
The art of the healthcare spin-off: 5 leadership lessons

The medical products industry has been marked in recent years by a significant uptick in the number of corporate spin-offs and private equity carve-outs. Given our experience advising healthcare clients at every stage of the spin-off process, Russell Reynolds Associates (RRA) has gained a great deal of insight into what works – and what doesn't.

Building further on this insight, we recently conducted interviews with client chief executive officers (CEOs), chief human resources officers (CHROs) and their investors who have successfully set up and run corporate spin-offs in the healthcare industry. The resulting wisdom can inform leaders of other newly spun-off companies as they launch and grow the business – not only in healthcare, but in other industries as well.

Our conversations uncovered five leading topics of concern for executives launching a SpinCo:

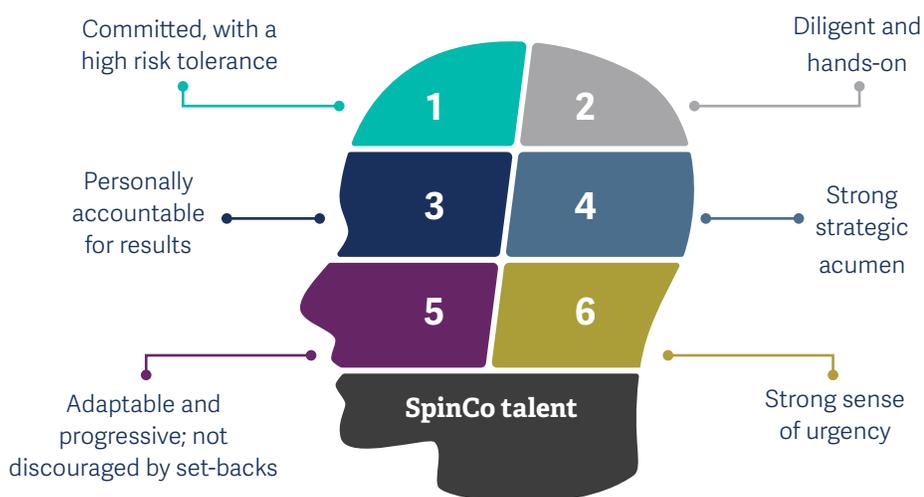


LEADERSHIP ATTRIBUTES

The time required to acclimate a first-time CEO or CFO can be 12 to 18 months, yet a SpinCo is often expected to be fully up and running – and significantly outperforming its previous state – within a similar time period. Not surprisingly, therefore, many of the CEOs, CHROs and investors with whom we spoke pointed out that identifying a C-suite leader with previous SpinCo experience is high on their list of priorities. This may not always be possible, but at a minimum it is critical to have either a CEO or CFO with prior experience in the role, given there is little time for a typical learning curve.

Recruiting a leader with this specific experience is not always practical or possible, however. As a result, RRA sought out additional leadership characteristics that tend to set successful SpinCo leaders apart. One theme that has appeared consistently in our work and came up often in these conversations was that companies should expect that nothing will be as it seems, and should hire resilient leaders who can thrive in this type of uncertainty. The attributes listed below emerged as being particularly important.

1. It is essential that SpinCo leaders be **committed** to the organization, with a **high risk tolerance**, given the number of uncertainties in any spinoff.
2. They must be **diligent** and **hands-on**, willing to take on even the most mundane tasks as project managers – particularly in the first, lean days of the new business.
3. Given the very hands-on nature of the work, SpinCo leaders must be willing to hold themselves **personally accountable for results**.
4. SpinCo leaders should have **strong strategic acumen**, as the work will require continual problem-solving.
5. They must be **adaptable** and **unflappable, not discouraged by set-backs**, given that the reality on the ground may be nothing like the assumptions going in.
6. Finally, a **strong sense of urgency** will mean they have the ability to get the work done, no matter the challenges.



“Understand that whatever they tell you in the management presentation or what the seller represents, right or wrong, is the best-case scenario. Assume you will find other things that were known or were not known that will be worse than what your assumption was going in. In general, that’s just how spin-offs work.”

Martin Madaus, Chairman and Chief Executive Officer, Ortho Clinical Diagnostics

UNDERESTIMATED FUNCTIONS

What are the most critical hires for a SpinCo to make? A few specific C-level roles were repeatedly cited in our conversations with executives as the most essential roles to fill first when setting up a new company. We also learned that sometimes the most critical hires are also the most underestimated. In fact, many of these experienced executives told us that if they had it all to do again, they would place far more emphasis on three functions in particular: information technology (IT), finance and human resources (HR).

