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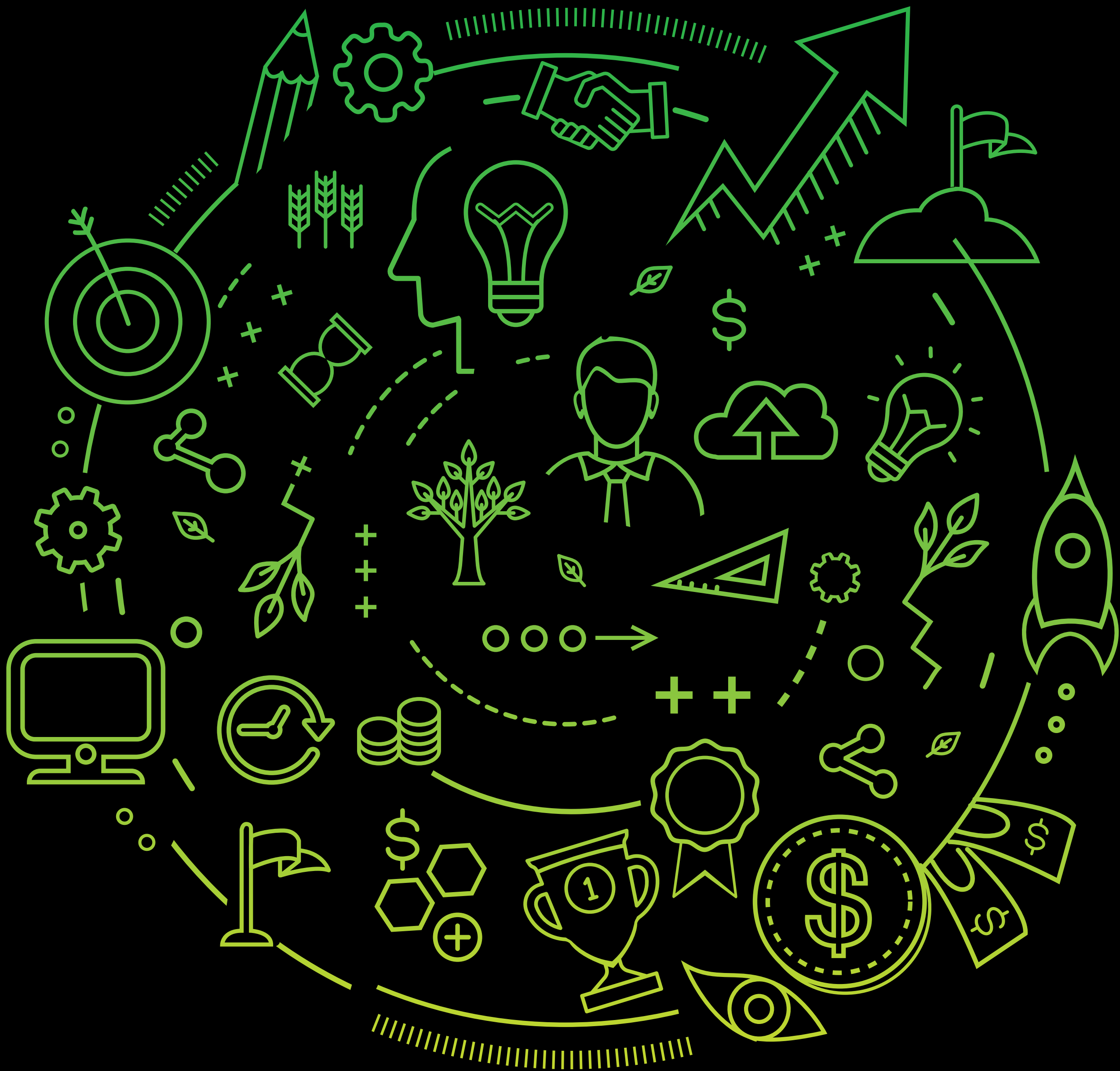


Role of the CFO

Private Equity

February 2019

Content

Foreword

In Deloitte, we have had the pleasure of working with PE firms and PE-backed companies for many years, providing both buy and sell-side advice, audit and other types of services, including facilitating networks for CFOs.

