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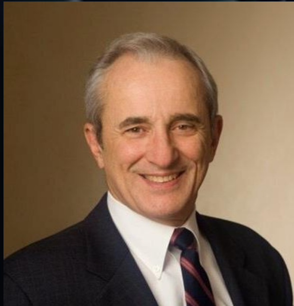
Virtual Event Series

Institutional Grade Governance



Guest Speaker:

Dennis Chookaszian

Corporate Director
CME Group

Hosts:

Kenny Estes
CEO and Founder
Diffuse

Ayla Kremb
Chief of Staff
Diffuse

DiffuseTap: Institutional Grade Governance

In our session featuring **Dennis Chookaszian, Corporate Director at Perdoceo Education and CME Group**, we talked about corporate governance, including how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check.

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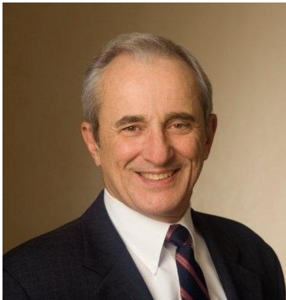
DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll DiffuseTap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speaker



Dennis Chookaszian is a prominent director and advisor to many successful public and private companies. After serving as the chairman, CEO of CNA insurance companies, he has sat on the boards of 13 public companies currently including the CME Group, Pillarstone, and Perdoceo education, as well as a handful of other non-public entities currently including Northwestern and University of Chicago Booth. Linkedin: @dennis-chookaszian

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KENNY ESTES: Today's insights are going to come from Dennis Chookaszian. I'll do a brief intro, but frankly, there's just too much going on here to do the whole thing in a short time.

He's the former chairman and CEO of CNA Insurance companies. Since retiring, he now has taken on a number of director and advisory roles. He's been a board member on 13 public companies, including and is currently on at the CME Group, Perdoceo Education, and Pillarstone. And then on non-public entities, he serves as director and trustee advisory board member of lots of private companies and entities including Northwestern and University of Chicago Booth. He's also an advisory board member for a little-known company called Diffuse.

He teaches classes on corporate governance at a few universities including Chung Kong University in China, Shanghai Advanced Institute for Finance in China, IIPM in India, and University of Chicago Booth here in Chicago, where I had the pleasure of being one of his students, although a crap one. So, Dennis, thank you so much for joining us.

DENNIS CHOOKASZIAN: Thank you, Kenny. Appreciate it. Thank you. And Ayla, hello to you of course. I will tell you that you got a compliment in our quick breakout session for having the fastest fingers in the west, for being able to flip people in and out of breakout rooms as quickly as you can do it.

AYLA KREMB: It's an advanced skill I've been practicing for 30 sessions or something.

KENNY: Ayla is my partner in crime over at Diffuse, or I'm her partner in crime, whichever way you want to say it. We're gonna do a fireside chat and kind of tag team questions to you. To the audience, chuck questions into the chat, we will pick them up when we can. So Ayla, do you want to kick off with the first question?

AYLA: Yeah, absolutely. So, one of them is a bit controversial, but I know this is one of your favorite questions. Do fund partnerships actually work? What are the pros and cons of going into partnership? And what do people think about when they enter into a partnership with another person to fund?

DENNIS: Yeah. Well actually, a fund partnership isn't really all that different than any other partnership. It has all the same interpersonal dynamics that either make it work or not work. And I'll make a few bold statements. When you make a bold statement, you're always wrong, because there are always exceptions to it.

But as a general statement, it's really difficult to make “co” anything work. Your co-CEOs, co-partners, where everybody is equal. While they generally start out well, over a period of time, for a variety of reasons, people grow in different ways. Interests diverge, and they're hard to keep working for a long period of time.

Now, having said that, you can find some examples where they have worked, but many, many more examples where they don't. So, my advice whenever I'm talking to people, and they're about to do a co anything or a joint partnership, is prepare for divorce. And what I mean by that is think through the downside of what happens when we get to a point where we no longer agree. How are we going to get separated and create a prenup? In your documents, create mechanisms to first resolve disputes when you're equal.

