

The Operating Partner / Advisor Model

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While private equity as an industry still has a reputation for relying on financial engineering when investing in a company, the last decade has seen firms become much more focused on ways to grow their portfolio companies through operational improvements.

As financial sponsors increasingly focus on this strategy, the “Operating Partner” has become a much more prevalent role at firms large and small. While the majority of senior executives at a firm are transactional in nature, Operating Partners are typically proven business leaders whose focus is accelerating the value creation of portfolio companies and playing an active role through the lifetime of a given investment.

Operating partners integrate themselves fully within a platform investment, often taking on the role of an active chairman. They spend a significant amount of time on-site, work closely with management teams, give high-level guidance, and help to identify and implement growth strategies, involving themselves in the day-to-day operations of a company.

Dedicated Resources

There are a couple of ways firms add to dedicated resources focus on the operational side of an investment. While some private equity firms bring on Operational Partners as full time employees, with the same standing as those running the deals and a stake in the fund, others use in-house consultants, bring on senior advisors/board members, or tap external resources (consulting firms, industry-specific professionals) to play the same role.

Terra Firma, a well-known UK based private equity firm, is one example of a successful fund that values having both the financial and operational focus in each of their portfolio companies. When engaging with a company, the firm assigns one Managing Director (typically a former CEO) and one Financial Director that stays with the company for the lifetime of the investment.

Leaner funds often have no choice in ensuring every partner assumes both a financial and operational position when identifying, buying and managing a company.

Three Models

There are three common models a private equity firm follows when taking the operational route. In a paper from INSEAD, the industry expert model, functional model and generalist model are laid out.

	Industry expert / former senior executive model	Functional model	Generalist model
Profiles of operating partners	<ul style="list-style-type: none"> Former senior executives typically CEO or SFO High-level general managers 	<ul style="list-style-type: none"> Former executives, consultants, accountants or lawyers with a deep expertise in a functional area, such as procurement, sales & marketing or lean manufacturing 	<ul style="list-style-type: none"> Former consultants, often complemented with a few years of industry experience
Description	<ul style="list-style-type: none"> As senior executives with experience in the industries targeted by the private equity firm, they bring in network and industry/management expertise. They give high-level strategic advice and generally sit on the board 	<ul style="list-style-type: none"> They belong to a separate pool of resources, on which the deal team / portfolio management can draw when needed for specific functional skill They are mostly not attached to one portfolio company, but are deployed across multiple companies where there is a need for a certain functional expertise 	<ul style="list-style-type: none"> They sit on-site alongside with management and develop a long-term relationship with management over the holding period. Their role is to lead value creation plan initiative, support and coach management, bring in external expertise and oversee implementation progress They are assigned to one company at a time
Examples	<ul style="list-style-type: none"> Clayton, Dubilier & Rice Lion Capital Permira (hybrid former CEO/generalist) Silver Lake (hybrid industry expert/generalist) Sun Capital 	<ul style="list-style-type: none"> Doughty Handson PAI Partners The Blackstone Group (US) 	<ul style="list-style-type: none"> Apax Partners Bain Capital Cerberus (hybrid generalist / functional expert) CVC Capital Partners Oaktree (hybrid generalist/industry expert) KKR Capstone (hybrid generalist/functional expert) Texas Pacific Group

Source: INSEAD

Before the Deal

One of the most significant roles for an Operating Partner actually takes place before a deal closes. During the due diligence phase of a transaction, an Operating Partner will step into the light, spending time to vet the company and any potential operational weaknesses.

Playing Coach

While some private equity acquisitions result in leadership changes, studies have indicated that replacing a CEO may increase the time it takes to generate stronger business results. Alternatively, many firms take the approach of supporting the existing CEO, with the operating partner frequently acting as the top executive's coach.

It's important that Operating Partners build a foundation of trust with a CEO, allowing an executive to still exercise independence in running his company and aligning with the values and culture upon which a company has been built. Many Operating Partners have been owners or operators of companies themselves, come from consulting background or have specific expertise in a given area, for example, IT, HR, marketing, purchasing or manufacturing. Taking the approach of augmenting a CEO's strengths or filling in for areas that need extra attention gives a CEO the feeling of cooperation and collaboration versus that of losing control.

Transformation not financial re-engineering!

The perception is generally ascribed to PE as one that suggests that most operate according to the lowest common denominator with the rationale and focus on cost reduction; leverage and a disposition on creating more with less at the detriment of investment for innovation and growth.

To an extent that is true, however; more Funds are realizing that clever financial tinkering will not on its own provide a path to growth and strong shareholder return.

The priority should be focused on how do we achieve a transformation of a business through harnessing human capital and smarter capital allocation to generate tangible value.

Your value

I see your value to a potential PE Firm as one that straddles between Industry expert and functional expert.

Able in parallel to leverage deep market experiences with strong domain and / or functional relevance around broad and granular technology best practice; innovation and strategic imperatives.

You mentioned the focus and benefits of developing a strong IP core, which is fundamental to any business irrespective of industry or market category, which if executed well establishes a strong value differentiator; market edge and higher barriers to entry.

In a sense the most attuned PE firms are the those that embrace those issues and achieve strong alignment with them through actionable strategies which combine a collaborative, cohesive structure and working relationship between the CEO (of a portfolio company), other members of the portfolio board and the Operating Partner who is usually on the board.