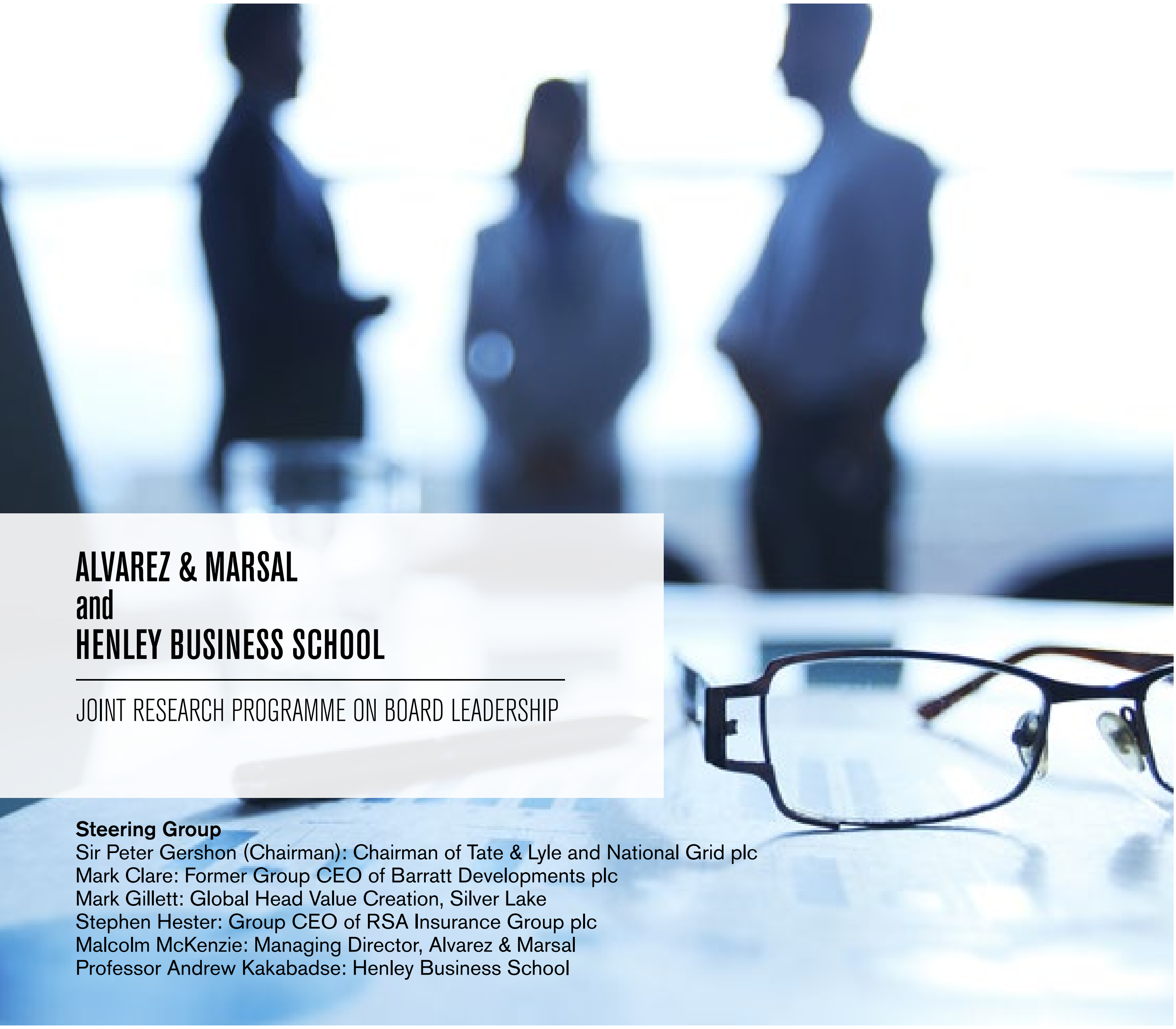
# BOARDS IN CHALLENGING TIMES: EXTRAORDINARY DISRUPTIONS

## Case Study: Barratt Developments Road to Recovery: The 2008 Financial and Property Crisis



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RESEARCH CASE STUDY

# BARRATT DEVELOPMENTS ROAD TO RECOVERY: THE 2008 FINANCIAL AND PROPERTY CRISIS

This case study is based on an analysis of interviews conducted during the first quarter of 2015 with the following participants:

