# Private Equity & Corporate Governance?

## Perfect marriage or contradiction in terms?

### Summary Report of ecoDa's annual conference
### 1st April 2008

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## Miles Templeman

Chairman of ecoDa

Director General of the IoD

PE around a long term, but only came to the fore last year in connection with CG. Last year, large well-known companies were taken over by PE companies. Too many people don't understand what PE is and therefore are very suspicious.

Private Equity managers have a greater degree of involvement in their invested companies. PE are insiders in the companies. They have ownership with an insider status; they are therefore changing the usual relations between board and management.

EVCA shaped European PE code of ethics and governance guidelines. In turn they have been adopted by BVCA and by some 55 other national PE & VC associations.

There is no need to require to companies owned by Private Equity the same governance, accountability, and reporting obligations of listed companies. There is no one fits-all system.

PE is not a uniform sector. It varies just like public equity. Does pressure on short term performance have impact on CG? Still need to make sure all the right processes and procedures are in place.

Far from being "in contradiction in terms", Private Equity can promote Corporate Governance. As poorly governed companies are more prone to failure, Private Equity companies have an interest in enhancing company's reputation and credibility. A private equity firm's reputation will suffer if an investee company in its portfolio becomes embroiled in a CG scandal.

Private Equity is likely to conform and contribute to a positive, efficient and long-term role for the capital markets in financing the amount of investment needed to achieve the Lisbon strategy where innovation and education have a key role to play.

The PE guidelines are more referring to "shareholders-oriented" Corporate Governance than to "stakeholders-oriented" Corporate Governance.

Beside the PE guidelines, and without calling for any additional code, could it be worthwhile to call for other recommendations:

- To ensure effective board and in order for the board to play an appropriate checks and balance, would it be appropriate to call for evaluation of its role?

- Would it be appropriate to call for independent directors?

- Would it be appropriate to mention the importance of the subcommittees' role?

- The risks PEC bring having to be managed, would it be appropriate to call for specific rules in respect of emergency situations?

These are the kind of question the speakers are going to debate on today.

### Short Biography

IoD Director General, Miles Templeman began his career as a marketing specialist and gained his pedigree leading such major consumer brands as Daz, Ribena, Lucozade and then Levi's jeans. He then moved to general management and became Managing Director of Threshers and then the Whitbread Beer Company. He had great success in building those companies, especially with the growth of such brands as Boddingtons and Stella Artois.

He then had a series of non-executive directorships and consultancy roles including Royal Mail, Ben Sherman and Accenture before becoming Chief Executive of Bulmers, which was eventually successfully sold to Scottish & Newcastle.

Alongside his IoD role, Miles is non-executive Chairman of Shepherd Neame, the Kentish family brewer; non-executive Chairman of restaurant chain YO! Sushi; and a non-executive director of Melrose PLC, the buy-out specialist

# Pervenche Berès

Chairwoman of the Economic and Monetary affairs Committee
European Parliament

I would like to thank the European Confederation of Directors' Associations (ecoDa) for this opportunity to address the issue of private equity.

In the current circumstances this discussion is highly topical. Not least because of the involvement of private equity firms in deepening the current disturbances on the global financial markets.

I will try to address whether there is a need for specific corporate governance codes regarding private equity and I will also touch upon strategies and independence under private equity. Finally, I will also look at the issue from the perspective of ordinary citizens as end-investors (via pension funds and similar) and of workers, employed by portfolio target companies of private equity investment.

First, I wish to address the need for specific corporate governance codes. Before giving a firm answer we obviously need to analyse the issues surrounding private equity. You will know that the European Parliament is currently doing so through the Rasmussen-report on private equity and hedge funds. The report is aiming to address all aspects of private equity: the limited partnership of the private equity firm, the activities of private equity funds as well as the portfolio company (target company). It will also examine different roles of different private equity funds ranging from leveraged buy outs (LBOs) to venture capital and expansion capital, which is often used for family owned business.

### Short Biography

Born in 1957, Pervenche Berès has been a Member of the European Parliament since 1994. In the new Parliament elected in 2004, she is the Chairwoman of the Economic and Monetary affairs Committee and a substitute member of the Legal Affairs Committee.

Previously, she was head of the French socialist delegation and vice-President of the Socialist group in the European Parliament (June 1997-June2004). From December 1999 to October 2000, she was the Vice-president of the European Parliament delegation to the Convention in charge of elaborating a European Union Charter of fundamental rights. She was also a member of the European Convention in charge of drafting a Constitution for Europe from February 2002 to July 2003.

Graduated from «Institut d'Etudes Politiques» in Paris, she worked from 1981 to 1988 and from 1993 to 1994 as an administrator in the French National Assembly; from 1988 to 1992 she was an advisor for International and European affairs to Laurent Fabius, Speaker of the National Assembly. Pervenche Berès was also a member of the City council of Sèvres (Département des Hauts-de-Seine) from 2001 to 2008.

It will look into the existing - or non-existing I should sometimes say - legislation at the national and EU level as well as into the existing codes of conduct, such as EVCA work and the conclusions of the UK Walker report.

However, a discussion on whether there is a need for specific corporate governance codes on private equity business is interesting from different perspectives. There is more than one dimension to the discussion on corporate governance in the private equity field:

- at the level of private equity firm,
- at the level of investing (via private equity funds),
- at the level of acting as shareholder of portfolio company (target company),
- at the level of (supervisory) board of the target company,
- at the level of management in the target company.

When it comes to the governance issues of the private equity investment firm improvements need to be made to the following issues:

- operational management of the partnership
- smooth succession, in case of a change in leadership and
- operational downsizing, when there is need to let go some of the partners due to economic reasons.

