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Private Equity Recruiting

The Widening War for Leadership

Leadership is the new bottom line for private equity operating executives seeking top talent for their portfolio businesses. Here's why.

TALENT CHALLENGES FACING SMALLER MID-MARKET PE PORTFOLIO COMPANIES

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Driving differentiated returns in a crowded private equity environment was never easy and has become significantly more difficult over time. Firms are paying top dollar to source and acquire companies in a market flooded with capital. Fewer deals are "locked up" in a proprietary manner. The areas where firms have true leverage to create value are short and long-term operating improvements.

Research from consulting firms like Bain & Company and others confirm that early "activism" on the part of the PE firm and a more systematic approach working with management yields better returns than more passive strategies. Everyone agrees that it is critical to have a well-defined value creation plan before executing a transaction and monitoring portfolio companies carefully and consistently throughout the lifecycle of the investment.

The Issue:

Businesses with ambitious plans often face a wide range of talent and organization issues.

WHAT CAN GO WRONG

Clarity & Alignment	■ Leadership doesn't set clear **priorities** or **communicate** vision and value creation initiatives throughout entire organization ■ Leadership team is **not aligned** on priorities—where to go and how to get there
Roles & Structure	■ **Accountabilities** are not clarified for the most critical decisions ■ Critical **interfaces** don't work together effectively ■ **Structure** gets in the way of delivering an effective value creation plan
Processes & Information	■ Key growth initiatives are **not resourced** to succeed—bench depth issue ■ **Bureacracy** gets in the way of growth
People & Performance	■ Value creation plan lacks the right talent or **leaders** (skill or will) ■ Insufficient **talent pipeline/capabilities** to sustain growth ambition ■ **Incentives** don't reinforce value drivers in most critical initiatives
Leadership & Culture	■ Inability to transition the top team to a **PE mindset,** required to balance big-picture thinking with hands-on style ■ The organization is not sold or **not excited** by the value creation plan
Results Delivery®/ Ability to Make Things Happen	■ Management **dashboards** don't provide visibility into key value creation drivers to **push and follow through** results achieved ■ Incomplete appreciation of company's **inability to manage the change**

"Results Delivery® is a registered trademark of Bain & Company, Inc.

With the above in mind, PE firms that specialize in lower mid-market transactions (sub-$100 million in revenue) have an added challenge. Attracting top talent that can function effectively in these smaller environments is not a trivial exercise. Smaller companies do not have the cost structure to support an army of staff and they have often been starved in one or more areas in terms of professionalized functions like finance, HR and sales. A decade ago, some thought executives coming from larger and more complex environments might naturally be able to manage smaller and supposedly not-so-complex environments. It seems safe to say that the latter has been disproved over time. It is impossible to ensure a new CEO or CFO will be successful unless one carefully considers their functional, technical and leadership competencies with a focus on their management/communication style and what behavior they exhibit that may or may not be suitable for a given culture in a smaller company.

Key Issues to Consider

Dearth of PE-Proven Talent – One way to minimize risk is to recruit executives with direct and successful experience working in a relevant PE funded environment. Unfortunately, there are only so many in the market at any given time and the pool of talent suitable for smaller companies may even be smaller and harder to access. It is critical to create a big enough pool to ensure the candidates can align with the culture and critical success factors facing the business. Entertaining executives who might commute is one way to open up the pool, but the decision to allow that is situational – highly dependent on the state of affairs at the company, the make-up and quality of the team and the extent of effort required tied to investment phase.

Source the Right Candidates – In order to broaden the pool of talent, it is important to find executives with AND without PE experience. Certain companies tend to cultivate P&L leaders that often are much better prepared to step into P&L as well as CFO roles. These companies are often decentralized where unit executives really own the P&L. A classic example of this is Danaher which, importantly, uses their own proven system of value creation – the so-called Danaher "business system. Executives coming from highly matrixed environments like GE, UTC and many others can struggle in smaller environments unless they have stepped out and already proven themselves in a smaller environment (or overseas or more entrepreneurial venture in some cases).

Geographic Considerations – When sourcing in tough-to-recruit areas, it is critical to have a clear search strategy on where to hunt for talent. A top executive from a company in Manhattan is unlikely to be the best fit for a company in Wichita, KS (and vice a versa) from a cultural standpoint. That said, there are executives who have grown up in or attended college in the Midwest, as an example. Perhaps they grew up on a farm in Michigan, went to school at Ohio State, and are now running a smaller company in New York. There is a much better chance someone like this will be more suitable to the culture of a Midwest company and can be recruited into a geography that once was home. Search firm partners and their staff must have experience running searches with these challenges in mind and qualify candidates early and often to be sure they are truly engaged.

Competitive Compensation – Irrespective of geography, smaller PE funded companies have a lower cost structure and that translates to reduced overall cash compensation at an executive level. Candidates for key roles must be convinced there is a compelling upside opportunity relative to the equity component of the compensation and a good career path. This means the recruiting firm, hiring manager and PE firm need to work closely on strategy to educate candidates. Before embarking on the search, all should agree on the "talking points" and materials (beyond a specification) that illustrate the magnitude of the opportunity. No matter how compelling the upside is, there is no reason to waste time on candidates that will not embrace the opportunity given certain cash requirements. Again, it is critical that the search firm qualify early and often and move on if candidates cannot accept cash compensation parameters.

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PE Firm Brand Awareness – Sometimes, it is not enough to educate the candidates on the business opportunity ahead; they need to learn more about the PE firm itself. Most executives have heard of Blackstone, but the same cannot be said of many smaller funds in the mid-market space that often, by design, operate with a low profile that aligns with their target portfolio companies. The team working the search must emphasize the value of the firm that will become their partner, both in terms of their successful track record and partnering style working with management.

Fly High and Fly Low – Executives stepping into smaller environments need to "fly high and fly low" AND be excited about this aspect of their role. With a well-crafted value creation plan in hand, laser-focused execution and a metric-oriented culture of accountability are critical. When something breaks, C-level executives need to problem solve with their team until course corrections are determined. They need to relish the opportunity to walk the factory floor, know every employee's name and work hand-in-glove with field personnel as they interact with customers. A CFO of a small company who has no interest in running his own numbers on a spreadsheet from time-to-time or writing some query code for the ERP to extract data may not be suitable. The right executives think like an owner of the business, are "hands-on" and value building a lean operation.

The Founder Led Small Business – Related to the above, it is often the case that PE firms are acquiring companies led by a founder that may be great at conserving cash but not versed in surgical capital allocation with a new capital structure focused on growth and transformation. Smaller companies typically need to be professionalized quickly – systems, processes and people. Small companies cannot just "save their way to success." They must transform with better execution focused on current products in current markets, new products in current products, new products in new markets, M&A, etc. Not every executive, no matter how good they look on paper, is wired for this type of role.

All PE funded companies are struggling to find the right talent, but the challenge is particularly pronounced in smaller mid-market entities. Several things can be done to reel in the right talent. Develop a search strategy where a broader pool is part of the process. Make sure all parties are clear on how best to educate candidates on the value of the opportunity and working style of the PE firm. A strong equity upside position to get candidates to engage is a must. And, most importantly, be sure you are working with a firm that has a proven process to assess this talent carefully for a hands-on working style that will match the culture. Thoughtful collaboration amongst the PE firm, management team and the search firm is the key to a successful outcome.