conversations on leadership

What Makes an Ideal Private Equity CFO?

What PE firms look for in hiring portfolio company CFOs

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As private equity firms look to maximize value from their investments, it is critical to ensure that portfolio company management teams have the right capabilities to execute against their investment theses. Though in many cases the underlying premise will lie in backing an existing management team, it is increasingly common for private equity firms to bring in a new CFO early in the lifespan of an investment.

Private equity firms look for CFOs who can run their "financial playbook", helping to drive operating excellence and support strategic decisions as the company scales. The private equity CFO will therefore be both strategic and operational, serving as a thought partner across various functional/divisional aspects of the business, while implementing the systems and processes to help a company get to the next stage. Unlike a Controller, whose role is to accurately report financial results, a strategic CFO will be growth-oriented and look at the business "through the windshield, rather than the rearview mirror". The truly operational CFO will often oversee multiple functions beyond Finance, most notably Information Technology, but also Legal, Human Resources, Real Estate and/or Supply Chain.

In private equity-backed companies, the CFO is often viewed as the common link between the portfolio company and the financial sponsor – communicating financial results, working through capital structure issues or M&A opportunities, and generally speaking the common language of finance. Therefore, private equity firms tend to be quite influential in the CFO selection process, even though the ultimate decision typically resides with the portfolio company CEO.

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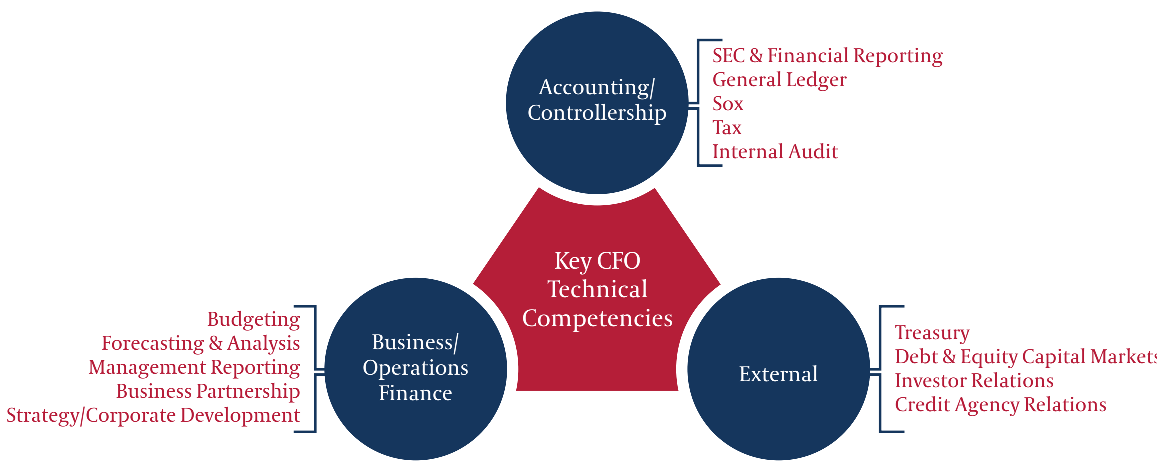
Finally, the CFO selection may also be driven by the underlying investment thesis for the company. If growth will come largely from M&A, then a CFO who is experienced in acquiring and integrating companies will be invaluable. If the exit strategy points to an IPO, then a CFO with public company and/or capital markets experience will be important.

While the underlying reasons for hiring a new portfolio company CFO may be straightforward, the trade-offs that are often debated in selecting the right candidate can be quite complex.

Selecting a portfolio company CFO: key trade-offs

Background and skills focus



While most CFOs have a well-rounded skill set, typically they will excel in one of three areas: 1) accounting/controllership, 2) business/operational finance, and 3) capital markets/treasury. Those who excel in accounting and controllership typically begin their careers in public accounting, where they develop strong technical finance and accounting skills while obtaining a CPA. Conversely, those who excel in business and operational finance will have honed their skills in divisional finance or FP&A roles. Former bankers tend to spike in the capital markets/treasury area.

Business/operational finance is often the most critical priority for private equity CFO roles.

