

ARE PRIVATE EQUITY OWNED FIRMS BETTER MANAGED?

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Nick Bloom (Stanford & Centre for Economic Performance)

Raffaella Sadun (Harvard Business School & CEP)

John Van Reenen (Centre for Economic Performance & LSE)



CENTRE *for* ECONOMIC
PERFORMANCE

MOTIVATION

Private equity (PE) ownership is common in the UK and US, and increasingly so in Europe and Asia.

One view of this is that PE firms undertake financial engineering to increase profits with little 'real' improvement

A second view is they do improve firm productivity, but only by improving allocations of labor/capital (e.g. spin-off assets)

A third view is they improve productivity also through better **management practices**

We investigate the third claim using new survey evidence on over 4,000 manufacturing firms across Asia, Europe and the US

SUMMARY OF RESULTS

We find three main results:

1) PE owned firms are:

- **Significantly** better managed than those owned by government, families, founders and private individuals
- Better managed than those owned by dispersed shareholders (but not significantly so)

2) PE owned firms have almost no “tail” of badly managed firms

3) PE owned firms are:

- good at people management (hiring, firing, pay and promotions)
- even better at operations management (lean manufacturing, continuous improvement, processes, etc.)

These results suggest PE ownership is *associated with* broad based improvements in management practices (selection issues)

OUTLINE

1. “Measuring” management practices

2. Differences across countries

3. Are Private Equity firms better managed?

4. Selection issues

THE SURVEY METHODOLOGY

1) Developing management questions

- Scorecard for 18 practices (monitoring, targets and people)
- ≈45 minute phone interview of manufacturing plant managers

2) Obtaining unbiased comparable responses (“Double-blind”)

- Interviewers do not know the company’s performance
- Managers are not informed (in advance) they are scored
- Run from LSE, with same training and country rotation

3) Getting firms to participate in the interview

- Introduced as “Lean-manufacturing” interview, no financials
- Official Endorsement: Bundesbank, Treasury, & RBI, etc.
- Run by 51 MBAs types (loud, assertive & business experience)

MONITORING - e.g. *“HOW IS PERFORMANCE TRACKED?”*

Score

(1): Measures tracked do not indicate directly if overall business objectives are being met. Certain processes aren't tracked at all

(3): Most key performance indicators are tracked formally. Tracking is overseen by senior management

(5): Performance is continuously tracked and communicated, both formally and informally, to all staff using a range of visual management tools

Note: All 18 dimensions and over 50 examples in Bloom & Van Reenen (2006).

PEOPLE – *e.g. DEALING WITH POOR PERFORMERS*

Score

(1) Poor performers are rarely removed from their positions

(3) Suspected poor performers stay in a position for a few years before action is taken

(5) We move poor performers out or to a less critical role as soon as a weakness is identified

