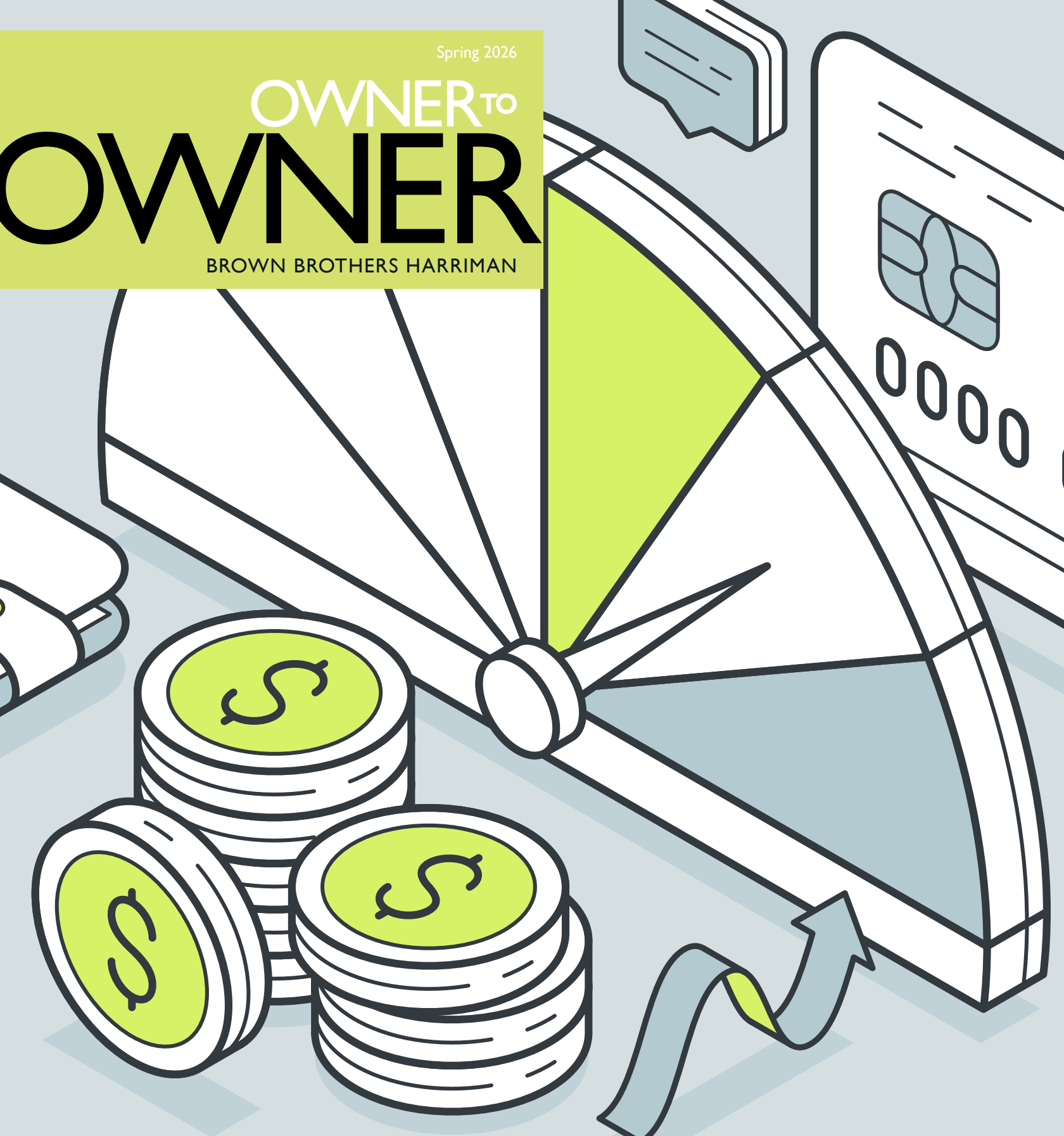


Spring 2026

# OWNER<sup>TO</sup> OWNER

BROWN BROTHERS HARRIMAN



## Plus Ça Change:

The Five Cs of Credit and Why Character Still Counts

# OWNER<sup>TO</sup>OWNER

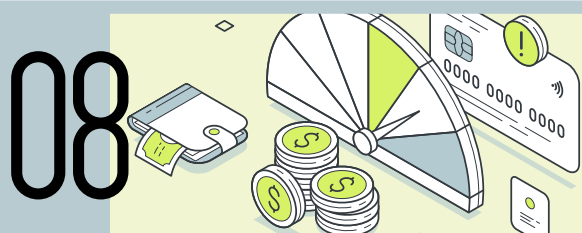
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**Jeff Meskin / Partner**

Dear clients and friends,

We hope 2026 is off to a smooth start for you. The year ahead promises to be an eventful one, highlighted by the 250th anniversary of the U.S. – the bisesquicentennial. As we mark this historic milestone, we reflect on the progress made and the opportunities that lie ahead for us all. We are excited to continue serving you this year, and we thank you for your ongoing partnership.

Against this backdrop of celebration and reflection, it is important to consider the current economic landscape. In today's credit market environment, risk is priced near perfection and cracks are beginning to emerge. During times like this, it is worth revisiting some of the first principles of credit underwriting, which BBH Partner Lewis Hart does in this issue's feature article. He looks at the five Cs of credit – character, capacity, capital, collateral, and conditions – and underscores that, especially when leverage is high and losses are increasing, creditors who diligently assess character are better positioned for success.

Turning to the other pages of this issue, we sit down with Tom Ripley, CEO of Ames Watson and former infantry and special operations officer in the U.S. Marine Corps, for a conversation on his journey from the military to the business world. Ripley's approach to leadership, mission, and responsibility reflects the enduring traits that have defined U.S. progress throughout the nation's history and highlights how individuals continue to shape the country's legacy in public and private spheres.

Across 250 years of U.S. history, there have been countless achievements, watershed moments, and lessons learned. We spoke with Pulitzer Prize-winning author and historian Jon Meacham about what these lessons mean for today's politics, economy, and society. He shares how our nation's past continues to shape our present and offers guidance for navigating the opportunities – and challenges – that lie ahead.

In addition to these insights, we focus on the foundations of organizational strength. Carefully selecting the right individuals for key roles is crucial to building a strong and lasting organization. Head of Corporate Advisory John Secor and Managing Director Kyle Gordon explain the nuances to attracting senior-level talent who will not only contribute to the business's success but also serve as great stewards for the future.

And as always, Michael Conti, William Mooney, and Christine Hourihan provide an overview of the economy, credit markets, and private equity and mergers and acquisitions markets.

We hope you enjoy this issue. If you have any questions about the topics covered in this edition, my colleagues and I would welcome the conversation.

Sincerely,

**Michael Conti, CFA** / Investment Research Group

**William Mooney, CFA** / Corporate Advisory & Banking

**Christine Hourihan** / BBH Capital Partners Private Equity

# The Business Environment Q1 2026



In each issue of *Owner to Owner*, we review aspects of the business environment on three fronts:

- Overall economy
- Credit markets
- Private equity (PE) and mergers and acquisitions (M&A) markets

The following article examines the state of the economy at the start of 2026, marked by growth amid continued policy uncertainty and high consumer delinquency rates, a pause in the rate-cutting cycle and tightening credit spreads, and renewed momentum in the PE and M&A markets..

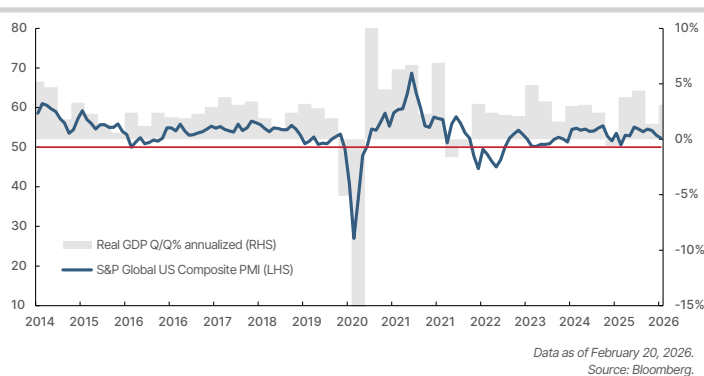
## The economy

According to the initial estimate by the U.S. Bureau of Economic Analysis (BEA), U.S. real gross domestic product (GDP) expanded at a quarter-over-quarter annualized rate of 1.4% in fourth quarter 2025, well below the 2.8% consensus estimate. This marks a sharp deceleration from the 4.4% real GDP growth recorded in third quarter 2025, reflecting downturns in government spending and exports and a deceleration in consumer spending that were partly offset by an acceleration in investment. There was considerable noise in this fourth quarter GDP growth estimate, as the U.S. government was shut down for almost half of the three-month period. The BEA estimates the reduction in federal services subtracted roughly 1% from GDP growth, suggesting GDP growth should have been roughly 2.4%. The personal consumption expenditure (PCE) component of GDP – which

drives 70% of GDP over the long run – advanced 2.4%, driven entirely by spending on services, as spending on capital goods was negative.

Despite the below-consensus fourth quarter 2025 GDP growth rate, as of March 2, 2026, the Atlanta Fed GDPNow Index forecasts first quarter 2026 GDP growth to rebound to 3.0%. Macro data, such as the S&P Global U.S. Composite PMI Index, suggests the economy is expected to remain in expansion territory, which sets a positive backdrop for companies’ earnings growth. The S&P 500 is estimated to generate earnings per share (EPS) growth of 14.5% in 2026 and 16.0% in 2027, up from an estimated 12.7% in 2025.

### The U.S. economy remains in expansion phase

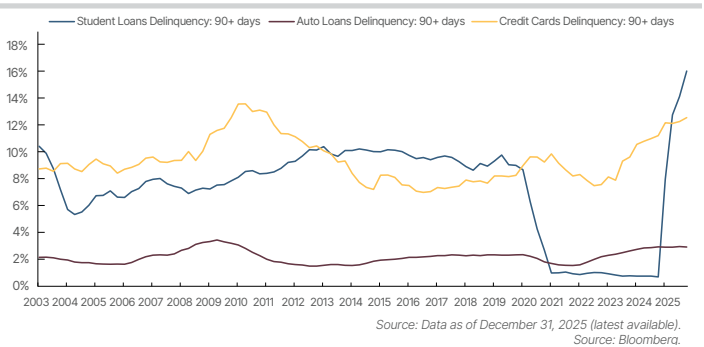


Shifting to the U.S. labor market, the U.S. economy added 130,000 jobs in January 2026, pushing the average three-month nonfarm payrolls net change into positive territory and its highest level since February 2025. As such, the U.S. unemployment rate (U-3 rate) declined to 4.3% in January 2026, down from 4.4% recorded in December 2025. Significant declines in the U-3 rate may prove to be challenging, as the number of job openings declined to 6.5 million, the lowest level in over five years and roughly 14% below the pre-COVID-19 peak set in November 2018.