When it comes to board room strategies and independence, I think it is very clear that too many company directors, manager, chairmen or alike think of their own purse when considering whether to accept an offer or not. If in many cases it is clear that the motivation for selling or buying is not a question of doing good for the company, shareholders or employees. But rather of doing good for the bank account of individual company directors or board members.

*« The fact that there have been so many new and revised codes proposed by different industry associations indicates that there is a problem of compliance!!! It shows that codes and guidelines do not work and that we need something more »*

We should keep in mind that «almost everybody can be bought» and therefore board members and senior executives have to recognise complex multidimensional nature of governance in private equity. Private equity firms and funds drive the corporate agenda in the privately owned businesses all over the world.

Therefore we have to ask the following underlying question: «Are voluntary codes enough to solve the existing issues of corporate governance in private equity business or should we call for action at the national or at the EU level?» In my opinion, private equity firms could start tomorrow by using existing codes as bench marks, if they wanted to. But so far the industry has not been interested. So far the impression that the industry leaves is that it is playing for time. It has been evading action and in the mean time the crisis deepens.

The fact that there have been so many new and revised codes proposed by different industry associations indicates that there is a problem of compliance!!! It shows that codes and guidelines do not work and that we need something more. If the industry is not interested in self-regulation then policy makers will be forced to intervene: either by introduction of a stricter code drafted by policy makers with set compliance deadlines as it has been the case of clearing and settlement, or by immediate proposal for EU level harmonised regulation.

I wish to stress that I am aware that there are number of cases where private equity has helped to turn companies around. I am also aware of the beneficial effects of venture capital for SMEs and technology oriented companies. I also know that several private equity firms have «green» investment strategies. This is laudable and I can only say «More of that».

The question is how we can get more of these sensible private equity investments. I would say through weeding out the «bad eggs» - and also by regulating. We should especially focus on how to increase cross-border availability of venture capital within the EU. Mutual recognition of venture capital regimes as suggested by the European Commission in its recent Communication is not enough and will not enable start-up companies to raise their second round or third round of capital needed to finance their business - which includes often expensive development of new technologies.

Private equity is a growing business and its share of global assets under management has been growing fast in the past decade. Growth in size is commendable of course, but it also means that private equity business has now a bigger impact on the financial markets as well as on labour markets globally and in the EU. And this calls for more responsibility.

You can of course say that it is good that the European Parliament does not have the proper right of initiative. This, and a disinterested Commissioner, will prevent regulation. To my mind you could be very wrong. The current turmoil builds up the political pressure. We have seen that the US is re-thinking its deregulated financial markets landscape and the same goes for many European countries.

*«Self-regulation has already proved not to work»*

A few more cases where it is clear that company directors, board members engage with private equity to fill their own pockets at the expense of workers and retail investors would make the political pressure irresistible. Just think of Northern Rock: it was not nationalised by the UK government and thus not given into the hands of private equity because of the EU but because of pressure at national level.

To conclude: I am a firm believer in Single Market and I am convinced on the basis if my experience with the existing EU level capital markets directives, banking and insurance legislation, that harmonised rules at EU level are mostly the optimal solution and there are fields where such rules would in the end be beneficial for all, for instance regarding incentives for long-term investment strategy or employees share holdings. They provide for level playing field, eliminate problems companies are facing when doing business cross border, enhance financial stability of the EU as a whole and offer end-investors a comparable provision of service and protection.

And if in addition self regulation has already pro
ved not to work, this makes for another reason for a streamlined EU level framework.

# Claire Bury

European Commission
Head of Unit for Company Law,
Corporate Governance and Financial Crime

Short Biography

Claire Bury is currently Head of Unit for Company Law, Corporate Governance and Financial Crime in Directorate General Internal Market and Services.

She was previously Deputy Head of Cabinet to Internal Market Commissioners Charlie McCreevy and Frits Bolkestein.

A UK barrister by training, she worked in the Commission's Legal Service and, before coming to Brussels, in the UK Foreign and Commonwealth Office.

In general, private equity plays a positive role in the EU economy. Its development in the EU improves the range of financing options available to European businesses and expands opportunities for investors. Private equity financing facilitates corporate innovation, company growth strategies and the restructuring of European businesses. This remains the case even in the light of the recent market turmoil and credit squeeze. For the most past, PE investment is considered to have a positive impact on the governance of companies through hands-on, active engagement with management teams.

Commission view is that it is imperative that we promote in Europe high standards of CG - for all companies and all investors - whether publicly or privately owned, whether involving private pools of capital or public funds. Conflicts of interest must be carefully managed on an ongoing basis by all relevant actors. This means controlling in particular potential conflicts of interest among managers, board members and shareholders.
There do not appear to us to be strong arguments for developing specific EU wide CG codes for private equity firms. infoundations, SWFs to name a few). CG issues are best addressed within the framework of existing codes.

Private equity investments are undertaken by a variety of different actors besides only private equity funds (eg banks, institutional investors, foundations, SWFs to name a few). CG issues are best addressed within the framework of existing codes.

In this context it is wise to consider carefully how they apply to governance practices commonly associated with private equity. Ref to OECD work of October 2007. Clear and thorough assessment: most CG issues are not unique to private equity, applicable more broadly to all types of MandA activity.

There is however a need for private equity firms to acknowledge wider stakeholder interest in their activities, business models and investment techniques.

Some actors within the PE industry have recognised this. A number of initiatives have already been undertaken, to improve communication and respond to public interest in this sector. While for some time now the industry has published EU wide reporting, valuation and disclosure standards, these are not well known outside the industry.

The work of the Walker Group in the UK has been a catalyst for some of the most recent development and communication. Representatives of industry here today will certainly set them out in detail and explain how industry players intend to respond to and meet these new requirements. I would be interested to know whether these guidelines can be usefully applied in other EU jurisdictions, or whether other initiatives are being explored.

