

Private Equity vs PLC Boards in the U.K.: A Comparison of Practices and Effectiveness

Finance Working Paper N°. 233/2009

August 2008

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Abstract

We interview 20 executives in the UK who have been members of both PE and PLC boards of relatively large companies. The main difference we find in PE and PLC board modus operandi is in the single-minded value creation focus of PE boards versus governance compliance and risk management focus of PLC boards. PE boards see their role as “leading” the strategy of the firm through intense engagement with top management; in contrast, PLC boards “accompany” the strategy of top management. PE boards report almost complete alignment in objectives between executive and non-executive directors, whereas the PLC boards report lack of complete alignment and focus on management of broader stakeholder interests. Finally, PE board members receive information that is primarily cash-focused and undergo an intensive induction during the due diligence phase. In contrast, PLC board members collect more diverse information and undergo a more structured (formal) rather than an intense induction.

Keywords: corporate governance, leveraged buyouts (LBO), management buyouts (MBO), active ownership

JEL Classifications: G31, G32, G34, G23, G24

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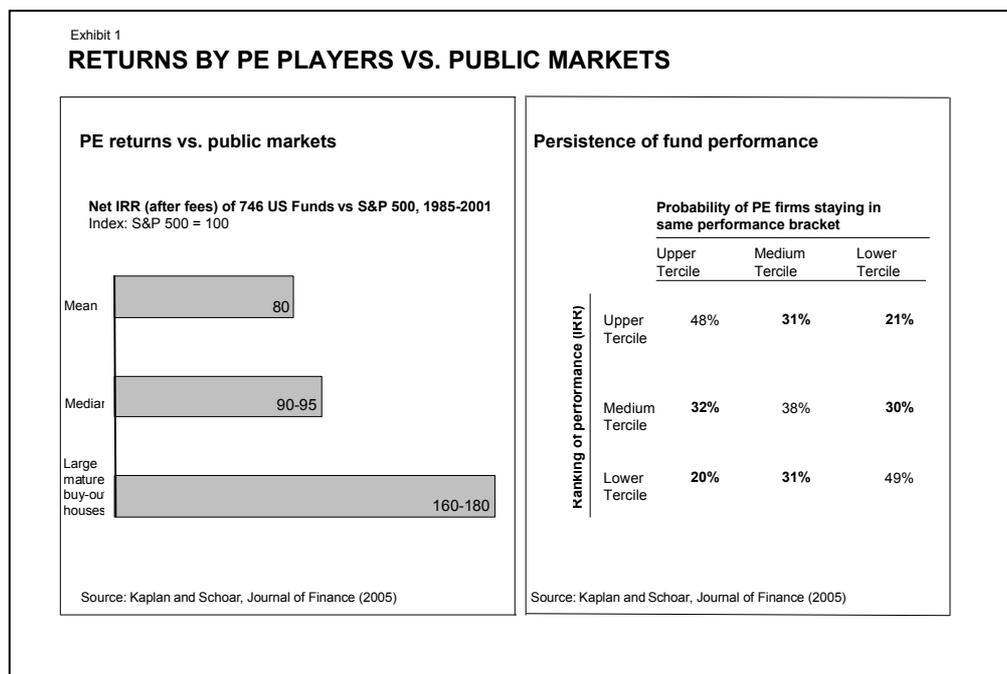
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1. BACKGROUND TO AND OBJECTIVES OF THE RESEARCH

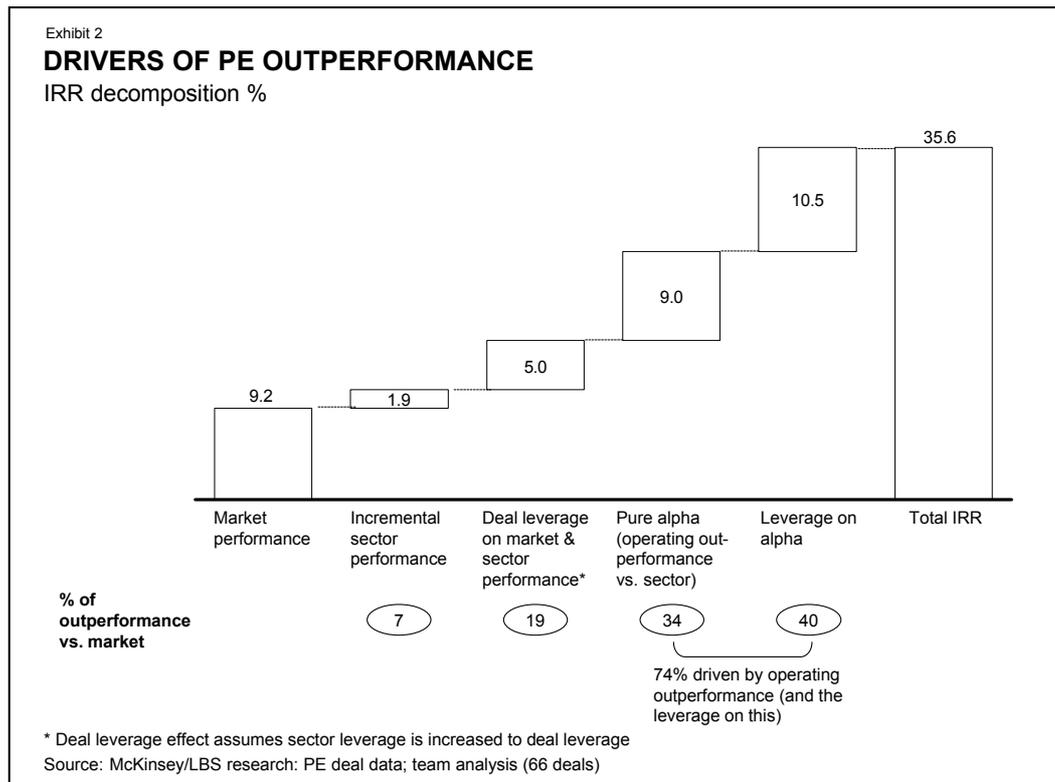
Over recent years, Private Equity (PE) owned businesses have become an increasingly important part of the business landscape. The enterprise value of Private Equity backed businesses compared to that of public companies doubled to 5.1% in the United States from 1995 to 2006 and increased from 1.1% to 3.0% in Europe over the same period (source: McKinsey analysis), and Private Equity owned companies accounted for over 1 million employees in the UK or 6% of the private sector workforce at the end of 2007 (source: BVCA).

