Leadership Capital 2023

Quantifying the impact of leadership in UK private equity backed businesses

Contents

Whilst we recommend reading the report in order, clicking on a specific topic below will take you directly to that part of the report.

About the LCap Group

The LCap Group supports investors, portfolio companies and their leadership teams through the entire 'leadership lifecycle' through leadership insights, executive change, and leadership development.

We enable our clients to optimise the design and composition of their leadership teams towards cognitive diversity, performance, and value creation, ultimately supporting successful exits.

Our services span the three phases of the 'leadership lifecycle' and cater to the spectrum of private equity, from private capital, to mid-cap and large-cap businesses.

Insights

Leadership Dynamics provides objective, data-led insights on leadership competencies and behaviours, enabling more proactive, evidence-based leadership decisions, which deliver better outcomes.

Change

Powered by insight, our executive change brands, DRAX Rowan and Altus support leadership optimisation to build an executive team with the right balance of competencies and behaviours to deliver growth.

Development

Our behavioural evaluation, PACE, enables clients to maximise the impact and effectiveness of their leadership capital, by providing the tools to engineer their culture.

About Leadership Dynamics
Leadership Dynamics is the first digital insight product designed for individual leaders and leadership teams of high-growth founder-led or private capital invested companies. Leadership Dynamics is designed specifically to optimise the potential of an individual or a leadership team whilst maximising their performance within high-growth businesses. It provides leadership foresight on the performance and potential of individual leaders and leadership teams with objective data-driven analysis.

About PACE
PACE stands for Pragmatism, Agility, Curiosity and Execution: and is the No.1 Private Equity behavioural evaluation, that allows high-performing leaders to understand their strengths, weaknesses, and the key to developing their performance levels. It is the only behavioural evaluation benchmarked against Private Equity executives, designed by leading psychologists, purpose built for the unique leadership demands of Venture, Private and Growth Capital.

The LCap Framework

The LCap Group has developed a framework for measuring Leadership Capital, supported by research carried out with leading academics, Adrian Furnham and Simmy Grover, at UCL and Birkbeck University.

The study has analysed every private equity deal across the UK and Europe since 2010 and is an ongoing study, incorporating new deals as they happen. Each company is analysed based on the profile of its management team throughout the hold period and its financial performance upon exit. Through this work, we have identified four key factors that determine leadership success:

Functional Competence	Does the team contain the right representation and depth within each of the key functional areas (i.e., finance, operations, technology etc), for the growth stage the business is at and moving into. Does this balance also suit the market that the business operates in?
Situational Competence	What situational challenges have leaders faced in the past and how well does that experience match the current challenges they face and their value creation journey?
Domain Competence	Does the leadership team have knowledge of the market, the customer base, and the business model?
Behavioural Competence	Is the team compatible at a behavioural level, based on the key behaviours of Pragmatism, Agility, Curiosity and Execution? Does the team have cognitive diversity; a wide range of perspectives and behaviours? Will they bring out the best in each other?

This report applies this framework to the UK private equity marketplace in the 2022/23 financial year, revealing fascinating insights about the power of leadership for value creation.

The LCap Group in numbers

Over 150

employees

Clients across

20 countries

Worked with

142

funds in 2022

Insights

Over

30,000

PE teams evaluated for Leadership Dynamics

Change

87%

Placement success rate

(Vs industry standard of 50%)

33%

Female placement by LCap

(Vs PE industry standard of 11%)

Development

Over **20%**

of all UK PE leaders have taken our PACE behavioural evaluation

The value of ‘Leadership Capital’

Leadership Capital
(NOUN)-[liːdəʃɪp 'kæpɪtᵊl]

"The collective capability and complementarity of the leadership team. A quantitative value that reflects a team's ability to contribute to a company's success. Leadership Capital within any business can grow, or it can lose value when the leadership team does not have the right experiences, functional blend, or behavioural complementarity."

Leadership Capital 2023 is a study of every private equity backed UK company that exited in 2022/23, to assess how Leadership Capital correlates with financial performance on exit. What are top quartile companies doing differently in terms of leadership optimisation, development and composition, to those in the bottom quartile? How are they assembling the optimal mix of leaders for their value creation journey, and what competencies and behaviours are they prioritising?

By answering these questions, we aim to arm investors and leaders with quantitative insights to facilitate objective leadership discussions, proactive decision-making, and ultimately enable them to build and develop the best leadership teams possible for their portfolio companies. Thus, driving impact, growth and making good companies great.

Leadership Capital delivers better companies and alpha returns

Following a decade of unprecedented fundraising and rapid growth, the wind has changed for private equity. Rising rates and falling valuations have added new complexity to deal making.

Private equity is a significant contributor to the UK economy, putting capital to work to build stronger companies, create jobs and drive value creation for shareholders. The sector has expanded rapidly in the last few years, developing a greater depth of funds and expertise, and despite current headwinds, there is plenty of dry powder on the table.

But the current climate is pushing investors to look harder and more creatively at how they make deals and drive value in their portfolio companies. With debt less available to facilitate growth, the race is on to find the edge that will set companies apart from the competition and continue to deliver outsized returns.

The critical role of people – and leadership – is coming to the fore.

In the current climate, great leaders ensure companies can navigate the obstacles and opportunities that are coming thick and fast. But, while the importance of leadership is increasingly well understood in private equity, measuring and quantifying that impact accurately has never been possible. Until now.

Methodology

Thanks to the power of data, top investors are now measuring Leadership Capital and engineering leadership teams in the same way that they do other areas of the business. This is enabling them to find an edge over the competition, and drive top quartile returns.

The LCap Group's Leadership Capital framework is based on the largest research study ever conducted into leadership within private equity backed businesses.

We have worked with leading academics at UCL and Birkbeck University to analyse every private equity deal across the UK and Europe since 2010, and on an ongoing basis, incorporating new deals as they happen.

Each company is analysed based on the structure and behaviours of its management team, and its performance from investment to exit, creating the largest dataset of its kind. This enables us to identify correlations between leadership optimisation, structure, competencies, and value creation.

By applying smart analytics to that dataset, through our Leadership Dynamics platform, we can understand trends and patterns in leadership in the best and worst-performing businesses, as well as analyse the leadership capabilities of any team in comparison to top and bottom quartile performers.

This report is a snapshot of leadership competencies of private equity backed leadership teams that exited across the UK during the financial year from April 2022 to April 2023, incorporating analysis of their leadership journey since their last acquisition.

Hold periods vary from between two and nine years, with an average of around 4.5 years. We draw on data from over 2,000 data sources and thousands of websites to build a career history of each leadership team.

Powered by

Leadership DYNAMICS.

An LCap Group Product

Methodology
CAGR weighted averages

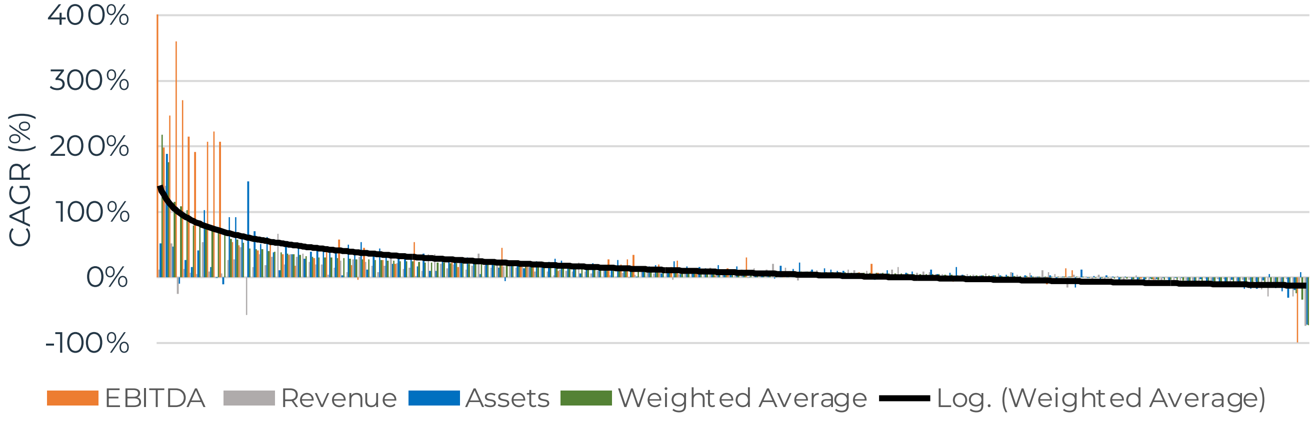
Throughout this report company performance is based on CAGR weighted average, which comprises three financial components: EBITDA, revenue and total assets. This allows for easy comparison across all exiting companies, which have been segmented into quartiles, referred to as 'upper quartile' (Q1), 'second quartile' (Q2), 'third quartile' (Q3) and 'lower quartile' (Q4) throughout this report.

A mature UK market

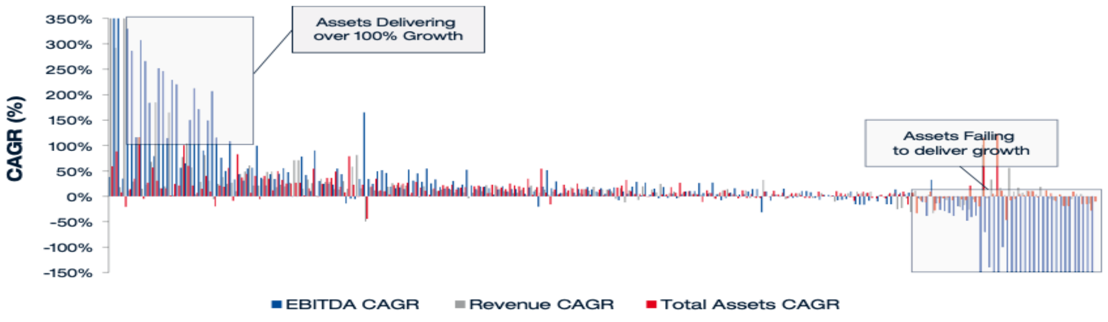
Mapping company CAGR components together demonstrates the overall maturity and success of the private equity asset class in the UK, as all companies have a positive CAGR on at least one measure. The best performing companies are differentiated by significant EBITDA growth, in comparison to their revenue and assets growth.

Overall, 2022/23 demonstrates a broader base of value creation, with fewer extreme gains and losses and only 15% of companies reporting negative CAGR growth, compared to 22% in 2018/19. However, broad consistency across the two charts demonstrates the integrity of the data and the maturity of the UK private equity marketplace.

85% of all PE backed exits in 22/23 delivered growth across the hold period



78% of all PE backed exits in 18/19 delivered growth across the hold period



Executive summary

Our analysis reveals 10 key insights which demonstrate that the best performing businesses are leveraging the true potential of their leadership teams to drive optimal financial performance.

Leadership optimisation drives performance

Top performing companies are proactively optimising their leadership teams to align competencies and experience to the challenges they face. Upper quartile companies are more likely to make at least one leadership change during the hold period; only one in 50 keep the team static compared to one in ten of lower quartile companies. Top performers also average a greater number of changes than those in the lower quartile; 4.7 compared to 4.4.

Top performers make key leadership decisions early

Top quartile performers make key leadership decisions more than 30 months earlier in the hold period than worse performers. Aligning leadership competencies with the value creation plan and business challenges quickly ensures leadership is ready to make an impact and has time to implement plans. Top performers are also more likely to exit with key leaders still in place, by taking a strategic and consistent approach to succession planning.

Situational competencies set apart top performers

Top performing businesses are focused on aligning the leadership team with their value creation journey, even sacrificing market knowledge to do so. Amongst Q1 businesses, there is a clear trend towards optimising for situational experience (+10.72pts) while holding steady for functional experience, and slightly reducing domain experience. In contrast, worse performing businesses are hiring for domain experience, while seeing a reduction in functional and situational experience.

Behavioural diversity drives performance.

The best performing businesses capture a greater degree of diversity across key behaviours of Pragmatism, Agility, Curiosity & Execution. Crucially, behavioural concentrations or "group think" where team members behaviours are all the same negatively correlate with business performance, demonstrating the importance of capturing diverse views and behaviours within a Leadership Team.

Strong CEOs are leadership team builders

The best CEOs understand the importance of having the right experience and competencies around them and proactively ensure they build the best team for the journey, whether through development or change. In Q1 businesses, 84% of new CEOs made at least one SLT change within a year and 39% made multiple further SLT changes. CFO and COO are the most popular follow-on leadership hires.

CFOs change most frequently

Almost two-thirds (63%) of businesses change their CFO during the hold period, the highest proportion of any role. Top performers are more likely to change the CFO (71%), and do so earlier, with 52% making the switch in the first two years compared to 38% of Q4 businesses. In contrast, Q4 CFO changes are significantly more likely to happen 6+ years into the hold period – a third are taking place at this late stage.

Top performers prioritise commercial and external facing leaders

Top performing businesses are optimising their leadership team towards a strategic and commercial focus, while ensuring each leader has a distinct functional role. Q1 businesses are typically unique in having a CMO on the SLT, while they are significantly more likely to change or develop the CCO, CMO and CTO to align with their value creation plan.

The CMO difference

One role consistently stands out amongst the top performing businesses: CMO. CMOs are a relative rarity amongst private equity backed businesses, in comparison to other leadership roles.

But Q1 businesses consistently prioritise the CMO. Over a quarter (28%) changed their CMO during the hold period, compared to just 7% of Q4 companies.

Are Chairs being overlooked?

More than any other role, Chair placement happens early, with 60% joining in the first two years. But unlike the CEO and CFO, there is no spike in Chair hires as companies approach exit; only 10% of businesses refreshed the Chair more than six years into the hold period. This suggests a tendency to overlook the Chair as a focus for potential late optimisation. Why are some firms prepared to make late changes to the CFO or CEO, but not the Chair?

Making the CTO decision early allows for digital impact

Around two thirds of Q1 and Q2 businesses bring in a CTO in the first two years, highlighting their capacity to make an impact through leveraging technology to drive compound year-on-year growth. Late CTO change is highly indicative of poor performance, with the average Q4 CTO change occurring 6.4 years into the hold period, over twice as long as in Q1 companies.

The 2022 private equity landscape

51 UK PE funds closed

£52 Billion capital raised

The average size of fund was £1.03bn., which represented a rise of 59% in the number of funds closed on 2018/19.

545 Investments

3468 Inflight

246 Exits

- → **Consumer, B2B and Technology businesses dominate exits**
- → **Technology, Financial Services and Energy companies most likely to deliver upper and second quartile returns**

Of the 246 companies that completed an exit in 2022, 78% were in three sectors: Consumer Products and Services (B2C), Business Products and Services (B2B) and Information Technology.[1.1]

Technology valuations have boomed in the last few years, and this is reflected in the figures, with the sector seeing a 63% rise in the number of exits compared to 2018/19, when we last carried out this analysis. Technology firms were also amongst the most successful for exit returns, along with Financial Services, with 60% and 40% of exits falling within the top two quartiles, respectively.