*«There is however a need for private equity firms to acknowledge wider stakeholder interest»*

Commission welcomes these voluntary, industry-driven codes of conduct on best practice and enhanced industry communication. Market is dynamic – we have all witnessed this especially over the last 3 years. Industry-driven codes are most appropriate at this stage.

# Lutagrt Van den Berghe
Executive Director
Guberna

PE are "by definition" not bad at all, but the sector got into a more negative limelight due to some 'criticised' practices. As in any comparable case of scandals or "bad practices" this often leads to a (public) cry for more regulation and control. The basic CG-principles are relevant for all types of organisations, so also for PE-companies, but there are specific challenges for translating to the different categories of firms. There are very important differences between the different types of PE

*There is a considerable demand to include in governance codes more attention to the duties of shareholders*

(PE as private company, PE as public company, PE investments in listed/public companies versus non-listed/private companies, PE as vehicle for private wealth management versus professional PE firms). There are numerous types of PE according to their investments focus and the type of participation (minority interest, controlling or even majority participation). We should not isolate these type of investors from the others (besides pure PE, what about, portfolio/holding companies, other corporate shareholders, other institutional shareholders, hedge funds, day traders, private individual shareholders, sovereign wealth funds, ….)
Provided a specific code would be required, the main challenge of such Code should cope with the same aspects as any corporate go vernance case. It should develop structu res and processes to direct and control, hereby, fostering perf- ormance and long term business success while at the same time foste ring compliance throu gh sufficient monito ring and control.

It should also build checks & balances, define accountability and transparency (disclosure) needs and, developing an effective board (composition, role, committees, organisation, remuneration, evaluation). Furthermore, it should include the exercise of shareholder rights.

Specific challenges PE firms are faced with are the following:
- How to govern their investee companies? How to exercise their shareholder rights? How to behave as insiders? The Lippens Code devotes attention to majority or controlling shareholders. It makes a distinction between the rights as shareholders in the shareholders' meeting (defend shareholder rights) and the rights/duties as directors (fostering the corporate interest) to ensure a good care of their powerful position.
- Concerning the question of alignment of the interests of PE firms with the strategy and interests of the investee company, the Lippens

### Short Biography

Prof Dr Lutgart Van den Berghe is Doctor in Economics, Ghent University. She is Executive Director and Partner of Vlerick Leuven Gent Management School and head of the Competence Centre Entrepreneurship, Governance and Strategy.

She is part-time professor at Ghent University (domain of corporate governance) and serves as non-executive director in a number of listed and non-listed multinational companies. She has been visiting or part-time professor at the universities of Rotterdam (Netherlands), Antwerp (Belgium), Lille (France), Bocconi (Italy), Vienna (Austria) and at the Georgia State University (USA).
Her research interests focus on corporate governance, institutional investors and financial conglomerates. She functions as Executive Director of Guberna.

Code and Belgian legislation of conflicts of interest (art 523/524) dedicates an important role to independent directors who should focus on the corporate interest. The question of the good willingness of PE firms remains: are they not reluctant in this respect?

- Another question concerns the reference of framework that should be used for listed companies (Lippens Code in Belgium) or/and for non-listed companies (Buysse Code in Belgium)??? However, most if not all, of these reference codes are focused on governing the company not at how shareholders have to exercise their shareholder rights (in other investee companies).

But already, there are quite a number of initiatives to develop specific governance guidance for PE and related type of companies: EVCA guidelines, ICGN principles on Institutional Shareholder Responsibilities, Hermes Principles etc.

SUGGESTION

There is in any case, a considerable demand to include in the governance codes more attention to the duties of shareholders; this demand is certainly driven by the much more activist attitude of certain types of investors (cf hedge funds).

Taken into consideration the increased attention for an eventual separate code for PE and the relevant initiatives in this respect, the two considerations could be combined into an update of the codes on (listed) companies

A Code is certainly preferable over a law, because governance needs tailoring to a firm, its life cycle situation, its shareholding structure, its evolution and the evolution in societal governance demands; only a comply or explain approach is able to offer such a flexible tailoring. However, a Code is only a viable solution if the business practice is adhering to the Code; therefore special attention is also necessary for monitoring how the Code's recommendations are complied with. If compliance is lacking, the route to hard law is often the next step taken.

Javier Echarri
Secretary General
EVCA

Thank you for the invitation, which indicates awareness of organizers of the importance of the PE industry. Unfortunately, the industry is not as well understood as I would wish, especially in terms of its economic and social contributions in Europe.

Before I address the theme of this panel ("Is there a need for specific corporate governance codes regarding private equity?"), I would like to give a brief overview of the contribution of PE to the European economy:

A number of reports recognize PE as a key financial instrument to push for economic development and growth across Europe. A key priority of the Barroso Commission is boosting the European economy by creating the conditions and opportunities for business to flourish in the EU. The Commission has repeatedly referred to VC and more broadly PE as a source for faster innovation and economic growth. For example, in its assessment of Member States' Lisbon programmes, it explicitly urged some Member States to increase the availability of venture capital.

Figures on economic and social impact of PE in Europe:
- 2000-06: €270bn+ invested in 56,000+ companies across the EU
- PE/VC represents 6.5 million jobs in Europe (3% of economically active population)
- 2000–2004: 1 million new jobs created by European PE/VC financed companies
- 5.4% employment growth in PE/VC financed companies per year
- Average employment growth in buyout-financed companies: 2.4%
- Annual employment growth in venture-backed companies: 30.5%
- Annual EU25 employment growth: 0.7%
- 617 companies brought to the stock markets 2000-2005
- According to a Deutsche Bank Research: +0,1% Investments/GDP creates 0,4% additional GDP by VCs and 0,2% for Buyouts

I would be happy to elaborate on this (maybe in the discussion that will follow the panel presentations) but the main focus of this session is the question of a need for a specific governance code for PE.