The growing willingness of major pension funds and institutions to invest in PE reflects the success that leading buyout funds have had over the years. Most academic studies suggest that, as an overall asset class, PE returns net of fees have been similar or marginally worse than those delivered from public markets over the last 15 to 20 years: Kaplan and Schoar's 2005 study of nearly 750 US Funds from 1985 to 2001 suggested that median returns were in aggregate 5-10% lower than would have been delivered by the S&P 500. However, larger, mature buyout firms (those with over 5 years' track record) outperformed the S&P by between 60 and 80%. Moreover, the returns delivered by top quartile funds have been significantly superior, even after accounting for the cost of the fees and 'carry' earned by the PE houses – and the strongest performing PE houses have a remarkably consistent record of delivering superior results over time (see Exhibit 1).



Clearly, one key driver of these superior returns by the better PE houses has been their willingness to take on high levels of debt at what have been very attractive rates in recent years and their ability to take advantage of rising stock markets to exit their investments at attractive multiples. However, recent research by London Business School and McKinsey (Acharya and Kehoe – 2008) has demonstrated that there is more to the success of the best PE houses than pure financial engineering (see Exhibit 2). This analysis suggests that less than 30% of the out-performance delivered by the top PE funds over stock market returns

(measured by deal-level internal rate of return before any fees) can be attributed to simple financial leverage and market timing; more than 70% represents ‘true out-performance’ or ‘alpha’ (and the leverage effects of this alpha). This ‘alpha’ reflects two key performance drivers: the ability of the PE backed companies to drive EBITDA growth ahead of their public peers for similar levels of sales growth, and their ability to exit at multiples above sector averages, indicating confidence of the subsequent owners that this EBITDA growth is sustainable.



The most successful PE buyout houses therefore do seem to drive superior operational performance from the companies they own. There are a number of factors that help drive this: amongst the factors highlighted by previous research are the more intense performance management culture created by much higher and simpler management incentives; the enhanced focus on cash; the ability to conduct more radical turnarounds free from quarterly earnings pressures; and the advantages of a stable shareholder base. However, based on our involvement with both public and PE portfolio company businesses, we have also observed fundamental differences in the way in which Boards operate in the two different contexts, and so we launched this research to explore to what extent this might also be an important contributory factor.

We sought to examine how plc and PE portfolio company Boards typically operate today, in order to explore three key questions:

- Are the Boards of PE portfolio companies more or less effective than their plc counterparts, both in providing effective stewardship and in adding value to their businesses?
- What do PE portfolio company Boards do differently from plc Boards and what benefits does this bring?

- Are the different Board behaviours driven purely by the different ownership models or are there important lessons that plc Boards can learn from PE portfolio company Boards to enhance their effectiveness?

The research had four major elements:

- 20 structured depth interviews with Chairmen or CEOs with experience of operating on both public and private Boards (often, but not always, at the same time), to explore the differences in modus operandi and the pros and cons of each [see footnote 1].
- Quantitative outside-in analysis of all the FTSE 100 Boards, exploring issues such as their composition, frequency of meeting, use of sub-committees and non-executive director remuneration [see footnote 2].
- Detailed case studies of 10 FTSE 100 Boards to examine how much time non-executive directors devote to them, how Boards spend their time, the nature of the information available to them etc [see footnote 3].
- High level data from 66 UK PE portfolio company Boards on composition and focus [see footnote 4].

This research provides a uniquely rich set of insights on how PE portfolio Boards compare to their public counterparts. We do not pretend that it gives a comprehensive picture and it would be misleading to suggest that all plc Boards or all PE portfolio company Boards are the same: plc Boards vary widely in terms of the challenges they face and their modus operandi, whilst different PE houses have quite different models for how they run portfolio company Boards. Nevertheless, our findings do raise some important challenges for plc Boards and their Chairmen:

- Whilst plc Boards are typically more effective at governance (compliance, risk management etc) and management succession, PE portfolio company Boards score significantly better on overall effectiveness, reflecting their greater added value on strategy and performance management.
- This added value is driven by PE Boards' aligned focus on value creation, their sharper clarity on strategic and performance priorities, and the greater engagement and commitment of their Board members.
- Plc Boards could improve their effectiveness, within the public company context they operate in, by following an integrated programme of six initiatives: refocusing on strategy and performance dialogues; reducing their size to encourage more effective collaboration; increasing the time expectation of non-executive directors; transforming how Boards are educated and informed about the business; significantly increasing informal interaction with Executives; and exploring ways to change the remuneration structure for non-executives.

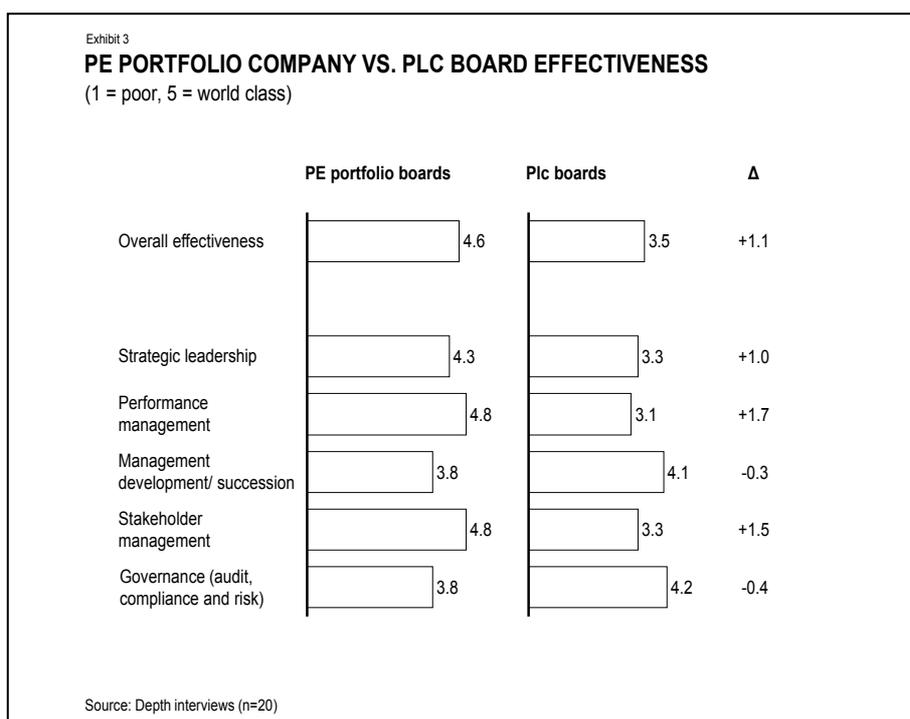
1. Directors chosen had been on the boards both of FTSE 100 or FTSE 250 businesses and PE owned companies typically with enterprise value of >£500m, over the last 5 years
2. Data was compiled from analysis of 2007 annual reports and Boardex
3. Case studies compiled via structured questionnaires and interviews with Company Secretaries
4. 66 deals were from 12 top PE houses; deals were initiated between 1996 and 2004

