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Partners in Value Creation: Unlocking Value Together — The Vital Bond Between Investors and CEOs

A robust partnership between the CEO and the sponsor is vital for maximizing returns on investment. Given that both CEOs and sponsors naturally share a common goal of achieving a successful exit, it makes sense to cultivate a strong partnership focused on maximizing returns. While this notion may appear self-evident, it prompts a critical question: Why do we so frequently hear reports of conflicts between private equity investors and their CEOs?

The answer to this question resides in the complexities of collaboration inherent in these relationships. Although the CEO and sponsor may have aligned objectives, the nuance in these partnerships is often overlooked. Misalignment can arise from differing expectations, communication styles or even varying priorities, all of which can cloud the path to shared success. This underscores the need for open communication and a genuine alignment of interests. By fostering an environment of transparency and trust, both the CEO and the sponsor can truly unlock the full potential of their partnership, driving not only improved financial outcomes but also a more cohesive organizational culture.

As organizational psychologist Daniel Kahneman suggests, even rational individuals can be swayed by cognitive biases, leading to irrational behaviors despite seemingly aligned interests. This underscores the critical need for intentionality in this relationship. Furthermore, as private equity firms increasingly recognize talent as a crucial value driver, they often overlook the importance of evaluating their personal dynamics within the human system. As such, it becomes essential for both parties to intentionally reflect on their relationship dynamics. Without taking a critical pause to re-contract around their relationship and agree on how they will manage conflict throughout their relationship together, the initial enthusiasm and alignment can quickly devolve into distrust and disengagement.

Divergent views on financial transparency, the pace of updates and how to handle adverse developments create a pressure cooker environment. As tensions escalate, investors may suspect that critical information is being withheld, while portfolio leaders often feel adrift and unsupported, as if “lost at sea.” In the most severe cases, this mounting frustration can culminate in the damaging removal of the CEO, undermining both value creation efforts and exit strategies.

Through our extensive work with some of the world’s leading private equity firms and portfolio company leaders, we’ve identified a recurring theme: conflicts often stem from a fundamental lack of trust and alignment. Leveraging insights from interviews with more than 300 successful investors and multi-time portfolio company CEOs, we present a strategic blueprint designed to cultivate a collaborative, trust-based relationship between the CEO and the sponsor. This framework not only addresses existing challenges but also paves the way for a thriving partnership that drives success.

Laying the foundation: build trust and set expectations during pre-deal and exclusivity

Here is our advice for building a foundation of trust and transparency.

Evaluate fit based on the investment plan and a scorecarding system that directly ties to the value creation plan

When assessing a new investment or deal opportunity, it’s natural to focus on valuations, potential synergies and cost-cutting possibilities. But an essential consideration for both private equity firms and CEOs is whether the match represents a good fit from a style and capabilities standpoint. In the excitement of doing a deal, sponsors can become enamored with the CEO — overweighting pedigree or overlooking important issues related to leadership style or culture fit. This infatuation may blind them to vital insights regarding the leader’s readiness to excel and collaborate effectively throughout the partnership. Whether it’s a sitting CEO in a new investment, a buy-in CEO or a prospective replacement, this oversight can prove to be a costly misstep. Shifting the lens from merely assessing the CEO to evaluating how their qualities align with a scorecard relevant to the value creation plan (VCP) can yield better fit.

Sponsors should be clear about what it will take to successfully lead the portfolio company based on the specific deal context, whether the CEO is brought in as part of the initial investment or later in the hold period. Our conversations and work with investors have revealed a set of attributes that tend to be the most important for portfolio company CEO success. (See sidebar.) Extensive referencing, third-party assessments and an in-person board presentation can help the sponsor evaluate the CEO's leadership style; their mindset, problem-solving skills and ability to tackle tough questions; as well as their reputation within their current organization, past companies and the wider industry landscape.

Attributes of high-performing portfolio company CEOs

Through our extensive work and in-depth interviews with private equity sponsors and successful CEOs, we have identified a recurring pattern of key characteristics that sponsors seek in best-in-class CEOs. These traits not only define exemplary leadership but also highlight the qualities that drive robust performance and alignment within organizations, ultimately influencing the success of their investments. By understanding these attributes, both sponsors and CEOs can better navigate the complexities of their partnerships and work collaboratively toward shared goals.