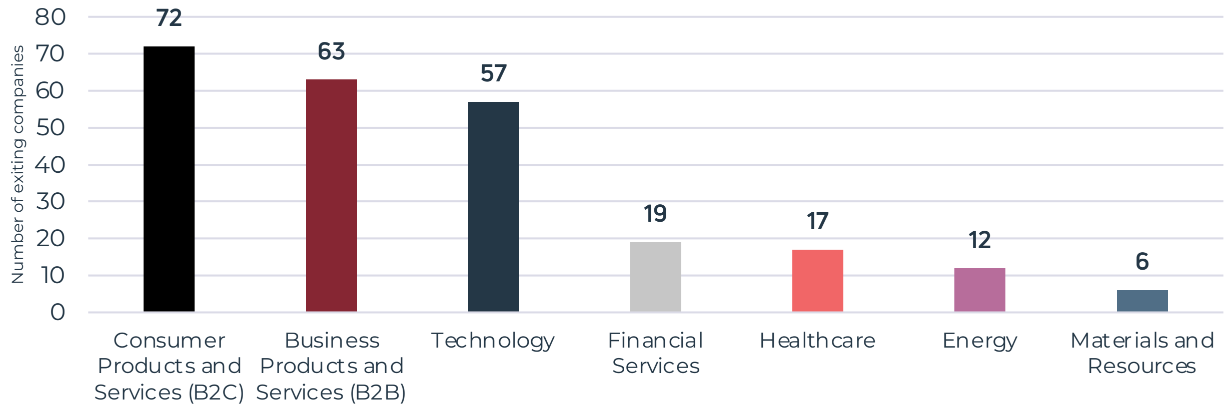
In contrast, the B2B sector had a less successful period, with exits falling by 30% on 2018/19 and roughly two thirds of exit deals falling in the lowest two quartiles, as investors came under pressure after a tough financial year.

Only the Energy, Technology, Financial Services and Consumer sectors produced above average returns throughout their hold periods[1.3]. Conversely, the Materials & Resources, Healthcare and B2B sectors produced below-average CAGR returns. However, it is worth noting that the Energy sector results were largely swayed by one company with a significantly greater weighted average CAGR.

A market snapshot

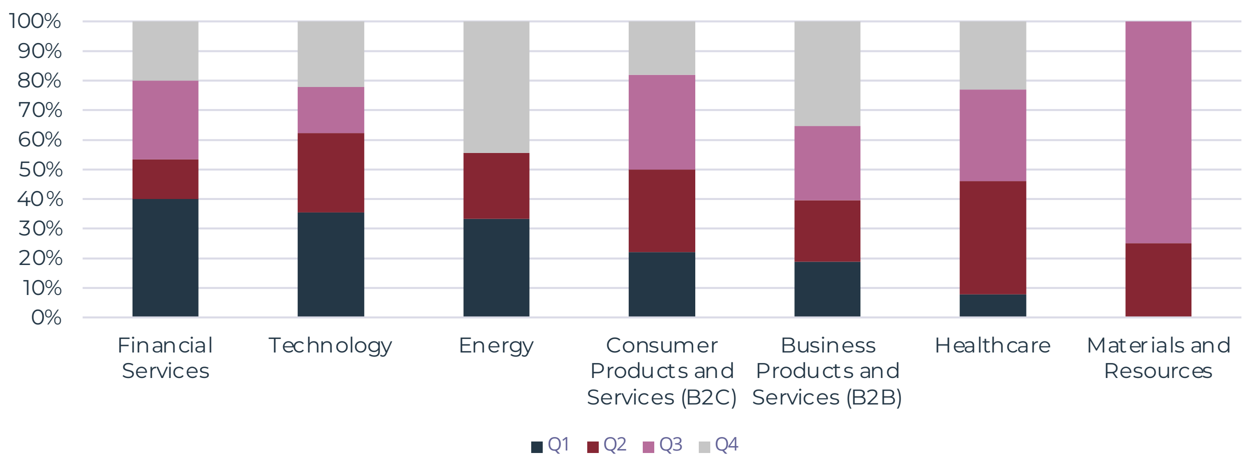
1.1

B2C, B2B and Technology are the most prevalent sectors among exiting companies



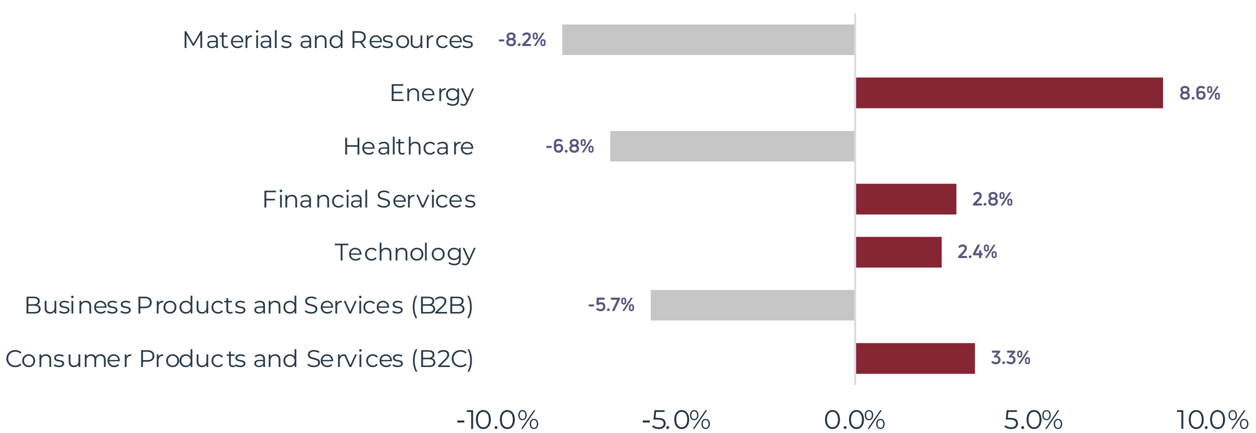
1.2

Financial Services & Technology delivered the highest proportion of Q1 exits



1.3

Sectors with above average (16.3%) returns are Energy, Finance, Technology and B2C.



Buyouts and trade sales most popular route to exit

→ Buyouts and trade sales are the most popular exit routes
→ More than 50% of IPO exits involved top quartile performers

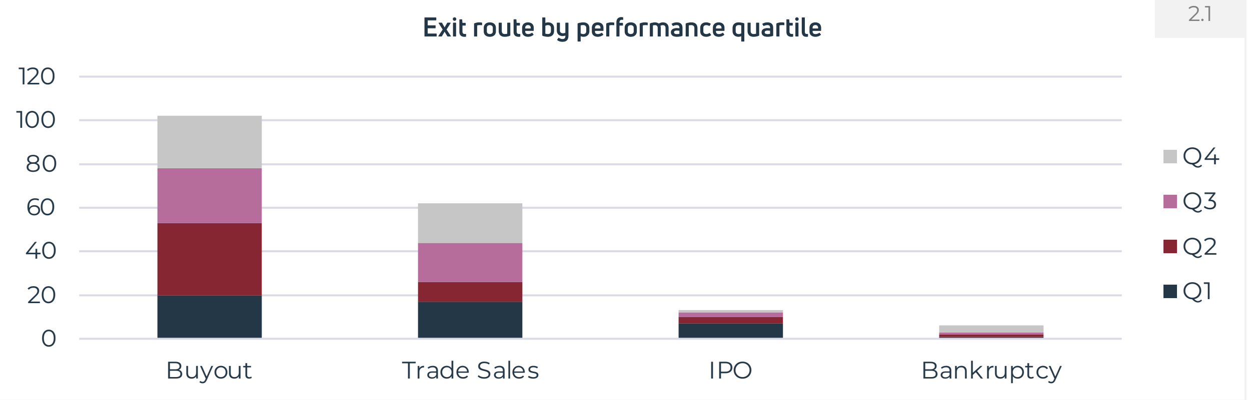
Buyouts and trade sales were by far the most popular exit routes for private equity in 2022, making up 87% of exits, highlighting the maturity of the European secondary marketplace.[2.1]

While IPOs have the highest probability of top quartile returns of any exit route - more than 50% of IPO exits involved top quartile performers - the low volume (7%) shows that this option only comes to fruition in a small number of cases.

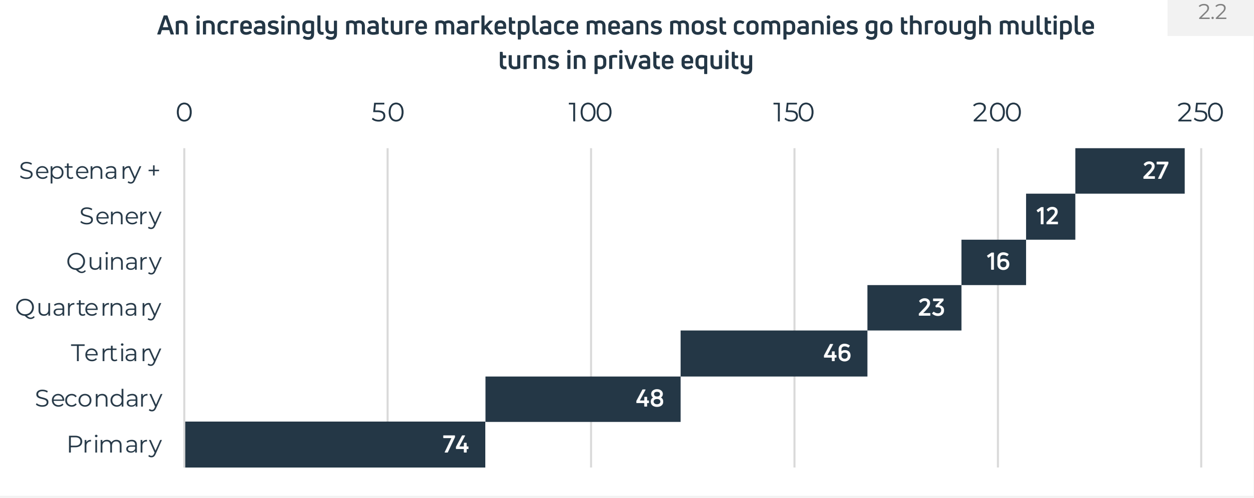
In contrast, trade sales are less likely to deliver Q1 performance, with returns frequently falling within the third and fourth quartiles, accounting for 58% of trade sales. This trend works in favour of corporates, which can purchase at a lower price to eliminate future competition and expand their market share.

More than two thirds (70%) of companies are completing more than one deal in their hold period, indicating an increasingly mature marketplace. Although, a decline in the number of primary investments (from 83 to 74) could also have a negative effect on income streams and new business.

2.1



2.2



Designing the leadership team for impact and advantage

Key Insights

- 98% of upper quartile exiting companies made at least one change to their SLT throughout the hold period
- Upper quartile performers make key leadership decisions an average of 20 months into the hold period, compared to 51 months for lower quartile
- Upper quartile companies made an average of 4.7 SLT changes during the hold period, compared to 4.4 for lower quartile companies

Upper quartile performers make more leadership change...

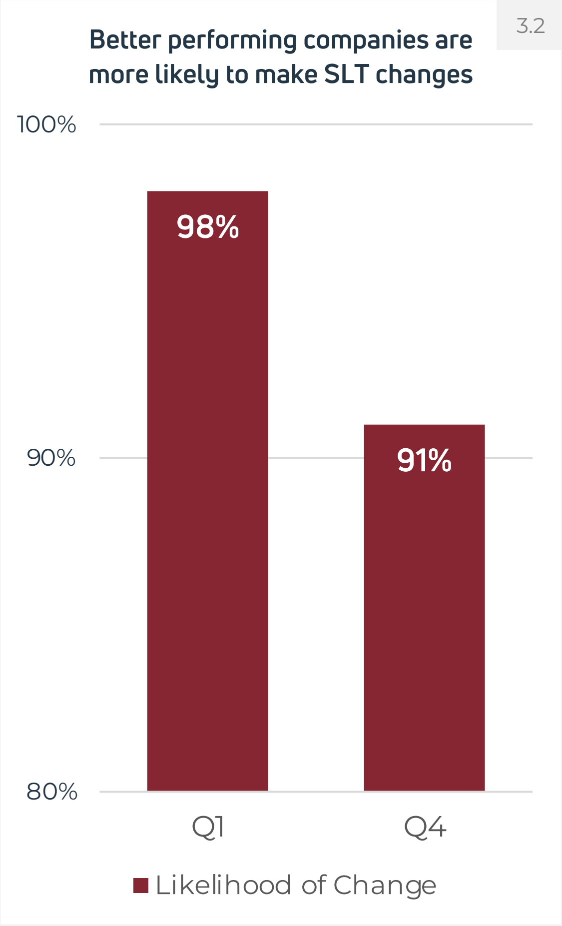
Having an effective senior leadership team (SLT) is one of the most critical value creation drivers for private equity backed businesses. New business ownership means new priorities and plans, and leadership change is invariably one of the best ways to ensure the SLT has the right mix of competencies to deliver the value creation plan, overcome challenges, and drive growth.

Our analysis backs this up, showing that, amongst 2022 exit deals, upper quartile companies made the most leadership change, with 98% making at least one, compared to 91% of lower quartile companies[3.2]. This amounts to just one in 50 upper quartile companies that didn't make any leadership change, compared to one in ten of the lower quartile. Upper quartile companies also averaged a greater number of leadership changes during the hold period, making 4.7 compared to 4.4 for those in the lower quartile.[3.3]

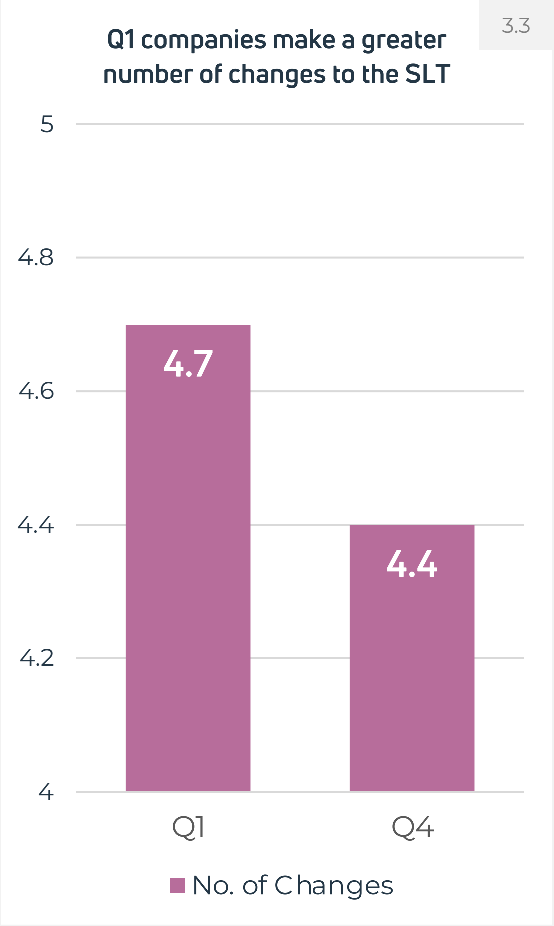
...and they optimise the team sooner

It isn't just how much change that is important but also when it is made. Upper quartile companies take key leadership decisions on average 20 months into the hold period, compared to over 50 months amongst lower quartile companies[3.1]. Making decisive, proactive change is clearly linked to performance, ensuring leadership teams are ready to make an impact as soon as possible and have time to implement their plans. In contrast, delayed decision-making points to a failure to prioritise leadership and have objective leadership conversations, leading to reactive hires, and a detrimental impact on performance.

3.1
Q1 companies make change significantly sooner
Months into hold period
60
50
40
30
20
10
0
20 Months
51 Months
Q1
Q4



3.2
Better performing companies are more likely to make SLT changes
100%
90%
80%
98%
91%
Q1
Q4
Likelihood of Change



3.3
Q1 companies make a greater number of changes to the SLT
5
4.8
4.6
4.4
4.2
4
4.7
4.4
Q1
Q4
No. of Changes

2. Top performers secure the right CEO early

Key Insights

→ **58% of upper quartile and 67% of second quartile businesses switched their CEO in the first two years**

→ **Lower quartile businesses changed CEO an average of 4.6 years into the hold period**

→ **Lower quartile businesses are twice as likely to exit without a CEO as upper quartile businesses (17% vs 9%)**

The CEO

The upper quartile CEO typically serves as the anchor of the team, with the ability to engage across all areas but with a commercial orientation, bringing domain expertise and a high-degree of curiosity.

See pages 38-45 for more on the profile of an upper quartile CEO

Early CEO decisions put investors in control

Building value within a defined timescale means having the right CEO in place early, to shape company direction and culture. Yet CEO change isn't easy for investors, involving sensitive conversations with current leaders and the perceived risk of disruption. Consequently, many delay broaching the CEO issue.