2. PLC vs. PE BOARD EFFECTIVENESS

2.1 Overall Board effectiveness

Our research suggests that directors who have experience of sitting on both public and private Boards (whether as non-executives or executives) strongly feel that PE portfolio company Boards [hereafter referred to as PE Boards] are significantly more effective than their plc counterparts. When we asked our interviewees to compare the overall effectiveness of PE and plc Boards, 75% felt that PE Boards were clearly superior in the value they added; none felt that their public counterparts were better. This sentiment was reinforced by the relative scores they gave each type of Board on a 5 point scale (where 1 was poor, and 5 was world class): PE Boards averaged 4.6 versus plc Boards at 3.5.

Respondents acknowledged that the different ownership structure and governance expectations of plc Boards both created different expectations for their role and provided constraints on how they were able to operate. Given the need in public companies to protect the interests of arm's length shareholders and to ensure accurate and equal information flow to the capital markets, governance issues such as audit, compliance, remuneration and risk management inevitably (and appropriately) loom much larger in the minds of plc Boards. Indeed, when we probed how effective Boards were on five specific key dimensions, our research did suggest that plc Boards scored more highly on governance – though the gap was narrower than might be expected – and on management development (see Exhibit 3).



However, our respondents were clear that the consequence of the way in which plc Boards typically operate is that they are much less effective in adding value to the businesses they lead in all but the most benign of environments: PE Boards scored significantly better on both the strategic leadership they provide and in the effectiveness of their performance management oversight, as well as (unsurprisingly) for their ability to manage key

stakeholders. For our respondents, these advantages clearly made the PE Boards more effective overall.

2.2 Strategic leadership

PE Boards provide much stronger and more effective strategic leadership than plc Boards. In almost all cases, our interviewees described PE Boards as leading the strategy formulation process, with all the Board Directors working together to shape the strategy and define the priority agenda; indeed key elements of this strategic plan are likely to have been laid out during the due diligence process. PE Boards will often be the source of major strategic initiatives and ideas (for example on M&A), and see their role is to stimulate the executive team into thinking more broadly about potential ‘out of the box’ opportunities. The role of the executive management team is then to implement this plan, reporting back on progress and highlighting any strategic issues that arise.

In contrast, even though most public companies state that ownership of strategy is a Board responsibility, the reality is that the executive team typically takes the lead in developing and proposing the strategy, with the Board’s role usually being to challenge and mould the management’s proposals. None of our interviewees described their public Boards as leading strategy: 70% described the Board as ‘accompanying’ management in defining strategy, whilst 30% admitted the Board played only a following role. Moreover, few of the public Boards playing this ‘accompanying’ role are seen as actively and effectively shaping strategy: amongst the typical weaknesses are devoting insufficient time to true strategic debates; not getting involved early enough and often enough in the strategy process; not being presented with or exploring credible alternatives; and not having sufficient information, understanding and insight to engage effectively in challenging the Executive team.

2.3 Performance management

Similarly, PE Boards play a much more active and positive role in driving performance management than their public counterparts: indeed the nature and intensity of the performance management culture and focus is perhaps the most striking difference between the two environments. PE Boards have what one respondent described as a “relentless focus on value creation levers” that leads them to identify and agree the critical initiatives and the resulting key performance indicators to monitor. These KPIs are not only defined more explicitly, but also include a much stronger focus on cash metrics as well as on speed of delivery. Having set these metrics, PE Boards then monitor progress much more actively and intensively, reviewing progress on key initiatives in great detail, deep diving on one or two areas at each meeting, and intervening when required to address areas of underperformance. “This performance management focus is the Board’s real ‘raison d’être” one respondent commented.

In contrast, the typical performance management approach in plc Boards is different both in nature and focus. Boards were described as much less engaged in the detail: at best their scrutiny was seen as higher level (“more macro than micro” as one interviewee put it) and at worst seen as superficial, with limited probing. Moreover, the focus is much less on progress on fundamental value creation levers and much more on delivery against quarterly profit targets and market expectations. Given the importance of ensuring that shareholders are

being given a fair and accurate picture of the business's short term performance prospects, this emphasis is in many respects understandable, but what it produces is a Board focused more on budgetary control, short-term delivery of accounting profit and avoiding surprising the market. In contrast, PE Boards work hand-in-hand with management to drive a broader, medium term value creation agenda.

2.4 Management development/succession

In contrast to strategic leadership and performance management, PE Boards scored less well on the quality of the development of their business's human capital – both in absolute terms and relative to plc Boards. PE Boards have a laser-like focus on the quality of the top executive team, in particular the CEO and the CFO: they consciously back or recruit top teams they believe in (with 39% of CEOs and 33% of CFOs in our sample of 66 case studies being replaced pre-closure or in the first 100 days), and are quick to replace senior executives who they feel are underperforming. They put in place highly geared incentive plans for top managers, with clear KPIs, tied strongly to the equity value at exit. However – perhaps unsurprisingly given their typical 3-5 year focus – they invest little or no time in exploring broader and longer term issues, such as reviewing management bench strength and succession plans or shaping management development processes. “Their interest in management development is frustratingly narrow”, one interviewee argued.

