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Private Equity Leadership Series

DO YOU HAVE THE RIGHT LEADERS TO DELIVER ABOVE MARKET RETURNS?

John Myers, Managing Partner
Kensington International

If your investment horizon is three to five years, you have six months (and certainly no longer than a year) to get top leadership right at your platform companies or they will under-perform compared to investment expectations.

Gone are the days when above-market investment returns can be achieved through financial engineering alone. Clearly the financial expertise of a private equity partner can fuel the next-stage growth of a company, but today's investors are keenly aware that operational expertise is also critical to the growth and profitability of platform companies.

Key to delivering above-market returns, and one operational area where a private equity firm can excel and make a critical impact in the performance of their platform companies is in the area of talent management.

Leadership under Private Equity Ownership is Different

For those of us who have spent time in the world of private equity, we know that effective leadership in this space is very different from other types of ownership platforms. The acquisition of a company by a private equity firm is a seismic change for its leaders and employees. Yet private equity firms place their "bet" in large part on the strength of a leadership team that has succeeded in the past.

Research shows that effective leadership is situational and there is no single effective leadership profile.

A great leader in one company and under one ownership/market/ financial situation can fail miserably in another, and it can happen quickly.

Leadership skills that successfully propelled a company in the early stages of growth may not be effective when that same company matures with more scope, scale and complexity. Correspondingly, a leader who has been effective in a turnaround may not be effective when the turnaround is complete and the focus is on growth.

The Wrong Leadership Destroys Enterprise Value

I think we all know, and have seen, that great leadership can significantly and quickly enhance stakeholder value. And, we also know how quickly bad leadership can destroy value. But if great leadership is situational and hard to profile, the same can be said of wrong leadership until it becomes a serious problem and has drained resources and profitability from the platform company.

An example of this difficult situation occurred when a client called us expressing concern that one of their portfolio companies, a medical device company with $75 million in revenue, was not performing up to expectation. They suspected that the legacy leadership was impacting results. An audit revealed that not only was the CEO producing poor results, but he was also engaging in behavior that opened the company up to liability that placed the entire sales trajectory at risk. The solution consisted of exiting the leader and finding his replacement within the existing ranks of the company, someone who was respected by his peers and the 150 employees in the firm. With the right leadership in place, the company started to see an immediate improvement in financial results.

Without the appropriate fiduciary oversight in place it can be difficult for private equity firms to spot when a leader is the wrong match for their platform companies. In a worst case scenario, private equity firms are surprised to find out that a CEO has carefully managed the Board by controlling both the information flow and their insights into what is really going on in the organization. This can be the result if the process of leadership oversight is ill-defined or non-existent. What is needed is a proactive leadership wellness program.

Six Principles to Ensure an Effective Leadership Wellness Program

As one of the Managing Partners at Kensington International, I can share with you a simple yet effective model we have developed. (Refer to Image 1.1. PE Leadership Model on the following page)

What this model proposes is that private equity firms develop standards in the "core areas" of leadership talent management that are similar in principle to the standards that most firms establish for financial analysis and reporting. The key difference is that there are no GAAP standards, bank covenants or IRS and investor reporting requirements to follow. You need to develop your own.

1. Make Talent Management a Top Priority

For bigger private equity firms operating in the large-cap company space, this likely means hiring a Chief Human Resources Officer, perhaps with a small staff to do recruiting, consulting, etc. For those mid-size firms operating in the mid-cap to small-cap company space, this likely involves partnering with an outside resource(s) to assist in the development and execution of talent management initiatives on a consistent but "as needed" and variable cost basis.

2. Perform Pre-Acquisition Leadership Due Diligence

As part of your due diligence process and in the final stages, it is a best practice to invest in leadership assessments. Although it is possible that such work can uncover leadership dysfunction that will "kill" the deal, that outcome is an exception.

Skillful leadership assessment can be a critical strategic tool, sending a positive message to the leaders of the company you are about to acquire.

As the potential buyer, it can expose you to a wider range of managers that are not as trained, experienced and polished in the "roadshow" sale process. The outcome of pre-acquisition due diligence is a baseline understanding of leadership strengths, bench strength, an areas of possible concern or need for development.

3. Immediately Clarify Private Equity/CEO Relationship

Using a consistent and formal process, invest in bringing clarity to the relationship between the CEO/President and the private equity firm. If this is not done, the CEO/President will continue to operate as he/she always has and all parties will waste time and energy trying to figure out how to work together. Although PE firms have different visions for what this "governance" needs to look like, we recommend a formal "Board of Directors" approach. In such an approach, the Board's role needs to be made clear in terms of both performance monitoring as well as strategic oversight. Board meetings should be regular and operate with a formal agenda. If this is a new experience for the CEO, he or she should be coached on how to work collaboratively with the Board.