But our analysis shows that taking proactive, early decisions about CEO alignment pays off, with 58% of upper quartile and 67% of second quartile businesses switching their CEO in the first two years - compared to just 37% of lower quartile performers[4.1]. Taking an early, strategic approach, backed up by data, puts investors in control and avoids the need for reactive hiring later.

Delaying CEO decision is costly

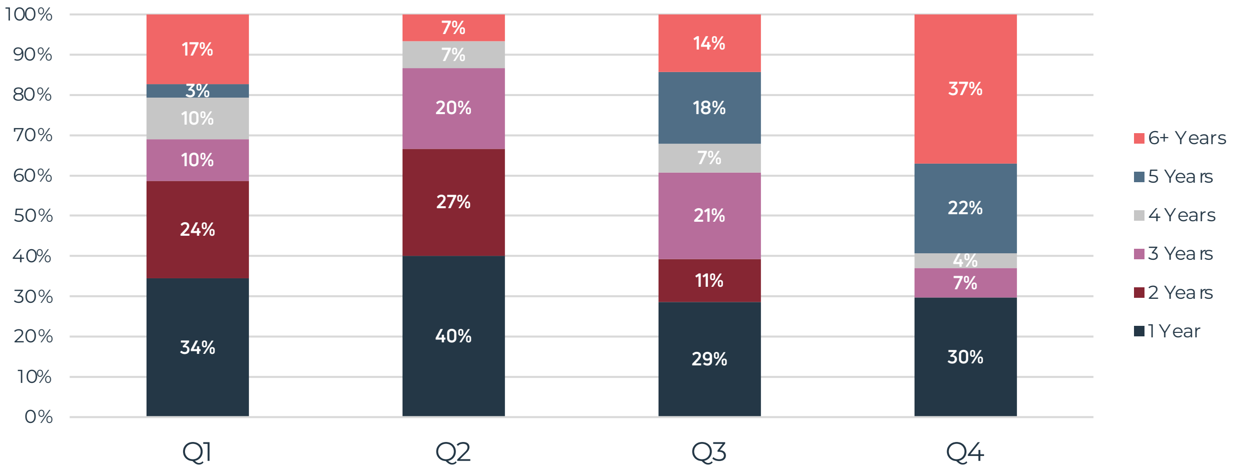
In contrast, the cost of delaying can be high. In 22/23, lower quartile companies changed their CEO an average of 4.6 years into the hold period – compared to 2.6 years for upper quartile performers[4.2] - with half waiting more than five years[4.1].

This suggests businesses have lost direction, in part due to a failure to adequately address leadership needs at the outset, leading to reactive change and a new CEO with very little time to make an impact. It is little surprise then that making late CEO change also lengthens the hold period, by almost one month for every month of delay, putting further pressure on exit timing.

A lack of leadership strategy is further demonstrated by the fact that lower quartile companies are almost twice as likely to exit without a CEO in place; 17% compared to just 9% of upper quartile businesses[4.3]. This suggests a failure to put a strategic succession plan in place and optimise leadership around building a secure and sustainable path to exit.

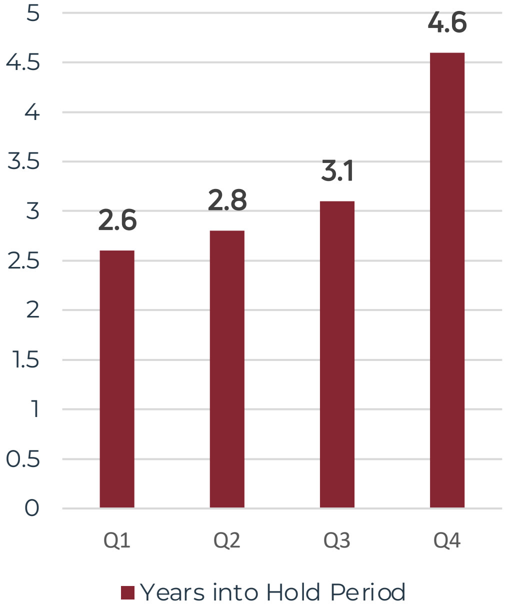
4.1

Best performing companies make a larger proportion of early CEO changes



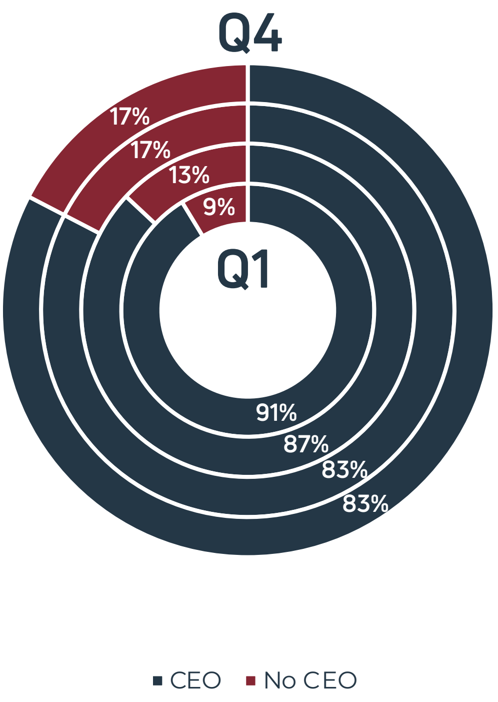
4.2

The worst performing companies change their CEO later into the hold period on average



4.3

Better performing companies are more likely to exit with a CEO



3. Strong CEOs are leadership team builders

Key Insights

- In upper quartile businesses, 84% of new CEOs evolved their SLT within a year
- Just 50% of CEOs in lower quartile companies did so
- CFO and COO were the most common follow-on leadership hires

Securing the right CEO early facilitates further team alignment

By making early CEO change, top performers are more likely to see further proactive leadership decisions within the top team, compounding the positive impact.

In upper quartile businesses, 84% of CEO change was followed by a further SLT hire within a year, while in 39% of cases it was followed by multiple further SLT changes[5.1].

Early CEO change affords businesses and their investors with the time and capacity to make further leadership decisions. Furthermore, a strong CEO will understand the importance of having the right competencies and behavioural complementarity around them and will proactively ensure that leadership optimisation and development happens.

In contrast, we see leaders in lower quartile businesses are being brought in later, more reactively and consequently are driving through less follow-on leadership alignment. Just 50% of lower quartile companies made another SLT change within a year, and 31% made multiple[5.1]. This suggests they are accepting the status quo, even if the balance of situational and behavioural competencies isn't right, thus potentially exacerbating the company's poorer performance.

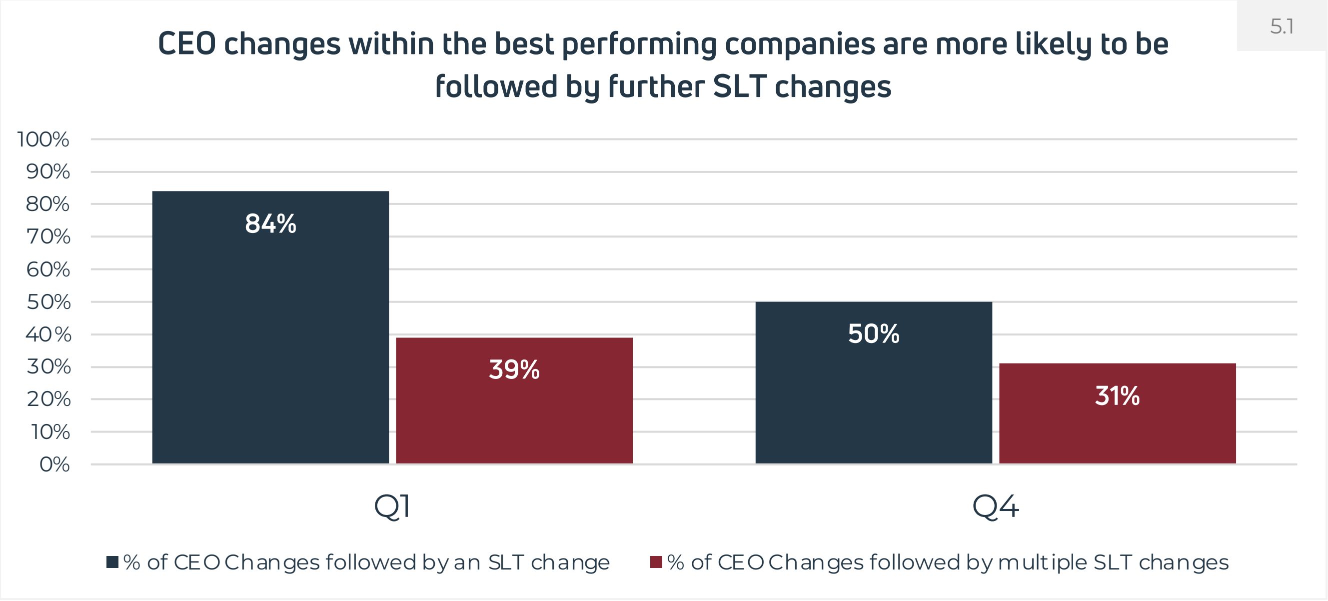
Which roles are new CEOs prioritising?

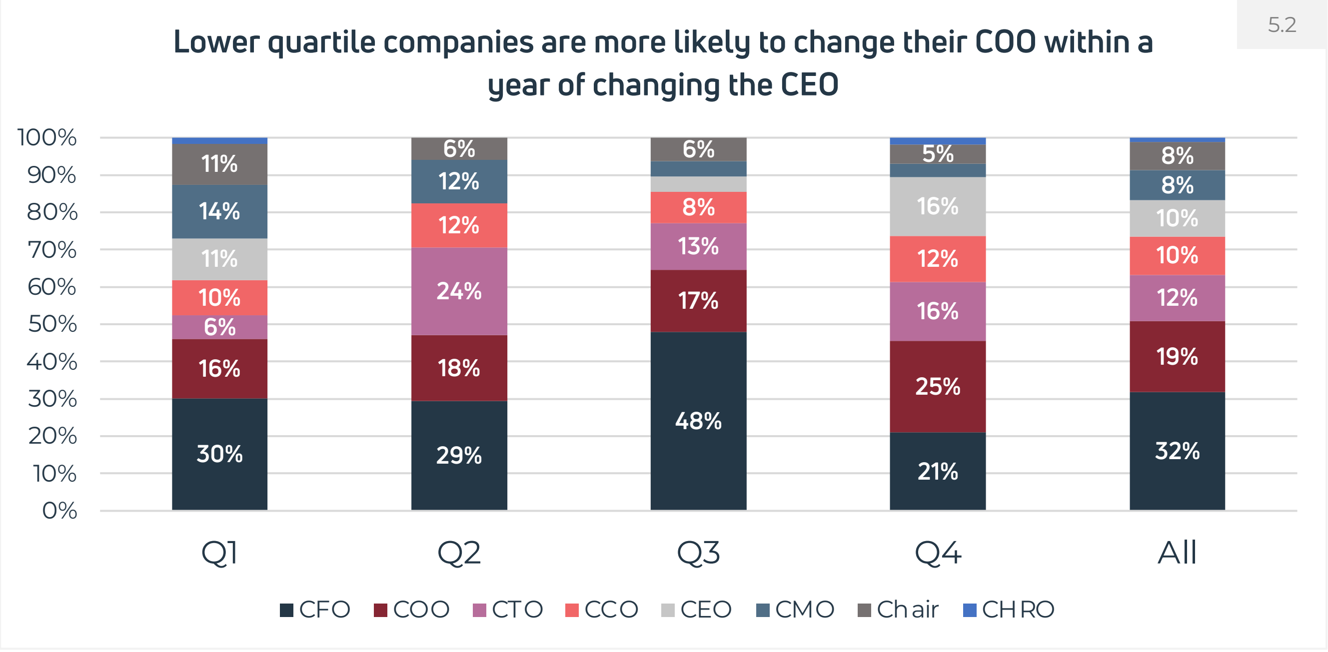
In around a third of upper quartile businesses (30%), a new CEO was followed by a CFO hire[5.2], pointing to the criticality of the relationship for governance, strategic direction, and value creation through M&A. A further 16% brought in a new COO, where complementarity with the CEO is crucial to provide a counterbalancing force.

However, interestingly, chart 5.2 also highlights a correlation between the frequency of follow-on COO hires and lower quartile performance (25%). One explanation for this could be that lower quartile businesses are making CEO change later, frequently as a reaction to performance issues. This means that subsequent change also becomes focused on addressing operational challenges, rather than enhancing the team for strategic or commercial priorities.

The CMO difference

Throughout our research, we see that one role consistently stands out amongst the top-performing businesses: the CMO. Often overlooked, upper quartile businesses consistently prioritise the CMO, as we can see here, with 14% of new CEOs making this change compared to just 4% of third and lower quartile businesses[5.2].





4. Late CFO switch piles on the pressure

Key Insights

→ **Three quarters of upper quartile companies (71%) brought in a new CFO**

→ **Upper quartile performers switched CFO on average 18 months sooner than lower quartile companies**

→ **A third of lower quartile CFO turnover happened 6+ years into the hold period**

The CFO

The upper quartile CFO brings a focus on value creation, measurement and crystallisation. With strong functional competence and experience of the growth journey, their strong execution helps ensure the team are delivering against value creation priorities.

See pages 38-45 for more on the profile of an upper quartile CFO

Top quartile performers more likely to change CFO

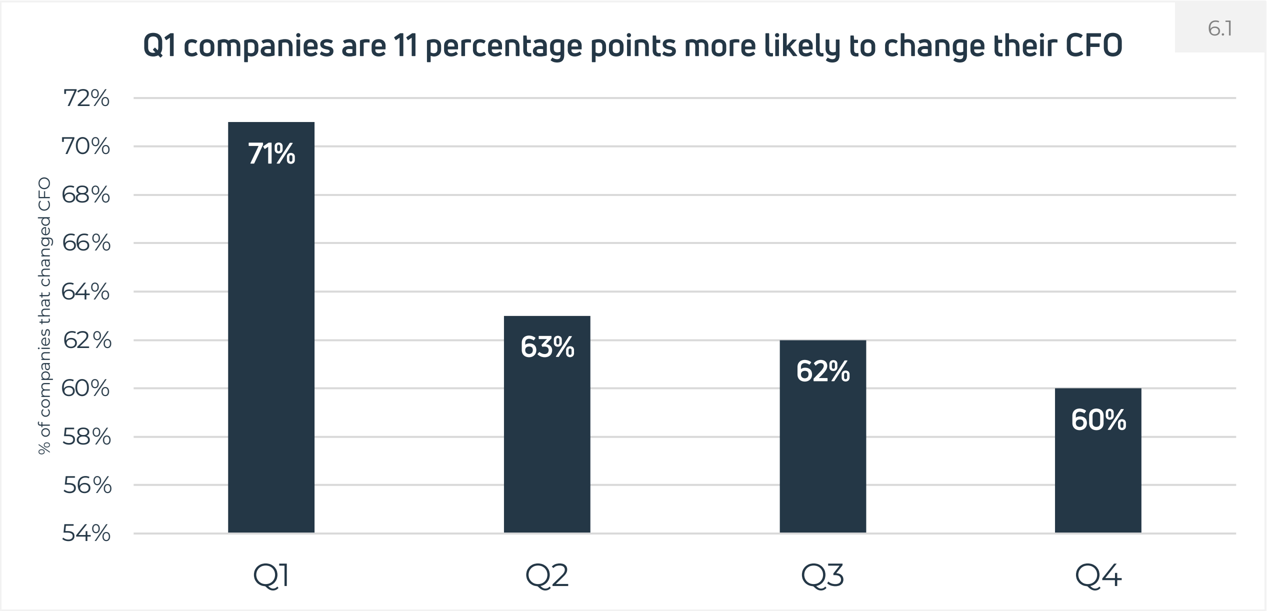
CFOs have a uniquely pivotal role in private equity backed businesses. Acting as the main conduit between investors and the SLT, they are relied upon to provide strong financial control and governance, regular financial updates, lead on M&A and expansion opportunities, and provide operational control for the rest of the SLT.