Plc Boards, by comparison, are seen as much more committed to and effective in playing a broader role on people issues. Typically, they insist on thorough management review processes and will discuss not only the top team but potential successors to this team; they will be involved in debates in the key capabilities the business will need for long-term success; they are more likely to get involved in challenging and influencing key management development processes; and they will play a much more active role in defining remuneration policies and plans beyond the top executives. Plc Boards are not stronger on all elements of people management: they can be slower to react when changes are needed and their voice on all but CEO succession tends to be more advisory than directive. Meanwhile, remuneration discussions are thorough and exhaustive, but can sometimes seem more concerned about the reaction of external stakeholders to potential plans rather than the impact they will have on business performance. Nevertheless, a consistent picture emerges of plc Boards being more focused on people, tackling a broader range of issues, and doing so in a more sophisticated way.

2.5 Stakeholder management

This was another area where PE Boards were seen as significantly more effective, though this is driven very much by the structural differences between the two ownership models. Plc Boards operate in a much more complex environment, not only in the range of stakeholders that they have to manage but also in the challenge of dealing with their investor base. As respondents pointed out, investors in public companies are a disparate group, with large institutions and small shareholders, value investors and growth investors, long-term stockholders and short-term hedge funds. These groups have differing priorities and demands (and in the case of short-selling hedge funds fundamentally misaligned interests). Even fund managers and analysts from the same institution may have different concerns and issues. The Chairmen and CEOs of plcs therefore have to invest a great deal of effort (some

surveys have suggested up to 10% of their time) in communicating to, meeting with, listening to and educating these divergent groups. This is a task that in general they carry out both diligently and skilfully, but many feel that the value generated from all this effort is modest.

The challenge for PE Boards is altogether more straightforward. Firstly, their effective shareholders (the investors in PE funds) are locked in for the duration of the fund. Secondly, the representatives of the shareholders (the PE house) are effectively a single block (or a very small number of blocks in a club deal) and so act in an aligned fashion. Thirdly, the representatives of the shareholders are much more engaged than in the plc world: they are literally “in the room” with the executives and are much better informed about the business realities than is the case for public investors. Unsurprisingly, therefore, the burden of investor management for PE Boards is dramatically less onerous and the quality of the dialogue much better.

That said, PE Boards are much less experienced in and skilled at engaging with broader stakeholders such as the media, unions and other pressure groups. This was evident in their initial response to the greater scrutiny they attracted in 2007. Whilst the Walker Report, and subsequent changes PE houses have made to increase the frequency and transparency of their communication, go some way to addressing their shortcomings, this remains an area where plc Boards are typically more sophisticated and effective.

2.6 Governance/risk management

This was the area where plc Boards scored best, reflecting the drive to improve governance standards and controls in the wake of the Enron, WorldCom and Tyco scandals that led to Sarbanes-Oxley and the initiatives suggested in the Higgs Report. The typical Board sub-committees (Audit, Nomination, Remuneration and Corporate/Social Responsibility) are seen as producing thorough, professional scrutiny of the agreed areas of focus, whilst the overall Board provides effective oversight and leverages a broad range of insights and experiences to help in the identification of potential risks. Compliance with the Combined Code is high and is an important factor in building investor confidence.

However, the high scores given by respondents to plc Boards for the effectiveness of their governance disguise some important underlying concerns. There was, unsurprisingly, a widely held view that some elements of governance are over-engineered and, as a result, are hugely time-consuming with little value generated in return. Perhaps more concerningly, many respondents felt that the thrust of plc Boards on governance had become far too conservative. “Boards seek to follow precedent and avoid conflict with investors, rather than exploring what could maximise value” commented one; “The focus is on box-ticking and covering the right inputs, not delivering the right outputs” said another.

PE Boards scored a little bit lower, reflecting the lower emphasis they put on governance and the less sophisticated processes that are often used – except in those companies preparing for an imminent IPO, which explicitly seek to replicate plc standards. In every case, the focus of governance efforts was on a narrower set of activities, although almost all had embraced the need for a formal Audit Committee. Interestingly, though, PE Boards were in general seen as having a deeper understanding of operational business risk as well as financial risks, and were perceived to be more focused on, and skilled in, risk *management* as opposed to risk *avoidance*.

3. KEY DRIVERS OF PE BOARD EFFECTIVENESS

Given that our respondents felt that PE Boards were typically more effective than plc Boards in adding value, we sought to identify what was driving this. Three key themes emerged from our interviews and analysis: PE Boards' aligned focus on value creation; their sharper clarity on strategic and performance priorities; and the greater engagement of their Board members.

3.1 Aligned focus on value creation

PE Boards naturally have an aligned focus on value creation. Fundamentally, all parties – the shareholders, the PE house, the Board members and the Executive Team – share the same objective: to maximise the equity value of the company at exit. Moreover, this shared objective is reinforced by incentives: not only the top executives but also any independent non-executive directors will typically have real 'skin in the game' through material levels of sweet equity, whilst the PE partners are incentivised based on the carry generated by the deal (and/or the broader fund), as well as typically having investments in the underlying fund.

This simplicity and natural alignment of focus is in marked contrast to the context within which plc Boards operate. There are three key differences: plc Boards have a broader and more complex remit; they are usually bigger and more diverse; and non-executives and executives have different incentives.

The first difference in context lies in the Board remit. The plc Board's role as defined by the Combined Code is superficially similar to that of a PE Board (see Box 1).

