AlixPartners

Private Equity & Investors
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INVESTMENT SUCCESS ISN’T JUST ABOUT THE NUMBERS. IT’S ABOUT THE PEOPLE:

Post-deal and the first 100 days

ALIXPARTNERS’ FOURTH ANNUAL PRIVATE EQUITY LEADERSHIP SURVEY

Last year, our private equity (PE) leadership survey—performed jointly with Vardis—dug deeper into a key aspect of the owner/CEO relationship: misalignment between the two sides on a wide range of critical matters.

In this year’s survey (our fourth annual), we take a closer look at the ongoing disconnection between respondents’ beliefs and behaviors, and between their views on certain topics—most notably, the role of addressing talent needs to drive growth in portfolio companies (portcos).

Respondents this year included portco CFOs, adding richness to the insights we gained from our survey findings.

Also new this year, we’ve organized our findings and analysis into two reports. The report you’re reading now is Part 2 of 2. In Part 1, we concentrated on three main themes:

1 Proactive management of the triangular relationship among PE sponsors and portco CEOs and CFOs

2 Early understanding of major misalignments related to the role of human capital in PE firms’ investment thesis

3 Disconnections between beliefs and behaviors regarding pre-deal assessment of prospective portcos

In Part 2, we shift focus to:

1 Keys to success in the first 100 days after a deal is inked

2 Management of performance evaluation, turnover, and replacement of portco executives

SUCCEEDING IN THE FIRST 100 DAYS: IT'S REALLY ALL ABOUT PEOPLE

As early as possible after closing an investment deal, PE firms must use every tool available to determine who the A, B, and C players are in their new asset. And they must swiftly define expectations and priorities for key roles, ensuring that those roles indeed create value and have measurable KPIs.

TOP PRIORITIES FOR CEOS IN THE FIRST 100 DAYS

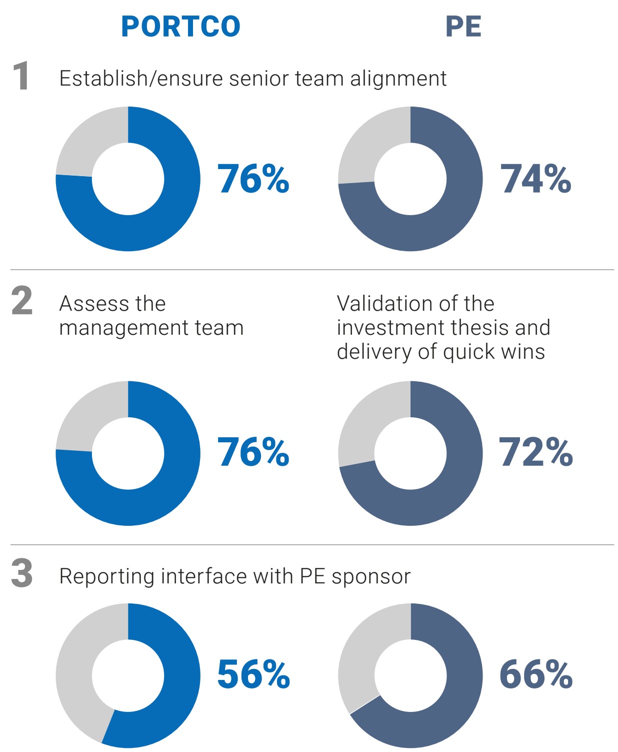
When asked what they thought a portco CEO's top two priorities should be in the first 100 days post-deal, 74% of our PE and 76% of our portco respondents alike listed "Establish/ensure senior-team alignment" as the number-one priority (figure 1). As their number-two priority, 76% of portco respondents cited "Assess the management team," while 72% of the PE respondents chose "Validation of the investment thesis and delivery of quick wins."

For PEs, assessing the management team was far down on their list—number six—while validating the investment thesis and delivering quick wins came in fifth place among portco executives. Interestingly, both groups rated "Reporting interface with PE sponsor (such as cash flow, financial reports, and KPIs)" as their number-three priority.

