

The rise of private equity: considerations for public company directors

Introduction

This issue of *InSights* has been developed to help public company board directors better understand the explosive growth of private equity as an alternative source of capital and the implications of this trend for public companies and their boards.¹ It also presents a number of practices that private equity professionals say public company directors might consider adopting. Although this document describes some differences between public markets and private equity, it does not offer a comprehensive comparison of benefits and limitations and does not presume to endorse either ownership or governance model.

Readers are urged to reflect on this material individually and to find time to discuss it with their boards collectively. While boards may conclude that some of the recommended practices are impractical and may already be implementing others, the discussions will almost certainly be lively, informative and constructive.

This document draws on the insights of many sources: discussions with audit committee chairs, private equity industry leaders, and institutional investors; comments expressed by individuals during public events; and publicly available research and media content. Although public sources are cited, views expressed during private discussions are covered by the Chatham House Rule and are not attributed to individuals or their organizations.

Executive Summary

This document will review the evolution of private equity and explore some important differences between public ownership and private equity ownership. It will then contrast the role of private equity portfolio company directors with that of their public company counterparts.

Several themes are developed in the following pages:

- **Private equity's role in global capital markets is significant and growing** (*page 2*)

In less than 40 years, private equity has emerged as an important part of the global capital markets. Institutional investors allocate a meaningful share of assets to private equity and have been rewarded by superior returns from top-tier firms. The industry's growth has been fueled by an explosion of liquidity, coupled with concerns about public company regulation.

- **Private equity-owned companies differ from public companies in important ways** (*page 3*)

Private equity professionals say the companies they own behave differently from public companies. In particular, they believe private equity has been successful in aligning management incentives with performance, imposing operating discipline, making decisions quickly, limiting the number of stakeholders, using leverage to enhance investor returns, and responding flexibly to rapid change.

¹ The term "private equity" can describe many sources of private capital, including venture capital, hedge funds, private debt, and buyouts (sometimes known as leveraged buyouts or LBOs). For the purpose of *InSights*, "private equity" refers to buyout firms that take controlling positions in privately held companies.

- **Private equity has attracted much criticism** (page 5)

Some observers are concerned about the growth of private equity. Some critics say increased debt levels are creating new risks. Others believe an emphasis on cost cutting negatively impacts workers and society. Furthermore, it is unclear whether public or private ownership is most effective at creating long-term value. For public company directors, management buyouts present a challenging oversight responsibility, as management is generally torn between conflicting interests.

- **Private equity boards play an active role in the value creation process** (page 8)

Private equity board directors face significantly fewer regulatory obligations than their public company counterparts. Because private equity boards often engage more deeply in strategy and operations than public company boards, they require a different type of commitment, information, and expertise. Many public company directors also want to engage more deeply with their companies, but lack the necessary time, resources, and information.

In the appendix, members of the Private Equity Leadership Network² offer several suggestions for public company directors, including limiting the size of the board, speaking with one voice, focusing on results over process, and increasing engagement in the business.

Private equity's role in global capital markets is significant and growing

The private equity industry started as a cottage industry in the 1960s, but took root in the 1970s with the establishment of three specialized firms: Kohlberg Kravis Roberts & Co. (KKR), Clayton, Dubilier & Rice (CDR), and Forstmann Little & Co. The industry pioneers worked out of small offices, launching their firms with a handful of people who had a deep network of relationships, sophisticated financial expertise, and the uncanny ability to identify and structure unique deals. By today's standards, those initial deals were small in size and few in number. In 1979, leveraged buyout transactions in the United States totaled only \$300 million.³ The industry exploded into the public's consciousness in 1988, with KKR's \$25 billion buyout of RJR Nabisco, described by Bryan Burrough and John Helyar in their classic business book *Barbarians at the Gate*. The 1980s boom ended when creditors pulled back after the failure of financier Marvin Davis's bid for UAL in October 1989.

