CEOS IN PRIVATE EQUITY SPONSORED COMPANIES: FUNCTIONAL COMPETENCIES AND BEHAVIORAL ATTRIBUTES CRITICAL FOR SUCCESS

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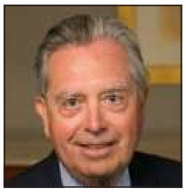
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Executive Summary

The ideal profile of a CEO in a private equity sponsored company is situational – highly dependent on the investment thesis for a particular entity. Value creation in a turnaround, for example, is quite different from that applied in a stable company looking to expand via new markets, products or M&A. Small cap companies typically require some transformation as they strive for growth in competitive markets. The value creation that can be achieved with cost line improvements alone in these small cap companies is very unlikely to meet investor return hurdles. The reverse is also often true. Larger companies, especially those with sizable production costs, can often be rationalized to produce significant cost saving that drive profit (product line focus, process reengineering, lean/six sigma, etc.).

At the same time, new CEOs often err in thinking that all PE firms operate the same and have the same expectations. In truth, their approach will vary depending on the investment thesis. One company, for example, may be a more troubled asset. Another might be at a later stage of the investment. Perhaps the private equity firm had owned it for five years, tried to sell it and couldn't, and now they've got to go back to the drawing board and start over again. Very often in that situation that asset will require a different skill-set based on the aspirations at that point in time versus when it was acquired. In other words, things have changed and therefore the skill-set of the CEO needs to map.

Different firms have a different investment theses, and that matters. What also matters is that different partners operate differently on the board. For a CEO, what worked in PE firm A with partner Joe Smith may not work with PE firm B with partner Tom Davis. Personal styles and motivations often differ. Once the CEO is actually executing the value creation plan, he or she must also map how the PE firm wants to be involved and how they can be helpful. Case by case that can be quite different.

Importantly, cultural factors also weigh heavily when considering the appropriate leadership style for a CEO in a given entity. Has the current culture served the company well or will it require transformation to deliver desired results? Will the hard-charging CEO of a large financial services company in New York City be effective running a mid-market financial services company based in the Midwest? Without clarity on the cultural issues that frame a hire – where it is today and where it needs to go -- it is easy to make an error. Executives who cannot navigate the culture cannot create the "followership" required to meet business objectives.

With all of the above in mind, there appears to be some consistency in the attributes of CEOs most often identified as "must have" by our private equity clients. While certainly not an exhaustive list, these more common attributes are explored below.

Find Value Accelerators

Thinks Like an Owner

The CEO aligns with the private equity sponsors, embraces the value creation plan, and thinks like an owner of the business.

Strategic resource allocation and capital expenditure is critical in any company as it makes investment decisions tied to the achievement of strategic objectives. In private equity sponsored companies, there is even less room for error when making investment decisions that affect the business. The CEO (like others on the management team) needs to align with the owners. They should have a personal ownership position in the company in addition to robust equity compensation tied to his or her direct efforts to meet financial metrics.

They need to act like an owner of the business with a maniacal focus on achievement of the value creation plan. Thus, they will expect their team to do more with less and carefully assess the true benefits of spending precious resources in pursuit of growth and operational excellence.

"CEOs need to do two things well to be successful in the long-term: run their operations efficiently and deploy the cash generated by those operations. Capital allocation is essentially investment and, as a result, CEOs working with their Boards need to be both capital allocators and investors. While CEOs have a wide range of responsibilities, this one just might be the most important of all."

- Will Thorndike, Managing Partner, Housatonic Partners and Author of *The Outsiders: Eight Unconventional CEOs and Their Radically Rational Blueprint for Success*.

Grasp the Value Drives

The CEO is crystal clear regarding what drives value in the business and is crisp in communicating areas that require strategic and operational focus.

