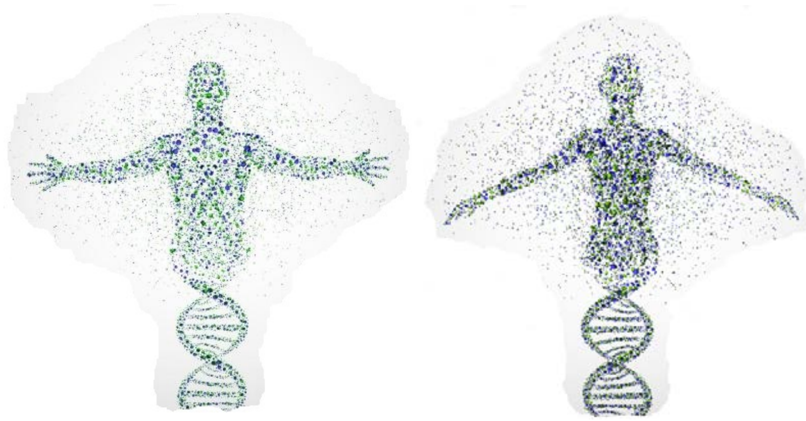
DNA of a Successful PE Portfolio CEO

By Joe Hunt



Private Equity is looking for CEO's who can drive and deliver performance in a defined timescale, optimizing the crystallization of value on exit. Given the time horizon of a typical investment, in a perfect world you would have the right leader in place from the outset, but it's not a perfect work and historically the most common time to change a CEO is two years into an investment which negatively impacts on IRR. Making matters worse, when I survey client stakeholders, many realized they made a mistake and didn't have the right CEO in place within the first 2-6 months, but made matters worse by prolonging the change.

Private equity and 'business as usual' rarely go hand in hand. This is why it's so important to know the CEO you're betting on can make the leap. You need to be certain they have the 'Private Equity DNA' to be successful.

Having the right CEO for a portfolio company can be the difference between a profitable investment and a 10X reverse ROI. The CEO envisions the path for growth and drives strategy and performance by flawlessly executing business initiatives, seizing opportunities and maneuvering around threats in order to help realize and deliver value to investors. Over the past 20 years, I've recruited, tracked and assessed PE-backed CEOs, helped build their teams and have developed a strategic point-of-view on what makes a successful CEO candidate.

An executive's past experience is a metric for future performance, but most certainly no guarantee and not an accurate predicter of success in and of itself. Demonstrated success in prior roles is critical – both on measurable elements like revenue and EBITDA growth, technical or market mastery in applicable verticals depending on the business and softer competencies like building organizational capabilities and a performance-focused culture are all table stakes. "A" player fit has to include performance (results and experience), leadership, team, culture and motivation. The dynamics of each usually varies significantly in every company, but can be quantified and benchmarked to best assure skill and will alignment.

Innumerable studies of best-in-class executives show, success is about 50 percent attributable to leadership characteristics, 40 percent to job and technical skills, and just 10 percent to motivation and experience. In other words, experience and skill only get you halfway there, but a miss on even the lesser 10% motivation and experience often proves to be regressive.

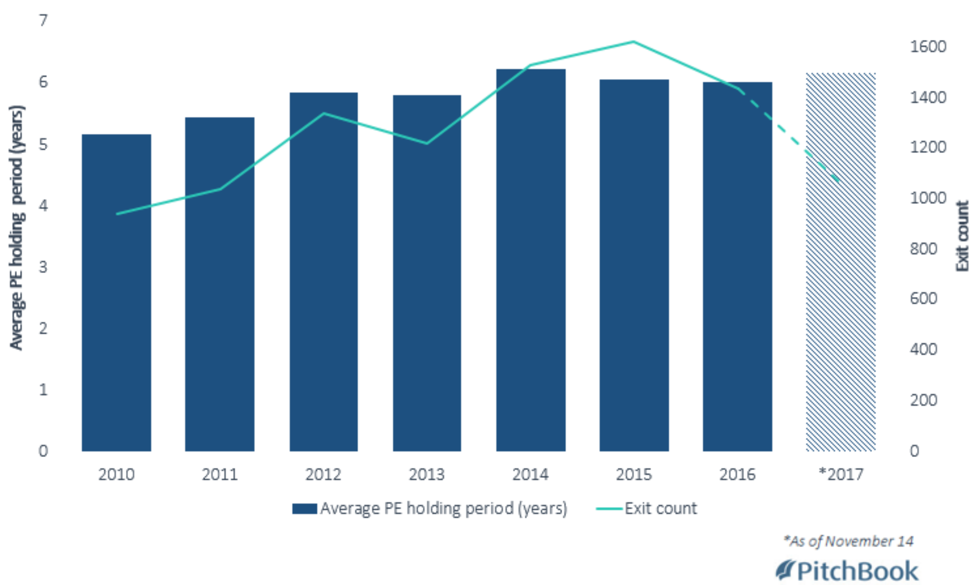
Many of the brightest and most talented senior executives have left the traditional employ of the large blue chips and multi-national and have landed in the private equity world. Further that vast majority of executives that still work at the likes of P&G, Unilever and Nestle, have an interest in the PE world.