Needless to say, the private equity industry has changed dramatically since its early days. There are now as many as 20 firms with assets exceeding \$10 billion,⁴ and two-thirds of board directors expect the role of

² The Private Equity Leadership Network (PELN) is a select group of senior partners from some of America's leading private equity firms, including Bain Capital, The Blackstone Group, The Carlyle Group, CCMP Capital Advisors, GTCR, Hellman & Friedman, HM Capital, Madison Dearborn Partners, Metalmark Capital, Providence Equity Partners, Silver Lake Partners, Summit Partners, TPG, and Warburg Pincus.

³ Richard Dresdale, *Private Equity – What's Ahead* (Sacramento, CA: Institute for Fiduciary Education, 2002), 1. Available at <http://ifecorp.com/Papers-PDFs/Dressdale602.PDF>.

⁴ According to Private Equity International's PEI 50 ranking of the largest private equity firms, May 2007, which is available at <http://www.privateequityinternational.com/pei/default.asp>.

private equity investors to increase over the next five years.⁵ No longer “barbarians at the gate,” private equity professionals have become mainstream players in the global capital markets.

Although some commentators have tried to link the ascent of private equity to the expanded regulatory burden public companies have shouldered under Sarbanes-Oxley, most also agree that low interest rates and increased liquidity have fueled the rise of private equity.

Institutions view private equity as an important investment class

Private equity investors include pension funds, college endowments, and high-net-worth individuals. These investors commit significant amounts of capital to illiquid funds managed by investment professionals who create value through a combination of shrewd deal making, financial engineering, and operational and strategic improvement. Investors pay an annual management fee of 1–2%, as well as a significant share of investment gains (known as “carried interest”) – usually 20%.

Despite the high fees, the average institutional investor has allocated 8% to private equity, and some leading universities (including Yale, Harvard, and Stanford) allocate as much as 10–20% of their endowment portfolios to private equity.⁶

Do private equity investments outperform public market investments? Research by McKinsey & Company shows that, “three-quarters of private equity firms perform no better than the stock market over time. Even so, the top 25 percent of private equity firms do outperform the relevant stock market indexes. Moreover, they do so by a considerable margin – and persistently.”⁷

Private equity–owned companies differ from public companies in important ways

Of course, public and private equity markets differ in important ways. The head of corporate governance at a large U.S. pension fund explained during a private discussion, “When an enterprise decides to accept money from the general public, it is required to operate in a different manner than when it has chosen to raise its capital privately. Laws have created a set of standards to protect the interests of the investing public. Those rules are very important and set standards in terms of the structure of companies and the disclosure regulations, so the public can’t be defrauded. That’s the fundamental difference between being private and public. I don’t think that difference should be eliminated.”

However, while recognizing that public companies operate in a different legal and regulatory environment from privately held companies, it is still helpful to consider some of the reasons private equity professionals cite for why their portfolio companies tend to outperform public companies:

⁵ McKinsey & Company, “The state of the corporate board, 2007: A McKinsey Global Survey,” June 2007. Available by subscription at http://www.mckinseyquarterly.com/article_abstract.aspx?ar=2011&l2=39&l3=3&srId=17&gp=0.

⁶ Fort Washington Capital Partners Group, *Investing in Private Equity through a Fund of Funds* (Cincinnati, OH: Fort Washington Capital Partners Group, 2006), 2. Available at <http://www.fortwashington.com/pdf/InvestinginPEPaperUpdated0609.pdf>.

⁷ Andreas Beroutsos, Andrew Freeman, and Conor F. Kehoe, “What public companies can learn from private equity,” *McKinsey on Finance*, no. 22 (Winter 2007), 1. Available at http://corporatefinance.mckinsey.com/_downloads/knowledge/mckinsey_on_finance/MoF_Issue_22.pdf.

