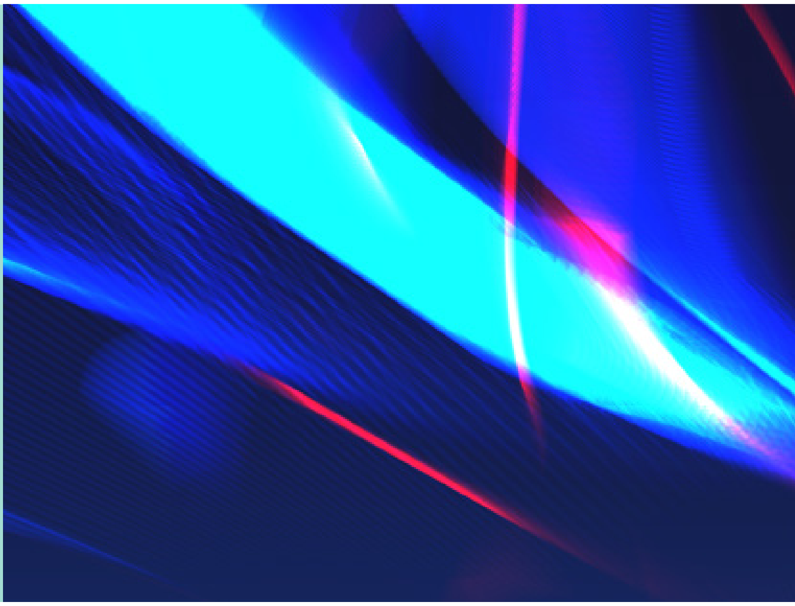
You Can't Always Get What You Want: But PE Investors Can Get What They Need in a New CEO



Private equity investors always seek proven PE-backed CEOs to lead their portfolio companies. An analysis of technology deals in private equity helps illuminate the risk of that strategy.

Private equity (PE) investment in technology companies has exploded, creating new opportunities for investors driven by increasing demand for digital solutions and innovation.

What do CEO searches in private equity have in common with the Rolling Stones? You can't always get what you want, but if you try sometimes, well, you might find you get what you need.

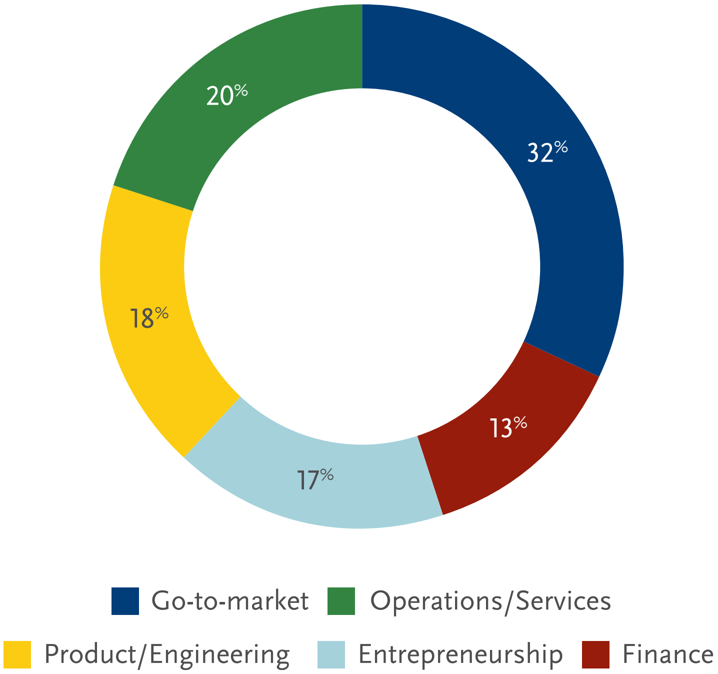
Private equity (PE) investment in technology companies has exploded, creating new opportunities for investors, driven by increasing demand for digital solutions and innovation. As investors seek ideal CEOs for each portfolio company, there is growing bias for a CEO who has successfully guided a PE-backed company to exit before. Our research suggests that while demand for this experience is growing, the supply of CEOs who have already led a PE-backed company is in decline. The good news for investors: first-time CEOs can be incredibly effective.

Concentrating our analysis on core technology and tech-adjacent transactions between 2003 and 2023, we analyzed CEOs' backgrounds and career patterns, what CEOs went on to do post-transaction and the implications for investors. Between the first and second decades of our analysis, deal volume grew over 3.5 times.

