Russell Reynolds Associates

Portfolio Company CFOs

Rethinking the Hiring Blueprint

The private equity portfolio CFO market is becoming increasingly competitive due to the recent volume and high valuation of private equity transactions. Investors and portfolio company CEOs are fighting for external talent, with increased expectation post-investment of prior private equity experience. The solution to the talent war for private equity CFOs, may lie in the success public companies have recently had in succession planning efforts.

To better understand Chief Financial Officer hiring trends in the United States' private equity landscape, Russell Reynolds Associates mapped 17 mid-cap to mega-cap private equity firms' portfolio companies (see appendix for full list). Analyzing a representative 150 portfolio companies or 20% of the firms' portfolio companies across sectors, we investigated the portfolio company CFO's journey to the top.

Our findings suggest that private equity firms can bring in the next generation of portfolio CFOs by rethinking:

1. Which competencies and experiences are critical to success in the role

2. Which criteria are preventing them from improving diversity hiring and reducing recruitment costs

To create new talent pools in an increasingly tapped market, private equity firms should look holistically across their portfolio companies' in-house finance talent and invest in the next generation leaders through career development through coaching, role rotation, enhanced scope of role and retention efforts.

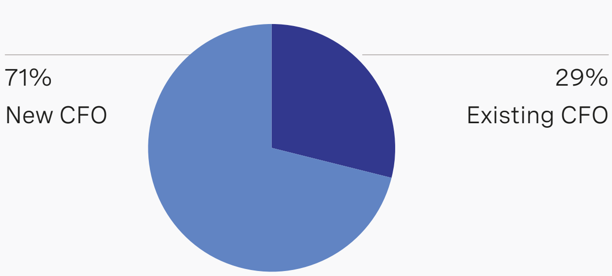
While investors believe the quality of the executive team is more important than business fundamentals, CFO turnover is still high

Hire new or keep the existing CFO?

According to Russell Reynolds' Evolving Expectations of Portfolio Company CFOs Survey, leading US private equity investors believe the quality of talent on the portfolio leadership team outweighs the fundamentals of the business when it comes to maximizing returns.[1] In other words, the CFO is key to unlocking value. This results in many PE firms preemptively replacing company CFO post-investment, especially if an IPO is on the horizon.

Of the portfolio company CFOs RRA mapped, 71% hired a new CFO post-investment, and over 80% were hired within four years of the first deal. With the majority of investors searching for a new CFO, the market is especially tight, when on average, portfolio companies have as many CFOs as deals (e.g., two CFOs, two deals). To unlock talent, investors need to think about their hiring strategy. Is it wiser to buy in the short-term, or build for the long-term across portfolio companies?

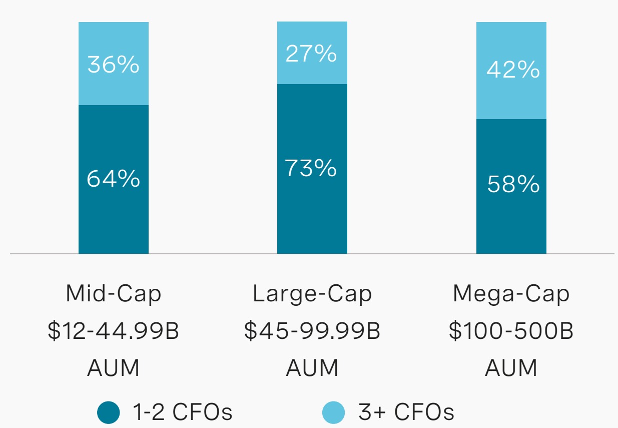
Figure 1: % Portfolio Company CFOs That Hire a New CFO Post-investment or Keep The Existing CFO



Russell Reynolds Associates analysis of 150 US Portfolio Company CFOs, 2022

The high rate of CFO turnover post-investment coupled by the lack of internal talent in the market, reiterates the importance of why investors need to focus on the talent of the leadership team. In addition, we found a positive correlation between size of PE fund and turnover rates. Portfolio companies of mega-cap firms ($100-500 billion AUM) are the most likely to replace their CFO post-investment, with 42% of these companies having had 3 or more CFOs on average within the first 5 years post-investment (Figure 2). This suggests that larger portfolio companies seek CFOs with specific experiences as the company scales, such as private equity or IPO exposure.