Corporate governance is essential to ensure accountability in all sectors and generate confidence and trust by employees, customers, investors, shareholders, regulators and the community at large. PE believes in corporate governance and abides to it.

Before I expand on this and on the potential need for additional codes, let me point out that from the outset, the theme of this panel does not specify whether codes should be mandatory (backed by regulation) or voluntary. In the few minutes available to me, I will give you three reasons why additional mandatory codes are not needed:

• PE does not operate in a regulatory vacuum. It already complies with all national and EU laws applicable;

• The PE corporate governance model is an active one, dedicated to raising business efficiency;

• The industry has pioneered the development of voluntary codes (including transparency requirements and disclosure rules) that are applied internationally.

I will now turn to each of these points in further detail.

*The existing regulatory environment for PE:*

As a corporate investor in public and private companies, PE respects exactly the same laws and regulations as any other investor. PE-backed companies are run under EU and national laws when it comes to corporate governance and board management.

PE is regulated nationally in most EU countries. The question as to who is subject to regulation is dependent on the type of legal entity, and either Management Company and/or the PE fund vehicle and/or Senior Management, according to the national legislation in force.

At EU level, PE is subject to a number of Directives, notably on company law (4th and 7th Directives) and in the field of financial services (CRD, MIFID). Again, their scope varies according to the type of investor base and fund vehicle involved.

*Private Equity: a unique business and governance model*

As active owners, PE demands management to be focused on goals. Many deals focus on the acquisition of underperforming companies. This underperformance can often be attributed to share price underperformance, operational inefficiency, inappropriate strategies or balance sheet disequilibrium. Correcting these types of problems is the focus of the PE owners and the management after a deal is concluded. In a word, PE is concerned in competitiveness and productivity – but in an era of not only financial but also economic globalization, in which Europe is regularly singled out for lagging behind, which company (public or private) would not be?

Accusations of “short-termism” have not been substantiated by hard evidence, quite on the contrary. PE deals are only concluded after extensive due diligence and strategic planning of growth prospects and other long-term goals (R&D returns, innovation). This was acknowledged by the already mentioned OECD Steering Group on Corporate Governance. PE has a medium-term ownership focus and long-term investment horizon. Its goal is capital gains for investors, who include pension funds and insurance companies

Since the private equity and venture capital industry is committed to corporate governance, our sector has been a pioneer in drawing up voluntary codes which are applicable internationally:

- EVCA Professional Standards;
- EVCA governing principles; International PE/VC Valuation Guidelines
- EVCA Reporting Guidelines
- EVCA Corporate Governance Guidelines
- New EVCA Code of Conduct/Ethics

The codes cover such areas as valuation and reporting guidelines and corporate governance principles for managing funds, management companies and the portfolio companies. More recently, EVCA has just approved the new Code of Ethics which replaces the current code of conduct. The new Code of Ethics incorporates the high level principles that are common to the different national regulations which govern the private equity and venture capital industry.

Industry codes of best practices are the favored choice of stakeholders, including regulators such as the UK FSA (Walker Report) and the OECD. Regulation is indeed one possibility but not necessarily the best solution in a dynamic market segment, given their reliance on thresholds that are quite arbitrary and hard to modify. On the contrary, codes have the advantage of being the outcome of broad negotiations seeing the participation of all actors involved in/affected by the industry. Furthermore, codes of conducts are by their very nature a flexible instrument and therefore can be adapted to reflect the evolution of a business model in constant flux.

*Conclusive remarks:*

existing voluntary codes are very effective in delivering good governance and socially responsible management policies.

PE is not and should not be above criticism but if we did not have it we would have to invent it. Why?

Because public companies do go into decline for a variety of reasons ranging from weak management to failing powers of innovation to losing touch with the customer's needs. PE investors are dedicated to returning these companies to good health to public equity markets. Their success rate is very high – and more often than not they are the recovery ward for ailing companies. I could mention a flurry of success stories here. We need PE. It makes for a healthier, more competitive job creating economy.


Short Biography

Javier Echarri, joined EVCA, the European Private Equity and Venture Capital Association in 1999 and is its Secretary General, since 2000.

Previously he has held the Retail Banking and Institutional Banking Director positions in charge of EU Institutions at ARGENTARIA bank (nowadays BBVA) from 1995.

Graduated in Economics and Business Studies and holding a post-graduate degree in European Union Economic Integration, Javier has also been Secretary General of the Spanish Chamber of Commerce for Benelux.

His current engagements include non-executive board positions at the European Federation of Junior Enterprises (JADE), the Asia Pacific Venture Capital Association, the buyout firm GED, and the secondary exchange platform Triago X.

## Mark Goyder

Founder Director

Tomorrow's Company

What you have just heard, in the debate between Mme Pervenche Beres and Javier Echarre, symbolises the need to do what Tomorrow's Company exists to do - to create a future for business that makes equal sense to staff, shareholders and society.

We are a business-led think tank. We ask difficult questions of business leaders, and challenge them to come up with answers that make sense in the light of their experience. Our track record in the UK has shown how powerful this process of dialogue and reflection can be: we developed the thinking which formed the basis for "enlightened shareholder value" in the UK's 2006 Companies Act.

Later on we engaged all the major participants in the UK's system of savings and investment in an inquiry which was chaired by Sir Richard Sykes and entitled Restoring Trust, investment in the twenty-first century. This argued that there needed to be a much stronger alignment throughout the investment system between the interests of the intermediaries and the interests of the original investors, saver and policy holders. To underpin this alignment there needed to be much more transparency. The report argued that all investors should have their own ethical code or "Hippocratic Oath" – I still believe that if the investment industry had taken this suggestion more seriously it could have protected itself from some of the heaviest losses it has suffered.