CEOs' functional backgrounds vary dramatically, with no single route up dominating the population — although the top two are go-to-market (GTM) and operations and services. This differs from public technology companies, where product and engineering leaders often take the top seat. A CEO's pathway to the role shapes their underlying capabilities and motivations. The experiences leading to the top significantly influence a leader's understanding of the business landscape, enabling them to develop critical skills pivotal for value creation.

In our experience, linking a holistic view of a CEO's capabilities to a nuanced understanding of value drivers is critical. Rather than a classic view, which assumes high performance in a role is linked to particular functional expertise or technical skill, the core unlock for the business may actually be critical thinking and self-awareness. Therefore, understanding the value creation plan beyond cookie-cutter assumptions is essential. As an example, almost all value creation plans include some amount of cost rationalization, but the skills needed to accomplish it may be quite different depending on the context. In one company, it may be about influencing the culture, whereas another might require the introduction of new workflows and technology. When an executive's unique experience, capabilities, motivation and leadership style closely align with the specific needs of a value creation situation, a powerful synergy emerges between their expertise and the deal requirements, significantly enhancing the potential for a successful exit.

PE-BACKED TECHNOLOGY COMPANY CEO ROUTE UP



While there isn't a clearly defined route to becoming a PE-backed CEO, there are trends among the paths executives pursue after an exit. Of the CEOs examined, 42 percent took another CEO role. Yet, of all the CEOs who exited, only 29 percent became CEO of a PE-backed company again. Among that group, nearly half secured their next opportunity with the same private equity firm from which they exited. There are two important implications of this. Firstly, a sizable share of CEOs who transition out of their roles remain within familiar networks and leverage established relationships to secure their next position. Secondly, with PE deals increasing 3.5 times during our analysis timeframe, there is a striking mismatch between the quantity of CEO roles and the availability of experienced CEOs.

> **Too often, firms overlook the important step of investing in CEOs after they are hired.**

This brings us to a pivotal opportunity for investors: truly appreciating the benefits of an outstanding first-time CEO. Some of the most successful CEOs in our analysis were first-time PE-backed CEOs, a finding that mirrors our earlier research on public company CEOs. Our 2021 study, published in the *Harvard Business Review*, found that over a 20-year period, the performance of S&P 500 CEOs with experience consistently lagged behind their novice peers over the medium to long term — defined as four years or more. In a recent *Fortune* article, Courtney della Cava, Blackstone's senior managing director and global head of portfolio talent and organizational performance, underscored the risks of becoming "enamored with past success" and argued that it's much more important to study someone's potential and fit for a specific role.

One important distinction for private equity versus the public market is the average tenure of a CEO. Because of an assumed four- to five-year hold period in PE, getting a first-time CEO up and running as quickly as possible is essential. Too often, firms overlook the important step of investing in CEOs after they are hired.

Some of the key priorities for a new CEO to accelerate impact include:

- Quickly connecting with and activating their executive team
- Getting clarity on how to stay aligned and connected with investors and, as needed, other board members, without those interactions absorbing a disproportionate percentage of a CEO's time
- Engaging with customers and other key stakeholders critical to the mission
- Driving impact beyond the leadership team by engaging layers of leaders who translate strategies into reality for the organization and have their ear on the "truth on the ground"
- Evolving their personal leadership effectiveness by creating a strategy for how they want to show up as a leader
- Defining a handful of early strategic moves that build momentum and signal a direction of travel that both aligns with and builds upon the value creation plan

We regularly support deal teams and CEOs on this journey and see the immense value of prioritizing the right things and creating an accurate feedback loop as early as possible.

As for the 58 percent of CEOs who did not take on a repeat CEO role, what did they do? One in five of these former CEOs operated in another capacity at a different company in roles such as chief financial officer or general manager. Of these executives, there was an even split between those who joined the company that acquired them beyond a typical hold period and those who joined a company completely unrelated to the exit deal. Among the remaining 80 percent, the majority opted to join a board, either securing a chair position or sitting on multiple boards relevant to their area of expertise. Others returned to private equity but became operating or managing partners, allowing them to apply their extensive experience to drive growth and enhance portfolio performance in a part-time capacity. Meanwhile, some former CEOs swapped the boardroom for ballot boxes and grapevines, pursuing passions ranging from politics to opening a vineyard — illustrating CEOs' varied pursuits.

