In times of extreme disruption, human capital matters more than ever to achieve investment success.
UNIQUE YEAR, PROVOCATIVE INSIGHTS

For six consecutive years, AlixPartners has tracked important trends and developments in private equity (PE) leadership through our annual survey of PE firms and portfolio companies (portcos), conducted jointly with Vardis. (See About Our Sixth Annual PE Leadership Survey at the end of this report to learn more.)

Each year, the findings from this survey generate valuable insights on themes important to the success of PE investments. Central themes examined in previous years have included:

- The quality of working relationships between PE owners and portco executives
- Key success factors in the first 100 days post-deal
- Organizational culture’s role in portco performance
- The impact of portcos’ human capital management practices on PE investment internal rate of return (IRR)

**THIS YEAR’S FOCUS: LEADING IN TIMES OF DISRUPTION**

Our latest survey uncovered insights on leadership in times of enduring uncertainty. Disruption cycles have become so frequent that they’ve rendered the credit cycle irrelevant as an economic predictor of the future (figure 1). With the pandemic, political strife, racial injustice, and extreme environmental events escalating disruption to unheard-of degrees in 2020, investors and portco executives have had to rethink many aspects of how they operate and how they craft strategic future plans in the midst of continued ambiguity and fluctuation.

In this year’s findings, we see a resurgence of attention to the importance of prudent management of human capital. That’s not surprising—because how a company manages its talent can not only make or break its ability to survive crises but also determine whether it will thrive in the aftermath.

**FIGURE 1: ACCELERATING DISRUPTION HAS MADE THE CREDIT CYCLE UNHELPFUL FOR PREDICTING THE FUTURE**

Traditional credit cycle versus disruption cycle
DISRUPTION IS RESHAPING THE PE INDUSTRY

Planning for the future becomes even more daunting when heightened disruption creates uncertainty about the direction that an industry’s fundamentals may take. For PE leaders, such fundamentals range from deal flow and deal volume to M&A activity and capital deployment—to name just a few. The disruptions of 2020 have made it difficult to confidently develop an outlook for the coming year or so, though we do have some insight into it. For example:

- PE investors are willing to pay more for companies that performed well during the worst of the pandemic and will hasten to complete those deals. In particular, they’ll look for management teams that can explain how they helped their companies navigate a business landscape transformed by the pandemic while also uncovering new opportunities for growth.¹
- After hitting speed bumps during 2020, M&A activity could surge back in 2021, including big upticks in special purpose acquisition company (SPAC) buying and cross-border transactions.²
- M&A deals in the last quarter of 2020 were at record volumes, and run rates in November showed impressive uplift compared with those of the same period in 2019. Meanwhile, dealmaking confidence as well as regulatory and lending conditions remained favorable—further suggesting forward momentum of global M&A activity.³

A PEEK AT KEY THEMES IN THIS YEAR’S SURVEY

In this report, we dig deeper into the survey findings and generate insights on how to best manage human capital during disruptive times, and we discuss:


Impacts on environmental, social, and governance (ESG) initiatives under way in portfolio companies
PE and portco leaders’ perceptions of one another
Ways PE investment strategies may be changing
New imperatives confronting portco C-level executives

There’s a lot to cover. So let’s get started.
KEY FINDINGS

FINDING #1: HUMAN CAPITAL IS EVEN MORE VITAL TO SUSTAINABLE GROWTH DURING PERIODS OF DISRUPTION

We asked survey respondents to tell us what is most important for generating value during disruptive times and what constituted their most-pressing issues this past year. Their responses point to a sharper focus on smart management of human capital.

HUMAN CAPITAL IS THE TOP PRIORITY FOR GENERATING VALUE DURING TIMES OF DISRUPTION

Leadership/human capital was identified by both respondent groups as most essential for generating value at a portfolio company in times of extreme volatility, with organizational efficiency coming in as a somewhat distant second (figure 2).

FIGURE 2: IN PERIODS OF DISRUPTION, WHAT LEVERS DO YOU CONSIDER TO BE TOP PRIORITIES FOR GENERATING VALUE WITHIN THE PORTFOLIO COMPANY?