- **David Thomas** | Chief Financial Officer | Barratt Developments plc
- **Gary Channon** | Chairman and Chief Investment Officer | Phoenix Asset Management Partners, Ltd
- **Mark Clare** | Chief Executive Officer | Barratt Developments plc
- **Mark Rolph** | Senior Independent Director | Barratt Developments plc
- **Richard Brookes** | Managing Director East Region | Barratt Developments plc
- **Steven Boyes** | Chief Operations Officer | Barratt Developments plc
- **Tristan Chapple** | Analyst | Phoenix Asset Management Partners, Ltd

## INTRODUCTION

The Barratt Developments' Board was under fire. It was early 2008 when U.K. banks stopped lending and what at this stage looked like yet another cyclical property downturn, turned into a dramatic disruption to the business. Barratt's sales during 2008 dropped by over 40 per cent and prices fell on average by 25 per cent. Barratt's challenges were compounded by a significant acquisition in April 2007 which added £1.3 billion of debt to an otherwise debt free business. The share price dropped dramatically from a high of £8.55 in February 2007 to a low of £0.32 in October 2008.

In April 2008, the Financial Times announced "Barratt slump continues to rattle housebuilding sector" and in July the same publication referred to the company as a walking-dead: "Barratt manages to lift the coffin lid a fraction."

Despite pressures from the media, analysts and City investors alike, the Board persevered and gave the CEO the trust and cover that he needed. In turn, the CEO marshalled the business' "depth and breadth" of industry expertise and acted swiftly and with determination, applying the business disciplines needed to see Barratt 'through the woods.' Here's how Barratt did it.

## RECOGNISE THE DISRUPTION: IS THIS ANOTHER CYCLICAL PROPERTY DOWNTURN?

One thing that all Barratt Board Members agreed upon is that the mortgage market collapse, initiated in September 2007 with Northern Rock's demise, was highly unpredictable in terms of its reach and impact on the industry. Although there were growing issues during 2007, such as a series of interest rate increases and some loss of customer confidence, the prevailing view through the first quarter of 2008 was that it was yet another traditional downturn or house building cycle. The full extent of the problem had not yet emerged and was not regarded as life threatening.

"When the U.S. collapses happened, we were into completely virgin territory here. So the big problem was just saying, how do we scope this problem, is this a traditional recession, in which case we know what we're doing? Is this a matter of life and death, in which case we really don´t have all the answers to this."

The difference to previous property downturns was the speed at which it happened, which left the company with less time to respond. Banks didn't just ease gradually off mortgage supply; rather they "pulled the plug" and there was a massive market correction.

For the finance Executives, it was equally important to understand the common factor with other property


downturns, which was affordability. In 2007, the average homeowner was spending more than 40 per cent of their net income on mortgage payments. The problem was that nobody wanted to be the person to 'call out the issue' first:

"Nobody wants to cut off say a third of the company's operational capability and find out that you were the guy that called it too soon."

Barratt turned to its Board Members who had been through a number of downturns to try and understand the likely duration and impact of the problem, and determine the correct course of action. Initially the view was that the effect would be short-term and that recovery was likely to occur relatively quickly, as had happened with previous 'corrections.'

The reality was that the full impact of the 'credit crunch' was still to come, with two further 'step downs' in lending availability in April 2008 and the coinciding collapse of Lehman Brothers in October:

"The CEO called a recovery subtly before it had happened, then Lehman's went bust and things got much worse."

## DETERMINING THE RIGHT LEADERSHIP

As the downturn unfolded, Barratt's situation became more precarious. Having orchestrated an acquisition at the top of the market and with significant debt, many voices coming from the City, from investors to analysts, called for the head of the CEO.

However, the Board, Chairman and the firm's top shareholders gave the CEO the backing he needed in order to pursue a recovery plan with a focus on Barratt's long-term sustainability.

