What makes a great PE portfolio company CEO?

Russell Reynolds Associates

Executive summary

PORTFOLIO COMPANY CEOs

We have analyzed 75 buyouts to determine the key attributes of the most successful portfolio company CEOs, based on realized multiple of equity invested.

We uncovered three important questions for sponsors to consider:

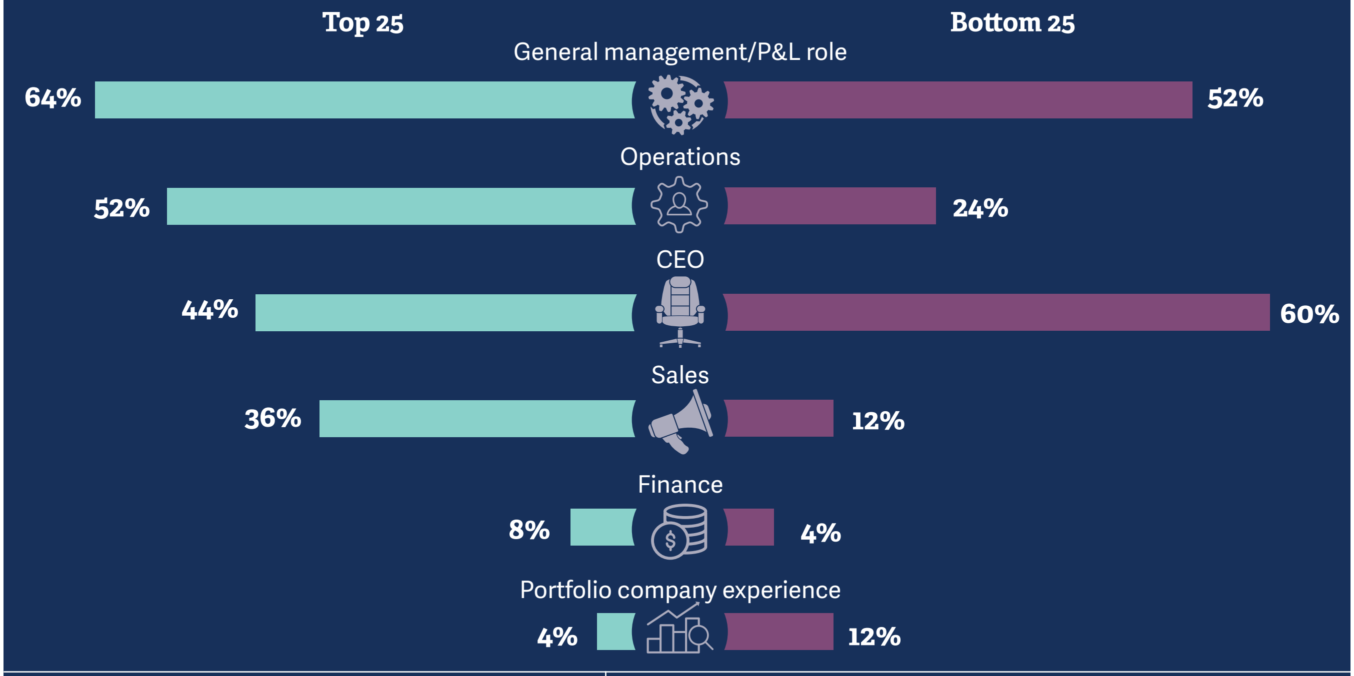
1. What is the typical background of successful portfolio company CEOs?
2. When are successful portfolio company CEOs appointed in the company life cycle?
3. How do successful portfolio company CEOs lead?

IN BRIEF:

BACKGROUND	▪ Low level of prior portfolio company leadership experience in the CEOs of the best-performing investments. ▪ In-industry P&L responsibility is key for success. ▪ More broadly, sales and operational leadership experience most linked to success as a portfolio CEO, less so finance.
APPOINTMENT	▪ Both longstanding and new CEOs can produce high growth. ▪ Delaying leadership change linked to lower returns. ▪ Internal appointments do work. 63% of CEOs for the top-performing investment were internal. Understanding potential for entire management team is essential.
LEADERSHIP STYLE AND COMPETENCIES	▪ Long-tenured portfolio company CEOs tend to be more "humble" when compared with other CEOs. ▪ They have an even manner and empower their team while able to juggle priorities. ▪ Jettisoned CEOs were profiled as more independent, with less regard for rules and processes. ▪ Results orientation and a sense of urgency perceived by General Partners (GPs) to be the most important leadership competencies for portfolio company leadership, less so strategic vision.

