

Leveraging Operating Executives Beyond the Boardroom: Turning Transactional Interactions into Lifelong Assets





As private equity firms increasingly involve experienced operating executives in critical investment functions – including deal sourcing, due diligence, and board engagement – demand for visionary industry leaders is stronger than ever. Heightened competition for executive talent has made recruiting and cultivating relationships with potential Operating Partners, Deal Advisors, and Outside Board Members (OBMs) more and more challenging. In this white paper, Notch Partners discusses the benefits of transforming executive relationships from transactional interactions to lifelong assets.

Notch previously published a white paper based on a survey of private equity investors regarding their use of Outside Board Members (OBMs), “[Laying the Foundation for Outside Board Members to Add Value Inside PE Portfolio Companies](#)”

Our research measured investors’ satisfaction against various approaches to recruitment, compensation, and engagement of OBMs. Survey responses revealed a striking positive correlation between active interaction (between PE investors, OBMs and portfolio company management teams) and board satisfaction. Those PE investors who cultivated the most robust three-way dialogue were ultimately most satisfied with their portfolio company boards.

As a follow-up, Notch conducted a survey of OBMs regarding their experiences serving on PE boards. Based on respondents’ feedback on over 60 unique PE board experiences, we analyzed expectations, satisfaction, and engagement and measured these variables against company performance and post-board engagement. Not surprisingly, executive feedback was consistent with Notch’s central conclusion from the first survey: that active dialogue and engagement between PE professionals, OBMs, and portfolio company management teams lead to success. Findings from our second survey indicate that the most effective executive-PE relationships are cultivated over time. Knowledge and experience from multiple and varied interactions with PE translate into board effectiveness.

Notch’s survey responses revealed the following about the most effective PE portfolio company boards and their OBMs:

- **Engaging high-performing Outside Board Members requires time and cultivation.** OBMs are typically brought in for their industry knowledge, gravitas, contacts and experience – and to collaborate with investors while mentoring management teams. Evaluating capabilities and chemistry takes time. PE firms that work closely with industry executives and cultivate active dialogues over time benefit not only from efficiency gains in recruiting, but also from enhanced company performance and increased personal satisfaction on both sides.
- **Portfolio companies benefit most when PE investors, OBMs and the portfolio company management team align their expectations for roles, responsibilities, strategy, and performance.** Immediately post-acquisition, leadership roles and lines of responsibility for OBMs, PE professionals, and management teams should be explicitly defined. Active two-way dialogue and robust transparent engagement between all parties should occur informally and regularly inside and outside of official board meetings.
- **Retaining high-performing OBMs beyond their board tenure is beneficial – and increasingly critical.** Engaging OBMs as Operating Partners and Deal Advisors before investment and after exit may seem unnecessary, but it pays off. Experienced OBMs consistently outperform new OBMs. Perpetuating the “asset life” of these top executives should be central to most PE investment programs.



Creating a Lifelong Asset by Perpetuating the PE-Executive Relationship

Building robust and mutually beneficial partnerships with industry executives has become critical to investment success. As the competition for executive talent increases, private equity firms that employ OBMs will need to maintain robust pipelines of talent, but importantly, they must also actively maintain their existing relationships. Notch has developed a four-stage framework for working with executives to increase the utility and success of PE-Executive relationships. The four stages are: Outreach and Recruitment, Engagement and Kick-off, Board Activities and Portfolio Company Management, and Exit/Post Exit.

1. Outreach and Recruitment

This is a critical and challenging first step in the process of adding OBMs, most of whom join PE portfolio boards at the beginning of an investment. OBMs are typically identified based on their industry reputation, their leadership track record, as well as strategic strengths and mentoring style. When OBMs are recruited for a specific investment, it's important that their background be evaluated against the investment thesis and that their personal style fits well with the PE investors and the management team.