Meanwhile, consumer delinquencies across auto loans, credit cards, and student loans have reached multiyear highs, and are at levels not seen since the 2008 global financial crisis (GFC). This raises concerns about the health of household balance sheets. Particularly striking is the sharp increase in student loan delinquencies as the grace period preventing negative credit reporting for missed payments expired in September 2024. Consequently, consumer confidence as measured by the Conference Board Consumer Confidence Index remains 20% below the four-year peak achieved in November 2024.

**“Macro data ... suggests the economy is expected to remain in expansion territory, which sets a positive backdrop for companies’ earnings growth.”**

### Sharp increase in consumer delinquency metrics



As it relates to monetary policy, in January 2026 the Federal Open Market Committee (FOMC) paused its interest rate-cutting cycle after reducing rates for three consecutive meetings from September 2025 to December 2025. Fed Chairman Jerome Powell stated that economic growth continues to surprise to the upside, noting real U.S. GDP grew at an annualized rate of 4.4% in third quarter 2025. With Powell’s term as chair ending in May, President Trump announced Kevin Warsh as his nominee to succeed Powell. Despite Warsh being labeled an “inflation hawk” during his tenure as Fed governor from 2006 to 2011, the fed funds futures curve continues to price in two rate cuts by year-end 2026, particularly as “supercore”<sup>1</sup> inflation reached multiyear lows in January 2026.

There is much underway as we progress throughout 2026 – a new Fed chair, monetary policy, President Trump’s tariff policy following the U.S. Supreme Court’s International Emergency Economic Powers Act (IEEPA) tariff ruling, the impact to inflation following the U.S./Israel attack on Iran, and the impact of artificial intelligence (AI) on economic growth, to name just a few – and we will be watching inflation and global growth developments closely.

### The credit market

The FOMC’s 25-basis point (bp)<sup>2</sup> rate cut in December 2025 continued an easing cycle that resulted in a total of 75 bps of cuts during 2025 and 175 bps since the cycle began in September 2024, for a total of seven cuts. The latest cut brings the fed funds target rate range to between 3.50% and 3.75%, a three-year low. Chairman Powell noted it is “within a broad range of estimates of its neutral value” and that the Fed is “well positioned to wait to see how the economy evolves.” The neutral value is the rate that keeps the economy at full employment while maintaining stable inflation around the Fed’s 2% target.

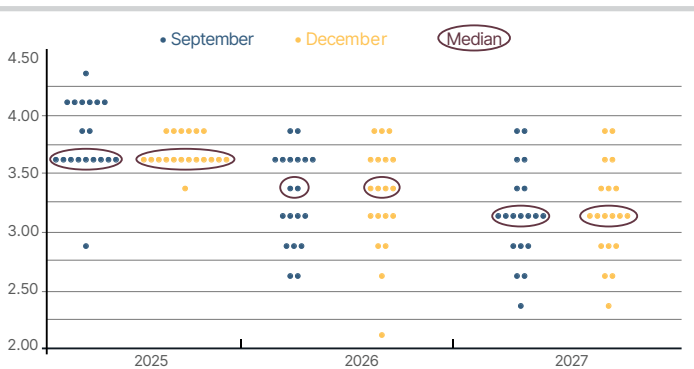
After “driving through the fog” heading into the December Fed meeting, the delayed release of U.S. labor market data in October and November due to the government shutdown from October 1, 2025, to November 12, 2025, sent conflicting signals. Job growth remained resilient even as participation and hiring momentum softened, and the data was further distorted by deferred resignations of government

<sup>1</sup> Supercore measures core CPI services ex. housing inflation  
<sup>2</sup> One basis point (bp) is equal to 1/100th of 1%, or 0.01%.

employees from earlier in the year. The absence of new economic data led the FOMC chair to promote a slowdown ahead of the December meeting to assess the impacts of a cooling labor market combined with persistent inflation. However, as tariff pressures appeared less likely to cause significant slowdowns in economic growth, the FOMC's December Economic Projections revised its 2026 real gross domestic product (GDP) growth forecast up from 1.8% in September to 2.3%, while lowering the Personal Consumption Expenditures (PCE) inflation forecast from 2.6% to 2.4%. These factors suggest this rate-cutting cycle is more reflective of a normalization of monetary policy rather than an accommodative easing.

The nearby dot plot from the December 2025 meeting showed that most FOMC members (12 of 19) expect at least one more 25-bp interest rate cut in 2026, with the median forecast suggesting a range of 3.25% to 3.50% by the end of 2026. One additional cut of 25 bps is expected in 2027 to a range of 3.0% to 3.25%, while the spread of dots (individual projections) was largely unchanged from September to the December meeting. Although a wide dispersion of views remains, the dot plot signals a slow, data-dependent path for rate cuts in 2026, with the majority expecting a modest reduction, but with internal disagreement on the pace and extent of easing.

### Federal reserve dot plot



At its January 2026 meeting, along with the decision to pause rate cuts, the FOMC left the fed funds rate unchanged at 3.50% to 3.75%. The pause was expected by markets, and officials characterized economic activity as healthier and expanding at a solid pace, vs. prior moderate descriptions. Despite lower job gains, the labor market was described as having stabilized with low unemployment, while inflation remains somewhat elevated, prompting a cautious approach to future rate adjustments. As discussed, as of February 2026, fed funds futures, in particular the CME FedWatch Tool, suggest the market anticipates around one to two 25-bp rate cuts in 2026. This estimate is broadly consistent with the FOMC's December dot plot projections, with potential easing beginning around June and near year-end 2026.<sup>3</sup>

A recent speech in January 2026 by Fed Vice Chair for Supervision

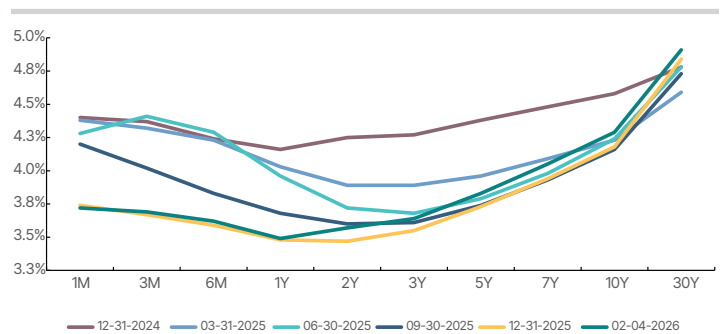
<sup>3</sup> Such tools provide only an indication about the extent to which markets are pricing in future monetary policy changes, and implied probabilities do not have strong predictive power over longer-term horizons.

Michelle Bowman reinforced these themes of conditionality and lack of clear consensus. She emphasized that the FOMC's latest cuts were intended to "proactively limit the risks of greater and more persistent damage to the labor market, while inflation continued to show signs that it is on a sustained downward trajectory toward the 2% objective." Future monetary policy will not follow a predetermined course, and decisions will continue to be made on meeting-by-meeting basis – an evolving outlook for future cuts determined by incoming economic data.

Additionally, growing political pressure on the Fed (e.g., the Department of Justice's criminal investigation into Chair Powell) could sway the interest rate outlook, which hinges on the Fed's ability to maintain its independence. Warsh, the nominee to succeed Powell as Fed chair, is broadly expected to advocate for lower rates, having echoed Trump's calls for lower rates and defending tariffs in recent months on television interviews. It remains unclear whether Powell will stay on as Fed governor for his remaining two-year term after his chair term expires in May 2026. Although Fed chairs cannot dictate policy decisions, which require building consensus with the FOMC, the impacts of Fed independence on monetary policy will be important to monitor looking forward.

History suggests that monetary policy and the Fed's overnight lending policy rates have a meaningful influence on the yield curve for shorter maturities of approximately two years or less, while medium- and longer-term yields are more heavily influenced by market expectations of economic growth, business cycles, inflation, and other risk premiums. The nearby chart of U.S. Treasury yield curves across various maturities illustrates this phenomenon.

### Yield curves over time



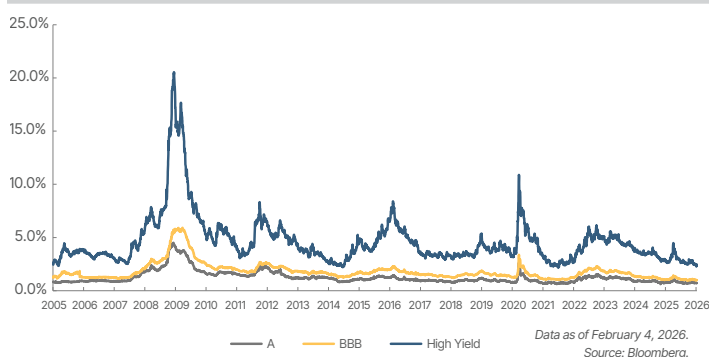
Data as of February 4, 2026. Source: Bloomberg.

With the Fed's control of the overnight lending window, shorter-term yields declined through December 31, 2025, following the September, October, and December meetings. Although FOMC commentary from the January 2026 meeting suggested a longer pause in the easing cycle, by early February 2026 short-term yields were minimally changed as markets adjusted to a higher-for-longer neutral rate expectation.

By contrast, longer-term yields traded within a relatively narrow range (generally oscillating within a 40- to 60-bp range) over the past 13 months as investor sentiment fluctuated. Since first quarter 2025, the yield curve has steadily steepened, with the difference between two- and 10-year yields reaching its steepest level (72 bps) since early 2022 and possibly reflecting the market’s outlook on stable or improving economic conditions and rising inflation.

Likewise, investors remain optimistic about the macroeconomic outlook on corporate prospects. Corporate bond prices continue to rise, and as shown in the nearby chart, spread compression occurred across investment grade to junk bonds throughout 2025, with corporate spreads entering 2026 at their narrowest levels in the past five years.

