THE PRIVATE EQUITY VERSUS THE TRADITIONAL CEO

By Mike Lorelli

Sure, they carry the same DNA and title. But the operating and expectation differences can be huge and capable of creating a fireball; heads up to headhunters.

The Shareholder vs. the Shareholders

Not having the ongoing management of the Shareholders is a plus for the p.e. CEO. No public earnings releases, analyst conference calls, important shareholder phone calls, preparation of fancy Annual Reports and the like. The p.e. CEO enjoys the simplicity of one or a couple of shareholders, or does he? The private equity firm has powerful and timely motives to succeed, creating a different set of pressures. I will disagree with every article written that says private equity companies are not under quarterly earning pressures. In many cases, it's substituted with <u>MONTHLY</u> EBITDA pressures and loan covenants that require NASCAR skills to stay off the guardrails.

The p.e. shareholder is focused on 3 metrics: ROI, Cash-on-Cash Return, and hold period. Two of those three metrics place enormous emphasis on time. Public Company EPS growth isn't as time sensitive as the bragging rights of a 4 year hold period. The public company CEO has no 'hold period.' In some ways, it's perpetual with no cliff date beyond which you've failed.

This can lead, and does lead, to more financial intrusiveness into the p.e. CEO's daily life. If acknowledged and expected by the p.e. CEO in advance, this is simply part of their new life. It can be a plus as the cadre of young MBAs are, after all, pretty good at this stuff and can carry much of the burden when it comes to areas like renegotiating the loan or re-setting covenants.

Private Equity firms usually expect their CEO to be very heavily operationally focused, and in some ways, behave more like a COO. That can be invigorating and fun for the right kind of CEO, since the focus on EBITDA doesn't afford the management layer of a COO at all. The p.e. CEO therefore needs to be totally comfortable and have the bandwidth to wear both hats.

The flip side, particularly in a small-cap p.e. environment, is that it's truly 'lonely at the top.' Where do you go to confidentially kick the dog? My experience with p.e. Deal Teams is that the average IQ is about 160, with no shortage of mental stimulation. A practice I engaged with one firm was to always book a half day at the p.e.'s office, between Board Meetings, largely with a scant agenda and just see where the conversation flowed. We always managed to use every minute of booked time.

Private equity CEOs have additional agenda items like The 100 Day Plan (how the Deal Thesis will be translated into an Operational Plan from the word go), and exit planning. Here is where the private equity partner's contribution really shines. They have mastered the art of the 100 Day Action Plan (or have fallen to bottom decile and extinguished from the earth). And they have tremendous resources at their disposal to craft an Excel likelihood vs. Purchase Multiple exit target matrix…. which the CEO can go and artfully cultivate.

Private equity deal teams nevertheless should be forewarned: add value to your CEO, or stay out of the way! There is a real difference between adding value, and simply having your hand (also) on the rudder because you need to. There's no faking it. The CEO's respect is earned.

The Private Equity CEO Candidate vs. The Traditional CEO

A Top 5 private equity firm has stated that in 50% of their acquisitions, there is an understanding that a new CEO will be recruited. Either the founder/owner/entrepreneur is totally cashing out, or by agreement, there is deemed a different skill set for the next stage of the company. That same p.e. firm goes on to say that by month nine, 50% of the CEOs are not still standing. This redefines the expression '*half-life of uranium*!' This tragic result has learnings for the candidate as they 'opt in,' and for the recruiter as they want to add successful notches on their gun, and for the private equity investor. The following characteristics best the odds of the new p.e. CEO:

- "Jack be nimble, Jack be quick." The time pressures (hold period, etc.) of the private equity environment put pressure on the stakeholders to change out the CEO certainly much earlier if there are performance questions. Call it a faster trigger if you will, but 'thems are the stakes.' They answer to their Limited Partners who are focused on returns. History suggests that Wall Street has more patience. Recruiters would be well advised to err on the side of the candidate who doesn't just have a tolerance for this immediacy but thrives on it.
- A 'Jack-of-all-Trades' skillset. You are indeed the chief cook and bottle washer. CEO, COO, Chief 'Lended' Officer, and given the scarcity of Administrative assistants, yes, <u>you</u> make the trip to Staples today.
- No Corporate Staff to write your Strategic Plan. It's you, dude.
- Cozy up and better luv the tight quarters with your Deal Team. Cause you're in this foxhole together and maybe sharing a pillow some nights.

Personally, I will say that after two tours-of-duty as a PepsiCo division president, I couldn't do what I do without the skills I learned in that 99.75 percentile performance culture and environment. But with those invaluable skills under my belt, I wouldn't trade in my present day private equity life for all the bit coins in the world.

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