These attributes can be structured into categories based on their relevance to investment success:

Skill Set Competencies

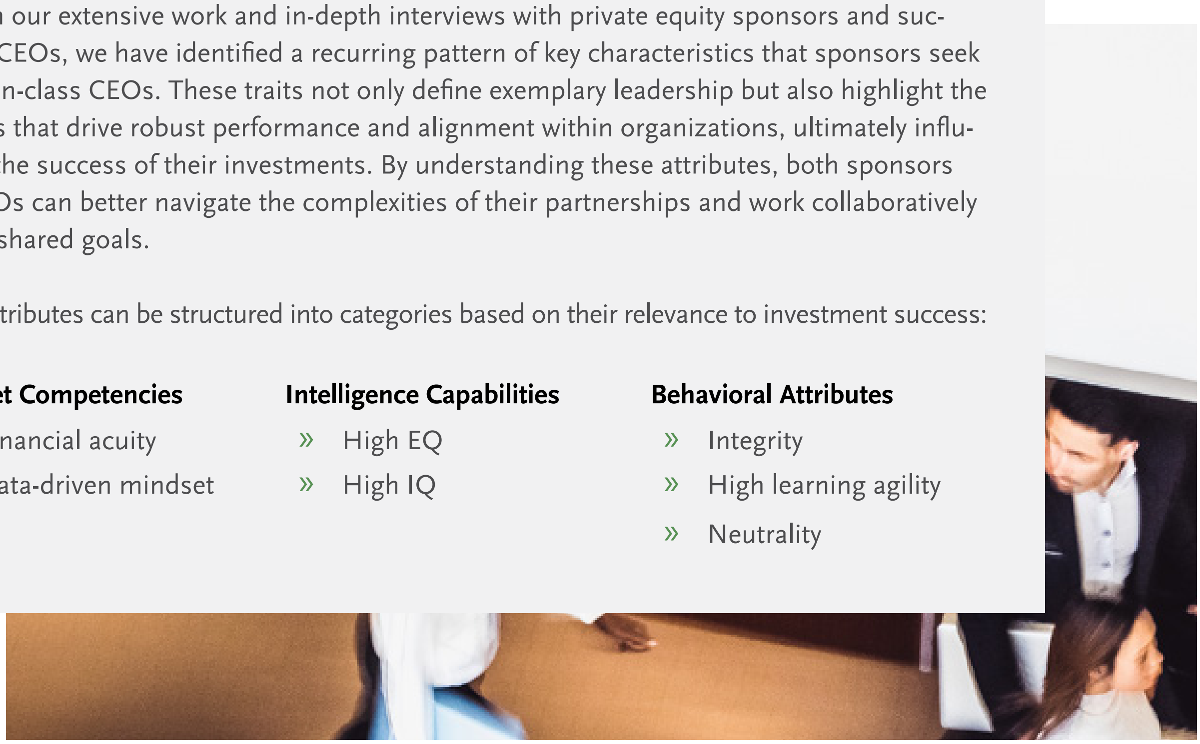
- Financial acuity
- Data-driven mindset

Intelligence Capabilities

- High EQ
- High IQ

Behavioral Attributes

- Integrity
- High learning agility
- Neutrality



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A hierarchy might begin with foundational qualities like financial acuity as table stakes, proceeding to essential characteristics such as high EQ and learning agility that are critical for sustained leadership effectiveness.

1. **Financial acuity**: The bedrock of effective leadership lies in financial acuity, which encompasses a CEO's ability to understand and manage the financial health of the organization. A financially astute CEO demonstrates a knack for understanding market dynamics, which enhances transparency and builds trust with stakeholders. This capability allows for favorable positioning during exit negotiations, whether through acquisition or public offering. CEOs who prioritize financial metrics can bridge the gap between high-level strategy and operational execution, ensuring that the organization remains agile in a competitive landscape. This foundational skill lays the groundwork for other leadership qualities to flourish.