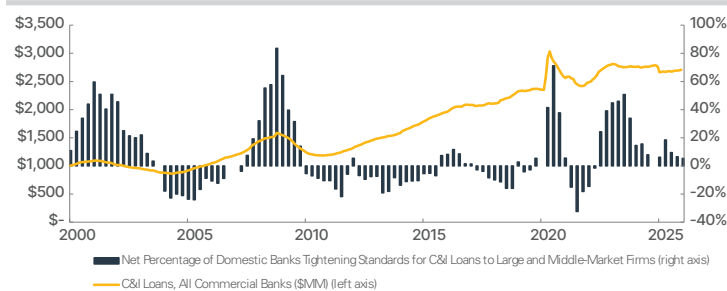
### Corporate spreads by quality



As of December 31, 2025, spreads for bonds rated high yield, BBB, and A stood at 2.4%, 1.0%, and 0.7%, respectively. On a year-over-year basis, spread compression was concentrated entirely in high yield, which tightened from 2.9% at the same time last year, while BBB and A spreads were unchanged. For context, the current spread compression compares similarly to the pre-Great Recession lows (2005 to 2006) of 2.3%, 1.2%, and 0.7%, respectively.

In mild contrast with these positive movements in the credit markets and narrowing corporate spreads, U.S. banks remain cautious, but had become less so during the second half of 2025, regarding the overall impact of tariffs and tax cuts on U.S. businesses and consumers. The nearby chart shows the historical trend in commercial and industrial (C&I) loans outstanding, along with the net percentage of U.S. banks that have adjusted credit standards for loans to large and middle-market firms, according to the Fed’s Senior Loan Officer Opinion Survey (SLOOS) on Bank Lending Practices.

### Amount of C&I loans vs. bank standards



Bar chart: Data as of October 31, 2025. Source: Federal Reserve, July 2025 Senior Loan Officer Opinion Survey on Bank Lending Practices.  
Line: Data as of October 31, 2025. Source: Federal Reserve Bank of St. Louis (FRED), C&I Loans, All Commercial Banks.

As with the previous four quarterly reports, the January 2026 SLOOS indicated that a majority of banks (net 5.3%) reported tighter standards during the quarter, citing economic uncertainty; industry-specific challenges; and legislation, regulation, and accounting changes. The combination of strict standards and reduced tolerance for risk correlates with most respondents reporting weaker demand across all borrower types. However, the net share reporting tighter standards has fallen modestly for the past three quarters from a net 18.5% in April 2025. In January 2026, survey respondents reported tighter lending standards for C&I loans to firms of all sizes, yet demand strengthened: In each of the past two quarters, a moderate net share of banks reported stronger demand from large and middle-market firms and an increase from potential borrowers regarding the availability and terms of new or increased credit lines.

Banks continuing caution, albeit easing, suggest a lending market that remains selective. Although private credit has played an important role in filling the gaps left by traditional banks through providing loans with more flexible structures at higher costs to riskier borrowers, cracks in this opaque market began to show with the public bankruptcies of First Brands and Tricolor during 2025. High-profile restructurings and bankruptcies across consumer-facing sectors such as retail and distribution have continued into early 2026, with the recent bankruptcies of Saks Fifth Avenue and Eddie Bauer highlighting the vulnerability of highly leveraged capital structures amid slowing demand and higher financing costs. These episodes underscore growing investor scrutiny around underwriting discipline, covenant protections, and sponsor behavior within the private credit ecosystem.

At BBH, our focus remains on deploying capital thoughtfully to resilient businesses and helping our clients navigate an evolving economic landscape. We believe patient, relationship-driven lending is well-positioned to deliver durable outcomes over generations of market cycles for both BBH and our clients.

## The private equity and mergers and acquisitions markets

The U.S. PE sector experienced a challenging start in 2025, despite initial optimism fueled by improving market sentiment, post-election clarity, and the anticipation of business-friendly policies. Unpredictable tariff announcements led to significant market volatility in activity during the second quarter. General partners (GPs) waited for clearer signals regarding macroeconomic risks, financing conditions, and valuation issues before proceeding. Fortunately, this period of caution subsided by third quarter 2025. Lower interest rates, greater market clarity, and the availability of over \$1 trillion in dry powder in the U.S. alone contributed to a favorable environment for dealmaking as the year progressed. Exit activity, which had been subdued in recent years due to firms holding assets for longer amid valuation uncertainty, saw a significant recovery in 2025. Fundraising continues to be the weakest area for PE, a significant year-over-year decline.<sup>4</sup>

As we enter 2026, the industry's resilience, combined with a willingness to learn and innovate, will be crucial in navigating future challenges and opportunities. PE's perseverance in 2025 underscores its enduring relevance and potential for long-term value creation.<sup>5</sup>

PE is being rapidly transformed by integrating technology throughout the investment process to address increasing demands from investors and stakeholders. Firms are actively assessing how AI can be utilized in fund and portfolio company management. AI applications are being incorporated throughout the investment lifecycle, including AI-driven deal sourcing, enhanced due diligence, portfolio monitoring, and standardized reporting. Looking ahead to 2026, many firms are expected to further develop their AI capabilities, embedding them into fund and portfolio management strategies. Adopting such approaches will position AI as a key competitive advantage within the increasingly complex PE landscape.<sup>6</sup> E&Y's most recent Private Equity Pulse survey reveals that 53% of PE firms plan to increase their hiring of digital transformation specialists compared to previous years, and 51% are looking to bring on more data scientists and AI professionals.<sup>7</sup>

Over the course of 2025, PE invested in an estimated 9,019 deals with an aggregate value approaching \$1.2 trillion. The data indicates a shift toward larger transactions, as evidenced by the renewed prominence of megadeals. This trend was supported by improved market conditions, enabling sponsors to once again pursue a wide variety of deals across the PE landscape. Following a brief slowdown in second quarter 2025, which coincided with the announcement of global tariffs, deal activity rebounded strongly in the second half of the year, with 4,560 deals completed with a combined value of \$632.2 billion. This resurgence helped push second half activity to levels not observed in recent years.<sup>8</sup> The financing environment is easing, as the average cost of funding for PE middle-market term loans has dropped 3 percentage

<sup>4</sup> PitchBook.

<sup>5</sup> E&Y PE Trends 2026.

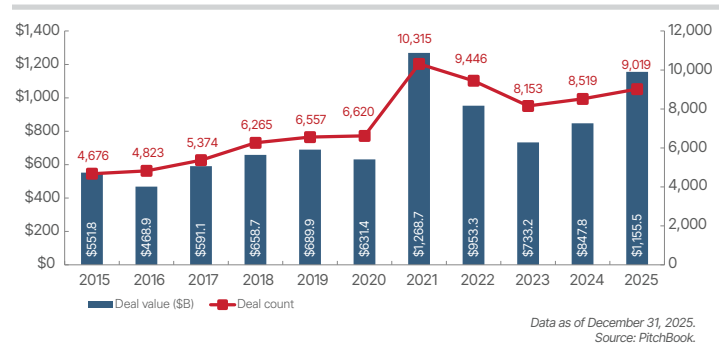
<sup>6</sup> BDO 2026 PE Predictions.

<sup>7</sup> E&Y PE Trends 2026.

<sup>8</sup> PitchBook.

points from its peak, with potential for further decline in 2026 if Fed rates are cut. Lower interest rates typically improve PE internal rates of return, and this trend is expected to continue.<sup>9</sup>

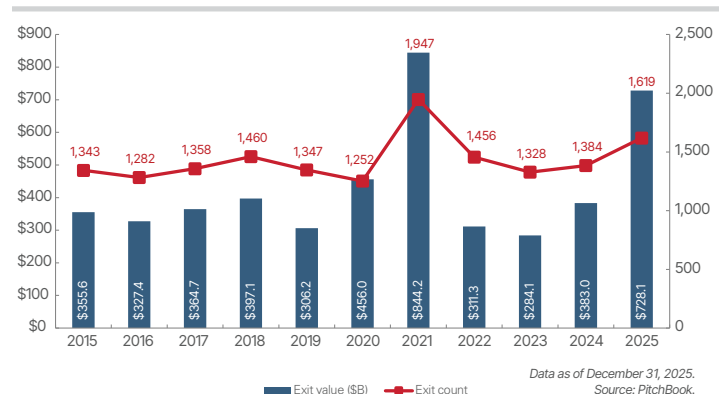
### Annual U.S. PE deal volumes



PE exit activity has moved past the challenges of recent years with a rebound that ranks second only to the record-breaking levels of 2021. In 2025, an estimated 1,619 exits were completed, totaling \$728.1 billion. This marks an improvement of 90.1% in exit value and a 17% increase in exit count compared with the previous year. In fourth quarter 2025, approximately 429 exits occurred, amounting to \$229.2 billion in aggregate value. While this represented a 7.7% quarter-over-quarter decline in exit count, exit value surged by 98.5%. The impressive jump in exit value was primarily driven by a handful of exceptionally large exits, resulting in the highest quarterly exit value since second quarter 2021.

The outlook for PE exits appears optimistic. According to PitchBook's inaugural U.S. Private Equity Survey, 61% of respondents foresee better exit conditions in the next six months, and half of those surveyed identified portfolio company exits as a key near-term priority.<sup>10</sup> In 2026, fund managers are expected to apply previous lessons amid higher capital costs and increased macro risks. With less room for error than in 2021, they will focus on rigorous valuations, pursue fewer but higher-quality deals, and incorporate flexible exit strategies from the outset, whether through sales, IPOs, or alternative structures like secondary processes.<sup>11</sup>

### Annual U.S. PE exit activity



<sup>9</sup> Morgan Stanley PE 2026 Outlook.

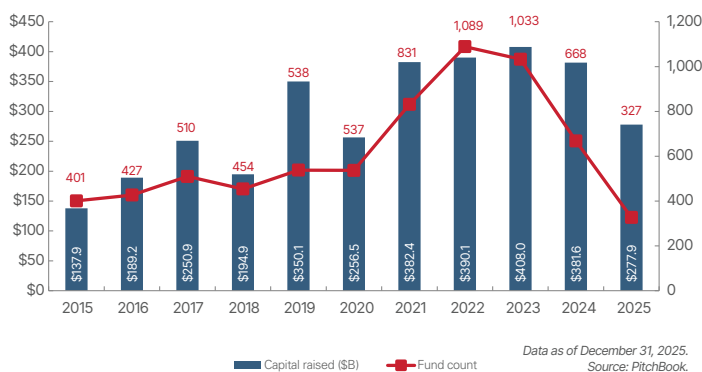
<sup>10</sup> PitchBook.

