Private Equity and the CEO

Partners in the Quest for Value
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AT A GLANCE

Most CEOs of private-equity-owned companies agree that private-equity (PE) firms can help their companies and advance their individual careers. But CEOs and PE firms often do not fully appreciate each other’s perspectives. This mutual misunderstanding can damage the relationship between the CEO and the PE sponsor.

Threats to a Vital Relationship
We believe that the PE-CEO relationship is vital to the central task of creating value at portfolio companies. The most common reasons for breakdowns in this relationship are a lack of understanding of the other side’s perspective; a lack of flexibility and pragmatism on both sides; a mutual lack of trust and transparency; and a failure to appreciate all that the other side has to offer.

Keeping the Peace—and Creating Value
A few basic best practices can prevent the relationship from running off the rails. Both sides need to make the effort to understand the other’s mindset. PE firms and their professionals need to tailor their interactions with each portfolio company to suit the operating style and strengths of the CEO. CEOs need to accept the high degree of accountability that PE firms demand. Both sides need to do all they can to be open with each other. And PE firms should highlight the support they can offer.
A special, mutually beneficial relationship exists between a small, brown African bird, the honeyguide, and the ratel (or honey badger). Both derive food from bee nests and the bird has no trouble finding these nests, although it can't get inside them. The ratel, however, has difficulty finding the nests. With its strong claws and muscular jaws, the honey badger can easily rip the hives open to get at the honey. So the bird and the ratel join forces. When the bird discovers a wild bees’ nest, it searches out a ratel and chatters loudly and persistently. The ratel answers by moving toward the bird, replying with chuckling and hissing sounds. On arrival at the nest, the badger breaks into it and begins to feast on the honey and larvae. Its feathered friend patiently awaits its turn at the leftovers, beeswax, and grubs.


We have learned from our close involvement with private-equity (PE) firms and portfolio companies that their relationship and mutual cooperation are instrumental in determining whether a company performs well or falls short of expectations. While the cooperation between the honeyguide and the ratel is probably apocryphal, our research has shown that the PE-CEO relationship can be highly symbiotic, producing significant benefits for both sides.

To more fully understand the nuances of the relationship between CEOs and their PE firms, BCG has conducted interviews and surveys with both PE professionals and current and former CEOs of PE portfolio companies. (See Exhibit 1.) This report covers the most revealing and salient results of these studies.

A Successful Partnership

Most PE professionals would describe their relationships with their CEOs as partnerships, but even the most successful partnerships have points of friction. For example, CEOs accustomed to running their own show often bristle when PE firms intervene in management issues.

By the same token, PE firms have the right (and indeed, the obligation, considering the fiduciary duty they owe their investors) to remove underperforming CEOs—and they are quick to assert that right when necessary. In fact, our research into 198 companies currently under PE ownership found that 57 percent have already changed CEOs since being acquired. Some of those changes were planned prior to acquisition, but many occurred because the PE owners came to the conclusion that the incumbent CEOs were not suited to the task at hand.
Despite the inevitable challenges and complexities of the relationship, we found that the overwhelming majority of CEOs at portfolio companies—more than 90 percent—agree that the PE owner has had a positive effect on their company’s performance. Perhaps more surprisingly, an almost equal percentage of CEOs say that the PE firm has enabled them to succeed in their role and has made them better at their jobs.

In this report, we will consider a few crucial questions, guided by the thoughtful and candid responses of the CEOs and PE professionals who participated in our research. Those questions include:

- **What do PE firms look for in a CEO?**
- **What role do both sides expect the PE firm to play?**
- **What are the most common reasons for a breakdown in the relationship between a PE firm and the CEO of a portfolio company?**
- **What key principles and best practices should PE firms and CEOs follow to promote and support a successful partnership?**

### What PE Firms Look for in a CEO

By its very nature, the PE-CEO relationship differs from other owner-manager relationships. The professionals at PE firms are highly skilled and expert shareholders and, crucially, they have been given powerful incentives to succeed. They therefore think and behave differently than less engaged shareholders do. Their mindsets and practices are sometimes misunderstood, and as a result, even the CEOs at port-
folio companies sometimes fail to grasp what PE firms prioritize when they select and evaluate a chief executive.