From these different touch points, we have observed how fundamental a change it is for a CFO when the company changes ownership to PE. The CFO is challenged both professionally and personally, and we have observed a high turnover rate of CFOs.

The aim of this report is to create insight into the value creation of the CFO in a PE-backed company. Furthermore, we want to provide a perspective on the high turnover rate and what can be done to reduce it.

We have conducted a survey focusing on the CFO in PE-backed companies seen from three different perspectives, namely PE professionals, CEOs/Chairmen and CFOs themselves.

After conducting the interviews, we decided to bring FRANQ, who are experts within the field of business psychology, into the process to unfold the analysis and give input to relevant actions.

The conclusions and recommendations in this report are the results of an ongoing dialogue between FRANQ and us where we have tried to condense the input from the respondents, our experience from working within the field and relevant psychological knowledge of people in a business context.

We sincerely hope that you will find the report relevant and that it will bring about new thoughts and ideas about CFOs in PE-backed companies.

Bill Haudal Pedersen　　Lars Berg-Nielsen

Executive Summary

The turnover rate of CFOs in PE-backed companies is high; in total, more than 80%. Even CFOs who have been onboarded during PE ownership seem to be replaced frequently contributing further to the turnover rate.

To understand the high turnover rate, the survey suggests two aspects to consider: how CFOs navigate their role and what it entails working in a PE-backed company.

There are two main ways you can fall short in the role as CFO in a PE-backed company: If you fail to get the basics right or if you are unable to act as a business partner and leverage strategic insights. The survey also shows that working as a CFO in a PE-backed company entails high demands and that support is an important but often scarce resource.

Reducing the high turnover rate of CFOs in PE-backed companies entails conscious choices about resources spent. It is worth considering whether enhanced development and support are worth prioritising in light of the negative consequences involved in – sometimes repeatedly – replacing the CFO. This poses requirements for CEOs, PE professionals and CFOs.

In order to reduce the high turnover rate, it is recommended to continuously develop the finance setup and the CFO based on an initial assessment and to enhance support of the CFO in order to balance the high demands.

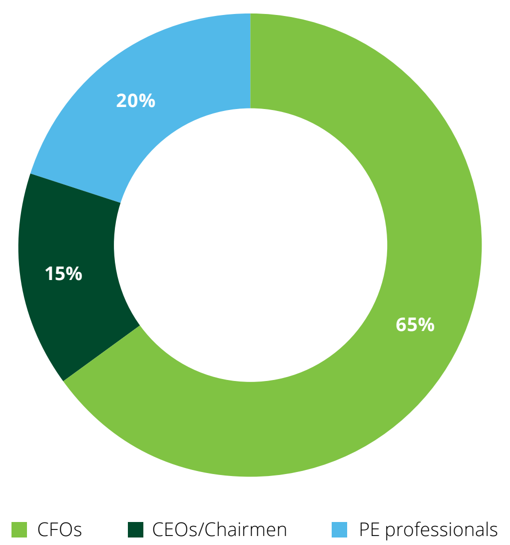
Methodology

The research comprises two parts: we gathered quantitative research to draw clear themes and discover how issues rank in terms of importance among the different respondents and carried out extensive interviews with PE professionals, CEOs/Chairmen and CFOs.

We interviewed 65 people operating in multiple sectors across a wide variety of companies in Denmark.

