CTPartners

2008

Is Your Skill Set in Demand?

A CTPartners Private Equity Practice Whitepaper

There is no doubt that private equity firms inserted a fresh dose of financial discipline into the marketplace during the first half of this decade. Their market savvy, combined with the considerable operational skills of their portfolio company management teams, altered the way businesses were both evaluated and run. Similarly, the very evident success of the Private Equity business model helped define the market's perception of the talent and skills of the "ideal" senior executive. As the Private Equity market evolves today, that influence is still quite powerful.

The Early Days

With 20/20 hindsight, it's clear that the optimal time for private equity firms to have purchased companies was from late 2000 through 2005. The recipe for getting rich during the last credit cycle was (1) get in and get out quickly, ideally within four years, and (2) hire a management team that was experienced at driving down costs. If an inefficient business could be acquired cheaply and the earnings before interest, taxes, depreciation and amortization (EBITDA) steadily improved, it was possible to repackage the business and push for either acquisition or IPO.

Timing was key. Look at Silver Lake's mastery when swooping in and breaking up sleepy Seagate Technology, or the prowess shown when three Private Equity funds, including The Carlyle Group, took Hertz off Ford Motor Co.'s hands, and then achieved partial liquidity at IPO within a year. Consider the string of financial restructurings that made a bundle for Sun Capital Partners.

Margins and profits dominated the dialogue between Private Equity Boards and their portfolio CEOs and CFOs. The 'in vogue' skill set included expertise at cost cutting and operational improvement. Investors wanted executives who knew how to manage to the bottom line. Which corporations do this best? Well, General Electric Co., Danaher Corp., United Technologies Corp., and Honeywell International Inc. jump to mind, which is one of the reasons we saw the Private Equity consortium behind Nielsen pay top dollar for GE's David Calhoun.

A Maturing Trend

By 2006, the so-called 'smart money' was backing away from overpriced deals, sensing that the markets were nearing the top. Canny deal-makers started to sell their portfolio companies to other investors while the going was good. Of course the pace of transactions was still frenetic. And to be fair, just because one pays aggressively for an asset does not mean that further value cannot be created.

The boom showed signs of decay during 2007 as the marketplace saw some likely deals getting pushed out. Then the credit crunch hit and the woes followed: Deals were hung-up because bankers who had always bent over backwards for private equity funds suddenly were saying "no" to loans; only the most established investors were able to raise capital; and many new funds were turned down by the asset management community.

Gradually, the financial community started assessing value based on other fundamentals beyond quarter-on-quarter EBITDA improvement. The buzzword became growth. We started to see CEOs who had failed to grow their business getting replaced.

Private Equity Hiring Today

From our vantage point as an executive search firm, we have not seen a slowdown in Private Equity recruiting projects. However, the mix and types of assignments have changed. We are seeing significant hiring activity in two specific categories:

Good Time for Growth-Oriented CEOs

With top-line growth now the paramount concern, Private Equity firms are seeking a different type of leadership team for their portfolio companies. Financial engineers who work the balance sheet will be left behind by holistic operators who can fix the income statement. Portfolio CEOs must understand the revenue/growth equation. In the past, a portfolio CEO's mission generally revolved around cost removal. The current business climate assumes cost control, but will only reward revenue and EBITDA growth.

Until the latter half of 2007, financial restructuring strategies offered Private Equity firms a variety of highly rewarding possibilities. When capital was easily accessible, financial expertise reigned supreme. Thus, the most valuable portfolio CEOs were dealmakers who used cheap debt to bundle together industry competitors, and then moved swiftly toward the goal of an IPO-ready business. But current conditions are unforgiving to simple M&A strategies or financial maneuverings. The IPO market has slowed considerably, the debt market is tight, and equity currencies are simply not available for use in acquiring other companies.

The net effect? This is a great time for executives who have stellar customer skills and market instincts. If you know how to ignite and lead growth, you will be a hot property for any private equity investor. With little room at the moment for financial creativity, the most valuable portfolio CEOs will be those who are capable of rolling up their sleeves and getting the most out of their companies. As executive search professionals, we now often are retained to seek operational superstars with the dexterity to step into a fluid situation, set vision and goals, and measure performance accurately and relentlessly.