1. What is the typical background of successful portfolio company CEOs?

FUNCTIONAL ORIENTATION OF PRIOR LEADERSHIP ROLES HELD



INDUSTRY EXPERIENCE

92%

Unsurprisingly, all but two of the top CEOs have a demonstrable track record in the industry of the company. On average, these top CEOs had more than 20 years of relevant industry experience.

STRONG LEADERSHIP EXPERIENCE

84%

The vast majority of top CEOs have held a general manager/ CEO role with P&L responsibility.

IMPLICATIONS FOR PRIVATE EQUITY PORTFOLIO COMPANIES: BE BOLD

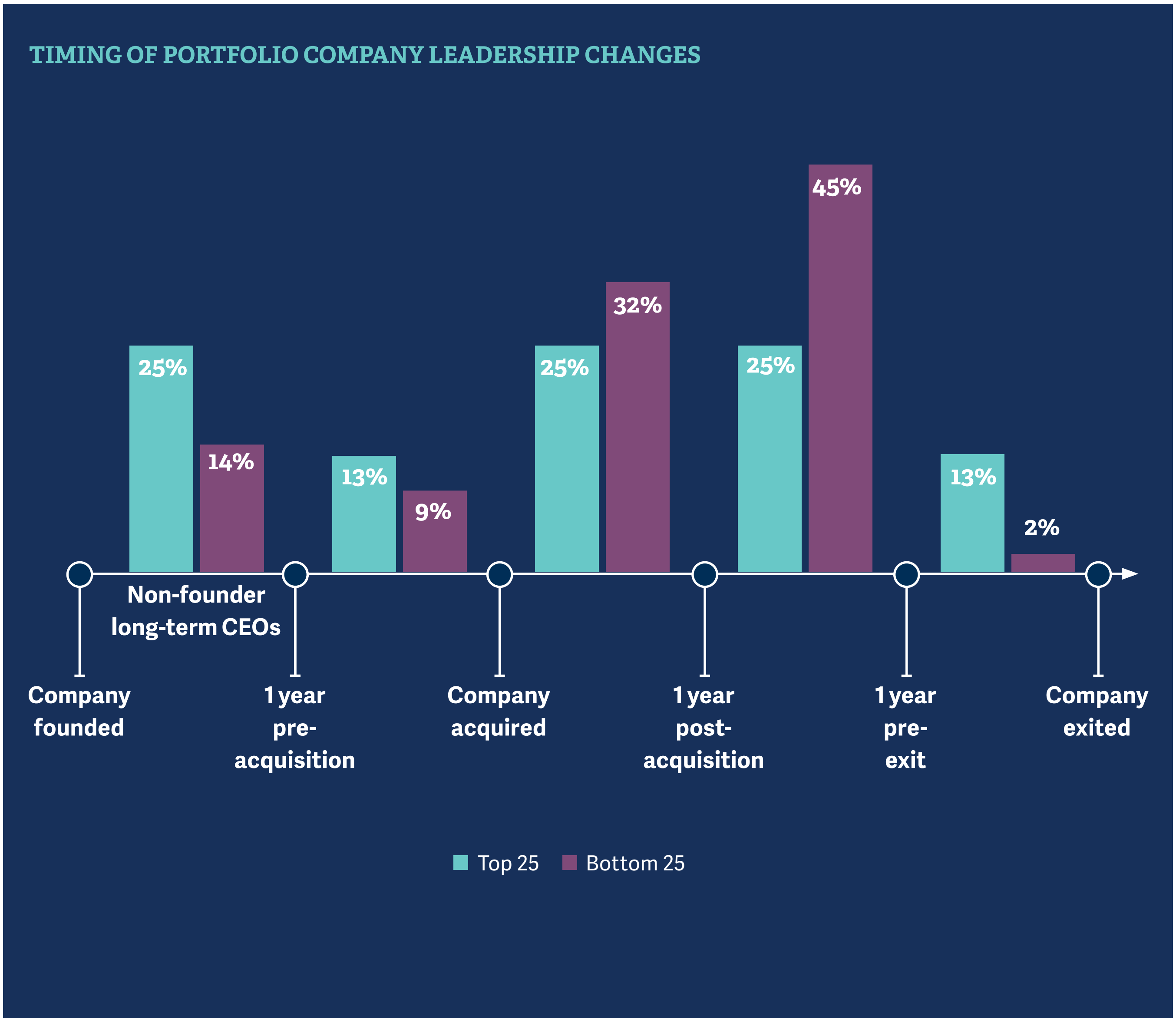
- Prior portfolio company CEO experience is actually not necessary for outperformance.
- Hire for potential, not just based on relevant experience: While P&L responsibility is a key experience milestone, top-performing investments actually had fewer repeat CEOs than bottom-performing investments (44% vs. 60% of investment performance).
- Sales leadership is shown to be a key differentiator among the top 25 successful buyouts, as is strong operational experience.