The polarised debate we have heard so far today is an old story. In one corner is business – pointing out that society needs the wealth that business creates but a bit too pleased with itself and not seeming to stay ahead of the expectations of society. In the other corner are its critics, seeing business as predatory, interested only in making money and threatening them with more regulation.

All the time business gives the impression that it is simply interested in making money, society will mistrust it and the regulatory threat will grow and eventually business will be caught up in a fresh round of regulation.

What we need is a foundation for the debate that offers some shared values on which we can all build. Society needs business. Business needs society. Society needs to value wealth creation, and that inevitably means making some individuals wealthy. Business needs to embrace its social role, and show the value it is adding to human wellbeing and demonstrate that it cares about something more than moneymaking.

So what we need in the European Union is a shared vision of business, and of the role that it can and should play, and of the accountability and responsibility that it needs to demonstrate in return.

### Short Biography

Mark Goyder is Founder Director of Tomorrow's Company, not-for-profit research and agenda-setting organisation which he formed in 1996. He has over 15 years management experience in manufacturing industry.

In 2006 he initiated the inquiry on Tomorrow's Global Company. Its findings, published in June 2007, represent the future vision of 11 leaders of global businesses from America, Asia and Europe. A business-led think-tank, Tomorrow's Company is committed to creating a future for business which makes equal sense to staff, shareholders and society. This followed the 2004 publication of Restoring Trust: investment in the twenty-first century (June 2004).

Tomorrow's Company's is now starting a project on «Tomorrow's Owners». A prolific broadcaster, writer and winner of the Institute of Management Studies (IMS) Tillers Millennium Trophy for best speaker, Mark has addressed audiences all over the world.

Mark has been a member of the British Airways Corporate Responsibility Board, the BT Leadership Advisory Panel and the Camelot Advisory Panel for Social Responsibility.

What's more, even the most hard-nosed and narrow business person needs to recognise that it is in their interest to respond in this way. Otherwise what you get is what happened in the USA after Enron a Sarbanes Oxley style backlash.

Private equity does provide a useful function as part of the total ecology of the market economy. It may well be, as the Mckinsey evidence which we quoted in our evidence to the Walker Committee suggests, that only the top 25% of private equity deals really make superior returns to shareholders. It may well be, as the article in the Financial Times of today's date (1 April 08) suggests, that much of the apparent advantage to private equity has actually come through leverage (borrowing more money cheaply) rather than superior performance of the companies invested in. But I know from my personal experience in manufacturing that many a sleepy company has been transformed in performance by a private equity financed management buyout.

*« We would challenge investors to set out their objectives, their timescales, their values, their commitments and then hold them to account in their actual performance»*

So, to answer Claire Bury's question, I am in favour a of a voluntarist approach to the reporting of private equity portfolio companies, as recommended by Sir David Walker for private equity in the UK. The market can then form its own judgements – and so, in time, can the regulators and other stakeholders.

There is a good habit in British corporate governance that dates back to the Cadbury Report. In this pattern the government responds to excesses in the business world by threatening action but first giving the industry time to sort itself out . Business people take the hint: they recognise that their industry has more to gain by staying ahead of the pressure from society – and agree to self-regulate. The rules they create tend to be flexible, often accompanied by "comply or explain". This is accompanied by clear reporting: investors and all stakeholders can judge for themselves, company by company, what efforts are being made and whether they are enough.

But for this to work there is one vital condition. Codes need to operate flexibly in the language of values, not prescriptively with imposed indicators. Business needs to be challenged to say what its values are even if it is left with some flexibility to report on its adherence to those values. This is far more powerful than instructing business to report a list of centrally imposed indicators. Regulation using the language of values and creating reporting and accountability against those values gets values into the bloodstream and leaves companies some freedom of expression.

It forces companies to say if, and in what way, they are interested in doing more than simply making money. Regulation which just imposes indicators without stimulating a dialogue around the values of a company requiring offers no such benefit. Reporting against indicators while saying nothing about your values is an exercise in compliance. Corporate Responsibility should be about conviction, not justcompliance.

So in companies owned by private equity as elsewhere
we should challenge investors to set out their objectives, their timescales, their values, their commitments and then hold them to account in their actual performance.

At the same time I am with other speakers in arguing that there can be conflicts of interest in private equity that need special attention. The interests of the general partners (the people who put the deal together in the first place, and are effectively paid a management fee as well as the capital gains at the end of a successful period of management) are not the same as the limited liability partners – other investors who agree to join them. There needs to be complete transparency in publishing who all the investors are, what they stand to gain over what time horizons and what may be their special interest in achieving particular deals. All parties, from investors, to workers to customers, need to know where they stand and who they are dealing with.

This is an issue which is of concern to our friends at Universities Superannuation Scheme in the UK, and I know Daniel Summerfield had been hoping to be here today to make the point that we need to ensure that limited liability partners enjoy full access to information about who all the other parties in the deal are and what they stand to benefit from it.

The point that we need to ensure that limited liability partners enjoy full access to information about who all the other parties in the deal are and what they stand to benefit from it.
Sometimes in these debates it is very tempting to generalise about a whole asset class.
We should not fall into this trap. If a company has big public impacts, its reporting responsibility should be set accordingly, whether it is quoted on an exchange or family owned or owned by a group of private equity companies.

The truth is there are many different sorts of behaviour manifested by private equity . It is not that helpful to single out private equity. We seem to have had a series of witch hunts against asset classes. First it was the evil of hedge funds. Next it was private equity. Now it seems to be overseeing wealth funds. This is an unproductive debate.

Ownership is changing as capital markets become more global . What matters is that there are some responsibilities which fall upon owners. We need to work out what these responsibilities are. Tomorrow's Company is now embarking on a new study entitled "Tomorrow's Owners" which will be business-led, and which is.
I invite all of you who care about these issues to engage with us in making sense of the changing nature of ownership in a global economy.