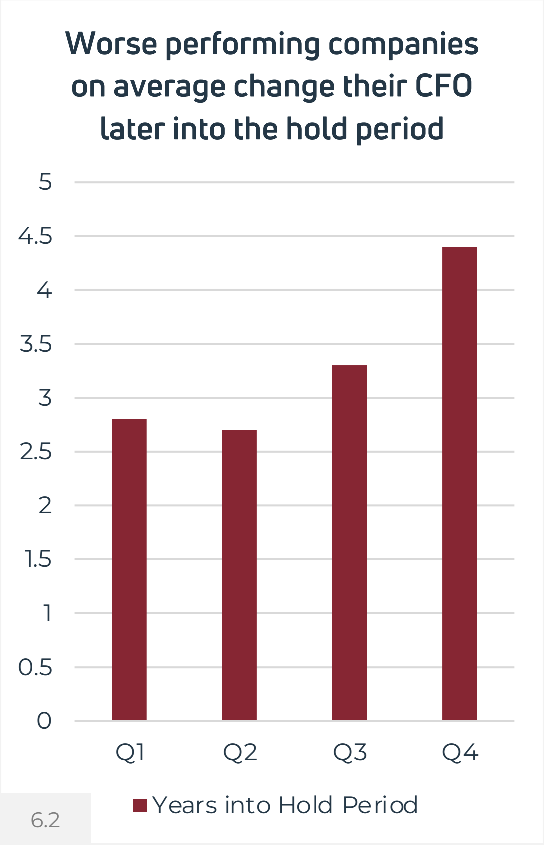
Their importance means investors frequently want to bring their own CFO on board and in 2022, it was the role most frequently changed, with 63% of all companies opting to bring in a new finance lead during the hold period. But, once again, it is upper quartile companies that are taking the most proactive approach, with nearly three quarters (71%) bringing in a new CFO - 11 percentage points more than those in the bottom quartile[6.1].

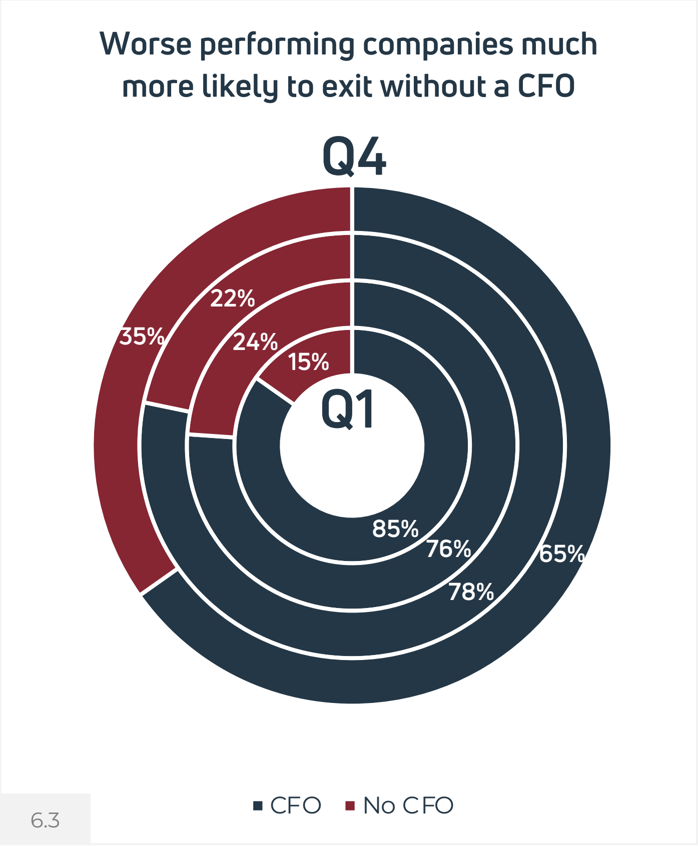
... and make early CFO decisions

The correlation between early, proactive decision-making and top performance also continues, with upper and second quartile companies wasting no time in bringing in a new financial head[6.2], doing so in just under three years on average.

The consequences of neglecting the leadership question are demonstrated by the fact that lower quartile CFO changes are significantly more likely to happen 6+ years into the hold period – a third are taking place at this late stage. These decisions are happening under pressure, without a strategic framework or succession plan, and can lead to a perpetual cycle of poor performance and poor choices. This is further highlighted by the fact that a third of lower quartile companies (35%) exited without a CFO in place, compared to just 15% of those in the upper quartile[6.3].


6.1
Q1 companies are 11 percentage points more likely to change their CFO
% of companies that changed CFO
72%
70%
68%
66%
64%
62%
60%
58%
56%
54%
71%
63%
62%
60%
Q1
Q2
Q3
Q4


Worse performing companies on average change their CFO later into the hold period
5
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
Q1
Q2
Q3
Q4
Years into Hold Period
6.2


Worse performing companies much more likely to exit without a CFO
Q4
Q1
35%
22%
24%
15%
85%
76%
78%
65%
CFO
No CFO
6.3

5. Complex COOs vital to get right

Key Insights

- → 47% of upper quartile businesses introduce a new COO within two years
- → 36% of lower quartile businesses switch COO 6+ years into the hold period
- → Second and third quartile businesses are the most likely to exit with a COO (63% and 50%)

The COO

The upper quartile COO provides a tactical focus on the delivery of value within the business, driving effectiveness and efficiency through a wealth of functional experience to maximise the ability of the business to deliver value.

See pages 38-45 for more on the profile of an upper quartile COO

A less clear archetype, but complementing the CEO is key

COO hires are amongst the hardest to get right, due to the fluidity of the role across different organisations. In the best performing businesses, COOs tend to be a foil for the CEO, so their appointment is highly dependent on the CEO profile. Hence, as with the CEO, we see that upper quartile companies are more likely to secure the right COO early – 47% do so within two years, compared to just 20% of Q4 businesses[7.3]. Settling a COO into the business early is also critical to ensure that the operational 'plumbing' is ready to scale.

Reactive COO change a sign of operational issues

In contrast, lower quartile businesses are significantly more likely to make late, reactionary COO decisions; 60% changed their COO more than four years into the hold period compared to 35% of upper quartile performers. This points to operational issues coming to the surface at a later stage, driven by a failure to make key leadership decisions early, particularly in relation to the CEO. Consequently, we see misalignment with value creation and business challenges – ultimately impacting exit performance.

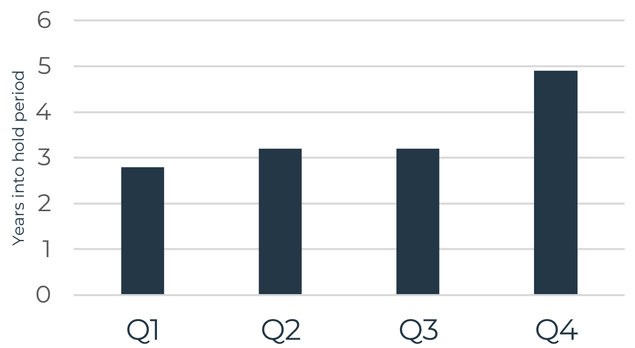
COOs critical for smaller leadership teams

Interestingly, it is second and third quartile businesses that are the most likely to exit with a COO (63% and 50%)[7.4], whereas the figure is only 46% in upper quartile businesses,

This is most likely explained by these businesses having smaller leadership teams which make a strong operational lead more important, to compensate for the absence of specific commercial functions such as CRO, CCO, CMO or CTO. In these businesses, COOs are often seen as a 'deputy CEO'.

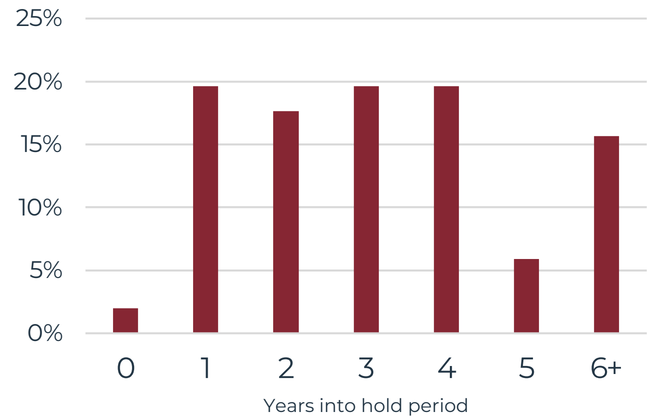
7.1

The average COO change for Q1,2,3 companies was similar, but Q4 companies typically saw a much later change



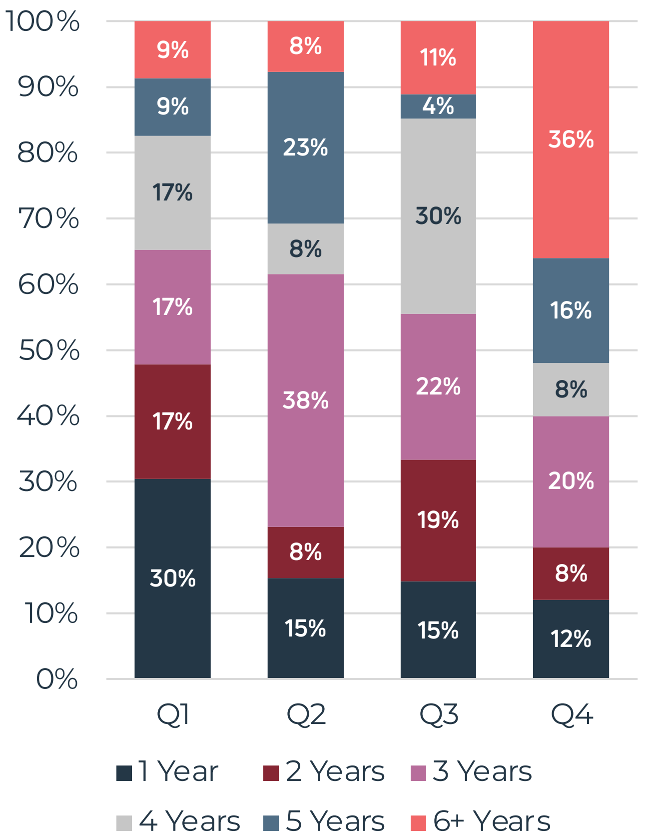
7.2

COO changes remain consistent throughout the hold period



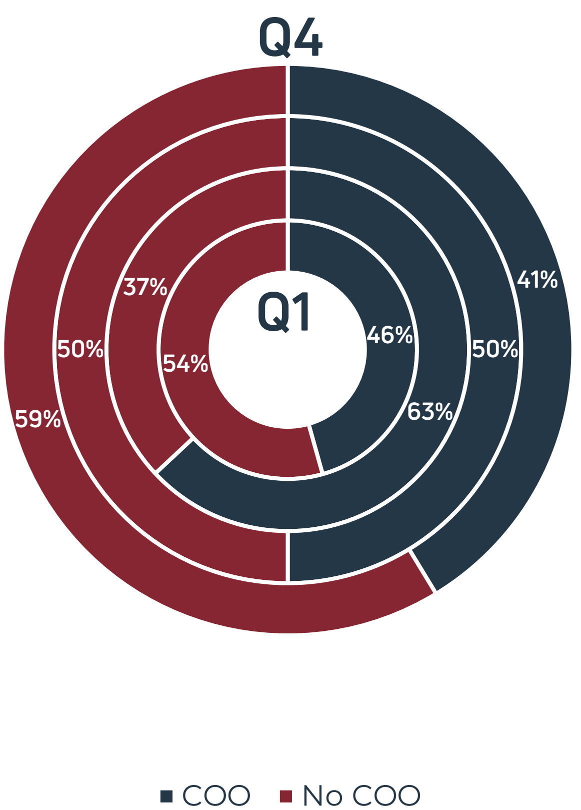
7.3

Q4 companies make a very significant number of COO changes 6+ years into the hold period



7.4

The best and worst performing companies are more likely to exit with a COO



6. Making the CTO decision early allows for digital impact

Key Insights

- Around two thirds of upper and second quartile businesses introduced a CTO in the first two years
- Only 20% of lower quartile businesses did so
- The average lower quartile CTO switch occurred 6.4 years into the hold period

The CTO

Upper quartile CTOs drive long term value creation within the business, leveraging their situational experience and technology to maximise and sustain the value of the business moving forward.

See pages 38-45 for more on the profile of an upper quartile CTO

Digitise faster, benefit for longer

The role of Chief Technology Officer has risen in prominence for private equity backed businesses, as digitisation and innovation have become increasingly important value drivers.

In the best performing businesses, CTOs harness technology to drive performance, service and efficiency, driving higher margins and lower marginal costs that have a compounding impact year-on-year. Hence, maximising the potential of a strong CTO early is a major factor in success, with around two thirds of upper and second quartile businesses making CTO change in the first two years[8.3].

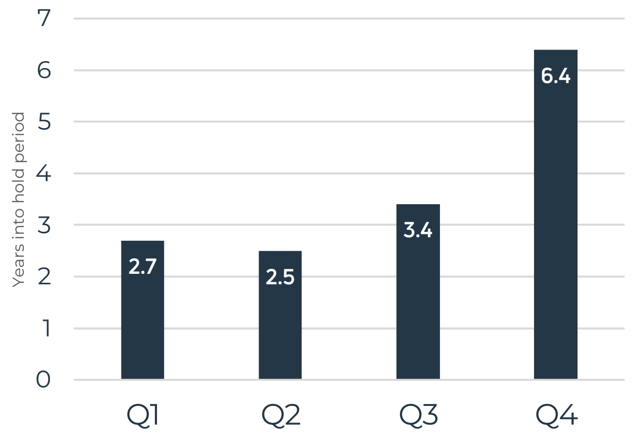
Late CTO alignment implies strategic issues

For that reason, late decisions are highly indicative of poor performance, with only 20% of lower quartile businesses changing the CTO in the first two years and the average lower quartile CTO change occurring 6.4 years into the hold period - over twice as long as in upper quartile companies[8.1]. This would imply a serious strategic issue, as having a meaningful impact is highly challenging at such a late stage.

Just one quarter of below average performing companies exited their value with a Chief Technology Officer in place, compared to 43% of upper quartile businesses that did so[8.4].