1. Leadership/Human capital
   - PE: 69%
   - PORTCO: 69%

2. Organizational efficiency (operating model, G&A, etc.)
   - PE: 44%
   - PORTCO: 49%

3. Organic growth (revenue, margin, etc.)
   - PE: 31%
   - PORTCO: 30%

PE AND PORTCO LEADERS AGREE: HUMAN CAPITAL DEMANDS ATTENTION NOW

Following the trend that emerged in our survey of two years ago, both respondent groups identified human capital as the second-most pressing near-term issue on their minds. Growth topped the list. Slightly more portco executives than PE leaders cited human capital as their number two concern. Such a close alignment is remarkable: Two years ago, the delta between PE firms and portco respondents was 21% on their responses related to human capital; now it’s just 1%. Clearly, both groups are now in tight agreement regarding human capital’s significance for value creation in the near term. The heightened focus on human capital in 2020 makes sense, given that successful navigation of a disrupted business landscape hinges on individuals’ and teams’ on-the-job performance.
Sharpening the focus on employees

When asked which stakeholder groups have increased most in priority as a result of the disruptions of 2020, a surprising 79% of PE leaders in our survey named employees, whereas 67% of the portco participants did.

What explains that seemingly greater prioritization of employees on the part of PE firms compared with portcos? We see portco executives’ closer proximity to employees as a likely factor. Since portco C-suite executives have more direct connections with employees, they may feel more confident in their human capital management approaches than investors do. With their longer-term view of portfolio performance, investors may also put more emphasis on ensuring that human capital receives adequate attention across their assets.

Several signs point to that increased acknowledgment of human capital’s vital role. For example, one of the fastest-growing jobs at PE firms isn’t deal partner; it’s human capital partner—a role often filled by former chief human resources officers (CHROs) and organizational development and talent management experts.

Indeed, over half of our PE respondents said the importance of human capital Due Diligence (DD) has increased during this time of disruption—even more so than commercial and operational due diligence.

53% OF PE RESPONDENTS reported an increase in Human Capital DD during this time of disruption in addition to Commercial DD (47%) and Operational DD (40%).

Human capital was rated as the #2 most pressing near-term issue for both PE and portco respondents, second only to ‘growth’, following the trend from our survey two years ago.
**FINDING #2: ATTITUDES TOWARD ESG ARE MIXED**

Long before the pandemic struck, companies in various industries had launched environmental, social, and governance (ESG) initiatives. Consider that:

- As much as 79% of venture-capital- and private-equity-backed companies and 67% of privately held companies currently have ESG programs in place.  
- The Conference Board’s latest report on social-change issues counts racism and gender inequity among the issues that employees find most important.  
- The US Securities and Exchange Commission is creating a task force to investigate alleged corporate ESG misdeeds by public companies.  
- The World Economic Forum has released a set of universal ESG metrics and disclosures to measure stakeholder capitalism that companies can report on, regardless of their industry or region.

In this year’s survey, we wanted to see how the disruptions of 2020 have affected ESG efforts—including how ESG efforts have affected PE firms’ investment theses and portcos’ sense of purpose.

**ADDRESSING SOCIAL JUSTICE ISSUES: A LUKEWARM RESPONSE**

When asked how PE investors could influence social-justice issues during the remainder of 2020 and throughout 2021, 67% of PE leaders in our study and 50% of portco executives declined to answer. That limited response rate could be explained in several ways—including lack of understanding of ESG efforts and lack of investors’ substantive directional focus.

The highest-rated responses from portco executives on how to best influence social justice focused on launching initiatives related to diversity and inclusion as well as leadership/management. Meanwhile, PE leaders’ responses also centered on diversity and inclusion but noted strategy/deal pursuit in addition.

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ESG EFFORTS ARE HAVING A MINOR IMPACT ON INVESTMENT THESES . . .

On a weighted average, 36.5% of both respondent groups in this year’s study reported that ESG factors are either not at all or only slightly important in the selection and crafting of investment theses. Nonetheless, 56% of PE investors acknowledge that they have greater interest in companies that embrace ESG standards (figure 3). That suggests the possibility of general, emerging support for ESG initiatives, even if there is lack of clarity on the range or meaning of the initiatives.

FIGURE 3: PE FIRMS SHOW INTEREST IN COMPANIES EMBRACING ESG STANDARDS

Q: Do you think the recent period of disruption (pandemic, racial injustice, climate change) has increased PE investors’ interest in companies that embrace high environmental, social, and governance (ESG) standards?

YES 56%

NO 20%

MAYBE 24%

... AND ON COMPANIES’ SENSE OF PURPOSE

Despite recent events centered on disruptions such as climate change and systemic racism, the majority of PE (60%) and portco (85%) respondents reported that they are not revisiting their firms’ purpose as a result of disruptions. On the other hand, 40% of PE respondents are revisiting their firms’ purpose. Specifically, aside from paying taxes, they cited providing opportunities for underrepresented groups as the second most important activity that firms perform for society.