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2. **Data-driven mindset**: Building on financial acuity is a data-driven mindset, which emphasizes making informed decisions grounded in analysis rather than intuition. A successful CEO rigorously tracks and analyzes financial performance indicators, such as revenue growth, profitability and cash flow. This focus on data allows leaders to provide valuable insights reflecting the company's progress toward exit strategies and fosters trust with investors, who increasingly rely on quantitative metrics. Without a data-driven approach, particularly for founder-based CEOs who may traditionally rely on intuition, establishing credibility can be challenging. A CEO who embraces this mindset not only enhances decision-making but also serves as a common language between the CEO and sponsors, solidifying their partnership.
3. **Learning agility**: Learning agility is vital for effective leadership in dynamic business environments. Portfolio company CEOs must possess self-awareness about their shortcomings and actively seek out feedback from executive teams, operating partners, board members and sponsors. Agility is about balancing conviction in their leadership vision with a relentless pursuit of improvement and adaptability. Effective leaders recognize when to stand firm and when to shift their approach, using their knowledge and insight to navigate changing circumstances. By fostering a culture of continuous improvement, CEOs encourage innovation, which in turn strengthens the organization's capacity for growth. Those with higher learning agility are better positioned to leverage their experiences for future success.
4. **Emotional intelligence (EQ)**: Emotional intelligence is closely tied to learning agility and is essential for cultivating strong organizational dynamics. Leaders with high EQ excel at empathizing with their employees and forging authentic connections, which fosters trust and rapport. This ability cultivates loyalty and motivates teams to commit to a shared vision. By actively listening and demonstrating empathy, these leaders create an inclusive culture that addresses team members' aspirations and concerns, enabling meaningful engagement that drives performance.

Additionally, understanding broader social dynamics is critical for CEOs as they navigate relationships with investors and board members. Recognizing power centers within their organizations and knowing how to influence key stakeholders is essential for driving change. Turnaround and transformational CEOs particularly need to balance advocating for aggressive change while bringing their teams along for the journey. This requires strong interpersonal skills and the courage to tackle challenging issues openly. Emotional intelligence intertwines with integrity; courageous leaders empower their teams to confront difficulties collaboratively, fostering trust and enhancing organizational effectiveness.

5. **Integrity**: With learning agility and emotional intelligence established, integrity forms the sturdy framework for leadership effectiveness. Exceptional CEOs embody courage as they make tough decisions and hold themselves and their teams accountable. Integrity links to processes that encourage transparency and openness, fostering a culture where honesty thrives. By prioritizing respect and shared commitment to values, leaders can navigate the most difficult issues efficiently, thereby enhancing the organization's reputation and long-term sustainability. Furthermore, integrity and learning agility often go hand in hand; leaders courageous enough to accept feedback and pivot create a more resilient and responsive organizational culture.

6. **IQ**: Critical and conceptual thinking serves as the IQ dimension crucial for successful portfolio company CEOs. This includes the ability to analyze frameworks quickly and adapt strategies in alignment with evolving market conditions. Effective leaders demonstrate critical thinking by synthesizing information and crafting innovative go-to-market strategies while maintaining a long-term strategic vision. High performers leverage this cognitive acuity to engage their teams, fostering an environment that encourages creativity and adaptability. However, sponsors must remain cautious of over-indexing on a CEO's IQ; high IQ without matching emotional or learning agility can lead to intransigence, where leaders may rigidly adhere to their vision, disregarding valuable feedback from their teams.

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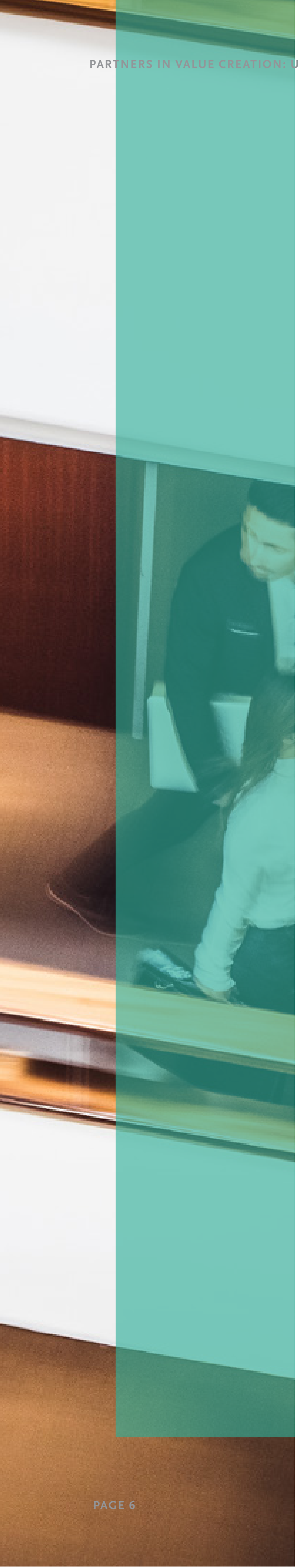
7. **Neutrality**: Finally, the capacity for maintaining neutrality in decision-making underscores the importance of objectivity. Effective CEOs prioritize value-driven choices, employing a balanced approach that weighs various factors without bias from favoritism or personal relationships. This impartiality becomes increasingly important for founders who may struggle with emotional attachments to certain products or team members. By reinforcing impartial decision-making aligned with organizational goals, CEOs foster a culture where decisions are made on merit and potential impact.



