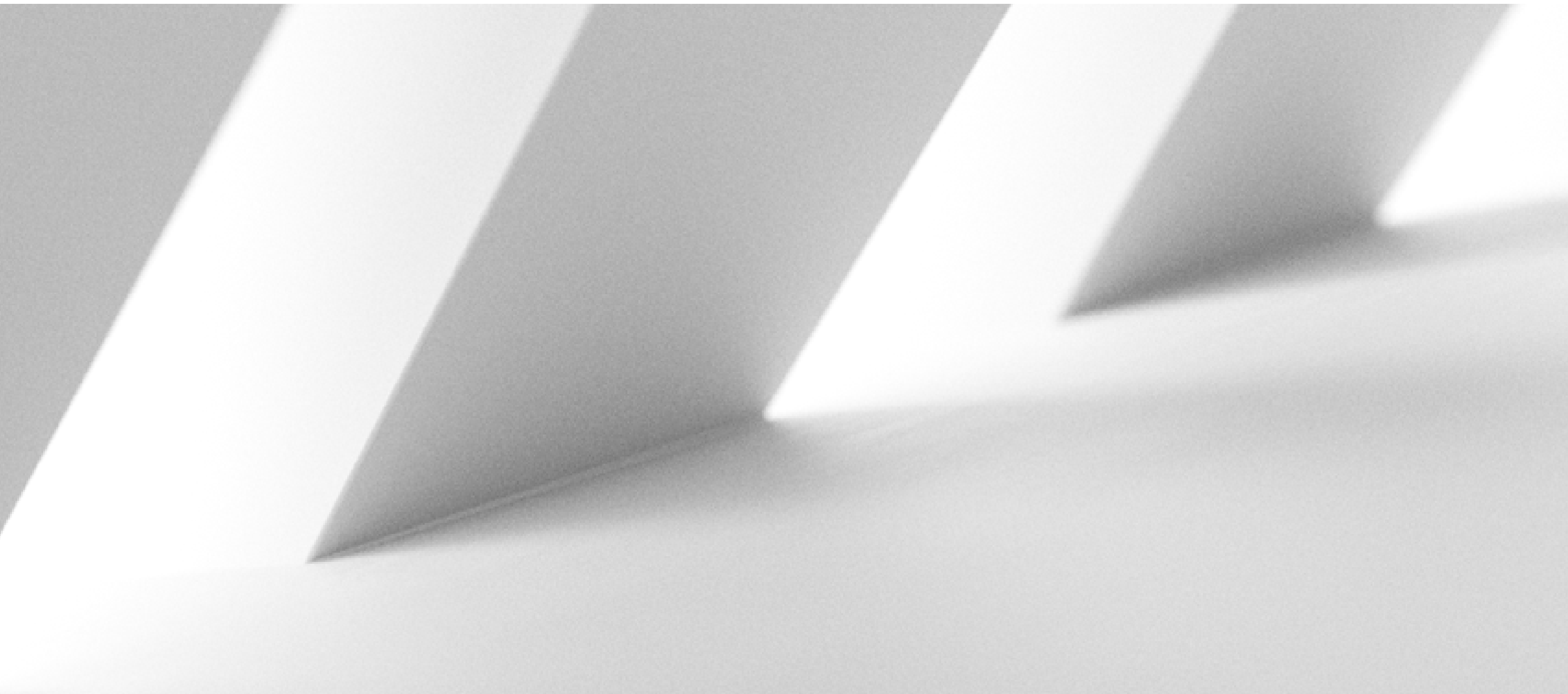
Five Leadership Insights from the Healthcare Industry on Launching a NewCo



Despite ongoing economic uncertainty stemming from the pandemic, public and private deal activity is surging. To remain competitive, multinational companies are turning to M&A for innovation in high-growth segments, while simultaneously divesting non-core assets.[1] The ready access to capital in the public market has also led to a surge in Special Purpose Acquisition Companies (SPACs), which are adding competition to the hunt for target companies.[2] On top of that, the private equity industry is poised for a record-setting year with over $1 trillion in dry powder and significant pent-up demand for deal-making.

In healthcare, the pandemic has had a material and likely lasting effect on many facets of the industry, creating new standards of care and accelerating the adoption of new technologies. The combination of the pandemic and the increased demand for deal-making has led many organizations to revisit their investment strategies. We are beginning to see a particularly high level of deal activity in the medical technology and broader healthcare industry.[3,4,5] A large proportion of these deals have taken the form of corporate spin-offs and public and private carve-outs. The structures of these types of organizations are inherently complex to create, as they require both unraveling and rebuilding talent, infrastructure and governance systems, almost always at the same time.