FINDING #3: PE AND PORTCO LEADERS EXPECT MORE FROM ONE ANOTHER

In every year’s survey, we examine both respondent groups’ perceptions and expectations of one another. This year, we asked each group to comment on the other’s initiative in the face of disruption and to weigh in on the quality of their relationship.

Some finger-pointing in both directions

This year’s data continues trends seen in prior years’ surveys. Specifically, PE leaders saw their portco executives as too slow to take action amid the current disruption—mostly with regard to changing market dynamics but also with regard to organizational culture and restructuring, management team configuration, and the updating and executing of strategy (figure 4).
Q to portco: In terms of pace of change, in what areas have PE execs been too slow to act during this period of disruption?

<table>
<thead>
<tr>
<th>Area</th>
<th>Percent</th>
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<tbody>
<tr>
<td>Change in market dynamics</td>
<td>10%</td>
</tr>
<tr>
<td>Organizational restructuring</td>
<td>20%</td>
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<tr>
<td>Management team changes</td>
<td>20%</td>
</tr>
<tr>
<td>Culture change</td>
<td>10%</td>
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Q to PE: In terms of pace of change, in what areas have portco CXOs been too slow to act during this period of disruption?

Management/board-relationship quality is holding steady or even improving

Despite continued mutual perceptions of insufficient action by both surveyed groups, PE and portco respondents in this year’s survey agreed that the quality of the relationships between management teams and boards has remained the same—or even strengthened—during the challenges of 2020. Just 20% of portcos and 10% of PE owners described the management/board relationship as strained.

We believe that this finding reflects the pulling together that groups with aligned goals do when confronted by a challenge. We’ve heard many anecdotal stories about board members who extended themselves to support and reassure their operators in the face of human capital challenges. That common human impulse has brought together—in a positive sense—many boards and operators.

Culture is emerging as an increasingly critical factor in driving sustainable financial performance and retaining top talent in an increasingly competitive job market.
FINDING #4: INVESTMENT THESES WILL CHANGE IN SOME WAYS IN THE POSTPANDEMIC AGE

Will the disruptions of 2020—especially those caused by the global pandemic—affect PE firms’ investment theses, and if so, how?

Amid the pandemic: Stay the course—or redirect?

Interestingly, 51% of PE leaders in our survey reported that they had altered their investment theses for just 0% to 20% of their portfolio companies during 2020. A possible explanation is that they were very confident in their original investment theses if they thought the reasons for investing in particular assets in the first place remained valid no matter what happened in 2020.

However, roughly 26% reported having modified their investment theses for significant percentages of the companies in their portfolios. Whereas only 3% said they’d made such changes for 81% to 100% of their assets, 15% said they’d done so for 41% to 60% of their portcos. We speculate that the firms that altered their investment theses were operating in industries hit hardest by the pandemic.

In the post-pandemic world: Rethink investment theses?

When asked how their initial investment theses might change once the worst of the pandemic has passed, 25% of PE leaders in our respondent pool said they expected no change. Of those who did anticipate rethinking their investment theses post-COVID-19, the expected changes centered on two factors: hold times and portco performance targets (figure 5).

Hold times could shift

When asked whether they had amended their projected hold times during 2020, 66% of the PE respondents said yes. Of those who answered affirmatively, 85% reported amending hold times by one or two years. Meanwhile, 56% of PE respondents said they anticipated changes in hold times and portco performance targets after the worst of the pandemic had eased, and 59% of portcos said they expected the same.

Changes in hold times have clear implications for how human capital gets managed in businesses owned by PE firms. Specifically, hold times strongly influence how an asset approaches vital human-resources-related processes such as succession planning, leadership development, and strategic talent management.

Portco performance targets could be revisited

When it came to anticipating changes in portco performance targets—specifically, those related to growth and EBITDA—we saw a major gap between the two groups in our study. Twice as many investors as portco executives expected the targets to shift, which suggests the possibility of misalignment between the two groups on how portco performance will be managed.
FINDING #5: PORTFOLIO COMPANY C-SUITE EXECS FACE NEW IMPERATIVES

During disruptive times, PE and portco leaders must balance attending to urgent matters in the immediate term while also ensuring that longer-term objectives are met. That’s not easy. Our survey participants’ responses to questions about that dual imperative suggest that portco executives will have to master a particular style of leadership in order to strike the necessary balance.

Transformative leadership is the ticket

In times of disruption, companies need transformative leaders more than ever—those who can balance operational demands with managing and motivating people. But to balance short- and long-term demands, where should transformative leaders focus their energies? This year’s survey findings point to some possible suggestions.

C-suite execs must strengthen key competencies

The two respondent groups in our survey agree that transformative leaders should concentrate most on strategic prioritization, followed closely by stepping up their communication and transparency (figure 6).