Our survey revealed significant differences in the ways that PE professionals and CEOs view the capabilities and mindset required to succeed as the CEO of a PE-owned company. (See Exhibit 2.) PE firms, for example, generally want their CEOs to focus primarily on operational matters, while CEOs view themselves as strategists first and operators second.

**EXHIBIT 2 | CEOs and PE Professionals Cite Different Success Factors for CEOs**

<table>
<thead>
<tr>
<th>Is it more important that CEOs:</th>
<th>Strategic</th>
<th>Balanced</th>
<th>Operational</th>
</tr>
</thead>
<tbody>
<tr>
<td>...have a strategic or operational mindset?</td>
<td>Balanced</td>
<td>Operational</td>
<td></td>
</tr>
<tr>
<td>...focus on the long or the short term?</td>
<td>Long term</td>
<td>Balanced</td>
<td>Short term</td>
</tr>
<tr>
<td>...focus on the big picture or be detail orientated?</td>
<td>Big picture</td>
<td>Balanced</td>
<td>Detailed</td>
</tr>
<tr>
<td>...build consensus or set direction?</td>
<td>Consensus</td>
<td>Balanced</td>
<td>Directive</td>
</tr>
<tr>
<td>...be driven by ideas or process?</td>
<td>Ideas</td>
<td>Balanced</td>
<td>Process</td>
</tr>
<tr>
<td>...be a risk mitigator or risk taker?</td>
<td>Risk mitigator</td>
<td>Balanced</td>
<td>Risk taker</td>
</tr>
</tbody>
</table>

Most common CEO response (highlighted in bold text)

Second most common CEO response

Source: BCG analysis.

PE firms also expect CEOs to balance their focus between the big picture and operational details. They demand that CEOs execute on stated plans and goals, and consequently they seek CEOs capable of intense attention to detail, with a hands-on operating style. CEOs, by contrast, believe that it is their role to focus more intently on the big picture.

It is also a common misconception that PE firms are biased toward short-term goals and thinking. In fact, PE professionals told us that they want CEOs to focus more on the long term. This is because PE firms take a long-term view of value creation. They embrace a holistic and pragmatic approach that sees no conflict between generating cash in the short term and building value in the business over the long term—both are equally valid and viable paths to their goal.
Finally, and perhaps most tellingly, PE professionals said that they want CEOs to be biased toward risk-taking. By contrast, CEOs believe they need to balance risk-taking with risk mitigation. These divergent views go a long way toward explaining why the relationship between the PE firm and the CEO can sometimes go awry.

What Role Both Sides Expect PE Firms to Play

We also asked PE professionals and the CEOs of PE portfolio companies to rank by importance several different roles for PE firms. (See Exhibit 3.) The points of agreement between the two sides are as telling as their differences. CEOs tend to believe that the proper role of the PE firm is to provide capital, monitor certain areas of performance, and serve in a limited way as a sounding board for managerial decisions. And they see less of a place for the PE firm as an advisor on operational matters or in day-to-day oversight of the business.

PE professionals, however, take a more expansive view of the firm’s role. They place somewhat less emphasis on capital provision and believe that the PE firm ought to have a greater voice in key decisions. And they see themselves as having significant expertise to offer on specific areas of the business. CEOs, by contrast, believe there should be little engagement from the PE firm on revenue-related and operational issues. As one CEO of a portfolio company told us, “PE firms should avoid getting involved in anything close to managing the business. That’s my job. They don’t have the resources or the expertise to offer the proper support.”
Our discussions with PE professionals and CEOs made clear that their differing perspectives on the appropriate level of engagement by the PE firm did not necessarily reflect any operational shortcomings of the PE firms themselves (of which there are some). Rather, their divergent views reflect a greater divide on the ways PE firms can and should contribute to value creation. (See Exhibit 4.)