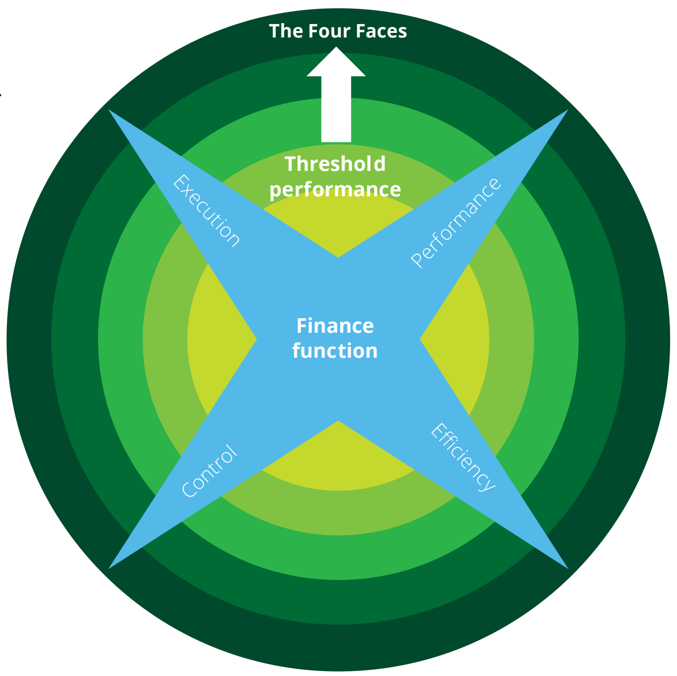
Today's CFOs are expected to play diverse roles, and at Deloitte we capture this in our "Four faces of the CFO" model. We have used this model in the survey as a shared reference point.

Research participants 2019



The Four Faces

Catalyst: Finance partnering with the business to deliver change, refining processes and IT systems.



Strategy: Input into decision - making on strategy/business plans, delivering mergers and acquisitions and debt refinancing.

Steward: Delivery of accurate numbers, financial reporting, internal control and compliance.

Operator: Quality management information, cash and working capital management as well as defining and developing the finance function.

Survey Highlights

CFO
How were you employed as CFO in your current position?
61% have been recruited under the current ownership – only **16%** were employed as CFO before the current ownership.

CFO
Within how many years do you expect an exit?
30% expect an exit within 1-2 years.

CFO
How long have you been CFO in the company?
50% have been CFO in the company for more than 2 years.

CFO
What do you believe is the most likely exit route for your business?
Only **20%** of the CFOs surveyed believe in an IPO either in Denmark or abroad.

PE rofessionals
What do you believe is the most likely exit route for your business?
50% of the surveyed funds' respondents believe in an IPO either in Denmark or abroad.

CFO
How long has the company been owned by the current PE fund?
50% answered more than **3** years.

CFO
What are your expectations for the EBIDA multiple at an exit?
41% expect a multiple above 10.

CFO
In which ways can a successful CFO most positively impact EBITDA?
74% beliceve that understanding of what drives gross margin is one of the most important factors.

CFO/board
In which ways can a successful CFO most positively impact EBITDA?
78% believe that high-quality reporting to management is one of the key factors.

PE professionals
In which ways can a successful CFO most positively impact EBITDA?
62% believe that understanding of what drives gross margin is one of the most important factors.

PE professionals
How confident are you that your CFOs can positively affect the value at an exit?
93% of those surveyed respond to a great extent.

PE professionals
Do you think that the majority of your CFOs understand what their roles are in driving value at an exit?
71% of those surveyed respond to some extent.

High Turnover Rate of CFOs

The turnover rate of CFOs in PE-backed companies is high. New CFOs are usually recruited outside the company, and even CFOs who have been onboarded during PE ownership seem to be replaced frequently.

From our experience from working with PE firms and PE-backed companies, we know that the turnover rate of CFOs is high.

This is substantiated in the survey by the key finding that the majority of CFOs are replaced either in connection with the takeover of the company or externally recruited during PE ownership; in total, more than 80% (see figure 1).

Furthermore, even CFOs who have been onboarded during PE ownership seem to have a high turnover rate. Half of the companies in the survey have been under PE ownership for more than three years, but half of the CFOs have been in their current position for less than two years. If this pattern is typical, the turnover rate will end up significantly higher than the approx. 80% (see figures 2 and 3).