Key Findings

- *High-impact OBMs are rarely found through one-off executive search processes. The most successful relationships are cultivated over time, in large part because style and presence are not measured easily, and mutual trust is not developed quickly. These intangible qualities cannot be assessed through a resume; they require time and focused effort to assess meaningfully. Given that proper vetting and rapport building take the greatest amount of time, PE investors should actively engage and cultivate relationships with executives to maintain a robust bench of potential board members.*

- *According to Notch's survey, 60% of OBMs were recruited through the PE firm's networks. A significantly smaller percentage were sourced on a transactional basis through traditional search firms or expert networks. Based on our survey, portfolio companies with OBMs recruited on a transactional basis through search firms or expert networks were twice as likely to underperform relative to the PE firms' expectations.*
- *OBMs are seasoned and accomplished leaders from industry. They are generally former C-suite executives who have handled significant P&L responsibility; 82% of our respondents were CEOs prior to working on a PE board and 96% of those surveyed ran much larger businesses than the portfolio company where they served on the board. Gravitas and decades of industry experience were frequently cited as important qualifications for their PE board roles. These executives oftentimes also had useful industry contacts. Outside of just their OBM activities, there were many ways these industry leaders could be leveraged into a range of PE deal and company-related activities.*

2. Engagement/Kick-off

Once the board is staffed, setting expectations, defining roles, building trust between board and management team, and charting a course forward with a clear investment thesis are of critical importance. Transparency goes a long way during this phase.

Key Findings

- *OBMs who understand their responsibilities and what is expected before the first board meeting perform better. OBMs in our survey who reported having a clear sense of their responsibilities were three times more likely to be part of an investment that performed well relative to expectations.*
- *Approximately 92% of respondents had experience working with private equity (not necessarily the same firm) prior to serving on the portfolio company board. Of these, 48% served as OBMs of multiple portfolio*



companies owned by the same PE firm. In some cases, the OBMs co-sourced successful investments with their PE partners. Active collaboration and longer-term partnerships fuel stronger working relationships and understanding of strengths and weaknesses between the OBM and PE investor. OBMs who work with the PE firm prior to joining the board are able to transition into board-level working relationships more smoothly.

3. Board Activities & Portfolio Company Management

When it comes to active portfolio company management, it is all about communication. For highest impact, OBMs must communicate regularly with all leadership groups and be actively engaged with the management of the portfolio company. In line with our previous research, communication between the management team, the outside board members, and the industry executives is strongly associated with successful investment outcomes.

Key Findings

- *OBMs of successful portfolio companies were three times more likely to interact frequently (>1x/month) with their PE investors outside of official board meetings than their unsuccessful counterparts. OBMs who communicated frequently with portfolio companies' management teams were almost twice as likely to be successful.*
- *Outside of official board meetings, OBMs were most frequently called upon to leverage their operating experience onsite with management teams. Shrewd PE investors, however, also tap into these executives' broad skillsets for situations outside of the portfolio company. When recruiting OBMs, PE investors should consider the executive's versatility and actively leverage those capabilities across multiple situations.*