Over the past ten years, Russell Reynolds Associates has advised many healthcare organizations as well as investment firms throughout the various stages of the spin-off and carve-out process. In doing so, we have gained a great deal of insight into which leadership elements are required to make these deals successful, as well as what can go wrong if left unaddressed. While our insights are drawn primarily from the healthcare industry, they apply broadly across a number of industries for organizations that choose to launch a spin-off or carve-out company (NewCo).

Based on our experience, we have uncovered five essential leadership topics for executives launching a NewCo to consider in their transactions:

1. **The board**
2. **CEO leadership attributes**
3. **Underestimated functions**
4. **Corporate culture**
5. **Timeline**

The Board

Every NewCo needs its own board, leading to the important question of board composition. We find an increased focus on this issue as investors emphasize the value of ESG and the need for greater board diversity. Given the wide variety of spin-off and carve-out scenarios, however, there is no single formula for assembling an ideal NewCo board. They are often comprised of a combination of directors appointed from the parent company or investor and new, independent appointments. Most CEOs appreciate having at least one director from the parent company who either transfers to the NewCo or maintains a seat on both boards. A director who has been part of the spin-off or carve-out strategy, is familiar with the crafting of the transition services agreements (TSAs), and is able to understand the parent company can be highly valuable. Beyond these incumbents, selecting and appointing other board members with the right experiences for the situation is both art and science.

The key to building an effective board is to gain early alignment around the NewCo's strategy as well as identify any potential competency or experience gaps that the board needs to address (Figure 1).

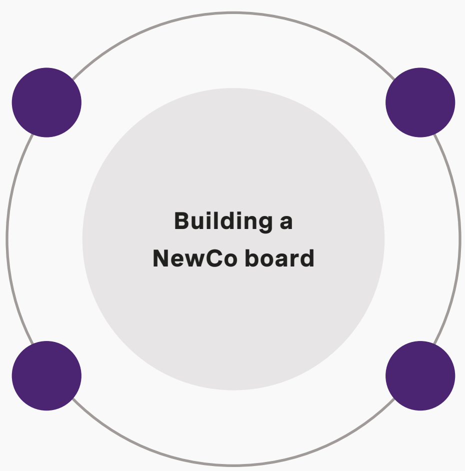
Figure 1: Principles of building an effective NewCo board

Alignment and gap analysis

Build board alignment with the investor base on growth strategy, ESG matters, and risk profile and identify gaps that need to be filled to optimize board composition: gender, ethnic, age diversity; industry expertise; transformation; digital; NewCo; major market change or turnaround experience

Structure and culture

Determine the structure of the board and committees; define the values, operating processes and culture of the board



Recruitment

Expertise in how to support day-to-day business strategies and general management should be prioritized over niche industry or governance expertise

Timing

Start the board small, while meeting statutory requirements and populating the key committees, allowing the company to add more directors post-spin-off or carve-out as required

In our experience, the next step is to focus on recruiting leaders who are current or recent operators (CEO, CFO) and can contribute at the board level. In fact, current and former operators should be prioritized over specialists, and prior spin-off or carve-out experience is strongly preferred. While governance skills and industry experience are also desirable, they are less important given the highly operational day-to-day tasks of the NewCo board. Board directors who can contribute to the core mission of the new company are also essential, whether they bring end-market or industry experience as well as experience in M&A, compensation structures, a robust talent network, or a strong business transformation track record.

Figure 2: Key considerations and questions when building a high-performing NewCo board

