
Renaissance Directors:

Reinvigorating Public Companies

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Executive Summary

Over the past few decades, the public company has generally been regarded as the optimal corporate ownership structure, in particular in the US and the UK. It offered ready access to capital for business, provided an assurance of good governance for investors and represented an attractive proposition for top talent.

In recent years the public company model is now increasingly being challenged. Investors and other external stakeholders are questioning how productive its governance and leadership is, shaken by corporate failures during the financial crisis and beyond.

The continued growth in CEO pay is also attracting political ire. Boards and executive teams, frustrated by the growing bureaucracy of public company governance and the emphasis on quarterly earnings, are attracted by the more driven nature of alternative ownership models such as private-equity backed businesses. Meanwhile, the expansion of alternative sources of finance, including cheap debt and the growth of sovereign wealth funds, make business less reliant on the equity markets.

Evidence of this growing questioning of the public company model is clear. Activist investors have grown from an occasional US phenomenon to a staple feature of the North American and European corporate scenes. Fewer businesses are coming onto the public markets, preferring other forms of investment.

And more mature businesses are moving into PE ownership. We do not believe that the decline of the public company model is inevitable or indeed desirable; well-run public companies are a fundamental part of the economy.

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But they need to rediscover their true purpose of creating long-term value, for the sake of both investors and their broader stakeholders; they must recapture the 'owner's mind-set' with which they were originally created.

So what should public companies do? In seeking to develop an agenda to drive

their revitalisation we drew not only on our own experience of seeing businesses in action, but also on the insights of directors who have operated in a range of ownership models: we spoke to over 70 chairmen, board directors and business leaders, with extensive experience on boards of different public and private businesses around the world.

The models we explored included:

- Listed public companies
- Private equity
- Entrepreneurs/families
- Sovereign wealth funds
- Public/government sector
- Mutual societies

We have also reviewed a range of existing studies and data published by consultancies, academics and commentators.

The message from these discussions was clear: while no ownership model is perfect or leads intrinsically by itself to superior results, public companies would benefit from infusing the best elements of other board models – in particular PE portfolio companies and family/founder-led businesses – in order to help restore a value creation orientation.

For example, well-run PE portfolio company boards have clearer objectives, a sharper edge when creating value over the medium term and a stronger alignment of objectives between management and owners. Family and founder-led companies tend to have a longer-term approach to value creation, entrepreneurialism and innovation, as well as a balanced sense of responsibility across a broad range of internal and external stakeholder groups.

These other models can also have real downsides and risks. Public companies should not seek simply to replicate fully how they operate. Nevertheless, we believe that board directors should concentrate on five principal

areas which would reinvigorate the public company model's ability to create value:

Public companies would benefit from infusing the best elements of other board models – in particular PE portfolio companies and family/founder-led businesses

- Recapturing the right equilibrium with regard to the time and nervous energy expended on value creation versus stewardship.
- Actively shaping the investor base better to align shareholder and business objectives.
- Explicitly recruiting 'renaissance' board members – individuals with experience operating in a variety of ownership models.
- Breaking the cycle of the 'capital markets circus', such as quarterly reporting and PR-led IR strategies.
- Changing how (and potentially how much) independent directors are paid.

The declining saliency of the public company needs urgently to be addressed and boards need to work actively to reinject an owner's mind-set into their business. We believe that this agenda can help stimulate the desired changes.

1. Findings

1.1 The public company model: under increasing scrutiny

In the second half of the 20th Century, the public company model was widely seen as the optimal business structure, particularly in the UK and US. For business owners, it guaranteed access to equity capital at attractive rates; for investors, it provided a reassurance of high standards of corporate governance and the ability to trade freely in the stock; and for the best business leaders, it offered attractive and fulfilling roles that brought with them the highest levels of respect.

The public company model expanded over this period. The number of public companies in the European Union increased just over 6,000 in 1975 to more than 10,500 in 2001 and in the US from under 3,000 in 1975 to 8,000 in 1996.¹

However, in recent years, stakeholders on all sides have become increasingly dissatisfied with the model.