OUTLINE

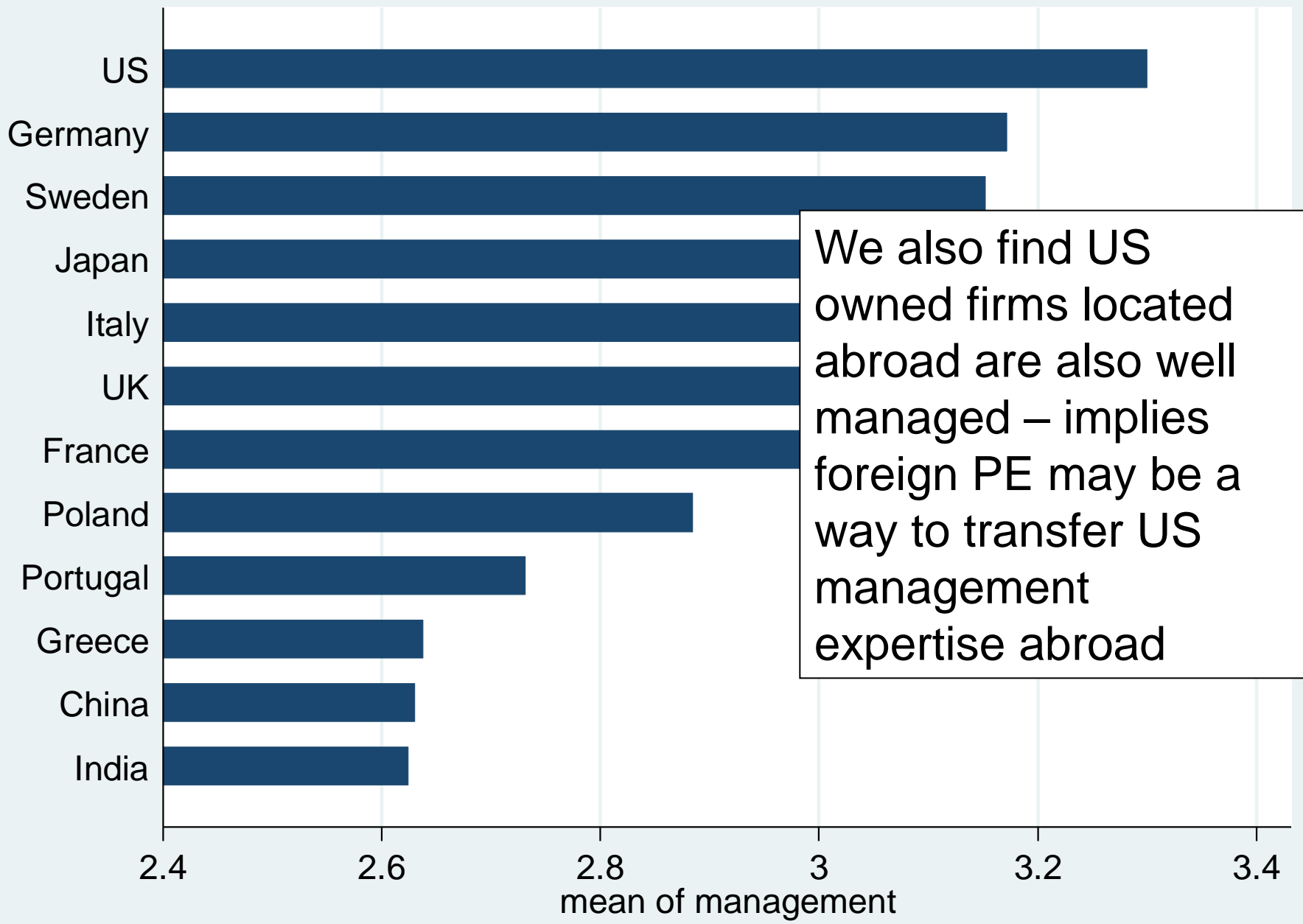
1. “Measuring” management practices

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COUNTRY LEVEL MANAGEMENT SCORES



We also find US owned firms located abroad are also well managed – implies foreign PE may be a way to transfer US management expertise abroad

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Private equity owned firms have the best raw management practice scores on average

