STATE OF THE MARKET

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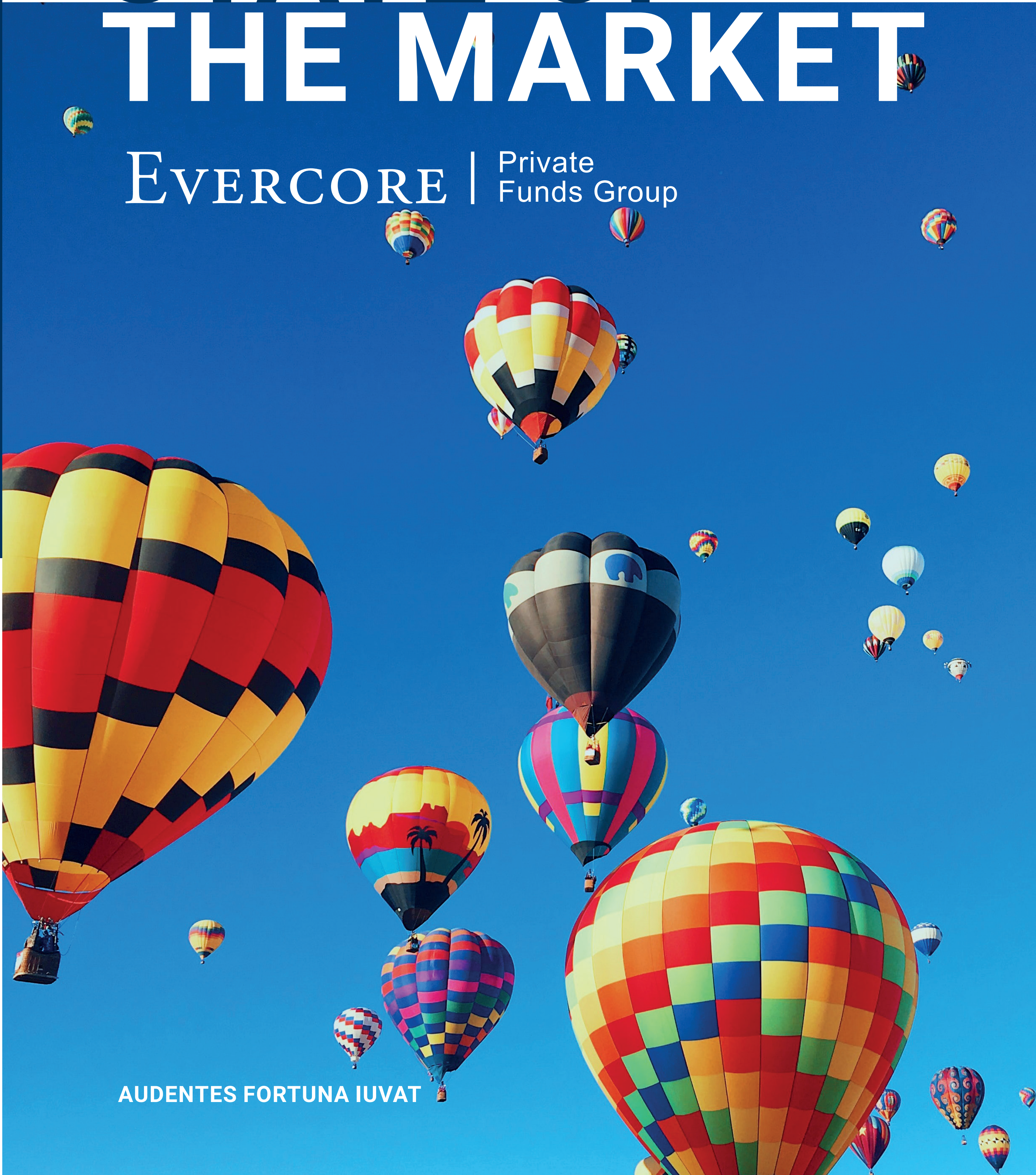