Act promptly if concerns about fit arise

During diligence, sponsors often assess what CEOs have accomplished to date and intuitively gauge their leadership qualities. However, taking a data-driven approach offers greater certainty and predictability regarding a CEO's potential effectiveness. Using validated tools — including psychometrics, capabilities assessments, scorecard-based interviews and competency-based activities — can help predict a CEO's executive intelligence, including IQ, EQ and learning agility, as well as their likelihood of demonstrating integrity and neutrality. Additionally, industry references covering past interactions with executives are critical. As investors conduct their due diligence before acquisition, it is essential to evaluate whether the CEO can guide the organization toward its strategic goals while mitigating associated risks.

The pivotal question becomes, "Can this person take us where we want to go?" The industry is increasingly focused on developing CEO scorecards during diligence, linking it to the investment thesis, as firms clarify growth plans and their VCP. These scorecards delineate the skills, capabilities and leadership styles indicative of a CEO's capacity to execute the VCP effectively.

If any doubts emerge regarding the CEO's ability to execute the value creation plan — whether due to deficiencies in specific capabilities, concerns about temperament or a misalignment with expectations — investors must recognize the potential negative impact of these red flags. In many cases, when faced with new investments or changes in the VCP, a CEO may be required to shift the company in a new direction. Therefore, assessing their IQ, EQ, learning agility and data mindset becomes increasingly vital for ascertaining their capacity to succeed in novel and complex environments.

If questions arise about the CEO's ability to enact the value creation plan, swift action is essential. A proactive plan to replace the CEO should be initiated without delay to safeguard the company's trajectory and long-term success. The right leadership is crucial for navigating challenges and seizing opportunities, and addressing any uncertainties surrounding the CEO's fit is not merely advisable, but essential to ensuring the organization remains on course toward achieving its ambitions. Timely intervention can protect not only the value of the investment but also preserve the overall health and vitality of the organization.

Begin fostering the relationship as early as possible

The increased reliance on virtual communication has created significant challenges in fostering transparent, trust-based connections between CEOs and deal teams. While digital tools offer convenience, they often lack the personal touch necessary for building strong relationships. To counter this, lead deal partners must take intentional steps to engage with CEOs face-to-face, recognizing the importance of personal interactions in establishing rapport and trust.

One effective approach is to incorporate in-person presentations during the due diligence process. These meetings provide a valuable opportunity for deal partners to assess the CEO's leadership style and strategic vision firsthand while also allowing for more nuanced discussions that can enhance understanding on both sides. Furthermore, arranging casual dinners or celebratory drinks following the signing of a deal helps to create a relaxed environment where genuine conversations can flourish.

Frequent meetings in informal settings — such as shared meals or team-building activities — not only facilitate open dialogue but also allow sponsors and CEOs to connect on a personal level. These interactions transform the relationship from a purely transactional one into a more holistic partnership, where individuals become acquainted as people rather than just executives.

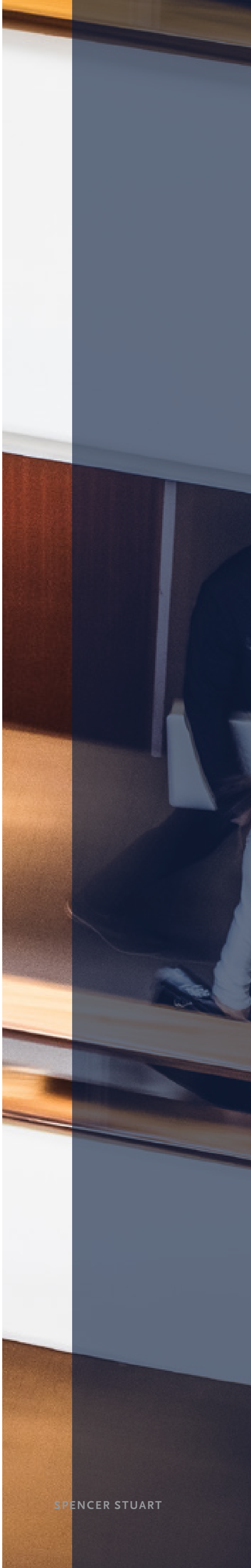
The ultimate goal of these deliberate efforts is to cultivate a degree of trust and mutual respect that form the backbone of a strong working partnership. When CEOs and deal teams establish a foundation built on transparency and personal connection, they can collaborate more effectively, navigate challenges with confidence and work together toward shared objectives with a sense of camaraderie. This investment in relationship-building not only enhances the effectiveness of their partnership but also significantly contributes to the overall success of the organization as it moves forward in an increasingly complex business landscape.