Box 1

THE ROLE OF THE BOARD AS DEFINED BY THE COMBINED CODE

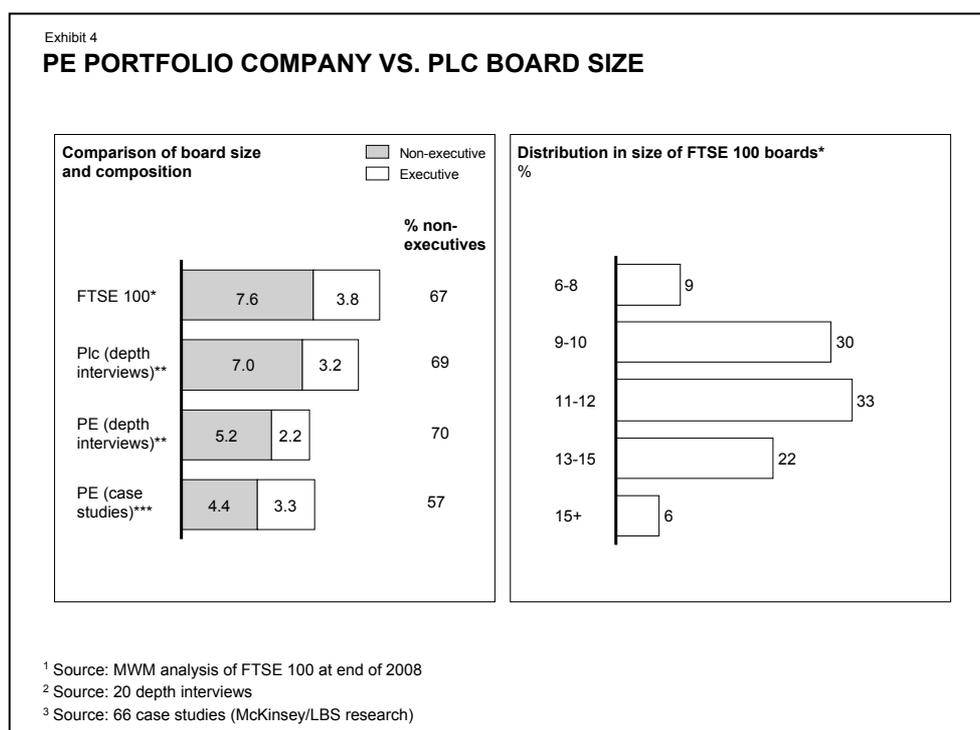
- The board is collectively responsible for promoting the success of the company by directing and supervising the company's affairs
- The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enable risk to be assessed and managed
- The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives, and review management performance
- The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met

Source: Combined Code Principle A.1 and A.1.1

However, in reality the Board has to try to balance the interests of a diffuse and more distant group of shareholders (who as described earlier may have differing priorities and time horizons) and also to ensure that these shareholders are equally and accurately informed

about the prospects of the business. This is very different from the PE world, where PE investors have signed up to a clear set of performance expectations, are locked into the company through the fund structure and have effectively ceded their votes to the PE house.

Secondly, Plc Boards tend to be much bigger than their PE equivalents (see Exhibit 4). Our analysis revealed that the average size of FTSE 100 Boards in 2007 was 11.4, with 7.6 Non-Executive Directors (or 67%); 28% of Boards had 13 or more members and only 9% had 8 or fewer. Whilst FTSE 350 Boards tend to be smaller, the average even here is over 10 members. In contrast, studies suggest that PE houses typically have Boards with 7-8 members, consistent with the findings of both our depth interviews and our detailed PE case studies.

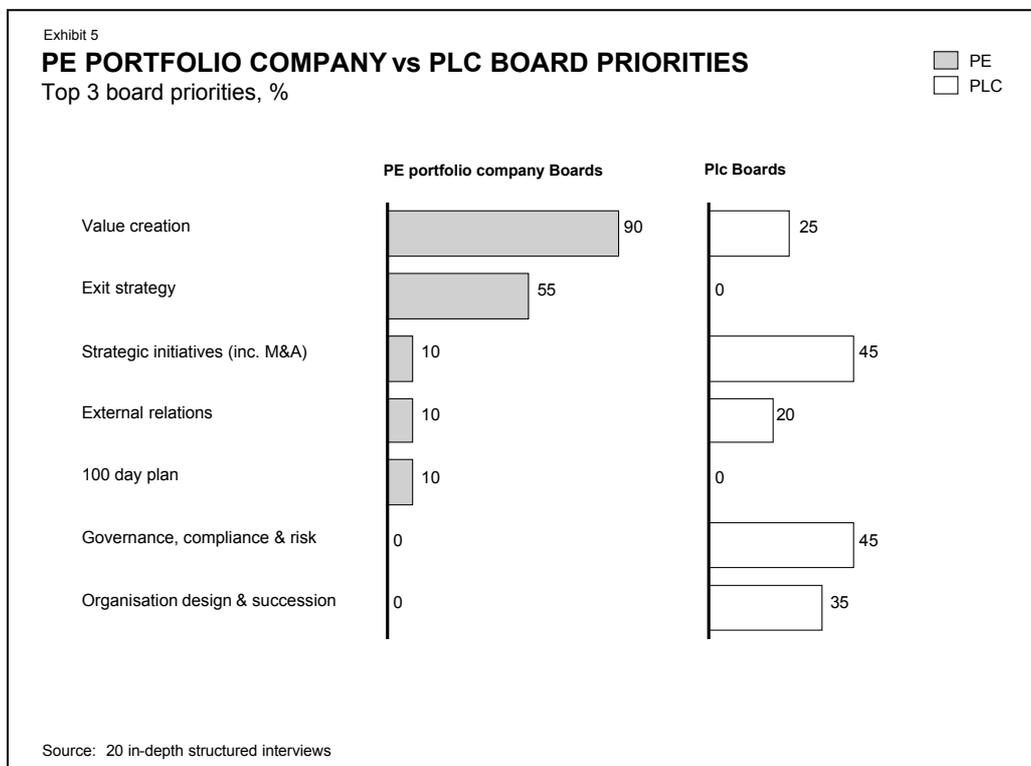


Large plc Boards are the result of understandable pressures and legitimate concerns – the desire to cover a broad range of functional and geographic capabilities, to ensure sufficient resources to staff the various committees and to represent appropriate diversity, for example. Nevertheless, this can create Boards that are much less effective teams and where discussions become much more formulaic and superficial; indeed academic studies (e.g Yermack in the Journal of Financial Economics, 1996) have suggested that smaller plc Boards are correlated with higher shareholder returns over time. In contrast, the smaller PE Boards help create stronger alignment and sharper, more focused debates.