Information technology: IT is especially important in a SpinCo, since many other business functions cannot run full speed without IT systems in place. However, extricating these systems from the former parent's systems is complex and outside spending on consultants and outsourcing can be costly. A new chief information officer (CIO) should therefore be in place as soon as possible to make important system choices. He or she should be particularly adept at keeping such outside spending under control. Many of the CEOs we interviewed regretted not having hired a CIO sooner or having hired one without spin-off experience.

"Information systems are really challenging. Building your set of requirements for the extraction is costly and extremely difficult. You need a CIO who has done this before, and there are not many of them."

Ron Labrum, Former President and Chief Executive Officer, Fenwal

Finance: In a PE carve-out scenario, finance – critical for every organization – takes on added importance. The SpinCo will need to begin detailed reporting even while some financial data may be still be with the parent and before the new systems are fully in place. The new CFO will be required to build out the finance function, including tax, treasury and accounting, and to manage large amounts of debt if the SpinCo is highly leveraged. As a result, there are significant benefits to hiring someone who has been the CFO either at a private-equity backed company, with a prior SpinCo, or in a turnaround or crisis situation, and to do so at the earliest possible date.

Human resources: Much of a SpinCo's success depends on the quality and drive of the organization's talent. Considering that a SpinCo will typically lose 40-80% of its existing leadership – from the C-level down through middle management – in the first twelve months, the CHRO should ideally join the CEO on day one as a close strategic partner. In addition to hiring new talent and implementing strong retention tools, the successful CHRO will help the CEO establish the new organization's culture.

"When it comes to people decisions, move twice as fast as you think you need to."

Brian Webster, Chief Executive Officer, Kestra Medical Technologies (former CEO, Physio-Control)

	75% said the CHRO is a critical strategic partner	92% stated they had underestimated the CIO and IT	100% said the CFO is mission-critical from day one
			
	Strategic partner who, with the CEO, defines and implements the culture of the organization	Develops and builds IT infrastructure to support business systems and operations	Builds a new corporate finance function; provides timely and accurate reporting from day one
WHY ROLE IS MISSION CRITICAL	<ul style="list-style-type: none"> ▪ SpinCo cannot achieve transformation without recruiting strong people to build quality teams ▪ 40-80% of the leadership team and mid-management turn over in the first 12 months ▪ Hiring and retaining top talent requires strong incentives, with benefits competitive with or comparable to those of the parent ▪ A strong HR organization provides a fast, reactive feedback loop to management 	<ul style="list-style-type: none"> ▪ Transition services agreements are finite ▪ Tens of millions of dollars can be saved on IT consulting and other outsourced services with the right CIO ▪ Efficient IT systems are essential to support all business functions, offer connectivity throughout the organization and increase accountability 	<ul style="list-style-type: none"> ▪ CFO builds entire finance function, possibly with incomplete information from the parent ▪ SpinCo must immediately begin quarterly reporting to public debt holders, meet deadlines and forecast accurately, possibly without control over financial and IT systems and/or with incomplete information ▪ PE specific: CFO must manage large amounts of debt
CHARACTERISTICS	<ul style="list-style-type: none"> ▪ Strategic CHRO more necessary than a tactical leader ▪ Total rewards experience ▪ Experience setting up the HR function ▪ Experience with cultural transformation 	<ul style="list-style-type: none"> ▪ Prior spin experience strongly preferred ▪ Experience setting up IT systems from scratch without heavy reliance on outsourcing 	<ul style="list-style-type: none"> ▪ Experience in turnaround or crisis preferred ▪ Ability to plan for multiple scenarios, as early quarters often reveal surprises

Other considerations: Many experienced CEOs say they would give more attention to investor relations and corporate communications if they had to do it all again. They admit they underestimated the importance of having an expert who could skillfully communicate the company's story and evolution while reaching out to both internal and external stakeholders. In addition, they would install a talented project manager (PM) during the transition who reports directly to the CEO and helps with every aspect of the execution. Whether pulled from the legacy business or from outside, ideal characteristics for a successful PM include strong communication skills and the ability to plan and execute in a very hands-on way.

