

THE POWER OF PEOPLE: HARNESSING HUMAN CAPITAL FOR MAXIMAL RETURN

LODESTONE PEOPLE CONSULTING

A key belief that has shifted over the last few years for the private equity (PE) industry is the growing realization that leadership effectiveness is the foundation of deals success and investment returns. In AlixPartners' 2022 survey of PE executives*, leadership effectiveness emerged as the most important lever for creating value in portfolio companies, cited 70% more frequently than operational effectiveness.

However, despite acknowledging the importance of effective leadership, often old habits die hard and PE firms tend to prioritize rapid operational changes and go-to-market strategies, underemphasizing time and investment on talent and culture concerns. This divergence can lead to strategic misalignment, cultural conflicts, and ultimately, suboptimal performance. For instance, a CEO focused solely on operational efficiency may inadvertently alienate key talent and customers, resulting in talent attrition and revenue decline. Statistics also show that about three out of five CEOs depart after a PE acquisition**, often due to unplanned exits, which can lead to significant disruptions and erosion of return on investment.

Such instability not only impacts the financial returns for PE firms, but also inhibits the growth trajectory and competitive positioning of the portfolio company. Furthermore, a disconnect between the current leadership's vision and the desired future state can lead to employee disengagement, further undermining organizational performance and hindering strategic progress.

To navigate these challenges and optimize leadership effectiveness, PE firms can leverage comprehensive solutions offered by organizational psychologists who serve as human capital consultants.

These solutions encompass various services, including rigorous assessments, targeted executive coaching, and customized leadership development programs. By focusing on cultivating authentic, inspiring, and emotionally intelligent leaders, these interventions can help align leadership priorities, enhance collaboration, and drive performance throughout the organization. Moreover, by fostering a culture of continuous learning and development, PE firms can build a robust leadership pipeline and a strong bench of organizational talent, ensuring long-term organizational resilience and sustainable growth.

While many mid-sized companies may lack the in-depth knowledge and scientific expertise to systematically enhance leadership capabilities on their own, providing C-suite teams with essential tools and support can bridge this gap. Engaging business psychologists to optimize C-suite capabilities not only enhances the resilience of portfolio companies but also positions them for enduring success in today's dynamic business environment.

Human Capital Inefficiencies Kill Value Creation

How many of your portfolio companies are currently experiencing these understandable, yet value diminishing growing pains?

- 1) Under-qualified executives
- 2) Lack of alignment between board/sponsor and executive priorities
- 3) Trust and conflict drama within the executive team or between the team and the board
- 4) Inability or unwillingness to hold the organization accountable
- 5) Poor, if any, succession plans rooted in objective data with supporting processes

These issues can be solved with scientific business psychology interventions. Proactively strategizing and implementing solutions are more effective than waiting for the problem to arise. Adopting a systematic approach to solutions with a focus on strategic integration across human resource management is far superior to piecemeal quick fixes.

Crafting High-Performing Management Teams for Value Creation: Not a One Solution Task

The success of Value Creation Plans rests on the shoulders of C-Level Portfolio leaders, or the "C-Team." Progressive PE firms meticulously assess the readiness of these teams to achieve the company's business imperatives.

Mid-sized companies excel when they prioritize growth, operational excellence, and talent enhancement. Effective C-Teams orchestrate these imperatives, requiring vigilant oversight and strategic direction. Collective capabilities within the enterprise, particularly within the executive team, are crucial for achieving success.

As PE firms acquire and integrate new organizations, strategic re-setting of the executive team becomes essential. But too often, firms delay necessary improvements or adopt a piecemeal approach. They may provide coaching for individual executives or assess potential candidates, yet fail to support the new executives' assimilation into the team and organization. Assumptions that the executive team will naturally "gel" and intuitively respond to the board's expectations can lead to ineffective functioning.

A Better Approach is Proactively and Holistically Solving the Issues

Simply put,

The whole is greater than the sum of its parts.

Our research and experience indicate that when boards proactively anticipate the need for human capital support and commit upfront to providing it through bundling three key initiatives, portfolio companies achieve accelerated growth with less conflict along the way.

Initiative One: Executive Assessment

Discerning private equity firms start by scientifically assessing the current executive team. When seeking to add or replace members, they employ the same process and tools. Lodestone's approach involves assessing both behavior and underlying personality, which drives that behavior. While many executives can navigate and manage their impression through an interview, especially an unstructured one, our method provides deeper insights.

Scientific best practice uses business simulations and the validated personality predictors of performance (i.e., measuring what are called The Big Five), combined with business impact interviews conducted by experienced business psychologists and anchored around the key business imperatives that drive the investment thesis. Notably, executive assessment is only as strong as the interpretation of the data; the role of business psychologists with credentials to administer, evaluate, and discuss implications of data is paramount for success with scientific assessment.