It is important to stress that the survey does not show whether the high turnover rate is a result of voluntary resignations or forced termination.

Figure 1: How did CFOs enter the current position?

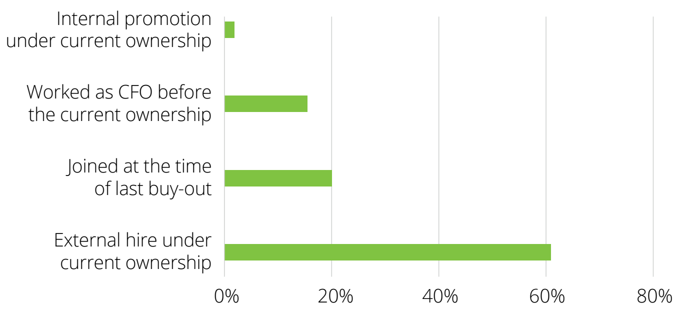


Figure 2: CFOs seniority in current position

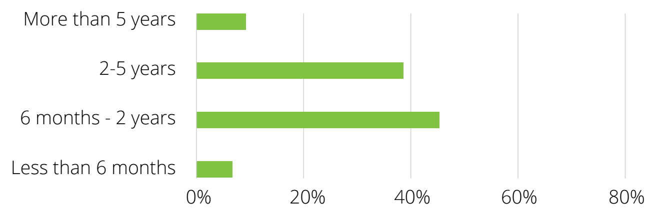
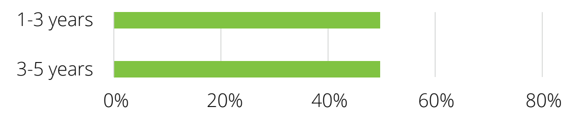


Figure 3: Duration of ownership in PE professional's portfolio



Navigating the CFO Role in a PE-backed Company

There are two main ways you can fall short in the role as CFO in a PE-backed company: If you fail to get the basics right or if you are unable to act as a business partner and leverage strategic insights.

Getting the Basics Right
The most repeated and stressed aspect in the survey for CFOs, CEOs/Chairmen and PE professionals is the importance of getting the numbers right and having own house in order. For example, there is agreement that high-quality management information is one of the most important ways a CFO positively can affect EBITDA.

"The most important part of the CFO role is to deliver 100% correct numbers."

Chairman

"Effective CFOs know their numbers and budgets in depth. Everything needs to be razor sharp."

PE professional

This corresponds with the traditional roles as "Steward", which include delivery of accurate numbers, financial reporting, internal control and compliance, and "Operator" where the focus is on quality management information, cash and working capital management as well as defining and developing the finance function. In combination these two roles are the CFO's "licence to play" and the survey shows that CFOs first and foremost need to get the basics right.

The Business-oriented CFO
In line with general trends within finance CFOs, CEOs/Chairmen and PE professionals all agree about the desired development of the CFO role. In recent years, the role of the CFO has evolved significantly from being a financial gatekeeper to a more business-oriented role as an adviser and a strategic partner to the CEO corresponding with the roles as "Catalyst" and "Strategist".

"My wish is always to have a business-oriented CFO. All the basics need to be in order, but the CFO ideally spends his time advising management."

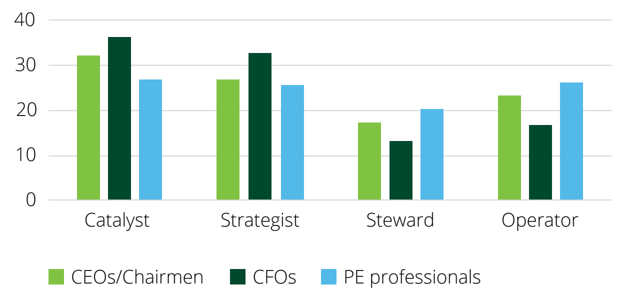
Chairman

"The most effective CFOs know the business."