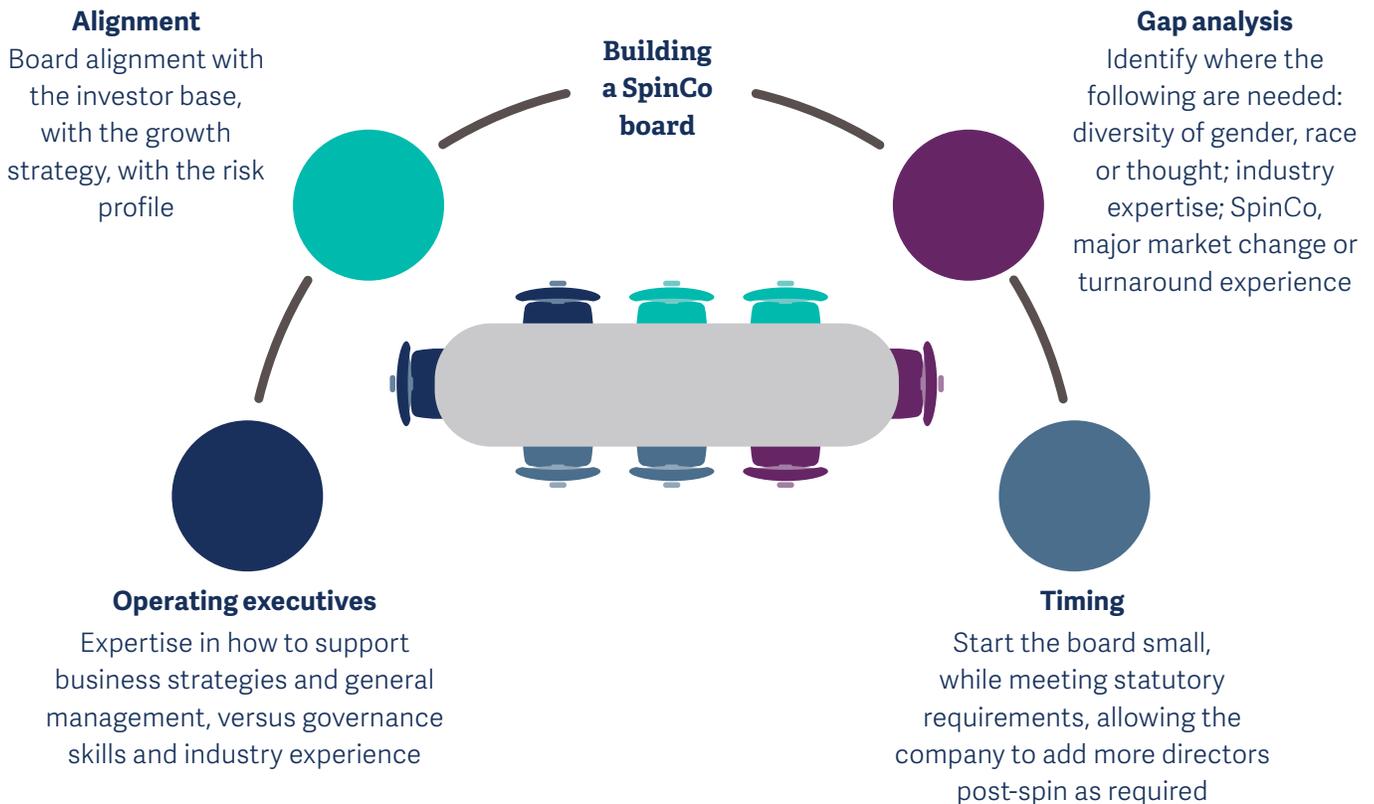
THE BOARD

Given the wide variety of spin-off scenarios, there is no single formula for assembling an ideal SpinCo board. Rather, the key to building the strongest board possible is to focus on recruiting operating executives who can contribute at the board level. In fact, current and former operators should be prioritized over specialists, and prior carve-out experience is strongly preferred. While governance skills and industry experience are also desirable, they are less important, given the highly operational day-to-day tasks of the SpinCo board. Contributors to the core mission of the new company are also essential, whether they bring M&A expertise, experience in setting compensation plans, a strong track record or a network of talent.

In public companies, most CEOs also appreciated having either a shared board director or a director pulled from the parent company, as having a director who was part of the spin strategy, familiar with the crafting of the transition services agreements (TSAs) and able to understand the parent company can be highly valuable.

“Mallinckrodt focused on recruiting board directors who were operating executives versus those who had governance experience.”

