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Executive in a PE-owned company: General or Soldier?

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The INSEAD Private Equity Association (IPEC) hosted an evening conference in January at the recently refurbished Restaurant Spitz in the Landesmuseum, welcoming more than 65 guests, two-thirds of whom were alumni. IPEC president, **Martin Spirig**, MBA'06J (pictured left), moderated the discussion that was based on the premise that PE professionals believe that the probability of a portfolio companies' success is largely driven by the management team.

The discussion covered key success factors in managing a PE-owned company, asking the basic question: what type of manager is required, is it a general or soldier? Sharing their insights and experiences, the panelists (pictured here from 2nd left to right) were **Fred Gamper**, Former CEO and C-level executive of several PE-owned companies, **Dorothea Kronenberghs**, Head of German Division, at Directorbank, a specialized executive search firm, and **Tomas Aubell**, MBA'99J, Head of Investments, Jacobs Holding AG, formerly with EQT.

Highlights and Insights

The short answer to the conference's main question was that PE needs a CEO who is both a "general", a strategic thinker with clever tactics, and a "soldier" who respects the interests of shareholders, as devotedly as a soldier would. Some buyout houses see management as the greatest risk factor, a dealmaker or dealbreaker. So some buyout firms even insist on having the right manager in place before the deal is signed.

What kind of person makes an ideal manager in a PE-owned company? It is a person with a great education, integrity, a track record, and hungry. Hungry doesn't mean greedy. It means

being committed to the success of the venture and willing to work long hours. Traits sought include, being a team player (perhaps even having worked with the same team in other companies) and exhibiting motivating leadership, as well as an entrepreneurial mindset, resilience, and a “special” drive.

Some successful managers are “edgy” and “tough” towards the investors and the board, but protective and warm, like a patriarch, towards the team and customers. Sometimes being “edgy”, demanding and determined are not necessarily negative if it comes from the management, however the converse is not true, that is, if the threatening attitude comes from the PE and shareholders’ side.

One panelist said that turning around a company or driving a rapid growth, value-creation and expansion required by PE is like an extreme team sport, or competing in the “champion’s league”. It requires the same kind of determination, high-performance, fitness and determination. Because of that, it is something that can realistically only be maintained for several years before the management begins to desire a slower paced role, which fortunately coincides with the typical PE cycle: the buy, hold, and sell period is 3 to 7 years.

Alignment of interest and strategy is a cornerstone of successful PE investments. Collaboration and alignment between management and shareholders is enabled by regular and fairly frequent board meetings, core team leader meetings, especially initially. Some investors will even call every day. Once there is trust, the frequency can be reduced.

It takes time to create alignment on goals and to learn each other’s language. Friction can occur over the timing of the exit. A good management team can sense when there’s a change in the economic environment, often before the PE managers. Again, there can be conflict if the board is not willing to listen and an opportunity is missed.

Managers also have to pay attention to the exit. Is the PE owner able to listen to management about the timing of the sale? Having a buyer in sight early on and a PE firm that is actively seeking buyers is essential. Competition amongst buyers is a key to achieving a high multiple on exit.

Laissez-faire but with clear guidance is a best practice. Besides communication, PE should set clear rules and targets and give managers freedom to achieve results, reporting weekly, monthly, or quarterly. Clarity about executive and non-executive roles will avoid frustration. Problems arise when things don’t go according to plan, then PE has to step in. Too often PE will just start asking questions without understanding the issues at hand, which can cause ill-will.

Being constructive and sharing information is preferable. This is when having an operational partner with CEO experience on the PE side is an advantage. It compensates for the fact that many PE professionals come from consulting, investment banking and finance industries.

Remuneration and Incentives. Candidates that have already done a management buy-in (MBI) have very different expectations compared to a candidate that is entering for the first time from a corporate role. Experienced MBI managers know there is a risk that they earn zero at exit. One panelist suggested at least 50% of managers earn zero at exit. Establishing a remuneration scheme that incentivizes growth and minimizes risk is a challenge. But a lot has been learned in European PE in recent years about how to balance salary, bonus and equity stakes.

Typically, bonus agreements hinge on performance, a profitability rate or sales figures outperforming the market. It needs to “hurt” if the management team misses the target, but not so much that it causes management to avoid risk altogether.

The 3G Capital approach to compensation, which relies on share lock-ups, a generous bonus plan and lower salaries, is seen by some longer term PE investors as a winning model. Others believe that the manager should buy-in, obtaining a minority stake right from the start. But this early dilution of equity can be difficult to manage and regular communication about the value of shares

is difficult in a privately-owned company. In some cases managers have to be taught about the implications of an equity stake.

There is a need to understand PE investor's approach. Managers who are looking to run a PE company would do well to understand the culture of the PE firms involved before committing. How do they manage the portfolio? How long do they typically hold before selling? Is it three, five, or ten years? These are important questions to ask because PE is a label applied to many different business plans and different cultures. Family offices and pension funds, for example, tend to have a longer-term holding period than a typical mid-market buyout house. Even partners within a single PE firm can be quite different.

Would you recommend running a PE-owned company to a friend? The role is warmly recommended for managers that have an entrepreneurial drive and a track record that shows their ability to turn around operations or create value in an organization. So it is not recommended (or even possible) for someone just starting out in management. It would not be recommended to a friend that is risk-averse, or who needs established processes, conformity and a high level certainty to perform well, such as one might find in a very large established corporation.