• **Incentives aligned with performance:** Kevin Conway of CD&R said recently, “Private equity tries to refocus management on key drivers of the business and make sure that compensation and incentives are aligned with these long term value building initiatives ... If you tell me how a person is paid, I have a good idea how he or she will behave.”⁸ Indeed, “performance-management conversations in private equity-owned companies are frequent, fact based, and hard edged. When their performance suffers, private equity players are quick to act, spending more time with management, replacing underperforming teams, and hiring external experts. While many publicly held companies have similar conversations, few are as rigorously implemented and as focused on value creation as those at private equity firms.”⁹

• **Operating discipline:** According to Johannes Huth of KKR, “Measurement systems and performance indicators are very important, and we pay a lot of attention to them when we actually enter a business. This goes beyond the monthly P&L cash flow and balance sheets to include the kinds of metrics that will give us some visibility into the future ... We develop these measurements as part of the acquisition process and then implement them once we take ownership. Clearly, we're very cash flow driven, rather than earnings driven, because for the first few years we have to repay the loans we take on to buy a business. So we have rolling daily cash flow forecasts in every business, and with today's technology, that's quite possible to implement in pretty much any business. Yet again and again we're amazed at how unsophisticated some of the cash-flow-monitoring mechanisms are, even in large businesses.”¹⁰

Of course, sophisticated financial professionals have not traditionally been viewed as operating experts. The CFO of the German chemical company BASF noted, “That's a very strange development when people who work in private equity often have a reputation for being more capable of running a business than people who have industry-specific experience in management.”¹¹

• **Rapid decision making:** Executives note the speed with which decisions are approved by private equity owners. Lennart Sundén, CEO of private equity-owned Sanitec, said, “We don't have to wait for the next planned board meeting, we don't need to communicate anything to a wide range of investors, and we don't need to tell competitors anything if we don't want to – just a very short communication between the owner and management and it's done. That makes it a very competitive model compared with larger public companies, where the board may be coming in on a more infrequent basis and a lot of time is spent meeting all the requirements that listed companies face today.”¹²

Underscoring the importance of rapid decision making, Don Gogel of CD&R notes, “Private equity owners bring a sense of urgency to the entire business. This reflects a realization that global forces erode a company's competitive position every day that the management does not act to deliver more value to

⁸ Kevin Conway, speaking at Buyouts Symposium East, New York, April 16–18, 2007.

⁹ Andreas Beroutsos, Andrew Freeman, and Conor F. Kehoe, “What public companies can learn from private equity,” 5.

¹⁰ McKinsey & Company, “Creating value: The debate over public vs. private ownership,” *McKinsey on Finance*, no. 21 (Autumn 2006), 7. Available at http://corporatefinance.mckinsey.com/_downloads/knowledge/mckinsey_on_finance/MoF_Issue_21.pdf.

¹¹ *Ibid.*, 4.

¹² *Ibid.*, 3.

its customers. Speed of execution itself becomes a competitive advantage that is squandered by companies that manage by committee and fail to seize opportunities.”¹³

- **Focus on fewer stakeholders:** Mr. Gogel observes, “Many public CEOs tell me that they feel like Gulliver bound by a thousand ropes: It is extremely difficult for public company CEOs and their management teams to focus and execute long-term strategies that require fundamental changes in business practices at the same time as they are responding to the cacophony of their many, multiple constituencies.”¹⁴ A PELN member recently observed that “[public company management] spends a lot of time dealing with Wall Street. They have a huge number of meetings, mostly with analysts.”
- **More comfort with leverage:** Private equity firms typically restructure a company’s balance sheet to include significantly higher levels of debt. One PELN member explained, “Clearly part of what happens [with private equity] is a change in capital structure. That drives some of the value creation.” Mr. Gogel goes a step further: “Private-equity firms are comfortable using significant – but safe – levels of debt to finance a significant portion of their investments. As a period of unequalled liquidity has swept the world capital markets in the past few years, private-equity firms have capitalized on low interest rates and relatively loose covenants to shape capital structures that improve likely returns on equity. Public companies could do the same – but are reluctant to do so, clinging to more conservative goals of maintaining historical debt ratings.”¹⁵ A public company director who serves on a private equity–controlled board confirmed Mr. Gogel’s perspective: “It’s difficult for public company boards to operate in the range of debt ratings that private equity is comfortable in ... If you went to 100 public companies that are investment grade, my bet is 90 would say they would not take it into junk bond rating.”
- **Flexible approach:** According to one PELN member, “This whole industry exists because we challenge convention.” Mr. Gogel says private equity firms are “supremely opportunistic, [and] they recognize that the flexible and transitional nature of their capital means that they can fill spots in the global restructuring environment that public company capital cannot. They have established a highly effective form of financing and governance that enables large struggling corporations to remain competitive in response to the rapid changes in the global economy. They ‘just do it.’ Many public companies struggle to keep up.”¹⁶