Mark Trudeau, Chief Executive Officer, Mallinckrodt



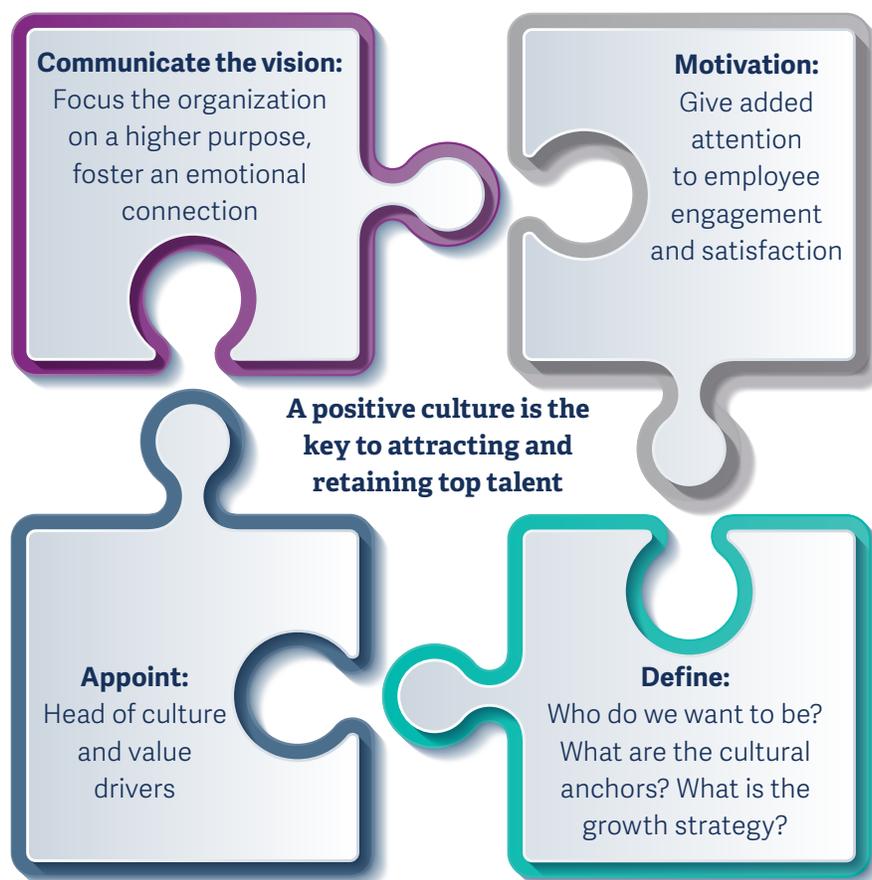
THE CORPORATE CULTURE

During the transition, a time of high uncertainty and heavy workloads, instilling employee ownership in the SpinCo must be one of every CEO's and CHRO's top priorities. A SpinCo CEO inherits a group of employees with various attitudes towards the changes occurring and different levels of engagement in the new company. Often, the pace and business drivers of the SpinCo are – by necessity – vastly different to those of the parent. Setting and communicating a simple, compelling vision to employees on day one is therefore essential to engaging the workforce, retaining top performers and attracting new leaders to the organization.

In addition, the disruption caused by a spin-off offers a unique opportunity to create a dialogue around, and to engage the organization in building, a positive culture. Interestingly, many of the CEOs we spoke with shared the thought that culture-setting in a newly spun-off company is easier than in any other CEO role or M&A environment. The reason? More often than not, employees are actively looking for new direction and support. At the heart of culture-building, just as with instilling employee ownership, is communication. To succeed, leaders must make the message simple and reinforce that message early and often.

“When it comes to culture, the spin-off is a unique opportunity to create a dialogue. Include the organization and let them know the new culture will be different. Strip away all assumptions that people have about the NewCo and create a mission that they can identify with the new enterprise. Communication is critical – establish a pace of communications, and exceed it.”