<sup>11</sup> BDO 2026 PE Predictions.

In 2025, PE fundraising registered its weakest performance since 2020. During the year, PE firms closed 327 funds, collectively raising \$277.9 billion. This represents a significant decline from the previous year's fund count and aggregate value. While exit activity continued to grow throughout 2025, it did not reach a level that would dramatically expand fundraising efforts. According to PitchBook's 2026 U.S. Private Equity Outlook, the fundraising environment is expected to remain highly concentrated as the 10 largest funds are projected to account for at least 40% of total capital raised in the U.S. If the strong trend in exit activity seen in 2025 persists into 2026, this consolidation among top funds could potentially subside. Despite an increase in exits during 2025, the volume remained insufficient to make up for the limited exit activity from 2022 to 2024, when many sponsors postponed bringing portfolio companies to market, leading to several years of reduced distributions to LPs, and thus less capital available for new fund commitments.

At the end of first quarter 2025, dry powder had rebounded (after a dip in 2024) to nearly \$1.1 trillion, marking the highest level of uncalled capital ever recorded for the asset class.<sup>12</sup> While fundraising is slow and challenging, factors for recovery are in place, and an increase is expected by early 2026.<sup>13</sup> While many PE funds seek more capital than LPs can provide, LP interest remains solid, and there is growing recognition among LPs that now is a good time to invest with adaptable GPs.<sup>14</sup>

### U.S. PE fundraising activity by year

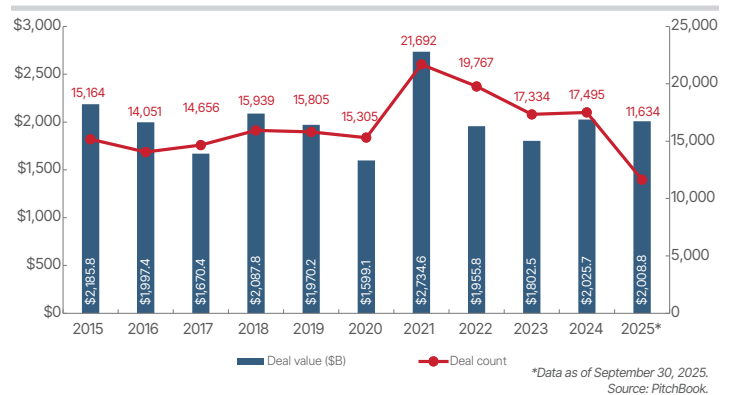


In third quarter 2025, North American M&A activity gained momentum after a flat second quarter, with deal count increasing by 5% quarter over quarter and deal value rising by 23%, including estimates for late reporting and nondisclosed deals. With 5,066 announced or completed deals totaling \$762.2 billion, the deal value of third quarter 2025 set a new quarterly record, surpassing the previous high of \$723.1 billion in fourth quarter 2021, achieved during a year of frenzied M&A activity. Quarterly deal count is also the highest it has been since second quarter 2022.

<sup>12</sup> PitchBook.  
<sup>13</sup> Paul, Weiss.  
<sup>14</sup> Ibid.

Although macroeconomic uncertainty caused by changing tariff announcements, low consumer and business confidence, and still-high interest rates led to some hesitation among investors in the second quarter, markets recovered by the third quarter and bounced back strongly with more deals at larger sizes. The interest rate cut by the Fed in September also supports the risk-on stance investors are increasingly returning to and is likely to boost the revival of dealmaking activity through the end of the year.<sup>15</sup>

### North American M&A activity

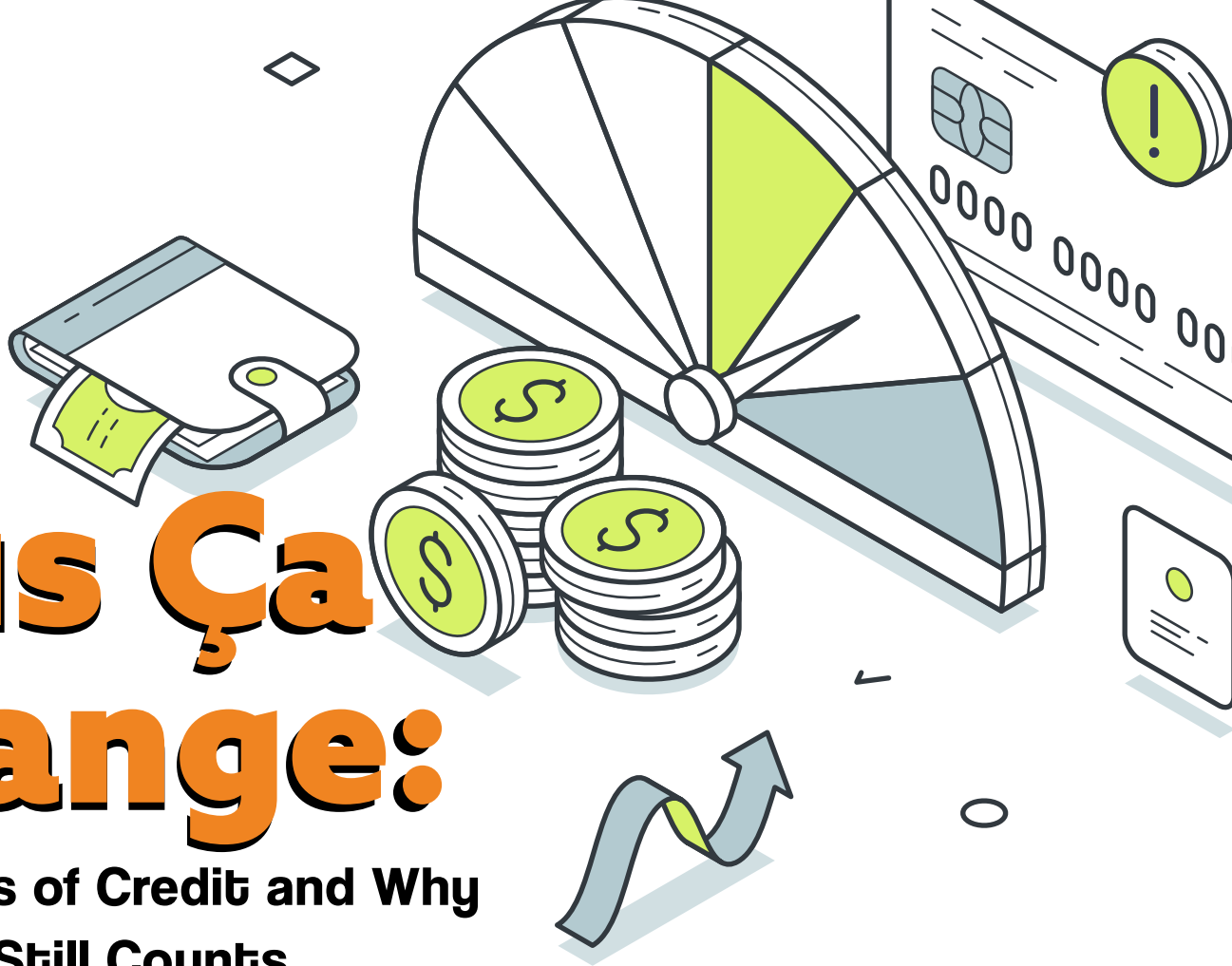


### Conclusion

As 2026 gets underway, the business environment remains shaped by policy uncertainty and evolving credit conditions. The Fed's recent rate-cutting pause signals a more cautious path, while narrow credit spreads and continued growth in private credit point to sustained investor confidence. Against this backdrop, the PE and M&A markets have regained momentum, underscoring renewed optimism despite the still-mixed macroeconomic environment.

***If you have any questions about navigating today's business environment, reach out to a BBH relationship manager***

<sup>15</sup> PitchBook.



# Plus Ça Change:

## The Five Cs of Credit and Why Character Still Counts

Lewis Hart / Partner, Head of Corporate Advisory & Banking

### THE TYRANNY OF METRICS

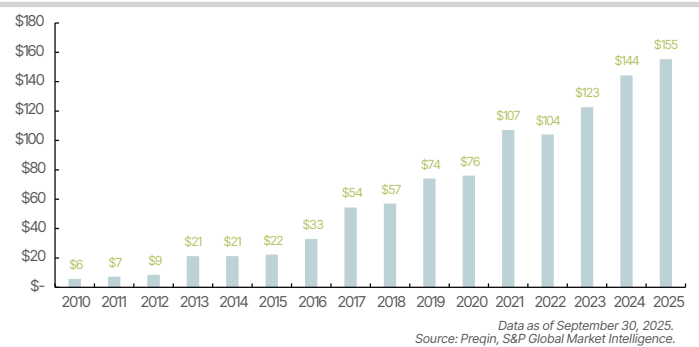
We live in an age of big data, where credit analysis has largely become an exercise in evaluating vast digital mosaics: loan to value and debt-to-EBITDA ratios, probabilities of default, expected losses, FICO scores, cash flow waterfalls, and downside scenarios. As technology has facilitated both more timely and plentiful information, lenders have never had such granular visibility into the financial condition of borrowers. With seemingly infinite data at our fingertips – and artificial intelligence (AI) tools at our disposal to accelerate the underwriting process – credit risk should be lower than ever; yet, amid this abundance of information, an essential aspect of credit underwriting may have quietly faded into the annals of history. Could it make a comeback?

The extension of credit, at its core, is not purely a spreadsheet exercise. It is an act of belief.

The Latin root of the word – *credo*, “I believe” – is a helpful starting point. Credit is a human relationship, one grounded in trust. Rigorous financial analysis must inform and underpin that relationship, sharpen it, and occasionally signal to the credit provider to run the other way. But data cannot fully replace human instinct. As several recent examples show, the danger of modern underwriting is not that we use too much information, but that the comfort of information tempts us to abandon the harder work of judgment – the ability to assess the

management integrity, governance practices, and economic incentives of imperfect human beings.

