The CFO conundrum: how can private equity contend with the talent war for experienced finance leaders?

Finatal's Managing Director Jack Lane explores how funds and portfolio businesses can respond to the shortage of supply for veteran private equity CFOs.

I suspect this won't be a revelation to most as the 'war for talent' continues to dominate headlines; the private equity CFO market has been incredibly volatile over the last 12 months.

The combination of lower deal volume and macroeconomic uncertainty has turned private equity investor heads inwards, focusing on value protection and maximisation across the existing portfolio. Management teams have found themselves under greater scrutiny as investors have less tolerance for underperformance. According to research undertaken at the end of 2023, 62% of PE CFOs felt that their PE backers spent more time with them in the last year - whilst not inherently a negative point it is obvious that the more time you spend with a microscope, the more likely you are to find a crack. Coupled with PE CFO salaries at record levels, up almost 8% year-on-year, the expectations for the individuals in post are at an all-time high. Sometimes the need for a replacement is not actually in response to a lack of quality but rather a response to a change in strategic direction. Take the hyper-growth, buy-and-build technology CFOs hired in 2021 – how many of those have found themselves overpaid, underutilised and perhaps ill-equipped to handle the challenges of today? Funds will no doubt be unhappy to actively part ways with such talent, especially given how much they were likely paid on entry, but what is the alternative? Hold out, weather the storm and hope they don't leave of their own accord?

The opposing force at play is that of the portfolio companies' ability to retain talent.

Those CFOs who have landed exceptional opportunities, with eye-watering equity upsides and growth trajectories charging them towards significant exit pay-days, have effectively become 'the untouchables'. Whether due to positioning, timing or structuring, there exists a portion of PE portfolio companies who have effectively locked out their CFO talent from the rest of the market. Put simply: the best people in the best jobs are not going to move and they're not going to be replaced.

This constricts an already diminishing talent pool. If PE works as intended, CFOs are unlikely to do more than a few cycles – either retiring completely or pursuing a portfolio career – meaning fewer PE CFOs enter the market after each successful cycle. What does this leave us with? Either PE must take a calculated risk and hire outside of the existing pool or they must turn to their known entities elsewhere in the market who may not be quite as happy in their current post...

PE has fallen victim to its own hiring selectivity here – by focusing on the existing PE candidate pool, PE have wound up with CFOs in situ who 'know the game'. Having either already experienced a capital event or having already pushed through an extended deal cycle, experienced PE CFOs are unwilling to endure their equity being underwater and are more open to moving on. Knowing the demand for their skillset elsewhere and not needing to prove themselves, like a step-up or an outside-PE hire might, the veterans have little reason to stick around.

The threat to the 'capital upside' in a PE deal has largely been out of the CFO's control. Geopolitical uncertainty, debt costs, recessionary pressures and a constricted M&A market is a combination that even the greatest CFO may struggle to navigate. Our latest market outlook survey also revealed that 90% of respondents cited macroeconomic environment as an issue, with 45% seeing it as a critical problem facing their business.

In light of this, businesses face extraordinary pressure in retaining their finance talent and the most obvious solution (writing an outsized cheque) is not particularly befitting to the way in which PE operate. We have seen a rise of retention bonuses being offered to 'top percentile' CFOs on top of existing packages to stay until exit, but it's always been a last resort and often as part of a counter offer.

I won't comment on what ends up being the more cost-effective strategy but replacing a CFO is and always will be a complete headache.

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The headaches of 2023 - and now of 2024 - are as follows:

1. PE CFOs are in incredibly high demand: the best CFOs in the best roles are not moving and not many others are particularly keen to jump out of the frying pan into the fire.
2. The macro pressures on business have elevated the role of the CFO in driving value creation.
3. The scrutiny on the increasingly highly paid CFO role means investors cannot and will not settle for average.
4. Companies are changing CFO mid-cycle at the same time for the same reasons.
5. Confidence in a resurgence of the M&A market brings new deals to the table, which need new CFOs. Unsurprisingly, these new deals do not come with lower expectations than their existing portfolio counterparts.

The result is that the time-to-hire for PE CFOs has significantly increased. However, when the very nature of private equity ownership dictates a certain operating pace, waiting around for a new CFO is hardly in keeping with the thesis. In fact, waiting on a perfect permanent hire can eat into a high proportion of the hold period and in turn impact the ability to drive change. No one is willing to drop their standards – nor do I blame them – but what solution are we left with?

Accelerate the process:

Investors and their portfolio companies ought to run harder and faster at searches in order to acquire top talent in 2024. Entering the market with a clear vision and criteria for a successful candidate, pricing the role appropriately and preparing to make an offer quickly will set them apart. With restricted supply and ever-increasing demand, PE can effectively outrun the competition by being willing to tackle the search with gusto. Anecdotally, CFO candidates are more committed in a process when they feel there is real drive and commitment to make the hire – perhaps seeing it as a commentary on the business' style and strategy. Of course, this should not be conflated with a 'rush job', whereby the risk is that the trigger is pulled on the wrong hire due to lack of sufficient planning.

Investors must ensure they are partnered with a firm who have excellent market knowledge, existing candidate pools, the capability to map and access top tier talent, as well as the agility to move at pace. Choosing to work with a firm who are deeply entrenched in the private equity community brings a clear advantage here.

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Accelerating the process may mean investing more time ahead of a hiring need. Talent and value creation teams within funds are spending more time on speculative introductions and developing relationships with CFOs ahead of them coming to market in a bid to secure them. CFOs with prior PE experience are going to have a great deal of interest if and when they decide to look – funds can shortcut this with existing prior relationships.