Investor and stakeholder dissatisfaction

Investors – and broader stakeholders, including politicians and the media – have had their confidence shaken by corporate failures, most obviously in the financial crisis of 2008-9 but also more broadly. There are few sectors that have not seen high-profile cases where businesses have run into unexpected problems, been forced to restate their profitability or address serious conduct issues; nearly 60% of the FTSE 100 has a business leader being

investigated over conduct questions. Extensive efforts to improve corporate governance around the world have introduced valuable changes, including the growing separation of the chairman and chief executive roles, having a majority of independent directors and professionalising their role. However, there are still too many occasions when boards have not anticipated or prevented major crises.

Equally, there is growing dissatisfaction in many quarters with boards for not driving change at the pace required – and with the inability of an increasingly fragmented investor base to exercise sufficient influence

to encourage better performance. This has led to a surge in activist investors, not only in the US but increasingly in Europe too. According to *Activist Insight*, 842 companies worldwide received public demands in 2016, up from 198 in 2010.

Activists, described by one interviewee as “*the sex and violence of the public markets*”, who lobby hard for radical actions to create short-term shareholder value, may or may not strengthen the long-term health of the company. Nevertheless, they are undoubtedly a symptom of significant investor frustration with the leadership boards are providing.

Despite the scrutiny of remuneration committees, disclosure, investor engagement and votes on remuneration policies, boards are criticised for failing to control executive pay. Since 2002, the average ratio of CEO compensation to average worker income has more than doubled to 150 times, while pay levels have risen by c.250%, a number

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¹ Data from the World Bank: EU 6,141 (1975) to 10,529 (2001); US 2,670 (1975) to 8,090 (1996)

considerably out of line with all underlying metrics of business and share price performance.

Board and executive frustrations

At the same time, board directors and senior executives have become increasingly frustrated by many elements of how the model has come to work – in particular, the increasing impact of unproductive governance requirements, the difficulty of engaging constructively with investors and the short-termism endemic in the markets.

An (at least partly) unintended consequence of attempts to improve governance is that the expectations of, and burden on, boards has grown dramatically. This has led to more board committees, ever-lengthier board packs and more time devoted to governance. Regulation and disclosure requirements have expanded, as shown in the length of annual reports; a Deloitte study in 2015 showed a 50% increase on average over the previous decade from 85 pages to 130. At the same time, reporting has become harder to interpret and decipher.

In particular in financial services, but increasingly in a wide range of regulated industries, independent directors are increasingly held accountable for activities and outcomes that in reality they cannot control, and should not be trying to as they are clearly management's domain.

At a minimum, these governance tasks absorb too much time and attention, while distracting boards from driving business growth and shaping strategy. Too often, they engender a regrettable yet entirely understandable tick-box and risk-averse mind-set, whose main purpose is to avoid errors and protect the board from criticism. For many boards, governance is stealing the oxygen from debate and sapping its nervous energy. Directors are no longer so emotionally invested in value creation; instead they prioritise corporate governance.

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As one director put it: *“For some public companies, post financial crisis there is a greater emphasis on independence, which is great; however, now non-executive directors are so independent that they risk becoming irrelevant... We need to bring a shared passion for supporting the long-term development of the group back to the boardroom”.*

Boards are equally frustrated by the challenge of engaging constructively with their investor base.

Independent directors are increasingly held accountable for activities and outcomes that in reality they cannot control

The fragmented ownership of public companies has become more pronounced, with the continuing rise of passive and index funds. Boards have to deal with investors with sometimes contradictory objectives, time horizons and desired levels of engagement.

It can at times be nigh on impossible to discern a clear and aligned sense of what shareholders want. Moreover, boards often hear conflicting messages from the same investor: fund

managers often have different priorities from their governance colleagues. Indeed, passive investors are increasingly expressing themselves through proxy or outsourced voting services such as ISS and PIRC, which prioritise conforming to governance expectations over value creation. One interviewee complained that *“the likes of ISS and PIRC are becoming ever more influential, but for them it’s all about box-ticking, with no focus on performance.”*

Finally, boards and executive teams are constrained by the quarterly earnings cycle. Quite apart from the time this absorbs, it too often leads to managing and delivering against short-term expectations – to avoid dramatic share price swings and the substantial media attention that can accompany even modest shortfalls in performance. Fund managers can appear far more interested in these short-term results (and on the short-term impact on the performance of their own funds, and hence their own personal incentives) than on whether the business is making the right choices for long-term success and value creation.