Private equity has attracted much criticism

In spite of the stated benefits associated with private equity ownership, the industry has its share of critics. Some business leaders, investors, and regulators worry that private equity firms are opportunistically burdening portfolio companies with excessive levels of debt, enriching themselves while creating new risks for both investors and the broader market. Others believe private equity’s business practices should be more

¹³ Donald Gogel, “What’s So Great About Private Equity?” *Wall Street Journal*, November 27, 2006. Available to subscribers at http://online.wsj.com/article/SB116459816859233270.html?mod=todays_us_opinion.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

transparent and argue for more regulatory oversight. As private equity funds and profits increase, some question whether the industry enjoys unfair tax advantages relative to public companies or their investors.

Labor leaders often argue that private equity deals benefit investors to the detriment of workers and society. John Adler of the Service Employees International Union points out, for example, that “typically it’s easier to decrease costs quickly by cutting heads, which is why buyouts have typically been accompanied by layoffs.”¹⁷ However, Steven Kaplan of the University of Chicago’s Graduate School of Business takes a more balanced view, claiming, “Private equity is both a job creator and job destroyer ... Part of what private equity does is make companies more efficient – which may mean cutting jobs. But you can create value by growing faster or doing things better, which can increase jobs.”¹⁸

Although unions criticize private equity for imposing “crushing debt loads” on companies while generating “immense wealth” for themselves, some labor leaders say they would rather negotiate with private equity leaders than with public company executives. Andy Stern of the Service Employees International Union said, “I’ve been incredibly impressed. Compared to most of my meetings with company CEOs, these men are much more businesslike, and have much more understanding of what we are trying to accomplish. I’m not saying we agree. But they are much more calculating than they are ideological.”¹⁹

Despite short holding periods, private equity often takes a long-term perspective

Public company executives and directors often argue that because private equity firms rarely hold an investment for more than five or six years, these owners do not take a long-term perspective on the business. Certainly, time horizon affects behavior and can present operating challenges for private equity executives. Tracy Billbrough, the CEO of private equity–owned Generation Brands, said, “You’re trying to lead an organization where everybody in the organization knows we’re going to be sold. It just hangs over them like a cloud as a constant distraction for people.”²⁰

However, not all CEOs of private equity–owned companies agree. Mr. Sundén said, “It’s true that private equity funds are temporary owners of a business; that’s their model. But if we expect to generate good value when we sell that business either to the stock market or to another acquirer, we have to remember that those potential acquirers will only pay for something that they believe will have value in the long term. So if we haven’t invested in research and development, if we haven’t invested in marketing, if we basically have stripped a business of its future growth opportunities, we won’t get paid for that business when we sell it. The only way that we can actually create something that will have value is if we do invest in that future growth, and I really fundamentally believe in that.”²¹

¹⁷ Grace Wong, “Private equity and the job cut myth,” *CNNMoney.com*, May 2, 2007. Available at http://money.cnn.com/2007/05/02/markets/pe_jobs/index.htm?postversion=2007050213.

¹⁸ Ibid.

¹⁹ Alan Murray, “Labor Leaders, Buyout Kings Speak the Same Language,” *Wall Street Journal*, May 30, 2007. Available to subscribers at <http://online.wsj.com/article/SB118047895423717749.html>.

²⁰ Erin White and Gregory Zuckerman, “The Private-Equity CEO,” *Wall Street Journal*, November 6, 2006. Available to subscribers at <http://online.wsj.com/article/SB116278251151514211.html>.

²¹ McKinsey & Company, “Creating value: The debate over public vs. private ownership,” 4.

