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The Peer-to-Peer Board Community

DRIVING FAST GROWTH VIA PRIVATE EQUITY

Private equity ownership remains a highly attractive way for management teams to grow their businesses. Criticaleye's **Jacob Ambrose Willson** asks Members with decades of experience working in PE about what to expect and how to ensure ambitions and dreams are turned into reality

The rise of private equity (PE) as an ownership route for growth businesses has been remarkable over the last two decades, moving from a specialised investment strategy to a mainstream and lucrative method for building scale and delivering high multiple returns for management teams and investors alike.

While it's certainly true that an era of historically low interest rates helped the PE model become more attractive, with cheap debt allowing PE houses to finance on a larger scale and make huge returns. However, there seems to be little indication of the industry being hamstrung by the recent spike in interest rates, if the US$2.5 trillion waiting to be deployed globally by PE houses is anything to go by.

Clearly, PE investment remains an attractive route for leaders looking to accelerate the growth trajectories of their businesses, but it doesn't come without challenges. PE representatives on the Board take a hands-on approach to strategy, emphasise quick decision-making and have an unrelenting focus on growth and achieving a high return at exit.

Martin Balaam has worked extensively with PE houses over the last 20 years, having been CEO of two businesses under PE backing, and is currently founder and Chief Exec of venture capital-backed SaaS platform Pimberly.

To executives considering their options when it comes to first-time PE investment, **Martin** advises: "What you should be doing is looking at those private equity houses that act in the way that you would like to act, but also generate the returns consistently, because those are the ones that you ultimately want to work with.

> *"I would actually describe it [PE ownership] as having a 'critical friend', who is completely aligned with you so long as you are in this to ultimately grow and create an exit"*
>
> Martin Balaam

"Private equity houses have managed many, many investments. Most of them will have been successful; some of them will have failed. But I think it would be unwise to ignore their experience, which is, by definition, the reason that you've chosen them."

Getting up to Speed

In the Boardroom, there are many unique considerations to be aware of when working with PE for the first time. For most of his career, **Ben Hewetson** has worked in PE at Board level – on the PE side with Hg Capital and Ontario Teachers' Pension Plan, as well as advising dozens of management teams and founders.

Formerly Chair of UK-focused Wishford Education, **Ben** says: "If a business is to grow exponentially, the key thing is to have great products and a great market, but it's also about fast decision-making based on data. Therefore, there needs to be brutal honesty at the Board level. You [the exec team] have got to come to the Board meeting utterly prepared.

"As a non-exec, priority number one would be to educate the execs about the needs and demands of the PE shop. Each PE shop is slightly different as to what their priorities are in a Board meeting. Once that is done, you get into a better rhythm, and then it's all about relationships and trust."

Sangeeta Desai, who is a Board Director and Non-executive Director at two media production businesses, Anton and Boat Rocker Media, also boasts vast experience working with PE on both the management and non-exec sides. Perhaps most notably, she fulfilled the role of Chair at Mopar Studios—a Nordic production firm backed by the PE house Bridgepoint Capital.

When asked about what to expect from PE in the Boardroom, **Sangeeta** – who is also a Criticaleye Board Mentor – describes a lean and fast-paced environment. "I would say the conversation can be much more dynamic, strategic and insightful rather than what you often see on non-private equity Boards, where a large portion of the meeting is the management team updating the Board on the business and financial results."

PE houses typically conduct rigorous tracking of the performance of their portfolio companies and are highly >

involved in the reporting of financials, key transactions and other KPIs, but will largely have these conversations outside of the Boardroom, according to **Sangeeta**. "Private equity Boards are so much more knowledgeable about the company than a Plc Board, because they have done extensive due diligence on the business. Odds are they're super involved, even post-acquisition, and outside of the Boardroom.

"They are very in touch with the strategy of the company, and what needs to happen to achieve that. For example, if there is M&A, they are right at the table doing the work, and very commercial in that sense. Similarly, if there are big operational deals, you spend less time getting them up to speed on how it fits with the strategy because they know the company so well and have already bought into the strategy."

PE can also offer up strategic expertise and guidance to more junior senior leadership teams who lack experience in formalised Board structures. **Ben** says: "A proper grown-up strategy puts you on the next level, and it means you can achieve greater things that will bear fruit in, say, three years' time. They [PE] will be hands-on as to the structure and rigour of a proper strategic plan."

The proactive nature of PE houses can work incredibly well for some management teams, but for others – particularly founders – it can be difficult to adapt. **Martin** explains: "Suddenly, having a private equity house [on the Board] does mean that it's like being back at school, when the work that you're doing gets marked by your teacher.

MAXIMISING VALUE CREATION

"In the past 10 years, the average buyout fund has consistently outperformed the S&P 500—by a significant margin across multiple time periods and geographies. Not surprisingly, money has followed success. In 2022, private equity (PE) firms raised a record US$938 billion; today, they have about $2.5 trillion waiting to be deployed."

Taken from:
AlixPartners Private Equity article
Maximizing Value Creation During Times of Uncertainty

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The Same Page

There needs to be strong alignment on the strategy and the value realisation timeline for any relationship between PE and management to yield results. A key way of ensuring this consensus is via both parties agreeing performance-based compensation packages and equity participation for senior execs.

Speaking from experience, **Martin** says: "I wouldn't have anybody on my SLT that wasn't equity aligned. All of them are excited, as a minimum, by the fact that they might generate a life changing amount of money." Of course, this is contingent on improving the quality of the business during the ownership period and generating value at exit.