These methods increase predictive power of executive success compared to mere score-carding or clinical and anthropological assessments. Importantly, scientific assessments all candidates to demonstrate their capabilities and competencies, rather than simply talking about them. This approach is better received by candidates, perceived as more just and fair, and helps level the playing field for underrepresented groups. In summary, these assessment methods

increase the likelihood of choosing an executive who will deliver upon your investment thesis and decrease implicit bias and the tendency to choose a candidate who is “just like me”.

Initiative Two: Individual Executive Development

Many firms are familiar with and utilize executive coaching. Too often, this is done as a “fix the person” initiative versus proactively working to enhance the executive’s leadership capabilities and align the leader’s strengths and development areas with both short and long-term organizational strategy and vision. Introducing a new sponsor brings significant challenges for even the most talented and motivated C-suite leaders, compounded by the demands of rapid growth and scalability. The stress—even if it’s positive stress—associated with this fast change brings out derailing patterns in any executive.

Understanding this phenomenon and proactively engaging an executive coach can help smooth the change curve and enhance leader effectiveness. Additionally, having a coach for the CEO can also alleviate pressure on the sponsor, providing the leader with a ‘safe space’ to navigate the pace and expectations of private equity. Additionally, scaling talent and implementing advanced human capital systems are typically imperatives within the investment thesis, often before a dedicated CHRO is in place.

A strong leadership advisor often has had CHRO experience or CHRO de facto experience, and can provide strategic guidance on people initiatives in addition to leadership coaching.

Initiative Three: C-Suite Team Effectiveness

Selecting a great CEO based on scientific assessment and setting that great CEO up with a qualified coach are nice, but the CEO does not operate in a vacuum. The success of the organization requires a highly functioning executive team, not just a highly functioning chief executive. Particularly when a new CEO is brought into an organization, trust issues between the “old and new” can emerge, creating barriers to effective change.

Even in situations where trust issues aren't pervasive, operationally- or market-focused leaders often overlook crucial steps in setting expectations regarding executive team norms and responsibilities. When a team fails to establish upfront agreements on how they will operate together, including understanding the personalities and characteristics which comprise their team mosaic, they invariably will face frustration, conflict, unmet expectations, and fall short of optimal performance.

Team sessions, facilitated by someone trained in leadership and team psychology and dynamics, are essential for success, smooth transitions, meaningful change, and maximized business impact. Such sessions are not simply “touchy feely team building.” Effective team sessions involve scientifically understanding the personalities of the team members, identifying their strengths and areas of expertise, recognizing where diversity of thought can be a strategic advantage, scenario planning for decision-making processes given the mosaic of the team, and establishing clear RACIs—both between team members and with respect to the board.

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Exemplary Companies Pull All Three Initiatives Together for Accelerated Positive Impact

Case 1: Systemic Human Capital Optimization Increases Company Value

Situation: A leading PE firm faces the task of integrating an organization made up of one primary platform and several additional acquisitions. These acquisitions were each led by executives with unique leadership styles and corporate cultures, which created a significant challenge. The firm was about to appoint a first-time CEO and sought scientific data to substantiate their belief in her potential to unify these diverse elements into a single, high-performing company.

Approach: Lodestone was commissioned for its expertise in swift, precise, executive assessment and feedback, evaluating each member of the Executive Level Team (ELT), including the CEO, CFO, CRO, VP of HR, and OGC. The board and CEO were provided with a comprehensive "Talent Mosaic," forecasting the team's capacity to meet the investment thesis goals. With the guidance of Lodestone's Leadership Advisory Services, the CEO adeptly navigated team dynamics and board interactions, and also undertook strategic HR initiatives through Lodestone in the absence of a CHRO. The ELT then engaged in Lodestone's 'Knowing Me, Knowing You™' and 'Vision and Values' sessions, laying the cornerstone for their collective values, operational norms, and accountability structures. Moreover, the CRO adopted the advisory services, integrating scientific assessment in the development of the sales leadership team.

Result: This strategic intervention strengthened leadership and played a pivotal role in the company's recognition as the PE firm's 'Portfolio Company of the Year.' Both the board and the deal team credited this success to the executive team's resilience and outstanding operational performance. The ultimate success came with the company's acquisition, resulting in a highly profitable outcome for our client PE firm.

Case 2: Sustainable Energy Company Tries Piecemeal Approach, Delays Growth

Situation: A firm needed to choose a CEO for a recently acquired portfolio company. Initially relying solely on their internal due diligence processes, they opted not to utilize comprehensive assessment services. However, they later decided to have Lodestone assess their final CEO candidate as a precautionary measure. After the candidate received an assessment and feedback, they chose not to continue engaging with Lodestone beyond that point.

