Expediting the CEO Assessment

Board Perspectives

Replacing an underperforming CEO promptly following a transaction can be crucial for growth, morale, and returns for private-equity portfolio companies. Yet many investors and independent directors say doing so often takes two or more years, according to the 2017 AlixPartners-Vardis Private Equity Survey.

Given the expected five- to seven-year holding period for portfolio companies, boards may be able to avoid having to make a switch in two years by being more proactive in assessing the CEO early in the ownership period. This may require directors to be more mindful of the most effective qualities of a private equity portfolio company CEO, as well as what the board's relationship should be with the CEO.

A Harvard Business Review article, "How Private Equity Firms Hire CEOs," looked at five qualities that researchers say private equity firms look for in CEOs for portfolio companies:

— **Experience.** Private equity firms were more open to "nontraditional "candidates. Former CEOs may be accomplished, but that doesn't necessarily mean they are best suited to respond to current challenges.

— **Team-building skills.** Of the 13 attributes included in the survey, the candidate's ability to assemble a high-performing team was ranked the highest.

— **Urgency.** The CEO faces heightened expectations about the speed with which cost cuts or revenue growth will take place.

— **Resilience.** Business plans never go the way you think they will, and the CEO needs to adapt.

— **Authenticity.** The CEO needs to be transparent and open about his or her team and anything bad happening in the business.

The chair of an international search firm, however, offers a few caveats. "Private equity investors typically back the CEO and his/her management team when they make their investment," he wrote in a recent article. "The investment is predicated on top management's ongoing involvement because of their knowledge of the business and/or relationships with customers and other key employees. This can create a level of dependency, however, which impedes the ability of a private equity board to be independent of management and, for example, deal with a problematic CEO in a timely manner."

So how does the board expedite its assessment of the CEO? By tackling areas of miscommunication between the board and the CEO that can be more readily assessed than underperformance, which may take several quarters to observe.

In an effort to learn what behaviors contributed to the retention or dismissal of a founder/CEO, Larry Stybel and Maryanne Peabody interviewed private equity investors for the *Journal of Leadership and Management*. One observed behavior dubbed "Smoke Gets in Your Eyes" refers to when the CEO agrees with an investor or director suggestion without any level of follow through or investigation. A second behavior, labeled "The 'Problem Solved' Problem," demonstrates the portfolio company CEO's perception of the board (and the investors) with regard to the business. Here, a problem is first reported to the board only after it has been resolved, and is a sign that the CEO misunderstands his or her relationship with the board.

The directors who participated in Stybel and Peabody's research suggested that alleviating these types of contentious relationships (or at least surfacing them sooner) often requires a type of shuttle diplomacy on the board's part. This could take the form of an

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independent director playing "good cop" to the controlling investor board member's "bad cop"—which may be too obvious and appear forced—or simply result from the presence of several independent board members who serve as a safe harbor for executives.

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