**Direct lending dry powder has expanded rapidly**  
Dry powder trends in direct lending-focused funds since 2010 (\$ billions)



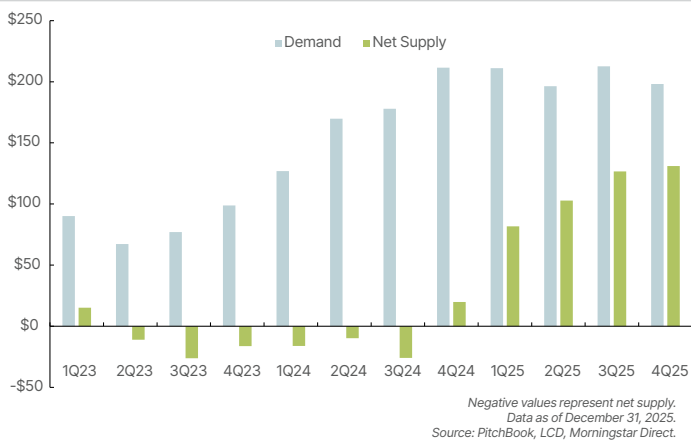
Thoughtful credit underwriting requires lenders to construct downside financial models with thousands of Excel cells and dozens of potential future scenarios. Those who fail to do comprehensive, fundamental credit research will underperform. But the output of these models can at times offer the illusion of safety. Occasionally, the market reminds us that deep personal relationships, firsthand knowledge, and qualitative assessment are not just relics of a less sophisticated era. As history suggests, credit cycles have occurred consistently across centuries, and they tend to follow a similar arc:

1. Capital becomes plentiful
2. Competition intensifies
3. Pressure to scale accelerates
4. Risk premiums compress as more capital chases fewer attractive opportunities
5. Caution fades
6. Standards for select market participants quietly erode

Case in point: Since 2023, measured investor demand has remained strong even as measurable supply has lagged. This creates a competitive deployment environment in which discipline carries the greatest opportunity cost – and therefore, is hard to maintain. Thus, the risk is not always imprudence; more often, it arrives through gradual concessions made to preserve competitiveness.

### Persistent investor demand has kept the leveraged loan market competitive

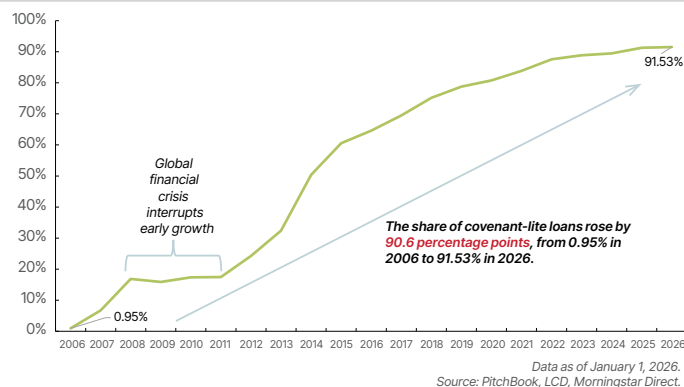
U.S. leveraged loan market — measurable investor demand and supply, rolling 12 months (\$ billions)



Whether it's the proliferation of nonbank lending or the historically tight spreads in corporate credit, today's market's confidence is visible in both price and structure. U.S. corporate bond spreads reflect a market that is priced for perfection.

### What once was niche in the leveraged loan market became conventional

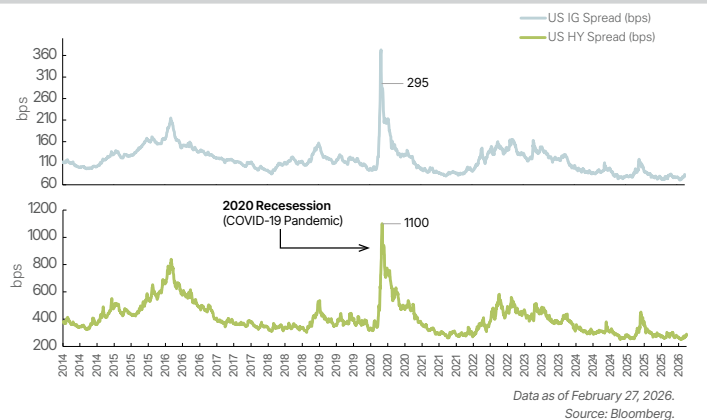
Covenant-lite loans as a % of total U.S. outstanding leveraged loans



Structurally, the gradual erosion of lender protections reveals a borrower-friendly marketplace. In 2006, covenant-lite loans – structures that remove the financial maintenance tests that historically served as lenders' early warning mechanisms – accounted for less than 1% of the total U.S. leveraged loan market; by 2026, this number rose to 91.53%. Alongside this shift, market norms have evolved in ways that further favor borrowers, including the routine use of liability management exercises<sup>1</sup> that reflect the increased flexibility in modern capital structures. Such conditions do not imply imminent disruption. However, if history is any guide, the tide always turns as lenders stretch too far – spreads widen, markdowns occur, and capital is permanently lost. Then, the cycle begins anew as bargain hunters swoop in to purchase discounted assets, providing a floor to values and ushering in a new cycle. These cycles are not over. In an environment where risk is priced near perfection and cracks are beginning to emerge, it is worth revisiting some of the first principles of credit underwriting.

### The last time spreads were this tight was 2007

U.S. corporate credit investment grade spread vs. high-yield spread, 2014-2026



### REMEMBERING THE FIVE CS OF CREDIT

Recent events should feel uncomfortably familiar. The well publicized fraud events of the past year and signs of rising volatility serve as yet another reminder of an old French adage: "Plus ça change, plus c'est la même chose." The more things change, the more they remain the same. We seem to be entering another period where history rhymes.

In this period, it may be helpful to revisit the old-fashioned but tried-and-true mnemonic device: the five Cs.

Whether financing a manufacturing company's strategic acquisition, backing a shipment of goods across the ocean, or purchasing a complex structured note, the foundational principles of underwriting endure. The five Cs of credit remain as relevant today as they were generations ago:

<sup>1</sup> Transactions in which a borrower restructures, exchanges, or reprioritizes its existing obligations (often within the flexibility permitted by its credit documentation) to extend maturities, reduce near-term cash interest, or otherwise manage balance-sheet pressure.

- **Character:** The *will* to pay
- **Capacity:** The *ability* to pay
- **Capital:** The borrower's own "skin in the game"
- **Collateral:** The secondary source of repayment
- **Conditions:** The broader economic and industry environment

While modern markets devote extraordinary attention to four of these five Cs, **character** – the first C – has become increasingly marginalized in a world of financial innovation, AI, increased intermediation, and big data. "Character" refers to a borrower's track record of business transparency, integrity in financial dealings, and willingness to repay creditors, rather than any assessment of political views, personal views, or lawful industry participation. Given the time required to evaluate it and the challenge of measuring it precisely, character has been treated as subjective, unquantifiable, or even quaint. This is not entirely surprising. The other four Cs are fundamentally problems of financial *risk*, yielding to data, stress scenarios, and models. The measurement of character, by contrast, is inherently *imprecise*.

Risk factors that cannot be measured are far harder to build into a scalable, repeatable process. The assessment of character resists the spreadsheet. Over time, especially in periods of sporty growth, markets tend to de-emphasize it, not because participants are blind to its importance, but because it is harder to embed in a process. Judgment about character, even when correct, is more difficult to leverage.

The result, perhaps, in our current environment has not been so much the disappearance of qualitative judgment altogether, but rather a gradual repricing of its importance. Standardized diligence and background checks are indispensable, and in many cases, they improve underwriting discipline. However, they can also create the impression that what is hardest to quantify – the complex realities of human behavior – can be reduced to a repetitive task. The COVID-19 period of less travel and Zoom-only meetings exacerbated this trend, as fewer investment professionals felt it necessary to walk the factory floor and look into a borrower's eyes.

A CEO with strong character cannot protect a creditor from a significant industry disruption at a highly levered enterprise – but at the margin, no assessment of a management team's talent is complete without it. And in periods when leverage levels are elevated and losses begin to rise, those creditors who endure the hard work of evaluating character are more likely to succeed.

Financial history offers some useful reminders. Consider the Brown Brothers' "Circular Letter of Credit," the 19th century precursor to the modern credit card. As The New York Times once observed, its effectiveness rested on its "confidential character," requiring the firm to be "thoroughly acquainted with the standing of the persons" involved – knowledge that extended well beyond cash balances or holdings of "sound stocks."

A century later, J.P. Morgan made the same point. Testifying before Congress in 1912, he argued: "The first thing [credit is based upon] is character. Before money or anything else ... because a man I do not trust could not get money from me on all the bonds in Christendom." Capacity might tell you whether a borrower *can* pay. Only character tells you whether they *will*.

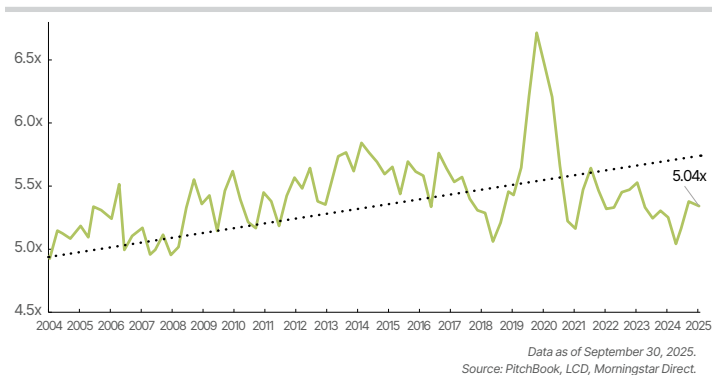
That insight has gone in and out of fashion, and the number of devotees to the five Cs has gradually declined, nearly to the point of extinction during the pandemic.

### WHAT DOES A HEALTHY CREDIT PROCESS LOOK LIKE?

Today's credit processes are increasingly focused on scale and efficiency. They understandably gravitate toward key metrics and performance indicators: debt-to-EBITDA, debt to enterprise value (the backbone of the loan-to-value ratio in corporate credit), and cash flow available for debt service. These metrics are fundamental aspects of a borrower's **capacity** to repay, and any credit analysis without them is insufficient. But they can also become a trap, offering a false sense of precision and certainty that history repeatedly exposes itself as fragile. Models assume continuity. Markets specialize in rupture. Character often only comes to light in the darkest of markets. Are we at a similar inflection point?