Finally, there is in plc Boards (deliberately) little alignment of incentives. Unlike in PE deals, the independent non-executive directors are paid only via relatively modest fees (the average basic fee for FTSE 100 companies is just over £50,000 with additional payments for committee roles; Chairmen average £335,000) rather than equity, and so typically have limited economic interest in the success of the business: on average, FTSE 100 Chairmen own 0.04% of the equity and FTSE 100 Non-Executives only 0.01%. Moreover, the Combined Code explicitly discourages the use of any share options or performance-related

pay to reward non-executives. This ensures their independence, but does not provide the same shared interest in value creation that characterises PE Boards.

This very different context produces quite different Board behaviour. At a tactical level, PE Boards are able to avoid the ‘distraction’ of shareholder management, which our research suggested consumes c.10% of Board time and is an even bigger commitment for the Chairman individually. More fundamentally, the plc context has two major drawbacks. Firstly, it serves to make non-executive directors – whether consciously or unconsciously – much more focused on risk avoidance than on value creation. This is not necessarily illogical: they have little to gain financially from success, whereas disappointing investors can cost them their hard-earned reputations. Nevertheless, it can lead the Board to focus on ensuring delivery against short-term performance expectations, avoiding unpleasant surprises and complying with governance requirements, rather than driving value creation. In our depth interviews, we asked our respondents to name (unprompted) the key board priorities in public companies they had worked in: governance was the most frequent answer and only 25% cited value creation (ranking fourth after governance, strategy/M&A and succession planning). In contrast, in PE portfolio companies, 90% cited value creation (see Exhibit 5).



Secondly, in public companies there is less natural alignment of interests between the Non-Executive Directors and the Executive team, and hence the relationship can be less collaborative. Executives often see the Board as a potential threat to be ‘managed’ with the intention of keeping them at arm’s length and hence minimising the ‘distraction’ they cause; in turn, Non-Executives can feel suspicious about whether they’re getting a fully honest picture and see their role as providing an explicit check and balance to the management team. Significant effort may be devoted on both sides to defining precise roles and responsibilities and governance protocols. That picture (which of course does not fairly characterise the most effective public company Boards) is very different from the typical pattern in PE portfolio

companies: here the Executives are much less concerned about formal roles and boundaries, more embracing of help from the Non-Executives and more open in their communication.

3.2 Clarity of strategic and performance priorities

Our research also suggests that PE Boards are often characterised both by greater clarity of, and focus on, key strategic and performance priorities. This is partly driven by the ‘event-based’ nature of PE investments: the due diligence process drives deep business understanding and forces the creation of a concrete business plan, whilst the fact that all non-executive Board members effectively join at the same time encourages the development of a shared plan. This compares to plc Boards where Non-Executives join at different times and are armed with less thorough business understanding gained through their induction process: only a third of our respondents in our in-depth interviews described the quality of the induction they received into their public company as high (compared to 90% in PE Boards).

However, equally vital are the disciplines that characterise the post-acquisition model followed by the best PE houses: a rigorous plan developed in the first 100 days with very concrete strategic and performance improvement initiatives; the careful definition of a suite of KPIs (including cash-based metrics) that are intensively scrutinised at all times; and a greater sense of urgency engendered by the commitment to exit and the awareness of the ‘cost’ of time on IRRs.

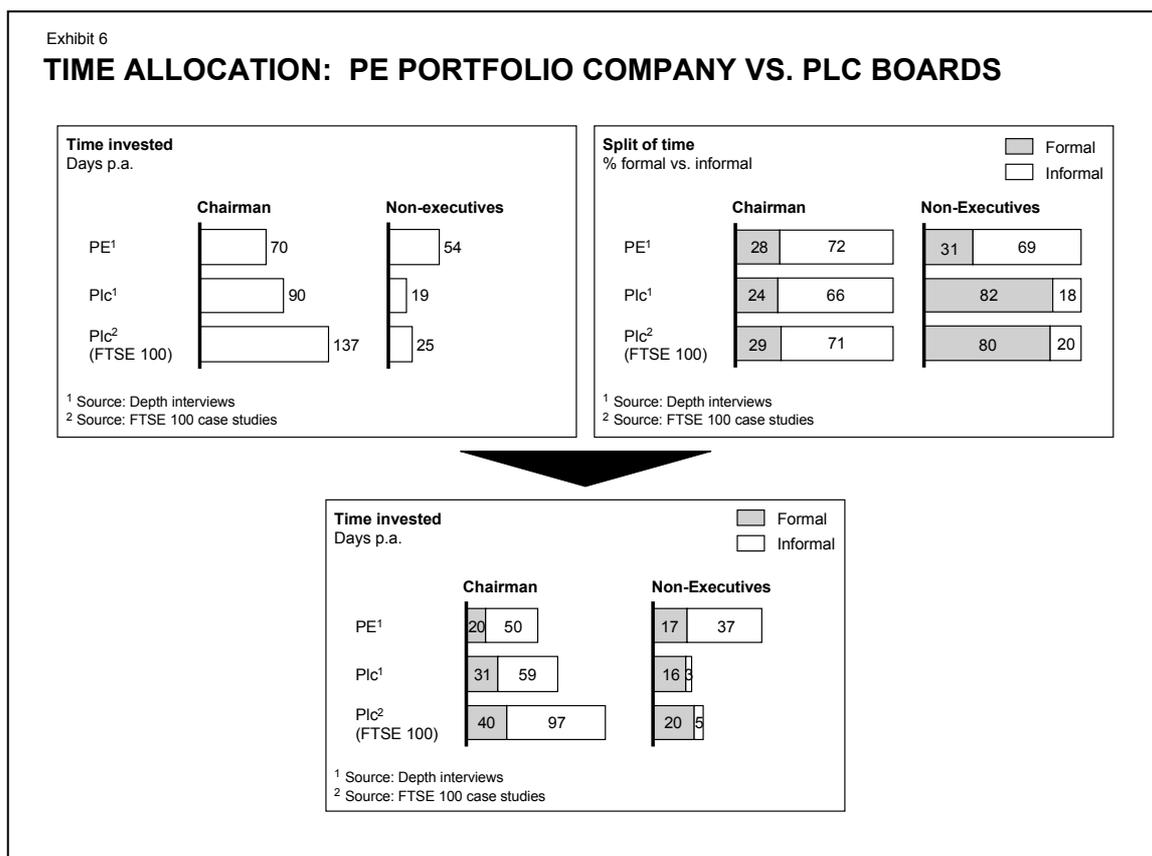
This model produces a number of benefits. Firstly, it engenders a much higher level of insight on the part of *all* Board members into the business, its key challenges and its key performance drivers. Secondly, it ensures high alignment between Non-Executive and Executive Directors: in our research, respondents in our depth interviews described their Boards as fully aligned in 100% of the PE examples but only 46% of the plc cases. Finally, and perhaps most importantly, it changes the focus of how the Board spend their time. Agendas in plc Boards can become formulaic and superficial, covering a set sequence of topics at a relatively high level: our detailed plc case studies suggested that over 70% of the time is devoted to routine or planned items, and typically over 50% of Board meetings is devoted to formal presentations. PE portfolio Boards are much more fluid, typically with much less regimented agendas, much greater focus with selective deep dives at different Board meetings on priority topics, and a much greater emphasis on a detailed review of KPIs and progress against key milestones: performance management discussions usually take up the lion’s share of the time versus an estimated 20% of the time in plc Boards.