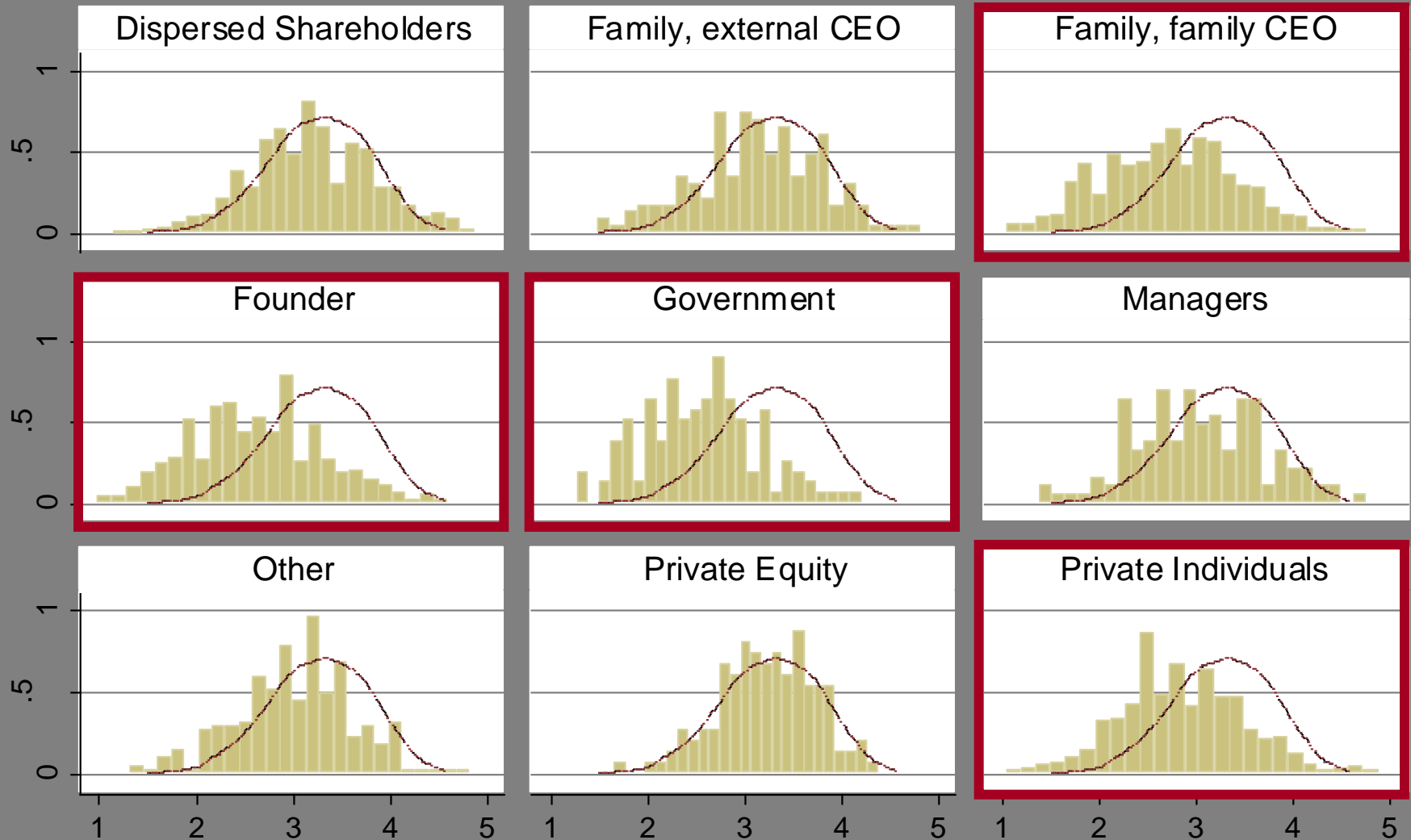
Average score on 18 management practice questions



Note: Sample of 4,221 medium-sized manufacturing firms. The bottom bar-chart only covers the 3696 firms which have been in the same ownership for the last 3 years. The "Other" category includes venture capital, joint-ventures, charitable foundations and unknown ownership.

Private equity owned firms high average scores reflect their small “tail” of badly managed firms

Distribution of firm management scores by ownership. Overlaid dashed line is the PE kernel density



Note: Sample of 4,221 medium-sized manufacturing firms.

PE Not just incentive – PE associated with Particularly Strong Operations Management

