Solving the Private Equity Talent Dilemma.

→ How Private Equity Investors Can Avoid CEO Misfires

→ How to Survive and Thrive as a Private Equity-Backed CEO

SRi

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Is there something broken in Private Equity?

Private-Equity backed companies are suffering from an abnormally high rate of CEO turnover compared to their public company counterparts.

The statistics are stark: A 2017 survey conducted by consulting firm AlixPartners reported that an astonishing 73% of portfolio company CEOs are replaced within the investment lifecycle of a deal (from acquisition to exit). Even more remarkably, 59% of those replacements take place within the first two years.

This compares to an average of approximately 15% annual CEO turnover among publicly-listed companies in the U.S. and Canada.[1]

Although the AlixPartners research did not specifically address the attrition rate of "replacement" CEOs within PE portfolio companies, anecdotal experience suggests that turnover among that group is also higher than the levels set by non-private equity-backed companies.

This level of churn comes with a myriad of downstream costs. From damage to the CEO's career and professional reputation, to the loss of company productivity and focus, to the erosion of the investor's internal rate of return and a lengthening of investment hold times.

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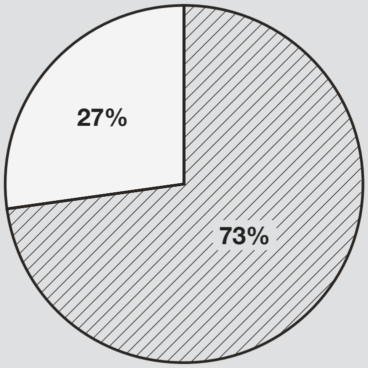

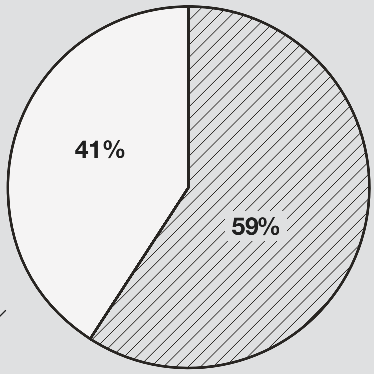

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[1] **PwC;** *CEO Success Study*, 2016.

[2] **AlixPartners;** 2nd *Annual Private Equity/CEO Survey*, 2017.

A unique set of challenges await portco CEOs

The role of a private equity portfolio company CEO can be one of the most challenging, rewarding, and potentially lucrative, in industry.

It can also be fraught with pitfalls, detours and landmines that requires a Chief Executive to balance the sometimes-competing demands of investor-driven financial models, dynamic market conditions and long-term growth priorities. For even the most talented executives the role can be daunting, particularly for those, as saying goes, making their first trip to the “rodeo”.

To better understand the causes and cures for the PE CEO turnover epidemic, SRi spoke with a group of private equity investors and portfolio company CEOs to get their insights and advice.

The responses varied greatly between investors and CEOs, with sage advice for new portfolio company leaders.

Our respondents included several from “bulge bracket” PE firms, as well as those from firms that focus on the middle market. Likewise, the portfolio company CEOs we interviewed led businesses ranging from several hundred million to several billion in annual revenue and spanned a variety of industry sectors.

INDUSTRIES REPRESENTED

Consumer goods & retail
Industrial
Information services
Media & Content
Professional services
Sports & Sporting Goods
Technology

GEOGRAPHIES

U.K. & U.S.A.

FIRM TYPES SURVEYED

Bulge Bracket
Mid-Market
Large Family office

CEO PROFILES

CEOs with mix of PE and Public Co. experience
First time PE CEOs
Serial PE CEOs

WHY DO EVEN PREVIOUSLY SUCCESSFUL CEOS OFTEN FAIL TO ADAPT TO THE DEMANDS OF THEIR PRIVATE EQUITY INVESTORS?

CEOs

STRUGGLE TO BALANCE SHORT v LONG-TERM OBJECTIVES.

Portco CEOs pointed to the delicate balance between delivering EBITDA-driving cost savings to anxious investors while at the same time finding new growth vectors through product and/or market investments. One CEO who was able to strike that balance told us: ‘In between cutting and squeezing existing operations to improve margins, I worked closely with the Board to identify acquisition targets that would position us in new, higher growth segments. M&A was a much quicker route to growth than organic investment.’

MANAGING FINANCIAL COMPLEXITY.

Several of the portco CEOs we spoke with described working under private equity ownership as their ‘second MBA.’ To succeed they had to quickly get up to speed on a range of financial issues from structured debt refinancing to free cash flow ratios. Most also described a close working relationship with their CFO as a critical success factor. ‘It’s important to remember…’, said one portco CEO, ‘that the Investors often view the CFO as a *direct report* to the board as much as it is to the CEO. You have to be comfortable with that dynamic and ensure that there’s a solid partnership in place.’

MISUNDERSTANDING THE CEO ROLE.

Almost all of the portco chiefs with whom we spoke noted the striking difference between operating as an independent company CEO (whether public or private) versus operating as a PE-owned CEO. Many noted the increased operating scrutiny that comes with monthly in-depth operating reviews with the PE firm versus traditional quarterly board cadence.

Another common refrain: the portco CEO is there to execute in support of the PE firm’s investment thesis, and not to formulate a new company vision.

Investors

FAILURE TO EXECUTE ON THE STRATEGY.

