The Leadership Tapestry of Industrial Portfolio Companies

As the landscape of private equity value creation evolves, the shift away from financial engineering towards operational improvement requires portfolio company management teams that are capable of executing at a higher level than ever before.

Executive Summary:
We examined the talent trends in today's industrial portfolio market. Here's what they mean for leaders.

To better understand this evolution within the industrial sector, Russell Reynolds Associates conducted an analysis of our recent successful placements within North American private equity (PE) portfolio companies, learning that:

- PE firms are looking beyond the traditional domain for talent
- Step up candidates are becoming more prevalent
- Prior PE experience is no longer a must-have for success
- PE firms must look beyond the CEO role for value creation

Challenges on the path to value creation

War for Top Talent

Talent Retention

Burnout

Economic tides continue to rapidly shift, finding the right talent remains a challenge for private equity portfolio companies. As holding periods extend, talent availability remains tight, and the risks around retention and burnout increase, PE firms must be more proactive in addressing these challenges to ensure a successful exit.

According to RRA's Global Leadership Monitor, 58% of industrial leaders are looking to move beyond their current roles. Additionally, recent AlixPartners research found that approximately 75% of CEOs exit after a change in control.1 Surprisingly, 54% of these exits occur one to two years following the transaction, and are most often initiated by the CEOs themselves. The consequences of unplanned CEO turnover are not to be underestimated, as they cause significant disruption within the organization. A substantial 46% of PE firms revealed that such unplanned CEO turnover erodes the rate of return on their investments. Furthermore, a staggering 83% of them stated that unplanned CEO turnover leads to longer investment hold times.

These statistics serve as a stark reminder of the detrimental effects of unplanned CEO turnover. They highlight the critical importance of strategic alignment and expectations between the sponsors and the CEO. Nearly 17% of portfolio company executives have expressed experiencing major operational challenges due to a clash of working styles with their PE investors.[1]

What do tight markets mean for the PE industrial CEO talent pool?

As the PE playbook evolves, so must the industrial portfolio company CEO. An analysis of Russell Reynold's CEO placements in industrial portfolio companies shows that the successful candidate is often not a traditional match.

Talent comes from beyond the traditional industry domain

In order to source high-quality talent, private equity firms must remain open-minded about looking outside of their primary industry. We are seeing a growing migration of talent between subsectors. In our analysis of RRA's industrial portfolio company placements in the US, two-thirds of CEOs came from outside of the client's primary industry.

32%
Of CEOs placed were from the hiring company's primary industry.

45%
Of CEOs placed were from industries ***adjacent*** to the hiring company's primary industry.

23%
Of CEOs placed were from industries ***outside*** of the traditional Industrial and natural Resources sector.

2/3 of CEOs placed were from outside of the client's primary industry

Source: RRA Industrial Portfolio Company CEO Placements in North America, 2018 - Oct 2023, n = 66 placements

Step up candidates are becoming more prevalent

While a "seasoned, successful PE CEO" remains the gold standard, step-up candidates are gaining traction. Our analysis showed that 59% of our recent CEO placements in the space were step-up candidates in the role for the first-time. Many PE firms are embracing first-time CEOs, as these candidates are eager to prove themselves, often more technologically savvy, and typically less expensive. Oftentimes these are second-in-command leaders (COOs and presidents) from the PE world, or P&L leaders from heavily decentralized organizations who have run their businesses with a CEO mindset. These first time CEOs almost have proven success in areas imperative to the investment thesis (e.g., operational turnaround, M&A roll-up experience, commercial transformation).

59%

of CEOs placed were first-time CEO/step-up candidates

44%

of CEOs had prior senior experience at a PE backed company

Prior PE experience is no longer a must-have for industrial portfolio company CEOs

While prior private equity experience used to be viewed as a requirement for success, that sentiment has started to shift. Our analysis found that only 44% of these CEOs had prior senior experience in a PE-backed company. The trade-off between prior PE and public experience is gradually shrinking as a wider range of candidates continue to demonstrate successful transitions into the PE environment.