Bain & Company's research over the last 40 years has discovered that the smartest PE firms focus on creating operating value within their portfolios and are doing so in a more systematic, focused and aggressive way than their competition. Bain has found that the CEOs who are most successful define the full potential of the portfolio company, foster a results-oriented mind set within the company and measure the core areas that drive real value. This unique attitude is just as important as stellar professional skills and an exceptional track record. In the words of Bain, they make equity "sweat" – putting all of the company's capital to work in order to harness talent, accelerate performance and develop an actionable blueprint for value creation.

"The single most important thing is to make sure you have the right leadership for the business. In a world economy that remains prone to macro shocks, the firms we work for are looking for expertise and a successful record, but equally important, CEOs who really want to make a difference transforming a company."

- Hugh MacArthur, Head of Bain's Global Private Equity Practice and lead author of Bain's 5th Annual Private Equity Report (publication date: February 2014).

Measures Organizational Health

The CEO has a finger on the pulse of the organization, is constantly assessing organizational health and ensures all levels of management embrace key imperatives.

A great CEO and leadership team that cannot activate mid-level management to achieve value creation goals will not succeed. Thus, it is critical that the CEO establish a methodology for measuring organizational health. At a minimum, the CEO needs to spend time regularly in the "field" with the troops, especially those that touch the customer base most regularly. In smaller companies, this effort to be in the field on a consistent basis, listening carefully to opportunities for improvements, may be adequate. In larger companies, more structured processes may be required. For example, McKinsey & Company has established an "Organizational Health Index" that allows a larger organization to be surveyed periodically to see how key programs and strategic imperatives are being embraced during change management programs. (Please see "Beyond Performance" by McKinsey & Company Partners: Scott Keller and Colin Price.)

"Focusing on performance isn't enough. Owners need to measure organizational health with the same rigor applied to performance metrics like revenue, cost and EBITDA. Such a measurement system and discipline is critical to create sustainable value; it is most certainly an early warning system that elucidates business performance issues."

- Gary Pinkus, Director & Global Head Private Equity and Principal Investing Practice, McKinsey & Company.

Is Focused on Employees

Working closely with senior management, the CEO needs to create a healthy and robust work environment that ultimately drives customer satisfaction and superior equity returns.

Traditionally, most companies have emphasized the need to satisfy shareholders and customers as key priorities, but only more recently have companies – PE funded and otherwise -- embraced more assertively an employee-first mentality. The theory is that engaged and focused employees, operating with well-articulated goals that are engrained into their daily routine, is the most efficient route to customer satisfaction. By focusing on the work environment as a priority, companies inevitably create a culture of value creation implicit in their daily operating system.

"CEOs and their senior teams should create a stimulating work environment that empowers their employees to take care of their customers. At Ascenty, we believe in the upside-down pyramid whereby first companies focus on creating a great work environment for their employees. Second, employees focus on providing superior goods or services to their customers. And third, satisfied customers lead to profits and excellent returns for the shareholders. Ultimately though, it is the entire organization that needs to believe in this chain reaction. CEOs and senior managers that only focus on the customers or even just financial returns to their shareholders will miss out on the most important link in the chain: your employees."

- Christopher Torto, CEO of Ascenty, PE sponsored by Great Hill Partners (Prior, serial CEO of PE funded companies with multiple liquidity events, including IPO)

Top Grades Management

The CEO builds and cultivates a world-class team, celebrates successes, and acts quickly and decisively in addressing performance shortfalls.

World-class CEOs place greater emphasis than their competitive peers on attracting, developing and retaining top talent. Such CEOs are focused on empowering and delegating greater responsibilities to those employees who will respond to the challenge. They set a collaborative tone across functions and business units through mutual trust and clarity of shared purpose. Clear performance expectations are set based on attaining tactical milestones that align with the value creation plan. Appraisal systems are based on factual quantitative and qualitative objectives that stretch business performance expectations, recognize outstanding achievements and identify areas for personal development and improvement.

"There is nothing more important to building a business than recruiting exceptional talent and creating an environment that is team driven and all players feel a sense of fairness. I grew a business from 60 employees to 1,400 in 4 years and it could not have been accomplished without strict adherence to sound management practices and fair play."