Another example of the market's gradual loss of discipline is the widespread growth of EBITDA addbacks in leveraged finance and direct lending. Despite tightening spreads, these addbacks have increasingly inflated covenant-defined earnings, obscured true leverage, and reduced equity cushions for lenders. While certain legitimate one-time addbacks should not cause concern, the risk of nonrecurring addbacks becoming permanent has increased, and the additions of addbacks stemming from mergers and acquisitions (M&A) synergies and other future events should be scrutinized. In the future, lenders may consider capping addbacks as a percent of EBITDA.

**Leverage remains elevated despite resilient economic backdrop**  
Average loan leverage (debt/EBITDA) in leveraged loan market, 2007-2025



That is what makes the present moment so interesting. By many macroeconomic measures, the backdrop appears broadly supportive: Unemployment was 4.3% in January, real gross domestic product (GDP) grew 2.2% in 2025, and corporate earnings have generally beat

“ While modern markets devote extraordinary attention to four of these five Cs, character – the first C – has become increasingly marginalized in a world of financial innovation, AI, increased intermediation, and big data.”

expectations. Yet, average leverage in the leveraged loan market sits around 5x debt-to-EBITDA and has not come down with earnings growth. This is elevated enough that repayment capacity remains heavily dependent on earnings durability and refinancing access. In other words, the burden has not reset – conditions have merely remained favorable enough to carry it.

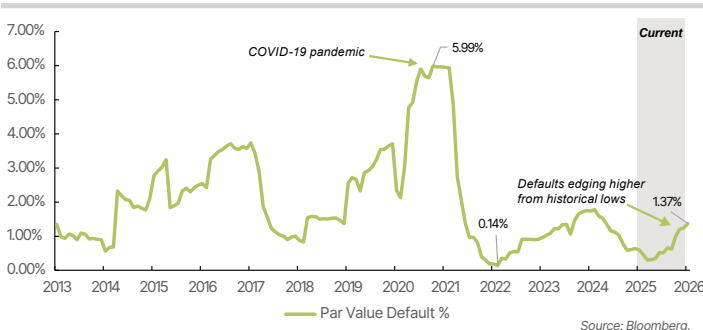
Analysis of collateral remains equally important. In the event of a default, how do I access any **collateral** that may support my exposure? Or mitigate the risk that it could be pledged to multiple lenders? Several recent examples testify to the importance of the “trust but verify” approach to collateral management – and the importance of knowing who’s on the other side of the transaction.

Focusing on the borrower’s **capital** – the “skin in the game” of key executives and owners – is equally critical. The lender’s alignment with management and ownership is especially important. For example, what is the incentive for an equity sponsor to support a company whose earnings are declining if it has already generated a 2x multiple on invested cash through three dividend recaps over eight years?

And, as the recent events in technology and software remind us, one should not minimize the importance of taking a view on the macro-economy, industry factors, and competitive environment in which a borrower operates – **conditions** matter.

At BBH, when lenders come to meetings with perfect analysis of those capacity, collateral, capital, and conditions, we often ask: How would you grade the management team? How have they worked with capital providers in tough situations in the past? Do folks whom we trust trust them?

**Is the tide beginning to turn?**  
U.S. corporate loan default rates, 2013-2026



In some ways, the **character** is the hardest C to evaluate – the most subjective, the most judgment-laden, and certainly the hardest to pin down. In a world where scale is everything, it can also slow down your process. Taking a day trip to an inconvenient location to break bread with the owner may prevent you from meeting your quota for the year, but that meeting is critical to build the evaluation of this “C” into your process.


From Antonio’s “merry bond” in “The Merchant of Venice” to the covenant heavy structures of a 2026 private equity transaction, the central question remains unchanged: Who is on the other side of the signature?

One of our retired Partners used to say that credit is as much about sociology and human behavior as it is about ratios. It is an observation worth taking seriously. When conditions deteriorate and collateral values evaporate, character is often the only remaining line of defense between a successful investment and a permanent loss of capital. For borrowers, too, lenders with good characters ensure a human on the other side of the table who may save a business in times of distress.

In an increasingly volatile landscape, the industry would do well to continue its rigorous analytical credit research but also remember its first principles. Data matters. Structure matters. Collateral matters. But when the cycle turns – as it always does – it is attention to character that separates the benchmark outperformers from the benchmark underperformers.

*The author would like to thank Alexa Arana for her contributions to this article.*

“ When conditions deteriorate and collateral values evaporate, character is often the only remaining line of defense between a successful investment and a permanent loss of capital.”



# From Sea to C-Suite:

Lewis Hart / Partner, Head of Corporate Advisory & Banking

## Tom Ripley's Journey from U.S. Marine Corps to CEO

Tom Ripley was an infantry and special operations officer in the U.S. Marine Corps – what he considers his family's business. Today, he is a partner and co-founder of Ames Watson, a private holding company with over \$2 billion in revenue that purchases, transforms, and partners with companies to create long-term value. We recently sat down with him to uncover how his military experience shaped his approach to leadership, mission, and responsibility in the business world.

**Let's start with the "original family business." Your father, Col. John Ripley, was a decorated Marine and showed you what true leadership meant from an early age. Tell us about your early life.**

I like to joke that my family business turned 250 years old last year. I'm from a Marine household – my grandfather, dad, uncles, brothers, and nephews are all Marines. I grew up on Marine Corps bases and moved 14 times. I loved my childhood and wanted to be exactly like my father. He is famous for singlehandedly blowing up a bridge during the Vietnam War – the story of which is actually now required reading for all first-year Marines. My father was one of the best Marines I have ever heard of – he was the person I idealized, the person I wanted to be.

He was my mentor, and I was incredibly fortunate to have him as a wealth of knowledge in my early career.

**The Marines have a few great sayings. Two that come to mind are "Mission first, Marines always," and "Leadership isn't about rank; it's about responsibility," the second of which your dad coined. Talk about what you learned from him and the Marines about leadership.**

As an officer in the Marine Corps, you're taught early on that you can delegate authority, but you cannot delegate responsibility. In the end, you're responsible for everything that your unit does or fails to do. That's no different than any business. When we buy a company and hire someone as president, I tell them, "Congratulations! You have the loneliest job in the building. You have no peers and no one you can commiserate with. And when you come to work every morning, outside your door will be a line of other people's problems to solve."

My Marine Corps experience prepared me very well for that kind of mindset. As an officer, you don't

commiserate with your Marines. You deal with the problems and move forward. Sometimes, you have to be optimistic when there's nothing to be optimistic about. You have to compel people to do dangerous things that they probably rationally wouldn't want to do and make sure that it's done completely.

Now, I buy distressed companies, which are basically in triage. You can't do everything to fix them immediately; you need to prioritize the things that have to happen. And you need to be direct and clear about it.

You mentioned "Mission first, Marines always." As a young Marine officer, you're taught that the mission is all that matters. If you don't do it, you have to send another Marine to do it. That said, you'll never accomplish your mission if you don't take care of people.

**Talk about being shoulder to shoulder with your team and how that's transferred from your military service to the business world.**

When I was a young officer, my father told me that leadership is a contact sport. People want to see a steady hand at the wheel, especially in distressed situations. They want to see someone in the trenches with them, standing shoulder to shoulder, and working on a problem.

When I buy a business, one of the first things I tell the teams is that I work for them. I am the chief problem solver.

**You've helped turn around brands like Lids, Champion, and South Moon Under, and right now you are focused on helping Claire's do the same. What about these businesses was the common thread that made you believe you could turn them around?**

Across those businesses, we have a little over 3,000 stores.

**“ [Y]ou'll never accomplish your mission if you don't take care of people.”**

When we bought Lids, it was not bankrupt, but it was on its way. The singular thing that we had to do was create a reason for people to walk into the store. It sounds simple, but that's it. If they don't have a reason to walk into your store, they're going to buy it online.

We're fortunate that hats can be tricky and vary greatly from person to person, so there is a compelling reason to go. But we had to make it an impressive, exciting experience for a young customer to come in and see the hat selection, pick the team they want, try on different hats, have access to exclusive products, and so forth.

With Claire's, we keep getting asked what we're going to do about mall traffic. Mall traffic goes down every year. What you need to do is create the environment so that people want to go. Engage your customers when they walk across your lease line. Have exclusive products; have things that get them excited about the experience.

**Let's look at Claire's a bit more for a moment since it's one of your newer projects. How are you re-thinking this brand to make it resonate with the new generation?**

Claire's has 1,000 stores across North America, almost all of which are in malls. We bought the business out of Chapter 11. The first thing you often need to do at a distressed business is turn around the irrational behavior that was happening as it fought to hang on.

I also set up a standing weekly meeting immediately. Everyone comes together in person to talk about what they're working on and where they need support. These meetings are very candid and direct. This was something we did in the Marines. You start off with the basic, everyday things of the business.

The next step is to clean up the company. We're going to organize the company and have a singular focus in our mission. Claire's has seen an explosion in stock-keeping units (SKUs). They've tried a bit of everything, so we need to bring that target closer and refine the assortment.

The last piece is that we need to talk to our customers where they are. Right now, Claire's does very little social media. But their target audience is there, so we will start to engage them.

**When I think of both Lids and Claire's, there is definitely an experiential connection for those stores. It is fun to try on accessories in person. Was that what drew you to them?**

The biggest component for us with Lids, Claire's, and Champion, which we purchased from Hanes, was dominant market share.

As an example, there are going to be about 40 million hats sold in the U.S. this year. Lids will sell 33 million. Roughly 45% of what is sold in every college bookstore is a Champion product. And then, 60% of all ears pierced in the U.S. happen at Claire's. That dominant market position means the business has a reason to exist.

Aged brick-and-mortar businesses better have a reason to exist. That's our starting footprint. From there, it's about creating excitement and a reason to be there.

**You have some unique approaches to how you recruit and retain talent. You've talked about hiring for three things: judgment, professional courage, and being able to find problems before solving them. How did you identify those three characteristics?**

The first criterion I have for my team is excellent judgment, because I can't be there for every decision that is made. I have to rely on the team to make decisions – or to have the judgment to know when to pull me into a situation to ask for help or resources.

I can't train judgment – you either have it or you don't. To me, the biggest indicator for excellent judgment is a lack of ego. If you approach problems recognizing that you are not the most qualified person in the room, that you need help, you're going to be quicker to raise your hand.

