What it Takes to Lead a Private Equity Portfolio Company – Rob Andrews

General managers of big private companies and Presidents of multinationals often aspire to CEO roles and view private equity as a first choice to run their own show, add CEO to their resume, and build significant wealth.

Our experience indicates that while principals at private equity firms value the experience of these kinds of executives, they often question their ability to function well in this fast-paced, more financially levered world. This reticence is well founded as many presidents of even the largest multinationals are not yet ready for such a CEO role, and some will never be. The fact of the matter is that becoming a rock star private equity CEO is a very different gig.

Running a large division of a big company often gives brilliant, well-educated candidates good technical training, industry knowledge, leadership skills and general knowledge of how the overall enterprise operates. It does not necessarily prepare an executive to run a portfolio company, in which he or she will be responsible for vision, financial, business and human capital issues in total.

The CEO must either develop or drive the vision of the entire company, which also means selling the company at the end of the investment horizon. While in most cases this is done in concert with the PE principals, the CEO should be fully on board with the overall vision and strategy. This component is not typically a part of running a division of a larger enterprise. The private equity CEO is also the primary business development executive in most portfolio companies and must balance short-term results, cash flow, and ultimately successfully execute the PE firm's playbook and create long-term enterprise value. Division presidents often have inadequate understanding and appreciation of what it means to have to make payroll, wear multiple hats, keep the troops motivated, and still deliver the bacon at the end of the investment period.

Division heads also have to adjust to a pace that can seem frenetic and expectations that are far more demanding than anything they've experienced in the corporate world. The division president who has been getting great reviews, raises and accolades for producing 3 percent growth and managing what are typically referred to as controllable costs, may suffer some serious culture shock. He might find himself facing the expectation that he must double his revenues and EBITDA in three years while hitting budget every quarter along the way. Simultaneously juggling and delivering of all of these objectives requires agility, adaptability and an entrepreneurial spirit absent in many large company executives.

Clearly articulating a strategic plan helps shape and preserve alliance between the CEO and the investors. This plan, or strategic roadmap, playbook or value creation plan, often aids to provide alignment for the stakeholders. The plan focuses on what the PE firm wants to be able to say in their presentation to strategic buyers at the end of the investment horizon.

There are typically three to five important initiatives associated with a portfolio company playbook. It's not just about making this quarter's numbers. It's pulling off an acquisition where the competition is fierce. It's making the right strategic calls to alter the direction of the enterprise. It's acquiring key people in critical new areas, sometimes unknown to the existing organization. And it's rebuilding the team's culture, systems and processes to be more efficient while getting it all done in three to five years, rather than over a decade. A very good friend of our firm, who has been enormously successful as CEO of several portfolio companies under several different owners, and now the senior operating partner for a premier global PE firm, says that the playbook is often wrong, and that the right CEO should be able to validate the firm’s plays.

In addition to a track record of exceptional leadership and driving growth, private equity principals look for adaptability, particularly going from "big" to "small," where results must be achieved with a much leaner staff. Autonomous and full functional responsibility, as well as a tolerance for risk, are also important indicators of the ability to transition to private equity.

Another valued trait is the confidence to run the business as if it is his or her company. Private equity firms have no interest in managing the business. Private equity teams are mostly small, talented, and highly focused groups supporting the CEO. Many veteran private equity CEOs said they learned that building the ideal team early in the investment lifecycle is key to success.

The depth and quality of personnel, processes, and systems are always unique when you move to a smaller private equity company from a larger corporate environment. Understanding that and making the changes necessary to elevate talent and processes is critical to long-term success.

CEOs and senior executives in a PE company have to be willing to be "doers" and not just leaders. With limited resources, you have to make sure you're hiring complementary and supplementary skills to the team; not duplicative. People will need to be "hands-on" and roll up their sleeves and do the work.

Working with a private equity board is also very different. A private equity company's board typically consists of investors and perhaps one or two additional outside directors with relevant operating experience. First-time CEOs often feel the need to bring fully developed strategies and reports to the board members — rather than engaging directors on key tactical and operational issues. Another culture shock that often occurs with new PE CEOs is coming face- to-face with members of the board who know what the numbers should look like and expect quick answers if they are out of line.

The best portfolio company CEOs are comfortable with collaboration with the board and sponsors and treat them as partners and advisors in the business. PE board members want to hear about things proactively, and they want to hear about them regularly. Investors and directors appreciate getting out way ahead of something and giving them an opportunity to weigh in. Big company division heads often attempt to work with private equity investors by managing information to them and presenting in a formal setting. Experienced PE CEOs typically conclude that they are in a true partnership with the board and commit to leveraging board members to make everyone's job easier.

Some PE CEOs have near-daily conversations with the lead principal on multiple issues ranging from Mergers & Acquisitions, cash flow, business performance, and longer-term capital expenditures. It necessitates more poise rather than less to be that open with the board. The CEO needs to engage the board in strategy, organization, execution and people. Successful CEOs are transparent and proactive in their communications with the board.

Before the board meetings, most investors want the CEO to arrange a calendar of topics to be discussed. These issues should match the cycles of the business — strategic planning, operating planning and budget-setting, being mindful of deadlines and anticipating what the board will want to discuss.

Veteran portfolio company CEOs say first-time CEOs profit from having a mentor on the board, in the beginning. The mentor can be anyone with whom the CEO has some synergy, but ideally, should be someone who has a broad point of view on the investor side as well as operating knowledge and skills.

The CEO must understand the basics of a fund's inner workings, raising money, the chain of command, and how its policies can influence the firm's interactions with your business. Are there other deals in the works that could be a distraction?

First-time portfolio company CEOs must admit that they don't have the solution to every problem and should learn to engage the board on the toughest challenges. Seeking advice and ideas from the board often can result in surprising and successful solutions.

The portfolio company CFO has an extensive and multifaceted role, serving as a partner to and proxy for the CEO and a link from the business to the private equity firm. The CFO has to have the trust of the investors and be aligned completely with the CEO. Although specific capabilities may vary depending on the business needs, the portfolio company CFO has to have outstanding technical finance skills, a passion for diving into details and strong communication skills.

The ideal CFO is someone with high intellect who can communicate better than anybody, the drivers of the business and how the business is doing. You want a strategic business partner who understands the business at an instinctive level; that's valuable for a CEO.

Besides the CEO, the CFO is probably the most important position. The CFO must be open and transparent with the CEO and have his back as much can occur that the CEO may not be aware of, both inside and outside the business and with the private equity investors. The CFO must understand the numbers and be part of the strategy development.

Financial sponsors will expect the CFO of portfolio companies to be the key conduit of information to the private equity firm. The CFO has to have the confidence of the CEO and the private equity firm.

Even though a strong CFO, expectations will be that the CEO has a keen awareness of all the financial matters of the business as well.

The bottom line is that making the transition from big company executive to private equity CEO requires a delicate balancing act and a rare combination of attributes. The best PE CEOs have imagination and vision with the ability to deliver short-term results. They have self-confidence and personal presence with the appropriate dose of humility. They are strategic thinkers and planners with a bias toward action and calculated risk. They are very hard workers with adaptability and the ability to deal effectively with ambiguity. Given these prerequisites, one must have proven that they are self-starters and true leaders capable of operating in a highly autonomous environment.