The declining appeal of the public company model

Investors and other stakeholders are frustrated by not being able to drive the performance that they want from public companies; and boards are equally frustrated by their inability to engage constructively in the task of long-term value creation. In this context, Lord Myners’ characterisation of public companies as *‘ownerless corporations’* portrays accurately the frequent lack of alignment and direction.

Thus the public company becomes a less attractive environment in which to operate.

This observation may seem curious at a time when public markets stand at all-time highs. However, the prolonged economic and market growth cycle since March 2009, partly created by the QE-fuelled money supply chasing fewer good investment opportunities and inflating valuations, has arguably flattered the underlying real value and productivity in public companies.

Between 1997 and 2012, the number of public companies in the US and the UK almost halved – down 38% and 48% respectively

Several indicators illustrate the shift away from the public company model:

- Between 1997 and 2012, the number of public companies in the US and the UK almost halved – down 38% and 48%, respectively.
- There were 2,590 companies listed on the LSE’s markets at the end of 2016. This compares with 3,141 in 2006.²
- The annual number of IPOs in the US declined from an average of 311 from 1980 to 2000, down to 99 for the period from 2001 to 2011.³
- The value of late-stage technology companies in the US and Europe has soared to nearly \$500bn, a fivefold increase in the last four years, according to an index compiled by Scenic Advisement, a boutique investment bank.
- There were just 25 tech sector IPOs in 2016,

² LSEG annual reports (2006 and 2016).

³ The Economist, 19th May, 2012.

down from a peak of 254 in 1999.⁴ These high-growth tech companies are generally staying private for longer than their predecessors, as there is no incentive to cede control if they can raise funds privately.

- Assets owned by PE houses rose from \$465bn to \$2.4trn globally in the decade to 2015.⁵

An ever-growing number of chairmen, non-executive directors (NEDs) and executives – often those with the strongest record in value creation – are choosing to eschew public companies in favour of private ones. *“I have more impact, have more fun and make more money on private company boards,”* observed one seasoned Director.

**“I have more impact,
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majority of companies are well-governed, by boards of directors who fulfil their responsibilities with assiduous care and increasing professionalism. As one CEO of a public company, with a controlling family interest, acknowledged, *“Being public brings valuable discipline; we’d have sloppier governance otherwise”*.

Moreover, each ownership model has its weaknesses – a conclusion supported by the vast majority of our interviewees. One commented that *“all forms of ownership can work well – it comes down to people, modus operandi and behaviour.”* Nevertheless, other models do offer important strengths from which public companies could learn.

Cheap money

These trends partly reflect the fact that historic low interest rates and an over-inflated money supply have turbo charged alternative sources of finance. Capital from PE, sovereign wealth funds and inexpensive borrowing has made funding more plentiful. It has accelerated the prevalence of alternative ownership models to the public company and their ability to attract the most talented executives. Such companies represent an ever-expanding proportion of the economy.

1.2 The strengths of alternative models

There is no doubt that the public company model retains many advantages. The vast

Private equity

There is a wide range of practices observed in PE portfolio company boards – reflecting the scale and nature of the businesses owned, the preferences of relevant general partners and indeed the skills and style of the individual partners involved. Some are led extremely well; others are not. Nonetheless, the private equity model engenders five frequently observed advantages.

Aligned focus on value creation

PE portfolio company boards are naturally aligned with value creation. All parties – the limited partners (fund investors), the general partner (PE manager), the board members and the executive team – share the same objective: to maximise the equity value of the company at exit. This shared objective is reinforced by incentives. Not only the top executives but also

⁴ Financial Times, 23 February, 2017.

⁵ Financial Times, 23 February 2017.

any independent NEDs will typically have real 'skin in the game' through material levels of sweet equity, while the PE partners are incentivised based on the 'carry' generated by the deal, as well as usually having investments in the underlying fund.