KEY FINDINGS

- In the top 25 successful buyouts, excluding founders, 63% were internal appointments despite the widely held belief that an externally appointed CEO leads to better returns.
- Despite the risk of appointing a CEO without prior private equity experience, of the top 25 buyouts, only one CEO had prior leadership experience in a portfolio company.
- Industry experience is key: Almost all top CEOs had longstanding industry experience. Only two CEOs had banking or consulting experience.
- Where the CEOs had not already held a general management position, the most successful came from a strong sales or operational background, leading to high growth and returns. Rationalizing costs is no longer a differentiator.
- Within their industry, almost all CEOs have demonstrable leadership experience.

Source: PitchBook, Russell Reynolds Associates' analysis.

2. When are successful portfolio company CEOs appointed in the company life cycle?



KEY FINDINGS

- No single "best time" when appointing a CEO: Both longstanding and new CEOs can produce high growth.
- Underperforming investments were significantly more likely to change leadership midway through the hold period with few internal appointments (30%) vs. those in the top 25, where mid-cycle appointments were an even split.
- Even given the potential risks of changing leadership just prior to exit, 13% of the top 25 companies did indeed change CEOs within one year of exit, emphasizing the positive outcome of making active and bold choices at the right stage of the company's life cycle. It is worth noting that none of the CEO changes made in the year preceding exit were in companies that went public.

Source: PitchBook, Russell Reynolds Associates' analysis.

3. How do successful portfolio company CEOs lead?

- Successful portfolio CEOs tend to be more "humble", approaching others in an even manner, empowering their peers and assuming others are reliable.
- While they are fierce competitors, they are quietly self-confident and do not trumpet their achievements.
- They excel in rapidly changing business situations, speeding up their work style as needed and juggling competing priorities.

VERY SIMILAR TO NON–PRIVATE EQUITY CEOs IN MOST QUALITIES

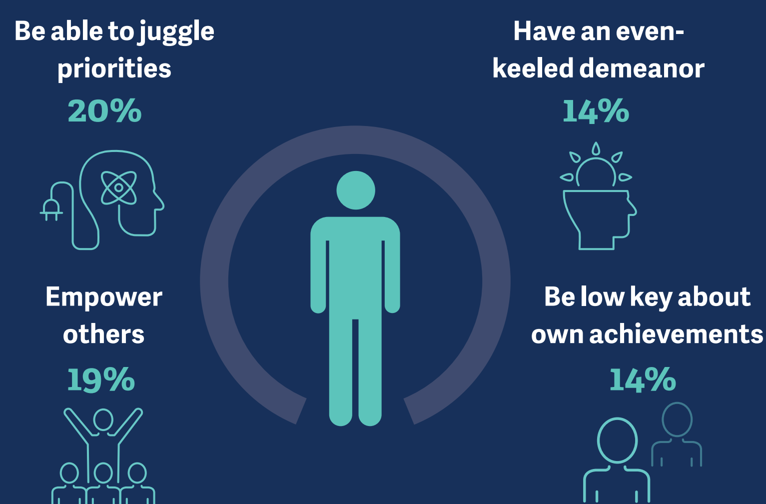
On 56 of the 60 psychometric scales examined, successful portfolio company CEOs were very similar to non–private equity CEO profiles. This is consistent with our finding that CEOs do not need previous PE experience to be successful.

WHAT DIFFERENTIATES CEOs WHO REMAIN WITH A PORTFOLIO COMPANY FOR THE LONG TERM FROM THOSE WHO EXIT EARLY?

- Our data directionally suggest CEOs who exited the business midway through the hold period have several common attributes:
  - More independent: They are more willing to carve their own path with less input or feedback from others.
  - Less rule and process oriented: They work toward their own objectives.
- Given that portfolio company CEOs need to ensure that their direction aligns with the private equity sponsors' strategic plan, any tendencies to self-govern may be quite detrimental to their success.

SIGNIFICANT DIFFERENCES IN FOUR AREAS

Successful portfolio CEOs are more likely than other CEOs to ...



Note: The samples compare CEOs who remained with the company for at least three years post-acquisition with those who did not.
Source: Russell Reynolds Associates' proprietary assessment database.