Because of short-term market pressures, public companies may, in fact, evaluate some opportunities on a shorter time horizon than private equity. In a recent survey, the majority of public company CFOs said “they would cut a project with a positive net present value to hit a short-term earnings target set by the market.”²² As a result, companies that are acquired by private equity may find certain pressures are relaxed: Cristóbal Conde, the CEO of SunGard, which was acquired by a consortium of private equity investors in 2005, said the company now has 53 research and development projects under way, many of them long term, compared with about 10 before the takeover.²³

Blackstone chief executive and co-founder Stephen Schwarzman argues that, for many public companies, “the tyranny of quarterly earnings has created a systemic issue. In many cases, senior managers have terrific ideas of what to do with their companies but they are not prepared to do it because their shareholders are not willing to put up with delayed gratification.”²⁴

Management buyouts pose special challenges for boards

For public company board directors, management buyouts pose a special set of problems. Wall Street veteran Felix G. Rohatyn, now a senior adviser at Lehman Brothers, observed that on the one hand, “for the management of the company, [a buyout is] usually a windfall.”²⁵ On the other hand, in a private conversation, a leading institutional investor expressed concern about the “conflict of interest when executives are given incentive to take the company private. There needs to be closer examination of this phenomenon.”

Actor, lawyer, writer, and economist Ben Stein has been highly critical of management-led buyouts, arguing, “To my mind, these deals should be illegal on their face ... As a matter of basic fiduciary duty law, managers are bound to put the interests of stockholders ahead of their own, in each and every situation. By buying the assets on the cheap and then reaping the benefits, management is breaching that fiduciary duty, or so it seems to me. Likewise, if the managers can run the company more profitably, they owe it to the stockholders to do that for them ... If the stockholders have hired you and pay your wage to manage their assets, your job is to do that for them – not to buy them out at fire-sale prices and turn around and make billions that rightfully belong to them. The management buyout is a sad and infuriating avatar of a decadent age.”²⁶

The board can play an important role in allaying Mr. Stein’s fears. According to William Regner, a partner at Debevoise & Plimpton, “It has become customary for boards to form special committees of independent directors to evaluate going private transactions ... [This committee] can help demonstrate that the board has

²² Ibid, 3.

²³ Erin White and Gregory Zuckerman, “The Private-Equity CEO.”

²⁴ Francesco Guerrera and James Politi, “Private equity: Life on the other side,” *Financial Times*, April 24, 2007. Available at <http://search.ft.com/ftArticle?queryText=private+equity+life+on+the+other+side&aje=true&id=070424000158>.

²⁵ Emily Thornton, “Gluttons at the Gate,” *BusinessWeek*, October 30, 2006. Available at http://www.businessweek.com/magazine/content/06_44/b4007001.htm.

²⁶ Ben Stein, “On Buyouts, There Ought to Be a Law,” *New York Times*, September 3, 2006. Available at <http://www.nytimes.com/2006/09/03/business/yourmoney/03every.html?ex=1314936000&en=6679077c5af5c4a6&ei=5088>.

responded appropriately to the conflicts presented.”²⁷ Mr. Regner also notes that the board needs to set clear boundaries, recognizing that “management does not have authority to hold discussions with financial sponsors – or other parties – regarding a takeover ... If management is approached by a prospective buyer, it should promptly notify the board, or possibly a lead outside director.”²⁸ Furthermore, “management should be reminded that confidential information (including projections) is an asset of the company. Projections should not be used for purposes not authorized by the board – such as showing them to financial sponsors to explore the feasibility of an MBO.”²⁹

Private equity boards play an active role in the value creation process

Whatever criticism private equity attracts, its ability to create value is undeniable. “The source of [private equity firms’] success is the governance model they apply to the companies they own. It is an advantage that public companies find hard to emulate. The top private equity firms have created a means to exert ownership control over management that can create sustainable above-average performance. The contrast in governance style is particularly striking when these firms are measured against traditional public companies, with their typically diffuse shareholder bases, powerful chief executives and under-resourced non-executive directors ... Some might argue that governance has been greatly improved in public markets, notably since the clean-ups that followed high-profile corporate scandals. But the overwhelming effort has been directed not at governance that creates value, but at compliance – ensuring no codes are breached.”³⁰