"The Chairman has been incredibly supportive all the way through. There were some really quite challenging periods but the Board was always supportive to what we were trying to do."

Executives and Non-Executives described a CEO who was abundant in the necessary leadership preconditions. He displayed emotional resilience to persevere in difficult conditions and had strong communication skills. He aligned the company to the strategy by communicating relentlessly, consistently and clearly. He was seen as a positive person who could energise his team, even in the darkest of scenarios:

"DURING EXTRAORDINARY DISRUPTIONS THERE IS NO ROOM FOR AN UNALIGNED, UNENGAGED BOARD AND TOP TEAM. MEMBERS OF BARRETT'S BOARD DESCRIBED HOW THE CHAIRMAN AND THE CEO HELPED TO CREATE A CONSTRUCTIVE BOARD ENVIRONMENT THAT ADDRESSED ANY UNRESOLVED CONFLICTS AND PROVIDED SUFFICIENT STABILITY TO ENSURE A UNIFIED AND WELL-ALIGNED BOARD."

"In terms of leadership, our Chief Executive led us extremely well, he made us face reality."

The other characteristics highlighted by his peers included a leadership style focused on trust and empowerment of the senior Executives. This meant the depth and breadth of the team's industry experience was recognised and used to complement the CEO's own strengths and weaknesses. The CEO also displayed an honesty that shareholders, the Board and his team truly appreciated.

"That's credit to the CEO that he hasn´t built a whole personality. What he's built is a good firm."

During extraordinary disruptions there is no room for an unaligned, unengaged Board and top team. Members of Barratt's board described how the Chairman and the CEO helped to create a constructive board environment that addressed any unresolved conflicts and provided sufficient stability to ensure a unified and well-aligned Board.

"You don't want people feeling comfortable, but you want people feeling stability.  If you've got people sitting around the table that are worried about their jobs, there is no way that you're going to get the best performance from them."

# FORGING BARRATT'S STRATEGIC DIRECTION & ALIGNMENT

In response to the disruption, board engagement increased significantly in terms of number of meetings, detail of Board papers and Non-Executive input. Initially the Board shared its experience and skills to contribute to the "directional response" and to ensure that Executive action was appropriate. Once alignment around the strategy was achieved, the Board coalesced around the Executives to facilitate the implementation of the plan and to monitor progress.

The board environment was described as open and transparent, and energy was focused on resolving the challenge rather than on 'own-agendas.' This helped to deploy a swift response.

"I think the positive for me was that the Board was united, very proactive in taking action."

Crucial to ensure initial and continuous alignment between the board, the Executive team and the "directional response" was the Chairman. According to some shareholders, the Chairman was outstanding. As part of his role, he gathered independent information, conducted site visits without the CEO and observed middle management training from the back of the room.

He also genuinely listened to shareholders. For example, he took direct action in response to competitor analysis insights, kept the Board focused on the long-term and provided the cover and the confidence needed for the CEO to continue on the "Road to Recovery."

Evidence suggests that the discipline of "Ensuring a Constructive Chairman-CEO Relationship" had been successfully applied throughout the disruption, which enabled the company to deliver clear messages and engage effectively with stakeholders.

"You've got to have clarity of purpose, you've got to communicate it very clearly, you've got to be relentless in your focus, you've just got to keep going. And if you're all fighting with each other you're never going to get anywhere."

The directional response had to be assessed, refined and adjusted at times, as different events would alter the assumptions under which plans were made.

"It wasn't death by 1,000 cuts, it was arguably two deep cuts and then no more. It was difficult to gauge how bad the market would get, but we made two cuts and then moved on."

# SPEED OF RESPONSE AND APPLYING THE RIGHT DISCIPLINES IS CRITICAL

## 1. ARTICULATE THE PURPOSE, TAKE CALCULATED RISKS AND GET PACE

As soon as the full extent of the 'credit crunch' was understood, the company went into proactive response mode, stopping all new land investment and rapidly reducing the costs of the business. The strategy was composed of three broad stages:

I. Impose very tight disciplines (cost and WIP) into the business

II. Centralise all investment authority

III. Refinance the business

The response in terms of cash conservation, including not paying out dividends and cost reduction, was formulated and presented to the Board. Once agreed upon, this approach cascaded down to the top 50 senior Executives of Managing Directors and Regional Managing Directors within the Senior Leadership Group.