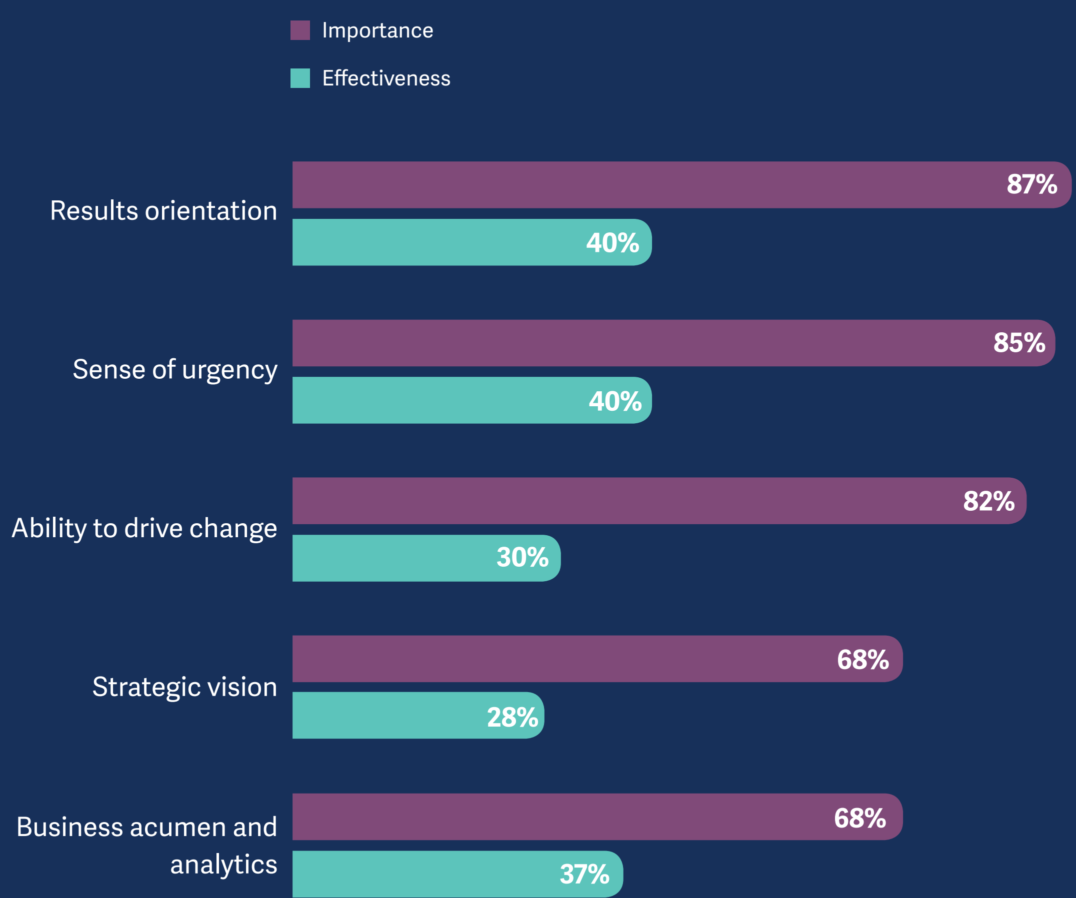
3. How do successful portfolio company CEOs lead? (cont'd)

The competencies required for successful portfolio company leadership

PORTFOLIO COMPANY LEADERSHIP GAPS

- In a separate global study, we surveyed more than 300 senior private equity investment professionals on the most important leadership competencies for portfolio company success.
- There are significant discrepancies between the competencies that were deemed **most important** and the **perceived effectiveness** of portfolio company leaders in these areas.
- This gap is especially pronounced for the ability to drive change.

INVESTMENT PROFESSIONALS' VIEW OF PORTFOLIO COMPANY LEADERSHIP ATTRIBUTES



Methodology

BACKGROUND AND TIMING FINDINGS

Our analysis looks at 75 CEOs of portfolio companies across all sectors, owned by private equity firms that were acquired and exited between 2008 and 2015.

Our criteria for selection included portfolio companies with equity investments of more than $100 million and exits of more than $300 million.

The analysis included portfolio companies owned by funds of varying sizes.

Average investment period circa five years

Total return ranging from 0.1x to 17x[1]

Average return for top 25 exits: 4.8x

Average return for bottom 25 exits: 0.98x

Top 25 exits labeled as "successful" for the purpose of this study

LEADERSHIP AND COMPETENCIES FINDINGS

The Russell Reynolds Associates executive assessment database contains more than 5,000 leadership profiles, allowing us to make statistically driven observations about the characteristics possessed by leaders in a particular field.

We compared portfolio company CEOs who remained with the portfolio company for three years post-investment with a broader database of 350 CEOs.

We examined 60 psychometric scales from well-validated leadership assessments to understand on which scales the private equity CEOs showed statistical differences.

[1] Multiple approximated based on a total value to paid-in (TVPI).
Source: PitchBook, Russell Reynolds Associates' analysis.

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