These interactions can't begin too early. One CEO shared that a factor in the decision to agree to a deal with one particular sponsor was a multi-year-long connection with one of the deal sponsors, who showed interest in engaging with the CEO in person long before the company entered the market.

Define the support the CEO will need

Formal due diligence, personal interactions and conversations about the business are critical for evaluating a potential deal opportunity but also for understanding the strengths and weaknesses of the sitting CEO and broader management team, including team dynamics. Confidential interviews with people who have worked with the leadership team can provide important perspectives about leaders' capabilities, ambitions, style and weaknesses. These insights can inform thinking about the support the sitting CEO may need to address gaps in experience or knowledge, which could include an external adviser, a well-networked executive chair to act as a mentor, a hands-on operating partner or enhancements to the management team.

It's crucial to adapt to the unique needs of the CEO, regardless of whether they are new to the role or seasoned. Even those with previous experience as CEOs in portfolio companies may require tailored support and guidance based on the specific context of the deal. Therefore, sponsors should undertake thorough diligence for both first-time and experienced CEO candidates. The most effective CEOs view this as an opportunity to collaborate with sponsors to identify their leadership gaps and ensure they receive the necessary support for success.



Begin aligning on the thesis, exit plan and "rules of engagement" — creating a talent agenda

Entering a deal with a clear understanding of objectives and expectations can prevent trust-eroding surprises down the line and establish a solid foundation for collaboration. Deal partners should engage with the CEO early on to clarify the growth strategy and objectives, ensuring a mutual understanding that will facilitate clear and achievable goals for the company. Developing a shared vision of the organization's current state, including potential changes, can help foster alignment on sensitive topics. This proactive approach can significantly enhance partnership effectiveness. As one managing director told us, "It's really important for investors and CEOs to acknowledge and understand that we are partners in this, and that we will be doing it together for many years to come."

To emphasize this partnership, sponsors are increasingly focused on creating a human capital plan or talent agenda in collaboration with the CEO. This should revolve around four critical areas that operationalize the human capital aspects of the VCP into a talent agenda:

1. **Executive team capabilities**: Assess whether the current executive team possesses the right capabilities to execute the VCP and determine how to acquire the necessary skills and experience.
2. **Team effectiveness**: Evaluate how effectively the team operates and identify processes that may require upgrading to enhance efficiency as the organization grows.
3. **Organizational factors**: Consider organizational structure, health and culture, ensuring they evolve to support the VCP, especially for strategies focused on acquisitions.
4. **Board dynamics and sponsor partnership**: Focus on the relationship between the sponsor and the CEO, clarifying points of contention before they arise and establishing respectful ways to resolve disagreements.

Some CEOs express sensitivity around employee compensation, while others want more decision-making authority in M&A deals. Understanding the CEO's priorities and openly discussing how disagreements will be handled is crucial for fostering a solid long-term relationship. This proactive contracting is especially important as the organization prepares for exit; it's not only critical to establish who the decision-makers are but also the processes by which decisions will be made. As the organization approaches the exit phase, various stakeholders — including the sponsor, the CEO and often the executive chair — must agree on the direction. Without established clarity regarding who makes which decisions, the organization may face fragmentation, resulting in a lack of cohesive effort toward shared goals.

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Cultivating a lasting partnership

Here is our advice for fostering a partnership over time.

Embrace a partnership mindset

Challenges and disagreements will arise. The best sponsors expect challenges, questions and occasional disagreements with the CEO during the life of the investment. They understand that questions are a sign of strong commercial skills and represent management's interest in delivering results for the business. Rigorous debate between the CEO and sponsor can provide a fuller picture of the critical issues and potential paths forward.