Figure 2: Number of Portfolio Company CFOs by Private Equity Fund Size



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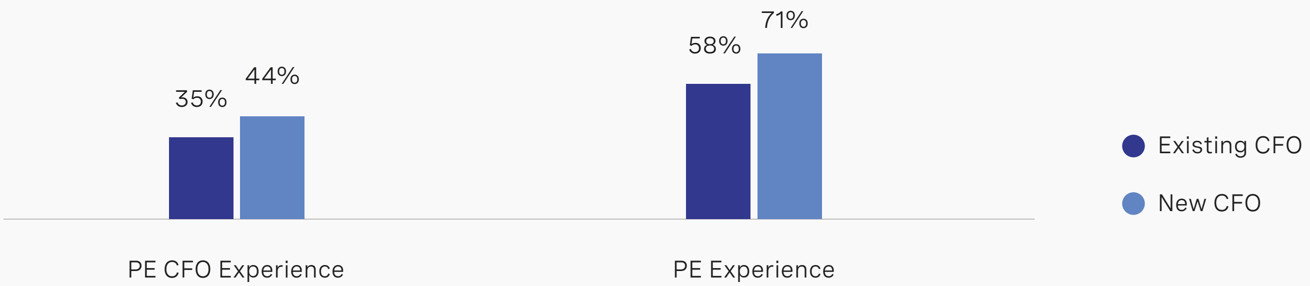
New portfolio company CFOs have more private equity experience

Half of private equity investors surveyed cited previous PE experience as "very to extremely important" for a portfolio company CFO to have.[1] Portfolio CFO hiring trends follow suit—new CFOs brought on board post-investment are 13% more likely to have private equity CFO experience and/or previous private equity experience than existing CFOs (see Figure 3.)

Figure 3: Private Equity Experience



Russell Reynolds Associates analysis of 150 US Portfolio Company CFOs, 2022

IPO experience remains important, yet elusive, in the CFO talent pool. 82% of investors surveyed prefer a CFO with previous IPO experience,[1] yet only 15% actually have said experience. Of that 15%, 68% are new CFOs placed post-investment. The large and mega-cap funds are most successful at placing CFOs with IPO experience, again highlighting the importance of certain experiences for the large and mega-cap funds' portfolio companies.

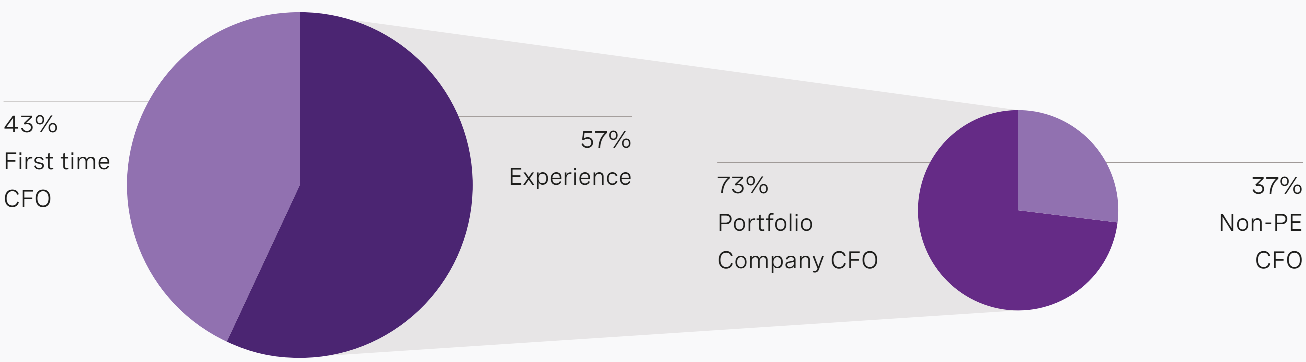
Portfolio company CFOs: a fight for external talent

Public and private equity companies are increasingly competing for talent, with portfolio companies offering larger equity deals. However public companies are increasingly promoting from within, while portfolio companies continue to look externally for experienced talent. It's time for private equity firms to consider that the portfolio company hiring blueprint might be limiting their search for great CFO talent.

Previous CFO experience

57% of portfolio CFOs have previous "top-seat" CFO experience — the majority of which have spent time at a portfolio company — while only 41% of S&P 500 have previous experience (Figure 4.) With the resources to develop a robust finance team internally, S&P 500 companies can succession plan accordingly, while portfolio companies aiming for a successful exit either don't have a succession plan in place or can't afford to wait for it to come to fruition, forcing them to rely on external candidates with previous CFO experience.