"Speed of response is absolutely critical, either simply to manage your survival or to seek or gain competitive advantage at a time when you and your peers are both trying to hit the sweet spot in the market."

Still, a number of dilemmas were faced by the Executive team and the Board during this stage in terms of balancing the short-term needs with Barratt's long-term sustainability.

A key dilemma was to understand how to cut hard and fast without destroying the firm's core competencies and capabilities for future growth.

Striking the right balance between existing needs and future growth meant Barratt had to maintain its competitive advantage through delivering top sales and great product design and delivery. Pushing product design and investing in the development of new ranges of house types, designs and technical planning helped to secure future growth.

Under the banner of "Planning for Recovery" (with its forward-looking message), the CEO went on an eight-week tour through the business, directly communicating face-to-face with thousands of employees. There were three clear and simple messages:

I. Drive for cash

II. Reduce costs

III. Deliver on sales

"In terms of what they did operationally, they were superb. They did the right things.  They didn't abandon the future, they didn't damage the business so that you had a shell afterwards."

## 2. BE EVIDENCE LED

Throughout the disruption, information flow from the periphery to the centre improved greatly. Barratt's ability to pull data right through the organisation and produce detailed reports enabled the board to effectively categorise and size the disruption, determine the directional response and then revise and refine their plans.

## 3. ENSURE EFFECTIVE STAKEHOLDER MANAGEMENT

Stakeholder management and communication was emphasised as an absolutely crucial discipline.

"The communication was absolutely critical because we were dealing with multiple stakeholders. Stakeholders were there in spades and if we didn't manage them, whether it's the banks, investors or media, then that would have had a detrimental effect on what we were trying to deliver."

The CEO and Chairman played to their strengths and delivered high quality stakeholder management both internally and externally.

> "THE BOARD ENVIRONMENT WAS DESCRIBED AS OPEN AND TRANSPARENT, AND ENERGY WAS FOCUSED ON RESOLVING THE CHALLENGE RATHER THAN ON 'OWN-AGENDAS.' THIS HELPED TO DEPLOY A SWIFT RESPONSE."

"They would spend hours talking to a sales advisor or a forklift driver on site, and you knew from the words they used that they really cared. This sort of messaging can be much more effective than if it were to come from the top, down."

## CHOOSING THE POINT TO INVEST AGAIN

One clear challenge for the business was when to start investing in the land market again. Without making such advances, the business would have continued to shrink and the opportunity to acquire good land at the bottom of the cycle would have been lost.

In January 2009, the market started to stabilise in terms of pricing. In the previous six months, the average property sales price had declined by as much as 30 per cent, which had the effect of driving down the cost of new land. At this point the Chief Executive , with the support of the Board, took the decision to start investing, albeit at low levels. Every piece of land acquired was approved centrally, a discipline that still exists today.

With almost no competition for land, the company was able to acquire some of the best opportunities available. Based on this success it then took the step of going to shareholders to raise additional funds to accelerate its rate of acquisition, something shareholders fully supported.

Since that time the group has invested over £4 billion in new land, which has driven the record performance now being delivered.

## DECLARING SUCCESS AND LEARNINGS FOR THE FUTURE

Barratt has now declared victory. It is effectively debt free and analysts expect record profits for FY15. In addition, the company is once again delivering high returns on Capital Employed and its market capitalisation is now at an all time high. After nine years as CEO, Mark Clare handed over the reins to David Thomas (previously the Group Finance Director) to provide the long-term leadership for the next stage in the company's development.