The model ensures a strong owner's mind-set that underpins all discussions. One chairman and director with experience of public, family and PE companies concluded: *"All models have advantages and disadvantages. But, in general, private equity is a superior model, due to the clarity on value creation and alignment of incentives between investors, private equity firm managers and company managers."*

A medium-term focus

PE-backed businesses have a single-minded approach to maximising value at exit and are relatively indifferent to short-term performance, provided that they are confident that progress is being made. They are free of the tyranny of quarterly results and the temptation to manage to them, instead being willing to make investments with an immediate cost, but a clear mid-term pay-off. One Director who has worked extensively on both public and PE boards commended how the latter *"have no need for applause every quarter and take a 3-5 year view."*

Real strategic clarity

PE portfolio boards are also often characterised both by greater clarity on strategic and performance priorities. This is partly driven by the 'event-based' nature of PE investments: the due diligence process drives deep business understanding and forces the creation of a

concrete business plan, while the fact that all non-executive board members largely join at the same time encourages a shared plan. The post-acquisition model is disciplined: a rigorous indicators (including cash-based metrics) intensively scrutinised at all times; and sense plan formed in the first 100 days, with concrete improvement initiatives; the careful definition of a suite of key performance of urgency engendered by the commitment to exit and the awareness of the 'cost' of time on internal rates of return.

Committed and engaged board members

PE board members invest more time than public company directors do. Our earlier research suggested that the typical time commitment for independent NEDs is over 50 days per year, twice the norm in non-banking FTSE 100 businesses. This extra time is used outside of formal board sessions, working with management where the directors have expertise; they are usually seen by the executives as a resource to be leveraged, rather than a burdensome intrusion to be managed. One PE CEO described his Board members as *"much cheaper and much more valuable than any consultants I could use."*

Only as much governance as necessary

PE portfolio boards spend more time on value creation. The best-run businesses set aside as much time as is needed to governance through audit and remuneration committees, drawing explicitly on practices from the public company world – but no more.

They carefully and deliberately devote a higher proportion of their formal board meetings to

strategic shaping and performance management; in our previous research on this topic, 90% of PE boards listed value creation as one of their top three priorities versus only 25% of public company boards.

As one director with experience of public, PE and family companies put it:
“Private equity chairmen and board directors commit far more time than those in plcs – and 80% of their time is spent on the business and value creation discussions. The amount of governance in plcs squeezes out business focus.”

One chairman and director with experience of public, family and PE companies noted: *“All models have advantages and disadvantages. But, in general, private equity is a superior model, due to the clear focus on value creation and alignment of incentives between investors, private equity firm managers and company managers.”*

Nonetheless, the PE model is far from perfect. While it is longer term in perspective than the typical public company, there is little incentive to be concerned about what happens to the business after exit. Boards quickly assemble the right top team, but often show little interest in building the talent pipeline. Aggressive financing structures and high leverage can make companies vulnerable to changes in business cycles, or give them burdens that restrict their long-term flexibility.

Family and founder-backed companies

No one would argue that all family businesses

are well-run and well-governed. Common problems take a variety of forms. There may be competing objectives from different branches of an increasingly diffuse family or disruptive family dynamics, with personal and professional tensions getting blurred. There is a real risk of a lack of meritocracy in appointments, undermining the appeal to the best talent.

There can be complacency and lack of performance edge – family-owned businesses often do not have to answer to outside shareholders and activist investors. There may also be a conservatism and

defensiveness about the legacy portfolio: once ownership passes beyond the first generation, entrepreneurial drive can fade.

Conscious of these dangers, the best run founder-backed and family companies have sought to adopt and adapt features from public company governance, including having independent directors and board committees. However, when run well, such businesses can offer valuable lessons for public companies. Four lessons stand out:

Entrepreneurial energy and an owner’s mind-set

On successful family company boards, all directors – non-executive as well as executive – bring an owner’s mind-set to the table. While they want to control risks, they have a deep-rooted commitment to value creation; it is, after all, the family’s wealth that they are managing. *“They have a different attitude to risk: in some respects, they’re risk averse but also willing to move quickly and decisively on*

“Private equity chairmen and board directors commit far more time than those in plcs – and 80% of their time is spent on the business and value creation discussions”

occasion,” concluded one director of public and family companies. They seek not only to sustain and channel the original entrepreneurial energy that led to the creation and initial success of the business but also to manage resources carefully. They acknowledge that they are spending their own money. It is no accident that entrepreneurs and families can be notoriously frugal on advisers’ fees.

