» TOP STORY

Breaking new ground
Even with the notorious EMI investment lurking in its portfolio, Terra Firma, with charismatic front man Guy Hands at the wheel, is showing no sign of taking its foot off the pedal.
Tuesday, 18th August 2009

» LAW
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The near collapse of the banking sector in 2008 has led to significant ongoing restructuring and M&A activity among the UK's largest financial institutions. The many reasons for its near demise have been widely discussed, and in late July, Sir David Walker released his much-awaited report looking at the issues that have troubled the beleaguered sector. The report makes various recommendations about what measures should be put in place to prevent a future repeat of the banks' brush with institutional failure.

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The report calls for bank directors to have "greater skills, more experience and demonstrable independence". It also emphasises the need for boards to be equipped with the right skills, and for investors to be "active and engaged in scrutinising business strategy". Additionally, Walker recommends that non-executives reduce the number of appointments they take on and spend 50 per cent more time getting to know the businesses they work with. Other recommendations include that non-execs should systematically challenge chief executives to stop the institutions from assuming too much risk, and from paying top bankers excessively.

But despite the report's proposals, there is conflicting opinion about what measures should be put in place. For example, Keith Boyfield, chairman of the Adam Smith Institute's regulatory evaluation group, has called for a return to old-style boardroom structures for investment banks (where partnership arrangements meant that it was the board's own money they were risking). Yet we at Crelos, a UK-based business psychology consultancy, believe that returning to old-style boardroom structures would be a step backwards, and could result in more harm than good.

While it would be wrong to suggest that it was the lack of skills of some high-ranking bankers which was wholly responsible for the predicament that the UK (and indeed global) banking system found itself in, Crelos believes that a complete overhaul of the way management and boards are appointed and evaluated is required.

LEADER

The confidence trick

There has been a change of guard in this year's 20 Most Influential. Following a survey of over 500 industry professionals – who were asked: "Who is really wielding the power in European private equity?" – Stephen Schwarzman, David Bonderman and 2007's top dog Damon Buffini have nosedived into obscurity, while political movers and shakers from around the world are now dominating an industry in flux.

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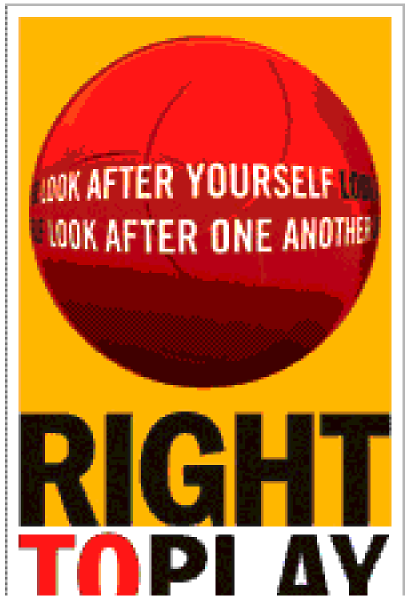


Now more than ever, in a very busy M&A climate, we believe that it is crucial to perform science-based due diligence on management teams. Some 40 per cent of a company's superior return on investment – and 35 per cent of its income growth – stem from the strength of the chief executive and the management team, yet they are rarely fully professionally assessed to ensure they are capable of delivering. Indeed, at this level, many non-executive directors are still "recruited" via the old boys' network. Currently, the number of chief executives removed from businesses for poor performance is around 35 per cent a year.

Crelos believes that a combination of Sir David Walker's recommendations, and yearly rounds of science-based due diligence of management teams running investment banks and financial institutions, would ensure that they are more appropriately skilled to take these institutions forward.

Crelos and the Institute of Chartered Accountants in England and Wales have just released the first ever set of formal guidelines on performing management due diligence – "Due Diligence: The assessment and development of management teams" – specifically designed for investors, private equity houses and venture capitalists. The guidelines explore how modern business psychology practices can be used to select a board and top team that are fit for purpose, and use Crelos's precise psychological measurement model, which can predict the performance of management teams.

FEATURE

20 most influential 2009

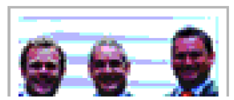
After 12 months of unprecedented financial turmoil, we polled 500 of the industry's top names to provide a definitive list of the most powerful people in European private equity.

COMMENT

Dawn of the dumb

The soaring size of private equity funds – and transactions – and the resulting reliance on commoditised deal flow may have been an inevitable evolution for the industry, but could also have spelled its undoing.

NEWS ANALYSIS



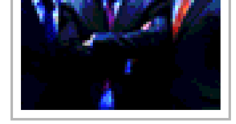
Close Growth Cap team spins out

There is a widely held myth that it is difficult to “prove and measure” the capability of a management team. However, the precision of the psychological measurement of people, organisations and performance has evolved immensely over the past ten years. This should be good news for corporate financiers and investors, who can now use such techniques to greatly enhance the predictability of business performance.

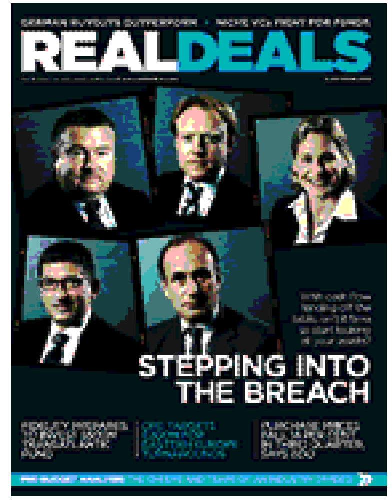
Crelos’ measurement model provides a precise assessment of management teams using proven psychological tools and techniques, leading to investors understanding how the members of the management team will behave in
a wide range of different future situations. The model also provides team development road maps and actions tightly woven into the business plan, thereby helping to significantly enhance the management control of the business, underpin the investors’ decision-making and deliver significant returns on investment.

To be successful, boards need to be schooled in the behaviours required to effect proper strategic or “integrated thinking”. This requires them to truly understand the mental processes and necessary behaviours to maximise the intellectual horsepower of the group. A proportion of any board’s time should be committed to enhanced awareness of inadequacies, weaknesses and strengths.

Using its expertise in team dynamics and behaviour, and drawing from the information generated during the assessment phase, Crelos enables boards to make use of the assessment data and learn to interact in a very efficient manner, so as to turn the team into a high-performing one.



The management team of Close Growth Capital Partners has completed a spinout from parent group Close Brothers to form Growth Capital Partners.



interact in a very efficient manner, so as to turn the team into a high-performing one.

In the past 12 months, Crelos has noticed a timely increase in the number of companies requesting professional assistance with management due diligence, particularly from the banking sector.

While it is the responsibility of the board to choose non-executive directors with the right mix of skills and abilities, research shows that they are often appointed because of who they know, and because they may already have a non-executive position. However, this might not be in the same sector. In order to truly know whether boards have the right mix of skills, they need to be thoroughly assessed by an independent third party at least every other year.

Sir David proposes that non-executives should work 30-36 days per year. We would propose that eight of these should be dedicated to the purpose of review and active development.

Ali Gill is chief executive of Crelos.

SECTOR REPORTS & SUPPLEMENTS