Global Leadership

Finding Your Private Company CFO

Russell Reynolds Associates

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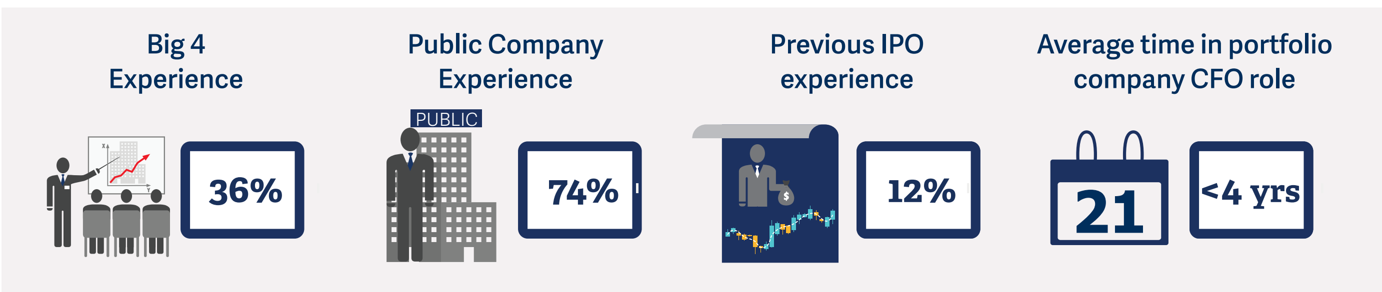
By Jenna Fisher, Financial Officers Practice, Russell Reynolds Associates

A technology industry chief financial officer (CFO) abandons Silicon Valley for a shipping company. A management consultant leaves a top-tier firm for a retailer with only $15 million in revenue. Most private equity (PE) investors wouldn't suspect either of these scenarios. Yet CFO candidates often turn up from the most improbable positions.

Russell Reynolds Associates took a look at CFOs of 50 private equity-backed portfolio companies. What backgrounds are getting hired? And how close are the "wants" vs. the "reality" of who is getting hired? We hear a lot about Big 4 experience, but our analysis showed that only 36% of the CFOs in the United States came from this background. Public company experience was a top attribute, with 74% of the CFOs having this credential. Private equity firms are hiring CFOs who bring the rigor, governance, processes and controls required by public company experience. Interestingly enough, we also found that previous initial public offering (IPO) experience was far less significant than portfolio experience, with just 12% of the portfolio CFOs having IPO experience. Our study also revealed that the average time in the portfolio company CFO role is less than four years.



CFO: THE FIRST MAJOR HIRE

When a private equity firm makes a new investment in a company, the investors' top goal is to improve that company's operations and profitability. But investors also want to give the company independence and make only minimal personnel changes. Typically, PE investors leave the CEO in place.

The CFO, however, is a different story. As a loyal follower of the CEO and member of the old executive guard, the CFO often is the first to go in a management shakeup. PE investors want a CFO who can support the executive team and be the eyes and ears on the ground. Additionally, the fiduciary skills that most investors require frequently are beyond the capabilities of the pre-existing CFO.

Accordingly, a replacement CFO commonly is the first hire a PE firm makes. But as any private equity investor knows, it rarely happens quickly. Most investors want someone they can connect with and trust. They also specify personal qualities and look for candidates who are impartial, independent thinkers, problem solvers and quick learners. The CFO has to reach a high intellectual bar, adapt easily and—if necessary—stand in for the CEO.

THE IDEAL CANDIDATE

Beyond these personal qualities, private equity firms focus on geography, private equity exposure and industry experience. To avoid a complicated relocation and to increase the probability of a long-term hire, investors normally want a local candidate. But boutique private equity firms tend to be more regional and, many times, struggle to attract the best candidates, in particular when their portfolio company is located outside a top-10 metropolitan market.

PE firms also want a CFO with experience working with private investors. The CFO must have an ego mild enough to fit with the executive team but also have the sense of fiduciary responsibility in order to work successfully with the PE firm and be able to push back when appropriate. Many do not have previous portfolio experience: Our study showed that only 16% of those CFOs had any private equity exposure as a CFO during their career.

Finally, PE firms generally insist that their candidate have experience in the new company's industry. Not surprisingly, 70% of private company CFOs recruited by Russell Reynolds Associates had at least some background in the industry where they were placed. Almost 50% had held a CFO position. PE investors don't want to hire someone who will need to learn on the job.

For some industries, pools of talented, seasoned executives are not difficult to assemble. While industry experience is necessary for the CFO of a large company (especially as companies trend toward promoting CFOs into general management positions), in a smaller company, it is possible to elevate the importance of industry experience to the detriment of the company's future.