Genuine long-term focus

Whereas public companies concentrate on quarterly reporting and PE portfolio companies focus on the lifecycle of their investment, family companies may think about the next generation. They possess what investor Tom Russo terms both “the capacity to invest” and “the capacity to suffer” – the hallmark of firms taking a longer-term view of value creation. *“In public companies, management can be tempted to look for the easy way out; in family companies, they position the business for the long-term,”* suggested one Chairman.

They can find it easier to make the right investments radically re-shape portfolios and take a counter-cyclical view. *“Family companies ensure a long-term perspective. They don’t underspend to hit quarterly earnings expectations. But you need a ‘good’ family,”* concluded one interviewee.

“In public companies, management can be tempted to look for the easy way out; in family companies, they position the business for the long-term”

“The capital has a face, opinion and personality and it cares, really cares”

Commitment to all stakeholders

Family businesses tend to take a broader view of their stakeholders. Public company boards sometimes simply try to meet the needs of the shareholders (arguably wrongly as a powerful recent HBR article outlines)⁶ while PE-backed businesses are often narrowly seeking to maximise equity value at exit. Yet family companies (like mutual societies) tend to consider a range of stakeholders, including their employees, the health of the communities where they operate, the customers they serve and other broader obligations.

“There’s a real sense of responsibility for the business and its people, as well as a commitment to CSR,” observed one experienced director.

Deep-rooted focus on brand and reputation

In a similar vein, family-controlled companies are usually more sensitive about ‘reputation’, especially when it is their name above the door. They care more deeply about what it said about them as they have a heritage to protect and a legacy to bequeath. This can lead to a deeply ingrained sense of values. As one leader of a family financial holding company said, *“the capital has a face, opinion and personality and it cares, really cares!”*.

⁶ Harvard Business Review, May-June 2017.

2. Recommendations: Reinstilling an owner's mind-set into public companies

As frustrations with the shortcomings of the public company have grown, politicians and commentators have increasingly threatened to intervene to improve the model. Most contributions propose more regulation or further governance prescriptions: ideas floated in the UK have included adding worker representatives on boards, making shareholder votes on pay binding and moving to investor-led nominations committees.

We strongly believe that more governance is not the answer; indeed, it will exacerbate the problems. Instead, the emphasis needs to be on reinjecting an owner's mind-set into boards and changing the way they behave.

By drawing on the examples set by some of the best PE-backed and family businesses, boards can help reignite the impetus for value and growth. We suggest five principal inter-related themes:

2.1 Restoring the right balance between value creation and stewardship

Boards must carefully and deliberately increase the time spent on the activities that truly underpin value creation: shaping strategy, challenging performance and succession planning. Independent directors should be there to ask the right questions, provide sage guidance and mentor management.

This is, of course, easier said than done. But chairmen – with the help of their board company secretaries – need to re-examine with a critical eye how boards spend their time, both

in individual meetings and across the year. Their purpose should be to actively rebalance their efforts.

This will involve simplifying the way in which they manage governance activities, as well as managing routine agenda items crisply and 'by exception'. They should adopt an investor's asset allocation approach to monitor how the time is allocated. Their targets should be a 70/30 ratio of time on creating value vs governance.

Streamlining governance is the beginning, however, not the full answer. Regular two-way strategic dialogue, value-adding performance scrutiny and insightful succession planning require that the core NEDs invest more time in those areas – as they tend to in PE-owned businesses. Non-executives who also have executive roles may find this too burdensome and boards should embrace a greater divergence in the time individuals can devote, rather than managing to the lowest common denominator.

Savvy investors understand this: one leading active investor observed:

“Plcs should learn from family companies and explicitly reject the pressures of quarterly reporting...”

“We always look for two to three directors who are really driving the company and understand capital allocation.”

At the same time, public company boards can explicitly learn from private companies' readiness to suffer short-term pain, for medium and long-term gain – and be more willing to support management in making the longer-term value creation case to investors. *“Plcs should learn from family companies and explicitly reject the pressures of quarterly reporting. They should act as if the owners are in the room,”* summarised one director.

