Do You Have What it Takes to Work in Private Equity?

The dynamic, fast-paced operating environment of a PE-backed company can provide executives with a unique career opportunity and very attractive rewards. But it's not for the faint hearted.

Managing a private equity-backed firm brings a unique set of opportunities and challenges for senior executives. On the one hand, private equity (PE) owners provide a degree of freedom and generous compensation unmatched by publicly-held corporations; on the other, PE investors' focus on results and their limited tolerance for under-performance can result in rapid turnover of management teams if the interests are not aligned.

Senior executives must be focused, driven and willing to roll up their sleeves to do whatever it takes to improve the respective portfolio company. In addition to managing the balance sheet, they will be expected to implement strategic change, grow the top line, and align the company for exit four to six years down the track - often while learning the business on the fly.

In return PE-backed firms give executives the chance to work with a dedicated owner who will give them the support needed to achieve the KPIs set at the start; if needed, PE owners will open the doors to a broad network of experts who can help drive performance. Managers working in smaller PE-backed companies with lean management teams and less bureaucracy are able to implement change fast and impact a wider range of company activities than their peers in publicly-owned corporations. However, the lean approach to business cuts both ways, and they may find themselves with limited resources for functions and activities not considered core to company interests.

Management teams and PE owners

To succeed in private equity executives must develop a transparent and collaborative relationship with PE owners, who are very hands on and expect answers to questions fast. "No surprises" – is the best advice one can give CXOs. Interaction between owners and company managers is most concentrated in the early months post-investment (when PE firms work closely with managers to implement strategic change, organisational redesign and processes to track performance) and later in preparation for exit.

PE-backed boards are typically leaner than those of publically listed companies and have a significantly lower percentage of independent directors. The number and composition of the board reflects the company's needs at different stages of the holding period, increasing in cases of struggling investments and decreasing with success.

Board members from the PE firm will come to their meetings well-prepared and informed and will expect the same level of commitment from others, making board meetings highly efficient and focused and will set a more rigorous pace (especially when compared to boards of Family businesses. They may include operating partners with specific expertise who will engage with their portfolio companies at a more granular operational level, while consultants will be brought in to help management identify and implement value-accretive projects.

Despite best intentions regarding roles and responsibilities, differing opinions can at times result in tensions between management teams and PE owners most notably due to:

· Differences of opinion regarding planning and KPI definition

· Break downs in transparency and accountability

· Poor business performance.

Despite this potential for discord an overwhelming number of CEOs - more than 90 percent of those surveyed for a **BCG report** - believed that PE ownership had a positive effect on performance and enabled them to be successful in their role.

Compensation risks and rewards

When it comes to compensation, managers of PE-backed companies are incentivised from the start, one of the fundamental reasons for the success of private equity transactions. Not only is management encouraged to invest alongside the PE owners, but remuneration packages for senior executives and the second layer in the organisation usually include a significant share of equity, aligning economic interests of owners and managers. While adding a portion of their net worth brings an element of downside risk for management, the co-investments are typically "sweetened"; for example management may receive an equity share five to seven times the value of its investment giving them the opportunity to generate outsized returns through upside leverage.

A study of CEO compensation packages for U.S. LBOs found that **CEOs received on average twice the amount of equity** in the businesses they ran for PE owners compared to those leading publicly-listed companies and took home salaries on average 10 percent lower than pleaders of publicly-listed companies. About 13 percent more of their annual cash compensation was variable pay; again placing a premium on performance improvement and growth of the business. Unlike equity compensation awarded to managers of public companies, management equity in PE-backed companies is highly illiquid and can typically only be sold alongside the PE investor, further strengthening the alignment of interests.

Landing a job in PE

With attractive remuneration packages, competition for positions in PE-backed companies is high. Experience leading across all key functions of a company is highly valued by private equity firms as is a willingness to tackle problems across the organisation. Previous experience with PE-backed companies will give executives an edge as PE firms often back the same manager in several portfolio investments.

Situational experience, such as executing turnaround or roll up strategies in a particular field or geography, that aligns with the company's specific needs is also a bonus.

To succeed executives need to show a willingness to take risks; flexibility to revisit strategy and tactics; the ability to make difficult decisions quickly; and the capability to develop strong relationships with, and take advice from, a very hands-on and financially astute board.

Achieving change and moving on

Private equity is a place where executives get to test every professional skill in their portfolio and prove that they make a difference and execute fast. For many the idea of finding companies, improving them and selling them on, holds great attraction. Others are drawn to the idea of working in an environment which has access to expert specialists and strong support from owners.

While there are definitely risks, executives who have confidence in their abilities, a preference for high-pressure, fast-paced work and the emotional intelligence to work with a very focused, hands-on owner, will find the rewards are certainly worth it.

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