Brian Webster, Former Chief Executive Officer, Physio-Control



THE TIMELINE

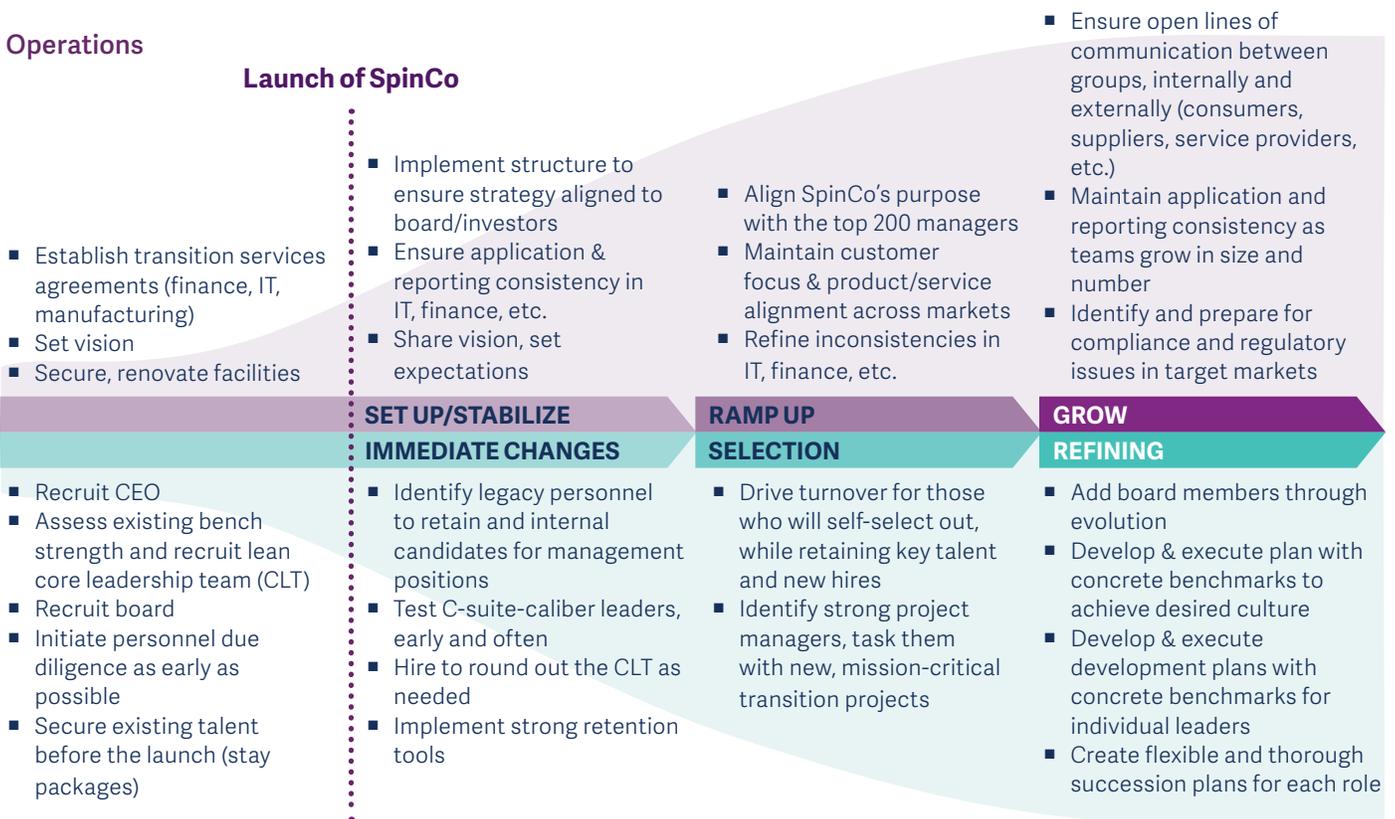
There are many moving parts at the launch of a SpinCo. The illustrative timeline below can provide guidance on the stages of a SpinCo’s development, from pre-launch (which takes approximately 3 months) through the successful launch (typically 18-36 months from pre-launch onwards). Note: It is critical to identify and retain those leaders who will be crucial to seeing the SpinCo through the transition, and – often separately – those who will guide the ongoing entity.

- **Pre-launch.** Timing varies widely, but ideally the SpinCo should have a few months in advance of the launch to put core leadership in place, such as a CEO, CHRO, CFO and the minimum board members to support the launch. Keeping the core team lean will give the company the flexibility to bring in the additional talent it needs as the company evolves. Additionally, key talent currently at the company should be locked down prior to launch.
- **Setup.** As essential functions are put in place and the SpinCo is launched, the company will communicate the vision, identify legacy talent to retain and promote, and round out the corporate leadership team (CLT).
- **Ramp-up.** With the new company moving toward independence, it is time to move out legacy employees who wish to leave, put retention methods in place for key talent and increase the customer focus, turning the company towards new growth and profit targets – connecting with new customers while holding onto the existing base.
- **Growth.** As the SpinCo approaches normalcy for a growing organization, the emphasis will now shift from building the business to maintaining the core vision. It is time to refine the talent strategy, develop benchmarks, bring on new board members and begin succession planning as the company looks increasingly toward the future.

Operations and talent evolution: illustrative timeline

Operations

Launch of SpinCo



Talent

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