PE professional

When asked how CFOs ideally spend their time on the four roles to create the most value for the company, the shared view in the survey is that CFOs should spend less time acting as stewards and operators and more times as catalysts and strategists (see figure 4).

Figure 4: Wanted development in CFO roles



Understanding the High Turnover Rate
Even though there is agreement in the survey about the development of the roles, the views on the starting point differ. In general, CFOs assess that they are less operational and stewardship-oriented and more catalysing and strategic than perceived by both CEOs/Chairmen and PE professionals (see figure 5).

This difference in perception poses the question whether CFOs fail to convey what they spend their time doing or their perception is skewed towards living up to the widespread trends within finance without being able to do so.

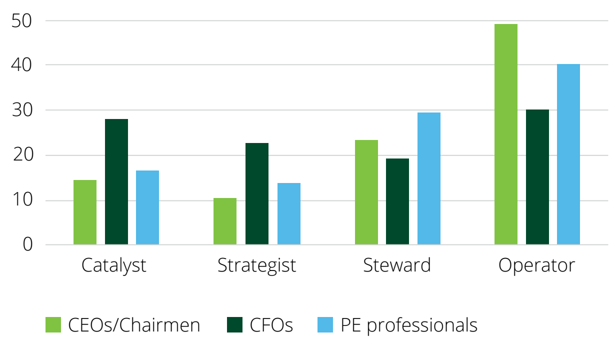
One hypothesis could be that the CFOs fail to create the foundation necessary for engaging on a more overall business level. The value creation of CFOs is dependent upon the availability and quality of competencies and infrastructure and requires that the CFO continuously develops the finance setup and leads the team. The three main enablers are finance processes, organisation and technology.

This hypothesis is substantiated in the survey by the fact that the CFOs report that the most important barriers that prevent them from spending their time in an ideal way are to be found in inefficient systems and processes and having the right team in place. Both CEOs/Chairmen and PE professionals agree but add that the CFO also needs to be the right profile.

Another hypothesis could be that CFOs face a dilemma navigating the role requirements given that they are expected to first and foremost getting the numbers right and having own house in order, but at the same time are expected to spend less time on this aspect. Even though acting as catalysts and strategists is an "add-on" and that in theory nobody would disagree about the value creation aspects of these roles, the reality of everyday life in a PE-backed company with its share of urgency and firefighting might not create the best starting point for spending less time on the numbers regardless of the overall finance setup.

Furthermore, it is important to bear in mind that CFOs typically have more experience and competencies within the two

Figure 5: How the CFO spends time today



traditional roles. When experienced professionals find themselves in a situation with new demands either for better performance within their current field of expertise or performing in a field where they have no or only limited experience, they can tend to stick to the tasks where they know they will perform and where they feel comfortable. Despite the best intentions, they can spend less time and effort than necessary on new and unfamiliar tasks.

These aspects raise the question whether more development of the finance setup and the CFO might decrease the high turnover rate. Seen from a business perspective, it is worth considering whether enhanced development might be resources well spent compared to the negative consequences involved in replacing the CFO.

Working in a PE-backed Company

Working as a CFO in a PE-backed company entails high demands, and support is an important but often scarce resource.

High Demands
The respondents of the survey agree that the transition into becoming PE-backed entails a significant change. The pace is perceived as higher, and as CFO you will get a more active owner than usual. Furthermore, PE firms are usually characterised by a project approach, work ethics of full commitment and long working hours. The survey shows that being a CFO in a PE-backed company equals high intensity and high workload.

"You need to accept that you have to prepare more if you want to deliver 100%. Prepare for delivering 110%. When you have delivered this, prepare for 120%."

CFO

"As CFO, you need to be prepared for an immense work pressure. You can be surprised about the pace in the PE environment."