It’s clear from the survey responses that PE firms are not as meddlesome as many CEOs might think or fear. CEOs told us that PE firms rarely initiate an intervention in operational issues and focus instead on strategic, financial, and—to a lesser extent—operational topics. (See Exhibit 5.)

Rather than barging into a CEO’s office issuing orders, most PE professionals take pains to persuade a CEO that an intervention is in the best interests of the organization. Following such discussions, BCG research has found, it is most often the CEO who initiates an intervention or who jointly agrees with the PE firm to step up its involvement.

When analyzing the responses to our survey by PE professionals and CEOs, clear points of contention emerge. At the same time, however, both CEOs and PE firms
have a deep appreciation for what the other side can contribute to value creation. Several topics, highlighted below, elicited the most passionate and thoughtful responses.

**The Importance of Engagement by PE Firms on Strategy and Governance.** CEOs see PE firms as natural partners in finance-related matters such as M&A, exit strategy, and balance-sheet management. In fact, many CEOs expect PE firms to take the lead when such questions arise. One CEO told us, “Our PE firm has been able to provide financing and legal expertise that we do not have in-house. We face more complicated issues than we did before the acquisition, and their expertise is welcome.”

**PE Involvement in Cost Issues and Revenue-Related Operational Questions.** Both sides agree that this type of involvement is not a priority. But PE professionals said they would like to be more engaged as a sounding board on these subjects. By contrast, CEOs in general want less involvement from PE firms on operational matters but recognize that PE firms can be helpful on questions of costs. They also accept that PE firms rightfully place a priority on issues of cash flow, such as capital expenditures and working capital. In general, CEOs said they believe that PE professionals’ experience qualifies them as experts on costs yet still leaves them without an intimate understanding of the business needed to address revenue issues. As one CEO said, “On detailed growth and cost projects, either you stay and help execute—which is not practical—or you stay away and let the CEO get on with running the business.”

**Which PE Interventions Are Viewed as Helpful and Desirable.** PE professionals told us that they see the value creation plan, with clearly associated key performance
indicators (KPIs), as the core of the PE governance model; they also said they want to play a large part in its creation. Typically, the PE firm and the CEO reach alignment on the plan’s thesis and underlying principles before closing the deal, and the plan’s principles are translated into a coherent set of activities during the first 100 days of the new entity’s operation. CEOs generally said they prefer to take charge of drawing up the action steps, and many expect a limited amount of input from the PE firm. Because the plan is central to the PE business model, however, firms generally want to be closely involved in putting the plan into operation.

Successful CEOs recognize the critical importance of aligning with their PE owners on the plan—which will set the CEO’s agenda for the next several years—and managing a division of labor that plays to the strengths of both sides. They take responsibility for the specific operational details but look to their PE owners for guidance on constructing a robust framework for tracking progress on the plan, knowing that PE firms place heavy emphasis on a considered use of KPIs and an effective program management office. Without the PE firm’s expertise in designing tracking frameworks, CEOs often resort to deploying measurement systems already in place to track other programs. Such programs, however, are usually smaller and less far-reaching than the value creation plan—and are thus unequal to the task.

Most CEOs, especially those with prior PE experience, also invite their PE owners to participate in discussions of geographic expansion. And they want more engagement from PE firms on matters regarding market and industry intelligence. The CEOs recognize that PE firms have valuable, well-developed external networks. As one CEO told us, “There is an opportunity that I didn’t fully appreciate the first time around with my last PE firm: I can get access to networks that would take me years to cultivate. Those networks can be really useful as a source of knowledge on things like joint ventures in China.”

