Why do so many PE firms fail to get the right senior leadership team in place?

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With private equity (PE) firms holding their portfolio companies just five to seven years on average, there's little time or margin for error.

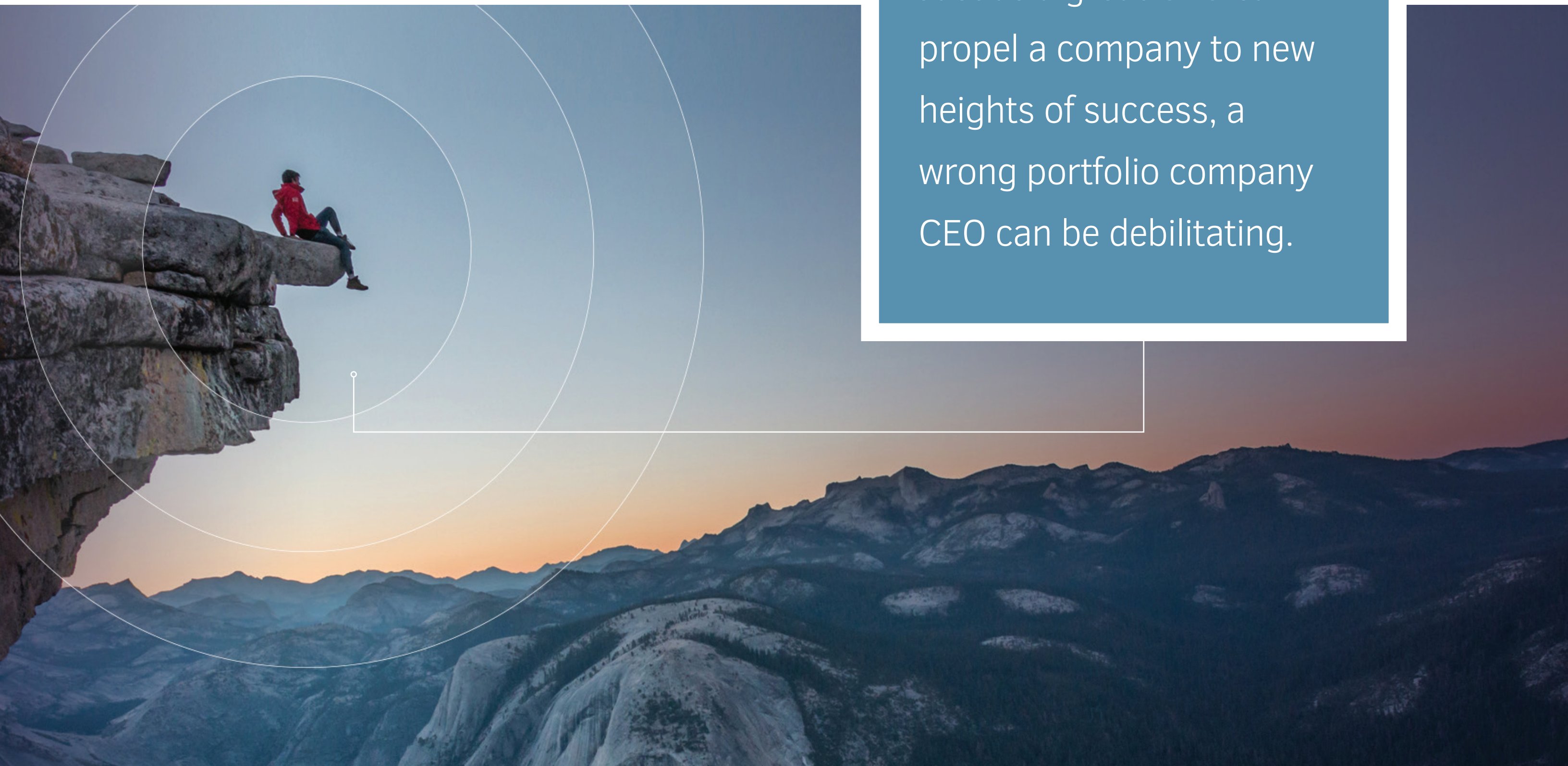
Due to a host of competitive pressures, strong leadership matters more today than ever. Just as importantly, the consequences of underperforming leadership can be catastrophic. Why then do so many PE firms fail to get the right senior leadership team in place in their portfolio companies?