CEO

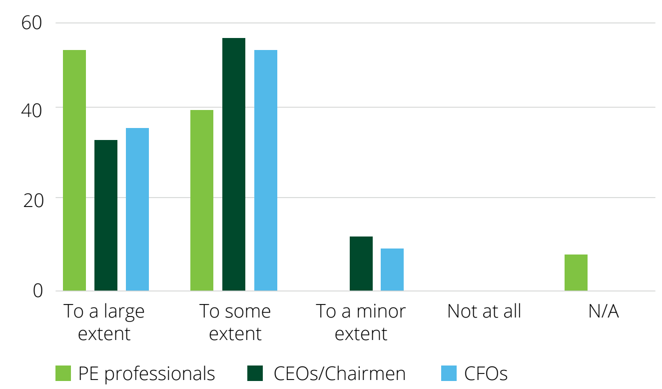
"It is frustrating when a CFO is not prepared to work the required number of hours."

PE professional

The high demands on the CFO are also illustrated in the survey by the fact that PE professionals have higher expectations for the extent to which the CFO positively can influence the exit value than the CFOs themselves and the CEOs/Chairmen (see figure 6).

High demands are by no means rare or something which only applies to CFOs in PE-backed companies. However, if other C-suite members in PE-backed companies do not have the same turnover rate, it poses the question whether CFOs in general are less competent or the expectations for CFOs are higher.

Figure 6: To which extent can a CFO influence the value at exit



An aspect could be that PE firms typically are data-driven with an immense focus on financial data. This causes the CFO to be of vital importance. This is substantiated in the survey by the fact that when asked how important it is to have confidence in the CFO when acquiring a new portfolio, the PE professionals unanimously respond that it is very important. Furthermore, the high demands could also be influenced by the fact that PE professionals typically have a background that makes them capable of immediately understanding and assessing the tasks of the CFO as opposed to other C-suite members.

"To be honest, the reason for the immense focus on CFOs and the reason why they often fail in the eyes of the PE firm is that they share the same professional field. PE firms are not able to be as critically challenging when it comes to for example a sales executive. However, with the CFO, PE firms know exactly how it is supposed to be done and have therefore very high expectations."

Chairman

Role of the CFO / Working in a PE-backed Company

Support as a Scarce Resource
It is of course the responsibility of the CEO to make certain that support is available for the leadership team. However, the survey shows that support from the PE firm also is important. It is stressed that the experience and competencies of the PE professionals are vital in helping the company to get ready for exit. However, despite good intentions, the survey indicates that support from the PE firm is often limited due to lack of time.

"You need to accept that you have to prepare more if you want to deliver 100%. Prepare for delivering 110%. When you have delivered this, prepare for 120%."

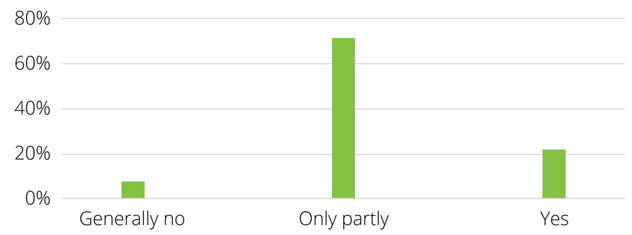
CFO

"We know that we need to share our experience and knowledge. Unfortunately, it is something that we don't get prioritised enough. The pace is so high all the time."

PE professional

Without knowing the previous level of dialogue about this, an indication that the CFOs do not receive the needed support is that both CEOs/Chairmen and PE professionals question whether CFOs understand their role in the exit process. Only half of CEOs/Chairmen think that CFOs understand their role in the exit process and about two thirds of PE professionals think that this is only partly the case (see figure 7).

Figure 7: Do PE professionals think that CFOs understand their role in driving the value at exit



Understanding the High Turnover Rate
The combination of high demands and limited support may play a role in the high turnover rate of CFOs. Imbalance between demands and the resources available to deal with those demands can result in high strain on the individual with potential effect on well-being and performance.

