on resolutions or approving minutes. This portion of the meeting, while important to the board's fiduciary role, should be kept to a minimum.

One way of organizing board meetings is to designate one topic to be explored in depth at each meeting over the course of a year. For example, the Q1 meeting can be sales centric, the Q2 meeting can drill in on operational issues, the Q3 meeting can be about human capital and the Q4 meeting about strategy and growth prospects. A slate of meetings centered on a single area can generate a more meaningful conversation. (See Exhibit #3 for Sample Board Meeting Planning Grid.)

The CEO can periodically invite guests to the board meeting. For example, an internal sales leader can visit for a meeting focused on the sales function. This can give the board a deeper feeling for key executives and their abilities. The CFO should always be available for at least part of the board meeting. The auditors should attend at least one meeting to review the completed audit.

In addition, the CEO can ask a board member to prepare a brief presentation on a specific topic with which they have an expertise. An invitation to speak engages board members and permits them to add value to the proceedings. For example, the CEO can ask a board member with great knowledge about capital markets to share some thoughts on debt opportunities for the company.

Within a week after the board meeting, the CEO should send out minutes. Minutes are a legal requirement and are usually somewhat terse, not representing a detailed summary of the discussion during the board meeting. In addition to the minutes, the CEO can share a more detailed summary of the discussion with any specific agreed upon action steps and plans with corresponding deadlines. At this time, the CEO should also share information with investors who are not board members. The company can send investors the complete board package or a condensed version. The CEO has an obligation to report out to all investors, not just board members.

While board meetings are a periodic requirement, a CEO, especially early in her tenure, might communicate with board members on a more frequent basis. One example might be a succinct, bullet-pointed, Friday afternoon email to board members recapping the events of the week. Alternatively, the CEO might send a monthly summary with financials. These types of communications might abate as a company grows, matures and stabilizes, but in the earliest days, it can help board members learn more about the company and the industry and feel like they are watching a movie as compared to an occasional snapshot.

The Board Member's Role

Board members should see themselves as coaches who encourage the CEO to be the best executive possible. This means negotiating a fine line between being supportive and demanding. It also requires the board member make themselves available to spend time with the CEO.

Board members need to remember that in addition to being fun and exciting, being a new search fund CEO can be an overwhelming, intimidating, and scary experience. Just listening to the CEO is a benefit. A board member further can assist the CEO by helping the CEO sort through the myriad questions and issues bombarding them. Assuaging the CEO's concerns and giving them the belief that the challenges they face are surmountable will build the CEO's confidence.

Board meetings represent the most obvious venue for board members to provide their expertise and wisdom. This means board members need to treat these gatherings seriously. In advance of the meetings, board members should review the provided materials and develop some thoughts, comments, or questions. Checking in with the CEO prior to a board meeting and outlining questions that the board member intends to raise will allow the CEO to prepare. At the meeting, board members should try to be fully present and resist the temptation to be on their phones checking email. After the meeting, the board member can follow-up with the CEO to highlight what went well or could be improved.

Whether in board meetings or in other conversations, board members should ask thoughtful and probing questions. This does not mean the board member should interrogate the CEO; rather the questioning should take a Socratic approach. Board members should push the CEO to examine and defend assumptions about the business and industry. In these sessions, the goal is to help the CEO develop her own outlook on the business. The board member does not need to prove to the CEO that he might have more experience and knowledge.

Beyond their responsibility to advise and support the CEO, board members have two special responsibilities. One is to address executive compensation, and ideally, this should be done in advance of the CEO having to bring up the topic. Executive compensation can be wrought with emotion. The board should assert their ownership of the topic without the CEO having to initiate the conversation. The other special role is to oversee annual audits of the firm. The board should interact with the audit firm before and after the audit to understand the audit scope and goals. It is the board that engages the audit firm, not the CEO.

From time to time, board members will be called upon to do other important tasks on behalf of the company, such as signing resolutions. Board members should endeavor to do these things in a timely manner. Attending to administrative tasks can be pesky, but the CEO is just doing her job and should not be required to chase down board members for administrative follow up.

