

Recruiting appropriate executive talent

Nick Tunbridge*

The heightened profile of the sector over recent years has convinced high calibre executives of the career opportunities offered by private equity backed companies.

As an owner of a company that is considering private equity involvement you will need to consider the strengths of your current senior management team and be confident that you have the right people in the right positions.

Private equity investment typically means increased debt and you must have a management team that understands how to achieve outcomes within a financially leveraged company.

Your leadership team will need to be able to make the right decisions with a focus on growth, cash flow and cost management.

Executives that have had private equity experience are a great asset to a portfolio company as they know how to work effectively with the private equity partner. The private equity experienced executive who has completed a successful exit and is now looking for their next private equity opportunity is a rare commodity. It is also very difficult to lure a chief executive away from one private equity backed company to another as they are usually anchored by the fact that they need a successful exit to realise the value they have built in the company.

More often than not, you must search the wider corporate world for executives. Many executives who have not had previous private

equity experience, those from the environment of large corporate businesses, may be attracted to private equity backed companies as a means of more quickly building substantial personal wealth. The reality, however, is often different to the dream; many of these executives lack recent hands-on experience in cash flow and cost management, two essential components in building value within a portfolio company.

They will also be required to take action within an environment where there are different expectations of roles and where, as a rule, fewer resources are available than in larger corporate businesses.

It can be difficult to identify the corporate executive who will thrive in a private equity backed company, as a lot of the skills needed, such as an entrepreneurial style, are not learned, or often are even valued, in a corporate environment.

Due diligence

High calibre executives will be interested in joining (and investing in) a portfolio company that, despite where it is in its cycle, still has the basic fundamentals to grow profitably. These executives will carry out their own due diligence to confirm that the company has adequate cash flow to support its debt. They may also want to investigate the proposed growth strategy and the ability of the business to provide the required return for

their equity investment, should they invest in the business. As it is common practice that the chief executive (and usually the senior leadership team) will take equity in the portfolio company, there must be willingness to provide information to the candidate to enable them to carry out this due diligence.

The process to identify and recruit talented executives can be made more complicated if it is not clear how the equity contribution is to be structured. Details of remuneration and how equity in the business will realise value need to be clear and specific. Although there may be a general understanding that the ultimate financial reward will be linked to a future liquidity event – sale or initial public offer – the more detail and clarity about the equity value calculation that is provided, the more at ease an incoming executive will be.

Chief executive

A chief executive who is taking his or her first role within a private equity backed company will face a unique set of challenges. He or she must be willing and able to take on activities outside the normal scope of the chief executive position. This can mean getting back into the detail of functions that they have left behind earlier in their careers such as business development, finance or operations management.

They will also have to develop a mindset that they are running their own business. Their

ability to be commercially astute and gain knowledge quickly in areas such as bank covenants and how to effectively pay down and maintain the optimal level of debt can be critical to their success.

When searching for a chief executive who will be successful in a portfolio company it is useful to look for the following:

- An ability to achieve profit growth beyond normal market conditions
- General management experience managing across a variety of functional disciplines
- The strength to look at the critical issues and take a hard line
- An entrepreneurial style
- The ability to accurately assess risk
- Someone who thrives on challenges and can adapt to new environments and different ownership structures

Management team

Operating within a shorter investment horizon can result in different expectations for the chief executive and their management team. There is more pressure on the management teams of portfolio companies as there is now a stronger dependency on value being built through financial and operational performance. The ability to quickly and positively impact the business, together with a clear understanding of what the business needs to look like in the future, will help create confidence within the private equity firm that the portfolio company has the right management team.

When recruiting the management team of a portfolio company the relationships that exist between members of the senior team can be



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even more important than when recruiting into traditional corporate roles. The focus that private equity puts on critical business issues and the fact that senior managers are often shareholders in the business, results in position demarcation being replaced with more willingness to give and accept cross functional advice.

This is particularly true of chief financial officers; they need to have knowledge of the entire business with an operational orientation and a focus on profit growth as well as on the regular monitoring of the cost position of the business.

The sales director and the chief operating officer also need to clearly understand each other's position and work cohesively as a team to build revenue growth while managing costs.

If one of the management team is acting out of alignment with the others the result can be a significant loss of equity or reward across

the whole team. An essential part of the due diligence of any incoming chief executive is to understand what the current culture of the portfolio company is and how much it needs to be changed to improve the results of the business.

"The management team must have an honest, collaborative and open relationship with each other, and this needs to be achieved as quickly as possible, so that strategy can be executed within the necessarily short time frames. As shareholding managers there is no place for egos in a portfolio company, it's all about enhancing value."

– **Barbara Sault, Chief Financial Officer, Australian Envelopes.**

Non-executive directors

One way to introduce executives to a private equity backed company is to invite them to join as a non-executive director.

Non-executives directors add value through:

- Assisting the board in appointing, encouraging, assessing and, if necessary, replacing the chief executive. This is the most important function of the board overall.
- Bringing an external, alternative perspective
- Questioning, encouraging and monitoring the management
- Bringing relevant competency, experience and legitimacy
- Ensuring proper corporate governance process is followed
- Approving overall strategy, budgets and large financial decisions such as capital expenditure

Many executives are open to consider positions as a non-executive director as it gives them an

opportunity to mentor and coach a chief executive who may be struggling with their first private equity backed position. An important contribution that a non-executive director can bring to a portfolio company's board is operational experience. A non-executive board member can act as a very useful bridge between the private equity partners and the management team of the portfolio company.

"The experiences and relationships a non-executive director can bring to the executive management group of a portfolio company are tremendously helpful ingredients to the recipe that will turn a growth 'concept' into the reality of a high performing entity."

– Gavin Partridge, non-executive chairman, Integrated Premises Services Ltd

Conclusion

It is generally agreed that management teams are critical to the success of private equity investee companies. It is interesting to note that the majority of chief executives (and management teams) who join these companies do so without prior experience of working in private equity investee businesses.

This puts considerable pressure on the search and selection process to identify and engage the right people. It is not enough to rely on past networks or an informal approach to the market to find people.

You must ensure that you have the best possible people in the key positions to deliver your business goals. A rigorous recruitment process is needed that identifies, benchmarks and engages the best candidates available. This process, supported by accurate dialogue regarding the vision of the business, will be critical in ensuring the success of both the portfolio company and the private equity investor.

*** Nick Tunbridge is head of a dedicated private equity executive search practice within Touchstone Executive Search.**



Touchstone Consulting Executive Search has a dedicated search practice servicing private equity backed companies.

Our reputation is built on our passion and ability to source and secure the best people to drive and deliver our client's goals and vision.

Key relationships with top performing executives, together with our detailed understanding of the needs of portfolio companies position us to create significant value to your business.

For further details contact Nick Tunbridge on 0416 051 339 or nt@tces.com.au

Touchstone Consulting Australia Pty Ltd

Melbourne office: 4 / 412 Collins Street Melbourne VIC 3000
T: +61 3 8615 9888 **F:** +61 3 8615 9899

Sydney office: 5 / 25 Blich Street Sydney NSW 2000
T: +61 2 9238 0374 **F:** +61 2 9238 0375

E: info@tces.com.au **W:** www.tces.com.au