To ensure that debates do not devolve into conflict, it is vital to maintain trust, transparency and alignment. This necessitates regular communication and a transparent, honest approach to information sharing. It involves a willingness to promptly address issues, acknowledge setbacks, seek input and collaboratively develop problem-solving strategies. CEOs want to know that the PE team is supporting their efforts. In the best cases, sponsors and CEOs respect one another's operational knowledge and experience and chart the best path forward together.

Jointly build the value creation plan and align on KPIs

Sponsors convey their recognition of the management team as genuine partners by transparently sharing the intricacies of the value creation plan and associated projections. They leverage the insights of the CEO and CFO by posing open-ended questions about the business's current landscape and future growth opportunities. This collaborative dialogue not only refines the VCP but also establishes clear, achievable goals for propelling the company forward. Recognizing that key performance indicators (KPIs) and metrics will differ based on specific investment objectives, it's crucial for the CEO, CFO and sponsor to establish a mutual agreement on reporting requirements. This collaboration allows the management team to focus on providing the essential information that the board needs, rather than creating unnecessary reports. By fostering an environment of strategic partnership and clarity, sponsors and management teams can significantly enhance their potential for success.

Define meeting cadence to stay aligned

The CEO and sponsor must engage in regular discussions to clarify expectations and minimize misunderstandings. Most successful leaders conduct weekly check-ins to assess progress on strategic initiatives, review financials and track KPIs, ensuring everyone stays aligned on the exit strategy and timeline. The best CEOs "overcommunicate," keeping sponsors continuously informed about business developments. While less common, monthly financial metrics meetings are highly recommended by many leaders. In these sessions, the CEO, CFO and sponsors review the mutually agreed-upon financial metrics tied to the value creation plan, allowing for focused oversight and strategic alignment. This disciplined approach not only strengthens collaboration but also drives accountability and success.

Establish structures for providing ongoing support for the CEO

To foster an environment that encourages the CEO to reach out with problems and solutions or to ask for support, related deal partners should continue to make themselves available to the CEO, especially for tough decisions, rather than delegating all interactions to lower-level leaders in the firm. While it is common for the senior sponsors to delegate to more junior members on their teams — especially attendance at reporting-oriented calls — it is important for sponsors to be clear with the CEO who will be in which meetings and stick to it.

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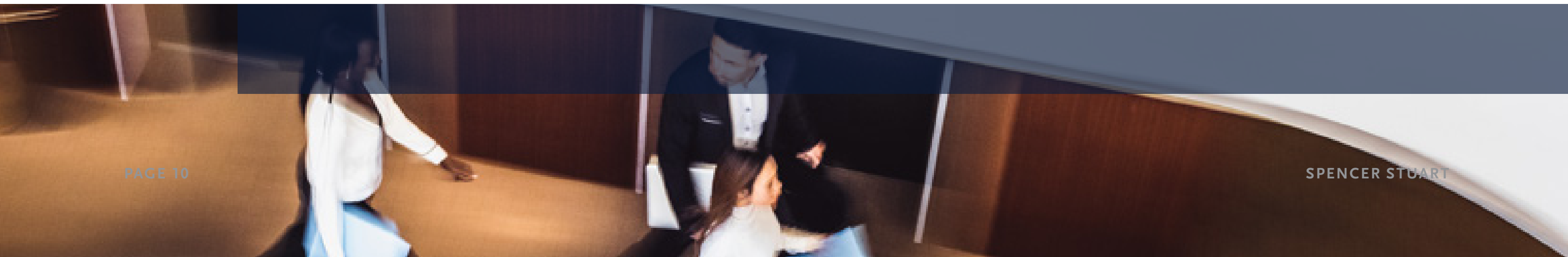
CEOs can also gain valuable support from various additional resources, including:

- **A formal mentor, such as the executive or non-executive chair**. Ideally, the chair is a retired, well-networked former CEO in the same industry who can credibly advise the CEO on a range of topics, from crafting board agendas to navigating M&A strategies and due diligence. This relationship is particularly vital for first-time CEOs, who may lack prior experience with balance sheets, cash flow statements and exit preparations. Having a seasoned chair mentor them through these complexities can significantly enhance their effectiveness and confidence in leadership.
- **Subcommittee or task force focused on a specific issue**. One effective example of this structure is an M&A subcommittee. Typically composed of the CEO, CFO, key management leaders and two or three members from the deal team, a subcommittee can play a crucial role in streamlining the evaluation of potential investments. By fostering a consistent feedback loop with the C-suite, the subcommittee ensures that decision-making is both informed and agile, enabling the organization to capitalize on opportunities swiftly. This collaborative approach not only accelerates the due diligence process but also integrates strategic insights from various perspectives, enhancing the quality of investment decisions.
- **Internal peer networks**. Portfolio company CEOs can significantly benefit from engaging with “captive” peer networks formed by leader peers within the investment firm’s other portfolio companies. Interactions among fellow CEOs create a strong sense of community and belonging, fostering an environment where personal experiences and business insights can be openly shared. Such exchanges are particularly valuable as they provide context and relevance to the sponsor’s specific investment approach, allowing CEOs to glean practical strategies that have been tested in similar environments.