Figure 4: Portfolio Company Previous CFO Experience



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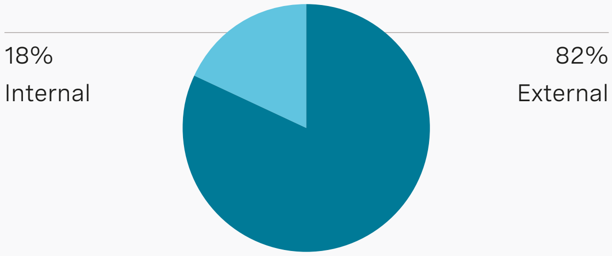
Internal versus external

As shown in Figure 5, over 80% of portfolio company CFOs are external hires, more than double the number of externally hired new S&P 500 CFOs. While public companies are starting to see the payoff of succession planning, many portfolio companies don't have the luxury of deeply seeded talent on their bench. Another factor impacting portfolio companies bench strength is the lack of equity for more junior talent on the team - without equity incentives, developing and retaining top talent is difficult.

Figure 5: Portfolio Company CFOs: Internal versus External Hire



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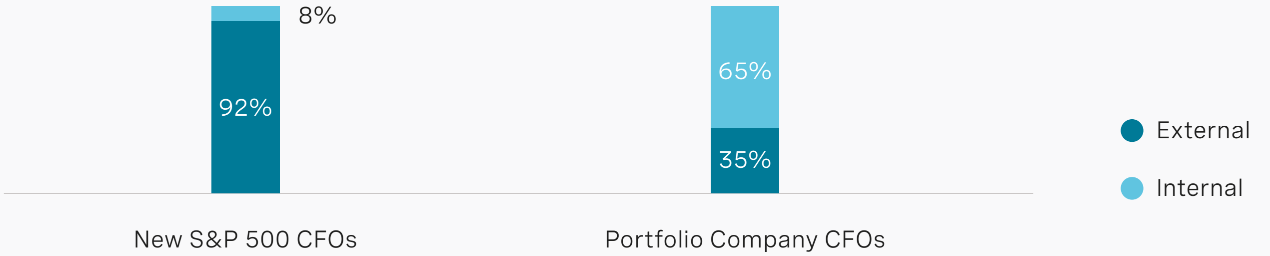
Next-Generation: make tradeoffs to open the talent aperture

The next generation of CFO talent has arrived to the S&P 500, with 59% of new CFOs in the role for the first time, versus 43% of new portfolio company CFOs. While more than nine out of 10 first time CFO S&P 500 candidates are promoted internally, as previously mentioned, portfolio companies don't have the same abundant supply of internal talent. 65% of portfolio first time CFOs are externally hired, compared to only 8% of new externally hired S&P 500 CFOs (Figure 6.). Given the abundant supply of first time public company CFOs, PE funds should look at the senior finance talent of developmentally focused public companies to broaden the narrow talent pool.

Figure 6: First Time CFOs Internal versus External Appointments



Russell Reynolds Associates analysis of 150 US Portfolio Company CFOs, 2022 and New S&P 500 CFOs, 2021

While they might not have been in seat before, considering first time CFOs can offer other benefits, including increased candidate pool gender and ethnic diversity. There is still much work to be done to achieve parity within the CFO ranks and portfolio companies have a longer road ahead, with 36% less women CFOs than public companies. Private equity firms should take note, especially if an IPO is on the horizon, as scrutiny surrounding gender diversity will increase and the business benefits provided by a diverse organization are numerous. Considering first time CFOs and developing internal talent by providing critical finance experiences to underrepresented minorities are a few of the many steps that can be taken to improve diversity. In fact, 17% of externally hired portfolio first time CFOs are women, compared to only 7% of experienced portfolio CFOs. Additionally, the majority of first time CFOs (52%) have previous private equity experience to offer.

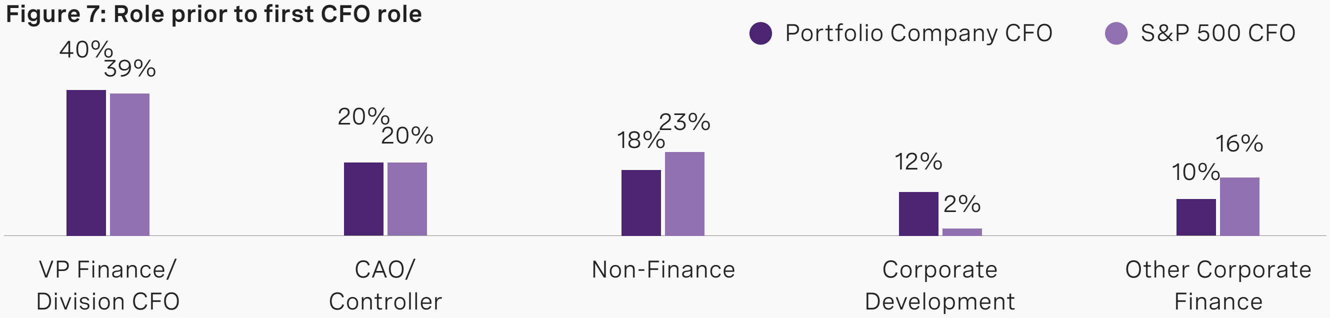
Portfolio and public CFOs follow similar routes to the top

Though portfolio CFOs are hired externally and with more sitting CFO experience than new S&P 500 CFOs, their career paths are largely the same. Portfolio CFOs are on average four years younger than public company CFOs, but have the same ratio of MBAs and CPAs to their names, and follow the same route to the top.