C-suite execs must manage increased levels of complexity in their roles

Our survey participants agree that portco executive roles have become more complex during the current period of disruption. For instance, not only must executives communicate more, but they must also lead from a distance in a world where many more people than ever are working remotely. Respondents pointed to additional realities further complicating company executives’ roles—including the need to embody their companies’ purpose and core values; to address ESG concerns; to help their companies build resilience in the face of multiple simultaneous disruptions; and to manage the increased scrutiny they’re under because of the power and ubiquity of social media.

For instance, 57% of our portco respondents and 29% of PE respondents said they sharpened their focus on communication this past year. Communication as an area of focus far outranked others, including:

- Strengthening adaptability
- Revising strategy
- Accelerating execution
- Attending more to wellness
- Managing performance as well as talent development and relationships more effectively

Disruption accelerates and prioritizes the importance of human capital, putting pressure on leadership to keep employees positively engaged with the change (transformation) process.
C-suite execs are emphasizing relationship building

Both PE and portco respondents agreed that motivating and inspiring others to high performance, along with defining robust strategic priorities, constituted the top two most-important competencies for CEOs seeking to generate higher returns for investors beyond the current disruptive period (figure 7).

But the biggest difference we saw between the two groups had to do with the weight given to building relationships among stakeholders: 31% of portco respondents included the issue of building relationships as an essential competency for CEOs, whereas just 13% of PE respondents did.

During times of extreme disruption, longer-term returns—which can be powerfully driven by the quality of relationships—may be top of mind for portco leaders.

FIGURE 7: TO GENERATE HIGHER INVESTMENT RETURNS BEYOND THE CURRENT DISRUPTIVE PERIOD, CEOS MUST MASTER SPECIFIC COMPETENCIES

Q: Which competencies of a CEO have the greatest impact on generating higher returns for investors beyond this period of disruption?

- Inspires and motivates others to high performance
- Develops strategic perspective
- Communicates powerfully and prolifically
- Builds relationships
- Displays high integrity and honesty
- Innovates
- Champions change
- Takes initiative

C-suite executives must demonstrate integrity and honesty

Also notable was our PE respondents’ emphasis on CEOs’ ability to display high levels of integrity and honesty. Such personal qualities are essential for building trust within an organization—which becomes especially vital during times of crisis and disruption. Indeed, the latest Edelman Trust Barometer report shows that amid the pandemic, business has become more trusted than nongovernmental organizations (NGOs), government, and media.8

Everyone may also be at risk of burnout—and beyond

We were surprised to see that the majority of respondents consider the additional amount of time currently required of leaders during this period of disruption as sustainable. Depending on respondents’ job situations and home-life realities, some may have arrived at that conclusion if changes during the past year seemed to improve work–life balance and reduce stress, including traveling less for business and spending more time at home with family and pets.

However, for many people, being forced to constantly juggle work and personal or family priorities in tight quarters under crisis conditions is far from sustainable and will in fact lead to burnout—if not worsen it. Indeed, the recent Harvard Business Review article “Beyond Burned Out” points out that even though chronic stress was already a problem before the pandemic struck, it escalated to decidedly new levels in 2020—and company leaders simply cannot afford to ignore it. 9

Investors and portco execs may have some level of awareness of burnout: When asked to select up to three areas in their businesses that were most affected by disruptions in the past year, portco respondents said the areas of leadership, health and safety, and talent/human resources—all directly linked to human capital—topped their lists (figure 8). For PE respondents, the three areas listed most often were health and safety, leadership, and supply chain and procurement, with digital following closely as a fourth area.

FIGURE 8: PORTCO AREAS MOST AFFECTED BY DISRUPTION ALL LINK TO HUMAN CAPITAL

Q: This period of disruption has impacted which areas within your portfolio of companies the most?

PTO? What PTO?

What we’re seeing in the portco responses about their businesses’ human-capital-related areas that are most affected by disruption may not be all that surprising. According to AlixPartners’ survey data on use of paid time off (PTO), employees in locations around the world have made little use of PTO during the pandemic.

Warning: a possible blind spot

Taken together, these findings point to a possible blind spot among portco leaders. Specifically, they may be pushing their organizations’ mental and emotional health to the limit without realizing it. They may not be fully aware of how burned out employees are feeling. And for executives themselves, the decreased travel and increased time with family may be creating an illusion that longer hours on the job are sustainable.

Extensive unused PTO also has financial implications for companies: it creates a cost line on the books that portcos will have to carry, which could affect valuations assessed by potential investors.