3.3 Engagement and commitment of Board members

The third key contributor to PE Boards’ superior effectiveness is the greater level of engagement and commitment shown by the non-executives, both PE partners and ‘independent’ directors. Importantly, our interviewees did not believe that the calibre of non-executive directors was in general higher in PE portfolio company Boards: indeed plc Boards typically contain more breadth of perspective (geographic, functional and industrial) and greater depth of managerial expertise, though they may sometimes lack detailed sector expertise. Our research however suggests that PE Boards are much more engaged with the business, driven by three key factors (see Exhibit 5): non-executives devote considerably

more time than their plc counterparts; they spend their time much more in informal interactions with management; and they flex this time much more according to need.

The first big difference is in the amount of time spent. The issue is not about Chairmen: indeed our interviews suggest that plc Chairmen devote more time than their PE equivalents – an average of 90 days a year in plcs compared to 70 days in PE portfolio company Boards. The commitment of plc Chairmen in FTSE 100 businesses is even greater: our detailed company case studies suggested an average of over 135 days a year. Instead, the issue is about non-executive directors, who devote on average nearly three times as many days in PE-backed companies as they do in plcs (54 versus 19 days); even in the bigger FTSE 100 companies, the average commitment is only 25 days a year (see Exhibit 6).



Not only do PE Boards devote more time, but they engage with the business in a very different way. We asked in our 20 in-depth interviews how directors spent their time across formal interactions (Board and committee meetings) versus more informal interactions (such as field visits, ad hoc meetings with executives, phone calls and e-mails). Again, there is little difference for Chairmen: our respondents suggested that 66% of the Chairmen’s time in plcs was spent in informal interactions versus 72% for PE Chairmen. But plc non-executives have very little time for informal interactions (18% of their time according to our interviews and 20% according to our case studies), whereas PE non-executives are spending 69% of their time in direct, informal discussions with management. When you put that together with the greater overall time commitment PE non-executives are making, a very striking picture emerges: in both plc and PE-backed companies non-executives spend c. 15-20 days a year in formal sessions, but whereas PE non-executives devote a further 35-40 days to hands-on

interaction with their businesses, plc directors spend only 3-5 days a year on such sessions – or about 10% of the time commitment spent by their PE counterparts.

Even this picture probably underestimates the disparity in time. Those PE non-executive directors who are representatives of the PE house itself will have junior staff that can analyse data and provide additional support and leverage. Interestingly, many activist investors joining public boards will similarly insist on having a budget to cover additional staff support.

The final difference is that PE non-executives flex their time up or down as required, investing more time at critical moments (the first 100 days, for example, or approaching exit), meaning that they are engaging heavily with management at such times. Obviously, plc Board members may also invest much more time on occasion, but interestingly this tends to be driven by external events (such as takeover bids) or at times of major crisis, rather than being proactively planned to help maximise their impact on value creation.

This very different extent and nature of engagement with the business inevitably enables the PE Board to play a different, more value-added role. Individual directors are much better informed and because they are out-and-about in the business much more, their understanding is much more granular and practical. Moreover, non-executives are encouraged to get involved more actively in those specific areas where they bring particular expertise – and are usually seen by the executives as a resource to be leveraged, rather than a burdensome intrusion to be managed. Finally, this engagement enables the pace of decision-making to become much faster, with decisions taken when they need to be rather than having to wait for the Board to assemble formally for official meetings. As a result, PE Boards are generally seen as much more active agents of change than plc Boards.

4. IMPLICATIONS FOR PLC BOARDS: SIX KEY LESSONS

Our research suggests therefore that PE Boards are typically more effective overall than their plc counterparts, and in particular in the value they add on strategic leadership and performance management oversight. But is that merely an inevitable consequence of the different context within which plc Boards operate – the result of operating as a public company and having access to the public equity markets – or can these Boards learn from their PE counterparts and improve their added value despite this context?

The plc context appears to be only part of the story: although 35% of our interviewees described the ownership structure as critical in driving Board effectiveness, another 30% described it as important (but not critical) and the final 35% saw it as only somewhat helpful.

These findings raise important questions about the pros and cons of public company status, how governance mechanisms might be redesigned to keep bureaucratic burdens to a minimum, where investor expectations need to be reset if value creation is to be better encouraged, and when it makes sense to take a company private. Certainly, there was a strong sense from our interviewees that private ownership is a much better environment to attempt fundamental business turnarounds: as one put it “it is so much easier to do the right things when you’re focused on value in 3-5 years, not the smooth progression of quarterly earnings targets”. These are issues that regulators, analysts and investors, as well as plc Boards, may want to consider.

However, the focus of this research has not been on addressing these questions. Instead, we have sought to identify lessons plc Boards can learn from their PE counterparts and implement within the context of their public company status. Clearly plc Boards cannot (and should not) seek to replicate all elements of the PE model: the public company model provides advantages in terms of access to capital and liquidity, but in return inevitably requires a more extensive and more transparent approach to governance and a more explicit balancing of stakeholder interests. Nevertheless, the research highlights six key prescriptions that plc Boards should consider as an integrated programme to enhance their effectiveness.