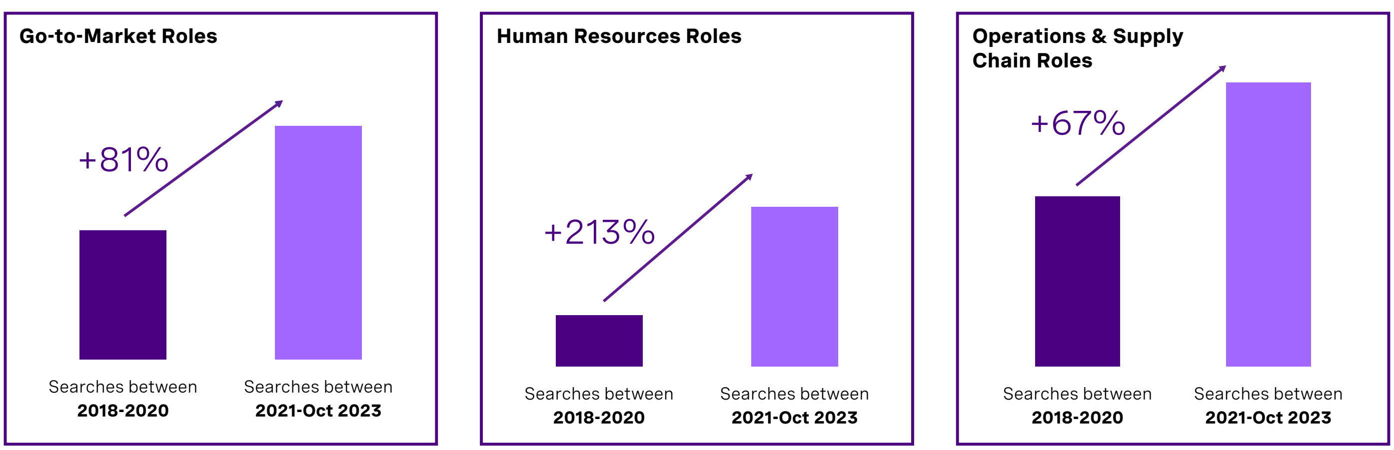
Looking beyond the CEO – Driving performance across the value chain

Empowering functional and business leadership (particularly early in investment cycles) is critical in delivering investment outperformance. Intensified focus by sponsors on these functional leaders beyond CEOs, and even beneath the C-suite is becoming an imperative. PE has long relied on the CEO role to drive value creation but it is apparent that today's environments demands additional scrutiny of management team roles, operating models, corporate structure, and company culture. To avoid misalignment, PE firms are placing greater emphasis on functional leadership and teams.

In our analysis of RRA industrial portfolio company placements over the past few years, we've seen a marked increase in placements focused on three key functional areas for industrial portfolio company leadership:

- Go-to-market (chief commercial officer, chief marketing officer, chief revenue officer)
- Human resources (CHRO)
- Operations & supply chain (chief operations officer, chief supply chain officer, chief procurement officer, chief logistics officer)

Growth of key functional roles in industrial portfolio companies



Source: RRA Go-to-Market, Human Resources and Operations & Supply Chain Industrial Portfolio Placements in North America, 2018 - Oct 2023, n = 164 placements

Typically these executives are brought in to upgrade a function core to the portfolio company deal thesis. These are two common archetypes for these functional leadership hires: 1) executives from best-in-class "academy" companies with the depth of applicable sector, customer, or transformation experience that can be easily leveraged into the new role; or 2) proven PE operators who can drive change at pace. Typically, ideal candidates come with both sets of experiences but, as with CEOs, prioritizing critical competencies is key in a tight talent market.

How PE Firms can build a talent advantage in their industrial portfolio companies

Creating a high-performing, cohesive team for an industrial portfolio company is more challenging than ever, but there are proven levers that improve talent management (and, by extension, ROI) across a fund portfolio.

1. Formal ownership of human capital at the fund level

Many private equity firms have established a senior-level leadership role (chief talent officer, chief people officer) that owns talent strategy across the portfolio. While backgrounds of these executives—and the roles themselves—vary widely across firms, there's a consistent mandate for these leaders:

1. Create standardized executive hiring processes

2. Establish company-specific talent KPIs and

3. Build a bench and broader advisor network beyond any one individual search.

50% of PE firms with AUM>$2B have a dedicated talent leader, however, these executives are rare in smaller firms.3 This represents an opportunity for smaller firms to differentiate their talent strategy and derive additional value across the deal cycle. And larger funds will continue to mature the directive for their CTOs and CPOs, focusing on data-driven talent insights to drive future decision-making.