This year’s survey findings indicate that, for investors and portfolio companies seeking to emerge intact from the shocks of 2020, the ability to effectively manage human capital will separate the winners from the rest—now and well into the future.

With that in mind, we offer the following suggestions.

**Amid disruption, manage human capital to move toward sustainable growth.**

The business ecosystem is shifting in real time for PE firms and portcos. The PE industry is at an inflection point: it’s growing more sophisticated, but it’s also facing unfamiliar challenges that include especially heightened competition for millennial-aged talent and people who want to work at companies that align with their individual values. To survive and thrive amid disruption, investors and portcos should assess company culture, businesses’ employee value propositions, and leadership teams’ alignment with companies’ purposes and core values, as well as with their strategies.

**Double down on ESG to maximize long-term value.**

Instead of treating stakeholder capitalism as a public relations talking point, investors and portcos must integrate that stakeholder capitalism into the PE ecosystem. For investors’ parts, simply weeding out companies that engage in certain activities to shape their portfolios will no longer cut it. Nor will merely issuing ESG reports every year.

PE firms, like any other investors, are competing for capital, and ESG funds count among the fastest-growing types of investment. To attract that capital, PE firms must clearly articulate their ESG strategies and explain how the strategies influence their investment-decision-making process. Indeed, investors are increasingly asking PE firms what their stances on ESG efforts are in order to ensure that where those investors are putting their dollars aligns with their own values.

**Elevate the criticality of culture.**

The relationship between investors and their portfolio company management teams is central to the success of any investment over time. Experience has shown that issues between a board and its CEO in particular can trickle down through the organization, resulting in performance-related challenges and, in the worst cases, problematic disruptions to culture.

It is imperative that portco executives understand and accept the accelerated nature of performance during an investment hold period and cascade that understanding down through their leadership and rank-and-file employees. It is equally important that investors understand that PE involvement in a portfolio company will, by means of accelerated performance over time, potentially disrupt its culture.

It must not be incumbent solely on portco executives to understand both their company’s culture and the broader private equity ecosystem. Investors have to become familiar with the cultures of the companies in which they invest and have to appreciate that they also represent integral components of their cultures.

A shift in mindset here will:

- Move both groups toward higher degrees of collaboration
- Support positive cultures with expectations of high levels of performance and continuous improvement
- Drive higher returns while mitigating the derailing impact of finger-pointing between the two intrinsically linked parties
Put the right person in the CHRO role.

Given the primacy of human capital to investment returns, both investors and portcos must elevate the CHRO role with a view to increasing the odds that investment theses continue delivering the intended value even as key elements such as hold times and portco performance metrics may shift. As an organization’s human capital leader, the CHRO has a unique opportunity to ensure the organization has efficient people processes and policies in place while also acting as a strategic advisor to the executive leadership team and board when it comes to key talent attraction and retention topics such as diversity and inclusion, employee experience, training and development, and workforce planning.

How to make sure the right person is in the CHRO role?

Look for an executive who has the skills and experiences required to be not only a human resources expert but also a well-rounded operational leader. The best CHROs also know how to achieve alignment between their companies’ growth strategies and their human capital strategies. They understand those two strategies’ mutual interdependence and can help the executive team and the board in diagnosing and correcting areas of misalignment between the two strategies.

Embrace transformative leadership.

Simply put, transformation is the antidote to disruption. Certain styles of leadership may have proved more popular than others over the cycles of the past few decades, but experience has shown that when a company faces disruption or crisis, the cure for the pain points the disruption creates is a transformative leader.

It is critical that leaders learn to mix their own personal styles of leadership—styles that take into account who they are, what their purpose is, and what they stand for—with the core tenets of transformative leadership.

Competencies in the areas of communication, strategic thinking, relationship development, empathy, and compassion are no longer merely suggestions for improvement but, rather, the specific prescriptions for curing an ailment. And although development is not limited to those areas alone, improvements in capability and competency in transformative leadership will greatly assist in the resolution of emerging complexities by building new relationships, fixing burnout through compassion and empathy, and instilling resilience through inspiration.
ABOUT OUR SIXTH ANNUAL PE LEADERSHIP SURVEY

The survey was administered online from October through December 2020. Respondents consisted of 61 managing directors, operating partners, or founders from PE firms and 61 senior executives—primarily CEOs and CFOs—from portfolio companies. Eighty percent of the respondents hailed from companies based in North America, with much of the remaining ones from locations in Europe. The largest share of portfolio company respondents were with companies registering annual revenues of $100 million to $500 million; the majority of PE firm respondents reported their firms’ assets under management were less than $5 billion.

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ABOUT US

For more than 40 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.

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