The Most Common Reasons the PE-CEO Relationship Breaks Down

From our research and extensive experience in the private-equity arena, we have identified four root causes that result in the relationship between a CEO and the PE firm failing to reach its full potential:

- A lack of understanding of the other side’s perspective
- A failure to adapt to the unique demands of the relationship
- The lack of a fully trusting and transparent relationship between the CEO and PE firm
- An incomplete appreciation of the value a PE firm brings to the table

In the following section, we’ll examine each of these root causes of failure and recommend approaches for resolving issues in the relationship—and for preventing them from arising in the first place.
A LACK OF UNDERSTANDING OF THE OTHER SIDE’S PERSPECTIVE

CEOs with little prior interaction with PE firms are often unaware that each firm has its own unique approach to its portfolio companies. (A taxonomy of the various approaches can be found in The Boston Consulting Group’s 2012 report, Private Equity: Engaging for Growth.”) Some firms focus intently on the buyout transaction, and, after the acquisition, allocate few resources to support the portfolio company. Other firms, by contrast, have full operating teams that can provide hands-on support, and still others fall somewhere between these two poles.

Less experienced CEOs are also often unaware that the level of operational engagement undertaken by a PE firm depends to a great extent on the performance of the portfolio company, the PE fund itself, or even the responsible PE professional. If the fund, portfolio company, and PE professional all are performing well, the PE firm is more inclined to allow the CEO and senior management greater operational autonomy.

It’s also the case that the level of operational engagement changes over time. The closer a PE firm gets to its exit, the less willing it is to invest in corporate development initiatives or change its strategic direction.

Successful CEOs understand the actions and decisions of their private-equity shareholders and the lens through which those shareholders view the company and the CEO. They prepare intensively for meetings with their PE professionals; consequently, they have a command of the numbers and key operating data at their fingertips. They never find themselves in a situation like that described by one PE partner: “A sure sign of trouble is when you ask a direct, detailed question to the CEO and he looks at the CFO to respond. He doesn’t realize how important it is for him to answer the question himself. The impression he leaves with the PE firm is that he doesn’t get it—and that we’re in trouble.”

CEOs getting their first taste of PE ownership need to strengthen their private-equity skill set and display their grasp of the business from the very start of the relationship. Not only do they need to hone their basic finance and legal technical knowledge but they also should understand the company’s position in the marketplace as well as the terms of the buyout and their personal incentives. Such preparation creates a strongly positive impression with the CEO’s PE partners.

It’s equally important for the PE firm to get the relationship off to a good start by addressing any concerns the CEO may have about PE ownership and by correcting any misperceptions about such topics as cost cutting, funding for growth, and an orientation toward the short-term.

PE firms also need to be mindful that every single interaction with the portfolio company shapes the CEO’s impression of PE in general and the firm in particular. Every CEO, for example, is sure to remember the initial meeting with the PE firm, particularly if the PE professionals promised during that meeting to keep their hands off operations and to finance bolt-on acquisitions. Such a promise might be informal, but most CEOs will see it as a contract and expect their PE sponsors to honor it.
A Failure to Adapt to the Unique Demands of the Relationship

The diverse and complex relationship between CEOs and PE firms demands flexibility on both sides. Many PE firms do not fully appreciate the degree to which the CEO should determine how and how much the firm is involved with the portfolio company. As a result, they fail to be pragmatic about tailoring their approach to the CEO from the outset. The PE firm often assumes, on insufficient evidence, that it is in full alignment with the CEO on their respective roles and on the company’s strategic direction. That alignment is, in fact, often less than complete, and gaps that appear small at the beginning can widen over time to become unbridgeable gulfs.

To prevent these fissures from forming, both CEOs and PE firms need to reach a shared definition of the process of interaction early on, spelling out the planned frequency of contact, the level of detail addressed in interactions, and the roles of both parties. The PE firm should clearly communicate its expectations of accountability to the CEO but at the same time demonstrate support. They can do this by meeting informally with the CEO on a regular basis and contributing to the decision-making without undercutting the CEO.

Of course, CEOs can be inflexible, too. Many fail to adapt to the cultural changes that accompany a conversion to PE ownership. In particular, many CEOs underestimate the greater level of accountability that the private-equity environment demands and are blindsided when they are sanctioned—or even fired—when KPIs fall below expectations.