All the qualifications listed above are vital. But when you emphasize these criteria too much, you'll miss great candidates. Privately backed companies—specifically those under $200 million in revenue—should de-emphasize PE exposure, industry experience and geography and, instead, hire the best athletes. Examples from the searches described below prove that when private equity firms are focusing on the qualifications deemed most important rather than "checking every box" and, in particular, giving up some of their "non-negotiables," a company may find just the right person for the job.

PATIENTSOFT[1]: A COMMUTING CEO

After investing in PatientSoft, a healthcare information technology (IT) company in Wisconsin, Sierra Partners began a CFO search. When the transaction closed, the CEO retired.

PatientSoft was a hot company—potential acquirers already were sniffing around the business. A bookkeeper ran PatientSoft's financial operations, but the company needed someone who could manage financial activities on a day-to-day basis and would be capable of working through a possible transaction. The candidate needed the gravitas and confidence to lead a sale. The investors also wanted a CFO with software expertise and, of note, familiarity with SaaS (Software-as-a-Service) accounting practices.

It was an attractive opportunity and would have been easy to find the "bull's-eye" candidate in a large metropolitan market on the East or West Coast. But the job was in Wisconsin. With most of the SaaS companies located on the coasts, none of the highest caliber candidates wanted to move to Wisconsin. A few Chicago-based candidates were interested but only on condition that they could commute.

Months into the search, one of the investors met a CFO based in the San Francisco Bay Area. The CFO had retired after selling a company nine months prior, and he was sitting on several corporate boards. In his mid-60s, he was capable and experienced; he had taken larger companies public and had worked with private equity firms in previous roles.

[1] To protect confidentiality, the names of all companies, investors and candidates have been changed.

Sierra Partners approached him. He was interested in the job but not in a relocation. He, however, was willing to be on-site from Monday to Friday. His children were grown, and, after having her husband at home for a few months, his wife was happy to have her own time back during the week.

Though he didn't have any background involving SaaS, he brought a level of talent and experience that PatientSoft never anticipated. PatientSoft only had to concede that the CFO would commute. For five days a week though, he had no family or outside responsibilities and devoted himself to PatientSoft. After three years, the organization was acquired by a large software company, and the CFO handled all aspects of the successful transaction.

CALSHIP: FROM TECH TO LOGISTICS

Groveland Partners invested in CalShip, a $100 million family-run shipping and logistics company in the San Francisco Bay Area. The transaction occurred when the founder retired and the owners, a family, sought liquidity.

Right away, Groveland realized the CalShip management team was unsophisticated. Groveland needed a CFO who could be its eyes and ears and interface with the firm but approach the job with a low ego. The CFO would need to continually interact with other executives, as well as minimum wage hourly employees. It was not a glamorous environment.

Finding the right candidate proved to be difficult. In addition to logistics being an inherently "unsexy" industry, Bay Area candidates wanted to work for tech firms, not a shipping and logistics firm. Groveland even tried to hire a CFO from another distribution company, but the cost for the relocation was expensive and also risky—involving moving a family across the country and expecting everyone to be happy with a lower standard of living.

Groveland's ideal CFO would be smart and experienced and also would have worked with private equity investors and bankers. While the CFOs who had run industrial firms had strong accounting credentials, Groveland felt that higher degrees of aptitude came from people in the technology vertical.

What Groveland didn't realize was the relative attractiveness of the CFO position at CalShip vs. other CFO roles in the Bay Area. Technology CFOs often had prestige but lacked having a major impact on the business. A tech company's main focal areas are sales and engineering—departments outside a CFO's control. The CFO of a tech company is most important during fundraising periods. Once those rounds are closed, the job is not mission critical.

Industrial firms, however, offer the meaningful EBITDA that many tech startups don't have. A CFO of a private industrial firm could have a role in the company's strategic direction and also add sophisticated management and operational controls to optimize an already well-functioning business. The CFO can be paramount to improving the business.

When Russell Reynolds Associates introduced Groveland to Joe Hunter, it was clear the company had found its CFO. Hunter had two decades of experience in finance at well-run technology firms. He was looking for a change and, notably, the chance to be more involved in a business' operations. Although Hunter had limited experience working with private equity, his background with venture investors and banks translated nicely into the new company.

