KEYNOTE INTERVIEW

Staying the course



A clear, well-executed strategy that focuses on customer needs can help portfolio companies come out of challenging environments stronger, say senior advisers to CD&R funds Sir Terry Leahy, Jim McNerney and David Taylor

Q You have led businesses through several market cycles. What challenges and opportunities do testing environments like the one we are experiencing today present?

David Taylor: We are certainly experiencing a difficult environment right now. I have had the opportunity to deal with many of these over the course of my career, including the first contemporary global financial crisis in the late 1980s, the various recessions and dot-com crash in the 1990s, the great recession in the late 2000s and certainly when covid-19 first hit.

These kinds of crises tend to create differentiation within the market and highlight the importance of strategy. For CD&R, that involves remaining focused on consumers' needs and creating opportunities to address those needs.

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We believe that sharpening your focus on the core areas that drive performance within a business, supporting your people and helping them have confidence that the outlook on the other side of the crisis will be brighter, makes this possible.

In addition, M&A opportunities can become more available in trying times, as some companies are looking for a way out of a difficult situation. This provides more stable companies with the chance to consolidate and come out of a crisis much better than before.

Q David mentioned his experience with different market cycles. What experiences are you drawing on that have been helpful for the management teams in CD&R's portfolio?

Jim McNerney: The early 1980s is the last time I saw the slow growth, high inflation environment that we're faced with today. I was leading several GE divisions at the time, and reflecting on that experience – which may not be exactly the same as the management teams are facing today, but is close enough – allows us to assess our businesses' current risks and opportunities more clearly. Whether it's a major

Q What do you look for in a portfolio company CEO during these periods?

TL: During challenging economic times, you want a leader, not a manager. The attractiveness of the perfectly process-driven CEO tends to wane when things get tough. We believe what you need is a CEO who can communicate, who people will follow and who is convincing about the short-term sacrifices that need to be made for longer-term gains.

You also need someone who can demonstrate to their team why they need to run twice as hard as they were running yesterday when they already thought they were running about as fast as they could. I believe all these things make a difference in helping a company successfully come out of the other side of a challenging period.

growth programme, restructuring, or finding new leadership, we can bring our lived experience to the discussion and proactively guide management.

Sir Terry Leahy: I believe it is also particularly helpful that CD&R has such deep experience in the hard-hit consumer industries, both financially and from an operating standpoint, with an average of 20-plus years' experience across a range of business models. This insight helps us serve as a sounding board that can test various solutions and encourage the innovation that I believe businesses need to thrive through an economic downturn.

Q What should operating teams and portfolio company management focus on when facing macro-economic headwinds?

DT: We believe that having a clear strategy, setting transparent expectations and supporting people so they can execute against headwinds is essential.

> *"These kinds of crises tend to create differentiation within the market and highlight the importance of strategy"*
>
> **DAVID TAYLOR**

Fear disables, but we believe that confidence and clarity enable organisations to go out and execute a strategy effectively. If you had a strong strategy going in, stay focused on the critical elements, have high expectations and bring the resources to bear to take advantage of any opportunities that may be in front of you.

We believe that companies should not lower their expectations because of what they might have heard in the media about an impending recession or other macro concerns. Look at your industry, identify opportunities, work with your team and then execute well.

JM: In today's environment, we believe that winning companies will do the basics very well. They will manage inflation effectively, make their supply chains more resilient and price new product introductions flawlessly.

If I had to focus on two elements, it would be pricing and productivity. In tougher times, we believe that being able to price effectively is critical and productivity is key. Another important aspect to consider is company leadership and ensuring you have the right team in place to navigate choppy waters.

Q Does the way in which you engage with portfolio companies change during periods of uncertainty?

JM: The frequency of our interactions with portfolio companies doesn't change that much during tough times because we are already close to the ground. A lot of teamwork is established on a routine basis, but the subjects that we deal with may vary as a more challenging macro environment closes in. During turbulent times there may be more focus on the balance sheet and cash, as well as pulling in growth opportunities that we want to invest in.

Q What impact does rising inflation have on your strategy and that of your portfolio companies?

TL: At the business level, I don't think our strategy changes in an inflationary environment, but the guardrails around how you implement it do, and that is what we are attentive to in our portfolio. It is not the case that you stop driving growth programmes or you focus exclusively on productivity programmes and cash management. You still need to consider all of those in balance, but you must be sure to keep your feet underneath you.

DT: You still have to understand what the priorities are for consumers and the businesses that serve them. That includes knowing what they are looking for from you and making sure you deliver that through your products, staff and investments. So, in that sense, things don't change, but tactically you need to alter your approach.

We believe that you need to make sure that you can create new products and occupy new positions in the market that offer genuine value – it is not

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JIM MCNERNEY

simply a question of passing on costs to the consumer. Rebuilding your product and service offerings to make sure that they still constitute good value for the consumer and in a way that is still profitable for you as a business, despite the rising costs you might be facing, I believe is paramount.

Q Can you provide an example of how macro concerns are impacting a business you have invested in and how it is navigating today's environment?

TL: CD&R recently backed UK supermarket chain Morrisons. Like all supermarkets, in the short term, Morrisons faces a challenging time. Customers are worried about rising energy costs and rising prices in their everyday essentials, including food, so they are spending less where they can. There has also been supply chain disruption and labour market shortages in the UK. Morrisons is navigating all these circumstances, and we believe that the business has the experience, leadership and staff to successfully do so.

Historically, people come to supermarkets when they are looking for value, and we believe they come to Morrisons because of its reputation for appealing and affordable products. That is always important, but it is especially important in these challenging times.

The business also has a reputation as a good place to work. It provides training and management support and offers young people the opportunity to start their careers with useful skills. We believe that being an attractive employer is especially helpful when the labour market is tight.

Q What do you view as the most critical operational levers when evaluating a potential investment?

JM: When evaluating a new investment, we believe that finding those places where you have leverage that your competitors do not is crucial. That often comes down to assessing the leadership team, the way the business has allocated capital and the strength of its critical functions.

For example, with logistics, supply chains or customer-facing functions, we believe you need to really dig in and understand where the business currently is and what your investment can do to improve it. You do not want to make an investment where you are not sure that there are operating levers that you can pull that your competitors do not have.

Q What are the advantages for PE-backed private companies in times such as these?

DT: I think the private company environment has many advantages over the public company environment, and that has turned conventional wisdom from 20 and 30 years ago on its head. It is my view that private companies, particularly those led by sponsors such as CD&R, take a longer view, are less hobbled by conventional wisdom, less hierarchical, and they are therefore faster in their decision making. We believe that these are critical attributes to have as we brace for the macro headwinds ahead. ■

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