DIRECTORBANK.

THE ROLE OF THE PRIVATE EQUITY CHAIRMAN

Part 2.
Should a PE Chairman always invest in the business?

A series of short reports on the role of the PE Chairman encompassing the views of 240 experienced Chairmen and 30 Private Equity investors.

SHOULD A PE CHAIRMAN ALWAYS INVEST IN THE BUSINESS?

In a series of reports, Directorbank explores the role of the PE Chairman – the draw, the required skill set, the opportunities and the challenges, particularly concerning the relationship with the CEO, the wider management team and the backers.

View from Private Equity …

Almost **90%** of the PE Investors surveyed believed that a PE Chairman should invest in the business when appointed in order to ensure their interests are aligned with both the Management Team and the PE backers.

"We need the individual to have skin in the game."

"We prefer our Chairman to be aligned with ourselves and management through direct investment."

"Alignment of interests is healthy, and investing increases diligence. Plus, the Chairman should share in the upside."

"The quantum doesn't have to be significant necessarily, but it's important to know they are aligned and thinking like a business owner."

The Chairman's View …

240 Chairmen also shared their views on this question with **59%** of respondents firmly believing that a PE Chairman should invest in the business.

The main reason cited was helping to align interests with both management and PE and to create the appropriate sharing of risk and reward. Having "*skin in the game*" is seen as a demonstration of confidence and helps motivate hard work and better decision making.

In terms of the amount invested, many of the Chairmen agreed that the proportion of investment should differ from that of the CEO and other executive members.

There was, however, an underlying warning regarding independence with several of the surveyed Chairmen stating that one needs sufficient personal experience and integrity to remain independent regardless of the equity position.

"Yes, a Chairman should invest to ensure good alignment, but a Chairman should not be doing this primarily for investment return, and they must not have so much riding on the outcome that their judgement could become compromised."

"The Chairman should be independent, but also share some of the risk. He should not be seen as a provider of essential capital, but instead should have a modest stake in the success of the business."

"If the amount is too high, the Chairman can become risk averse or make decisions that are based on personal investment and personal financial situation rather than the company's best interests. It needs to be a balanced amount that does not lead to bias."

16% of the Chairmen surveyed agreed that investing was preferable, but argued that it depends on the nature of the challenge and the timescale. Certain circumstances which might make investment inappropriate or irrelevant include rescue situations or a short-term project, such as preparing a business for sale, where there isn't the time to achieve real strategic impact.

"Preferably yes, but there are circumstances where it could be better not to. If, for example, a chairman is brought in to sort out a major problem where there are substantial downside risks, it may be unfair to expect them to invest until the situation has improved."

"It depends upon the stage that the PE Chairman is introduced. I have been brought in to replace a previous Chairman making investment an expensive option relative to the reward. It is possible to structure other models – in this case growth shares were used to provide a fairer measure of contribution."

"If there is uncertainty over the outcome and very high leverage this can have negative consequences. It depends how the capital structure works. The Chairman must have an equity incentive, but it can be out of the money at inception."

20% of those surveyed thought that a PE Chairman should not have to invest stating that this compromises independence and objectivity. Most argued that investment is not the only way of aligning all parties and other methods could be explored and agreed.

"Unless the PE Chairman is the leading strategist behind the business it is better not to invest. The real game is the executive team delivering the strategy and business plan. The Chairman should only be rewarded on exit."

"There is a real risk than an investing chairman is selected not because of their ability to help facilitate significant growth, but the depth of their pocket. Investment and the Chair role should be treated as two separate issues. I understand the desire for the Chair to have 'skin in the game' but I believe this can be achieved in other ways without corrupting the appointment of the person best able to help deliver growth/shareholder returns."

"Looking after all the shareholders should always outweigh personal interest; particularly in situations where there are different factions amongst shareholders. To be able to stand back impartially can be helpful."

"Financial exposure may appear to evidence commitment but can erode objectivity. As Chairman you hope to avoid the accusation by investors that you advocate a particular policy mainly because it may be in your singular financial interest."

5% of those surveyed chose not answer the question.

ABOUT DIRECTORBANK ...

We are a specialist executive search firm that introduces entrepreneurial board-level directors to the private equity industry across the investment cycle. We also conduct board and senior level search assignments for privately-owned and AIM listed businesses.

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