These numbers illuminate a major disconnect between the two groups—and between their beliefs and behaviors—regarding what top priorities should be in that crucial time period after a deal closes. For instance, while PE responses to other questions in the survey indicate that they view human capital as key to investment success, the fact that assessing a portco's management team came in sixth place in their list of priorities suggests that they may be devoting insufficient attention to human capital needs in their portcos.

And while "Analyze the company culture" was closer to the bottom of the list, 50% of the portco respondents prioritized it, versus only 19% of the PE firms. This 31% delta dovetails with comments in Part 1 of this report about misaligned views regarding the importance of organizational culture assessment.

FIGURE 1: WHAT SHOULD BE THE TOP PRIORITIES IN THE FIRST 100 DAYS?



Further echoing the theme of human capital and talent needs, when we asked both CEOs and CFOs what they saw as their top three priorities during the first 100 days, their answers centered on three themes.

Ensuring role clarity

Aligning the leadership team on strategy

Putting the right people in the right roles

However, we saw nuances in their responses, depending on the role. CEOs' three top-stated priorities (as noted above) suggest that theyfocus on establishing the infrastructure for success in the post-deal period. For the CFOs, the top three priorities were:

ESTABLISH EFFECTIVE MANAGEMENT REPORTING AND KPIS

76%

DEVELOP RELATIONSHIP WITH CEO

76%

ASSESS THE FINANCE TEAM

69%

The CFO responses indicate a possible focus on reporting, relationships, and the finance function specifically.

HOW PE CAN BEST SUPPORT PORTCO CEOs AND CFOs

Responses also differed regarding the types of support that portco CEOs and CFOs wanted from their PE investors during the first 100 days post-deal.

60% of both executive groups said they wanted formal assessments of their own direct reports and team dynamics

Clearly, many portco executives are eager to ensure they possess the talent needed to execute on their PE firm's investment thesis.

Self assessment:

But while only 27% of the CEOs wanted assessments of their own strengths and challenges, 52% of the CFOs said they desired this form of support. The delta may indicate that CFOs are seeking clarity about accountability and expectations for their role.

Operating Partner support:

In addition, significantly more of the CEOs than the CFOs (53% versus 38%) said they'd like to be assigned an operating partner or team from their PE firm. Roughly 65% of the portco executives acknowledged that their main point of contact at their PE firm is an operating partner—down from 75% last year. But those who responded as such described that partner as a generalist, versus an industry specialist or functional expert.

When we compared this year's results with last year's, it appears that PE firms and portcos are paying greater attention to the impact of effective human-capital management during the first 100 days. After all, the 2018 results highlighted the importance of individual portco CEOs' ability to focus simultaneously on a wide range of challenges, including defining a vision and executing on strategy. But the 2019 findings point to sharper awareness that success in the first 100 days isn't just about the CEO—it's about everyone around him or her as well.

AFTER THE DEAL: MANAGING PERFORMANCE EVALUATION, TURNOVER, AND REPLACEMENT OF PORTCO EXECUTIVES

Survey results related to post-deal performance evaluation, turnover, and replacement of portfolio-company executives provide additional signs of a shift in emphasis toward human capital and talent needs that we saw in other findings from this year's study.

CEO AND CFO PERFORMANCE EVALUATION: DIFFERENT ROLES, DIFFERENT CRITERIA

When we asked the portco executives "What mechanisms are in place to review and assess your performance?" we saw that, as in last year's survey, PE investors rely heavily on traditional approaches to evaluate CEOs' performance:

70%
Using business reviews

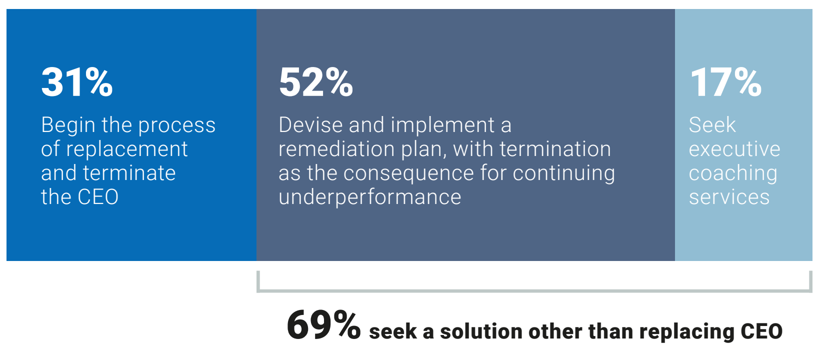
52%
Real-time metrics (such as number of customers, delivery backlog, product forecasting, stock performance, systems downtime, and cash flow)

52%
Insights gleaned from PE investors' conversations with CEO's direct reports

However, use of feedback from CEOs' direct reports has decreased in the past year (52% for 2019 versus 74% for 2018). Overall, these findings suggest that CEOs' performance is judged mostly by their leadership capabilities.

What's more, only 24% of the CEOs cited individual performance reviews as an assessment mechanism. In our view, this suggests that investors are missing an opportunity to deepen their understanding of how well portco CEOs are supporting the company's growth and profitability goals. To be sure, if a portco is successful, that suggests effective leadership on the CEO's part. Yet individual performance reviews provide more nuanced details about how a CEO is executing on more specific accountabilities beyond broad running of the business.

Interestingly, 69% of the PE respondents in our study said that, in cases where a portco CEO's performance is deemed inadequate, they seek a solution other than replacing him or her. As much as 52% said they craft a remediation plan, with termination as the consequence of continued underperformance. And 17% said they look to executive coaching.



The desire to give underperforming CEOs a chance to improve is understandable, given the disruption and costs that turnover in this role can inflict on a portfolio company. For example, sources estimate that total costs of replacing an executive can amount to as much as 12-15 times his or her salary.[1] However, this choice also comes with risks: If it drags out what ultimately becomes an unavoidable firing of the CEO, the portfolio company is forced to operate for that much longer without an able leader at the helm.

In contrast to CEO performance evaluation, CFOs' performance is being assessed primarily through individual performance reviews (73%) and business reviews (70%), with use of real-time metrics coming in at a distant 33%. These findings suggest that, unlike with CEOs, CFOs' performance is judged on their functional or operational expertise rather than on their organizational leadership prowess. This may reflect PE firms' belief that the main driver behind CFO turnover is lack of sufficient technical and financial capability.

1. "What Is the True Cost of Hiring a Bad Employee?" TheUndercoverRecruiter.com. https://theundercoverrecruiter.com/infographic-what-cost-hiring-wrong-employee/. Accessed 12 April 2019

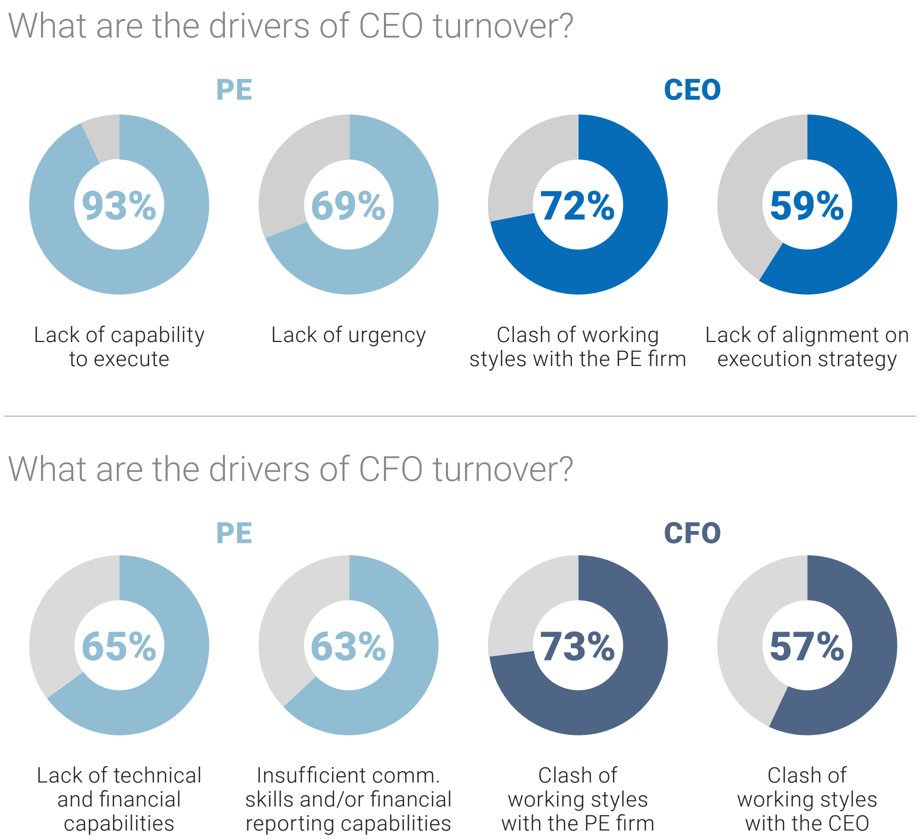
CAUSES OF CEO AND CFO TURNOVER? THAT DEPENDS ON WHO YOU ASK . . .

