

Logistics CEOs
after Private Equity

Superstars and sideliners

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The tide of private equity investment that has washed over logistics companies in the past ten years has not only roiled the waters of competition, it has also created tremendous churn among the CEOs at those companies. Of the top 50 logistics companies in North America 20% are Private Equity (PE) backed and 84% of their CEOs have hired a new CEO in the past five years. Fourteen percent of privately held companies have switched out their CEO in the same period compared to 35% of public company CEOs.

This PE-driven turnover at the top, coupled with the intervening recession, has resulted in a sharp bifurcation of the CEO talent pool. The charmed CEOs who have led successful liquidity events are highly sought after by PE companies to lead their acquisitions. These superstars can command high cash and high equity stakes up front, whereas five to seven years ago, most packages were low in up front cash with high reward loaded on the back-end.

On the other side of this divide stand those who have been sidelined or chose to stay on the sidelines when it comes to PE plays. Before the crash of 2008 many CEOs of PE-backed logistics companies were licking their chops at the prospect of a big payday from a future liquidity event. Now many are licking their wounds, facing another five-year stint trying to find that elusive exit strategy that was snatched away by the recession. Others have opted out or have been eased out of the high-pressure role that comes with private equity. The inboxes of headhunters are filled with messages from former PE-backed CEOs who had the misfortune to run into the wall of the recession or were unable to satisfy their PE taskmasters. "The timing just wasn't right," say these messages, or "Private equity just doesn't understand our industry."

Meanwhile, PE firms continue to look for the superstar CEOs who can roll up acquisitions, drive operational excellence, lead the way to a big payoff, and bend steel with their bare hands. At the same time, more candidates, many of them with the capabilities a PE firm seeks, have been attracted to the sector by the professional prospects and personal rewards. For those who can deliver to the exacting specifications of PE bosses, it is a good time to be a CEO candidate. For PE firms, there has never been a richer or more sophisticated pool of such talent in the industry.

Great expectations

PE firms not only set very high expectations but also very tight time frames for fulfilling those expectations. The CEO may be charged with executing a strategy that entails organic growth as well as complementary acquisitions, extracting synergies from integration, driving top-line revenue through aggressive sales, achieving operational improvements that go straight to the bottom line, and

preparing the company for multiple exit strategies, including a possible IPO, within two years or less. As the economy recovers and the pace of IPOs and other liquidity events picks up, those already tight time frames could get even tighter. Meeting these expectations requires some distinctive leadership and business competencies on the part of the CEO, including:

- The ability to effectively lead an often brand-new senior management team while changing an entrenched culture.
- A disciplined approach to financials in conjunction with strategy.
- An innovative approach to growth, both organic and by acquisition.
- Ability to drive technology and process improvements
- A natural affinity for dealing with the highly analytical private equity community.
- Willingness to provide performance projections for the private equity firm and constantly measure against that plan.
- Commitment to complete transparency with the private equity board and continual communication with them.

All the while, under great pressure, the CEO must orchestrate all of these capabilities toward one of three possible exits: an IPO, a sale to a strategic player in the industry, or a sale to another PE firm eager to move into the logistics space.

A quickening pace

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Opportunities for such superstar logistics CEOs are likely to increase – industry observers foresee PE activity in the sector continuing to climb through 2012. Outside the top 50, there is even more PE action in the mid-market. Such activity always picks up following a recession, but there are also inherent characteristics of the industry that make logistics an attractive target for PE firms, including:

- **A high degree of fragmentation:** According to the Transportation Intermediaries Association, no single company controls more than 6% of the US market. And the fragments come in all shapes: freight brokerage, freight forwarding, third-party logistics, and consultancy services. Buyers have the opportunity to roll up many similar acquisitions and leverage economies of scale, or they can put together the many different kinds of services to create a broader-based provider.
- **A high growth rate:** The industry is expected to grow at double-digit rates for the next several years, providing another strong attraction for PE firms.
- **A high profile:** Because of the increased importance of velocity through the market for companies in many industries, the logistics industry has become central to the competitive strategies of its customers. Logistics companies and their PE backers who can rapidly assemble high-velocity, high-efficiency services will find enormous opportunities for growth in revenues, market share, and profits. In addition, such premium companies will be highly attractive to other buyers or in IPOs.
- **Numerous opportunities for investment:** At any given time, a number of family owners, lacking a suitable heir to take over or simply seeking to cash out, are looking to sell their businesses. Further, many of these opportunities are low-cost, enabling PE buyers to easily digest them.
- **Room for improvement:** Because the industry is largely composed of many small players, it is rife with inefficiencies. Consolidation and infusions of technology and process improvement methodologies can quickly result in the kind of dramatic operational improvement that PE firms seek to squeeze out of their portfolio companies.

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The view from the sidelines

For logistics companies that aren't backed by private equity, such as public companies and family-owned businesses, the attraction of CEO superstars to the PE world presents a real challenge. Although these companies may change CEOs less frequently, the quality of such succession when it occurs will play a large role in their ability to compete with the leaner and meaner PE-backed companies. Family-owned companies should take care not to simply pass the business on to the next family member in line, but to identify the *right* family member to groom for the chief executive role. And if there is no suitable successor, they should recruit high-potential talent now, give them an equity stake in the business, and begin developing them to assume the top job. Similarly, public companies should have in place solid CEO succession plans and should commit themselves to strengthening their talent benches.

The pool of CEO talent for such companies is not necessarily poorer; it is simply different. In part, it consists of CEOs who did not find the PE world congenial and who are looking for situations where there is less risk and intensity and more stability. They have found, like many of their peers who don't wish to be in the PE world in the first place, that they prefer to create value for the long term rather than working feverishly toward a liquidity event. Further, the logistics industry has managed to retain many experienced executives with CEO potential among its older generation.

Giving diligence its due

As the pace of PE investment in the sector picks up and terms of competition continue to change, all parties – CEO candidates, companies, and PE firms alike – will need to exercise due diligence. Candidates being courted by any company, whether PE-backed, family-owned, or public, should not simply be dazzled by the compensation or the opportunity for wealth-building. In fact, they should investigate the company as if they were acquiring it themselves. What are the financials, the competitive position, the chances for success? What do knowledgeable people say about the company? Will it be a good cultural fit? Do I have the competencies that are required under the competitive circumstances and ownership structure?

When it comes to companies exercising due diligence with candidates, PE firms are highly likely to treat the task with the same degree of rigorous analysis they bring to every business issue. In assessing CEO candidates, they should pay particular attention to the requisite leadership qualities as well as M&A experience, operational acumen, and experience with Lean, Six Sigma, and other improvement methodologies. Most importantly, the potential CEO and the private equity firm should be absolutely clear up front about the planned exit strategy and how they are going to work together to get there.

Public and family-owned companies should exercise similar diligence, resisting the tendency of this inbred industry to rely on informal networks and friendly recommendations to fill critical roles. For while the talent pool is bifurcated and the industry is fragmented, the determinant of success is uniform: the right CEO. ■

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