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Insights

What does it take to be an effective CEO of a Private Equity backed business

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CEO exits are often planned as part of a deal, but up to a half of CEO exits are unplanned – typically because of poor performance, or disagreements with the investor (1). This represents a significant loss of value, but the risks can be reduced by careful assessment and selection. Helen Roberts, head of our Leadership Advisory Practice, reports on what it takes to make an effective CEO of a PE backed business.

The private equity market is in rude health; Bain recently reported that "un-invested dry powder stands at a record $1.3 trillion" (2) and the environment for fund-raising is also strong.

Not surprisingly we are seeing increasing competition for the talent needed to turn these market dynamics into deal value – all the more fierce because the combination of characteristics needed to be a truly effective CEO in a PE backed business is rare. Importantly, it is not the same as the skill set needed to rise within the ranks of a large corporation, or to succeed as the CEO of a complex publicly quoted company.

In our experience, four things in particular are crucial: the ability to execute, the right motivation, the ability to manage the relationship with the board, and fit with the culture.

Why execution?

Execution means making what is meant to happen actually happen in the time frame it is meant to. To do this is often complex and intellectually demanding. It is a challenge in any business, but it is an even greater challenge in many PE backed businesses because:

- Investors typically set very demanding targets
- These targets often represent a change of direction
- The debt structures don't allow much room for mistakes
- There won't normally be a well-tested machine in place to do the work
- It needs to happen at pace.

The contrast with the situation in large, long-established quoted companies is well illustrated in an HBR interview with John Reed, former Chairman of Citigroup. He described what he thought it took to be successful in banking:

Success comes when you routinize things to a point where a group of people at the top build the strategy, drive the creative work, and push the new products, while execution takes place relatively effortlessly.(3)

What does it take to be good at execution?

In our experience, successful PE CEOs have to be **clear thinkers with a very good and detailed understanding of the profit and revenue drivers.** In line with this, our experience shows that successful candidates, like their counterparts in quoted companies, tend to have strong analytical abilities. More specifically, successful PE CEOs have a "complete grasp of the financial model", and "know where the cash is" as one of them put it to us. They need a grip on this kind of detail in a way that most CEOs of publicly quoted companies do not: in a business that is six times leveraged you can't delegate this to the CFO. Covenants will have acquired "quasi-religious status".

But it's **dealing with fast paced change** that forms the toughest challenge. The KPIs will be very demanding, and the pace of change will normally be intense. This creates an overriding "sense of urgency" as another PE CEO put it to us: you have to respond and respond quickly. You also have to have the "physical energy to work at speed", in the words of another, with the agility to change the plan even while sticking to the overall direction. You need to be "intense, engaged and energetic" in the words of a third.

Our experience is that many executives in large companies have not had to be responsive in quite this way, and cannot make the shift. This is one of the leading reasons we see for CEO failure. PE CEOs need to be comfortable making the decision, not building consensus through protracted discussion and influencing.

It is also perhaps why **impatience and plain speaking** seem to be valued in PE companies - in contrast to the culture of most quoted companies where executives often have to 'play the long game', patience and managing the message are valued and there simply isn't the same sense of urgency.

Closely linked to this is the **ability to get others to respond promptly** as well, and our analysis shows that the ability to collaborate and influence is, along with responsiveness itself, one of two qualities that most clearly mark out successful from unsuccessful candidates for PE CEO positions.

PE CEOs need to be good leaders and are generally good at delegating and motivating, but we have noticed that the successful ones **don't tend to rely on their colleagues blindly** – at least they often find themselves feeling they could do the job better if only they had the time. This can lead to micromanagement if it gets out of control, but it can also be useful: it encourages the CEO to stay close to the business and to customers, paying attention to detail. As one PE CEO put it to us, you need to "solve problems for [subordinates] and with them", and this includes "really understanding the data and knowing what to do with it".

What about strategy?

On the other hand, **"building the strategy"** as referred to by Reed in his account of what it takes to be successful in banking is often not so important. Professor Claudia Zeisberger, Academic Director of Insead's Global Private Equity Initiative, goes so far as to say that "what is often needed is a COO as opposed to a CEO" given that "for the most part the investment company has already worked out the strategy before they make the investment."(4) Unlike in a quoted company, there is a need to "roll up one's sleeves and get one's hands dirty".

We agree with the thrust of this, although we would not go quite as far as Professor Zeisberger. It is true that PE CEOs and management teams do not develop strategy, PE *boards* develop strategy. This is different from the normal practice in quoted companies where CEOs and their management teams develop strategy. Similarly, PE CEOs usually do not manage diverse shareholder and stakeholder groups or have to focus on public affairs in the way that quoted company CEOs often have to.

However **the point shouldn't be overstated.** Strategy often evolves and sometimes has to change significantly within the investment horizon, and then the CEO has to work closely with the board, and with the representatives of the investor company that sit on it. Our candidate assessment scores show that success is associated with relatively strong strategic thinking (even if successful quoted company candidates tend to score even better than successful PE candidates). Strong commercial judgement is also crucial.

Nor does the focus on execution mean an unbalanced focus on the short term. In our experience, PE houses put more emphasis on long term performance than many CEOs. They want a business with good prospects when the time comes to sell, meaning the CEO's strategic horizon should be longer than the investment horizon.

What motivates successful PE CEOs?

