skills focus changes for private equity executives

By Simon Monks

Before the credit market volatility, private equity super-executives needed superb financial engineering skills and the ability to structure a deal to extract maximum "instant" returns. Now, they need to add to their portfolio of super-powers the capacity to transform a business to deliver cash over the medium term.

There's still plenty of money around and private equity firms are still scouring the market for turnaround targets. They are particularly interested these days in industries undergoing structural change – including medical device and biotech companies, pay TV, mining services and financial services organizations.

Executives must be able to unlock value through business transformation as well as growth strategies, finding savings and turning around a business operationally and strategically.

For example, in the challenged retail sector, the value-unlocking approach calls for executives with deep industry experience who will need to bring in strong customer-facing strategies to keep the cash flowing as consumer spending slows.

At Heidrick & Struggles, we believe that the times are calling for seasoned executives rather than the financial whiz kids who could flip companies rapidly in an atmosphere of easy money.

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In Australia, Momentum Private Equity managing director Kevin Jacobson says that private equity now has to be more involved in building the businesses it was buying. His firm owns the department store chain Harris Scarfe.

“The days of selling into rising markets by buying on a low multiple, highly gearing and selling to trade buyers or the market at a higher multiple are gone,” Jacobson says. “Economic conditions require more active involvement by private equity managers.”

In other sectors, executives may need to find synergies and roll-ups to leverage performance.

Less Leverage, More Experience

According to Ed Francis, the London-based senior private equity consultant for Watson Wyatt, the key to successful investments is “the skill and strength of the manager who can make an investment work”.

He says the characteristics of private equity investment have changed. There is now less reliance on leverage and more on skills to expand the business.

“In an environment in which debt may be difficult to obtain, the drive for capital rather than leverage will continue,” Wyatt says.

Former Sealord CEO Doug McKay agrees. McKay left the fisheries company to become executive chairman of Independent Liquor, which was bought by PEP in partnership with CCMP for $NZ1.3 billion.

McKay was previously chief operating officer and board director of Goodman Fielder and managing director of Lion Breweries. During his five years at Sealord, he achieved record earnings during a period of escalating fuel prices, quota reductions and a rising New Zealand dollar.

"There is much more of a premium on operational improvement in the businesses that private equity are buying," he says in an interview for this article.

"Multiples for purchase have gone up and the cost of debt has gone up from two or three years ago – so where we might have been looking for what you might have called financial arbitrage as part of the upside over the period of ownership, that is much harder to get now," McKay says.

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Turnaround Skills

Next Capital partner Sandy Lockhart, one of three Macquarie Bank executives who left to form the private equity firm which rolled up New Zealand's Hirepool into their On Site Australia business, says the industry will see a greater emphasis on turnaround management – as distinct from just growth – following the exuberance of the past few years.

"Some of the transactions that have been done around the world will require perhaps resetting or re-structuring and therefore will favour those executives with more turnaround experience, rather than those with the sort of airy fairy consulting and financial engineering skills that we have seen," Lockhart says.

"You would have been looking for people to grow businesses in the past and I am sure you still will. But our view would be that you've also got to find the sort of executives who are used to sorting out the wheat from the chaff," Lockhart says. "Those skills are in more demand now than they have been."

"Operating excellence" more than financial skills is now the critical success factor, according to Greg Kay, who before joining Pacific Road Corporate finance was CEO of Wrightson and CEO of Coal Corporation of New Zealand (now known as Solid Energy). While with Telecom, he was closely associated with its privatization and listing, as well as its initial move into Australia.

"Private equity believes it can bring the strategic and financial skills to the table, so the particular focus now is on someone that can manage the business very well and very successfully."

"Executives obviously have to have a good visional strategy, but they can get assistance from the private equity shareholder in that regard, so the executives we like are those who have good, strong, hands-on operation management expertise and competence," Kay says.

"You might say that this is the same for everyone, but it's particularly relevant here."

Search Criteria Change

In working with private equity firms, Heidrick & Struggles has noticed that the time-frame for returns has lengthened, with a commensurate change in the qualities of the executives.

The rationale is that once the takeover is made, there is no time to waste. Time is money and the newly acquired business needs to be put on a strategic growth path immediately.

These executives are often chosen well ahead of the play. Private equity operators are putting much advance work into thinking about the leadership team they will put in place.

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Because the privatized companies are heavily geared, the executives need to thrive under those additional financial pressures. They need to become familiar quickly with the heavily leveraged balanced sheets and to both understand and be comfortable with the complexity of the financial structure. After all, they are shareholders also.

The executives should not simply be looking to get out of their current roles because of the pressures that come in with listed companies and the upside generated by private companies. They should rather be people who are inspired and motivated by the value challenge over a three to five-year time-frame.

People skills are just as important as in public companies. But there is more freedom to act, because privatized businesses are operating without the sorts of media and governance scrutiny that bedevils listed businesses. Without the constant pressure of "share price-watching", chief executives can simply get on with the job, doing what's needed, in the knowledge that in three years there is likely to be a good payback.

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