4. Exit/Post Exit

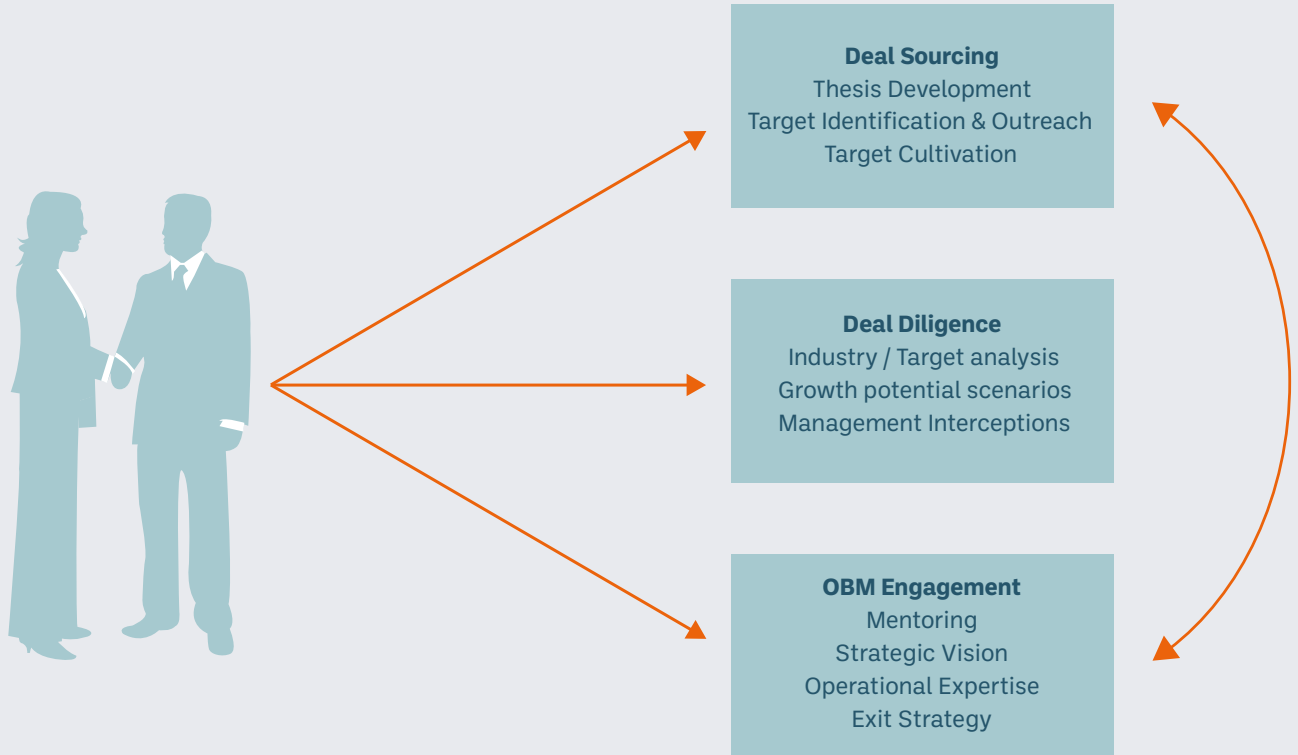
About 40% of OBMs surveyed said they played a meaningful role in the sale process of the portfolio company. After the deal closes, maintaining a relationship with the OBM, particularly without an actionable opportunity, requires proactivity and effort.

Key Findings

- *Surprisingly, OBM satisfaction was not highly correlated with investment success or with compensation. In our data, the only clear factor associated with "satisfaction" for OBMs was the quality of their relationships with the PE investors and the management team. All of the OBMs in our survey who were "unsatisfied" or "very unsatisfied" with their board experiences reported not continuing with their original PE partner, as board members or in any other capacity. (Interestingly, those same "unsatisfied" OBMs in our survey all went on to serve as board members for other PE firms.)*
- *38% of OBMs who served on three or more boards reported that their third portfolio company role significantly exceeded the PE fund's expectations, as compared to 27% for second time board members and 0% for first time board members. Generally, it stands to reason that experienced OBMs perform better than first-time OBMs. Even if they do not perform well early on, the experience of serving on a PE board enables them to perform better in the future.*

For PE firms, retaining and cultivating OBMs is vital to future board success. As demand for leading industry executives grows – particularly those with prior PE board experience – maintaining dialogue with executives between board engagements is worthwhile.

How does one engage with an OBM post-exit? There are several opportunities, such as collaborating on a deal thesis, partnering in due diligence on future acquisitions, or utilizing the executive on another board. While a PE firm can engage with an operating executive at any stage of the investment cycle, collaborating early to generate ideas and source deals together is a good way to get optimal leverage, impact, and cultivation.



Conclusion

In our survey, executives who served on three or more PE portfolio company boards reported the highest levels of satisfaction with their PE relationships. Because of their experience, not surprisingly, they had exposure to a diverse range of PE activities, including co-sourcing investments, opening doors to valuable contacts, and interacting with potential acquirers. These executives exemplify the value of cultivating relationships beyond the board.

The PE world is transaction-driven, but the most valuable executive relationships serve as lifelong assets. Executive insight and on-the-ground experience are vital, not only during the ownership phase, but increasingly - as multiples climb in a frothy deal environment - during the deal evaluation period. Given unique investment styles, holding onto successful executives who understand their PE partners is imperative.

Notch Partners is the preeminent provider of CEO-level talent to private equity firms seeking competitive advantage through proprietary deal flow, industry insider knowledge, and superior management teams. Notch cultivates high-impact relationships that result in superior returns for investors and transformative career opportunities for executives.

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