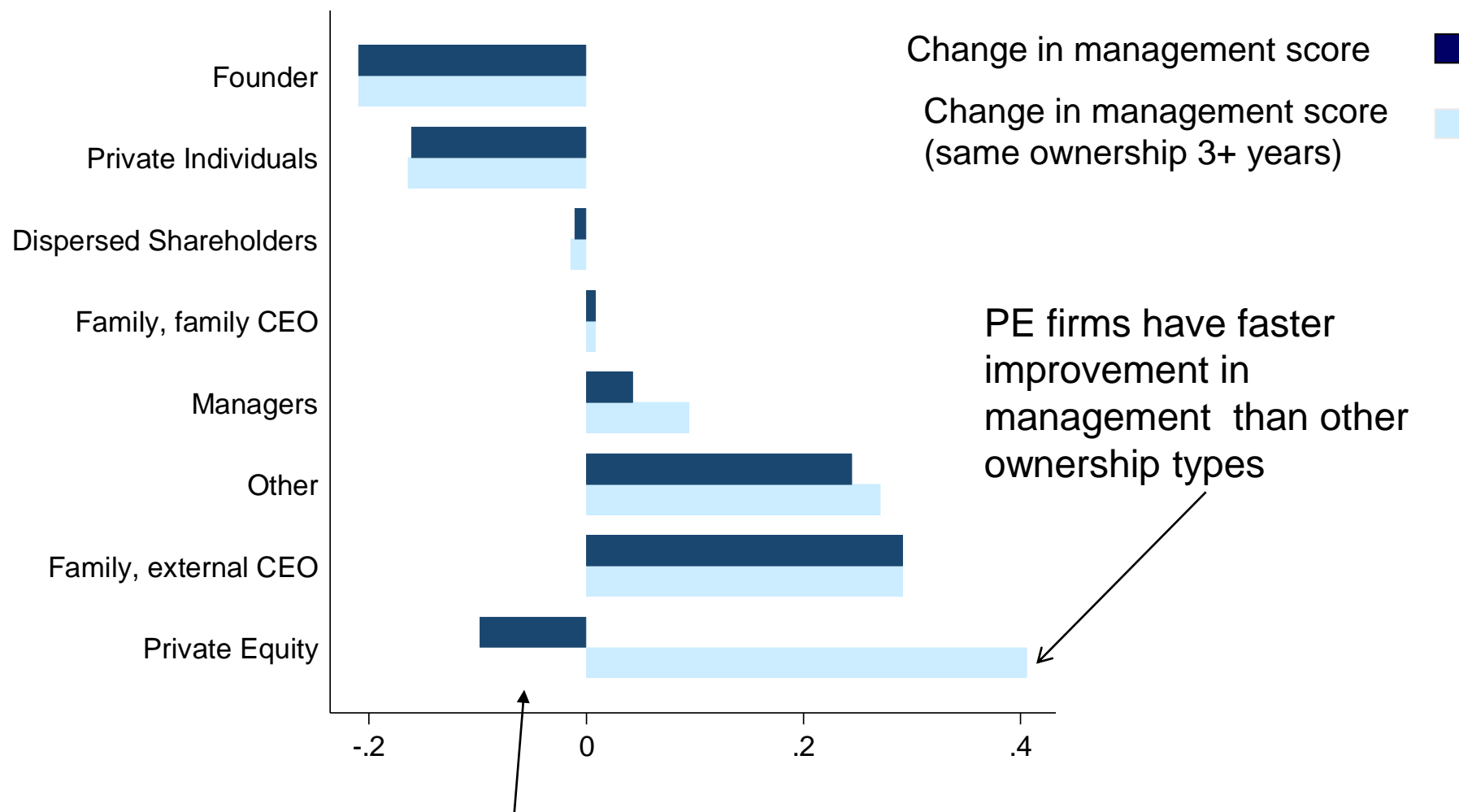
Dependent var is: (normalized to SD=1)	Operations Management		Targets Management		People Management	
PE Ownership	0.454***	0.163***	0.239***	0.138**	0.196***	0.108*
Country dummies	NO	YES	NO	YES	NO	YES
Industry dummies	NO	YES	NO	YES	NO	YES
Firm & plant size	NO	YES	NO	YES	NO	YES
Noise Controls	NO	YES	NO	YES	NO	YES
Observations	4081	4081	4081	4081	4081	4081

Note: Baseline is non-PE ownership. Standard errors are robust. All dependent variable management practice scores are normalized to have a standard error of 1

OUTLINE

1. “Measuring” management practices
2. Differences across countries
3. Are Private Equity firms better managed?
- 4. Selection issues**

Private Equity firms have greater improvements in management practice over time



Firms with deteriorating management are more likely to be taken in to PE

TO SUMMARIZE

- Robust methodology for measuring management practices across firms and countries
- Find three interesting results
 - PE firms are better managed than firms owned by Government, family, founder and other private individuals (but similar to those with dispersed ownership)
 - PE firms have almost no tail of badly managed firms
 - PE firms are particularly strong on operations management

Quotes:

MY FAVOURITE QUOTES:

The difficulties of defining ownership in Europe

Production Manager: “We’re owned by the Mafia”

Interviewer: “I think that’s the “*Other*” category.....although I guess I could put you down as an “*Italian multinational*” ?”

Americans on geography

Interviewer: “How many production sites do you have abroad?”

Manager in Indiana, US: “Well...we have one in Texas...”

MY FAVOURITE QUOTES:

The traditional British Chat-Up

[Male manager speaking to an Australian female interviewer]

Production Manager: “Your accent is really cute and I love the way you talk. Do you fancy meeting up near the factory?”

Interviewer “Sorry, but I’m washing my hair every night for the next month....”

MY FAVOURITE QUOTES:

The traditional Indian Chat-Up

Production Manager: “Are you a Brahmin?”

Interviewer “Yes, why do you ask?”

Production manager “And are you married?”

Interviewer “No?”

Production manager “Excellent, excellent, my son is looking for a bride and I think you could be perfect. I must contact your parents to discuss this”

BACKUP SLIDES

TARGETS - e.g. "HOW TOUGH ARE TARGETS?"