Journey to the Top Seat

Around 80% of both listed and portfolio CFOs were in traditional finance roles before their first CFO roles, such as chief accounting officer or divisional CFO. It's worth noting that almost 20% of CFOs come from non-finance roles, such as a vice president of strategy, chief operating officer, or a divisional CEO role. This is also becoming more common among S&P 500 CFOs. Interestingly, as shown in Figure 7, six times more portfolio company CFOs come from a corporate development background, likely due to private equity experience or operating in a smaller company where M&A is not a separate function.

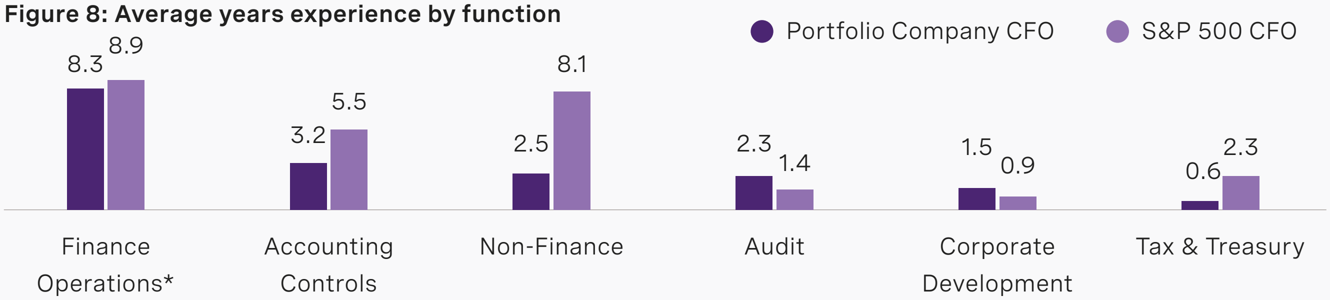
Figure 7: Role prior to first CFO role



Russell Reynolds Associates analysis of 150 US Portfolio Company CFOs, 2022 and S&P 500 CFOs, 2022

Key functional tenure differs more between portfolio company CFOs and S&P 500 CFOs, explainable by public company CFOs being older and often having longer careers. Consequentially, we see S&P 500 CFOs have more than three times as many years of non-finance experience, and almost two times as many years of accounting/controls experience. On average, portfolio company CFOs have 23.3 years of finance experience and have predominantly focused on finance operations (including FP&A, VP finance, CFO, and division/regional CFO roles), which remains the most obvious background of a portfolio company CFO, consistent with public company CFOs.

Figure 8: Average years experience by function



*Includes FP&A, VP Finance, and Divisional/Regional CFO
Russell Reynolds Associates analysis of 150 US Portfolio Company CFOs, 2022 and S&P 500 CFOs, 2022

Recommendations: Think holistically about your portfolio

To adapt to an increasingly competitive market, the blueprint for hiring portfolio CFOs needs to change. With the majority of private equity firms hiring new portfolio company CFOs post-investment, experienced CFOs will only become rarer. For a competitive advantage and recruitment-saving costs, private equity firms need to start thinking holistically about their portfolio company finance teams to build and unlock new talent.

Strengthen near-term succession planning

While the S&P 500 continues to make progress on succession planning, portfolio companies continue to look externally for experienced CFOs in an incredibly tight talent market. From the start of the deal, invest in the whole finance team and develop a succession plan at least three years before the CFO is expected to change to ensure a smooth exit. Look beyond each portfolio company's finance team and holistically consider all finance teams by applying a consistent leadership assessment process on externally recruited talent to baseline their aptitude for broader portfolio finance roles. Investing and developing across portfolio companies allows private equity firms to unlock new talent pipelines.

First time CFOs

If they are good enough for the S&P 500, why not for portfolio companies? Not only are they viable candidates, but the majority of these first time CFO candidates (52%) also bring private equity experience and a source of gender diversity, which should be a key priority for private equity firms. Applying the "build-not-buy" approach to all your portfolio companies unlocks new opportunities for next-generation CFO leadership. Consider what in-house coaching or external development programs may exist and plan for your finance team's development.