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STATE OF THE MARKET 2022

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Return on culture

'Culture eats strategy for breakfast'[1]

SHEILA DHARMARAJAN, PARTNER AND HEAD OF BUSINESS DEVELOPMENT AND INVESTOR RELATIONS AT ZMC, INTERVIEWS ANDREW VOGEL, CO-CHIEF INVESTMENT OFFICER AND MANAGING PARTNER OF ZMC

ZMC was founded in 2001 with the kernel of an idea: the accelerating confluence of digital technology with media and communications products and services would be a source of extraordinary value creation — and value destruction. The partnership believed that investing behind trends that emanated from this technological upheaval, along with a focus on operations, a passion for people, and forging strong partnerships, would redound to the benefit of our customers, companies, employees and investor stakeholders. Equally, the team also knew that success, however defined, necessitated building a world-class firm whose doors they would be proud to walk through every single day. Said differently, cultivating an exceptional culture that would complement and sustain the commercial opportunity was imperative. Twenty years later, ZMC's Andrew Vogel reflects on the importance of culture and its impact on returns.

Sheila: Andrew, here we are 20 years since the founding of ZMC. We talk a lot about ZMC's unique culture. Let's start with the basics. How do you define our culture?

Andrew: Our mission statement captures the values that define our culture: transparency, integrity, high performance, teamwork, service and kindness. I'm going to go out on a limb and speculate that there aren't many private equity firms with the word 'kindness' in their mission statement. Each one of those attributes is important individually, but it's the combination that is especially potent. We believe that ZMC's culture has been the underpinning of the firm's comportment as a fiduciary as well as its economic performance.

Sheila: Let's dive into those attributes that define our culture. It's easy to take those words and throw them on a website. How do they translate into action?

Andrew: It's easy to talk about kindness, transparency and teamwork when everything is 'up and to the right,' but there will always be challenges and events that don't go your way. One of our many aphorisms from the last 20 years is that 'culture, like character, is tested in the breach.' We have had our fair share of difficult times over the years, including fundraising during the global financial crisis and 'fires' that needed dousing in several portfolio companies.

More recently, the Covid-19 pandemic brought unprecedented upheaval and chaos for employees and businesses alike. In fact, our sports ticketing and analytics portfolio company saw its revenue go to zero in a matter of weeks as most of the country went into lockdown. From time to time, you need to make very tough decisions and deliver difficult messages — but that comes with the territory. It is in these moments, however, that acting with integrity and kindness is of the utmost importance. We are fortunate that in each instance we've achieved successful financial outcomes; what makes us prouder, however, is that we did so while upholding and acting in accordance with our core values.

Sheila: Culture is often presented as a big idea or concept. What I am taking away is that the little things — like how you deliver a message — are equally important.

Andrew: Arguably, more important. When considering the values that you want your firm's culture to represent, it's important to think about how they are expressed in daily actions, both internally and externally. At ZMC, our culture reverberates throughout every aspect of what we do. How we run our internal investment committee, for example, is emblematic of ZMC's values. The entire professional team takes part in our IC meetings. Everyone in the firm has an opportunity to challenge and ask questions. In fact, at the close of an investment committee meeting, we go around the table and everyone is expected to have an opinion and weigh in on the deal.

Another empowerment construct we employ is that the deal Partner never presents the materials; rather, it's an Associate or a VP who takes the lead. While these nuances may seem minor, they have a significant impact. Our goal is to encourage multiple, diverse points of view and mitigate the stifling effect that senior voices can have on the room.

This also speaks to another important part of our culture: developing young professionals and honing their investment judgment. Being asked to vote 'yes or no' on an investment, without equivocation or caveat, is an important exercise in transitioning from the mentality of an adviser to one of an investor.

Sheila: All great points on how to motivate and mentor people. But what about paying people? Isn't that ultimately what matters?