## Dominique Tessier
Independent Advisor

*« all shareholders should have the same right to information ! »*

*Is there a need for specific Governance codes in companies sponsored by Private Equity ?*

A somewhat controversial context

I would first of all, like to inform you on my personal experience. I sit in 3 company boards. In the first one, Private Equity Funds altogether hold a majority. In the second one, PE holds a minority share and the third one is privately owned but is on its way to increase the equity and invite PE Funds. These are (still) medium size companies.

In all companies, may they be publicly or privately owned, central governance rules are/should, in my personal opinion, (be) the following:
- board members should only care for the company's interest and not for an individual shareholder
- all shareholders should have the same right to information !

In France, two kinds of board exist: supervisory board (SB), or « classical » board of Directors (BD). Funds often prefer SB as they see them as a way not to have their responsibility engaged in the event of bankruptcy. In such an event, the split between control (SB) and management (the operational team) is clear… but this does not in itself lead to good Governance as Funds have many ways to put managers under pressure.

It is obvious PE Funds interest's carries out on short term rather than long term, but being forced to rapidly sort out short terms issues is not in itself a negative aspect (I have experienced that when running companies myself).

From my personal experience, I believe there is a risk, PE Funds protect their private interest more than the company's. In particular when a funding issue is at stake (especially if that happens when the PE Fund is approaching the end of its life cycle). This risk is even higher when PE funds have a majority share in the company, and in the board.

How can we ensure good Governance?

To begin with, we should have independent directors (both from the operational management and from the Funds) on the board is a key to balance the risks, but it is not an easy life ! Why is not easy?

*« independent directors are seen by the management more as a lobby tool to help developing the company's business, than as a lver for good governance»*

First of all, independent directors are seen/chosen by the management more as a lobby tool to help developing the company's business, than as a lever for good Governance. (Lobbying for the company is not an issue, provided that it does not become their only role, and that the split is very clear with their role as board member).

Secondly, PE funds do not hesitate to try to influence independent directors when a board decision may have an impact on their own interests

This brings me to remind you some rules that have to be respected:

- independent directors must really be independent ! Hence, they need to be well aware of the major issues of the company and of its stakeholders – and this takes time !

- all shareholders are entitled to the same information
- when an independent director spends a significant part of his time on lobbying or helping on operational issues, this must be compensated in a specific (and auditable) way
- when an independent director helps on an operational issue, he/she must stick to the rule, that the company's management, makes the decision
- a funding decision must be thoroughly documented (auditable)

This job, as described above, really needs these rules of common sense to be respected.

Should we have specific corporate governance codes, should they be enforced ?

A minimum set of rules should enclose the following elements:
- have one or several independent directors;
- make sure they are independent /PE Funds, and have access to all relevant information
- PE funds, if key shareholders, should be on the board, and they must respect the principle according to which, the board is a team dedicated to the best decision making, in the company's interests
- if independent director do more for the company, it must be recognised in a specific way.

At this stage, my position is to prefer an approach recognising and fostering best/better practices, to legal enforcement

- Should a comparison be made with the Quality approach: It doesn't dictate a set of procedures, but it makes sure some procedures exist and that their efficiency is regularly measured, or in other words, that the company is run by these findings.

- have a regular measurement of how Governance rules are respected or not

- consider wether this measurement should be done by an external independent body (as in ISO) ?

- a list of items that should be assessed, specific to companies owned by PE Funds, to check could be proposed by the Regulator or by the national « IFA like » association.

For instance:

- does the company have one of several independent directors?
- Which information is being regularly distributed to all shareholders ? do you see this as guarantying equal access to a relevant information ?
- how has the company managed Equity increase discussion if any?
- by whom should the corresponding report be signed? should it be joined to the yearly company report ?

Short Biography

Dominique Tessier is graduated from the Ecole Polytechnique, postgraduated in Engineering and holds a Ph D in Applied Maths. He started his career at the Ministry of Transportation and Housing reaching the Deputy CIO position in 1984.

He then was CTO and Development Manager at Communication-Developpement SA, and successively Managing Director of LOCSTAR, CEO of MATRA SECURITE of the LAGARDERE Group and Director of the SEMA GROUP TELECOM.

From 2000 to 2006, Mr Tessier was Managing Director of TELINDUS France as well as its Vice-President.

Currently, he works as an independent advisor and independent director of three ICT companies – focusing on strategy consulting, business development and plans improvement.

Frédéric de Laminne
Director Issuers & Listing
Nyse Euronext

Boardroom strategies and independence under private equity

There are numerous conflicts of interest in a boardroom and it is never easy to avoid them. I have tried to find a few examples that have are linked with the exit and the remuneration of the shareholders.

1°) Differences in tax situation can alter the appetite for dividends

The tax system can influence the appetite of investors for dividends or for capital gains. Physical persons or corporate x may have diverging tax treatments. Or there could be differences between domestic and foreign investors.

2°) Differences in historical price can also influence the exit strategy

Even between similar investors, the same proposition can be viewed as attractive or not according to the historical price: I remember a case where several VC had participated in several rounds of financing for a high tech company. When a take-over proposal came from a larger competitor, those of the VC who had a low historical price were more eager to accept than those who had invested at another moment (and at a higher price): they wanted to wait for a while as the offer was not as high as their entry price.

3°) Conflict concerning a possible IPO

Another potential conflict could be the way to exit: for instance, the members of the founding family who are active in the management of the company could prefer an IPO to a trade sale because they will keep their job.