Where boards are finding that they are unable to maintain the 70/30 balance in the use of board time, then the executive should be asked to revisit what and how they present to the board. The Chairman should work closely with the board secretary and general counsel to see what can be done to redress this balance without creating undue risks.

2.2 Recruiting 'renaissance directors'

When constructing their boards, chairmen should explicitly seek to bring in 'renaissance directors', i.e. individuals with experience of different ownership models such as PE-backed businesses. There is a growing cadre of such directors who have assembled portfolios across a range of different board ownership structures.

These directors bring invaluable diversity of perspective and can serve to promote greater cross-fertilisation of insight. *"It is invaluable to have directors who have served on several boards, and beyond that under different models,"* noted one of the most experienced chairmen around. *"It helps to stimulate a pick and mix debate; what are the best elements we can take from different environments."*

Such directors can serve to rebalance the debate and help the board to use different ownership lenses to challenge the strategy and priorities. Boards should ask: What would a PE

"It is invaluable to have directors who have served on several boards, and beyond that under different models"

Boards should actively build a share register that will reinforce their long-term strategic aims

owner or activist do and what can we learn from that? What would a family owner do? These questions serve to challenge group think, inject a stronger external perspective and help to rebalance the emphasis towards long-term value creation and how to have a positive impact on all the stakeholders. Directors who have operated under the different shareholder models are able to bring these perspectives from their other experiences and suggest realistic and practical improvement.

2.3 Actively shaping the investor base to get register the business needs

Rather than simply seeking to broaden demand for their shares and hence raise their share price in the short-term, boards should actively build a share register that will reinforce their long-term strategic aims. They should reduce and consolidate the number of shareholders where possible and actively seek like-minded anchor investors. They will then be in a better position to move forward with a common purpose. Where there is a serious misalignment of objectives, addressing this should be a greater priority.

In practice, this means concentrating on securing 'long-only' active investors and explicitly seeking major investment from 'patient' sources of capital, such as sovereign wealth funds, major pension funds and family investment offices. With a core of investors with a longer-term horizon, plc

boards can rebuild a genuine strategic dialogue with engaged owners and gain confidence that sustainable value creation will be supported.

As one interviewee with experience of PE, family and public boards argued: *“As chairman of a public company, I want to introduce the entrepreneurialism, innovation and long-term view of a family business. It would certainly be easier with an anchor investor.”*

Another observed that: *“For companies with long R&D cycles, to have a strategic shareholder is invaluable; if you have 15-year product cycles, it helps to have a core investor with a matching time horizon for realising value.”*

This is undoubtedly toughest to achieve in the UK context. *“The UK has the most fragmented shareholder base of any market,”* explained one chief investment officer. *“The regulatory environment doesn’t encourage it. Because all shareholders are treated equally, it’s not worth having the illiquidity of 10% ownership as it brings no advantage of more information.”* Moreover, the models of ‘A’ and ‘B’ class shares that are found in Europe and in Silicon Valley, giving enhanced power to founders/families or long-term investors, are at odds with the UK Corporate Governance Code.

Nevertheless, boards can do more even in the UK to shape their register – and Chairmen should also seek to re-open the debate on

changes that would better promote and reward long-term share ownership.

2.4 Breaking the cycle of the ‘capital markets circus’

Too often, the agenda and thinking of public company boards is overly influenced by external advisers – investment bankers, remuneration consultants or PR/IR consultancies. Directors need to regain the confidence to take greater control of their advisers (as is the norm in PE and family businesses), rather than to hide behind them. This is what they were appointed to the board to do: to bring high-level judgement, borne of experience.

“If you have 15-year product cycles, it helps to have a core investor with a matching time horizon for realizing value”

“If public company directors were spending their own money, they’d be much more challenging on the fees they pay to advisors”

In practice, that raises a number of challenges. It means being constructively sceptical about the ideas on acquisitions, disposals and funding brought by investment bankers, given their vested interest in generating fees – and, indeed, being prepared to push back on established fee norms where these don’t seem justified. *“If public company Directors were spending their own money, they’d be much more challenging on the fees they pay to advisors,”* suggested one interviewee.