Responses more specifically related to CEO and CFO turnover (voluntary or involuntary) illuminate misalignment in perceptions and a lack of upfront expectation-setting. Together, these signify that a talent need is not being met.

For instance, when asked "What do you believe drives CEO turnover?" 93% of the PE investors in our respondent pool cited "lack of capability" as the biggest driver (versus just 57% of the portco CEOs), followed by "lack of urgency" (69%) (figure 2). Meanwhile, 72% of the portco respondents named "a clash of working styles with the PE firm" as the top driver of CEO turnover.

When asked "What do you believe drives CFO turnover?", "lack of technical and financial capabilities" topped the list for PE firms. And again, "clash of working styles with the PE firm" came out on top for portco CFOs, though their second-most often cited driver was "clash of working styles with the CEO." The good news is that the relationship between a portco's CEO and CFO can—and should—be assessed by sponsors, as we discussed in Part 1 of this report. If the working relationship between these two key leaders is a productive and strong one, then the decision to let a CFO go may indeed hinge more on his or her lack of technical or financial capabilities—as cited by our PE respondents.

FIGURE 2: EXECUTIVE TURNOVER



EXECUTIVE REPLACEMENT: NO B PLAYERS ALLOWED

In acquiring new assets for their portfolio, 70% of the PE investors in this year's survey say they prioritize retaining of a portco's existing management team, while 19% seek to install a new team or upgrade the existing one.

95%

Among PE firms whose investment thesis includes retaining the existing management team, say they "always or often" include keeping the current CEO in that thesis—while only 47% include retention of the current CFO.

What explains this difference? PE sponsors may view the roles differently in terms of how much impact each has on driving and executing strategy. The lesser focus on CFO retention may indicate that investors view the role as less strategic compared to the CEO role. Yet CFOs want to be recognized for their strategic and business-building capabilities—the very talents that enable them to create value for the organization. Sponsors that view these executives as merely glorified comptrollers are missing an important opportunity to leverage those capabilities.

Of course, in some situations, replacing a portco executive becomes necessary. In last year's survey, an overall majority of our PE respondents reported replacing underperforming portco CEOs over one year into the investment. This year, 63% of the PE respondents said that their timing for installing a new portco CEO is six months—or less. Clearly, many investors are tightening up their timeline for replacing problematic portco CEOs—almost certainly in response to the increased velocity of change afflicting the business world. Sponsors simply don't have the luxury of time when it comes to executing on such judgment calls.

While many investors previously adopted a "get out of the way" attitude after closing a deal, our survey results suggest that they're growing more decisive—and playing an increasingly active role in management of their portcos. Sponsors understand that in today's world, it's no longer good enough to have merely acceptable talent at the helm of a portfolio company. Allowing B players to remain in key value-creating roles has become increasingly unacceptable to sponsors—further affirming their sharpened focus on human capital.