On the other hand, the VC may prefer a trade sale as they will get the opportunity to exit at once: in the case of an IPO, they will usually not get the opportunity to sell all their shares at the IPO price… And nobody knows in which circumstances they will be able to get rid of their shares six months or one year later, once he lock-up clauses will elapse…

I was told recently about another kind of conflict between shareholders linked with a possible IPO: It's a highly attractive company owned let's say at 60 % by its founders and managers and 40% by VC. There is a discussion concerning the next round of financing: the financial investors are ready to provide the company with the money needed to finance the growth. Indeed, they want to keep the largest part of a very promising company. On the other hand, the founders and the management don't have enough money to keep the control of the company: so, they would prefer the company to go public in order to remain the dominant shareholders and because they expect a higher visibility for the company.

*«There are numerous conflicts of interests in a boardroom»*

What can be done to avoid such conflicts?

I think part of the solution could be found right at the moment of the opening of the capital, when the VC (or in general when investors who are not part of the founding family) enter into the capital. It is highly advisable that the new shareholders announce their preferences and their long term objective. If the founders or the managers/shareholders want the company to go public, they should require from the new financial partners that they will not oppose it.

Speaking of the payment of dividends, the shareholders can agree on a dividend policy even when the company is not profitable yet. For instance, the shareholders can decide that, once the company is profitable, or after retained earnings reach some specified level, the company should aim at a payout of X %.

*«can PE get the rewards of a good strategy without taking the risks of being a board member?»*

Why don't people clarify the situation before the conflict arises?

Part of the difficulty is that we are living in a rapidly changing world and it is never easy to anticipate how the situation will or can evolve. So, perhaps some time should be spent in writing several scenarios in order for each party to clarify what he would favor.

Another difficulty is linked with the complexity of the opening of the capital of a company: most of the times, it takes months of negotiations and weeks of due diligence before a deal can be reached. So, the parties may neglect to put into the agreement elements that will only happen perhaps only years after.

However, I suspect several conflicts could have been avoided if the parties had agreed on their common LT objectives beforehand.

Other conflicts of interest: The responsibility of board members: can PE get the rewards of a good strategy without taking the risks of being a board member? I think no: as they are part of the shareholders, they should also take their part of the responsibility and, with the same reasoning, I would argue against the presence of the lenders in the board because I suspect they have an interest in a very safe strategy in order to minimize the risk.

### Short Biography

Graduated from ULG in Civil Engineering, from the Cornell University (NY) with an MBA and from the Solvay Business School, Frédéric de Laminne has worked 15 years for the General Bank occupying several positions such as Senior Financial Engineer, Senior Corporate Finance Officer and Manager in Corporate Research.

In 1999, he co-founded E-Capital, a venture capital fund and since 2003, he is the Director for Issuers Relations and Listing at Nyse Euronext.
Frédéric de Laminne is a very active individual, speaker in several seminars and a lecturer in many academic and professional frameworks, he is also Member of the advisory board of a head hunting company, and Member of the European Advisory Board of Cornell.

## Miles Templeman

Chairman of ecoDa

Director General of the IoD

There are similarities between family companies and PE companies, but differences in the way they operate. In both cases, "Comply and Explain" should be the motto.

Miles currently chairs a family company and is also chairman of a PE company which has just been sold very successfully. The question of exit is always hanging in the air with PE owners, which just means ownership is going to shift. Two forces of very long term family company and a five year horizon of public company are similar issues.

Appropriate and well run incentive schemes tend to raise performance. Well run but comfortable family run company needs more incentivisation and perhaps aggression.

Miles Templeman is an independent chairman in both of these examples. He is neither part of PE nor part of management. In both circumstances, the role of independence is important.

PE company and portfolio company are slightly different in terms of CG, but transparency remains fundamental.

Conflict of interest can occur and it is not always easy to reach all shareholders with the same message. In one of these companies - YO! Sushi - the initial investors were 3i. YO! Sushi was poorly managed at the start; it was bought at cheap price. Now it has just been sold very successfully by another PE to become more international. Corporate governance is now very strong. Conflict of interest did not occur because shareholders were kept informed. Providing the same information to all shareholders is not always true or possible in family companies.

## Raf Moons

Senior Investment Manager
Fortis Private Equity

A first point I would like to make when presenting the PE view on board room strategies is; Yes there exits an obvious difference between public equity and private equity, but there is also equal difference between private equity and private equity. PE exists in so many flavors that it is hard to catch under a single head. PE refers as well to venture capital as to management buyouts. And board strategies will of course differ whether a PE player is a minority investor in a consortium with other PE funds (which if often the case when financing biotech or ICT ventures) or whether the PE investor is the majority shareholder, holding a stake of over 80%, which is typically the case in a management buyout.

If we now focus on this specific sub-sector of management buyout, in which a PE firm becomes majority shareholder of a company via an MBO transaction.

Then, I would like to point to 2 elements which characterize a PE firm as board member.

### Short Biography

Raf Moons has been working for Fortis Private Equity since 1999. As senior investment manager, he acts as a Board member in several high-tech spin-off companies and is actively involved in managing university linked seed capital funds. Prior to his career in venture capital, he served as an industrial advisor at the business development group of IMEC and as a scientific researcher at the university of Leuven. He holds a PhD in physics and a MBA (Leuven).

*«board strategies will of course differ whether a PE player is a minority investor or wether the PE investor is the majority shareholder»*

1. PE board member executes an in-depth due diligence process of the company prior to becoming a board member
2. Before joining the board, legal documentation has been signed (shareholders agreement, byelaws, warrant plans, management contracts, and contract with bank and mezzanine providers) and all these agreements are drafted in such a way that they perfectly align the interest of the different stakeholders involved, with basically the single objective: shareholder value creation on the mid-term.

I would like to address these characteristics in more detail:

Because a recent study by McKinsey showed that is that the real – and often overlooked source of success in PE is the not price arbitrage (buying low, selling high) but the superior PE governance model.

First in-depth due diligence on all possible business aspects (market, competition, production, IP, investment plan, …) in which a PE firm engages a group of external consultants.