Most commonly we heard investors describe CEO underperformance as a lack of alignment around, and/or a failure to deliver on, the financial KPIs that matter most to them (predominantly EBITDA growth).

They described successful CEOs, on the other hand, as those able to execute an operational strategy and go-to-market plan that delivered on the investors’ financial assumptions and models. ‘Make no mistake’ one investor said ‘our mission is to deliver the expected return. The CEO’s mission is to execute a plan that makes that happen.’

INSUFFICIENT VELOCITY.

In an increasingly competitive market for private equity deals, valuations are going up and investment timelines are contracting. As a result, investors are looking to their portco CEOs to move the needle quickly. It’s not coincidental that the AlixPartners research shows that more than half of CEO turnover is coming within the first two years of deal close.

POOR CULTURAL FIT.

‘Culture fit’ is often a catch all term to describe any number of disappointments with CEO performance. Probing a bit deeper the investors we spoke to described cultural mismatch as anything from a ‘lack of transparency’, ‘poor communications with the board’, to a ‘lack of fluency around the financial levers that drive the business.’

GIVEN THESE ISSUES, HOW DOES A CEO AVOID CAREER-LIMITING LANDMINES?

CEOs

UNDERSTAND THE INVESTMENT THESIS.

To avoid career-limiting surprises, seasoned portco CEOs stressed the importance of diving deep into the PE firm's investment model in order to understand how they view the financial levers, desired outcomes and timelines for success. Said one, 'If your operating thesis doesn't line up with their investment thesis, you will not end up in a happy place.'

CREATE CONFIDENCE THROUGH YOUR PLAN.

Momentum requires a set of quick wins, and quick wins typically require a thoughtful and detailed plan right from the start.

Most of the CEO respondents stressed the critical importance of building, communicating and relentlessly executing a 'first hundred days' plan. Several also noted that building early momentum means having the confidence to 'do a lot of things at the same time…this is not an environment that allows for the serial processing of problems.'

MAKE THE PRIVATE EQUITY NETWORK WORK FOR YOU.

Particularly in larger PE firms there are resources and institutional knowledge that can be an important force multiplier for portco CEOs.

These may include a team of operating partners with functional specialists in supply chain, IT, HR, M&A resources, and a network of other portco CEOs that can provide a mentorship or a sounding board for difficult issues.

One CEO respondent advised 'Figure out what resources are available and actively engage with them as early as possible. By the time the PE firm starts offering them to you, it's usually a sign that you are in trouble.'

Investors

ASSESS CEO TALENT FOR COMPETENCIES.

Several investors warned of the pitfall of hiring 'brand name' CEOs without enough diligence into their underlying leadership competencies.

Several firms are now using consultants armed with sophisticated leadership assessment and psychometric tools to peer more deeply into a potential CEO's decision making style, behavioral traits and intellectual agility.

However, a proven track record of leading a PE-backed company to a successful exit still stands as the trump card credential for any portco CEO candidate.

FOCUS ON THE CEO/CFO PARTNERSHIP.

Consistent with the sentiments expressed by CEOs, investors also tended to view the association of the CEO and CFO as the most critical.

Several PE partners expressed the view that a portco CFO is an extension of their deal team, with a direct communications link and accountability to the private equity owners. One PE deal partner said 'the CEO needs to be comfortable with the direct relationship we have with our CFOs. This takes a certain amount of confidence and humility on the part of the CEO to understand the CFO is working with them, not always for them.'

WHAT'S THE MOST IMPORTANT ADVICE FOR NEW PORTFOLIO COMPANY LEADERS?

CEOs

'Be flexible but be confident. The PE folks very well may be the smartest in the room, but you are the industry expert. You need to educate your investors about the specific dynamics and nuances of your industry.'

'Be transparent with your investors and with your team. Put the financial goals out there front and center and use them as a rallying point for all of your stakeholders.'

'Embrace the ambiguity and be comfortable with making decisions on incomplete data. It's much better to be 51% right than 100% late in making the call.'

Investors

'Remember, we are hiring you not to be king of the company, we are hiring you to execute on behalf of our investment plan.'

'Keep a copy of the investment memo and reread it, often. It's the best way to keep your priorities straight.'

'No surprises. We hate surprises.'

'Call us, ask for help. We've lived through every problem at least once before.'

Jay Hussey, **CEO, North America**

Jay Hussey is the CEO, North America, of SRi. Based in Boston and New York, Jay leads our North American business and specializes in C-level executive searches for public, Private Equity-backed, and growth-stage companies

Jay brings extensive domain expertise in technology, media & content, and data & analytics services. With more than 20 years of industry operating experience, and 15 in executive search, Jay has built broad expertise helping companies grow and excel in rapidly transforming and highly competitive market segments.

Before joining SRi, Jay served as search consultant, Partner and Practice Leader for a leading global executive search firm. Prior to his search career, he was President of a publicly-traded web services and digital marketing firm.

As a CEO and as a search partner, Jay brings a passion for the work we do, disciplined leadership and an unwavering focus on delivering results.

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About SRi

SRi is a boutique global executive search and consulting firm focused on media, content, technology and sport.

We work as one partner-led team with staff based in key global markets across eleven offices on four continents. We offer dedicated and specific sector, function and region expertise. Our services include executive search, board assessment, succession planning, salary benchmarking, advising clients on their internal and external hiring strategy, new market entry and multi-vacancy projects.