Score

(1) Goals are either too easy or impossible to achieve; managers low-ball estimates to ensure easy goals

(3) In most areas, top management pushes for aggressive goals based on solid economic rationale. There are a few "sacred cows" not held to the same rigorous standard

(5) Goals are genuinely demanding for all divisions. They are grounded in solid, solid economic rational

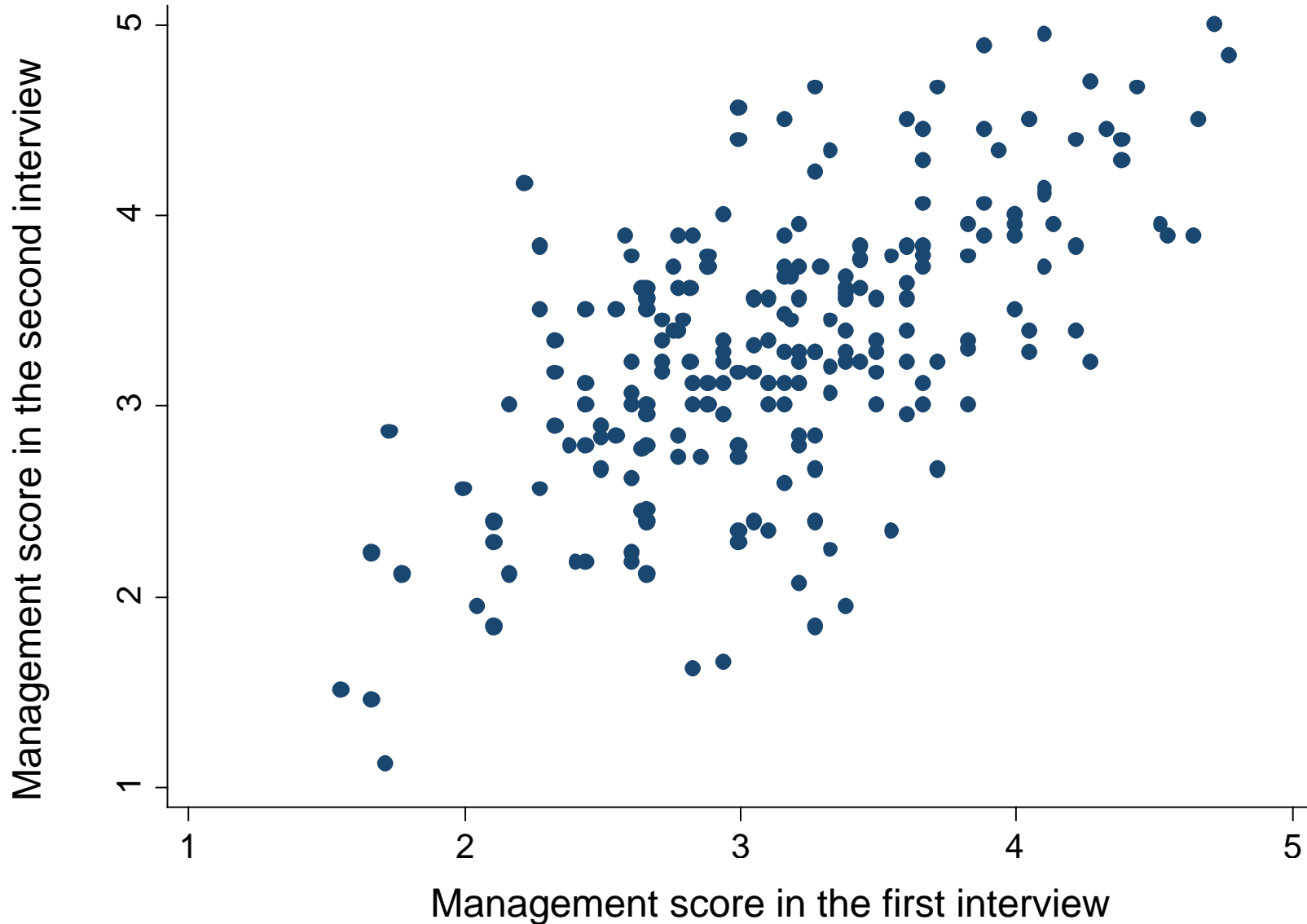
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INCENTIVES - e.g. “HOW DOES THE PROMOTION SYSTEM WORK?”