And then second, when the dispute can't be resolved, what's the dissolution process? If you can't think that through in the beginning, you're really going to have a problem at the end. Because it's going to be much, much worse. So as a general statement, I would say, it's very hard to make them work. But if you can think through the alternatives — I call them escape routes — and define them in advance as to what you'll do, it will make it much easier to run it.

KENNY: So, this is one of the things that, as you know, is part of our structure. And we really spend a lot of time on corporate governance for the exact reasons because at the end of the day, if GPs fall out, it's the LPS who suffer. I've seen in a lot of cases; they're not getting the capital deployed the way they wanted to. So, what are some of these escape routes, like the actual mechanisms that you see that work particularly well, that you can put in place up front?

DENNIS: One that I usually advise people to use is this very basic one, and I'm sure most of you have done this. When you were younger, as a kid, where there was a cookie and you had to split it in half, one person divides it, and the other person chooses which one they want. Now, that works really well.

So, what you do is, if you're in a situation you typically have in writing a set of buy-sell proposals, and there can be many different types. But one very basic one is that either partner has the right to offer to buy the other one out at a price. And then the other partner can either buy or sell at that price. So, if one names the price, the other gets to choose whether they're a buyer or seller. That means the person making the offer knows they're not going to be too high or too low, or it's going to push it in the wrong direction to their disadvantage.

And that usually brings about a fair resolution. You can also create other mechanisms like right of first refusal, or right of first offer. And they're slightly different technically, but there are pretty material differences into how you would implement them. And I use those all also in many cases. But the very basic stuff works well, if you have something like that in place to resolve disputes.

The other element of it is the working relationships. It's the same thing that we discussed in my corporate governance course about as a CEO, what's the most important thing that you need to do: It's don't lose your board. The CEO, even though they're the leader of the firm, has full obligations to run the firm. They still report to a board. And oftentimes, a CEO will get distance from the board and won't stay close enough to the board to understand what the thoughts and the direction of the board are. They get distanced, and eventually it breaks up with partners.

A similar thing is don't get distanced from your partner. Set up regular mechanisms to make sure that you communicate. Set up some things where you have some social interactions, because social interactions, like the little breakout rooms that you're doing here, are friendly. They tend to get you to

understand a little more about what's going on in the other person's life. And it tends to make you more empathetic with that person, and usually helps build a longer-term relationship.

AYLA: Beautiful. And I think one of the big bits that is supposed to help us manage some of these risks is insurance. I know you mentioned keyman insurance as something that you'd recommend people actually get ahead of as they're entering into a partnership. Could you spend a bit more about how insurance plays a part in governance and managing risk?

DENNIS: Yes, sure. Well, it particularly plays a role in a partnership or a smaller organization where if something unfortunate were to happen to one of the partners, and that person passed away, then what usually happens is that the ownership stake that that person has would either pass to the spouse or children. That oftentimes causes a problem.

Because even though the two partners may have been very aligned, when you bring a family or a spouse into the situation, they may be very different. So, one of the challenges becomes how you actually buy that other person out. So, if you use a technique like some of the ones I described, you need a way to do that, and you can buy what is called keyman insurance.

Also, you can buy second-to-die policies that say two people have to pass away before the policy pays the benefit to the beneficiary. You can use policies of that nature to assist in estate planning. In keyman insurance, the company generally owns the policy. And there is also COLI insurance (Corporate Owned Life Insurance), which has some tax advantages.

You can buy these forms of life insurance, to allow orderly transition of ownership. In the event of the passing of one of the owners. the insurance pays for the acquisition of the deceased person’s interest in the company, by the remaining partner who normally would not have the funds to purchase the interest on their own. This is actually a very good risk management strategy. These forms are not that expensive if the partners are young.

KENNY: Second-to-die. I love that. And you know, coupling that with your earlier comment about the social element is really important, and just having that continual communication. It just reminds me. It’s people, right. It's just people doing stuff.