PE CEOs feel a need to achieve, to be seen to achieve and to lead others in achieving. This is also true of entrepreneurs, but in contrast to entrepreneurs, PE CEOs are less concerned with what they achieve. Entrepreneurs are often driven by a vision of the products they want to sell or the company they want to build. PE CEOs by contrast tend to be happy to accept other people's goals and deliver them – provided their achievement is recognised. They relish the "focus on the prize" as one put it to us.

So while PE CEOs have a much stronger drive for achievement than the average person, they are not exceptional when it comes to defining goals. Indeed they may have a lower need for autonomy and a much lower interest in theoretical or abstract questions than the average executive[5].

On the other hand, our view, shared by some investors and PE CEOs, is that the most successful CEOs balance strong achievement orientation with concern for the culture and values of the organisation.

Ultimately, of course, achievement depends on these because they shape the behaviour of the people implementing the strategy and building engagement at all levels.

In addition to drive, **successful CEOs also have the resilience to thrive in an unstable, fast moving business environment.** They can cope with setbacks and seek to learn from them.

Relations with the board

Good relations between the CEO and the board are essential to success, and investors and PE CEOs emphasise this point. The ideal is the kind of informal relationship where the CEO and the representative of the PE house talk regularly about how things are going. "Think of the board as like that of a family company", says one PE CEO, "with a number of characters who have accumulated real knowledge of the business over the years".

Unfortunately things do go wrong sometimes. We have identified five main reasons:

- There can be **tension about roles.** Not surprisingly CEOs tend to see their role as somewhat more strategic and big picture than investors do, and most would probably bridle at Professor Zeisberger's comment that "what is often needed is a COO"
- There can also be problems when nervous **CEOs over-promise,** resulting in over-demanding performance targets, and turning what should have been good performance into underperformance
- Sometimes **CEOs are underprepared for meetings** and do not appear to have all the details at their fingertips, perhaps relying on CFOs or other colleagues. Not surprisingly this damages investor confidence who tend to be very data oriented
- Some **CEOs resist the ideas and expertise of the investors.** Executives who have been in an industry for a long time may have a set way of doing things, and, in one investor's words, they tend to have a short shelf life. "An ability to listen" is a key requirement, as one investor put it to us
- Worst of all, **lack of openness** and transparency sends very bad signals, at best leading to greater scrutiny from the investor, at worst to dismissal.

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The **intellectual agility** a CEO needs to deal with fast paced change will also serve him or her well in board meetings and help avoid some of these problems. There is a need to move from operational detail to present the big picture, and to take on board new ideas quickly. Similarly the willingness to accept other people's goals that makes the CEO good at execution will most likely help smooth the relationship.

A particularly important factor is **underlying self-confidence.**[6] Almost all PE CEOs will come across as optimistic, self-confident and with high self-esteem. However in our experience some people mask underlying vulnerability with a display of exaggerated self-confidence, which turns into defensiveness when things go wrong. This trait can be particularly damaging in a PE setting, leading to overpromising at the outset and attempts to deny or cover up problems that emerge later. It is as well to try and detect it when recruiting, which is why we use some of the assessment tools we do.

Fitting the culture

Choosing the right PE CEO is partly a matter of assessing for the characteristics we have described, but **it is also a matter of fit – with the culture both of the company and of the PE house.** In the words of one highly experienced PE CEO who has also worked in quoted companies, anyone considering a move into PE should "diligence the PE house [as] they are all different and you'll be working closely with them". For example, who do they put on the board? How hands on are they? What style of communication do they like? Perhaps most important of all, potential recruits should look carefully at "the funding model and what comes out of that" – how will you and the PE house react to the pressures this creates – and will that make for a good working relationship? Assessing this fit is a vital part of the work we do – both for investors and executives.

Conclusions

There is no identikit PE CEO; they vary hugely. Still, we can sum up some of the key characteristics of the successful PE CEO.

Like the CEO of a quoted company he or she needs to have:

- a very clear sense of the business's profit drivers, analytical ability, judgement, and an ability to think long term
- leadership skills, with an ability to collaborate and influence and an understanding of how to influence culture and values.

Over and above this, he or she needs to have:

- willingness to "roll up his or her sleeves"
- the ability to respond very quickly to events and a strong sense of urgency
- a focus on cash, detail and problem solving with a reluctance to delegate completely
- willingness to accept other people's goals
- exceptional levels of underlying self-confidence and resilience.

Less important as compared with the CEO of a quoted company are:

- the ability to engage with public stakeholders and the press
- diplomatic and presentational skills
- strategic skills
- the ability to develop a vision and new goals.

This combination of characteristics needed is demanding and in our experience quite rare.

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1 Skillcapital database of PE deals and executive changes

2 Bain & Company Global Private Equity Report 2016

3 https://hbr.org/1990/11/citicorp-faces-the-world-an-interview-with-john-reed

4 L Pratch and J Jakobowitz, "Successful CEOs of Private Equity Funded Ventures" Pratchco, 2015

5 Pratch et al op cit

6 Pratch et al op cit

Helen Roberts is a partner at Skill Capital LLP ("Skillcapital") and Practice Head of Leadership Advisory Services. Helen is responsible for leading assignments on a range of topics, including assessing management teams pre and post-deal, developing 100-day plans, board reviews, team effectiveness coaching, organisation design and culture change. She also works with private equity funds on selecting and developing their teams. Her work covers all sectors and she has extensive international experience covering all continents gathered during her 25 years in consulting.

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