Board Recruiter Takes on Small-Cap Challenges

Interview by Adam J. Epstein

Beth Stewart is the founder and CEO of Trewstar Corporate Board Services, a search firm dedicated to corporate board recruitment for high-growth companies. Stewart is a recognized expert on board composition, particularly with respect to small- and mid-cap companies, and speaks regularly at industry events. Previously, Stewart was a senior investment banker at Goldman Sachs and a corporate board member of Carmax, General Growth Properties, and AV Homes. In the United States, several institutional investors, including State Street Global Advisors and state pension funds in California, Massachusetts, and New York, are prodding companies to diversify, threatening to vote against certain board members at firms lacking female directors. In an April interview with *The Wall Street Journal*, Stewart said that in the first three months of this year she placed more women on previously all-male boards than she did in all of 2017. The common refrain she hears: "We've gotten enough letters. We've had enough pressure. We're doing something about it." Here, she discusses some of the challenges facing small-cap companies in particular.

Would you agree that smaller public companies have unique challenges when it comes to board composition as a whole?

Yes, we find that there are a number of factors that limit the ability of smaller public companies to craft dynamic, modern boards. For newly public companies, the constraint is often transitional directors from the private company world who have a legal right to hold their seats. While they may have played an important role in the pre-public phase, they often lack the larger company governance and operational foundation to navigate the public company world. Nonetheless, they stay for years as the venture capital (VC) backers wait to sell down their equity positions.

Another challenge is the ubiquity of domineering personalities in the small company boardroom. Both hot new tech companies and perennially small companies may be controlled by individual founders or multigenerational families. Founders may give board seats to friends, while patriarchs may focus on those who share their names. Opportunities to build a strong board or refresh the composition to meet changing strategies may be hampered by these founder, family, and friendship ties. The result can be unproductive meetings and insufficient strategic guidance for the CEO.

Even if open seats exist, recruiting directors to smaller companies can be complicated. The existing board's network may be limited, and there may be resource constraints. Smaller companies are less likely to want to spend scarce resources on additional directors' fees. And if they decide to add directors, they often balk at paying outside consultants who could help guide the process of finding directors, in spite of having smaller staffs with less time to run a search themselves.

Whether it is a fast-growing private company preparing for an IPO or a small cap that is already public, these companies are regularly beset by new impediments that require strategic pivots. Shouldn't these companies be refreshing their boards even more often than larger, more established companies?

I agree. These smaller companies tend to face dynamic risk environments, and bringing on new directors with skills to match evolving strategies is a prudent idea. We find that when our clients are willing to continuously examine strategic needs and the skill set of their existing directors, they have exceptional results. For example, we worked with an East Coast consumer tech company [that was] embroiled in massive litigation to bring on an expert in intellectual property and patent law who also had deep Silicon Valley tech experience and an engineering degree. We also worked with a Midwestern manufacturing company looking to expand into China that brought on someone who had immigrated to the US from China after college and had had a 25-year career with a U.S. company working in both their Chinese and U.S. operations. In each of these cases, the key was the board's honest recognition of the experience gap. In one case, they added a new seat, and in the other, there was a vacancy to fill. Unfortunately, we have seen situations in which companies are too timid. Recently we worked with a client to find a director who could help pivot into a new line of busi-


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ness. In the course of the search it became clear that there were other experience gaps in the boardroom. But instead of taking advantage of the opportunity to add several new directors who surfaced as part of the search process, the company added only one. Three weeks later, an activist took a major position in the stock, and within six months the CEO and two of the weaker directors were all replaced.

Many governance commentators bemoan the fact that board composition practices haven't changed very much in the private equity (PE) world for decades. Have you seen any signs of change in that realm?

The governance commentators are right. I mentioned that most companies go public with boards that are heavy on financial experts. In addition, the majority of portfolio companies go public with no women on their boards. This is such a wasted opportunity, as market forces often mandate a board refresh soon after an IPO. Why not take the opportunity to craft a strong board in advance? But there are signs of change. For example, we recently worked with a well-known PE firm to place independent directors on seven portfolio companies in advance of their IPOs. In another case, a VC on a portfolio company board volunteered to take an observer seat. This made room for a woman with public company strategy and human resources (HR) experience while allowing the VC the same board access he had before. It was a no-cost solution where everyone was a winner—including the CEO, who is thrilled with a new "advisor" in the boardroom with a fresh perspective on the challenges facing his rapidly growing company.

Boardroom thought diversity means different things to different constituencies. How have the inbound requests to your firm changed over the years, and how do you encourage boards to think about diversity?

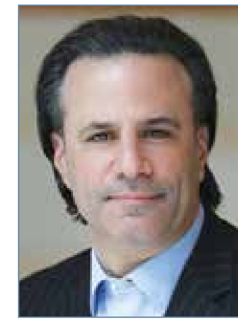
More outside pressure is being brought to bear on boardrooms than ever before, from both institutional investors and activist challenges. This has led boards to be more proactive in anticipating strategic needs. We see a lot of requests for experts in data analytics, cyber, and digital. Also, as human capital has become a global strategic concern, we are seeing requests for HR experts on boards. As we work with clients to help craft the specifications of their board searches, we encourage them to think about diversity writ large and not put the burden of bringing thought, experience, ethnic, and gender diversity all on a single new candidate. We encourage them to take a strategic approach to refreshment with a multiyear plan for gaining the diversity they need. Boards can no longer afford to leave refreshment to chance. One way or the other, it behooves small companies to manage the process and start making plans now.

Have you seen evidence that the benefits of refreshment and diverse boardroom voices trickle down to the C-suite?

There isn't any doubt that adding apt new governance talent can energize the management team through more robust and relevant discussions in the boardroom. In addition, we have seen board members interact with management outside of board meetings as go-to experts for the team—for example, the China expert who worked on strategy and helped open doors. We have also seen cyber and tech experts deployed as a resource outside the boardroom and as voices in the boardroom to translate tech issues for non–tech-savvy directors. Finally, in companies that are light on women at the top, we have seen women directors asked to address and inspire women executive team members. At the moment, however, it is not clear that diversity in the boardroom has led to more women in the C-suite. But I would guess that as the number of women on boards reaches parity, they will be willing to speak up on the challenging topic of the executive pipeline. That would be the ultimate trickle-down effect.

When it comes down to it, how is your advice to nominating and governance chairs different in the smaller companies you work with versus the larger companies?

We acknowledge that for all the reasons discussed here, there can be greater obstacles to refreshment for smaller companies. Nonetheless, we advise all our clients that shareholder issues are paramount and shouldn't be subordinated to the prerogatives of sitting directors.



Adam J. Epstein was an institutional investor who now advises pre-IPO and small-cap boards through his firm, Third Creek Advisors LLC. He is the author of *The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies* (McGraw-Hill, 2012).