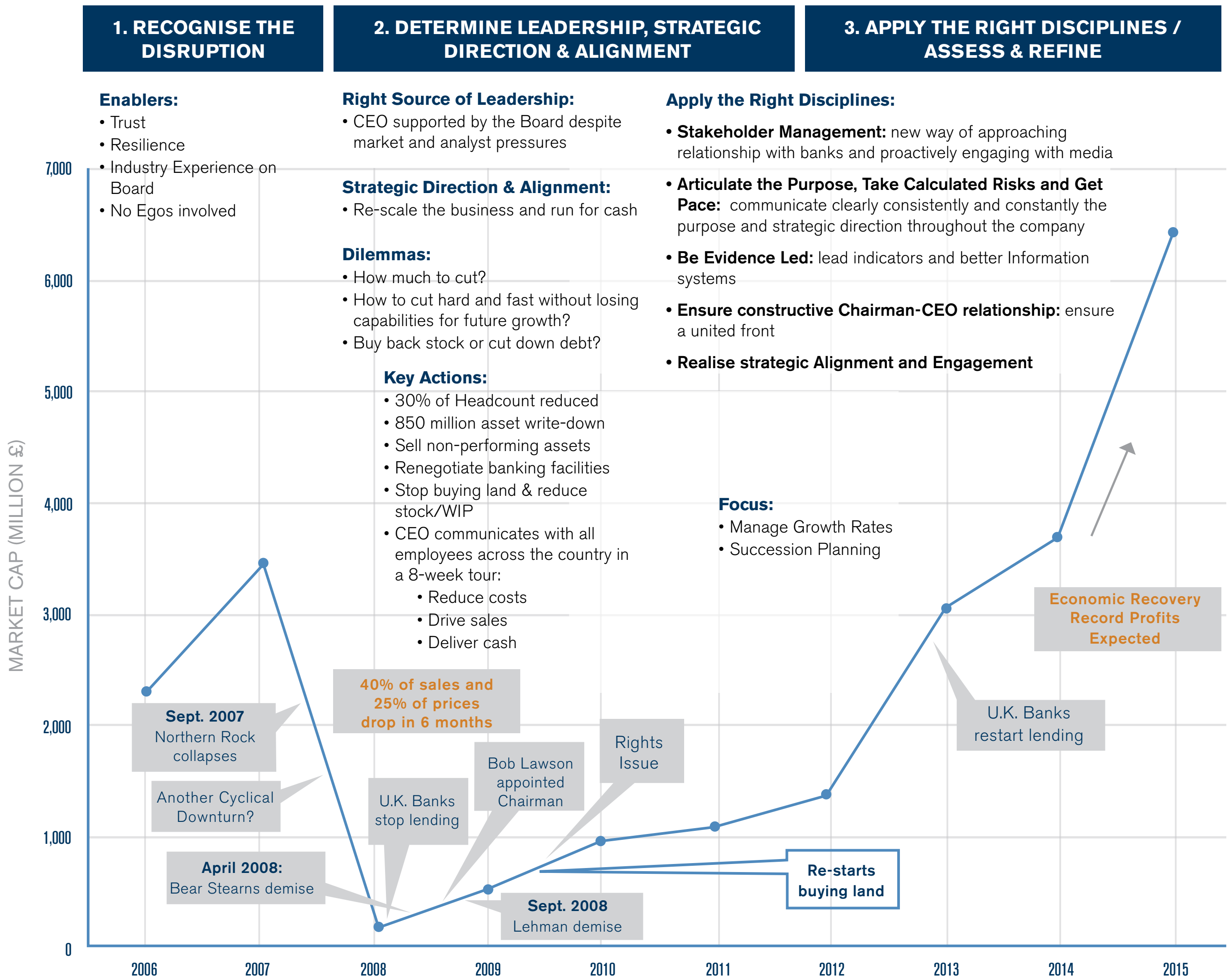
The management team compiled and documented its experience through the 2008 downturn up to 2013 in two 'books' which serve as guidance for current and future Executives and other employees on how to manage large disruptions.

"I always say in times of peace, prepare for war; we're in an upturn, when is the next downturn going to be and how we're going to manage our downside risk. I think there's been some good learning."

A completely different approach now exists within Barratt, with dedicated Executives in the business looking at trends in the mortgage market, lending, availability of funding and various sources of mortgage products.

An exhaustive crisis management model with various levels of indicators and responses (a weather warning type of system) has been implemented at Board level. The lessons should remain for future generations and perhaps a more risk conservative approach will persist in the business.

# APPENDIX A: BARRATT DEVELOPMENTS' TIMELINE OF EVENTS



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