Initial Approach: The firm asked Lodestone to assess the chosen candidate to give him feedback on his strengths and on development areas. This feedback highlighted for the CEO his narrow but strong operational focus and likelihood of friction with some direct reports.

Result: The appointed CEO hit the ground running, swiftly implementing operational efficiencies and strategically recruiting a CRO within the pivotal first 100 days. However, beneath this veneer of early success, a discord brewed. Within six months, a misalignment arose between the CEO and CRO regarding market strategy. The CEO's intense focus on operations inadvertently overshadowed the broader market vision and talent development. Further, other ELT members, including the COO, were disengaging and feeling micromanaged by the CEO.

Revised Approach: Recognizing the urgency to salvage the situation, the sponsor re-engaged Lodestone to orchestrate an ELT intervention. Through tailored team effectiveness sessions and targeted Leadership Advisory Services (LAS) for the CEO, Lodestone set to work supporting the executive team in realigning their vision, strategy, and focus.

New Result: This recalibrated approach fostered a renewed sense of unity and purpose within the executive team. The company, albeit delayed, began to realize its market potential, pivoting towards a balanced operational and market-centric strategy. This newfound synergy not only propelled the company towards its targeted goals but also reinforced the importance of holistic leadership assessment, team development, and alignment from the beginning.

Case 3: CEO/COO Calibration to Scale the Organization

Situation: At a critical point of growth, a PE firm identified the need to optimize the leadership tandem of a highly promising yet struggling CEO and their COO. Prior to engaging Lodestone, the firm had conducted a baseline objective scorecard assessment on the CEO, revealing a discrepancy between his ambitious vision and the immediate pragmatic needs of the business, a gap that jeopardized both market confidence and vital funding. Meanwhile, the COO, essential for driving operational efficiency, faced the daunting task of rapidly scaling the company's operations. In light of these insights, the PE firm enlisted Lodestone's Leadership Advisory Services to recalibrate and enhance the executive partnership.

Approach: The strategy hinged on fostering a symbiotic partnership between the CEO and COO, so Lodestone used a specific version of Leadership Advisory Services—dyadic coaching. Lodestone focused on realigning the CEO and COO's individual strengths to the company's tactical and strategic objectives. This was orchestrated through bi-monthly dyadic coaching sessions designed for intentional and ongoing role calibration. These sessions heavily leaned on the organization's business imperatives as a guiding compass, helping to create clear 'swim lanes' of accountability and ensuring that the dreamer CEO's expansive visions were grounded by the executor COO's practical focus.

Result: Lodestone's coaching process enabled the CEO and COO to bridge the gap between vision and execution. Through learning to navigate their respective roles and responsibilities, they transformed frustration into functional collaboration. Implementing a robust RACI matrix solidified their operational harmony, resulting in improved effectiveness. The organization not only experienced enhanced business performance but also benefited from a rejuvenated leadership dynamic. Internal discord was replaced by collective clarity of purpose and direction.

The Bottom Line on Business Psychology's Positive Impact

In the fast-paced world of private equity, the imperative for accelerating value creation and swiftly gaining insights isn't just a goal—it's a necessity. Achieving this acceleration requires a blend of executive assessment, bespoke executive development, and team effectiveness initiatives - resulting in operational excellence. The integration of these three pillars, facilitated by expert business psychologists equipped with both scientific data and practical wisdom, ensures not only advancements in organizational effectiveness but also significant returns on human capital investments.

Embracing a methodical and holistic regimen in human capital optimization isn't just a strategic choice; it is the foundation for building sustainable growth and success.

About Us

Lodestone People Consulting is a firm of workplace psychologists who bring human capital science to sponsors and their portfolio companies. We help discerning Private Equity Firms understand people and people systems during due diligence. After your acquisition, we conduct your new executive selection, bolster or change HR practices, enhance organizational culture, and provide individual and team development. The result is a more effectively running organization, thus increasing your ROI.

If you need assistance with any of the issues addressed here, please contact us at info@LodestoneHR.com or our founder, Dr. Sandy Fiaschetti, at the conference.



Sandy Fiaschetti, Ph.D.

Dr. Fiaschetti is the founder and Managing Partner of Lodestone People Consulting. She has been both an internal and external consultant to both private equity firms and mid-cap and large companies across a variety of industries. Sandy's experience has been focused on organizational culture and effectiveness, talent assessment, and leader development. She has assessed and advised hundreds of C-suite executives. She is particularly passionate about the importance of pragmatically integrating people initiatives into strategic business plans to increase value.



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HUMAN CAPITAL SCIENCE