THE NEXT LEVER OF VALUE CREATION

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better boards.

The challenges associated with value creation drive us all in Private Equity (PE). Any investment professional is eager to make their mark by delivering great returns. When analysing how these returns are achieved one soon discovers that the vast majority of investment professionals rely on financial engineering and operational improvements. These are, of course, the basics of the trade. True mastery is, however, achieved by adding more tools and techniques to the basic repertoire of value creation. Even better when the tools satisfy the needs of other stakeholders and support you in your fundraising efforts.

In this article I would like to focus on the insight gained from developing more effective boards. I am not talking about "leadership development programmes", rather a fully integrated approach to value creation, that is grounded in data and does not only ensure greater value creation but also brings governance to life, enhances the story of fundraising and differentiates a firm in the eyes of its management. It underpins a genuinely collaborative approach and provides management with a unique development opportunity.

Let's first have a closer look at where and how the value is created. The main pillar of the PE operating model and a key belief of investors is having the right management team in place. However, statistics show a different picture.

Over the lifespan of an investment there is a CEO turnover rate of over 50% and an even higher number relating to other board members compared to a 15% rate in the world's 2,500 largest public companies. In around 50% of the cases the change in CEO was not planned and is due to underperformance of the individuals. This 'underperformance' is, in many cases, simply caused by a mismatch of the skill set with the requirements after a change in strategy, 'human incompatibility' with other board members, the incapability to gain the trust of the shareholder, lacking empathy to convince within the organisation and not acting as a role model for the employees – to name a few.

Given that management is the key enabler and driver of value creation it is quite surprising how little effort is presently put into the systematic development of executive boards of portfolio companies considering they are supposed to be the key drivers of value creation in the portfolio organisation. Having said that, I also have to confess that many development programmes or board audits offered are ill-suited to drive value creation.

In order for board audits and development programmes to provide a return on investment and a positive impact on value creation, there are five prerequisites for investment professionals to fulfil:

1. **Ensure that any board audit/board development is an integral part of the value creation process.**
   Anyone engaged in conducting a board audit and/or board development programmes must have an in-depth understanding of the value creation plan of the organisation and integrate the insight into the audit/programme.
2. **Provide for an evidence-based approach.**
   A lot of data can be collected but it is only useful if it is the right data. In our analysis we found that sadly more often than not board audits touch on issues/themes where there is no evidence whatsoever that could have an impact on effectiveness and value creation.
3. **Ensure that you provide management with real data.**
   The members of executive boards are achievers and clever people in their own right. They want to succeed and develop, look good and develop their own careers. In our experience they do engage if they see real hard data that provides them with genuine insight that is really relevant to their role.
4. **Provide the management with a safe, neutral and confidential environment** to reflect about the data collected and explore which actions would help them to strengthen their own position and that of the collective board in relation to the value creation plan.
5. **Establish a mechanism** so that data can be collected on a continuous basis and the executive board can monitor progress.

Once you have ensured that these five prerequisites are in place you need to determine which are the crucial pillars of effective boards that ensure superior returns. Our research shows that there are seven pillars of effective boards. Each pillar can drive value creation.

SEVEN PILLARS TO DRIVE VALUE CREATION

The composition of the board
It is crucial to understand how different areas of expertise, preferred roles in a group setting and personality styles complement each other and fit into the development cycle of the organisation and the value creation plan.

The ability of the board to use the strength of its members
It is important that the individual members of the executive board understand their own strength, how they are perceived, the collective strengths of the group and how all can be leveraged to implement and execute the value creation plan.

Clarity about roles and responsibilities
Ill-defined roles and grey areas of responsibilities are the norm rather than the exception. Clarity and transparency of roles and responsibilities need to be in place.

Joint vision
A clear and common vision and orientation is pivotal. Transparency at the outset is vital.

Ability to resolve conflicts between the board and management
Effective executive boards and their members understand how to resolve conflicts between the board and the next management level.

The structure and organisation of the board's work
The organisation of the executive board's work depends critically on the board secretaries and the interplay of the chairman and CEO. Effective boards understand how to organise and structure their work..

Regular reviews and reflections about the board's work
Regular time-outs, where board members can connect, leave the daily work behind and reflect on their work are crucial to success.

Investment professionals have the capability of mastering the art of value creation. They need to dare to reach out and incorporate other tools and techniques into their repertoire to create superior returns and enhance their own career along the way.

Each and every single issue and pillar detailed here can provide you with a lever to achieve the goals set out in the value creation plan. If implemented in a consequential and professional manner your organisation can also add an interesting feature to their fundraising story, make it more attractive for management teams to work with you and increase your chances of being chosen over other firms that are also eager to secure the deal.

Dembkowski, S. (2015): „The next lever of value creation," Women in Private Equity Awards Magazine, November, pp. 10-11.