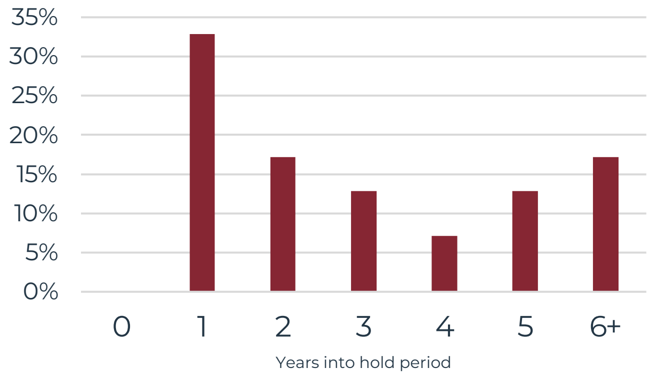
8.1

The average Q1 CTO change occurs in half the time of Q4

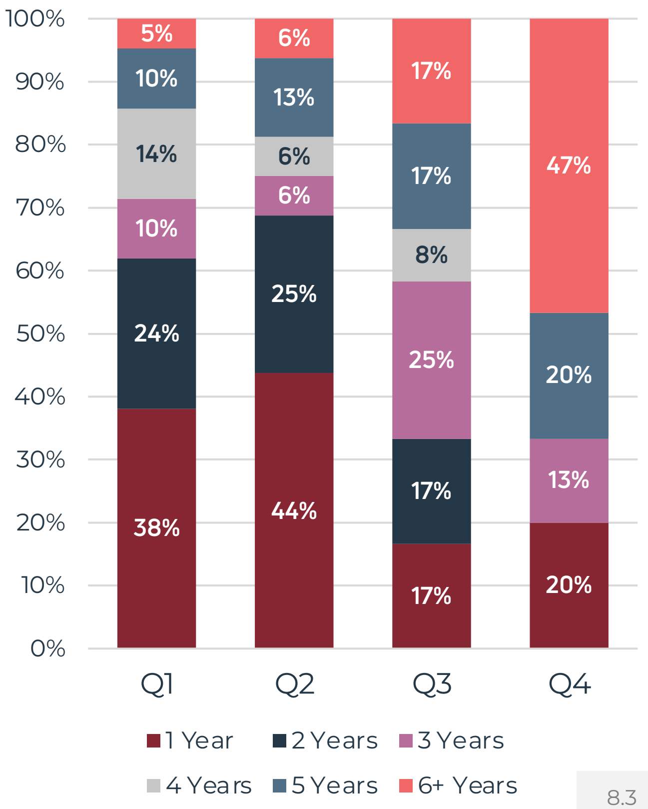


8.2

The proportion of CTOs changed decreased throughout the hold period, until year 4, then rises to exit.

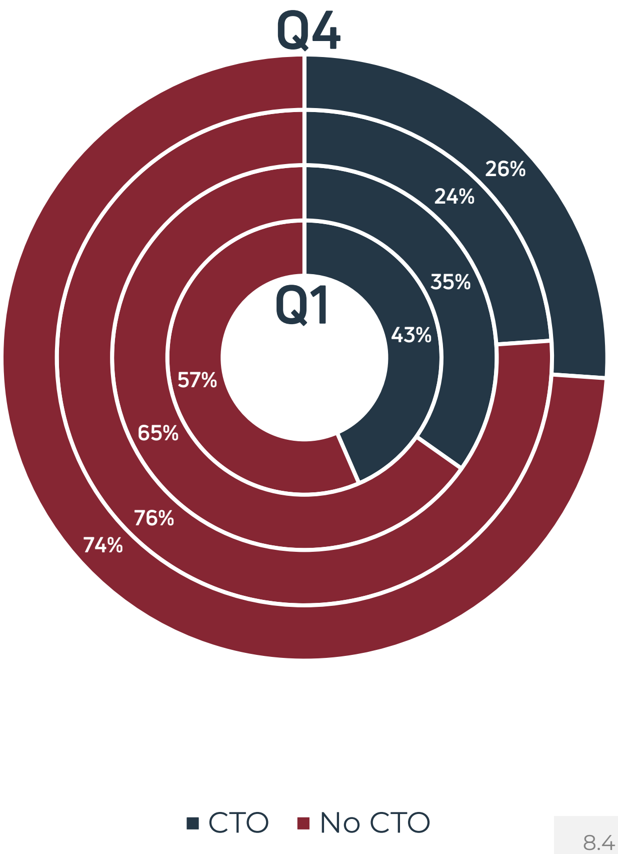


Above average performing companies make significantly more CTO changes within the first 2 years of the hold period



8.3

Below average performing companies are more likely to exit without a CTO



8.4

7. Upside of CCO change must outweigh risk

Key Insights

- → **Upper quartile companies were more likely to take the risk of CCO switch; 28% vs 17% of lower quartile**
- → **They also made CCO decisions earlier; 2.7 years compared to 3.6 years into the hold period**
- → **Lower quartile companies made 57% of CCO changes four+ years into the hold period**

The CCO

The upper quartile CCO possesses strong market expertise, tactical value creation focus, and high agility, supporting their responsibility for driving revenue growth.

See pages 38-45 for more on the profile of an upper quartile CCO

High bar for CCO change

As revenue generation and go-to-market strategy have moved up the business agenda, Chief Commercial Officers (CCOs), or Chief Revenue Officers (CROs), have cemented their place at the top table of private equity backed companies.

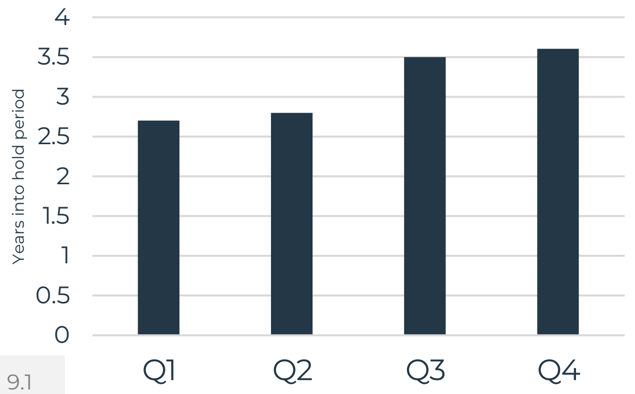
Yet their responsibility for the lifeblood of fast-growing businesses means that CCOs are also one of the positions that investors are most reluctant to change, with just under a quarter of exiting companies (23%) introducing a new CCO during the hold period. The disruption cost to sales teams and channels has the potential to out-weigh the possible upside and this breeds a high degree of caution.

But sooner is still better than later

Nonetheless, upper quartile companies are more likely to take the risk of seeking out a new commercial leader (28% vs 17% of lower quartile companies), and again make decisions earlier (2.7 years compared to 3.6 years into the hold period[9.1]), although the contrast is less pronounced than with other roles. Earlier change ensures that a new CCO has time to establish themselves and deliver the benefits of any sales or revenue transformation initiatives.

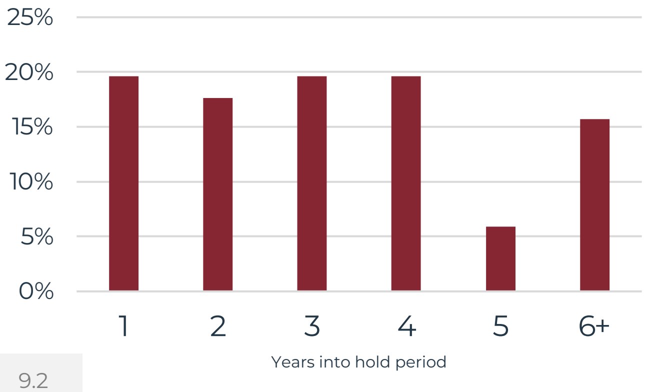
Overall, later changes are again indicative of poor performance; lower quartile companies made 57% of CCO changes four+ years into the hold period, compared to just 31% of upper quartile companies[9.3]. If a business is making such a risky leadership decision so late into the hold period, then it could indicate a serious issue, as could the fact that over three quarters of lower quartile performers are exiting without a CCO in place.

The best performing businesses make slightly earlier changes to the CCO on average



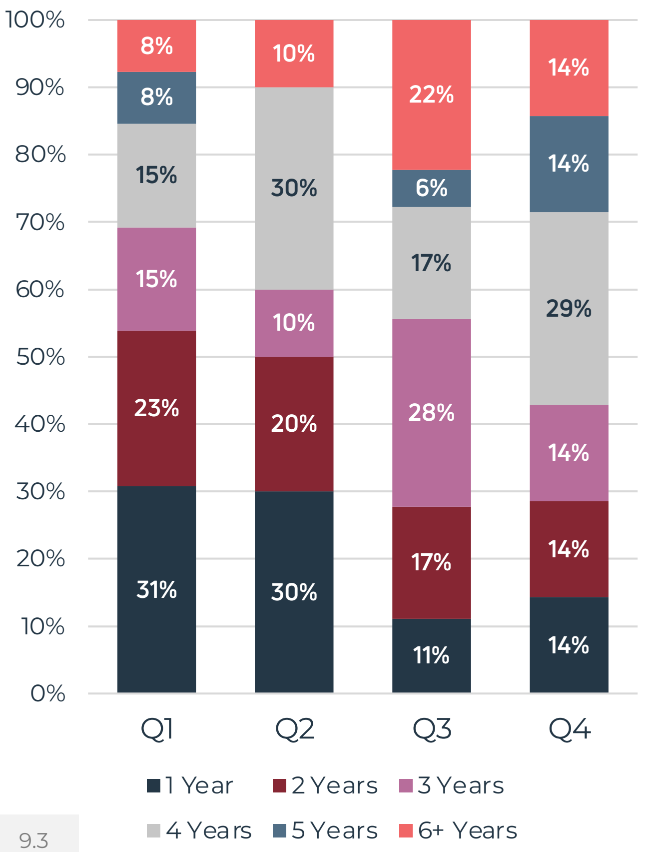
9.1

Reluctance to make CCO changes due to perceived risk drives a constant rate of change year on year



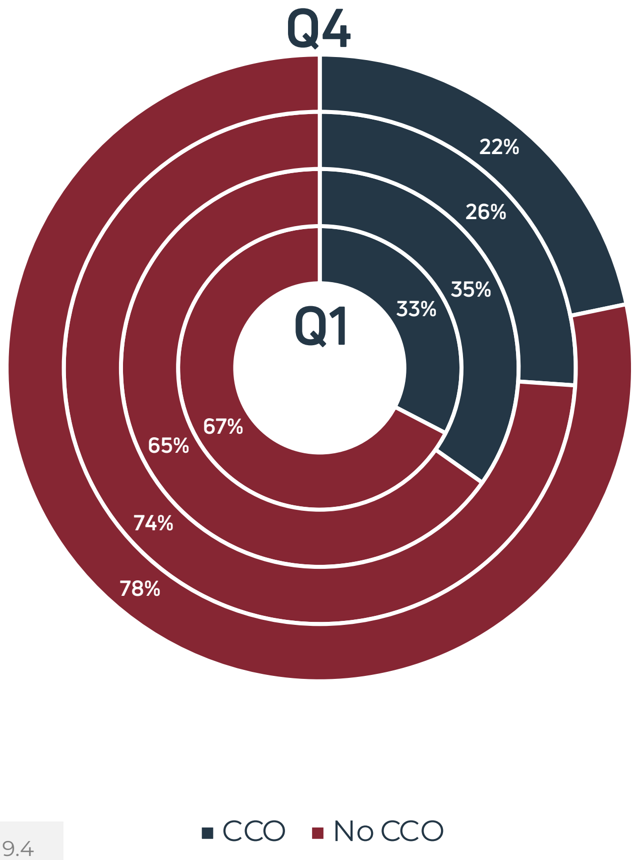
9.2

Worst performing companies make significantly more mid-hold period CCO changes



9.3

Above average performing companies are more likely to exit with a CCO



9.4

8. CMOs mark out upper quartile performers

Key Insights

- → **Over a quarter of upper quartile businesses introduced a new CMO (28%), compared to 7% of lower quartile companies.**
- → **Majority of CMO hires were within the first three years of the hold period (69%)**
- → **Upper quartile companies significantly more likely to exit with a CMO (26%)**

The CMO

The upper quartile CMO brings a high degree of curiosity, balances commercial and strategic focus and leverages situational experience to drive effective market engagement.

See pages 38-45 for more on the profile of an upper quartile CMO

Top performers significantly more likely to leverage a new CMO

CMOs are a relative rarity amongst private equity backed businesses, in comparison to other leadership roles. But that looks set to change, with the data consistently showing that the best performing businesses are prioritising the CMO.

Upper quartile companies were significantly more likely to introduce a new CMO; over a quarter (28%) did so, compared to just 7% of lower quartile companies[10.2]. These top businesses are adapting to the current climate where creating value through debt has become more challenging, by finding ways to drive more topline growth and scale more quickly. That, in turn, is boosting the potential impact of strong, scalable marketing.

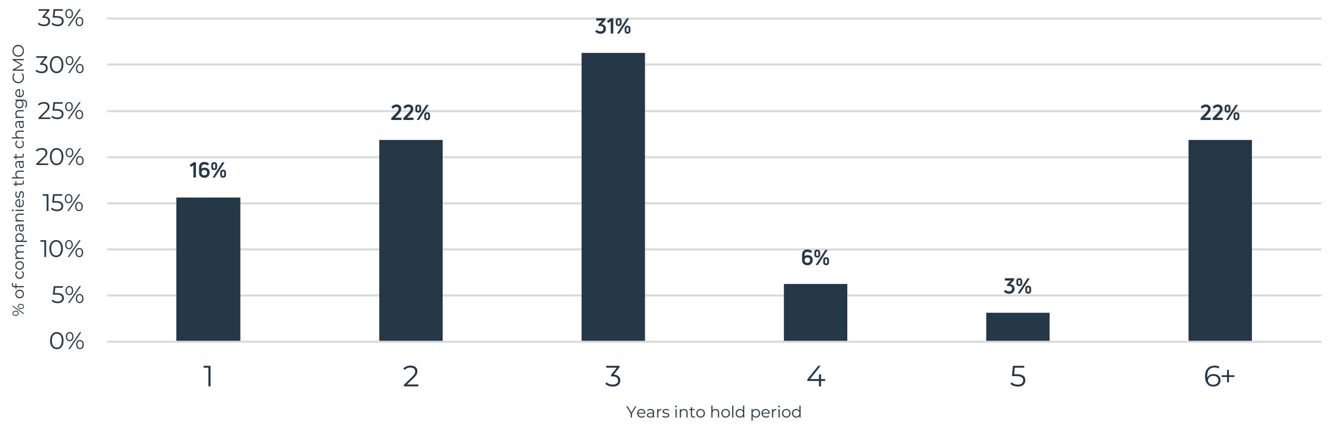
A step on the path to an upper quartile exit

But compared to other leadership roles, CMO decisions are not happening within the same rapid timescale, even amongst the best performing businesses. Instead, it tends to be a mid-cycle change, with the majority of CMO hires being made three years into the hold period (31%)[10.1].

By this time businesses have most of their leadership team in place, including the revenue, commercial and technology functions, to best leverage the potential of a CMO.