2. Alignment & flexibility

Achieving a successful executive hire quickly requires prioritization around the leadership profile. Additionally, PE firms benefit when they are open-minded about an executive's PE or CEO experience—or lack thereof. In the industrial world, flexibility between sectors is particularly applicable, and we have seen successful candidates move from adjacent spaces (from discrete manufacturing to process manufacturing businesses) or make even broader leaps (from automotive to consumer durables).

3. Define critical competencies upfront

Even when the need for change is clear, PE sponsors often struggle to align on the mission-critical functional and experiential competencies. Furthermore, PE leadership is often comprised of dealmakers who may place a premium on "charismatic" leadership and rapid-fire execution, instead of heavily weighting the value drivers specific to the portfolio company.

Defining the truly critical competencies up front, (rather than creating a laundry list of "nice-to-haves") is a key success driver, typically accelerating C-suite executive placement.

Talent management remains the top strategic priority across the PE landscape. Funds that adapt to today's talent market can attract and develop top-tier industrial CEOs and establish a top talent pipeline for the future.

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Sources

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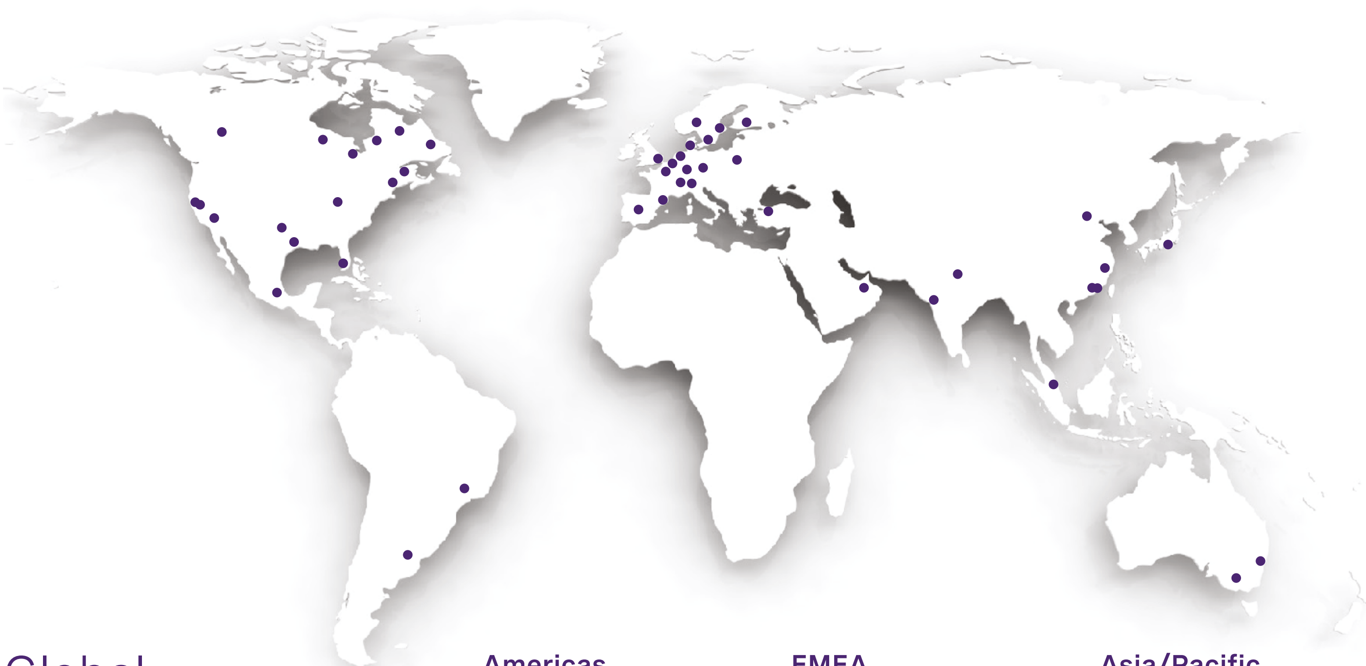

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