The downside is that it's a much more intense role, according to **Martin**. PE will be incredibly demanding of portfolio executives in each Board meeting, typically asking for detailed reports on monthly successes and areas of improvement, and there is an expectation of absolute commitment to the cause.

"There's a heightened amount of pressure," he says. "For some people, that will not be seen as worth it compared to the financial upside, because some people aren't in it for the financial upside, and that's where you can get misalignment."

Conflict can also arise when it comes to timelines, usually when the owner is looking at an exit in the near term. **Ben** says: "It [the exit] might well be to another private equity shop. In which case, the management team are going to have to roll their equity through and own a piece of the business going forwards."

This is the point at which differences of opinion can arise when it comes to investment decisions. **Ben** explains: "The current owner will say, 'I don't really want to do that [investment] because I'm not going to get the benefit.' The management team says, 'Well, I do because I'll have part ownership of the business with the next owner.' That conflict is difficult to avoid."

He continues: "If there's a founder involved, and they are a majority – or significant minority – owner, that's really hard to manage. That's where a Chair earns their spurs I think, because the founder is going to have more than just financial motivations." >

This is just one example of the many nuances and added complexities that come with being a Chair on a PE Board. In many instances, the Chair is the only independent on the Board, **Sangeeta** says. "As such, you have quite an important role in maintaining that independence and being the voice for both PE and the company / management team.

"Often, you will be the intermediary, ensuring that the relationship between PE and the CEO is maintained, but also you can deliver some of the tougher messages, often on both sides," she adds.

A PE Chair must have the ability to 'go both ways', in the sense of explaining to the house the executive view and how things work in the given industry, while also positioning the PE perspective and why things are done in a certain way to the management team.

"Where you also play a really important role as the independent Chair is in the negotiation of the MIP [Management Incentive Plan]," **Sangeeta** explains. "It's often helpful to have an independent in that discussion, because comp

THE NEW PE IMPERATIVE

"64 percent of PE firm leaders say meeting value creation milestones is the top challenge portcos [portfolio companies] face, followed by top-line growth (56 percent) and operational effectiveness and margin management (42 percent)."

Taken from:
AlixPartners Ninth Annual Private Equity (PE) Leadership Survey

> *"PE Boards are more a plus than a minus because they are so knowledgeable about the business and strategy ... and are generally willing to put more capital to work"*
>
> Sangeeta Desai

can be quite an emotive issue for management. You really want to preserve their relationship with the PE owners as much as possible."

Managing the Exit

Ultimately, the period during which a company is PE-owned will be judged on by the exit value and multiples at which the business is sold. PE houses will make clear to management the duration –typically three to five years – they expect to hold the investment for at the beginning of the ownership, and what will need to be achieved to garner a strong return at the predicted exit window.

When the exit arrives, the adequate preparation of management is absolutely crucial, according to **Ben**: "The sooner you can start that process the better, not least because you will then discover the gaps that you need to fill, so that you look like the perfect swan sailing across the water when it comes to the sale process, because there's a lot of paddling that happens underneath."

The exec team will be given plenty of support from the PE house, non-execs and Chair on the Board, but also from advisors ranging from investment banks to lawyers. However, there's no denying that the exit process – whether it's to a trade buyer, another PE shop or even an IPO – is incredibly demanding in terms of the amount of work and the pressure attached to delivering the transaction.

"It's not just the volume of work, but you're going to be asked questions constantly and you're going to feel as though they're questioning your integrity, when really all they're doing is asking about the business. So, you've got to put a shell on."

The need to get an exit away naturally creates a highly emotive pressure cooker environment in the Boardroom, but it's of utmost importance to maintain alignment between PE house and management all the way through to the end.

Martin says: "Once you press the button for an exit, suddenly there's a high degree of distraction amongst your SLT, and you have to manage that. The number one thing during that period is don't let any wheels come off at all, because if a wheel comes off, that deal is dead." He references a previous chastening experience when a process had to be terminated, and then facing the challenge of getting energy back into a frazzled management team.

Sangeeta has also been involved in several exits, including at HIT Entertainment – when she was COO >

– and with Mopar. "I would say private equity will control the exit process. But management is also extremely important, because they're having to sell the business and chances are they're going to be staying.

"Even though in some ways management and private equity are aligned on the exit, there's a lot of potential for conflicted interests," she stresses. "Private equity cares about maximising the sale price. While management is also incentivised to maximise the sale price, they often have other considerations such as their own future with the company, the future owners' plans for the company and ensuring employees are looked after. So, there can be divergent interests as you get to towards the finish line."

A New World for PE

While the current macroeconomic environment has put an end to an unprecedented period of outsized returns for PE houses and management teams alike, the model for growing businesses looks set to stay. As such, there is an ongoing need for growth company leaders – whether founders, execs or non-execs – to know what to expect under PE ownership.

On one hand, it will feel like the temperature has been ratcheted up a notch across certain PE Boardrooms, as houses struggle to achieve the valuations they've become accustomed to in years gone by. But on the other, fund extensions across the industry have provided some relief, and the best PE houses will remain patient when it comes to an exit strategy for their portfolio companies.

PE Board dynamics continue to be typified by a high degree of oversight and strategic involvement from the house, and a relentless focus on building sustainable growth ahead of an exit. There will be periods of real pressure, but non-execs and the Chair play a key role in supporting management through difficult periods, while equity participation remains vital in maintaining alignment.

Sangeeta concludes: "The private equity experience can be full on and certainly there can be moments of stickiness with the PE investor. But overall, I would say PE Boards are more a plus than a minus because they are so knowledgeable about the business and strategy; they move quickly and are generally willing to put more capital [in] to work for the right opportunities." ■

Featuring commentary from:

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