If you're a General Manager and qualified to be a portfolio company CEO, it's a no brainer to jump into PE, as it offers fulfillment in all the intrinsic and extrinsic drivers. The corner office, more control of your own destiny, opportunity to build or grow something yourself, rewarding work with a lot less politics and bureaucracy to get things done. The extrinsics are usually far greater than the traditional salary, variable bonus and LTIP, even though it's clearly a risk vs. return bet on oneself.

Things are changing however, and the risks and bets are becoming longer and longer, making it an imperative the CEO and his/her staff have the longevity and sustainable agility required for as long as it takes. PE-backed exits in the US have declined for the second consecutive year and the average PE holding period for US-based companies has increased to 6.17 years.

Below is a look at the average PE investment holding period in US companies during that time span:

The prolonged hold times are reflective of a deal making environment that's become more challenging, even as private equity firms round up record amounts of dry powder. Further, the rise in deal prices has made generating returns for LPs increasingly difficult—especially given that the selection of deal flow remains limited.



Hunt Executive Search has developed a comprehensive methodology for assessing the capabilities and experiences most desirable in PE-backed CEOs.

PRIOR EXPERIENCE PROFILE

While directly relevant industry experience is compelling and sometimes even deemed necessary that a strong CEO candidate come from a specific industry domain, it is imperative to look beyond an executive's prior titles and brand affiliations to consider more broadly the financial responsibilities and organizational structures of their previous roles.

Full P&L Responsibility: Being a division president or general manager is not the same as being a CEO, particularly since a PE situation requires managing cash and dealing with leverage. There is big difference between managing a budget or making a number and managing a P&L. While it is certainly possible to step up to a CEO-level P&L successfully, there is a learning curve which will likely place increased emphasis on the capabilities of a strong CFO.

Classically Trained, Once Removed: Moving from a big company to the middle market is a significant change. The systems and support are typically not available, so it requires an agility, nimbleness and ability to operate in a roll-up-your-sleeves environment. I have found that executives who began their career in an "academy" company and then transitioned successfully to a smaller, more entrepreneurial company or business unit are a better fit for PE-backed situations. The exceptions are executives who had unusually scrappy and resource-starved roles within big companies, which were not that common a decade, but not uncommon today. Even the largest companies like P&G, Unilever or J&J have executive who ran Eastern Europe or were tapped for an internal start-up or to independently run a small acquisition, where they had to demonstrate learning agility and succeeded.

SEVEN LEADER*SHIFT* COMPETENCIES FOR SUCCESS

Beyond a candidate's experience profile, our assessments and 360° referencing seeks to uncover intangibles and softer competencies that are even more critical to success:

1. **Focus on Results**: Does he/she have an almost maddening focus on results that aligns with the vision, objectives and exit strategy of the PE sponsors? For example, a CEO who focuses on building a brand for the long-term is fundamentally out of sync with a sponsor who only cares about reaching an EBITDA goal with revenue growth.

2. **Bias for Action**: Does the executive have a palpable bias for action – a real sense of urgency about positive change? If a CEO is too slow to hire or too slow to fire, it's a problem. If a CEO is too slow in taking advantage of opportunities or changing things that aren't working, it may be an even bigger problem.

3. **Fact-Based and VUCA**: Private equity firms are driven by data and facts, so their CEOs need to make decisions that way too. At the same time, executives who know how to take calculated risks and are comfortable making decisions in VUCA (volatility, uncertainty, complexity and ambiguity) that requires trusting their intuition and having the agility to pivot when necessary, most often produce breakthrough results.

4. **Team Savvy:** Does the CEO build teams that complement his/her skillset? All PE portfolio companies are lean, delayered and ZBB'd, so having "A" players in all leadership roles is mission critical. While all roles are important, having a rock star CFO is particularly important in the PE-backed world. In some cases, channel and/or value chain functional vertical expertise is just as critical to the success of the enterprise.

5. **Transparency and Authenticity**: A true "business partner" is key to an effective relationship between a CEO and investors, and nothing undermines that relationship faster than withholding information. We look for evidence of a completely transparent style and truly authentic leadership. Will the CEO alert the sponsors to potential problems early and bring alternative paths of action?

6. **Confident and Temperance**: CEOs will be challenged and questioned by PE professionals, who are usually younger and always whip smart. It takes a level of self-confidence, patience and open-mindedness to get the most out of these relationship and interactions. Ego must be in check and balanced with confidence and abnegation based on the CEO's competence.

7. **Intelligence (IQ and EQ):** While IQ is not an accurate predictor of success in and of itself, critical thinking ability is a cornerstone for a CEO and all C-1 positions. That said, EQ (emotional intelligence) is a hallmark of successful leader. Being equally self-aware and having an accurate barometer of others is the best skill to possess for a leader to get things done through others at scale.