Ego is a very dangerous thing and can lead you to stop learning. And when you stop learning, you stop asking questions and looking around corners – and that is when catastrophe happens. I'm looking to hire egoless people, because those people are quick to say, "I don't know the answer. I need help." That is courage.

Finally, teams, not individuals, are what solve problems. What I need are problem finders. I need people

# “ [T]eams, not individuals, are what solve problems.”

to come and have the courage to talk to me about the problems. I am supremely confident I can assemble a team to solve the problem, but I have to know about it first.

As leaders, we need to create an environment where it's okay to talk about problems.

## What are some of your main areas of focus after buying a distressed business, specifically as it relates to culture and purpose?

We are not passive investors – we buy two to three companies a year and are fully invested and involved in them. We believe those companies have dominant market share and are distressed due to some bad decisions.

When we look at our businesses, one of the first controllable things that we try to attack is rent. We work very hard on having relationships with our landlords. If we can make that rent variable, it's a homerun for us. It means we give up some of the upside, but it also means that we make money in all markets and all conditions.

Second, we work to change employees' mindset. A lot of these companies have a problem in corporate and send it down to the stores to solve it. That is the opposite of what you should do. If you have a problem, you take that problem and solve it so that the stores can do what they're supposed to do, which is engage customers.

The last thing that we've done in some of our companies is make a material investment in our benefits. I don't design benefits for the people in corporate. I design benefits for the store manager. It's about investing in the ground floor of the team that is doing the work where the metal meets the meat – at that point of contact with the customer.

It also feels very simple to say it, but you just have to be really honest. Not everyone is going to make it.

Not all revenue is good revenue. Be very direct and honest about the changes you're going to make and the speed at which you're going to make them.

## Last question: What do you want your legacy to be?

You prepare the child for the path, not the path for the child.

Tom, thank you for your time.

## Key Takeaways

- 1. Lead by taking responsibility:** True leadership is about owning outcomes and supporting your team directly, not just holding a title.
- 1. Focus on mission and people:** Successful turnarounds require prioritizing what matters most – staffing, inventory, and customer experience – while investing in frontline employees.
- 1. Build teams with judgment and humility:** Hire people who show sound judgment, courage, and a willingness to ask for help. Teamwork and openness are essential for solving real business challenges.

# Curiosity, Candor, and Empathy:

A Conversation with Historian Jon Meacham on the U.S. at 250

**Scott Clemons** / Partner, Chief Investment Strategist



*Author and historian Jon Meacham is a chronicler of U.S. leadership and a professor at Vanderbilt University. He has authored more than a dozen biographies, including "Franklin and Winston: A Portrait of Friendship," "Thomas Jefferson: The Art of Power," "Destiny and Power: The American Odyssey of George Herbert Walker Bush," and the 2009 Pulitzer Prize-winning "American Lion: Andrew Jackson in the White House."*

*Meacham recently joined us to discuss what 250 years of U.S. history has taught him about progress vs. perfection, the core attributes of effective leadership, and what these ideas mean for today's politics, business environment, and society.*

**Thanks for joining us, Jon. We're especially excited to talk to you during the U.S. sesquicentennial. Is 250 years young for a democracy in a republic?**

We are the oldest country structured in that way, but we are a remarkably young nation in the end.

I think this is the greatest country, and I have nothing but love for the enterprise, but to love something does not mean you don't see its faults. The glory of the U.S. is not that we were conceived in perfection, but that we have become more perfect over time – and that's a journey that can't stop.

**Let's talk about that journey. What lessons from previous eras can we lean into that might guide us back to more reasoned discourse today, when it feels like every discussion can turn contentious?**

It's not about going back to some magical moment in the past where everything was great. It's about building and improving so that the country works out for everyone – which was the original goal. You don't want to simply try to recover some fictional Shangri-La.

We need to learn from the past to make the future better at every point. If you ask, "What did the U.S. do

right? What was a moment of collective action where everything seemed to work?" I'd say World War II. It's the defeat of fascism, the projection of force across two oceans to reject a rule of law, to create markets and a universe for democratic capitalism.

Most people think that the U.S. declared war on Nazi Germany right after Pearl Harbor happened. That's not the case. We didn't declare war on Nazi Germany until Nazi Germany declared war on us five days after Pearl Harbor. President Roosevelt (FDR) wasn't sure he had the votes to declare war on Germany in December 1941. We rose to the occasion, but we waited.

That's not being condescending about the past. It's looking it in the eye and learning something important, which is that we don't have to get everything right.

Another lesson is that the more we have leaned into the implications of the Declaration of Independence, the better we have been. I have something I call the portrait test: When someone looks at a picture of you, what are they going to think? You want to act and lead in a way where someone contemplates your image and is suffused with the sense that that was someone who built and who cared, not someone who tore down and who took for themselves.

**What leadership attributes have historically given presidents the ability to adapt without changing the fundamental moral values that got them elected in the first place or led them into public service?**

Three attributes come to mind: curiosity, candor, and empathy.

First, great presidents, leaders, citizens, and people are curious. They want to know what's going on. I came to that conclusion after spending four years virtually living with Thomas Jefferson. Curiosity was his defining characteristic. When he doubled the size of the country with the Louisiana Purchase, he did so

not simply because he was a skilled politician, though he was, but because he'd been in a kind of figurative conversation with the previous three or four centuries of Western life.

What was going on that culminated in Philadelphia in the late 18th century?

- There was Johannes Gutenberg, who invented printing with movable type, which democratized information
- The Protestant Reformation, where we saw power shift from being embedded in popes, princes, prelates, and kings, who either by accident of birth or incident of election were given authority over everyone
- The translation of sacred scripture into the vernacular
- The Scientific Revolution
- The rise of the bourgeoisie
- The development of market capitalism

All this combined to lead to an entire reorientation of the world from something that was seen as vertical, where the people on top were there forever, to a more horizontal understanding, where the means of prosperity and political liberty were available to all because of an innate understanding.

That is still the most important shift in Western life since the passion of Jesus, which determines how we tell time that's still unfolding. The iPhone in your pocket is part of that shift. The ongoing features and resilience of capitalism are part of that shift. Jefferson captured all of that and was able to do it because he had been thinking about what the political manifestation of that shift would be.

Second, great presidents are candid. The presidents who get in trouble are the ones who think they're a little bit smarter than we are. The U.S. population deserves to have it straight from the shoulder.

I think of FDR and Winston Churchill. In 1942, FDR said the news was going to get worse before it got better. He was basing that on a speech that Churchill

had given earlier that year in which he said, "The British people can face any misfortune with fortitude and buoyancy, as long as they are convinced that those who are in charge of their affairs are not deceiving them or not themselves dwelling in a fool's paradise." It's a two-pronged test. People want to be sure, but they also want to be sure those in charge aren't lying to themselves. If people can check those two boxes, the covenant in modern democracies has been that they will do what it takes when called upon.

Third, great leaders are empathetic. Empathy is the oxygen of democracy. If we can't put ourselves in each other's shoes, democracy doesn't work. It requires give and take. This is an elemental human drama that unfolds every day. President George H.W. Bush, the most empathetic man I have ever known, used to say, "If you can't put yourself in the other guy's shoes, why would they vote for you?"

**Bush was committed to public service throughout his life. Do we have that level of public service today? Politics seems different.**

The arena requires a certain kind of iron stomach that Bush had. He proved it when he was shot down at 20 years old over the island of Chichi Jima while serving in the U.S. Navy. He was on a mission in 1944 and was ejected from the plane and plunged into the ocean. His two crewmates did not survive. I asked him what he learned from that, and he said, "I think about them every day, and I ask myself, 'Why me?'" I would submit that his life of public service was a daily effort to answer that question and to justify that fate had spared him.

Politics today is more performative. This is a case where technology has changed things. Human nature is constant, but the ways in which human nature manifests itself change. Whereas Bush was in pursuit of justifying his having been spared during World War II, many of the folks in the arena today are in pursuit of likes, followers, cable news hits, or fundraising (the last of which has always been important).

It's an attention economy. Political power used to create fame. Now, we are increasingly in a world where fame is the means to political power.

The background of the entire page is a photograph of the Statue of Liberty. The statue is shown from the waist up, standing on its pedestal. It is holding a torch in its right hand, which is lit. The sky is a mix of deep blue and orange, suggesting a sunset or sunrise. There are several white, five-pointed stars scattered across the sky, some appearing to be floating or falling. The overall mood is patriotic and contemplative.

““””

Empathy is the oxygen of democracy. If we can't put ourselves in each other's shoes, democracy doesn't work.



The test is not how you get there or who you were. It's what you do when you're there.

**We've been talking a lot about political and national leadership. What is transportable from this into the private sector and running, building, and sustaining a business?**

Those principles of curiosity, candor, and empathy are about leading anything, whether it's a family, business, or country.

What makes me confident about democratic capitalism is that if you break the Constitution, what makes you think any contract is safe? In constitutional democracy, it is hard to get anything done because the founding fathers believed that most of what we would want to do would be bad. But the rule of law, the spirit of the laws, the recognition of certain limits to create the means by which we can amass wealth and live our lives as we wish – these principles are vitally entwined, affecting democracy itself.

If you begin to select where the rule of law applies because you have strength in a moment, be careful. In *The Federalist Papers* No. 1, Alexander Hamilton wrote that the convention aimed to prove that man could create a government with calmness and deliberation instead of by force and accident. That's what's at stake every day in the U.S., and it is what we have been doing for

““””

[The] principles of curiosity, candor, and empathy are about leading anything, whether it's a family, business, or country.

almost 250 years – trying to stand against force and accident and for calmness and deliberation. Without those guardrails, we fall into a state of nature – a war of all against all.

Today's political culture is such that the other side is immoral, illegitimate, and worthy of being destroyed. We can't work that way if we move to total war. It is not durable.

**You have written about historical figures like Jefferson, who you did not have the opportunity to interview and had to interview through primary resources. You have also written about people like Bush, who was alive when you authored his biography. How are those crafts different?**

In the absence of the subject, you must go where they were and make the imaginative leap. I actually slept in Jefferson's bed.

The benefit of being with Bush while he was alive was not that he was able to tell me what he wanted to, but to be able to access specific documents and his diary that he had kept over the years. He didn't think that anybody wanted to hear the U.S. president complain, so he spent time talking into a tape recorder multiple times a week while in office about his woes. I felt like I got to relive his life through those recordings.