According to a recent Bain & Co. report, nearly half of all PE firms studied needed to replace the CEOs running their portfolio companies. A whopping 60 percent of those changes were unplanned at acquisition, with most happening after the critical first year of ownership had passed. These changes come at a considerable time and opportunity cost to investors. Rather than working to improve portfolio company value, PE firms are instead being forced to swap out their portfolio company leadership.

Why is this happening with increasing regularity? It would seem that as competition for quality portfolio companies increases, it can be tempting for deal-hungry PE firms to gloss over the suitability of a target portfolio company's leadership.

You can significantly reduce PE investment risk and potentially achieve a more productive and less stressful return by making portfolio company leadership assessment standard in your due diligence process. Far from being disruptive to deal-making, an objective, professionally administered assessment can be done simultaneously with all other top- and bottom-line pre-close analysis. An assessment can significantly strengthen the rationale for a deal or help keep you from making a major investment mistake.

> Just as a great CEO can propel a company to new heights of success, a wrong portfolio company CEO can be debilitating.



Not all leadership assessments are alike

According to *Harvard Business Review*, portfolio company leadership has a 10-15 percent impact on financial performance and a 25-30 percent impact on market valuation.

For decades, PE firms have relied on one-on-one leadership interviews and team meetings with target company leaders to drive their due diligence. While these “wooing phase” pre-deal personal interactions still have their place, they are insufficient for revealing the full, true strengths—and weaknesses—of a target company’s leadership team relative to their ability to lead the business forward under your ownership. That’s why so many PE firms are eventually forced to replace their portfolio company CEOs.

To try to compensate for the inherent weaknesses of personal interviews and meetings, some PE firms make do by using simple assessments to determine the personalities of portfolio company leaders. Such broad-based instruments are typically insufficiently in-depth, robust or accurate enough to function as quality due diligence tools.

For these reasons, more PE firms are turning to external experts to scrutinize the leadership of prospective portfolio companies. Equipped with critical assessment analysis and insights, you can more confidently be assured you have the right CEO and leadership team in place on day one of your acquisitions—and avoid the stumbles affecting so many other PE firms.

Measuring Success

While the ideal measurement of a leadership assessment’s value and accuracy happens long term (3-5 years), you should be able to glean insights from your professional assessment almost immediately.

If the assessment reveals a need to make leadership changes in a target company, you will automatically have in place a template for the type of leadership this company requires. Conversely, if the assessment shows that the company has the right leadership in place (perhaps with some development needs), you can turn your attention toward working with its leaders to collaboratively achieve the company’s strategic goals. Either way, you’ll avoid the tremendous business and investment disruption that can occur when a PE firm is forced to swap out a portfolio company’s leadership, post-acquisition.