- **External associations**. Membership in external peer networks can further enrich a CEO's perspective. These associations, often funded by the portfolio companies themselves, offer opportunities for leaders to stay informed about broader industry developments, emerging trends and pressing issues facing their businesses. By participating in these networks, CEOs not only enhance their knowledge base but also build valuable relationships that can lead to collaborative innovations and solutions. Ultimately, leveraging both internal and external networks empowers portfolio company CEOs to navigate challenges more effectively, driving growth and success while aligning strategically with their sponsors' visions.
- **Annual leadership summits or CEO roundtables**. Nearly half of the private equity sponsors we interviewed said their firms convened an annual summit for top leaders of their portfolio companies, including CEOs, CFOs, HR leads, CIOs/CTOs and go-to-market leaders. These forums allow CEOs and others to share their learnings and challenges and are typically closed to PE firm representatives to promote an open dialogue among CEOs and enable collective problem-solving. These events help make the CEO job less lonely and provide opportunities to share ideas and strategies with leaders in similar industry verticals or growth stages.

Focus on talent — together

Top CEOs are able to act swiftly on talent decisions, positioning themselves to create a trusted management team within 90 days of joining. Because of the importance of quickly pulling together and aligning the management team, sponsors are likely to give extra scrutiny to the management team of sitting CEOs, who may be slower to make tough decisions when it comes to talent, allowing people without the needed capabilities or sense of urgency to stay in key roles for too long. While the CEO should have domain over people decisions, they can sometimes lack perspective about "what good looks like" in a given role or move too slowly out of loyalty to a long-time employee.

Creating a human capital plan or talent agenda with their CEOs, which reviews executive team capabilities, team effectiveness, organizational factors and the sponsor/board partnership, can ease this discussion. By aligning on what is needed for the executive team to be successful, both parties can establish more rigorous scorecards with clear goals for executive team members, ensuring effective execution of the VCP. This process often helps CEOs and sponsors identify gaps across the team that need to be filled with new roles or enhanced capabilities.

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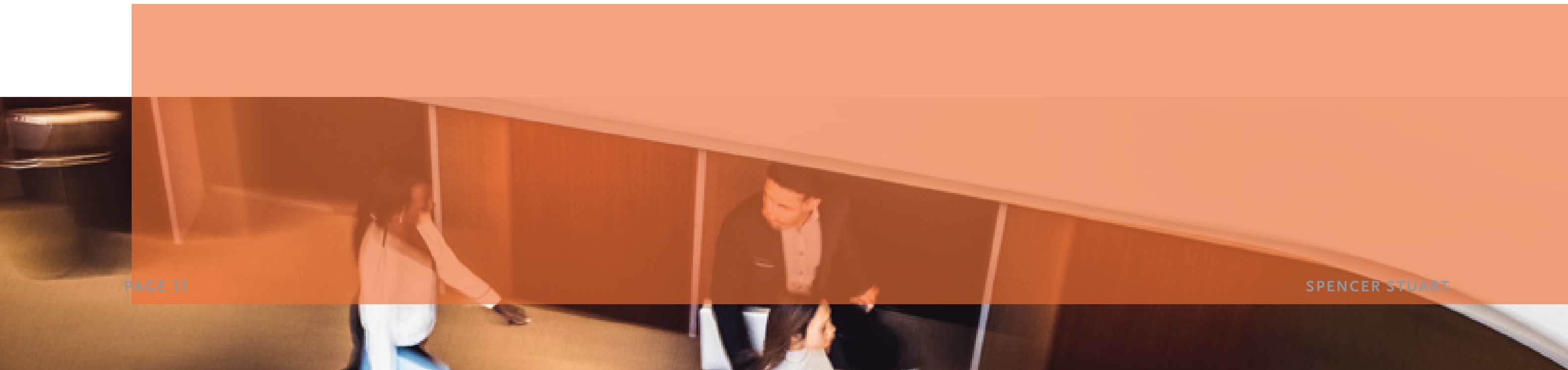


Some proactive CEOs and sponsors use this opportunity to create succession plans by giving certain leaders broader responsibilities. Additionally, a common practice is ensuring there is a chief transformation officer or chief of staff solely focused on VCP execution, alleviating some of the CEO's workload. This individual often has a management consulting background and previous operational experience, positioning them as a potential successor within the company or across other portfolio companies.