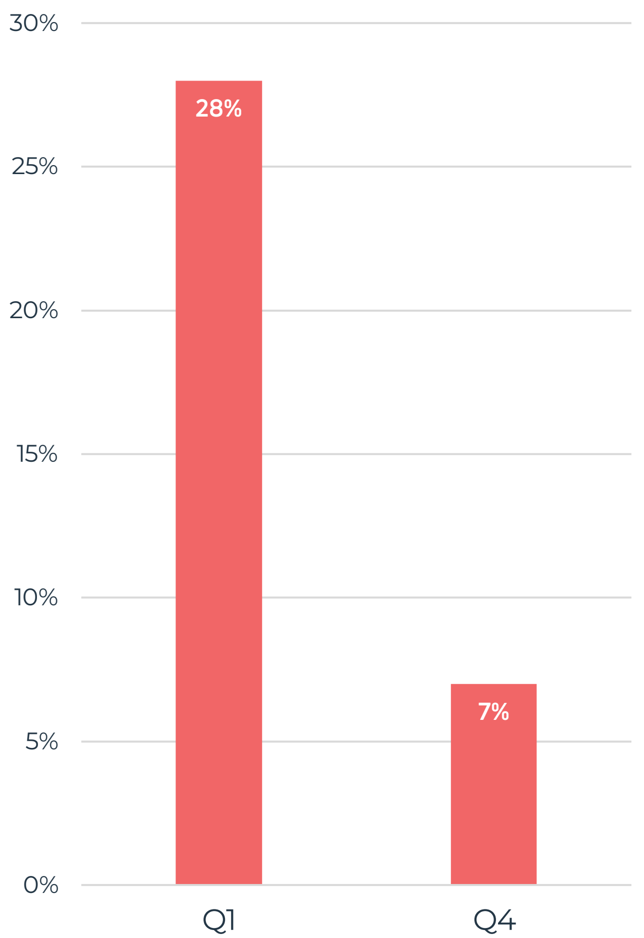
10.1

CMO changes increase throughout the hold period into year 3, then fall, indicating a particular sequencing to the introduction of this role on the SLT

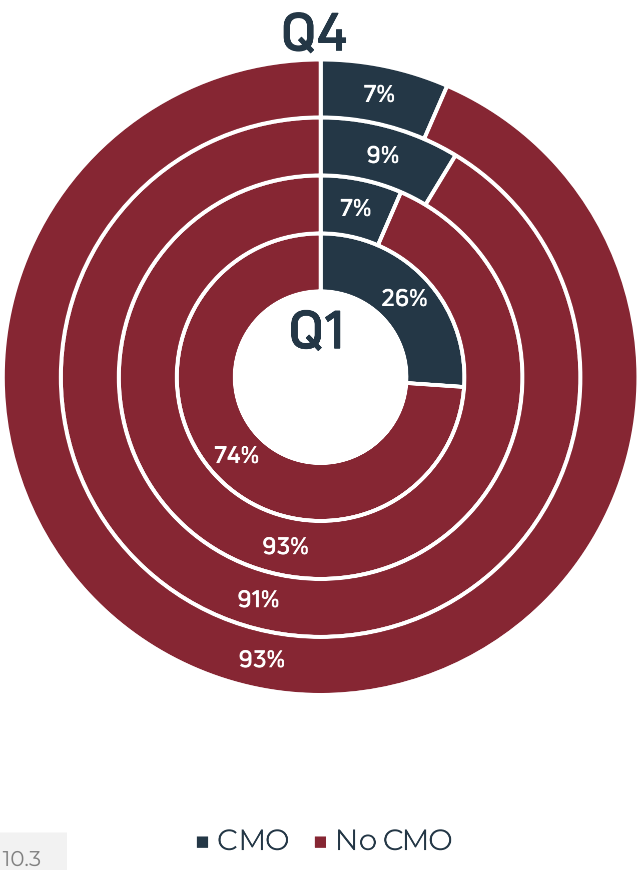


10.2

CMO rate of change



The best performing companies are more likely to exit with a CMO



10.3

9. Are Chairs being overlooked for tactical optimisation?

Key Insights

→ **60% of Chair decisions were made in the first two years.**

→ **Only 10% of new Chairs were introduced 6+ years into the hold period**

→ **43% of upper quartile companies exited with a Chair compared to less than a third of lower quartile companies.**

The Chair

The upper quartile Chair brings a wealth of value creation and market experience, has a strategic responsibility within the team and openness to new experience, thus ensuring priorities are developed and implemented.

See pages 38-45 for more on the profile of an upper quartile Chair

Investors reluctant to make late Chair decisions

More than any other role, Chair changes are skewed to happen early, with 60% made in the first two years[11.2]. But unlike the CEO and CFO, there is no spike in Chair hires as companies approach exit. In 2022/23, only 10% of businesses hired a new Chair more than six years into the hold period.

The right Chair for the right period of growth?

The timing of Chair decisions reflects the strategic nature of the role, and their responsibility for board oversight, however, it also suggests a tendency to overlook the Chair for potential optimisation later, as the business needs evolve. Chairs tend to be hired and then left alone until exit, and investors could be missing an opportunity to evaluate Chair performance and consider change later. Doing this could enable them to tweak the focus and competencies of the board as the business approaches exit.

Independent Chairs can drive performance

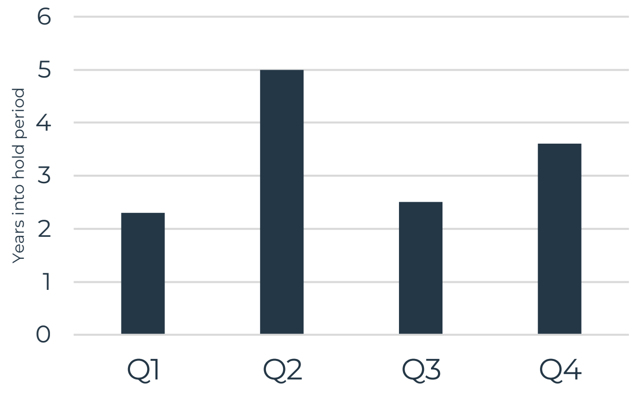
The high proportion of businesses exiting without a Chair is likely to be because many investors choose to appoint one of their own board advisors, rather than hiring an independent Chair. However, previous research[11.3] shows that this could be an oversight, with independent Chairs driving stronger returns by improving the cognitive diversity and objectivity of the leadership team.

Founder to Chair graduation is common, but must be planned

In founder-led businesses, it's common for the founder to graduate into the Chair position. For this transition to be successful however, it's critical to deploy meticulous succession planning. Most important is the need to find an effective new CEO who is more than just a replacement, but complementary to the original founder, now Chair.

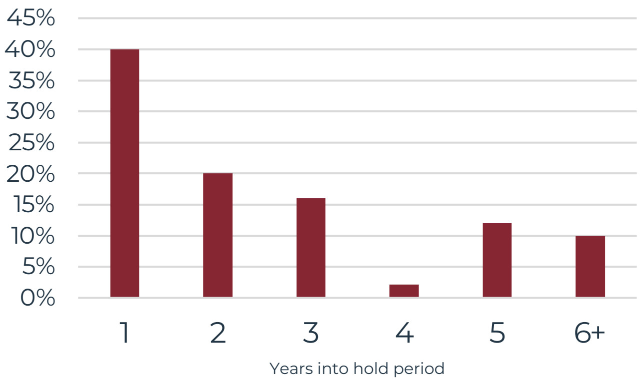
The best performing companies on average change their Chair earlier in the hold period

11.1

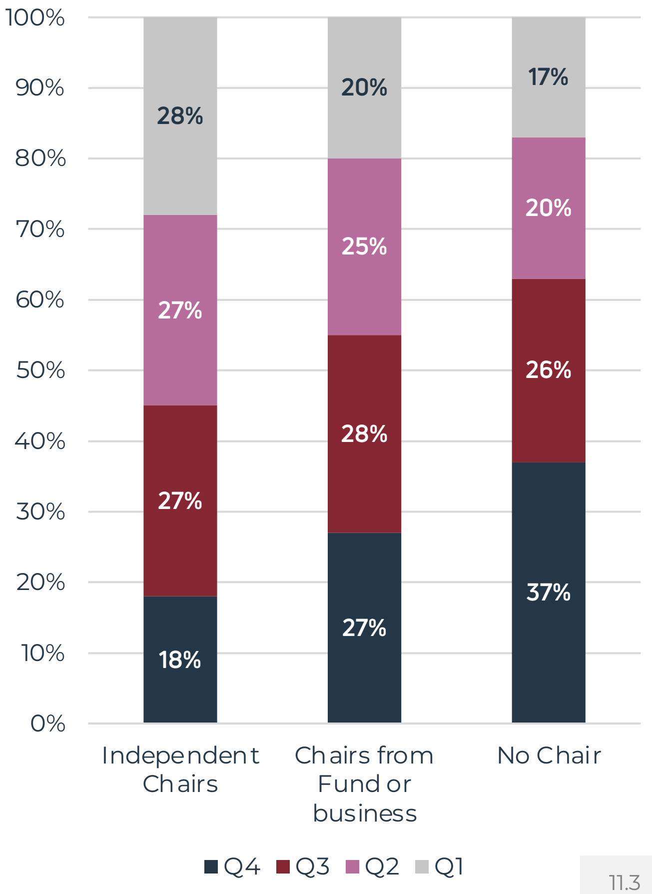


There is a clear pattern amongst Chair appointments, with most happening early in the cycle

11.2

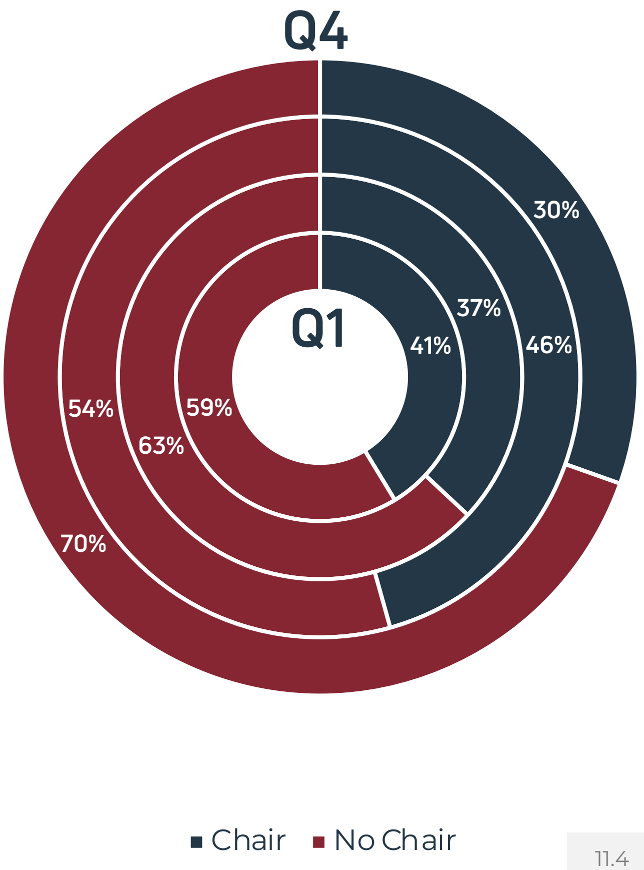


Upper quartile businesses are more likely to have independent Chairs



11.3

Worse performing companies are less likely to exit with a Chair



11.4

Profile of a top quartile leadership team

What is the optimal leadership team structure for performance?

Key Insights

- → **Leadership composition, structure and competencies key to optimal performance**
- → **Larger leadership teams give upper quartile businesses greater bandwidth to maximise potential**
- → **CTO and CMO stand out as more common in upper quartile businesses**

Making leadership change at the right time is a clear differentiator between the best and worst performing businesses. However, equally important is focusing on the composition, competencies and structure of the leadership team. Here, we analyse how PE backed businesses assess the competencies, behaviours and experience they need within individual leaders and across leadership teams, to ensure they can work effectively together to deliver the value creation journey.

A top performing C-Suite (modal leadership composition)

What does the typical C-Suite look like in different quartiles? The three most common roles are perhaps predictable across all businesses - CEO, CFO, COO.

Notably, Chairs are not within the top three most common roles despite the importance of the role. This can be explained by the fact that in 41% of instances the business does not have a designated chair, although this role could be filled by the Investor or Founder.

Furthermore, there are some notable differences linked to business performance. Only in upper quartile businesses do you see the CTO prioritised over the chair, demonstrating a greater focus on building value through digital change and impact, than on strategic oversight. Upper quartile teams also stand out due to the presence of a CMO on the board, as discussed elsewhere. These two roles point to a more strategically and commercially focused C-Suite, as opposed to one that prioritises management and governance, as can be found in lower quartile businesses.

Larger teams means greater capacity for change (median team size)

Better performing companies on average have larger leadership teams, giving them the bandwidth to consider a wider variety of distinct functional roles, and team dynamics. It is interesting to note however that lower quartile businesses have leadership teams equal in size to second quartile businesses and larger than those in the third quartile. In this instance, performance could, in fact, be compromised by the size of the leadership team, if the CEO lacks the capability to manage a large team, or the composition or competencies of the team are misaligned, making it more challenging to manage. In contrast, in the best teams, structure, competencies and behaviours are in alignment with the business needs.

Most Common SLT Composition, by quartile

12.1

Q1

CEO	Most common
CFO	
COO	
CTO	
Chair	
CCO	
CMO	Least common

Median size of SLT at exit = 7.2

Q2

CEO	Most common
CFO	
COO	
Chair	
CTO	
CCO	Least common

Most Common SLT Composition, by quartile

12.1

Q3

CEO	Most common
CFO	
COO	
Chair	
CCO	Least common

Q4

CEO	Most common
CFO	
COO	
Chair	
CTO	
CCO	Least common

Median size of SLT at exit = 5.6

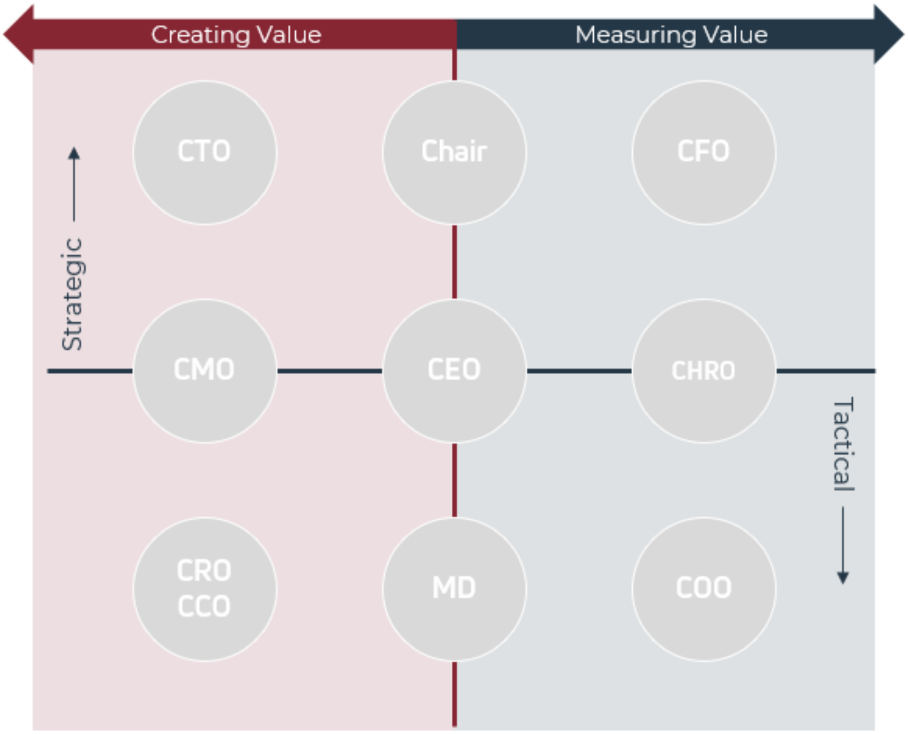
Key Insights

- **Upper quartile teams are focused on creating rather than measuring value**
- **More concentrated lower quartile team indicates less clarity of roles and responsibilities**

Leadership structure can also be assessed by looking at the functional balance of leadership teams and how this correlates with performance. **The functional balance chart** visualises a team based on depth of experience within key functional roles, and how it aligns with the value creation plan and the team's ability to deliver it.

The functional balance chart - Explained

The location of an individual on the chart represents whether they create or measure value (to the left or right of the Y-axis, respectively), and whether they are more strategic or tactical (Above or below the X-axis, respectively). Each position is designed to reflect the archetype of the specific role, based on real leadership team data. The size of the bubble represents how much experience that individual has within their function.



A focus on functional balance

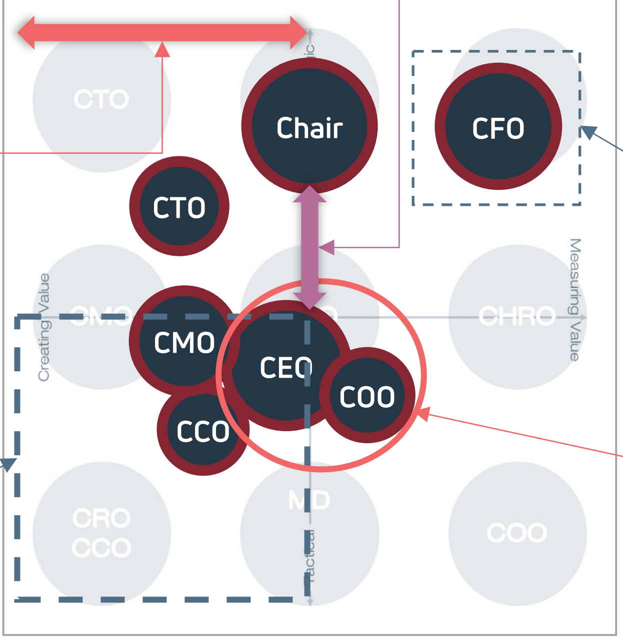
Q1

Upper quartile businesses have a general bias towards value creation and value capture, with four of the seven leaders on the left-hand side. This points to a commercial focus.