4.1 Refocusing on strategy formulation and performance dialogues

Whilst plc Boards need to be mindful of their full range of responsibilities, it is important that they do not allow a commitment to good governance to crowd out their focus on trying to drive value creation. This should perhaps be made more explicit than it is in the current description of the Board’s role in the Combined Code; certainly, we would encourage Chairmen and Non-Executive Directors to rebalance their mindsets more towards exploring how shareholder value creation should be maximised. It should not take the threat of a bid – whether from a trade buyer or a PE house – or the approach of activist investors for Boards to ensure that they are focused on pulling all the levers required to grow value.

Plc Chairmen should explicitly reduce time on ‘boilerplate’ standard governance items and continue to delegate detailed work as necessary to the Committees. Instead, they should focus collective Board time on both strategy formulation and performance dialogues. The Annual Awayday should not be the only forum for discussions on strategy: instead a rhythm of debates should be developed that make the Board a true participant in the strategy

formulation process, generating and exploring options rather than just challenging and approving the Executive Team's final recommendation. On performance management, Chairmen should plan for substantive discussions at each meeting on one or two high priority topics that he/she selects, allowing for true joint problem-solving rather than cursory reviews.

4.2 Reducing their size to encourage more effective collaboration

Smaller Boards produce more effective teams and in designing their Boards Chairmen should more consciously seek to keep them as small as possible. The need to ensure that the right capabilities are represented around the table, as well as the importance of ensuring adequate resources for the Committees, are real challenges and it is inevitable that plc Boards (and in particular for the larger, more complex businesses) will usually be bigger than their PE counterparts. But Chairmen should explicitly follow the mantra of "as small as possible – though as big as necessary", challenging whether all Board members add real value to the boardroom debate and exploring how more specialised perspectives (such as particular geographic or functional skills) can be brought to bear in other ways, for example through advisory committees.

4.3 Increasing the time expectation of Non-Executive Directors

It is difficult to see how plc non-executive directors can ever hope to add real value to their businesses if they only have 20 days a year to spend on them – and if the vast majority of that time is spent on formal Boards and committee meetings. This is particularly true for the larger and more complex public companies, such as Banks. Plc Boards therefore face a stark choice: either to accept that their role remains a governance-centric one focused on avoiding surprises for investors, or significantly increasing the time expectation for some or all of their non-executives. The latter option would of course raise its own challenges, in particular how to attract serving executives on to Boards given the demands of their main job (and such executives are often highly valuable Board members) and how to make rewards for Board members consistent with the greater demands placed on them. However, only if plc Boards change the amount of time at least the core of non-executives can devote can they hope to deliver the same extent and nature of value added that their PE counterparts typically do.

4.4 Transforming how Boards are educated and informed about the business

Plc non-executives often have a much less detailed understanding of their businesses than the Board members in PE businesses. Addressing this may require four changes, beyond simply investing more time. Firstly, plc induction processes (which have greatly improved in recent years) need to be far more thorough if they are to rival the PE due diligence process: a fair expectation is that a new non-executive might need to devote five to ten days to induction, rather than the usual one or two, and spend them in engaging with a wider range of managers and in site visits, customer meetings, discussions with analysts/industry experts etc as well as in Head Office briefings. Secondly, plc Boards need to define with the same precision that is typical of PE Boards the regular information they require (including agreeing the KPIs that highlight priority value drivers, including cash) to stay fully up to date with business performance and trends. Thirdly, Boards should consider providing the Chairman and the non-executive directors with modest levels of further staff support, in addition to that already

provided by the Company Secretary's office and through the key Committees, to provide the analytical resource that exists in PE houses and in activist investors. Finally, plc non-executives should ensure that (as is already the case in the best run Boards) they ask for and get detailed background briefings on technical issues or major themes as required.

4.5 Significantly increasing informal interaction with Executives

The plc non-executives should focus any greater time they are able to make available on informal discussions with Executives: as in PE portfolio companies, formal meetings should become the structured backbone but not the main body of Board interactions. These informal sessions should be tailored according to the particular skills of each non-executive and the specific needs of the business at a given point in time. Clearly, for these to be effective executive directors will need to be open to help and non-executive directors will need to ensure that their style is appropriately consultative, so that they are truly seen as adding value. This will not always be easy, given historical patterns of behaviour, but the time spent in and the quality of such interactions is a key driver of the effectiveness of PE Boards.

4.6 Exploring ways to change the remuneration structure for Non-Executives

The recommendations outlined above would significantly increase the burden on the non-executives: as time expectations increase then, at a minimum, the payments received by non-executives would need to increase proportionately if high calibre candidates are to be attracted to the role. However, there is also a more fundamental question to explore. If investors see the primary role of the non-executives as to 'control' the executives and prevent them from either taking undesirable risks or misleading investors, then a flat fee system is most appropriate. If, on the other hand, investors wish non-executives to represent their interests by seeking to challenge and coach the executive team into maximising value, then a system which links their remuneration more to shareholder value creation would seem preferable. However, the discouragement of such incentives is arguably an inherent contradiction in the Combined Code and fundamentally changing the behaviour of non-executives will be difficult without addressing this. Clearly such incentivised compensation programmes will require a redefinition of the notion of 'independence', and will need to be designed carefully to ensure that non-executives take an appropriately long-term view, but this should not prove impossible. Providing them, for example, with performance shares tied to TSR over a rolling 3 year period would both align them with shareholders and give them scope for greater upside: this could serve to attract high quality directors (despite the greater time commitment) and motivate the desired behaviour.

These lessons will not be easy to implement: the additional time expectations will be hard to meet whilst the changes to remuneration will require careful consideration and discussion. Plc Boards should also be careful not to lose sight of the valuable enhancements in Corporate Governance that the Combined Code has brought. However, the performance of the better PE portfolio companies raises a challenge for plc Chairmen and non-executive directors – and their investors – and our research suggests following these lessons could help create more effective Boards and greater value for shareholders.

APPENDIX: ABOUT THE AUTHORS

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