In all matters, board members should remember that they represent all shareholders and not just their own interest. The board member should remind the CEO to provide timely information to all investors.

Conclusion

A good board meeting allows the board and the CEO to engage in a wide-ranging conversation that leads the CEO to formulate new hypotheses or discard preconceived notions. The board meeting should be collaborative in nature and should excite and energize the CEO. If the board meeting just feels like a run through of the board materials and does not give the CEO some specific ideas to think about - it was likely not a crisp meeting or the best use of time.

In her relationship with the board, the CEO always should be completely honest and transparent. No matter what the venue, the CEO should not lie, mislead or spin to the board. Small companies have problems, and the CEO should not hide troubling issues. Once the board loses trust in the CEO it is just about impossible to recuperate.

Board members also need to be transparent and fair with CEOs. They should remember that the board relationship with the CEO is different in search funds than in a private equity backed company, family held business, or a public entity. Given the CEO's level of experience, the board must not only give oversight, but coach.

Although a best-in-class board will not ensure success, a good board can help tilt the probabilities in a positive direction. Interacting with a board is a bilateral relationship and it is incumbent upon the CEO to set the tone by operating in the most scrupulous manner while serving the board. Reciprocating, the board should also attend to the CEO and help facilitate her development as a CEO and leader.

Endnotes

[1] Eugene F. Williams, Jr. Lecturer in the Practice of Management

[2] Visiting Executive

Exhibit 1: Board Composition Matrix

Name	Donna Smith	Joe Guyer	Marjorie Patton	Tom Dorr	Ron Chappano
Current role	CEO of $10m business services co in Dallas	Retired from active business. Active investor	PE partner at Park City Capital ($3B in assets). Specializes in technology	CFO at $250m public company. Expert in M&A and consolidation	Founder at search fund firm. $150m in assets
Current board seats	1	7	5	1	7
Expertise	Scaling and operations	Deals and deal evaluation	Technology	M&A, metrics	Capital structure
Investor size/ Outsider	Investor at $500,000	Investor at $1,000,000	Investor at $400,000	Outsider	Investor at $1,600,000
Homebase	Tampa	Hawaii	San Francisco	Milwaukee	Boston

Exhibit 2: Sample Board Meeting Agenda

1. What is Going Well
    a. New sales
    b. EBITDA margin expansion
    c. Price increases
2. What is Not Going Well
    a. Customer churn rates
    b. New hires in the call center
    c. Operations in our Syracuse market
3. What Are We Doing to Improve What is Not Going Well
    a. CFO is running data to explore patterns in churn rates
    b. Interviewing recruiting firms to help with call center hire strategy and implementation
    c. Sally, Ops Manager in Buffalo and our number one ranked ops player, is spending one month in Syracuse to audit standard systems and processes and evaluate the team
4. Deep Dive into Human Capital Function
    a. Gap assessments
    b. Key hire wish list
    c. Compensation versus market
    d. Churn in drivers – why?
    e. No churn in sales – why?
    f. Implementation of new evaluation software system
    g. Compensation issues and strategy for next year
5. Financial Highlights
    a. Sales above plan
    b. Costs on target
    c. Tight on loan covenants – why
6. Compliance
    a. Resolution 1
    b. Resolution 2
    c. Confirm next board meeting date and location
    d. Approve prior minutes
7. Other Topics
8. Executive Session (board meets without management)

Exhibit 3: Sample Board Meeting Planning Grid

	Q1 Meeting	Q2 Meeting	Q3 Meeting	Q4 Meeting
Date	March 15	June 15	September 15	December 15
Start	8:00 AM	10:00 AM	12:00 PM	8:00 AM
End	12:00 PM	3:00 PM	3:00 PM	2:00 PM
Location	Company headquarters	Dallas Airport	Company Field Location	Investor Office in Chicago
Deep Dive	Capital Structure	Sales Function	Human Capital	Strategy & Financial Plan
Guest	Banker or Mezz	VP Sales	COO and HR lead	Audit Firm
Board Role	New debt leads	Technology in sales	Use of options	How fast do we want to grow
Other		Open call with investors	Review and renew D&O policy	Exec bonus plan