Private equity directors take a “Guidance” rather than a “Compliance” approach

In a recent *Wall Street Journal* commentary, legendary venture capitalist Tom Perkins of Kleiner Perkins Caufield & Byers distinguished between the “Guidance board” and the “Compliance board”:

The Guidance board is typically very involved: Strategy, tactics, hiring, firing, technology and engineering reviews are normal. The board may meet monthly and the chairman may visit the company on a weekly basis. Normally the board is small. Directors tend to be no-nonsense people who expect to be listened to and who take responsibility for their decisions – and sometimes this intense involvement is annoying to the management. But the results can be more than gratifying...

A Compliance board is a very, very busy board. It works as hard, maybe harder (because it's all so boring) than a Guidance board. There are so very many matters to comply with, so very many governance (compliance) experts to listen to...

Diversity and inclusionary problems are always there to be discussed. Sarbanes-Oxley audit committee meetings can easily require a five-hour agenda, and require one hour even to summarize for the full

²⁷ William D. Regner, “MBO Jumbo: What Directors Need to Know About Going Private,” *Boardroom Briefing* 4 no. 2 (Summer 2007), 14. Available at <http://www.directorsandboards.com/Summer07BB.pdf>.

²⁸ *Ibid.*, 12.

²⁹ *Ibid.*

³⁰ Andreas Beroutsos and Conor Kehoe, “A lesson in governance from the private equity firms,” *Financial Times*, November 30, 2006. Available at <http://search.ft.com/ftArticle?id=061130001206>.

board. Governance and compensation committees are similarly demanding. Inevitably consultants and lawyers take more and more of center stage in the workings of a Compliance board.³¹

Unlike public company board directors, who typically provide strategic and operational oversight, private equity directors generally take a more hands-on (Guidance board) approach. This role may require a different type of expertise and commitment. An audit committee chair with experience on a private equity-controlled board noted, “At least one of the private equity guys [on the board] probably has more understanding of the business and the numbers that drive the business than the average board member. They’ve done a lot of analysis, due diligence, and have a lot on the line in terms of making sure the investment works. They’re close to the business.” By way of comparison, a PELN member who serves on a public company board described this board as “very dedicated ... [comprised] of good, smart, well-intentioned people, but from one meeting to the next they are not engaged ... not on the CEO’s [back].”

As Mr. Gogel observed, “Private-equity firms recruit industry and functional experts as directors who want tangible engagement with the business rather than a social forum; start off with a well-defined set of objectives to change business performance; insist on tight reporting requirements; and run board meetings that are issue-oriented, not show-and-tell.”³² Mr. Huth echoed those comments: “When we acquire a business, we spend a lot of time on due diligence so that when we sit on the board, we have a detailed understanding of what the company does. That enables us to be very good sparring partners for the management team in further driving value.”³³

Public company directors face information constraints

Make no mistake – many public company directors yearn for deeper engagement with strategy. A recent article from McKinsey & Company noted that “nonexecutive directors of public companies may simply lack the necessary information. Those McKinsey polled in 2005 complained that they wanted to spend more time on strategy and on selecting and developing management talent – and less time on audit and compensation issues. But only about 10 percent of these directors felt that the board had a complete understanding of their company’s strategy and long-term objectives or of the key initiatives designed to achieve them (the rough equivalent of the value creation plan for private equity). Indeed, when asked to describe the extent of the board’s understanding of the long-term objectives, more than half of our respondents answered ‘limited’ or ‘none.’ Over a quarter felt the same about the board’s understanding of corporate strategy. Most felt starved of operational and strategic information; more than 70 percent wanted more of it, while only a minority wanted more financial information.”³⁴

³¹ Tom Perkins, “The ‘Compliance’ Board,” *Wall Street Journal*, March 2, 2007. Available to subscribers at <http://online.wsj.com/article/SB117280725006124469-search.html>.