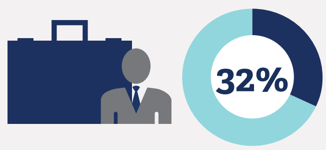
SOUTHBREAD: MATCHING AMBITION TO GROWTH

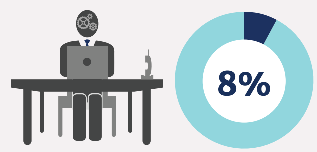
How do you recruit a rock star CFO when you have giant upside but only $15 million in annual revenue? A multi-site retailer headquartered in Los Angeles (LA), SouthBread had modest but growing revenue. After investing in the company, Sapphire Capital began searching for a CFO, a newly created position at the company. First, Sapphire and SouthBread wanted a local candidate with multi-site retail experience, familiarity with food and beverage services, and operational experience in the areas of human resources (HR), IT infrastructure, and financial planning and analysis. Second, since SouthBread would be expanding rapidly, the CFO needed real estate knowledge to aid with site selection. Third, SouthBread ideally wanted a woman for the role. Finally, as CFO of a small company, the individual would have no internal mentor who could teach one the ropes; the winning candidate would need to come with solid experience, plenty of self-confidence and "fire in the belly."

The job specifications made the search complicated. Most candidates who fit the profile were not interested in going to a company with less than $75 million in revenue. Also, the pool for CFOs with retail experience wasn't as robust as Sapphire Capital demanded. And the people who did have that expertise either lacked the intellectual rigor required or didn't want to move to LA, where the cost of living is high. Russell Reynolds Associates spoke with hundreds of people all across the country.

Because of these constraints, our consultants suggested looking at someone who currently was not in a CFO position. Sapphire and SouthBread were introduced to a management consultant who came from the LA office of a top-three strategy consulting firm and who specialized in retail. Polly Young was at a point in her career where she was ready to take some risk and go to a company that was smaller. She wanted an opportunity to be "hands on" in a high-growth organization with equity upside. Our study indicated that 32% of the portfolio CFOs had previous portfolio experience at some point in their career but not necessarily as a CFO. We also found that 8% of the CFOs had management consulting in their background.

Previous portfolio company experience, whether as CFO or not





Management Consulting

Sapphire Capital and SouthBread had to reset their expectations and pinpoint the most important factors: They favored knowledge in retail over experience either as a CFO or in food and beverage. They had to give up some of their operating requirements—HR and IT—but acquired a candidate who was strong in financial planning and analysis. In addition to having real estate and retail experience, Young was a great cultural fit with the CEO and team, and she lived just two miles from the corporate office.

BAY ELECTRONICS: FINDING TALENT OUTSIDE CALIFORNIA

Bay Electronics is an electronics manufacturing services (EMS) firm in San Francisco that designs, tests, manufactures, distributes and provides return/repair services for electronic components and assembles products for original equipment manufacturers. It is a low-margin, gritty business in a consolidating industry.

TechInvest, the private equity firm that invested in Bay Electronics, had recruited a CFO from a public company just two years prior. The individual loved investor relations and capital markets but had no experience—or interest—in working with private equity investors and lacked operational expertise. He liked to handle road shows, not find ways to extract costs from the business.

After the company had invested in a CFO who, in the end, was a poor fit, TechInvest and Bay Electronics sought out a new CFO with operational experience in EMS. Unwilling to look outside the industry, Bay Electronics mapped every possible candidate in United States: Each one lived in a small, affordable locale—a world away from the Bay Area.

TIPS FOR FINDING A CFO

- Look outside your company's vertical.
- Don't get "hung up" on IPO experience.
- Be open to commuter situations, particularly in the short term.
- Prioritize intellectual horsepower above "box checking."
- Consider step-up candidates from pedigree organizations.

Ultimately, the perfect candidate—in terms of both experience and culture—lived in the Midwest. He had children in high school and didn't want to move his family. However, the partner at Russell Reynolds Associates was able to convince Bay Electronics and TechInvest that a commuter situation would work. In fact, the CFO was so incredibly focused on his job from Monday through Friday that the commute was never an issue. And after two years and two high school graduations, he relocated to the West Coast.

Finding the ideal CFO can happen, but it nearly is impossible without some compromise. To make the decision less complex, look first for the qualities and capabilities that are most important for your organization. Once you have pinned down those top priorities, be open to creative solutions that can ensure that the position is effective for all participants.

ABOUT JENNA FISHER

Jenna Fisher leads the Financial Officers Practice in the Americas and specializes in leading senior financial officer assignments, serving clients across various sectors, including the technology, consumer, healthcare and retail industries. Jenna's clients include Fortune 1000 corporations, middle-market private equity portfolio companies, as well as highly visible, pre-public venture capital-backed enterprises. The majority of her work over the past ten years has been recruiting CFOs, although she has conducted numerous assignments for treasurers, controllers, internal audit executives, and division chief financial officers. Jenna is also involved at the board level, recruiting financial experts to serve on Audit Committees.

Russell Reynolds Associates is a global leader in assessment, recruitment and succession planning for boards of directors, chief executive officers and key roles within the C-suite. With more than 370 consultants in 45 offices around the world, we work closely with public, private and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic, environmental and political trends that are reshaping the global business environment. Find out more at **www.russellreynolds.com. Follow us on Twitter: @RRAonLeadership**

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