It's a very human problem. And a lot of cases, in your experience in corporate governance, obviously there's the board, and then there's the executive team, there's the CEO, who's obviously kind of in theory out in front. I know you have some interesting theories about how many people actually run a company. Now, what that dynamic really looks like as it relates to the board, you kind of want to expand. It’s a super leading question, but do you wanna expand on that a bit?

DENNIS: Sure. And I’ve had the good fortune to work with Kenny in my class, so, Kenny, you’ve heard this before, and I'll give you a quick summary answer. Observing all the different companies I've been involved in, because as Kenny was mentioning, I've been on 13 public company boards, 70 private company boards, and 15 not-for-profits. So, I've been on 100 boards.

When you've been out 100 boards, you've seen just about everything that you can imagine. And I will tell you, looking across all 100 of those companies or organizations in the not for profits, every one of them was run by somewhere between two and five people. Never one, and never more than five.

And the reason for that is that even in a company that looks like it's monolithic, such as Apple with Steve Jobs, Steve Jobs never made a decision without talking to Tim Cook. And you didn't know that because it was in the background that he was talking to him. And he had another financial person he talked with as well.

But even though it looked like it was just him, he had his group. And it's very difficult in any kind of an organization where you are so solitary that you don't have other people aligned with you, that help you make that decision. It's really, really rare to find that. I can't think of one of the companies that I've worked with that is different from this structure. The CEO always has someone as a confidante to talk to even if It wasn't very obvious who the person was, and sometimes the person wasn't even on the organization chart.

And why is the maximum five? Because once you get to five opinions, you don't want six. So, there's a maximum number of opinions, and when you get to five, another opinion is just too many. It's almost always that structure in an organization, whether it's a fund or another type of corporation. The leadership group will generally be the CEO, who will usually be a single leader and not a Co-CEO. The leadership group will generally include a financial leader such as a CFO. Sometimes the group will include the Chief Revenue Officer, the Chief Risk Officer, the CTO/CIO, the General Counsel and possibly others.

typically, that small group will be the ones that are the primary decision makers who might not even be on an organization chart, but it's a critical factor in controlling the organization. And so, the first issue is to understand how you make decisions, and how you break ties, when something happens. If you have people on one side or the other, how do you resolve those problems? There are a number of elements of decision making that we discuss in the course that I teach at Booth.

AYLA: I guess one of the questions we just got from the group that kind of links up with this a bit as well, talking about specifically what kinds of risks should be specifically managed. And so, the question comes from Joe and the audience. And what do you think are the biggest risks that we should focus on managing? And why is that non-systemic risk systemic risk or decision process risk?

DENNIS: I have been involved with many different startup ventures and I have worked with more than 10 private equity and venture capital firms, both as a portfolio board member, and also as an advisor to the PE or VC firm. I believe there are two answers to that question.

It starts with instead of asking what you need to be successful, you need to look at what causes failure. As you were describing, there are really only two major reasons why entities fail. The most important reason why entities fail is lack of revenue. They can almost always get everything else, right?

They can manufacture the product, they can establish a risk management process, they can manage the logistics, they can hire the right people and do all of the other things necessary to be successful. Why do

they fail? Not enough revenue. If you can't increase your revenue rapidly enough, you fail. Once you have revenue, you can usually make the organization a success. The second reason for failure, which happens less frequently but is more severe is lack of integrity of management. You may think you've got the right person managing the organization, but if they lack integrity, the organization will eventually fail.

And so, when I see failure, it's almost always caused by one of those two elements. Failure is either caused by no revenue, or a business model that lacks integrity. I have a model that I use to test whether I believe a new business venture will generate sufficient revenue to succeed. It is a very simple three-part model.

The other element of it is to try to do sufficient checking on the people that are going to be in the management of the company to understand whether they have integrity, and whether you can work with them. The management must agree to take strategic and operational direction from the board. And the most important thing for VCs to remember, is a little adage, "noses in, fingers out." That's the role of the board.