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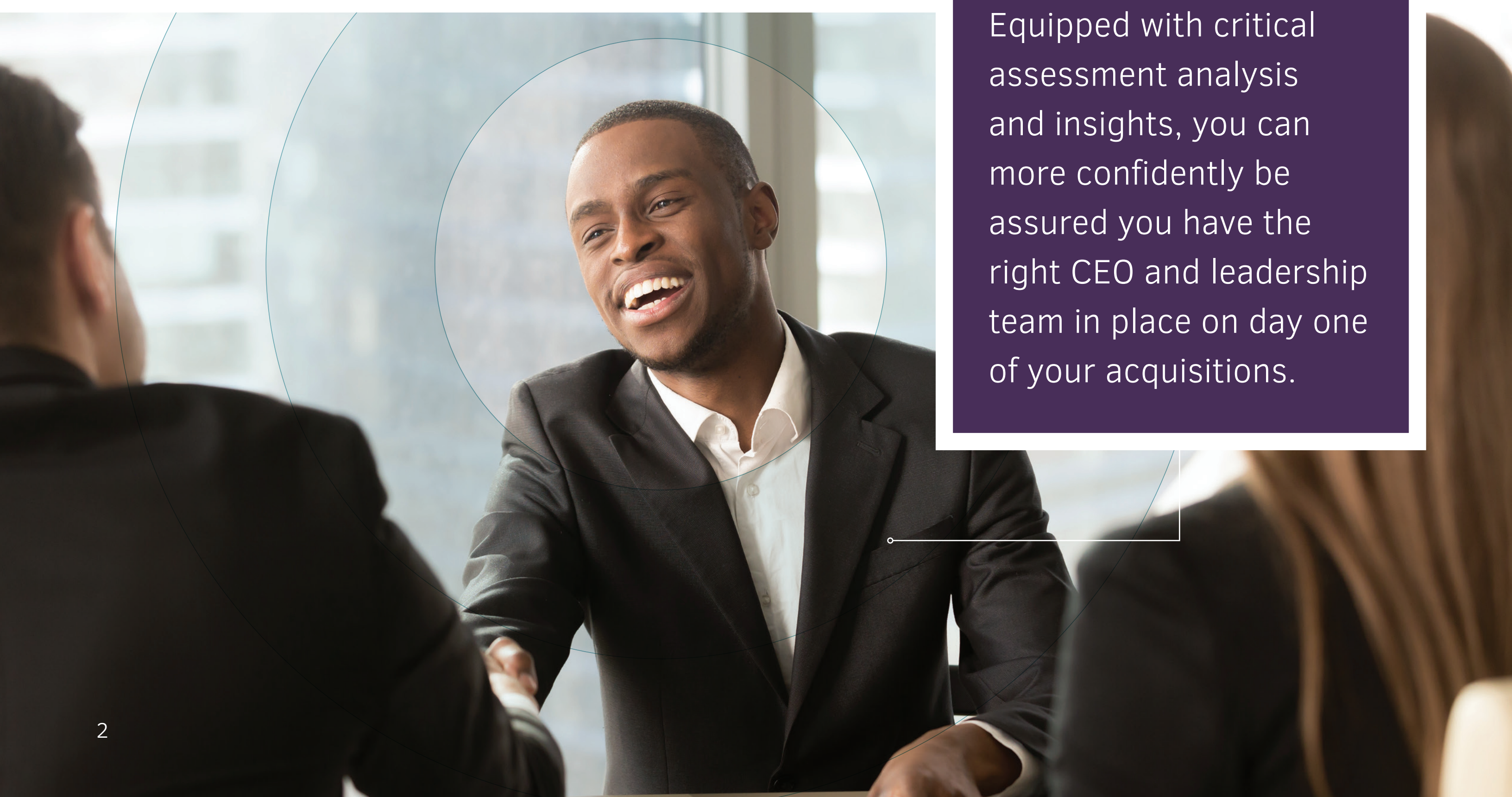

How do you know which consulting firm is best-equipped to meet your needs?

You'll want to ask these important questions:

1

What is the type, depth, and breadth of your business assessment experience?

Many consulting firms claim to have significant business assessment experience, but in reality focus on just a few industries or geographies. Ideally, you want an assessment firm steeped in the nuances of many different industries and business situations, and particularly in the type of business of your target portfolio company.

2

How do you conduct your assessments and what deliverables do you provide?

In-depth interviews can still be a key component of a PE firm's due diligence. The advantage of using a professional assessment firm to conduct such interviews is a higher degree of objectivity and professionality. Ask about the type of assessment tools the firm uses and for a sample assessment output report. Ideally, the firm should use multiple types of assessment tools to reveal the full gamut of leadership capabilities, and provide clear and concise post-assessment analysis and insights.

3

What type of insights will I receive?

Assessment insights should be rich, predictive, and have applicability to the "real world." What are the motives and drivers for a particular leader? How is this leader likely to respond in the face of stress or pressure (i.e., potential derailers)? Ask whether the firm translates insights into implications, so that you can answer the question: What does this mean for our business? Deep insights lead to better talent decisions.

4

What is your experience working with a PE firm like ours?

Rather than offering a cookie-cutter, one-size-fits-all assessment approach, a quality firm should be able to tailor its assessment offerings to the needs and nuances of your PE firm and to your specific target company. With a more tailored approach, you can gain greater certainty that the assessment report you receive matches your investors' interests—and the needs of your portfolio companies.

5

Can you provide references from other PE firms?

A professional assessment firm proud of its record of success in assessing portfolio company leadership should have no hesitancy providing you with references from other PE firms. Ask about the assessment firm's long-term track record with questions like "How accurate have its leadership assessments been over the years?"

6

What additional leadership resources can you provide?

A full-fledged assessment consulting firm should also offer a robust array of leadership-related tools and services, including executive coaching, C-suite and executive team development, and leadership development. For example, if a CEO assessment reveals multiple growth opportunities, yet this CEO is still capable of leading the portfolio company forward, the PE firm would be wise to invest in additional coaching and accelerated development for this executive—ideally with the same firm that provided the original assessment.

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