Investors know it's no longer acceptable to have merely good enough talent in their portco leadership teams

REPLACING PORTCO EXECUTIVES: A DOUBLE-EDGED SWORD?

Greater decisiveness in replacing underperforming portco executives has its pros and cons. On the plus side, it activates the machinery for moving mediocre leaders out of a portco. On the minus side, finding replacements who will excel in the role—and recruiting them—can prove decidedly difficult. Sponsors who cut underperformers loose sooner and then have trouble finding replacements risk having key roles sit vacant for a lengthier period of time—as long as 1.5 to 2 years, we've calculated.

The fact that investors are moving much more quickly than last year to replace underperforming portco leaders sends a powerful message. Sponsors are clearly willing to risk having key roles sit empty longer—and to endure the angst involved in seeking replacements—if that means they stand a greater chance of putting a truly exceptional leader at the helm of a portco.

Sponsors are even willing to destabilize an asset by removing a senior executive, as well as risk creating unfavorable "optics" for the market, by taking such action quickly.

It's no surprise that some PE firms take too long to replace underperforming portco CEOs. But many (78%) of this year's PE respondents believe that their portco CEOs are dragging their feet in executing the management-team changes that the sponsor and portco previously agreed on—including replacing direct reports of the CEO who aren't getting the job done. Given PE firms' recognition that having the right talent in place is vital to fueling growth in their portcos, investors would do well to closely monitor and manage CEOs' commitment to making such agreed-upon changes.

NEXT STEPS FOR PE FIRMS AND PORTFOLIO COMPANIES

As this year's survey findings make clear, misalignment between PE investors' and portco executives' perceptions and expectations have persisted—on multiple fronts. Proactive effort can help all parties involved identify the most problematic sources of such misalignment. Equally important, such effort can help them address these issues—before they can pose a serious threat to each party's goals.

With this in mind, we offer the following suggestions for PE firms and portfolio companies seeking to continue setting the stage for mutual success after an investment deal is inked:

ALIGNMENT IN THE FIRST 100 DAYS

Conduct an independently facilitated alignment workshop between the PE sponsor and the portco management team within the first 100 days post-close. Devote the gathering to agreeing on and committing to shared expectations. The workshop, when held as standard practice in that crucial period, is the easiest way to get off to a productive start in the post-deal phase.

UPFRONT ORGANIZATIONAL DIAGNOSTIC

Conduct the deepest assessments possible of portcos' executive leadership teams, organizational effectiveness, cultures, and so forth during the post-deal period. During that phase, greater access is available to build a comprehensive picture of the new asset's possibilities and challenges—including relationships among senior leaders, and how well the portco's culture supports the investment thesis.

Indeed, an interview-based survey of the portco's executive team and a layer or two below will yield important information on strengths and risk areas across six key areas: strategic context, leadership effectiveness, organizational design, capabilities, talent management, and culture. Armed with the fuller picture that such an assessment helps to build, sponsors can more effectively determine how best to maximize value creation in their new portco.

ROLE CLARITY

Ensure that the right roles are created, are well defined, and have clear metrics, so every member of the executive team understands his or her own and one another's core responsibilities. Develop these role profiles as separate and distinct from the current role profiles.

COMMITMENT TO LEARNING AND FEEDBACK

Consider executive coaching for not only portco CEOs and CFOs but also PE sponsors to better zero in on and tackle challenges that spawn misalignments. These might range from poor communication skills to incomplete knowledge of the nuanced forces shaping the industry in which a portfolio company is competing. Players on both sides of the investment deal can benefit from ongoing development in the service of a mutually successful partnership.

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ABOUT OUR 2019 SURVEY

This year's survey was administered online from October through December 2018. Respondents comprised 54 managing directors and operating partners from PE firms and 98 senior executives (primarily CEOs and CFOs) from portfolio companies. Roughly three-quarters of the survey participants hailed from locations in North America, with much of the remaining coming from Europe. The largest share of portco respondents worked for companies with annual revenues of $100 million to $500 million, while the majority of our PE firm respondents reported assets under management of less than $20 billion.

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ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.