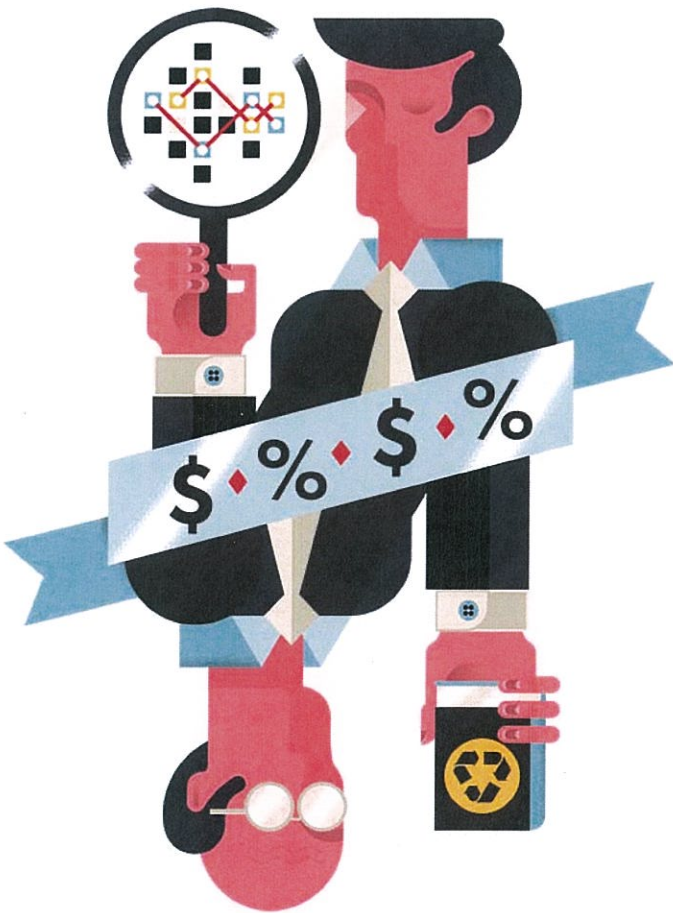


HIRING

# How Private Equity Firms Hire CEOs

FROM THE JUNE 2016 ISSUE



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**C**orporate boards often say that succession planning is their top priority, but at publicly traded companies, directors rarely get to turn that planning into action: The average CEO tenure at S&P 500 firms is nearly 10 years. That's in sharp contrast to the private equity world. PE firms hold investments in dozens of companies, and after making an investment, they nearly always replace the CEO. As a result, although a typical public company director might help hire a CEO a few times in a career, veteran PE executives hire multiple CEOs each year and many dozens over the course of a career, giving them a far greater ability to observe trends and learn from successes and mistakes.

To tap this expertise, Jeffrey Cohn, of the executive search firm DHR International, and J.P. Flaum, of the consulting firm Green Peak Partners, surveyed and interviewed the managing partners of 32 private equity firms (including Blackstone, Carlyle, KKR, and Silver Lake) about

their CEO search process and how it has changed over time. Among the surprises: Executives said they've learned to pay less attention to attributes such as track record and experience, the criteria typically most prized by recruiters, and to give more weight to softer skills.

“There’s a big difference in philosophy, economics, and process” between PE firms and public company boards, Cohn says. “The private equity firms have a lot more skin in the game—so they feel the burn if they make a bad selection.”

The researchers drew five conclusions:

### **Experience is overrated.**

When filling a CEO position, there’s comfort in hiring someone with prior CEO and industry experience. But the first criterion can dramatically narrow the pool, and the second can yield candidates who are so familiar with the industry that they’re hidebound or likely just to recycle the strategic playbook from their last job. Similarly, overemphasizing quantifiable success in prior positions can be misleading, because results are often a function of “right place/right time” or organizational or team factors rather than one individual. And even within an industry, different competitive positions can demand very different skills—cost cutting versus product innovation versus business model change, for instance. The researchers write, “Past accomplishment and current challenge is rarely an apples-to-apples comparison.” Many of the interviewees said that over the years, they’ve become more open to “nontraditional” candidates who lack degrees from blue-chip schools and haven’t checked the usual boxes in a career progression. One put it this way: “You need someone who can come into a new situation and pick up the fundamentals quickly. A great athlete...is more important than someone with years of experience in an industry.”

