Succession in Private Equity

A solid succession plan should be an essential element of the exit strategy for most private equity-backed businesses. ***Criticaleye*** *assesses whether PE firms need to get smarter about talent management*

Succession planning is important for the sustainability of any organisation but in a private equity-backed business it's arguably more pertinent for senior executives to have developed a capable management team beneath them. After all, for the investment to be deemed a success there must be a pipeline of talent or there's the risk that value will be lost when the executives exit the business.

"Succession can often be a big issue for mid-market PE-backed companies", says **Ian Stuart**, Chairman of four sponsored companies, including Aspen Pumps, a 2007 Inflexion investment which produces air conditioning accessories.

"My experience in larger companies was that, generally, a talent pool existed that could provide succession. Smaller companies lack the scale to achieve this."

It's something a PE firm will be watching. **Andrew Vaughan**, Chairman of multiple PE-backed businesses, including online discounting concern Asperity Employee Benefits, says: "If you've got a particularly dominant leader you might need several years in advance, whereas if you have a broad minded leader who's established a competent team around them, you might only need six months… and it's worth bearing in mind that very dominant leaders struggle to attract the right calibre of second-tier management."

Graham Clark, Head of the UK Executive Coaching Practice at Hay Group, who has recently conducted research into how to minimise people risk in PE-backed firms, comments: "A new investor will be assessing where the business will be in three to five years on their exit and whether there is the right talent within the portfolio management team to drive the strategy…

"A lot of value would be lost through the departure of key executives if the succession planning process was done in a haphazard way and the reason why people leave it late is because of the perception that it doesn't really increase the value of the business on exit."

Steve Parkin, CEO of Mayborn Group, a 3i-backed company which makes baby and child products, comments: "In our business, we've got a number of multiple initiatives on the table to maximise the financial performance of the organisation, and driving aggressive top and bottom line growth can't be done unless you've the bench strength in place across both the senior management and executive team.

"Once you've done a stint in private equity, many will not have the desire or the resilience to go on and do another stretch under a new ownership structure. It's critical therefore that when you look at your exit scenario, you need to demonstrate that there's a succession plan in place beyond those executives that want to leave."

Andrew says: "If you've any single bottleneck or source of failure, whether it's a CEO, sales director or head of technology, they will immediately dilute the valuation based on the risks involved with certain key individuals. If you can demonstrate that the business is secure in its people and has a strong management team under the leadership it will materially affect value and appetite. I've seen plenty of businesses not sell simply because a very charismatic and dictatorial founder has failed to delegate and create a business that can survive without him."

There are plenty of instances of acquisitions failing because key people leave and with it goes the intellectual capital of a business. **John Allbrook**, Executive Chairman of IT financiers Syscap, comments: "Certainly during the due diligence phase you should be identifying the bench strength within the business...

"Succession should be one of the first things on the agenda of the new board, as and when it convenes, and it's a key responsibility of the non-execs or the portfolio managers to make sure that those considerations are heard."

EYE ON THE FUTURE

Underlying much of this is whether the executives who have equity are interested in the long-term prosperity of the business, or just worried about their post-exit returns. If it's the latter, then talent management won't be a significant concern, which would be a major oversight.

Sam Smith, Managing Director of Marble Hill Partners, an executive search practice which specialises in working with PE-backed businesses, says: "Incentivising middle managers, who don't have skin in the game, is the trick of good leadership. When you speak to the management teams of these businesses around the exit period, there's often a lot of uncertainty and employees will question where the business is headed and what's in it for them.

"The stock answer is to say: 'It's simply the shareholder that is changing and if we achieve our targets, we'll all do well out of it.' The message should be that managers have the prospect of exposure to many different stages of growth, whether it's a buy-out, a trade sale or a float, and that they can learn much from the experience."

Tania Howarth, Chief Operating Officer of PE-backed frozen food company Iglo, which operates under the Birds Eye brand in the UK, comments: "If you are hiring talent into the layer below the equity holder group, you must provide them with an excellent career experience and the

> *"The chairman has the best overview and the most experience to steer succession"*

aspiration of what they could move into in the future, through promotion. Clearly you have to be careful how you play that because it could be a little like wishing for jam tomorrow, but never jam today...