All three areas of focus are important, but we would argue that business/operational finance is often the most critical priority for private equity CFO roles, given the need to provide decision support across a range of operational and strategic initiatives. While technical accounting skills are clearly important, the ability to manage a Controller while having a good enough grasp to ask the right questions is typically sufficient. Despite the role leverage plays in a private equity context, capital markets experience is usually a "nice to have" rather than a "must have," as this is an area where the sponsor can step in to lend a hand – one notable exception of course being pre-IPO situations and the technical capital markets challenges they bring.

Sitting CFO vs. Divisional CFO

More often than not, private equity firms seek to fill portfolio CFO roles with executives who have already had experience as an enterprise-level CFO. These individuals will have had full ownership of the finance organization across all functions (audit, tax, treasury, FP&A, etc.) and will have interfaced with the company's board on strategic matters. Simply stated, they will have had full financial accountability for an organization.

Conversely, a divisional CFO will not have managed the entire range of corporate finance functions and may have relied on a shared services infrastructure to manage other finance areas. Additionally, a divisional CFO may have managed his/her business to only a certain level of profitability, focusing on, say, gross profit rather than on operating income or cash flow.

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That being said, there are situations in which a divisional CFO can offer just as compelling a skill set as an enterprise CFO. For instance, divisional CFOs from certain large corporations (such as Danaher) will have operated their businesses with a similar level of accountability as that of an independent company. Additionally, divisional CFOs from best-in-class organizations will often bring a highly strategic and operational approach to the finance function, which is integral in partnering with the business to drive growth and profitability. From a practical perspective, divisional CFOs may also be easier to attract, given the opportunity to assume a top CFO role for the first time.

Large company vs. small company

Conventional wisdom holds that an incoming CFO should have worked in an environment that is at least as large and complex as the future state of the portfolio company at the time of exit. For example, if a private equity firm is hiring a CFO for a $500 million company, whose investment thesis calls for doubling revenue through international expansion, then you will undoubtedly want a CFO who has managed a business of at least $1 billion in revenue with the complexities of having international operations.

Bigger is not always better.

While this theory is generally valid, it is important to recognize that "bigger is not always better." While the CFO of a multi-billion dollar business will bring more than enough scale, scope and credibility to the role, he/she will likely be accustomed to working in an environment with far more resources than in the $500 million company. The CFO may have cut his/her teeth in an environment where the infrastructure was already in place and the need to roll up one's sleeves and tackle the challenges of, say, an ERP implementation were not part of the role.

In fact, the ideal portfolio company CFO combines a knowledge of "what good looks like" from having worked in a larger organization with the entrepreneurial gumption required to be successful in a smaller environment. Not every CFO candidate will combine both categories of experience, but for CFOs who have only worked in larger company environments, the nature of their progressive roles can offer evidence of entrepreneurship. For example, finance executives who have rotated through emerging market regions of large multi-nationals will often have worked in low-resource environments, where the ability to adapt and take a hands-on approach are keys to success in the role.

Industry experience

It seems logical that private equity firms should source portfolio company CFO candidates from within the same industry. As the logic goes, a CFO who is familiar with the industry will be a more "plug-and-play" solution, bringing knowledge of the competitive landscape, relevant performance metrics, and instant credibility to stakeholders, both internally and externally. Highly regulated industries, such as financial services or healthcare, will often require a CFO with knowledge of sector-specific regulatory nuances. In an IRR-driven world, time is always of the essence, so the ability for an incoming CFO to get up to speed quickly is critical.

In the CFO role companies will often look beyond their own industry to recruit top talent.

Despite the clear benefits of hiring from within the industry, our experience has shown that in the CFO role – perhaps more than in any other function – companies will often look beyond their own industry to recruit top talent. When and why does it make sense to do so?

First, a particular industry or sector may not yield strong talent within the finance function. Some sectors, such as consumer packaged goods, are renowned for breeding best-in-class finance executives, while a creatively-led industry such as fashion may place less emphasis on the finance function. Moreover, bringing a CFO from outside the industry will bring a certain level of objectivity and freshness that can be helpful in thinking about different ways of operating the business. Finally, companies will sometimes look for CFOs who understand certain operating characteristics of the business without necessarily coming from the industry. For example, a consumer manufacturing business that is struggling with supply chain issues may look to hire an industrial CFO who understands plant operations and vertical manufacturing, irrespective of specific consumer products experience.