	Considerations	Questions
Structure	**Start small** by recruiting enough board members to populate the key committees **Leave room to grow** to allow the board an opportunity to expand in the future if unexpected gaps emerge	**Which committees** will be established from the start? What is the **right number** of board seats? What is the **frequency and location** of board and committee meetings?
Composition	It is essential to have a **clear definition of the critical competencies** needed on the board, including compliance issues (independence, financial experts, etc.) and skills to support growth/strategic initiatives **Independence requirements** may prevent **directors of the parent company** from serving on the NewCo board	What are the **key strategic goals** for the company in the next 3 - 5 years? Which directors will be inherited from the investor or **parent company**? How should **compensation** be structured?
Process	During the recruiting process, **special attention** should be paid to identify a potential **lead director or audit chair** **Develop consensus early** regarding timing, process, and desired board competencies Provide **ample time** to accommodate **candidates' schedules** for interviews	Who will form part of the **search committee**? Does anyone have **veto power**? In what **sequence** should board members be recruited? When do directors of the **investor or parent company** transition off the board? What are the **committee membership** and chair assignments?
Culture	Teamwork is essential for a high functioning board, therefore **cultural fit** must be considered throughout the recruiting process **Onboarding and training** can be used as a tool to bring new directors together and lay the groundwork for the team	What **behaviors** are important in directors for this particular board? How will candidates be **assessed to determine cultural fit**? What is the optimal **onboarding and sequencing process**?

CEO Leadership Attributes

First-time CEOs typically take between 12 and 18 months to acclimate to the role. This is often the same time period in which the new company is expected to be fully up and running - and significantly outperforming its previous state. Unsurprisingly, appointing C-suite leaders with previous spin-off or carve-out experience or prior experience in the CEO role is high on stakeholders' priority lists given the lack of time for the typical learning curve.

Recruiting a leader with this specific experience is not always practical or possible. Given the highly matrixed organizational structure of MedTech companies today, it is increasingly important to find CEOs who have run a true, fully-functional P&L. Through recent work, RRA identified the leadership characteristics that tend to set successful NewCo CEOs apart.

- NewCo CEOs need to be resilient and **committed** to the organization, with **high risk tolerance**, given the uncertainty that comes with a NewCo; there are *always* surprises
- NewCo leaders should have **strong strategic acumen**, as the work will require continuous problem-solving
- They must be **diligent** and **hands-on**; willing to take on even the most mundane tasks as project managers - particularly in the first, lean days of the new business
- Given the hands-on nature of the work, NewCo CEOs must be willing to hold themselves **personally accountable for results**
- They must be **adaptable, not discouraged by setbacks**, given the reality on the ground may be nothing like the assumptions going in
- Finally, a **strong sense of urgency** will mean they can get the work done, no matter the challenges

Underestimated Functions

What are the most critical hires for a NewCo to make? Aside from the importance of building a strong, diverse board and hiring a CEO, there are a few C-level roles that are essential to fill first when setting up a new company. Sometimes these most vital hires are also the most underestimated. In hindsight, spin-off and carve-out leaders mentioned they would place far more emphasis on the human resources, finance and IT functions.

Human Resources: Much of a NewCo's success depends on the quality and drive of the organization's talent. Considering that a NewCo can typically lose 40 to 80 percent of its existing leadership team and mid-management in the first 12 months, the CHRO should ideally join the CEO on day one as a close strategic partner. In addition to hiring new talent and implementing strong retention tools, a successful CHRO will help the CEO establish the new organization's culture. In our experience, nearly all CEOs regret not hiring this role sooner, or not hiring a senior enough leader.

Finance: A forward-looking, operational CFO is essential as this leader will be required to build out the finance function, including tax, treasury, and accounting. Additionally, the NewCo will need to begin detailed reporting before the new systems are fully in place and while some financial data may still be with the parent company. In a PE carve-out scenario, the CFO takes on added importance in managing large amounts of debt if the NewCo is highly leveraged. The CFO is mission-critical from day one and ideally has private-equity backed, prior NewCo, turnaround, or crisis experience.

Information Technology: IT is especially important in a NewCo as the systems are essential to support all business functions, offer connectivity throughout the organization and increase accountability. A new IT leader should therefore be in place as soon as possible to make important system choices. Extracting IT systems from the parent company is complex, and outside spending on IT consulting and outsourced services can be costly. The IT leader should be particularly adept at keeping such outside spending under control.

Other considerations: Many experienced spin-off and carve-out CEOs say they would give more attention to investor relations and corporate communications if they had to do it all again. They underestimated the importance of having an expert who could skillfully communicate the company's story and evolution while reaching out to both internal and external stakeholders. Additionally, they would appoint a talented project manager (PM) who reports directly to the CEO to help with every aspect of the execution during the transition. Whether pulled from the legacy business or from outside, ideal characteristics for a successful PM include strong communication skills and the ability to plan and execute in a very hands-on way.