We see a concentration of roles in bottom left - CMO, CCO and CEO - sharing similar functional backgrounds. This suggests a greater agility to respond to market changes and maximise commercial opportunities.

13.1

The functional balance of a typical Q1 SLT has a clear balance across roles



The Chair spans an executive and non-executive role, complementing a CEO who is more tactical & commercially orientated.

A highly functional CFO complements and counterbalances the commercial bias of team.

Here the operational COO acts as a foil to the commercial CEO, complementing each others' strengths and weaknesses. In Q1 businesses, the CEO and COO also possess strong general management experience.

Q4

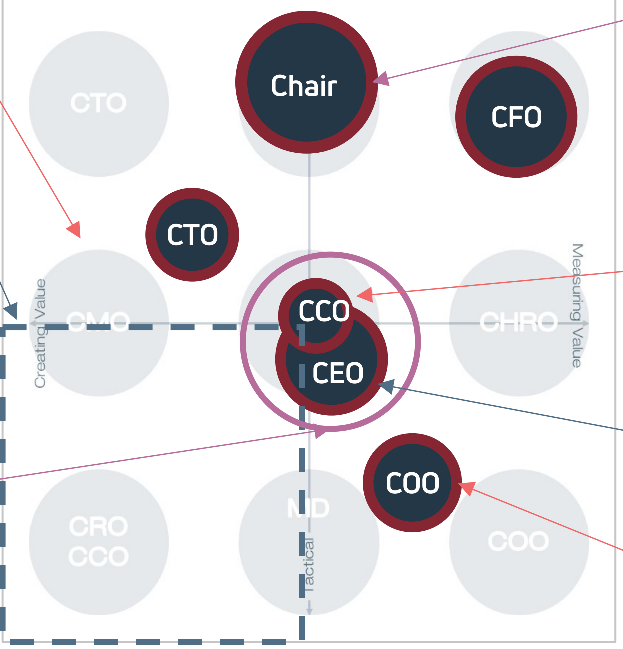
Lack of CMO

An empty bottom left quadrant indicates a general bias towards value measurement rather than value creation

Concentration of CEO and CCO in the centre of the chart indicates a high level of crossover in the competencies of these leaders, which is likely to become apparent through less clear and cohesive leadership.

13.2

The functional balance of a typical Q4 SLT has a higher degree of concentration among roles



Chair more strategic and hands off likely due to operationally sound CEO, but who is driving operational priorities rather than performance

CCO appears to be the least functionally experienced member of the team and a general manager by background

CEO is more operator than commercial

COO has a more functionally pure operational profile

Balancing domain and situational competencies

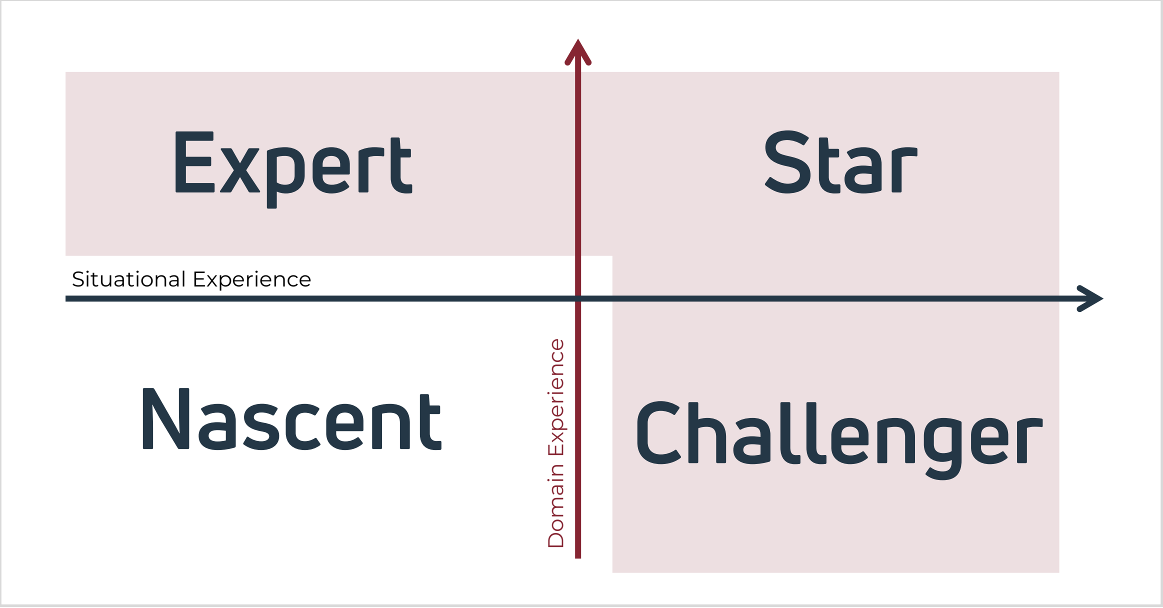
Key Insights

- **Upper quartile teams have a greater diversity of situational and domain experience**
- **Lower quartile teams have tightly concentrated experience, suggesting less diversity of perspectives**

The **leadership positioning chart** is where we can evaluate the domain (market) and situational experience of each leader, and the team, against the business's value creation strategy. This enables us to see how a leadership team can deliver against the investment hypothesis.

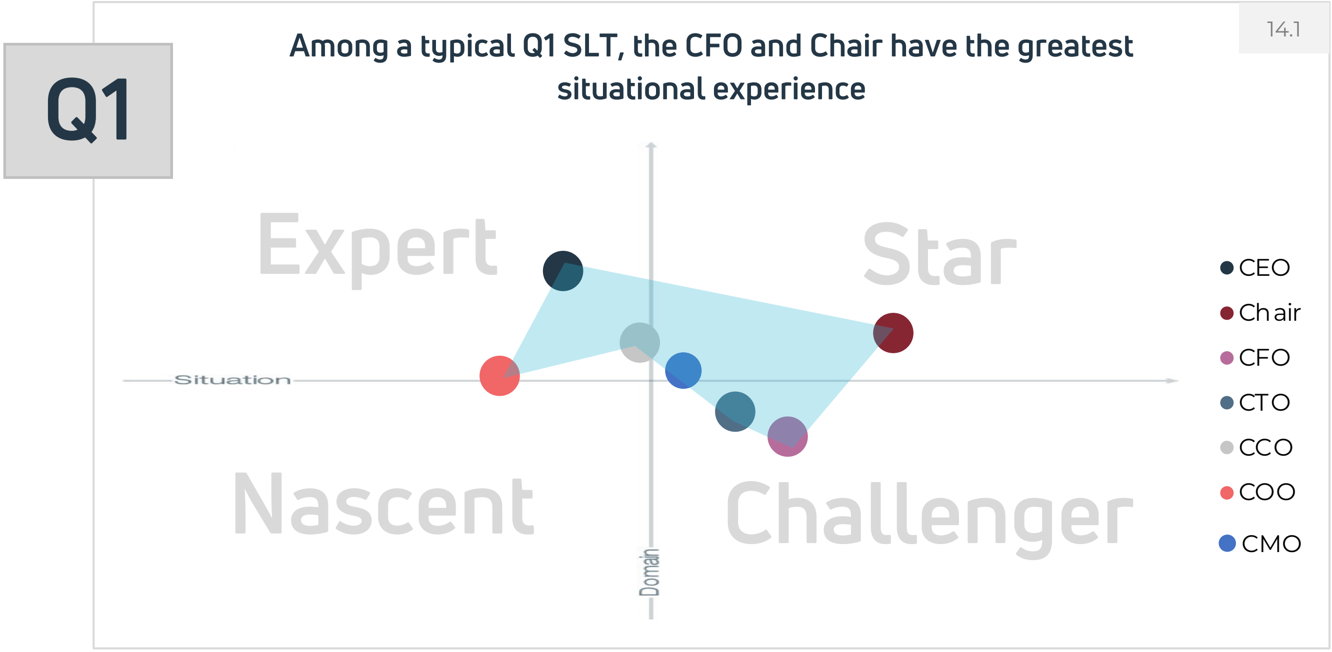
The leadership positioning chart - Explained

Ideally, a team should have a good balance of expertise across the Challenger, Expert and Star quadrants to provide a range of perspectives and capabilities.



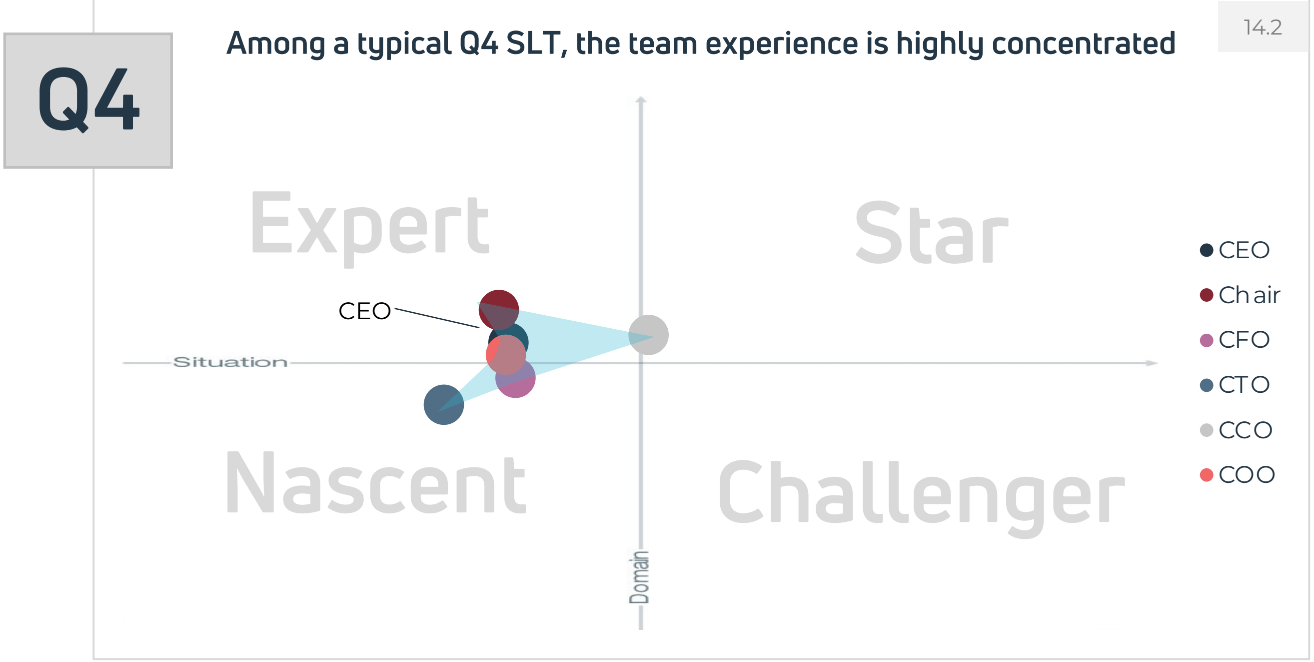
This is exactly what we see in upper quartile companies[14.1], where leaders are spread over the left and right sides of the chart, and across the Challenger, Expert and Star quadrants, indicating a diversity of situational and domain experience. Upper quartile teams are also differentiated by the presence of a very strong Chair in the Star quadrant to provide strategic direction and oversight. We also see that there are certain roles that lend themselves to a certain profile, for example, CTOs and CFOs are challengers and the CEO tracks highly for domain competencies.

Balancing domain and situational competencies



In contrast, lower quartile leaders are positioned closer together in the centre of the chart[14.2], indicating overlapping experience and a narrower range of perspectives and competencies.

A lack of experience in the Star and Challenger quadrants also indicates a shortage of knowledge of delivering the value creation plan, and instead a dominance of market knowledge. Some leaders appear to be nascent in their experiences, for example the CTO. This correlates with chart 15.1, indicating a greater focus on promoting junior talent over bringing in external expertise.



Key Insights

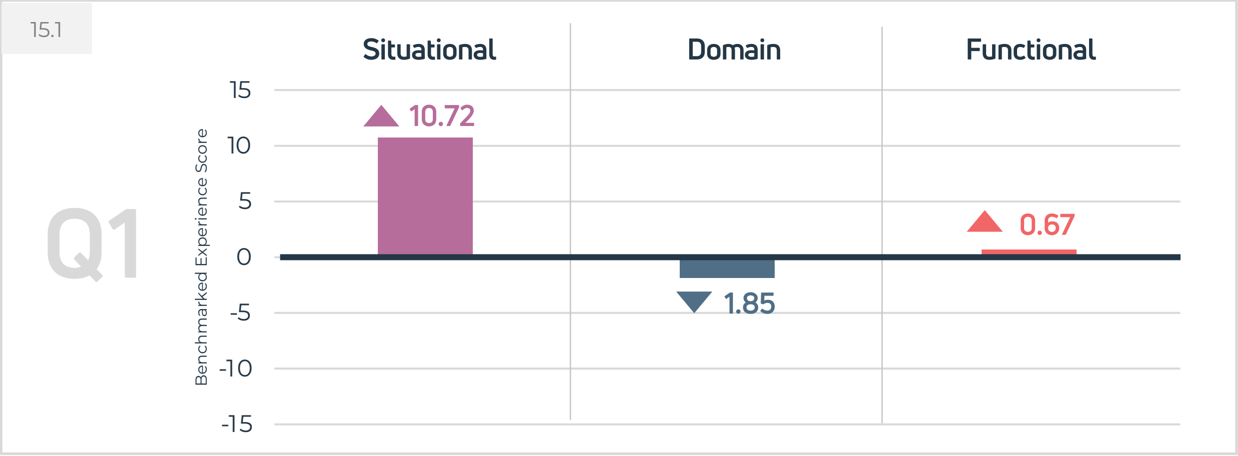
- → **Upper quartile businesses make leadership hires to boost situational experience**
- → **Lower quartile performers prioritise domain experience while sacrificing functional experience**

When optimising a private equity backed leadership team, the best performing businesses don't necessarily start better but they build better, by making leadership decisions that align with the needs of the business.

How does leadership change impact team competencies?

Whenever a leadership change is made, the team profile shifts based on the competencies of the new leadership hire. By analysing that change, we gain an insight into the leadership qualities that investors are prioritising and how that is impacting value creation and performance in the business.

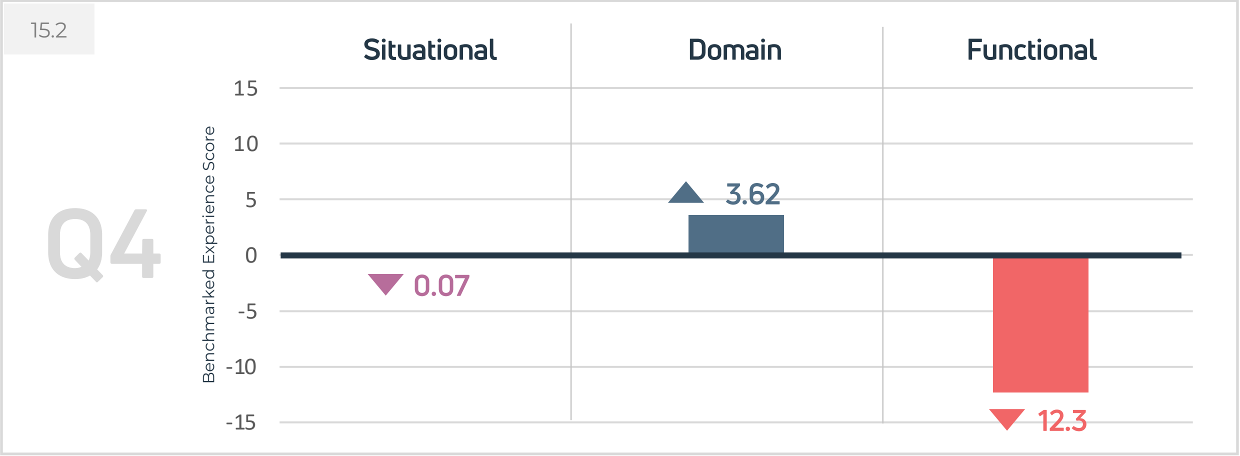
Upper quartile performers prioritise situational competencies when making change



Here, we can see that amongst upper quartile businesses, there is a clear trend towards hiring for situational experience, with a slight detrimental impact on domain competencies while holding steady for functional experience[15.1]. Upper quartile businesses are therefore putting a huge focus on finding leaders with experience and knowledge of the value creation journey, even sacrificing market knowledge to get it. And based on their financial performance, this is having a positive impact.