Andrew: To be credible, a firm's approach to compensation also needs to be reflective of its culture. In a for-profit, capitalist enterprise, people will follow the incentives; that is simply human nature. ZMC's view is that only when incentives and culture are aligned do you have everyone pulling together in the same direction — emotionally, operationally and financially. A compensation plan is a litmus test as to whether a company's culture is truly credible or simply words on a page. In the world of private equity, it's easy to talk about a collaborative culture, but if the economics fail to reflect it, culture becomes meaningless. At ZMC, deal teams, for example, are not given outsized economics. Rather, everyone wins together on the same basis for every deal and everyone is therefore motivated to help drive the best possible outcome across the portfolio.

The notion of aligning culture and compensation extends to our portfolio companies as well. In new investments, one of the first things we do is review the compensation programme to ensure interests are aligned. Compensation should be aligned with specific, objective goals and we eschew any form of discretionary remuneration. Discretionary bonuses tend to invite politics and lead to employees being more concerned with whether they are liked or giving answers that they think their superiors want to hear, as opposed to the right answer.

Sheila: Speaking of portfolio companies, a big part of ZMC's investment approach is our collaboration with management teams. How does our culture manifest itself in our relationship with portfolio companies?

Andrew: We are highly collaborative and partnership-oriented when it comes to how we work with our portfolio companies. While each investment is unique, there are a few principles that remain constant:

1. Respect — Members of our team have sat in the proverbial CEO seat when building and operating companies. Bottom line, it is no easy task to pursue a vision, motivate a team, satisfy customers, manage a P&L and do everything else in between that is required to run a business. As a result, we have great respect for our management teams and show them plenty of deference; we are humbled by what they do, day in and day out.

2. Be of service — We believe that our job is to serve our portfolio companies and help them, in turn, serve their customers in the most effective and efficient manner. Our service to them can mean many different things. For some companies, it is the important connections we can facilitate through our networks; for others, it can mean helping them transition from QuickBooks to a more robust ERP system. Like the Hippocratic Oath's 'do no harm', ZMC's modus operandi is if we cannot be of service and add value, we should stay out of the way.

3. 'The weekly' — We don't believe in a one-size-fits-all action plan or burdening teams with pre-conceived, off-the-shelf playbooks. Rather, we work closely with our management teams to identify specific value creation initiatives that we collectively believe will have an outsized impact. From there, 'the weekly' is literally just that: a weekly opportunity to connect with our CEOs and contribute towards advancing the projects and strategies that will drive the most value. For each company, the weekly will take a different form: for one of our CEOs, it's based on a 'what's on my mind' email of topics sent the night before; for another, it's a detailed report of the sales pipeline that then acts as a springboard for discussion.

4. Deliver the firm — We have the opposite of an 'eat what you kill' culture. As appropriate, any and every member of the firm will get involved when their unique skill set can help add value. Each portfolio company has access to the full mindshare of the firm.

5. Accountability — In order to have a successful working relationship with our portfolio companies, we believe it must be a two-way street. Anyone can talk about being an 'active partner' of management teams; however, we believe it's imperative to hold ourselves accountable as well. Our weekly management engagements are as much about what ZMC delivers to the executives as the other way around. We quite literally assign ourselves responsibilities that we put our name on and hold ourselves accountable for.

Sheila: What about our investors? How does our culture influence those relationships? Because, ultimately, we are fiduciaries.

Andrew: You know this better than anyone, given your role as Head of Investor Relations, but all the attributes of our culture absolutely extend to our investor relationships too. Our inclination towards transparency naturally results in over-communicating with our LPs. Whether through our quarterly reporting or drawdown memos and even LPAC agendas, we certainly go above and beyond the information we are contractually required to provide. We believe that the more informed our investors are, the better partners we can be for each other, which makes for enduring long-term relationships.