It’s a challenge for most CEOs to set ambitious targets while remaining realistic about the company’s capabilities. As one PE professional told us, “It’s easy to fall into the trap of trying to win over the PE firm by promising the world. You need to set clear boundaries at the start, because a lot is at stake.”

To avoid overpromising and underdelivering, CEOs need to take the lead in drawing up plans that describe their goals and in mapping a detailed path to success. PE firms respect such plans, even when those plans may appear more conservative than the firm would consider ideal.

The Lack of a Fully Trusting and Transparent Relationship Between the CEO and PE Firm

A PE firm that develops an open and trusting relationship with a CEO stands a better chance of gaining a clear view of the portfolio company’s performance on key initiatives. It also increases the likelihood that the firm will be invited to help out when an intervention would be beneficial. Responsibility for developing such a relationship falls equally on the CEO and the PE firm.

Some PE firms inadvertently inhibit the development of an open and trusting relationship by burdening the portfolio company with cumbersome and intrusive micromonitoring. By the same token, however, CEOs often destroy trust by waiting to inform the PE firm of problems only after they develop into full-blown crises. In fact, only 43 percent of the CEOs in our survey sample agreed that they should involve the PE firm on urgent operational issues.

Said one PE partner: “A sure sign of trouble is when you ask a direct, detailed question to the CEO and he looks at the CFO to respond... The impression... is that he doesn’t get it...”
CEOs have varying motives for their reluctance to share bad news with the PE firm. Some keep the PE firm at arm’s length because they worry that the firm will regard any wobble in company performance as a judgment on the CEO, without taking the larger economic and business context into account. Others withhold negative information out of concern that the PE firm will demand costly and time-consuming remediation measures. And still others simply don’t want to invite heightened scrutiny and increased reporting responsibility by alerting the PE firm to incipient problems.

The reluctance to come clean can damage the relationship beyond repair. “You need complete transparency,” one PE professional told us. “Things get bad very quickly if transparency vanishes.” As this quote suggests, the failure to share information is in itself a signal—an alarming one.

PE firms tend to assume the worst when they do not have an easy way to access information and often step up their questioning of the CEO. One PE partner made this point explicitly. “We would probably change management,” he told us, “if we got the sense company leaders were not being open.”

CEOs who enjoy friendly, informal relationships with senior PE professionals usually find that these interactions reduce the need for formal reports to the PE firm. They can instead discuss their organization’s challenges without elaborate preparation, in a context that’s more like “talking shop” than enduring a hostile interrogation.

Successful CEOs use their good relationships with their PE owners to reduce the risk inherent in key decisions. “The most experienced CEOs are very savvy,” one PE partner observed, “and get us not only to buy in but also to get involved in key decisions and important initiatives. This protects and buys them time if things don’t go to plan.”

A healthy relationship between the CEO and the PE firm also pays dividends for the organization as a whole. By the same token, a troubled relationship can undermine the CEO’s relationship with other shareholders and employees. When word seeps out that the CEO and the PE firm are at odds, employees tend to take the news as confirmation of their worst fears about private equity.

“You need to be very careful in managing the messages you send to the rest of the organization about what private equity means to them,” one CEO told us. “Many people will have strong views that private ownership will mean job losses, plant closures, and all sorts of other bad things. This applies to senior management as much as to the shop floor.” The PE firm and CEO should therefore align their messages to the company in advance. A failure to do so can have serious consequences, undermining morale and crippling the PE firm’s ability to make a positive impact.

Of course, it takes two sides to build a healthy, productive relationship, and PE firms must do their part. It is particularly important that the PE firm be forthcoming with information as the date of exit approaches. Exit transactions are unique to the private-equity business and are unfamiliar to many CEOs. In addition, the shift
in the PE firm’s priorities from creating value to executing the sale can stir strong and often conflicting emotions in the CEO and throughout the portfolio company. “It can be exhausting for management and can cripple the organization,” one CEO told us. “We did not see it coming and weren’t ready for it, and we lost a lot of good people when it didn’t work out.”

