FOR A CORPORATION AND ITS STOCKHOLDERS, THE PRIMARY BENEFITS OF A STRONG AND INDEPENDENT BOARD STRUCTURE ARE CLEAR: VALUE CREATION, EFFECTIVE MANAGEMENT AND COMPLIANCE WITH FIDUCIARY DUTIES. LESS OBVIOUS IS THE HIGH COST OF IMPLEMENTING AND MAINTAINING THIS BOARD STRUCTURE.

IF STOCK OWNERSHIP IS DISPERSED AMONG PUBLIC STOCKHOLDERS, AND A COMPANY LACKS REAL CONTROL STOCKHOLDERS, THE INTERESTS OF EXECUTIVES AND STOCKHOLDERS ARE NOT NECESSARILY ALIGNED. IT IS OFTEN COST-PROHIBITIVE FOR AN INDIVIDUAL STOCKHOLDER TO SUPERVISE EXECUTIVE MANAGEMENT, RESULTING IN SIGNIFICANT AGENCY COSTS TO SUSTAIN THIS GOVERNANCE STRUCTURE. IN CONTRAST, PRIVATE EQUITY–OWNED COMPANIES OFTEN ENJOY MARKEDLY LOWER GOVERNANCE COSTS AND, IN TURN, GREATER VALUE CREATION.

PRIVATE EQUITY–CONTROLLED COMPANIES CAN CREATE TRANSPARENT CORPORATE GOVERNANCE REGIMES ALIGNED TO THE INTERESTS OF THE BOARD. HERE’S HOW

BY ADAM WEINSTEIN

THE PE WAY

PRIVATE EQUITY–OWNED COMPANIES OFTEN ENJOY MARKEDLY LOWER GOVERNANCE COSTS AND, IN TURN, GREATER VALUE CREATION.
team, PE-controlled companies should have a set of corporate policies setting forth a clear blueprint of actions requiring board, committee and/or stockholder approval, including limits on capital expenditures, acquisitions, divestitures, debt incurrence, change of business lines, geographic expansion and management compensation/benefits plans.

Exit and liquidity. PE sponsors should have agreements in place that define the rights of the sponsor and other stockholders to initiate and participate in public offerings, restrict transfers by minority holders, drag along minority holders in a sale transaction and allow management/minority holders to participate in a sale.

Board meetings/conduct. Board and committee meetings should be carefully planned with clear agendas and advance distribution of board packages containing detailed information. Some meetings should be held without a management representative present.

PE sponsor consulting agreement. PE sponsors should have a consulting agreement in place defining the fees and expenses that the PE sponsor’s management affiliate will receive. Because PE sponsors are often named in litigation against the portfolio company, the agreement should contain an indemnification provision that survives the sale by the PE sponsor of its equity interests.

PE sponsors make significant control investments to cost effectively participate in the supervision of the executive management team by pooling money from limited partners. With a mix of PE professionals, industry experts and operating partners who are loyal to the PE sponsor, the interests of directors and stockholders can be aligned.

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