Score	(1) People are promoted primarily upon the basis of tenure	(3) People are promoted upon the basis of performance	(5) We actively identify, develop and promote our top performers
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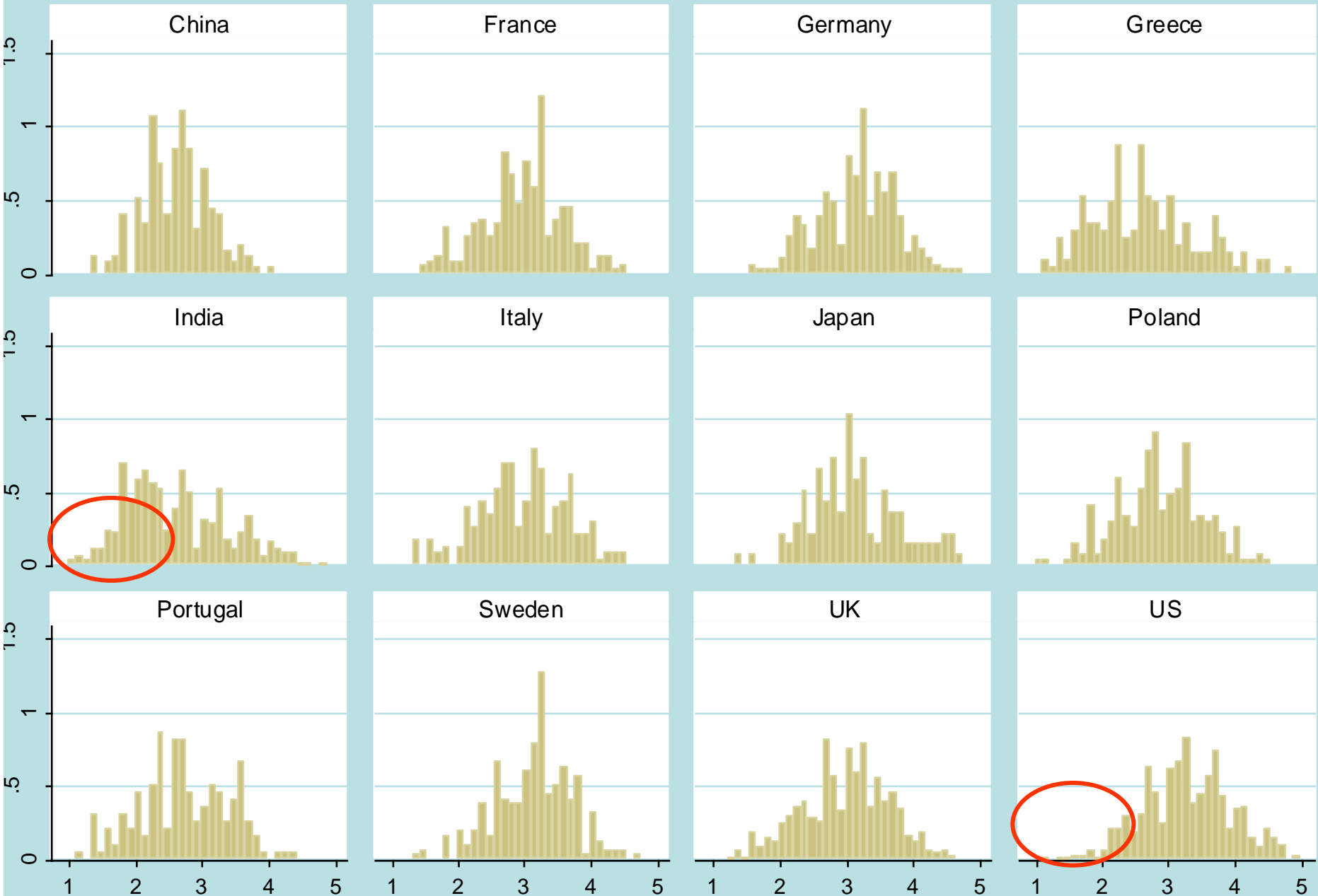
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Figure 1: Double Interviews of the Same Firm



Notes: The figure plots the management score from the first interview on a firm against the second interview on the firm. These two interviews are undertaken independently – so both the interviewer and interviewee are different across two interviews. There are 222 interview pairs plotted here.

FIRM LEVEL MANAGEMENT SCORES BY COUNTRY



Selection Issues

- PE benefits may be:
 - *understated* if PE target firms “in trouble”
 - *overstated* if PE avoids “basket case” firms
- Use panel (2004-2006) of *changes* in management practices (561 firms, 10% change ownership type)
- Our findings are consistent with model where
 - PE targets firms whose management is underperforming (i.e. falls in management practice associated with PE takeover)
 - After PE takeover management seems to improve faster than other firms