**AN INCOMPLETE APPRECIATION OF THE VALUE A PE FIRM BRINGS TO THE TABLE**

Most CEOs do not have a full understanding of the ways in which their PE shareholders can help them meet their objectives. One CEO who had run the same company under several PE owners described the long learning curve in the following way: “With our first PE firm, at the start they would always bring new ideas to me and I would send them on their way. Eventually, they were very useful in helping us rethink our R&D processes. The next PE firm played a central role in supporting our acquisition strategy in Europe. With our latest firm, we regularly discuss what resources they can offer to help the business, and they also support me personally in building my professional network.”

This CEO touched on a crucial point: CEOs strongly appreciate PE firms that, for example, link them to professional networks by hosting events such as conferences and functional workshops—yet few PE firms facilitate such opportunities.

**Four Imperatives for Successful Collaboration**

The most successful relationships require mutual and ongoing effort. (See the sidebar “Trusted Advice on Successful Strategies.”)

Both CEOs and PE firms have four imperatives to fulfill:

- **Understand where your partner is coming from.** In particular, understand their mindset. For CEOs, this often means refreshing or gaining new technical skills, and for the PE firms, this often means taking time to identify and dispel any preconceived notions about PE that CEOs might hold. PE firms also need to recognize that they probably made implicit agreements with the CEO before the acquisition—agreements they need to honor to foster trust and transparency.

- **Define the relationship up front.** Set clear and achievable objectives together, defining roles in detail and avoiding a one-size-fits-all approach.

- **Make the relationship work throughout the cycle.** Transparency is the most important factor in maintaining a relationship that adds value to the company and the PE firm. Maintain transparency when the news is bad as well as when it is good.

- **Get the full benefit from your partner.** Work together to make your partner your greatest ally.

Without doubt, a successful relationship between a PE firm and the CEO at a portfolio company can deliver huge benefits to the PE firm, the portfolio company, and
TRUSTED ADVICE ON SUCCESSFUL STRATEGIES

BCG works closely with both sides of the partnership between private equity (PE) and the CEO. What follows are just a few examples of the ways we have worked with CEOs and PE firms to help them reach their common goals.

During the first 100 days of ownership, we have assisted several PE-CEO teams in the development of an integrated value-creation plan for the next three to five years. These plans deliver significant value to both the PE firm and its portfolio company in three key ways. First, they translate the PE firm’s thesis on value creation into a workable plan and, accordingly, help prioritize the CEO’s agenda. Second, the plans also support alignment among the CEO, the PE firm, and other key stakeholders such as senior management and the wider board. Third and finally, they ensure that a robust tracking framework, such as key performance indicators (KPIs) and a program management office, is in place. Such a framework ensures that the plan is hardwired into the organization, positioning it for success.

During the PE firm’s period of ownership, deep industry and functional expertise can help inform the PE-CEO relationship and the company’s plans. Our experience working with both public companies and private equity firms has enabled us to adapt approaches developed for market-leading companies around the world to the private-equity environment. In addition, functional “health checks” can rapidly identify opportunities for value creation, helping company management and the PE firm develop a shared understanding of the opportunity—and then seize it.

Approaching the exit date, the company must ensure that it is prepared to realize its full exit potential. Too often, the CEO approaches this critical task only when the exit date is looming—a frequent source of friction between the CEO and the PE firm. In particular, we have assisted CEOs in developing a robust equity story that is compelling in itself and is sensitive to the priorities of potential buyers. Also beneficial is a revisiting and reinvigorating of the company’s overall strategic plan to create strong momentum upon exit. Finally, as a formal part of the exit process, a rigorous vendor due-diligence report can give potential buyers a robust fact base about the industry and business so that they can make an informed decision about the attractiveness of the investment.

the CEO. Conversely, a bad relationship can ruin the CEO’s career, tarnish the PE firm’s reputation, and cripple the company. In a world where private equity is focused on driving real value creation, making the relationship work should be a priority for PE firms and CEOs alike.
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