In terms of cultural fit, Private Equity firms seek CEOs who see the relationship as a partnership where there is common purpose, open discussion, and constructive debate. No optimists, no pessimists, just realists. Tough times require leaders who are just as skilled at dialogue as they are at deal-making. Today's portfolio CEOs must be able to communicate at the highest levels of effectiveness with a wide range of constituents, including customers, vendors, employees, bankers, and labor unions, as well as private equity investors and board members.

In a recent session that CTPartners hosted for one of our large Private Equity clients, our Financial Services Practice analyzed which companies might be the best sources for relevant and proven sales-and-marketing talent. The client's goal, and ours, is to identify CEO candidates who can cut costs at a portfolio company, pare it down to the basic strengths, run it better, and make it grow (again, without help from the M&A market).

International experience will be vital for a successful growth CEO. This April, the International Monetary Fund forecast a 6.7% growth rate during 2008 for emerging and developing economies, compared to a 1.3% growth projection for the world's advanced economies. A similar imbalance is expected to continue through 2009. Our advice to executives with domestic-only experience is to gain an international assignment.

Private Equity investors have always taken the time to hand-pick the 'right' CEO, but candidates should now

Is Your Skill Set in Demand? (continued)

expect the interview questions to have changed from a few years ago. Among other matters, investors will be hoping candidates can give them a clinic on how to lead organic growth without damaging the cost structure.

The Essential Operating Partner

Much has been written about the role of the operating partner within private equity. Typically, these are former strategy consultants who also have 5-10 years experience at Fortune 100 companies. Almost invariably, the mandate of the operating partner was to drive profit margins. In the main, they would bring deep functional expertise in supply chain management, lean manufacturing, and efficiency programs. A million dollars saved and dropped to the bottom line translated to 10 times that amount in a company's market valuation.

However, we are seeing a change in that mandate. Yes, every dime is still counted and costs are still squeezed, but today, unless a company can show consistent (four or more consecutive quarters) of top-line growth, it is hard to attract buyers or convince investment bankers to file an IPO.

Here's the challenge: Growth is really, really hard. Anyone can cut costs, (although it takes a true expert to know what is fat and what is muscle). The profile that excites investors today is that of someone who brings the analytical skills to assess a market, model out pricing, dig into sales force effectiveness, prioritize customer-relationship-management programs, and set strategy for rebranding, repositioning, and PR. McKinsey & Co. has a well established "growth" practice and perhaps the perfect operating partner started out there, or at the likes of Bain & Co. or The Boston Consulting Group, before transitioning into product management at companies like PepsiCo Inc., Procter & Gamble, American Express Co., or eBay Inc. For enterprise sales, IBM and Xerox Corp. were the academy companies in the 1980s, so apprenticeships and best practices learned there stand out on resumes. Talented senior executives at Apple Inc. and Google are getting bombarded because it is assumed they have the secret sauce.

Today, therefore, Private Equity funds are flying in two types of operating partners, toting transformation blueprints for both top- and bottom-line performance. Traditionally, during the first year or two of a given turnaround, there are always cost measures to put in place. However, once a company's costs are under control, it's all about the growth engine. We expect this trend will continue and, therefore, that operating partners with strong market-facing skill sets will see increased opportunities at the larger Private Equity funds (with appropriate compensation levels).

Timeless Requirements

Yes, this is a snapshot taken at a specific moment in time. As the Private Equity marketplace evolves, so will its list of priorities for skills and experiences required of portfolio company senior executives. Yet the areas of expertise outlined above—especially the ability to drive top-line growth while conscientiously maintaining bottom-line efficiencies—will be desirable in any marketplace. Candidates with such superior qualifications will always have the luxury of appealing choices.

CTPartners' global team of experienced search professionals brings deep domain knowledge and a broad understanding of the human capital needs within the Private Equity sector. Our strength and success are attributed to a core group of consultants who have led and completed search projects for private equity clients and their portfolio companies who continuously award them repeat searches.

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