Furthermore, this environment may not be perceived as desirable and could therefore be the reason for voluntary resignations. It is worth considering whether PE-backed companies can attract the best CFO candidates given that individuals who highly value balance between work and private life might not be interested.

These aspects raise the question whether more support might decrease the high turnover rate. Seen from a business perspective, it is worth considering whether enhanced support might be resources well spent compared to the negative consequences involved in replacing the CFO.

Recommendations

In order to reduce the high turnover rate, it is recommended to continuously develop the finance setup and the CFO and to enhance support of the CFO in order to balance the high demands.

Reducing the high turnover rate of CFOs in PE-backed companies requires conscious choices about resources spent. As stated, it is worth considering whether enhanced development and support might be worth prioritising in light of the negative consequences involved in – sometimes repeatedly – replacing the CFO. This poses requirements for CEOs, PE professionals and CFOs.

As the CFO's immediate manager, the CEO plays a vital role in ensuring development and enabling the right support. It is the CEO who has the responsibility to continuously make certain that the CFO has the right capabilities and resources. This part of the leadership role can typically get de-emphasised in a busy work life of a CEO but remains critical to the success of the CFO.

For the PE firm, it may seem as the easiest solution to replace the CFO when there are performance issues. However, driving a development agenda can be viewed as an integral part of active ownership. It requires that PE professionals have capabilities within development and creating sustainable change both on an organisational and individual level.

Even though the CEO and the PE firm play a significant role, the responsibility of the CFO cannot be denied. CFOs need to see development as part of the journey and be able to assess and express own challenges and ask for help. This makes self-awareness an important requirement.

The below recommendations can in some ways be viewed as basic but require a shift in perception and ultimately behaviour which by experience can be hard to implement without significant effort. If the suggestions were easy to implement without further consideration, they would already have been done. This calls for reflections upon the perceived barriers that prevent execution.

Enhanced Focus on Development
As the survey has shown, there are two main ways that you can fall short in the role as CFO in a PE-backed company: If you fail to get the basics right or if you are unable to step up as an adviser and a strategist.

A countermeasure is to thoroughly assess the finance organisation and the CFO in order to establish an initial baseline and to be able to initiate relevant development activities.

The assessment of the finance setup should cover the previously mentioned enablers for value creation, namely finance processes, organisation and technology (for more information, please see the "Wheel of Finance" used in Deloitte for finance transformations).

The evaluation of the CFO should encompass individual strengths and weaknesses in the different roles. It is also relevant to assess more generic individual elements, such as cognitive capacity, ambition and values. since being a CFO in a PE-backed company requires a high degree of stamina, perseverance and an enhanced understanding of own changing roles. Furthermore, it is vital to assess and develop the leadership capabilities of the CFO since leading finance transformations requires strong leadership skills.

Enhanced Focus on Support
As the survey has shown, working as a CFO in a PE-backed company entails high demands, and support is an important but often scarce resource.

A countermeasure is to enhance the support from the CEO, the PE firm and the peers.

As the CFO's immediate manager, the CEO plays a vital role in enabling the right support. It is the CEO who has the responsibility to continuously make sure that the CFO has the right resources to cope with the high demands.

As for the support from the PE firm, an initial dialogue entering the collaboration is necessary. Furthermore, continuous support despite high pace and urgency would have a high impact. Regular check-in points should cover dilemmas regarding role and organisation. Even though it typically is not easy for experienced professionals, such as CFOs, to ask for help, admit being wrong or feeling insecure, the dialogue should ideally open for such aspects. Many PE professionals may already have the needed experience and competencies to create such an open dialogue, but others will need to develop this area.

To further support the CFO, a facilitated network with other CFOs working in PE-backed companies is well-proven and time efficient. Such a network provides CFOs with both inspiration and input to professional aspects but also the opportunity to share more personal challenges in navigating the role and working in a PE environment.

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