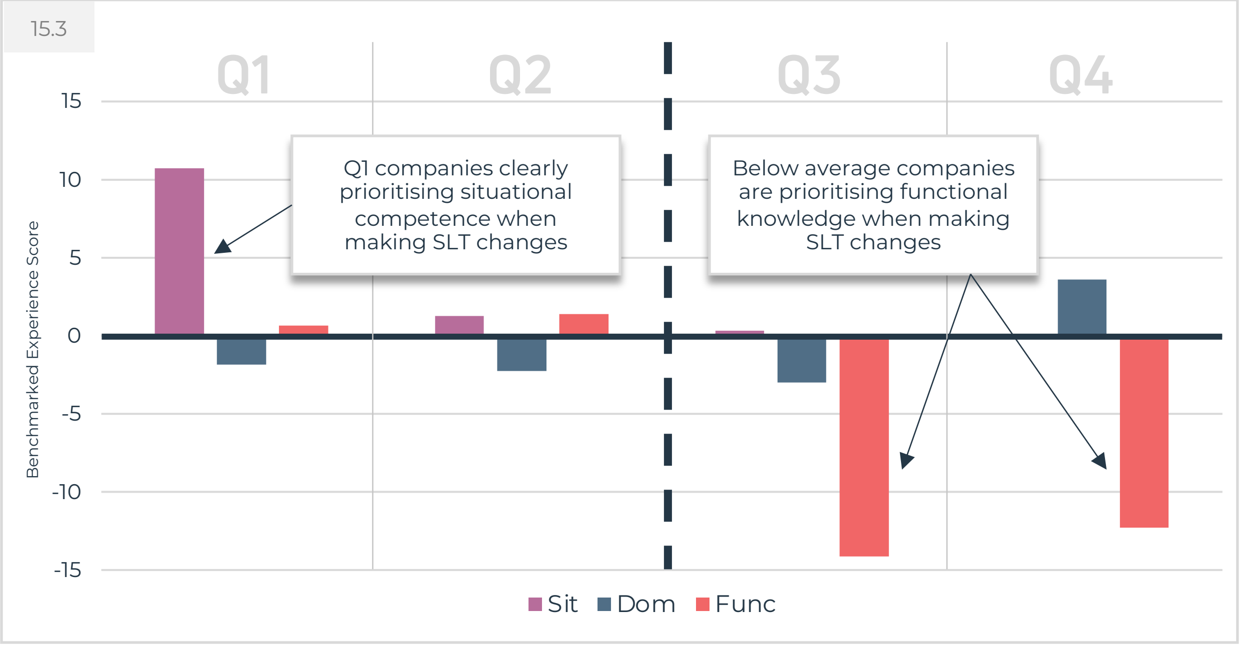
Building better by leveraging situational experience

Worst performers prioritise domain competencies when making change



In contrast, lower quartile businesses are hiring to boost domain experience, while seeing a significant reduction in functional experience and a slight reduction in situational experience[15.2]. This suggests that investors in these businesses are more focused on hiring junior talent moving through the ranks, rather than looking externally for the ideal mix of competencies for the business and value creation plan. This is compromising the performance of the team and the business. Promoting junior leaders also suggests a desire to hire individuals who are less threatening to the existing team.

The experience each quartile prioritises when making change, side by side



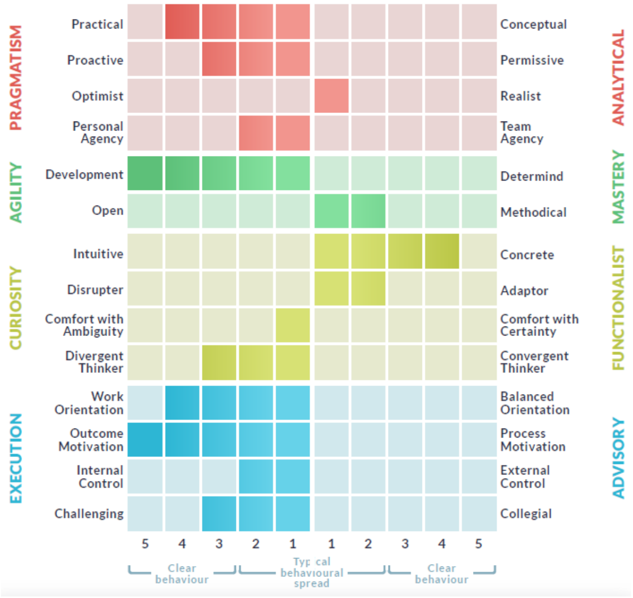
Key Insights

- → **Upper quartile teams score highly for Pragmatism, Agility, Curiosity and Execution**
- → **A diversity of behavioural profiles within upper quartile teams ensures effective interaction and collaboration**

About PACE

PACE stands for Pragmatism, Agility, Curiosity and Execution: and is the No.1 Private Equity behavioural evaluation, that allows high-performing leaders to understand their strengths, weaknesses, and the key to developing their performance levels. It is the only behavioural evaluation benchmarked against private equity executives, designed for the unique leadership demands of venture, private and growth capital.

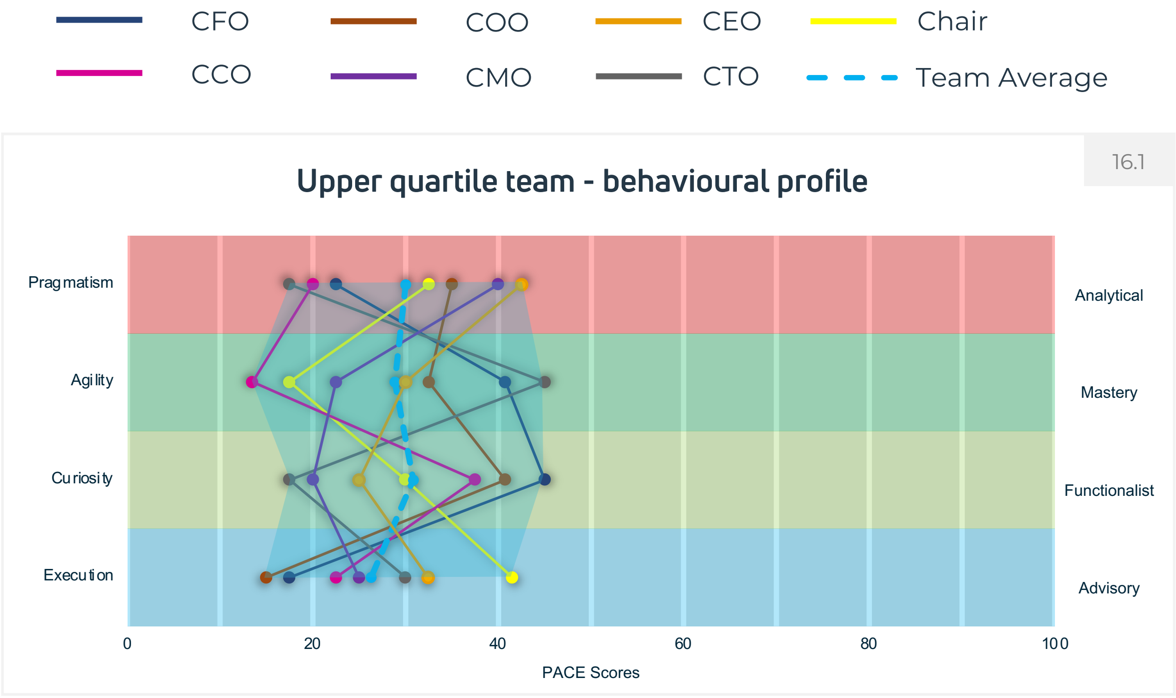
Each leader has an individual PACE profile, an example of which can be found below. The profile captures the typical behaviours of that individual, and how they score for Pragmatism, Agilty, Curiosity and Execution; the behaviours that are critical for success in fast-paced, high-growth businesses. Individuals who are strong in these areas are positioned towards the left of the chart.



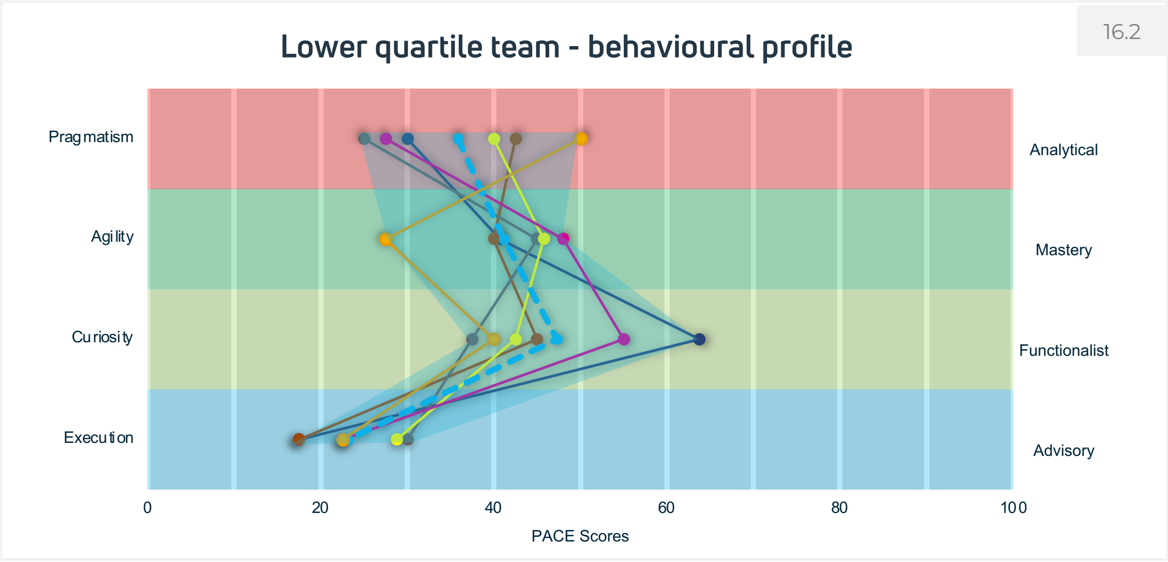
When analysing the behavioural profile of a team, each individual's profile is mapped alongside their colleagues to understand how the group will interact as together. Team interaction is a greater predictor of how they will perform together and of the overall outcome for the business.

As for individuals, our previous analysis has found that the best performing teams score highly for the PACE behaviours (positioned further to the left on the chart), but also show variation between individual leaders, to provide balance and cognitive diversity.

Becoming one: Maximising complementarity and cognitive diversity



Upper quartile teams in 2022/23 score more highly for the PACE behaviours[16.1], with a balance across all four behaviours, and avoiding any significant outliers, which can hinder effective collaboration and be a source of frustration, particularly in the case of the CEO. Upper quartile teams also avoid a high concentration in one area, which would result in group think and negatively correlate with performance.



The lower quartile leadership team looks quite different on the PACE chart[16.2], positioned further to the right side of the chart and therefore scoring lower for PACE behaviours, with less of a spread of behaviours and some concerning outliers. Consequently, lower quartile teams will struggle to collaborate and communicate effectively, or may struggle with groupthink, which impacts on decision-making and overall company performance.

From insight to action

Samuel Robberts, *Chief Strategy Officer at The LCap Group*

Private equity is operating within a turbulent, unpredictable world, and the skill of management in navigating uncertainty to build better, stronger companies and deliver alpha returns is even more critical. This message comes through loud and clear throughout our analysis, which shows time and again that a proactive approach to leadership optimisation drives performance.

Investors in top-quartile companies are making leadership decisions a strategic priority, within their first 20 months of ownership. This affords them the time to take a considered approach, to address exactly what competencies will align with the business needs and challenges, and then focus on developing and building out supporting roles, including key commercial hires such as CCO, CMO and CTO, while ironing out any issues with team dynamics.

From insight to action

Allowing misaligned leadership to continue comes with a heavy cost. Where investors are hesitating, whether that is due to a lack of direction, or a reluctance to have objective conversations with existing leaders, this is potentially having a huge impact on their companies' growth trajectory.

It means that the top team isn't aligned with the needs of the business, causing delays in implementing the value creation plan and realising value; every month that CEO optimisation is delayed means a month longer exit. It puts investors and the leadership team under pressure as the runway for change decreases and any subsequent leadership change becomes more and more challenging as a result.

So how should investors approach leadership change to ensure success?

Make leadership decisions as early as possible, ideally pre-deal

Investors need to think ahead and proactively make leadership decisions as early as possible, to maximise the runway for growth. Leadership analytics mean that it is possible to assess the competencies of a leadership team before you even start working with them, at arms-length. Investors can analyse the balance of functional, situational and domain experience, start to identify any gaps, and even map out potential change or virtually test out new hires.

Use data to inform difficult conversations

Part of the reason that leadership change is often delayed is that discussing these issues is difficult. Incumbents are concerned about their own future, and investors don't want to sour relations, which means that the can gets kicked down the road, to the detriment of the company. Using leadership analytics provides investors with the objective data to facilitate objective leadership conversations, removing the emotion, and aiding decision-making.

Leadership is a team sport

While individual leadership hires are critical, effective leadership comes from ensuring the optimal balance of competencies exists across the whole team. Roles must be clearly delineated to avoid conflict, and the team should include a mix of domain, situational and functional experience. Finally, are the team compatible behaviourally? Not only will they get on, but will they bring out the best in each other, bring a variety of perspectives to the table, and challenge each other in a constructive way?

From insight to action

Focus on the journey

Outsized growth doesn't just come from having the best market knowledge, but how well you can turn a situation or market to your advantage. The best private equity backed leadership teams have critical situational experience of rapidly scaling companies; they understand the levers to pull and the challenges that they'll face along the way. Using leadership analytics enables investors to break down leadership experience by its core components, to ensure that the team has the right balance for success.

Proactive (rather than reactive) leadership planning

Leadership optimisation isn't a one-off activity. As any business grows and changes, so will the needs of the leadership team, and the sooner investors can plan the better. Leadership shifts can happen suddenly or gradually, and a failure to plan can leave a business unable to deliver on its objectives and deliver growth. Do you know what the leadership team will look like in five years' time? Or who will take over key roles if the unexpected happens? Leadership analytics mean it is possible to map out a transition plan for all eventualities.

Invest in leadership

Our analysis proves conclusively the difference that great leadership can make, so getting it right must be a top priority. Too often leadership decisions are avoided due to the perceived risk of disruption, or corners are cut due to budgets, time saving, or internal politics. But invariably this just delays the inevitable, impacting growth, extending the hold period and making it harder to turn things around later. Where leadership is concerned, it pays to get it right.

Ready to maximise your Leadership Capital?

Email contact@thelcapgroup.com

Call 0870 770 0252

Follow LCap on LinkedIn for more insight

Savoy Hill House,
7-10 Savoy Hill,
London,
WC2R 0BU

Thelcapgroup.com