I would want someone who passed away before I authored their book to read it and say it was a fair portrait of what they were trying to do. To me, having a living person be able to then read it was not that different.

**For the majority of the past 100 years, the U.S. has been the global leader militarily, economically, culturally, creatively, technologically, and so forth. How does the next 100 years look?**

In 1989 to 1991, I wasn't an end of history guy, but democracy in a classical sense did seem to be on the ascent. History has confounded our expectations. Autocracy, illiberalism, and nativism are perennial human forces that ebb and flow. They are currently flowing around the world.



*BBH Partner and Chief Investment Strategist Scott Clemons (left) was joined by Meacham (right) at a recent BBH event.*

I'm working on a biography of Dwight D. Eisenhower right now, so I've been living with him. He ran for president in 1952 because Robert Taft would not commit to NATO, and Eisenhower was willing. Eisenhower believed that his fame had been purchased. He was incredibly conscientious and humble about that. His commitment to NATO and the Marshall Plan was driven by a deeply felt conviction that he had just sent 200,000 U.S. soldiers to die to defeat autocracy in Europe and to preserve and safeguard the legacy of that bloodshed was a commitment of the future.

I worry that for seemingly not particularly well-thought-out reasons, we are undoing a post-World War II order that did something remarkable. If any of us had been sitting around in 1961, 1971, or 1981 and had ventured to say that Soviet communism would collapse on Christmas Day 1991 without a single uniformed position in an active zone, you would have said you're being too optimistic. And yet the freedom and capitalism embodied in these alliances prevailed. That is a lesson. That is a fact. That's a story we have to tell and that we ignored at our peril.

**Jon, thank you for your time.**

# Attracting and Retaining Executives in a Closely Held Business

**John Secor** / Principal, Head of Corporate Advisory  
**Kyle Gordon** / Managing Director



Nearly all successful business owners eventually find themselves needing to hire senior executives. The owner may be stretched too thin, in need of specific expertise not currently resident in the business, or there may be a leadership gap between generations at a family-owned business that necessitates hiring executives from the outside to groom the next generation.

Though there are many reasons to bring on experienced executives, attracting and retaining senior-level talent is easier said than done for private business owners trying to balance skills and experience with shared values and cultural fit. It is particularly difficult for closely held businesses to compete for talent against publicly held companies offering lucrative pay packages that include company stock.

Establishing a specific hiring need based on the company's long-term strategy is an important first step before embarking on a search. The strategic plan is the basis upon which owners can identify the qualities and talents needed in an executive. The plan is also an important tool in pitching the candidate on the opportunity. In many cases, top talent can be just as motivated by the challenge as by the compensation.

While there is no one-size-fits-all approach to hiring executives, this article discusses key considerations for owners to identify, evaluate, attract, and retain experienced executives who will not only be great contributors to the business's success, but also serve as great stewards for many years.

### **Identifying qualified candidates**

In this age of mobility and online job boards, it may seem like there is a boundless pool of qualified available talent at the push of a button. However, the challenge is identifying which candidates possess the intangibles. Often, the best place to look is internally, as promoting from within is an effective and low-risk strategy. Existing employees have the benefit of being known quantities who have already demonstrated their value and potential to the organization. Owners should carefully consider the talent available within the organization when identifying candidates.

For owners who decide to broaden the search, there are several forms of outreach available. Social media and job boards are low-barrier avenues for identifying talent; sites such as LinkedIn and Indeed have search tools with extensive filters that allow owners to generate a curated list of executives. While online recruitment was once used primarily to recruit entry-level professionals, it is now a major platform to source and hire senior talent as well, underscoring the importance for businesses to have a social media presence.

Executive search firms, though expensive, often have access to a deeper pool of senior-level talent and can save owners time by screening resumes and conducting due diligence before introducing a candidate. A less structured but more cost-effective version of this strategy is utilizing one's own network. Owners should let their professional and personal networks know that they are hiring and provide sufficiently detailed job requirements to ensure they receive the most appropriate recommendations. Irrespective of the form of outreach, utilizing very specific criteria to qualify candidates is an important step in narrowing the list.

### **Evaluating and selecting the best candidate**

Candidate evaluation goes beyond technical skills, academic qualifications, or prior experience. In fact, what is often most critical is whether a candidate shares the company's values, is a good cultural fit, and has a shared vision for the company's future. This is especially true for family businesses, which maintain a much longer-term outlook and plan to keep control of the company within the family for future generations. The business is often the largest part of a family's net worth, so bringing in an external executive is essentially opening the door to the family home.

As such, succession is a highly sensitive topic given the commingling of personal and professional roles, making advanced planning and open communication among executives and family members critical. The right candidate will recognize and be comfortable with these dynamics. In addition, executives should understand – and appreciate – the company's history and be role models and trusted stewards for rising generations. While skills and experience are certainly important, it is critical that candidates demonstrate an appreciation for the mission of the business and align with its culture and values.

### **Attracting the right candidate with a compelling offer**

Compensation is the first thing that comes to mind when hiring because it is quantifiable and important to candidates on a personal level. There are typically three components of executive compensation:

- Annual salary
- Short-term incentive compensation, such as cash bonuses
- Long-term incentive compensation, such as equity, which is tied to the organization's longer-term goals

Salary and short-term compensation are often used to attract executives, while long-term compensation is used to retain and motivate.

Though it is important to offer a competitive package, compensation alone is not everything. This is especially true at closely held businesses, which may not be able to compete with larger, potentially public, companies when it comes to salary and bonus. Businesses can instead differentiate themselves in several ways. Culture tends to be the most effective method

through which to do so. One example is being more entrepreneurial and offering exposure to responsibilities that are often distributed to various individuals in more hierarchical organizations. An executive often has the ability to have a bigger impact at a closely held firm – for instance, a senior finance professional at a large company may be attracted by the opportunity to be the CFO of a smaller firm where the position involves not just managing the books but providing meaningful input on the company’s long-term strategy.

It is important to remember that the role and nature of the work should truly matter to candidates. If owners sense that it does not, then the candidate is likely not the right choice for the position.

The key for closely held business owners is to find someone who genuinely cares about and aligns with the company’s core principles and values. It is important to sell candidates on culture and role and paint a realistic picture of opportunity. The right candidate will balance these factors with the compensation package offered in making the career decision.

## Motivating and retaining for the long term

In addition to short-term compensation in the form of salary and cash bonuses, closely held businesses need to reward management for value creation over the long term in order to retain them. Effective long-term incentive plans link executive compensation to value creation, typically tied to the achievement of specific financial performance. Incentive programs can be an effective tool to focus an executive’s behavior and performance and align his or her interest with shareholder interest.

While the equity in a private company cannot be traded on a stock exchange and may not otherwise be marketable, there are various means by which private companies can provide long-term equity incentives. As seen in the nearby table, four common types of long-term equity incentives are:

### Selected long-term compensation options for closely held businesses

	Equity		Synthetic Equity	
	Stock options (or profits interests for an LLC)	Restricted stock awards	Stock appreciation rights (SARs)	Phantom stock
<b>Description</b>	<ul style="list-style-type: none"> <li>Grant the right to purchase equity in the company at a predetermined exercise price during a set time period in the future</li> </ul>	<ul style="list-style-type: none"> <li>A grant of stock that is typically subject to forfeiture if certain future conditions are not met (e.g., continued employment or performance goals)</li> </ul>	<ul style="list-style-type: none"> <li>Contractual right to receive a payout of a value equal to the appreciation of the stock from the grant date to the exercise date</li> </ul>	<ul style="list-style-type: none"> <li>Grants the right to participate in certain corporate events without actually issuing company stock</li> </ul>
<b>Key considerations</b>	<ul style="list-style-type: none"> <li>Widespread and generally most well understood by employees</li> <li>Long exercise period allows employee flexibility</li> <li>Employee cash outlay is required to exercise</li> <li>No benefit from dividends</li> </ul>	<ul style="list-style-type: none"> <li>Stronger retention tool than options if accompanied by a forfeiture provision</li> <li>Promotes immediate stock ownership</li> <li>Offers employee prospect of long-term appreciation as company grows</li> <li>No employee investment required</li> <li>Stock has value to holder even if stock price declines</li> </ul>	<ul style="list-style-type: none"> <li>Provides employees with the same financial gain as a comparable stock option, but without requiring a cash outlay to exercise</li> <li>Aligned with shareholder interests (unlike restricted stock, there is only value if the stock price increases after the grant date)</li> <li>Retention effect decreases if stock value depreciates</li> </ul>	<ul style="list-style-type: none"> <li>Similar to SARs, but less flexible because realization of value is tied to the occurrence of a specific event (e.g., sale of the company), not an employee’s unilateral action</li> <li>No dilution if paid in cash</li> <li>No employee cash outlay required to exercise</li> <li>No voting rights</li> </ul>



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Both stock options and restricted stock awards typically involve the issuance of equity and as such are dilutive to common ownership. Phantom stock and SARs, on the other hand, allow owners to reward executives with equity-like compensation tied to a company's stock performance and specific trigger events (for example, the sale of the company) but do not require the issuance of actual shares. These can be particularly useful for 100% family-owned companies, as they likely do not dilute ownership or affect corporate governance.

No matter which option owners select, what is critical is that the right incentives are created such that executives are focused on achieving the clearly established long-term performance targets. When deciding on the best long-term incentive program, owners should consult their accountant, attorney, and/or financial advisor, as there are numerous tax, legal, and accounting issues to consider to ensure the programs are designed to properly meet company goals.

Intangible incentives also affect retention. In family businesses, for example, owners should maintain an honest, ongoing conversation around a succession plan and expectations for executives as time passes and the rising generation grows older. Furthermore, closely held business owners should recognize executives' successes and follow through on promises of career development opportunities and greater authority, as fostering personal career growth will reduce the desire to seek new outside opportunities.

## Conclusion

Making the decision to hire an outside executive is just the first step for a closely held business. A number of considerations accompany finding, attracting, and keeping the right talent.

Choosing executives who share the company's values, believe in its mission, and possess the skills and experience needed to accomplish the strategic plan is one part of the equation. Once hired, it is necessary to provide both tangible and intangible short- and long-term incentives that align with the business's culture and goals, creating a professional environment that motivates the executive to achieve the company's long-term objectives.

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