"You need to provide people with a good compensation strategy, comparable to large multi nationals, or else you'll never recruit the best talent... PE-backed businesses offer a great career experience – they are all about turnaround; it's fast, exciting and exacting, and you will get much more responsibility than would you do in a big corporate."

John says: "Sometimes you need to put the handcuffs on through retention bonuses; sometimes you can be much more about growth, because the exit value is dependent on the success of the business today and it is, therefore, relatively easy to align the managers with the KPIs of the business in that moment. Personally, I'm not a huge fan of handcuffs and loyalty bonuses; I prefer to have people aligned with the true KPIs of the business."

There is also an argument that PE firms need to be more sophisticated and imaginative about nurturing existing talent in portfolio companies. **Graham** comments: "The reason why people will often bring in talent externally rather than developing from within is because it's seen as the safer option to bring in a CEO or CFO with a track record of delivering performance…

"For me, a part of what a good portfolio manager looks like is someone who assesses the pipeline of talent for these key positions within the organisation, but they often don't do this because it's seen as something that's harder to do and riskier, and there's generally a lack of impetus from PE houses to encourage this through what tends to be quite a lean HR function."

BEYOND THE NUMBERS

Naturally, there will be a need to bring in fresh faces too given the unique way PE functions, but the blend of skills and knowledge have to be right.

Mark Cole, an experienced non-executive director in financial services and private equity, comments: "Parachuting in last minute external hires who don't have the right attitude and culture can have undesired effects... Some industries, such as financial services, have an almost football culture of paying up for external deal doers, however, the impact of this on behaviour and existing staff comes under scrutiny post exit. Many companies are guilty of not maximising the value of their human capital and subsequently can overlook good people internally."

Steve says: "If you're going into new markets or new initiatives that the business hasn't necessarily done a lot of before, and you don't therefore have natural competence in the organisation, it is right to go out and build and bring in new people with the technical competency that you need for a specific business initiative."

Succession can be deferred simply because the process of developing the second tier of management is so fraught with risk. "It's really difficult to find good quality people that are going to make a difference," says **Andrew**. "Hiring senior people for senior positions when you're catering for succession planning is incredibly time consuming and very difficult to get right. When you're running a business that is always based on profit growth you can waste an awful lot of time, effort and money getting it wrong… Too many people hire the best available rather than the best, which always ends in tears."

But that's not a reason to ignore the issue entirely. "Even the best succession plans should be revisited before being blindly followed," says **David Harding**, Deputy Chairman at PE-backed Malaysian lottery operator Magnum Berhad and former CEO of bookmakers William Hill. "A key factor here is that succession plans drafted with current management will almost always assume a continuation of current strategy and culture and are unlikely to anticipate inflection points and the need for change.

"PE-backed ventures should therefore probably have two [succession plans]. One drawn in conjunction with the management, which will have the implied continuation of strategy and culture, and one by themselves which assumes a new direction is needed."

A good board, with a responsible set of non-executive directors, should be pushing the succession agenda. "The chairman has the best overview and the most experience to steer it," says **Sam**. "But if the CFO is not going to stay then the CEO should be thinking about who in the team can step up, because you normally find succession plans for the finance function aren't what they should be."

If CEOs don't tackle succession, others who think they know better will intervene. ■

Featuring Commentary From:

John Allbrook
Executive Chairman
Syscap

Graham Clark
Head of UK Executive Coaching Practice
Hay Group

Mark Cole
Experienced PE and financial services NED

David Harding
Deputy Chairman
Magnum Berhad

Tania Howarth
Chief Operating Officer
Iglo Group

Steve Parkin
CEO
Mayborn Group

Sam Smith
Managing Director
Marble Hill Partners

Ian Stuart
Chairman
Aspen Pumps

Andrew Vaughan
Chairman
Asperity Employee Benefits

Contact the contributors through:
www.criticaleye.net