In remuneration, it means not following the herd and choosing ‘best practice’ orthodoxy just because it is the easiest option. The tangled web of ever-more complicated remuneration schemes, perpetuated by remuneration

consultant industry, has done nothing to solve the perceived excesses of executive pay. Indeed, greater transparency and endless benchmarking has served to ratchet pay up; it has led to one-size-fits-all models, following the fashion of the day.

Boards should instead go back to first principles, identify the behaviours and performance that they want to incentivise and construct policies that meet their specific needs. They should embrace the challenge of selling differentiated approaches to investors, recognising that not everyone will agree with them, and be unafraid of getting ‘only’ 80% approval for a scheme they believe is right. Boards should challenge the 90% voting requirements of governance teams now, before it is too late. Chairmen should seek to influence investors to return voting rights to the fund manager, away from the governance teams.

Finally, they need to prevent investor relations deteriorating into exercises of public relations and expectation management, preventing analysts and fund managers from engaging constructively with boards. Boards are too complicit in this merry go round and should make braver choices on what reporting activities they engage in.

2.5 Changing the way that NEDs are paid

Finally, we believe it is time to rethink how NEDs are rewarded. There is a wide range of fees in different markets around the world, as well as differing practices on the balance between fees and shares.

For example, the average basic fee paid to FTSE 100 NEDs has only edged up by less than 10% from 2011 to 2016 to £66,000, even though the demands on NEDs have increased dramatically. While these NED fees may seem attractive to the man in the street, there is no doubt that current UK public company remuneration reflects neither the increased amount of work involved with being an NED, nor the risk.

In particular, the additional fees available to committee chairs remain modest, compared to the additional workload and responsibility required. There are, indeed, striking differences in NED remuneration in key geographies, which reflect historical levels far more than roles and workloads (and are seemingly unquestioned by international investors), as the table overleaf shows.

As a result, an ever-increasing number of highly qualified potential directors choose to devote their time and energies elsewhere, where the risk-reward balance is more attractive.

We are not advocating simply paying NEDs more, but rather more clearly differentiating based on time committed and performance. We agree with one activist investor who argued for a much stronger differentiation in pay levels across the board: *“I would compensate the real engine drivers an order of magnitude more than the other members who are more like administrators,”* he suggested.