Reallocate recruitment savings to increase talent equity

By thinking holistically about your overall finance talent, there is potential to save on recruitment costs. However, funds will need to be allocated elsewhere to attract and retain top finance talent. To retain finance bench strength across portfolio companies, re-evaluate the equity and LTIP associated with your number two roles. Ask: is it a career, when there are no development opportunities or equity, or is it just a job?

Appendix

Private Equity Firm	Capital Invested in Private Equity (Bn)
The Blackstone Group	407,716
KKR	212,113
The Carlyle Group	147,450
Apollo Global Management	127,971
Bain Capital	100,399
Hellman & Friedman	91,749
Thoma Bravo	80,261
Advent International	79,187
TPG	59,742
Warburg Pincus	56,570
Platinum Equity	48,956
Clayton, Dubilier & Rice	43,378
Onex	33,089
TH Lee	26,748
General Atlantic	19,866
American Securities	12,960
New Mountain Capital	12,042

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References

1. RRA Evolving Expectations of Portfolio company CFOs survey, N=30

About Russell Reynolds Associates

Russell Reynolds Associates is a global leadership advisory and search firm. Our 470+ consultants in 47 offices work with public, private and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic and political trends that are reshaping the global business environment. From helping boards with their structure, culture and effectiveness to identifying, assessing and defining the best leadership for organizations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led.

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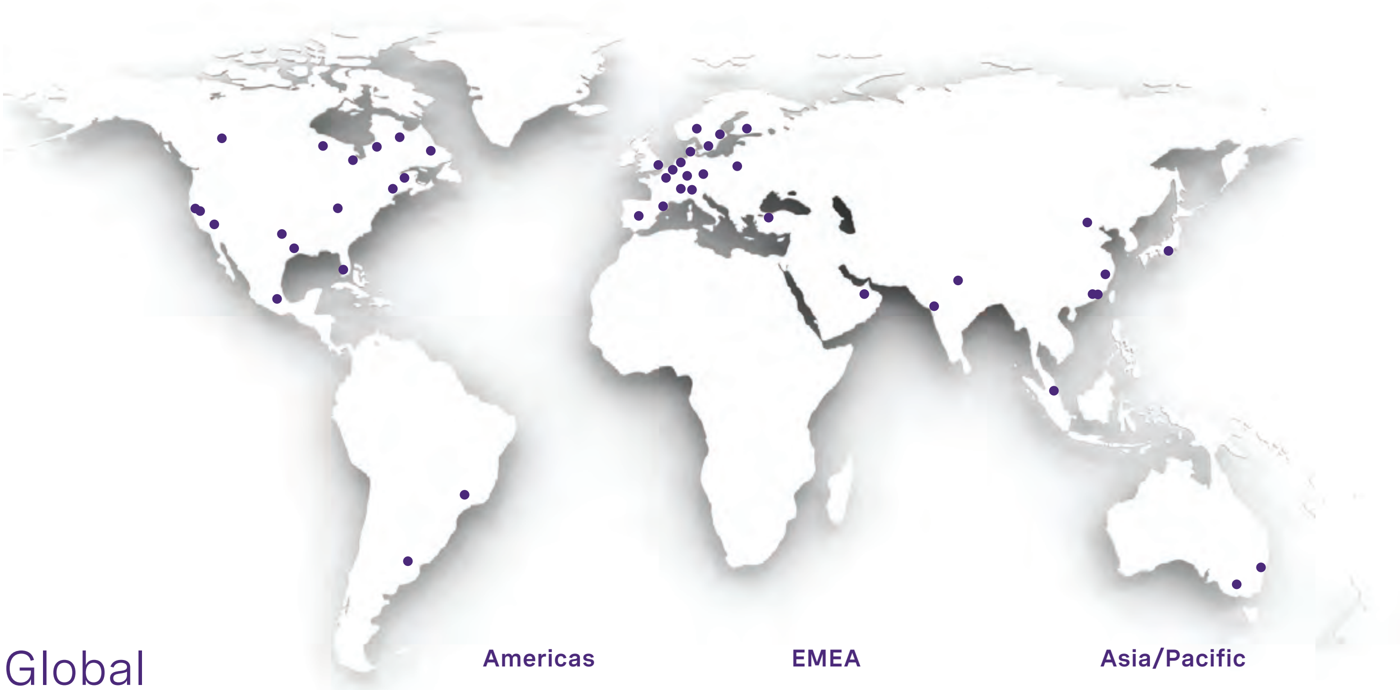

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