Our proprietary Enterprise GPS and Leader*Shift* Architect was specifically developed to assess business needs, develop an accurate performance profile for every position and compare/contrast candidates against the model.

In aggregate, softer competencies are at least as important as an executive's experiences. Comprehensive interviewing and assessments around work history, pedigree (quality of experience), behaviors, drivers (motivation/values), acumen (capacity/potential) and competencies (personal skill), combined with extensive and unbiased 360° referencing are all critical to hiring the right CEO for a PE-backed company.

About the Hunt Group

The Hunt Group is the leading private equity search specialist and advisory specializing in consumer goods & services, diversified industrial and professional services markets. It partners with investors throughout the deal cycle to help them Invest in, Grow and Exit their portfolio companies by appointing senior operating executives (CEOs and Direct Reports), Chairs and Outside Directors with Private Equity DNA. Our industry and functional vertical connections and engagement guarantees we're in the know and have broad insight and full access to the best talent in the marketplace. Our mission is to create and exponentially grow accretive value for all client stakeholders.

Why Many PE Portfolio CEO’s Fail

By Joe Hunt

1. Lack of a Leadership Thesis

While many hundreds of hours go into crafting, scrutinizing and road testing the Investment Thesis there is often less than a passing glance given to the skills that will be required to realize the Investment Thesis. A high percentage of investment firms don’t have a defined profile for their portfolio company’s CEO – they simply don’t know or haven’t thought through systematically the CEO skill set.

The Leadership Thesis is a highly developed and pre-agreed blueprint of the key skills and attributes required in the CEO from the outset of any investment and over its lifetime. It’s a living document which will flex and adapt as circumstances and market conditions change. It is a fundamental element at the outset of any investment and a key step in driving a successful outcome.

2. Lack of Assessment

Private equity is much less likely to have a developed internal succession plan, studies have shown ~50% have no formally identified CEO successor candidates and ~50% have no formal preparation or internal development for CEO successors. The process for succession is necessarily different in PE – in >85% of cases, external CEO candidates are recruited (compared to ~51% in public companies).

When appointments are made, most used just 1 tool / method to assess CEOs or prospective CEOs in addition to internal interviews. Assessment tools bring additional data to selection decisions and increase transparency, yet they are deployed in a limited capacity. Developing a Leadership Thesis and assessing against it early reduces the likelihood of having to change the leadership further down the line.

3. Rose-Tinted Glasses

Given the competition for assets among PE funds there is often a very long “romance” between a fund and the management of a prospective portfolio company as funds seek to create favored bidder status. This is often followed by an equivalently long “honeymoon” period post deal where investors congratulate themselves on having bought well and fail to scrutinize management performance effectively because they have not yet effectively shifted their mindset from prospective suitor to owner operator.

The most common time during the life of an investment to change the CEO is two years or more into the deal (30% of cases) and this is most commonly due to underperformance. Two years in is so often two years too late – the rose-tinted glasses or halo effect can threaten value delivery in even the most attractive looking investment.

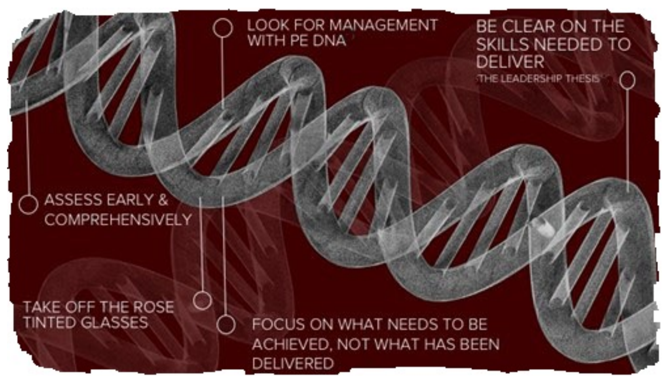
4. Not PE Ready

CEO's of portfolio companies need to be assessed not just on the basis of what they have done but on what they will be required to do over the period of the investment. The skills required for startup and early stage success are so different from those required to scale a company rapidly. The attributes that create success in a growth market may be both untested and inappropriate where conditions have changed, markets are tough and change management is required.

Many private equity partners prefer having a CEO with experience of similar strategic challenges. This ranks more highly than industry experience or intelligence. There is simply no room or time for learning on the job. Those that succeed are highly likely to have seen it and done it before.

Private equity is a very specific environment. Timescales are often short and expectations very high, stakeholder management issues differ considerably to corporate counterparts. The right person for the job is often not the incumbent but someone who knows the territory ahead and who can hit the ground running.

The Hunt Group has identified five key steps to ensuring that every asset has the right leader to maximize returns over the life of the investment:



- Take off the rose-tinted glasses and be mindful of the halo effect
- Focus on what needs to be achieved, not what has been delivered
- Be clear on the skills needed to deliver (The Leadership Thesis)
- Assess early and comprehensively
- Look for management with PE DNA

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