Broaden horizons:

Look to access the pool of talent outside of the PE rubric. Wherever possible, in order to combat the restricted supply of existing PE CFOs, investors should look at bringing in 'fresh blood'.

Without sacrificing the quality index, firms can attract high quality first-time PE CFOs by broadening their horizons beyond the classic PE sphere. By widening the existing pool to step-ups and ex-corporate candidates, PE find themselves fishing in a much wider pond. It may also allow them to index further on desired criteria, like data experience, that they may have found too restrictive in the existing PE CFO market.

Hiring a first time PE CFO has a multitude of benefits: experience suggests they are more likely to 'stick it out', rather than relying on their decorated PE career to hop into another role. We drive the supply for future CFOs – ironically enabling firms to do the very thing they fell foul of in the first place but still increasing the flow of talent into the future market. With an increased desire for D&I across boards in PE, evaluating step-up pools, corporate candidates and those transitioning from AIM-listed business gives firms more opportunity to offer the finance leadership role to those from a more diverse background. For example, a staggeringly small percentage of existing PE CFOs are female – just 13%.

Finally, there is an opportunity to generate loyalty – by offering candidates their first opportunity to step into their first time PE CFO role, funds who invest the time to upskill and develop them will have a greater chance of retaining them across their portfolio.

Broadening horizons for a search requires a deep knowledge of the operating requirements for private equity and how to map analogous markets and experiences to them. By partnering with PE specialists who have extensive experience of working in their market, funds can more effectively assess and scorecard against key criteria. Firms cannot sacrifice quality so a search partner needs to be able to accurately demonstrate why the selected candidate can draw on relevant experience to make the transition. Evidently this comes with a great deal more nuance than 'they've done it before'.

Bridging the gap:

We are seeing a significant resurgence in funds hiring interim CFOs to bridge the gap between permanent hires. We have a long track-record of placing CFOs on fixed-term contracts into PE portcos, but 2023 saw a significant weighting towards mid-cycle swap outs versus deal related appointments. Firms are increasingly reluctant to hold on to a CFO they need to swap out, especially when they are no longer fit for purpose. Instead, they are turning rapidly to veteran hires - often with deeper experience and higher price points than their permanent counterparts - to steady the ship.

Hiring an interim CFO can lighten the load on investors and management teams whilst they look to hire on a permanent basis.

In 2023, we deployed interim CFOs to 'hold the fort', allowing firms to take their time before pulling the trigger on a new hire – often actively trying to avoid competition dynamics in their likely candidate pool. This was a particularly popular strategy for mid-market SaaS investments, whereby the talent pool had been so heavily restricted that funds were deliberately hiring interim CFOs so they could wait for a new set of talent to come to market.

Finatal has championed step-up candidates long before the term was trending amongst current market dynamics. Having had an established C-1 Finance practice for almost 15 years, we have consistently engaged and tracked the emerging talent market, often being recommended candidates by their CFOs and investors at the end of a deal cycle. We have a tight grip on the CFOs of the future who already have exposure to PE – a huge advantage in when executing a search across a much wider talent pool.

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Hiring an interim CFO may allow firms to deal with short-term issues and alleviate both immediate pressure and potential pressure on an incoming CFO. By hiring into a 'snapshot' of the deal cycle, funds can over-index on certain skillsets (like cash management) in order to solve a short-term problem. They may look to hire someone who doesn't fit the broader investment criteria but, for a period of 3-6 months, can contribute to value creation in a set time period. This has on obvious benefit, especially if the previous CFO was found to no longer be fit for purpose. By extension is that whoever is due to take the reigns in future should be able to launch straight into longer-term value creation initiatives rather than time-consuming immersion processes. This may have a direct impact on the ability to attract talent in the first place.

In an increasingly competitive market, being able to communicate to prospective candidates than an Interim CFO is in-situ doing some of the heavy-lifting may help attract higher quality CFOs in the process. Permanent CFOs are keen not to go from one mess into another and knowing that someone high-quality is engaged and tackling the issues at hand may give them the confidence to take the leap. Not only might it support your ability to hire top talent, it may also enable you to widen the net. By prioritising short-term task orientation with an interim, firms may release certain indices from their hiring criteria – effectively giving themselves an opportunity to hire from a much wider pool than they otherwise felt able.

There is also a cost-benefit to interim resource that is appropriate to mention here. Frequently the cost of an interim professional can be treated as an exceptional and therefore won't hit the bottom line. Investors, with their keen eye on EBITDA, can leverage high-impact resource in a portfolio company without denting the very thing they seek to protect.

> Having a direct lens into a business and a constant communication angle can help drive a successful hire without major disruption.

Dual-process approach:

Being able to use the same partner to dovetail across both an interim and permanent CFO mandate is hugely advantageous, especially for time-poor investors and management teams. With a return to executing new deals, investment teams are even more thinly stretched and simply narrowing the stream of communication has value. Both solutions should be delivered separately but a unified approach should allow a portfolio company to streamline their hiring. Typically, information comes to light during an interim's tenure that force search parameters to shift – having a direct lens into business and a constant communication angle can help drive a successful hire without major disruption.

The majority of our interim CFO mandates are typically focused on value creation projects but we saw a large increase in archetypal gap-management roles in 2023. This trend has continued into early 2024 as firms, in the war for CFO talent, are taking every measure possible to avoid expensive misfires, equipping themselves with knowledge and leading partners to do so.

Finatal is the leading search partner for private capital, focused on building successful, talented teams for private equity funds and their portfolio companies. We partner with businesses at all stages of the investment cycle across the UK, Europe and North America, offering exceptional service at an unrivalled pace. In the last year, we have worked with 400 funds to make more than 700 senior hires globally.

Should you be considering hiring a new CFO or making your next move as one, please do not hesitate to reach out.

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