### **“We’re Looking for Player-Coaches”**

### **Team-building skills are paramount.**

Of the 13 attributes included in the survey, the highest ranked was a candidate’s ability to assemble a high-performing team. That makes sense, because many PE investments involve turnarounds in which the new CEO must



In a typical year, Tony de Nicola, copresident of the private equity firm Welsh, Carson, Anderson & Stowe, is involved in hiring 12 to 20 C-suite executives (a third of them CEOs) for WCAS's portfolio companies. He recently spoke with HBR about assessing talent. Edited excerpts follow.

**How do private equity firms think about CEO hires compared with how public companies think about them?**

Public company CEOs have to sell the company's story to different constituencies, including investors. Charisma and confidence are very important. And they often have large staffs; they're delegating and have less responsibility for day-to-day operations. In the private equity model, we're looking for "player-coaches" who will lead a smaller team and collaborate very closely with owners to create value.

**Has your hiring philosophy changed during your career?**

Definitely—over 25 years, I've seen what's worked and what hasn't. I used to hire a résumé—someone with the skills and experience that fit the specs. We usually reverted to someone who went to the right schools and grew up

completely rebuild the C-suite. And, because PE portfolio companies are typically smaller than publicly traded companies, CEOs spend more time in the trenches working alongside subordinates rather than providing autonomy with loose supervision. To avoid leaders who won't excel at building teams, PE execs say, they watch out for candidates who use "I" too much when talking about accomplishments or who display so much intellectual horsepower that they come across as arrogant, which can inhibit hiring and developing A-level talent. One executive told the researchers, "We ask questions like 'How many people followed you from your last job to the next one?' One CEO we interviewed had pulled 31 [former colleagues] into his portfolio company, and it has been a big part of his success." (See the Spotlight on Managing Teams, in this issue.)

**Urgency outranks empathy.**

PE firms operate with strict timetables for when a company should be improved and the investment recouped through sale or IPO. (The typical goal is five years.) This ticking clock means that a portfolio company CEO can expect close oversight and faces heightened expectations about the speed with which cost cuts or revenue growth will take place. The researchers write, "Many CEO wannabes will balk at a PE-driven pace, particularly those

in the industry. Today I worry less about the right pedigree or industry. I'm more interested in who someone is as a person and a leader and how good the candidate is at identifying talent, motivating a team, and building a culture of excellence.

### **Is your hiring more data-driven?**

Like everything in business, it's become more analytical, quantifiable, and metric-driven. We use scorecards and ratings. We have the same set of people conduct interviews, using the same set of questions. It's disciplined and rigorous. I think we're very good at it, but it's hard to get it right: Our success rate is still only about 60%.

### **Why so many failures?**

Sometimes the person lacks a sense of urgency, which can be hard to judge in interviews. Or the team dynamics don't gel. This is a team game; executives won't succeed by themselves.

who have grown accustomed to plusher, more heavily resourced environments." While this doesn't mean that a CEO shouldn't listen to customers or show concern for employees, it does require moving decisively and without regrets. One PE executive said, "I am not down on empathy, but [often] empathy needs to take a back seat to urgency. Some highly empathetic leaders are not able to make the tough personnel decisions that need to be made."

### **Resilience is a must.**

Parents understand that building resilience in children is important to character; PE types, too, cite it as an important leadership virtue. They've become skeptical about candidates who have skipped seamlessly from success to success. "PE firms want to see that a candidate has faced setbacks, made errors, and run adrift—yet lived to fight another day," according to the researchers' report. This attribute is

especially important because in turnaround situations, leaders are likely to encounter some negative results. "Business plans never go the way you think they will," one respondent said. "If the CEO does not adapt, you are going to be in trouble."

### **Authenticity, translated as candor, is also key.**

Like "resilience," "authenticity" has become so overused that its meaning can be vague. The researchers drilled down and found that PE executives use it to mean candor and a willingness to deliver bad news quickly and honestly. In a public company, sharing negative information is a delicate process—it's likely to move the stock price—but in a PE company,

real-time sharing takes precedence. One interview subject said, “I need my CEOs to have the confidence to be transparent with their PE sponsor—about their team and anything bad that is happening in the business. I hate when they just try to ‘manage up’ or act out of fear.”

A final difference between private equity and public company CEO hiring: PE execs tend to judge very quickly—usually within nine months—whether a new hire is working out. Compared with public company directors, they are quick to engineer a failing CEO’s exit—and when they think back, they often wish they’d moved even more quickly.

About the Research: “How to Pick CEOs When You Have Skin in the Game,” by J.P. Flaum and Jeffrey Cohn (Published in The Huffington Post, June 2016)