Proven private equity chops

How important is prior PE experience for an incoming portfolio company CFO? The answer will vary by sponsor, with some telling you it's a nice-to-have and others insisting that it's a requirement. Certainly, an executive who has previously worked as CFO of a private equity-backed company will be intrinsically familiar with dynamics such as operating in a levered environment, maintaining a relentless focus on cash flow, driving operational excellence, communicating with a private equity board, and knowing what information is needed and when. Even better is a CFO who has not only worked in a sponsor-backed company but who has also been involved in a successful exit for a private equity sponsor, with a proven track record of driving measurable value. While one can argue that a CFO learns as much, if not more, from a gritty, operationally challenged private equity situation, in reality sponsors will always feel more comfortable with a CFO who has rung the bell and helped to drive a positive outcome, all things being equal.

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One characteristic of private equity CFOs is that they will often look more "jumpy" on paper than counterparts in the corporate world who remain with a single organization. Due to the nature of three- to five-year hold periods, experienced private equity CFOs can have the episodic career path of a journeyman, which can sometimes be viewed as a red flag. Depending on the nature of the exit (sale to strategic, sale to a sponsor or IPO), a private equity CFO may be a victim of his/her own success, needing to find a new role after the sponsor has exited the transaction.

The Importance of Competencies

While industry background and technical abilities are important for portfolio company CFOs, in some ways they are table stakes. What will really distinguish one CFO's ultimate performance from that of another are his or her leadership competencies, which should be well aligned to the private equity sponsor's investment thesis. First among these is **performance orientation**, which is, not coincidentally, one of the central business priorities of private equity investors. This competency is characterized by a high sense of urgency, a bias for rapid change and continuous improvement, and a strenuous avoidance of negative surprises. From a financial perspective, the CFO's performance orientation will manifest itself through a demonstrable track record of consistently delivering significant year-over-year improvements in financial results.

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However, not all results are achieved equally. Some may require deep cost cutting and others strategic growth initiatives. While a turnaround situation will require a more surgical approach, most private equity investment theses will require the company to grow and evolve in new and different ways. In these instances, the successful CFO will have a build mentality and align the team appropriately to drive major **change management** initiatives, bringing a willingness to challenge existing ideas and facilitate continuous improvement.

Successfully driving change will require the CFO to **influence** the firm's decision making process, drawing upon not only his or her functional expertise, but also demonstrated leadership, initiative, and **collaboration**. The ability to build relationships across the organization and position finance as a business partner will enable the CFO to provide effective decision support. Externally, the CFO will align with stakeholders to communicate clear, accurate and timely financial information.

Importantly, the CFO will have the ability to collaborate with the CEO as a **strategic thought partner**, aligning around a shared vision for the organization and shaping the finance strategy in support of the company's business objectives. The strategic CFO will be creative and capable of thinking broadly about business – not just financial – issues in order to contribute to the bigger picture. Strategic orientation is particularly relevant when the investment thesis calls for inorganic growth.

Finally, as the head of the finance function, the successful private equity CFO will be a strong **team leader**, with a proven track record of building high-performance finance teams and driving accountability for achieving measurable shareholder value. This will require the CFO to assess and develop the best internal talent and attract and retain the best available external talent.

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Conclusion

While there is no one-size-fits-all solution to finding the right CFO, the successful portfolio company CFO will typically embody several key characteristics. He/she will be forward looking and strategic, serving as a thought partner to the CEO and a business partner to the organization in driving value. He/she will be hands-on and operational, often wearing multiple hats and overseeing additional functions beyond finance. And perhaps most importantly, he/she will think like an owner, bringing entrepreneurial gumption, a hands-on approach, and a clear and timely communication style. The experienced private equity CFO knows “what good looks like” both in the context of a best-in-class finance organization and in the context of delivering value through a successful exit for a private equity sponsor.

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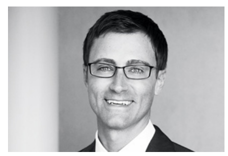

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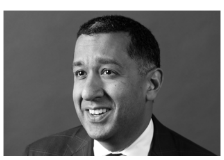

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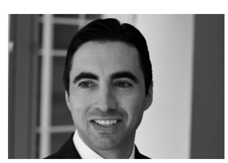

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