When joining the board of directors the PE firm will implement the results of this due diligence over the holding period of its investment. An intermittent due diligence will be ordered to update the findings in the first due diligence. The PE board member does not only - in a reactive way – comments and criticize business plan proposed by the management. A PE board member will – in a proactive way – draft-up own business plan in close concert with the management of the company.

The interest of the different stakeholders (shareholders, management, lenders, …) are aligned as stipulated in the shareholders, management and lenders agreements. All these agreements have been negotiated an agreed prior to joining the company.

To summarize, as the McKinsey study clearly showed that top-quartile PE firms conduct deep research into the company's prior to investing and taking up a board seats, moreover top private equity firms seem more committed to effective oversight of their investments And high levels of compensation both for management and investors are only achieved if substantial shareholder value has been created on the mid-term. So, not on the short term (quarter by quarter, as is the case in public quoted companies) but along the usual holding period of a PE investment (i.e. 5 years).

# Daniel Melin

Director, Air Liquide Welding
Former Director of Arcelor

There is no need for a special governance code for a company held by PE as long as the PE fund does respect the elected board.

But it is right the management of a company  the main shareholder of which is a PE – minority or majority player – is significantly different.

Come back to the basics : why do we need governance rules in a company – public or private - ?

CG rules are needed to be sure that interests of all the shareholders and even more all the stakeholders are fully taken in account and all the stakeholders are fully informed about strategy of the company.

Generally speaking management is under control of the PE fund, which tries to get privileged information through formal or informal ways, but it could accept, as long as PE fund plays a full part as a member of the board and the other board members share the same information with the other shareholders.

The most important stakeholder in a PE company , among those coming from a LBO, are the lenders – the banks - . The lenders through the covenants drive the management quarter by quarter... And as of today, it is unusual to see the lenders sitting at the board

we have a lot of examples of decisions taken by the management to fulfil covenants : divestitures, cost cutting on long term projects...We can accept what is part of the game for an LBO company, but I am not sure such decisions are taken by the board in full respect of corporate interests . The lender has its own road map “avoid a payment default” and tightly drives the management at short range, and the board which is in charge of corporate interests usually drives the management on longer term view.

The solution for more transparency is not to suggest a special CG code, but to ask the main creditors to sit at the board to share the same information with the other members.

It is obvious that some conflicts of interest might arise but it would be a significant move for the benefit of all the stakeholders.

### Short Biography

Graduated from Ecole Polytechnique (X64) and Ecole des Mines, Daniel Melin started his career working for GAZ DE FRANCE and the SAINT-GOBAIN group.

He has been CEO of CELLULOSE DU PIN and ran flat glass operations of SAINT-GOBAIN. He also was acting as SCNEIDER’s group Executive Vice President.

In 1995 he takes up SAINT-LOUIS’s group CEO position and chairmanship. In 1998, he is President of BSN, part of the DANONE group and founds EMADYS, a consultancy company acting in corporate strategy. In 2002, he is brought to run the southern European operations of EDS (Electronic data sytem).

Daniel Melin was a board member in ARCELOR until 2006 and is currently member of the board of  AIR LIQUIDE WELDING.

## Tom Palmberg
Chartered Director

From a Nordic viewpoint regulatory measures regarding private equity are not to be considered necessary. The corporate laws direct shareholdings in such a way that no extra regulation is needed. I quote the new Finnish corporate law:

«All shares shall carry the same rights in the company, unless it is otherwise provided in the Articles of Association. The General Meeting, the Board of Directors, the Managing Director and the Supervisory Board shall not make decisions or take other measures that are conducive to conferring an undue benefit to a shareholder or another person at the expense of the company or another shareholder.»

This law pragraph would leave little leeway for minority abuse and minority shareholders should be given fair treatment even in a situation where all shares in the company might not carry the same rights. In most cases a company acquired by a private equity firm has, as minority shareholders, the management of the company. This would certainly also prevent the majority investors (the private equity firm) from acting in an unduly fashion. Hence, additional regulation is considered unnecessary.

There are similarities between a family company and PE. Owners expect annual returns. Owners should be more interested in putting competence in boards. We sould emphasize the quality criteria concerning board compistion.

### Short Biography

Having finished his studies at Helsinki University (MsocSc) in 1967 Tom Palmberg had a long career in banking and finance. Having spent 15 years at Union Bank of Finland (1967-1982) he joined Scandinavian Bank Ltd in London in 1982. He was promoted to CEO-Banking at the listed Scandinavian Bank Group Plc in London 1987. From then on and during the 1990ies he participated in establishing and managing a number of finance-related companies in Finland.
Having been among the first to pass the Chartered Director exam at The Institute of Directors, London in 2000 Tom Palmberg has concentrated the activities of his company CV Board Ltd on corporate governance and board development issues. Mr. Palmberg is currently a director of four Finnish companies. He is a founding member of the association Hallitusammattilaiset ry (The Finnish Association of Professional Board Members) and has been its chairman since the establishment in 2001. Mr. Palmberg is also a frequent lecturer at corporate governance and board related seminars and conferences throughout Europe. Since October 2005 Mr. Palmberg is a member of the Board of The European Confederation of Directors´ Associations (ecoDa) of which organisation Hallitusammattilaiset ry became a member in October 2005.

## Miles Templeman

Chairman of ecoDa

Director General of the IoD

Further regulation is not the answer. Rather than separating out, transparency is the key. There is a need to recognise broader stakeholder groups, environmental concerns, CSR, etc. PE mustn't ignore broader responsibility. In the UK, leading PE companies tend to keep their heads down until the storm blows over, which isn't the correct approach. We can't avoid public scrutiny. It's important to get PE business to come out and talk more positively about what they're doing. We need to recognise there is a strong body of opinion in the European Parliament and that we have to get our action order.