Q&A with Jeff Gramm: A Hedge Fund Founder Gives His Views on the Corporate Director Job

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(This post is part of The Conference Board Governance Center series on the job description of a corporate director from the perspective of various stakeholders. Quotes from this Q&A is highlighted in Just What Is the Corporate Director's Job? Activist Hedge Funds Perspectives on the Board Member's Job Description.)

Jeff Gramm is co-founder and portfolio manager at the hedge fund Bandera Partners. Gramm, who co-founded the hedge fund with Greg Bylinsky in 2006, also serves as a director on the boards of two companies that Bandera took a large stake: Tandy Leather and Rubicon Technology. He also served on the boards of Peerless, Morgan's Foods, and the now defunct Ambassadors Group.

He teaches applied value investing at Columbia Business School. Prior to starting Bandera, Gramm was a junior partner at a start-up investment advisor Arklow Capital. He is the author of the 2016 corporate governance book *Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism*, a book about shareholder activism.

Gramm recently took some time to talk with the author about the job description of a corporate director from the point of view of a hedge fund. What follows are his thoughts:

As a hedge fund investor, how do you see the job of a corporate director? What are the key attributes and skill set for a perfect corporate director?

Because I invest in small cap companies, I often come across complacent boards where the power resides with one person – the chair or the CEO. To me, the overarching key attribute for directors is that they are "checked-in" and engaged, and willing to put some time into their directorships. It sounds cynical and simplistic, but step one is taking the effort to really engage with the business.

What do you mean by a "checked-in" director?

Being attentive and doing your homework on the business. For example, one underappreciated aspect of being on a board is that it takes time to become fluent in the financial language of the company. Every company is a little different in how they report their numbers to the board. Directors have to take the time to really understand the numbers, so they can truly grasp how the company makes money, and what the key drivers of the business are.

How important is it for your fund to have representation on the board of a company you invest in?

It's not critically important for us. We're not a dedicated activist hedge fund, and even if we could win a board seat at each of our portfolio companies, we wouldn't have time to serve on every board. There are plenty of companies we own where we don't have a say in the governance. To me, the best investments are ones where management and the board don't require an intervention.

When it comes to engagement with a company, how much involvement do you seek from directors? What is your protocol for company engagement?

I almost always go to the CEO first. If I feel that a CEO is not responsive, then I go to the chair and then other directors on the board.

Why is that your protocol?

It's probably not the correct protocol in world of perfect governance, but honestly, at most companies the CEO still runs the show. So I approach him or her first out of courtesy, and I don't want to be perceived as going behind their back. This of course speaks to the fact that CEOs continue to have power over their directors at most small public companies.

What should the role of the board be in times of crisis? When and how much should they let major investors know about a crisis?

In a non-crisis state, the role of the board is straightforward: Choose the CEO, evaluate the CEO, and set the [CEO's] compensation. In a crisis, the job becomes a lot more difficult and you often devote hours a day to what was formerly a part-time commitment. The board has to ramp up oversight, and it often goes so far as to take the reins from the CEO. Crises can be chaotic, and information can come in waves, so I'm not sure there are "best practices" for when and how to inform investors outside of obvious legal obligations. This is one of many areas where directors don't have a playbook to rely on and they need to use their best judgment.

How much should directors trust in the information management gives them?

That's one of the hardest aspects of serving on a board. Management controls the flow of information to directors, and it is very easy to cherry-pick numbers to excuse weak performance or support a strategic decision. Directors must evaluate management performance as well as advise on strategic direction, but this is hard to do when management provides all the data. I'm not saying directors should not trust the numbers or the people providing them, but they have to be skeptical and ask hard questions. Directors must remember that they are often on the receiving end of a sales job, and they need to do the necessary work to ensure they are getting the complete picture from management.

How should that information be delivered, how often, and in what format?

The format doesn't matter much to me but the frequency matters. One thing that we have done on our boards is to schedule optional, but frequent calls with directors and management. Increased information flow is good for everybody, it creates a valuable feedback loop, and it helps the board understand the business better than it would if it relied merely on quarterly meetings.

Should the directors seek information outside the company, and can that include other investors? Are you concerned about Regulation Fair Disclosure issues if this happens?

I think it's a minefield, but if there is a specific question you have and you're not getting the answer, what other resource do you have? A director shouldn't be forbidden from seeking information externally. A lot of the hedge funds out there have sophisticated real-time customer information on public companies. But if directors go outside the company, they need to gather data in a way that does not accidentally reveal information to investors. If you can't do it without giving away such information, then you shouldn't be doing it.

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