- Walter Raquet, Founder, Green Earth Technologies (former Co-Founder of Knight Capital [1995-2002])

Creates Followership

The CEO is a superb leader and communicator who builds relationships well, sets a clear and compelling vision, and can rally the organization from the Board down to the field staff.

Some see "charisma" as a necessary element of effective leadership, but research, (Jim Collins, "Good to Great, and others) has proven that a long-term, willful, less egocentric approach to the business yields optimum value creation for the entity. Some dispute these findings when considering the success of technology CEOs like Steve Jobs at Apple (the Product guy) and Larry Ellison at Oracle (the General). Effective leadership styles will vary based on the company's culture, the markets served and business requirements, but there is some commonality. Great CEOs have presence and gravitas that allows them to get the attention of their people – from the Chairman of the Board down to the customer service representative. They communicate key imperatives clearly and build a motivated team that can establish momentum and measurement systems that ensure the key imperatives stick.

"The best CEO will fail if they cannot get others to follow based on a well-developed understanding of the business and how to drive value. While simple, high-impact delivery is critical, the substance of our messages is just as important. It is important to convey information transparently and with accuracy as you problem solve with the team to focus and motivate the organization on key initiatives that drive value for customers, employees and the investors in the business."

- Peter Weber, CEO, Curvature (PE sponsored by the Partners Group)

Knows the Customers

The CEO is keenly aware of how the company and its product and services are perceived by the customer base and continually verify how the company syncs with current and ongoing customer requirements.

The CEO develops and executes an appropriate strategy and, more importantly, effectively evolves that strategy based on a solid understanding of the company's core offerings, be they product or service or both, through the lens of their customers. Without an understanding of customer requirements and a concomitant focus on serving customers well, companies cannot meet their top line or bottom line growth objectives. Great CEOs prioritize time spent with customers as well as internal functions like sales and customer service as part of their daily routine. They align customer needs with internal business operations and make measurement of the company's effectiveness in meeting those requirements an absolute imperative.

"CEOs need to stay strategic in their overall management style to effectively orchestrate and coach the team for success, but cannot maintain such an abstracted view that they miss insights coming directly from the customer base. These insights are critical in accurate strategic and resource allocation decisions."

- Tom Tiernan, President & CEO, VFO Group (former Operating Partner at Francisco Partners)

Knows the Numbers

The CEO knows how to interpret and communicate the financial status of the business with cash-flow and balance sheet management as the mantra.

While there is no question that CEOs need an outstanding Chief Financial Officer (CFO) as a business partner, there is a preference for CEOs who can go deeper on the numbers. That does not mean the CEO needs to have grown up in the finance silo. Quite the contrary, a lot of contextual factors will dictate whether a more market-facing, finance-oriented or operations-driven CEO is appropriate for the business. Whatever the functional background of the CEO (and they all have a "spike" in terms of their functional abilities), fluency and granularity in the analysis and communications of numbers-related issues related to Profit & Loss is critical.

"When we look across our portfolio and our history, we have looked to our CEOs to be more accountable for the strategic running of the business, pulling levers and orchestrating the team against a value creation plan. But it is clear from our experience that there is a threshold level of competency required in understanding the core financial issues facing the business. Our best CEOs are strong leaders with good balance in their functional expertise and always have a great

CFO by their side as a true partner running the business and making good capital and resource allocation decisions."

- Greg Pappas, Managing Director & Head of Portfolio Support Operations, Berkshire Partners.

Conclusion

CEOs of private equity sponsored companies have a tough job. It requires a disciplined, focused and metric oriented approach. Importantly, CEOs need to effectively balance the interests of a range of stakeholders, including investors, management, customers and, in many cases, founders and families. When CEOs think like an owner of the business driven by their equity position, and instill the same mentality throughout the organization, true breakthrough performance can occur and all stakeholders win along the way.