4. Conduct an Early Leadership Effectiveness Audit

At the three to six month mark the honeymoon is over and there is a greater awareness on all sides as to how well the leadership/private equity ownership team is doing. It is also the critical "tipping point" where great leadership will propel the organization toward top tier private equity investment returns and less effective or bad leadership will underperform. A well designed and consistently applied leadership assessment and development process will make good teams great, and if there are issues that are too big for development, changes can be made (top executive team additions or subtractions) at a critical time in the investment life cycle.

5. Own the Executive Recruiting Process

As the private equity owner, don't abdicate responsibility for finding the "right-fit" new executive. When key leadership additions are required, think about the recruitment process strategically and not as a transaction.

> ***Without a vision of what's needed, you may just get a retread of the very executive you decided to move out.***

The executive employment markets are so transparent that it is easy to find executive level candidates who have industry, function or product/market experience. But, what is more important and not as easy to find is the leader who will bring the right new leadership behaviors into the organization. Organizational and cultural transformation starts at the top and if left solely to the discretion of the platform company, they will be more likely to hire in their own image.

As a result, we encourage our private equity clients to build a short-list of search firms who know how to assess the current culture of a company, and what changes are believed to be necessary in order to find the best new executive(s). Let the platform company executive make the final selection, but insist on a "best practices" process and firm.

6. Effectively Manage Executive Transitions

Don't underestimate the importance of effective executive transition management, and especially when it involves a previous owner. Even if they feel they are ready to move on to a new life stage, some career/life transition support would be a good investment. It sends a positive signal to all stakeholders, including owners of future company acquisition candidates.

A prime example of this situation is when a $150 million energy company brought in our firm to coach an executive who was taking over the reins from the former owner. Through careful planning, an effective transition plan was put in place that recognized the contributions of the exiting leader, reassured the 1,000 employees in the workplace and successfully positioned the new leader to navigate his new role. Supported with targeted reorganization and role alignment, within a mere three months, the company's financial results were strong and the prospects for the future are bright.

Leadership Makes the Difference

Look at any business success story from start-up to turn-around, and the prime factor in realizing ROI is leadership. Effective leaders inspire employees, make bold decisions and propel good companies to greatness. Conversely, average or poor leadership puts downward pressure on results. If you're looking to optimize your return on investment, you can't start too early to make this assessment. Ideally it should occur during due diligence, but if not, start now. Or else you'll be leaving money on the table.

To learn more about the author, please see the following page.

Image 1.1 PE Leadership Model

PRE/POST-ACQUISITION DUE DILIGENCE/ INTEGRATION	EXECUTIVE & ORGANIZATION ASSESSMENT	EXECUTIVE & TEAM DEVELOPMENT
Do you know what you're buying?	*Is your management team built to perform?*	*Do you have management concerns?*
• Executive due diligence process to understand strengths, weaknesses, gaps and development areas • Executive team on-boarding and early development to ensure a fast start	• Selection Assessment to ensure "new executive hires" are right for the business • Assess management teams or key executives against integration, growth and exit strategies • Understand leadership capacity, diverse strengths and areas of development • Ensure right leaders in place and performing at peak levels	• Senior executives unable to adapt to new organizational expectations provide individual executive coaching and team development solutions • Hold leaders accountable for developing new behaviors and executing on goals and performance expectations

ABOUT THE AUTHOR

John Myers is a founder and an active managing partner at Kensington International, the Chicago office of Career Partners International. He is also a past board member and Chairman of CPI's board of managers. Prior to becoming an executive coach, he was a successful executive and general manager with Federal Signal Corporation John held positions in general management, marketing/product management and sales with P&L accountability.

With more than 20 years of executive coaching experience, John is a recognized expert in the custom design and delivery of programs for top executives and top executive teams. John is certified in using behavioral, team, and leadership assessments as a benchmark for improving executive performance. His coaching approach is notably pragmatic and rigorous.

John holds an MBA Degree from Northwestern University's J.L. Kellogg Graduate School of Management and a Bachelor of Arts Degree in Business Administration from Southern Methodist University.

ABOUT KENSINGTON

Kensington International's team has over 25 years of experience serving the private equity community. Kensington expertly partners with organizations in maximizing the contributions of their human capital and ranks among the largest and most successful combined Executive Search, Leadership Assessment, Executive Development, Coaching and Outplacement firms in the U.S. From our corporate headquarters in Chicago, and through our partnerships with Career Partners International and Agilium Worldwide, we deliver our services globally.

A high percentage of our private equity engagements represent repeat business and long-term relationships with clients who have come to depend on us for the complete suite of management solutions. Your responsibility to your investors and other stakeholders is always front and center in all aspects of our work. For additional information, please visit www.kionline.com.

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1515 W. 22nd Street, Oak Brook, IL 60523 – Phone: 630.571.0123 – Email: info@kionline.com