³² Donald Gogel, “What’s So Great About Private Equity?”

³³ McKinsey & Company, “Creating value: The debate over public vs. private ownership,” 2.

³⁴ Andreas Beroutsos, Andrew Freeman, and Conor F. Kehoe, “What public companies can learn from private equity,” 4.



Conclusion

In a recent speech, industry pioneer Henry Kravis said “the stars are aligned” for private equity to continue its rapid growth.³⁵ Still, private equity professionals agree that not every company is a suitable private equity investment. Private equity may be most effective as a transitional source of capital, enabling companies to make necessary changes without the constraints of the public markets. However, most private equity professionals believe that the public markets will – and should – continue to be the dominant source of equity capital.

Are the lessons from private equity professionals relevant to public company directors? Should a public company board behave more like a private equity board? These are questions for each board to answer. However, Carlyle Group co-founder David Rubenstein believes that competition from private equity will ultimately improve the performance of publicly traded companies: “There is clearly a good deal of capital in the private (equity) sector. Is this good for the public (quoted) sector? I think it is, because competition from private equity has focused CEOs on improving shareholder value.”³⁶

About this document

InSights is produced by Tapestry Networks to provide assessments of key issues of interest to audit committees. Initially, *InSights* will be distributed to network members who, in turn, will share it with colleagues on audit committees and boards, and their advisers. It will be distributed by Ernst & Young to its partners. Anyone who receives *InSights* may share it with those in their own network. The ultimate value of *InSights* lies in its power to help all constituencies develop their own informed points of view.

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³⁵ Duncan Mavin, “‘Stars aligned’ for private-equity sector growth: Kravis,” *Financial Post*, May 29, 2007. Available at <http://www.canada.com/nationalpost/financialpost/story.html?id=d4f32448-7219-436d-83b5-c3a316baa744&k=70445>.

³⁶ Francesco Guerrera and James Politi, “Private equity: Life on the other side.”

Appendix: Private equity leaders offer suggestions for public company directors

Members of the Private Equity Leadership Network were asked what they thought public company directors could learn from the experience of private equity. Their list included the following suggestions:

- **Limit the size of the board.** “Public company boards are too big, too unwieldy.” Another noted, “Most private equity firms use five to seven directors. [At public companies] there are too many chiefs and not enough Indians. Things don't get done. Directors think the other eight guys will handle it.”
- **Speak with one voice.** “Private equity boards speak with one voice. [Public company boards] have 11 directors with 11 different points of view. We have a very specific plan – what's good, what's not good, and what we're going to do about it.”
- **Set clear goals.** “We have a goal, an objective, and everyone understands what it is: to make things work. Our objectives are in a specific time frame, not just to keep the ship sailing.”
- **Focus on results over process.** PELN members believe regulation has caused public company boards to focus on “covering yourself, protecting yourself.” For private equity–owned companies, “the emphasis is, fundamentally, how is the business doing and how do we make it do better?”
- **Don't be afraid to challenge management.** One PELN member who has been involved in public companies said public company board directors are often presented with “low-level analysis” from management. Directors don't know to challenge information because “they're not on the inside.”
- **Change leadership, if necessary.** “One way or another, you need a good strategic vision and a sense of the company's ability to execute that vision. If you don't have the team to get that done, then you need to make a change.”
- **Align incentives for both management and directors.** PELN members said directors should have a greater financial stake in the success of the business: “We pay our directors a lot better, and usually there's an equity incentive.”
- **Take a long-term view.** “It's very simple. [Public companies must] stop focusing on quarterly earnings and avoiding capital expenditures that might hurt short-term earnings, but that are good for the long term.”
- **Increase engagement in the business.** “We think about how to make companies better every day. It's hard to separate director responsibilities from our objectives as investors.” Another PELN member who also serves on a public company board said, “I don't know how practical it is for directors in public companies to spend a huge amount of time, but it's necessary ... I take my board responsibility very seriously. Frankly, not all public company directors do.”