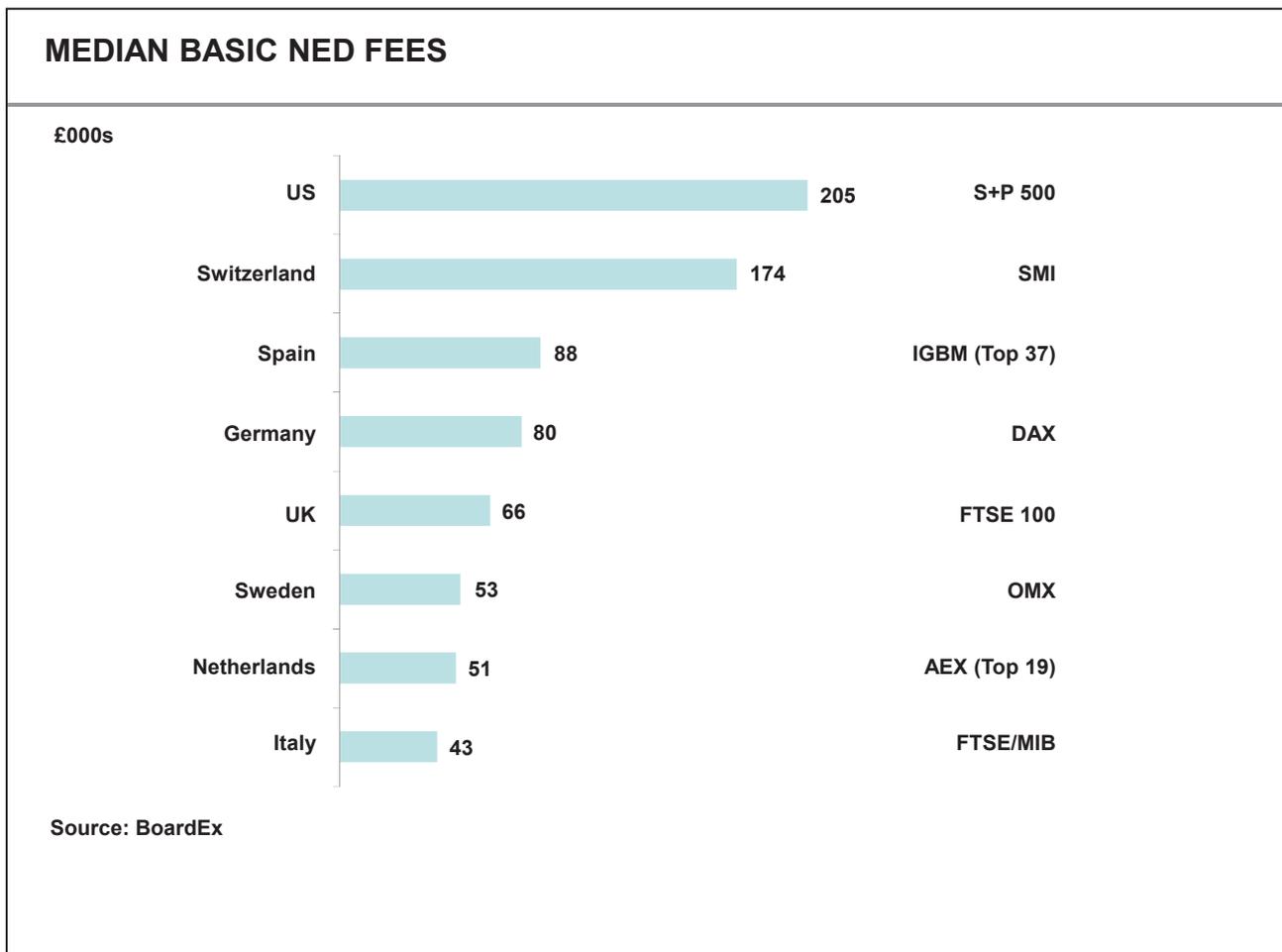
Moreover, it may be worth re-examining how NEDs are rewarded. The UK Corporate

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Governance Code explicitly prefers directors to be paid in fees, on the legitimate basis that this retains their independence.

However, if boards are to recapture an owner's mind-set, then we believe that paying NEDs a material part of their fee in shares is critical to providing them with the aligned incentive to

improve a company's fortunes. This is standard practice in the US, where on average over 60% of a NED's fee is paid in shares. Their remuneration should reward courageous behaviour that drives value; otherwise, the risk is that boards become dominated by the administrators concerned with risk avoidance and does not encourage calculated risk takers that create value.



Conclusion

Capitalism, democracy and societies need value-creating public companies to thrive. Yet, while the model is far from irrevocably broken, real fault-lines are increasingly clear. The answer does not lie in more prescriptive governance codes; instead individual boards must have the confidence and courage to take

the lead and do what is required to re-inject a stronger owner's mind-set and value orientation into their businesses. This is a complex and challenging task – but we believe the five recommendations outlined represent an excellent platform for discussion to stimulate the changes that are ever more pressing.

About MWM Consulting

MWM Consulting is a leading Board advisory and search firm. Founded in 2004, we act for a number of the largest companies in the world, both in the UK and internationally.

In the UK, we have supported the appointments of 15% of the current FTSE 100 Chairmen and CEOs; 40% of our work is for similar global enterprises based outside the UK and over the last two years we have worked with clients in markets across North America, Continental Europe, Asia, Africa, Latin America and Australasia.

This research was led by two of our team:

Michael Reyner joined MWM Consulting in 2007 and leads Board and Executive search work with top international clients across a wide range of sectors, for both public and private equity backed businesses. Before MWM, Michael was at McKinsey for 15 years where he was one of the partners leading the European Consumer practice.

Richard Phillips joined MWM Consulting in 2004, having previously worked in the Board Practice at Whitehead Mann. He has 20 years' board and executive search experience, acting for several of the world's leading enterprises across a diverse range of sectors and ownership models.

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