Sponsors can help expand the CEO's network and provide a better sense of external benchmarks by introducing them to top talent within the industry in various C-suite functional roles. In the most effective relationships, the CEO and sponsor regularly discuss talent in relation to the value creation plan, including areas such as the specific roles, capabilities and cultural traits that will be needed — or those that could impede progress.

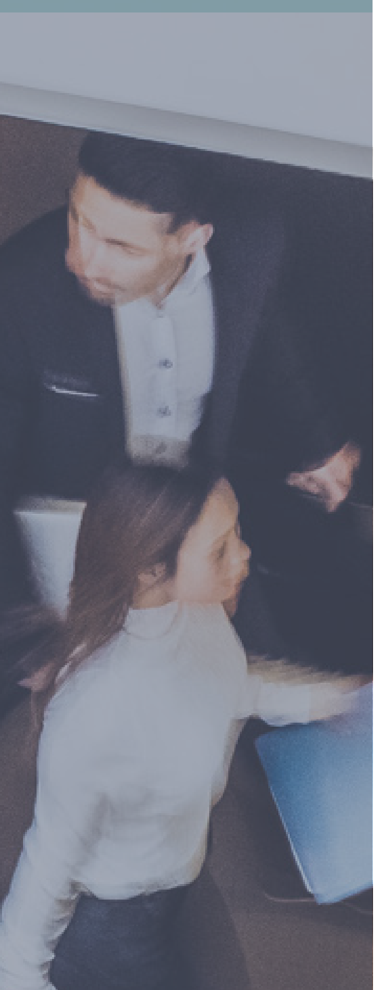
Conduct regular leadership assessments

Once the scorecards are created, they should be used to assess the C-suite and ideally their direct reports, depending on the size of the organization and critical business roles. Formal leadership assessments for the entire management team, tied to the VCP, are instrumental in fostering trust, particularly when these assessments emphasize developmental growth and long-term succession planning. When executed thoughtfully, these evaluations signal a commitment to enhancing individual and collective leadership capabilities, creating an environment where leaders feel supported in their professional journeys.

In line with successful CEO traits, assessments should focus on identifying leaders with high IQ, EQ, learning agility, financial and data mindsets, and integrity. While certain roles may require different weightings — such as a CFO necessitating a higher IQ, while a CHRO may require elevated EQ — emerging trends demonstrate that exceptional CHROs in private equity often possess strong data and financial capabilities, whereas outstanding CFOs exhibit high learning agility and people skills.

Whether through external mentors or seasoned board members, such assessments provide a holistic view of each leader's strengths and areas for improvement as it relates to the value creation plan. This multifaceted feedback not only illuminates specific pain points or developmental needs but also facilitates targeted coaching opportunities. Moreover, assessment discussions should be seamlessly integrated into succession planning, reinforcing the idea that leadership development is an ongoing priority, not a one-time exercise. Making leadership assessment and succession planning a regular feature of board meetings elevates its importance and ensures that the board remains actively engaged in the cultivation of future leaders. Taking a proactive approach allows the organization to identify potential successors early, aligning their development with the value creation plan.

Sponsors and CEOs share a common objective: achieving a successful exit. The process of exiting a business is not only labor-intensive but often fraught with volatility and uncertainty. However, by cultivating a trust-based relationship, both parties can navigate this complex journey more effectively. Maintaining alignment on the value creation plan and regularly monitoring progress toward its goals are essential for success. Open communication, regular updates and ongoing collaboration are required to tackle the inevitable challenges that arise along the way. When sponsors and CEOs work together cohesively, they can adapt to shifting market conditions, pivot strategies when necessary and ultimately enhance the overall value of the business. By fostering a strong partnership focused on shared goals, both sponsors and CEOs significantly increase the likelihood of achieving a high return on investment at the time of exit, turning what can be a tumultuous process into a rewarding culmination of their joint efforts.



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