As for being fiduciaries, there is plenty of research that links positive organisational cultures to better outcomes across a variety of dimensions, from lower turnover and better engagement to higher productivity and superior returns. For example, McKinsey research showed that organisations that had 'healthy' cultures posted a return to shareholders 60 per cent higher than median companies and 200 per cent higher than those in the bottom quartile.[2] Harvard Business School Professors John Kotter and James Heskett's book *Corporate Culture and Performance* also concluded that, for better or for worse, the culture of a corporation has a powerful influence on its economic performance.[3]

Beyond the empirical evidence, though, ZMC's ethos is that if you start with a strong culture, the rest will follow. When private equity investors are asked who their customers or constituents are, the answer is typically their investors. We take a more nuanced approach. First, we prioritise the customers who buy the products and services our companies provide. Why? If we don't make a great product or service and offer it at a fair value, there is no reason for the company to be in business. Second in line, are the employees who work at our portfolio companies. If we don't support them and make sure they are happy, how can they effectively operate the companies providing the goods and services that delight our customers? The third priority is our investors, who entrust us with their capital and for whom we act as fiduciaries to deliver high risk-adjusted returns. As for ourselves, we are last in line.

Management guru, Peter Drucker, famously remarked that 'culture eats strategy for breakfast.' To be clear, one must have a sound business strategy in place — even the most amazing culture won't fix a broken strategy. That said, once a solid strategy is in place, we have observed that culture and performance go hand in hand. To be sure, this conjecture may not be strictly scientific, as it is based on a sample size of one. However, over the past twenty years our results suggest that by focusing on culture, several measures of 'return' do indeed follow.

1. Peter Drucker, renowned Management Consultant, Educator, and Author; often referred to as 'the man who invented management'. Drucker Institute, https://www.drucker.institute/perspective/about-peter-drucker/
2. McKinsey & Company, Culture: 4 keys to why it matters, 27 March 2018
3. John Kotter and James Heskett, Corporate culture and performance, 1992

Andrew Vogel joined ZMC in 2003 and is jointly responsible for overseeing the firm's private equity investment activities. Mr Vogel currently represents ZMC as Chairman of the Board of Directors of Simeio, CommentSold, Education Networks of America, Inc. and AdThrive, LLC, as well serving on the boards of The Second City, 9 Story Media Group Inc. and ITRenew, Inc. Prior to joining ZMC, Mr Vogel worked at Ripplewood Holdings, a private equity firm where he focused on investments in the media, consumer and industrial sectors. He also worked at McCown De Leeuw and Co., a private equity firm where he was responsible for investments in the consumer, building materials and health and leisure industries, including the firm's investment in 24 Hour Fitness. Previously, Mr Vogel was an investment banker in Lehman Brothers' Mergers and Acquisitions Group and interned as a Management Consultant for McKinsey and Company. Mr Vogel earned a BA in Mathematics and Economics from Wesleyan University. He also received an MBA from Harvard Business School, where he graduated as a Baker Scholar.

Sheila Dharmarajan joined ZMC in 2014 and leads all of the investor relations, fundraising and deal sourcing activities at the firm. Prior to joining ZMC, Ms Dharmarajan was an on-air television reporter for CNBC and Bloomberg Television, where she regularly reported on a wide range of business news and breaking stories. She has also served as the host of "The Future Is Now", a Yahoo! web series focused on innovation and cutting-edge technologies. Before her television career, Ms Dharmarajan was an investment professional at Permira and Welsh, Carson, Anderson & Stowe, where she focused on analysing and executing private equity investments across a range of industries including healthcare, consumer/retail and information services. Ms Dharmarajan began her career as an Investment Banking Analyst at Donaldson, Lufkin & Jenrette and was an Associate Director in the Mergers & Acquisitions Group at IAC/InterActiveCorp. She holds a BSc in Finance & Management from the Wharton School at the University of Pennsylvania. Ms Dharmarajan also earned an MBA from the Stanford Graduate School of Business.

EVERCORE

15 STANHOPE GATE
LONDON, W1K 1LN
TEL: +44 (0) 207 290 3290

40 EAST 52ND STREET
NEW YORK, NY 10022
TEL: +1 (646) 264 2374

THREE EMBARCADERO CENTRE
SUITE 1450
SAN FRANCISCO, CA 94111
TEL: +1 (415) 229 8096

TWO EXCHANGE SQUARE
CENTRAL, HONG KONG
TEL: +852 3983 2604