PCRI New York Event Summary

Sponsored by the Private Capital Research Institute

A group of practitioners gathered to have a discussion about recent relevant research. Professors Andrea Prat from the Columbia Business School and Josh Lerner from the Harvard Business School presented their recent work. Prat discussed his approach to examining CEO characteristics as an explanation for the superior performance of firms (co-authored with Oriana Bandiera of the London School of Economics, Stephen Hansen of Oxford University, and Raffaella Sadun of Harvard University). Lerner described his research on the impact of private equity investments on industry performance (co-authored with Shai Bernstein of Stanford Business School, Morten Sørensen of Copenhagen Business School, Per Strömberg of the Institute for Financial Research at the Stockholm School of Economics).

CEO BEHAVIOR AND FIRM PERFORMANCE

Presented by Professor Andrea Prat, Columbia Business School

Extensive evidence shows that some firms systematically perform better than others, due to differences in firm productivity. These differences are present even after controlling for location, size, industry, and a variety of other factors. One explanatory factor is the effect of management on the performance of a firm, and whether firm performance can be explained by the leadership style of its CEO.

Prat and his colleagues collected a representative sample of the daily activities and schedule plans from over 1100 CEOs in medium and large manufacturing firms located in the US, Brazil, France, Germany, India, and the UK. A random week and set of firms was selected and a call center was set up to recruit the CEOs. Based on this information, the authors systematically broke down CEO performance along five dimensions: priorities (share of time spent with different functions), skipping levels (time spent not with direct reports), mode (type of activity, duration, location, number of people), inside/outside (time spent in activities with outsiders), and planning (spontaneous vs planned activities).

The research seems to indicate that CEO time accounts for firm performance. Using performance measures that encompass productivity, return on capital employed (ROCE) and revenue growth, Prat found that a 10% increase in hours worked by a CEO per week led to a 7.5% increase in productivity, a 1.21% increase in ROCE, and a 1.05% increase in revenue growth.

The researchers also explored how CEOs use their time. Typically, a CEO seems to spend 70% of his time interacting with others, with a majority of this meeting time dedicated to an internal team composed of production, marketing, and other C-suite executives. A median of 80% of CEOs time was spent engaging in planned interactions, with about 70% of that time dedicated to an activity taking more than an hour.

Using machine learning techniques, Prat categorizes the behavior of CEOs along one dimension. On one extreme are CEOs who most of their time on structured coordination activities. On the other extreme are CEOs that take a more unstructured “micromanagement” approach. The results indicate that a “coordinator/ delegator” CEO improves productivity compared to a “micromanager".

PRIVATE EQUITY AND INDUSTRY PERFORMANCE

Presented by Professor Josh Lerner, Harvard Business School

The prevailing academic views of private equity investments posit that they are more effective than public corporations. Yet, there is still criticism from politicians and unions claiming that private equity funds leave companies saddled with debt and interest payments, and leave workers worse off. Many critics worry that these investments are destabilizing, because they are essentially "trend chasing" and take on too much leverage in companies. This view is reflected in recent reforms, i.e., the European Union's AIFM directive that stipulates minimum holding periods for PE funds and bans dividend recapitalizations.

No paper to date has addressed the impact of PE on the overall economy, due to the challenges of assessing macroeconomic impact. This omission is important because there is a need to address the cyclicality arguments inherent in the AIFM regulations and the concerns about spillovers on other firms.

Lerner and his colleagues examine the impact of PE investments on industry performance and cyclicality, across a range of 20 industries in 26 major nations from the years 1991 to 2009. The data include all private equity-backed LBO transactions from Capital IQ, about 14,300 transactions, and industry data from the OECD that includes information on production (gross output), value added, labor costs, number of employees, gross capital formation, and consumption of fixed capital. The researchers look at the effect of lagged PE activity on growth rates of productivity, employment, and capital formation.

The researchers conclude that PE investments are associated with subsequent higher growth in production, value added, total wage compensation, and capital formation. Moreover, PE investments appear to actually dampen industry shocks. It is hard to find support for claims that economic activity in industries with PE backing is more exposed to aggregate shocks. More research is needed in understanding industry spill-over effects. In the future, the researchers hope to look at the finer data on certain critical aspects of industry performance, and include later post-crisis data.