Corporate Culture

As the transition to a spin-off or carve-out will inevitably be a period of high uncertainty and heavy workloads, instilling employee confidence in the NewCo must be a top priority for every CEO and CHRO. A NewCo CEO inherits a group of employees with various attitudes towards the changes occurring and different levels of engagement in the new company. Often, the pace and business drivers of the NewCo are - by necessity - vastly different from those of the parent company. Setting and communicating a simple, compelling vision to employees on day one is essential to engaging the workforce, retaining top performers, and attracting new leaders to the organization.

The disruption caused by the transition to a NewCo also offers a unique opportunity to engage the organization in building a positive culture. Diversity, equity, and inclusion should be front and center in these discussions. Interestingly, most NewCo leaders find culture-setting in the newly established company easier than in any other CEO role or M&A environment. The reason? More often than not, employees are actively looking for new direction and support. Plus, **the NewCo was purposefully created to set a different path than the parent company**, making it easier to establish a culture that may be different from the legacy organization. At the heart of culture-building is communication. To succeed, just as with instilling employee confidence, leaders must keep their messages simple and reinforce those messages early and often.

Figure 3: Culture is key

Timeline

There are many moving parts involved in the launch of a NewCo. Leaders should find the right balance between focusing their energy on standing up the NewCo and driving future value. The illustrative timeline below (Figure 4) can provide guidance on when key decisions and milestones should occur, from pre-launch to growth.

- **Pre-launch.** Ideally, the NewCo has a few months to put core leadership in place ahead of the launch. These leaders include a CEO, CHRO, CFO, and the minimum number of board members needed to support the launch. Keeping the core team lean gives the company flexibility to bring on additional talent that will help the company evolve. Additionally, NewCo leaders should begin to identify, assess and focus on retaining key talent that was part of the parent company that is being spun-off or carved-out.
- **Setup.** As essential functions are put in place and the NewCo is launched, the new company will communicate the vision, identify legacy talent they want to retain and promote, and round out the corporate leadership team.
- **Ramp up.** With the new company moving towards independence, retention methods need to be put in place for key internal talent, as other legacy employees who wish to leave will likely start self-selecting out. To turn the company towards new growth and profit targets, it is also important to increase the focus on existing customers and connect with new ones.
- **Growth.** As the NewCo approaches normalcy for a growing organization, the emphasis will shift from building the business to maintaining its core vision. At this point, leaders need to refine their talent strategy, develop benchmarks, bring on new board members, and start their succession planning process as the company increasingly looks to the future.

Figure 4: Illustrative timeline of operations and talent evolution

	Pre-launch	Setup	Ramp up	Growth
Timeline	3 months →	18-36 months →		*ongoing*
Talent	• Recruit CEO • Recruit board • Recruit lean core leadership team • Assess existing bench strength • Identify and retain crucial existing talent	• Hire to round out core leadership team • Test C-suite caliber of leaders • Identify further existing talent to retain • Implement strong retention tools	• Identify strong project managers; task them with new, mission-critical transition projects • Allow legacy employees to self-select out • Retain key internal talent and new hires	• Add board members • Create succession plans for leadership team roles • Develop and execute on desired culture • Develop and execute on individual development plans
Operations	• Set vision • Establish TSAs • Secure, renovate facilities	• Share vision, set expectations • Implement structure that aligns strategy with board/investor expectations • Ensure consistency in IT and finance application and reporting	• Align purpose and culture of NewCo with top 200 managers • Maintain customer focus • Align product/services across markets • Refine inconsistencies in IT, finance etc.	• Maintain core vision through open communication between internal and external stakeholders • Maintain application and reporting consistency throughout growth • Identify and prepare for compliance and regulatory requirements

Launch of NewCo

Spin-off and Carve-Out Success

A NewCo will face many challenges as it launches and develops. Setting one up is an inherently delicate task, requiring leaders to unravel and rebuild highly complex overhead infrastructures within compressed timeframes, and under the scrutiny of public markets or engaged investors. The leadership lessons Russell Reynolds Associates uncovered around five key topics - board, leadership attributes, underestimated functions, corporate culture, and timeline - can provide insights to business leaders to help them best navigate the intricacies of launching a spin-off or carve-out company.

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Russell Reynolds Associates is a global leadership advisory and search firm. Our 470+ consultants in 46 offices work with public, private and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic and political trends that are reshaping the global business environment. From helping boards with their structure, culture and effectiveness to identifying, assessing and defining the best leadership for organizations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led.

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