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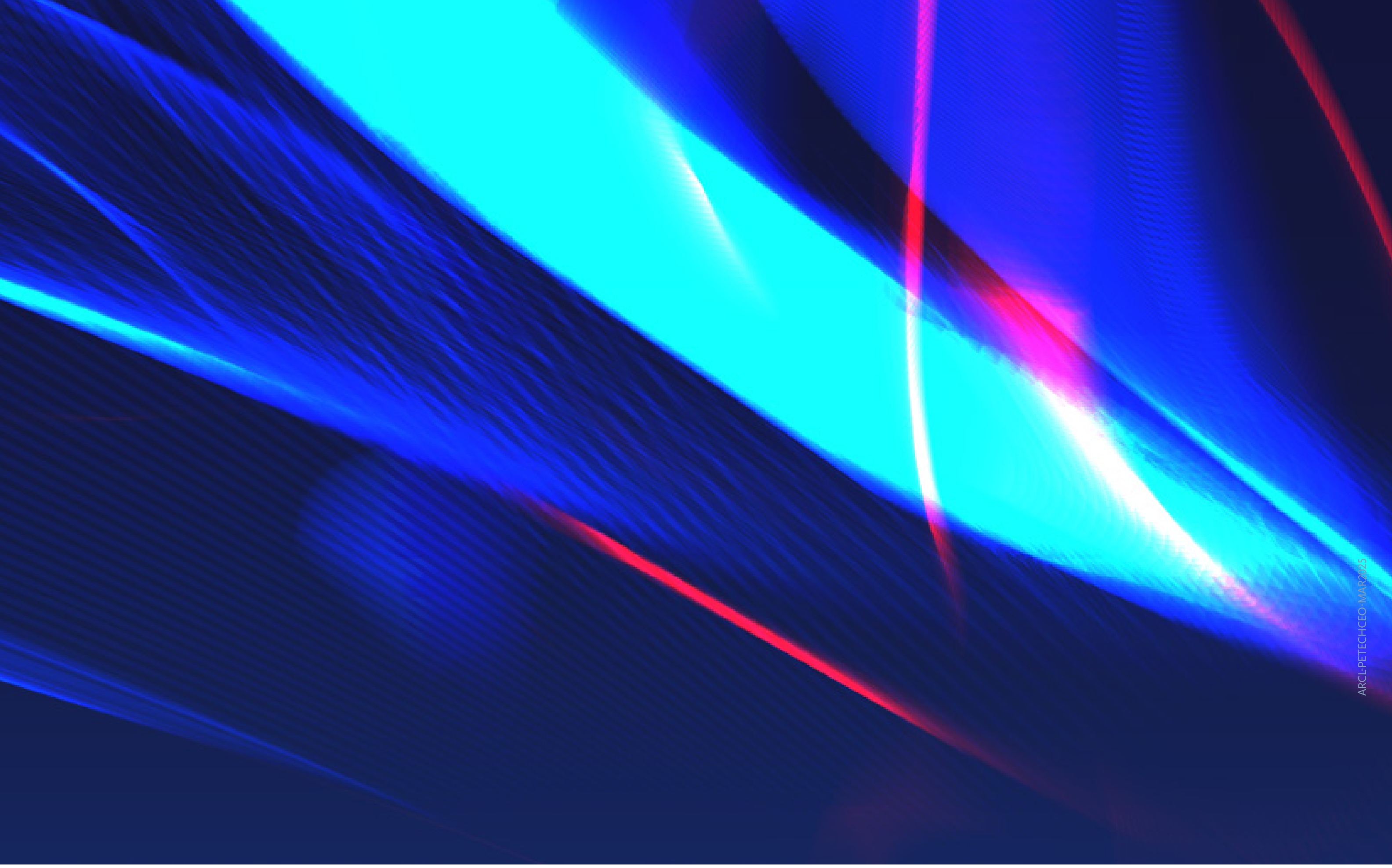
When deciding who will best lead a portfolio company into its next chapter, many investors want to hire from the ever-shrinking pool of proven PE-backed CEOs. Returning to our Rolling Stones allusion, we remind investors that if they can embrace the unexpected and be open to potential, you just might find a first-time CEO who can lead you to that coveted exit. In short, you can't always get what you want, but sometimes, you can get exactly what you need.



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Authors

Jason Baumgarten (Seattle)
Beau Blanchard (Seattle)

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