The board should be noses in, fingers out— know what's going on, be deeply involved, get involved with the company. But once the decision is made, get your fingers out of operations and let the management run it. So, it's those two elements. Revenue model how are you going to get revenue, who's your consumer — there's a series of things in that sub model. And then second, test the integrity.

When you test the integrity, it's not a five-minute interview or an hour interview, because nobody walks into an interview and says, I'm a serial killer and I hate my mother. You know that people are generally good at being interviewed. |And particularly, somebody who is unethical, will know how to be interviewed. So, you have to find other ways of cross-verifying a person's integrity and background.

And when I see certain things in someone's background, such as having moved around a lot from company to company, I want to know the reasons for the frequent job changes, and why they did not last in their prior positions.

KENNY: And I think Pete Townsend had a question, you almost set it up perfectly there. His question is about VCs. What is the kind of personality traits pertaining to VCs? But also, the directors? What are the things that you mentioned? The moving around a lot? What are some of the other things that maybe they started as an annoyance, and then really down the road it becomes bigger and bigger, and ultimately, a parting of ways.

DENNIS: I think the issue that oftentimes causes the problem is that assuming the management has integrity, you've got one of the most issues resolved, but a problem arises that becomes a management challenge. You sometimes find a person who is a "true believer," where the person has their view of how certain things should be done.

And in spite of advice from a board, or people with maybe more experience, they won't really follow the direction they are given. And that's a big problem. I'm actually going through that right now on one of the boards that I serve on. It's a pretty good size company, and the CEO of the company is really good at

elements of the technical side of the business, but there was a direction that he wanted to follow that several of us on the board had tried before and it did not work.

We've had discussions with the CEO and couldn't convince him and he went off on his own in a direction that we did not agree with. We are now running into problems as you might expect. And so, it was a difficult thing for the board., and the board didn't want to override him. I believe that as a result of that, we're probably going to have to deal with some problems that will emerge in the future.

It's the true believer mindset that becomes a problem, where if the CEO won't listen to advice from people who really know what they're doing, there will usually be problems. But again, the two primary reasons for failure are, lack of revenue or lack of integrity.

KENNY: That's fascinating. Just a personal anecdote, I'm sure you have about a gazillion more, but we had one of our companies we invested in, that the CTO, his exact words are, "this is the most important thing I will ever do in my life". And it was like that — pure true believer. And I'm like, that isn't necessarily entirely logical. And, you know, fast forward six months, and I'm kind of an interim CEO position just because of these issues. You just have to have an open mindset not be overly focused.

DENNIS: Yes. And sometimes, a leader gets into issues in technology selection that can become a real problem in the future. One of the examples of this — and it goes back a long way, there was a big battle between which desktop operating system companies were going to use. And many organizations at the time chose to use the Lotus suite of products.

The product suite was started with Lotus 123 and then Lotus Notes emerged as a desktop operating system that had very strong groupware features. There were other organizations that were using Microsoft Outlook. And what occurred was that the decision was often made based on which system had the best technical features without taking into consideration how widespread the use of the product was.

What you need to do is to look around you and, if you're out of step with the whole world, is the whole world out of step, or are you? Eventually, Microsoft won the battle and Lotus went out of business. The main reason that Microsoft now has the dominant share of the market is not that it's the best system, it's that it was the most widely used in corporate communications and compatibility became the winning strategy.

If you had a choice, technically you might have chosen to use a different system than Microsoft Outlook and Microsoft Office, but it was so widely used that it would be inconsistent with others in the business environment. A decision to go in a different direction ultimately became a major problem when Lotus failed. I use that as a rather simple example, but the same thing happens today when organizations decide whether or not to use a low code solution. The solution may not be as technically elegant, but it is faster to deploy and easier to maintain, so other considerations need to be considered rather than making a decision based solely on technical benefits.

And if you're a leader of an organization, with the new technologies that are emerging in the tech stack, it is very important for you to consider the long-term ramifications of systems decisions.

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Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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