



2018 Private Equity Survey

Effectiveness and financial impact derived from the use of operating partners in North America and Europe



Foreword

Increased reliance on operational value creation in recent years, especially in fund vintages since 2011, has required PE firms to diversify from their traditional ‘financial engineering’ role and either develop the in-house capabilities or look outside of their own organization for the operational expertise they require to achieve rapid, measurable results.

In 2015, Maine Pointe conducted a snapshot survey, on the status and trends in the use of the operating partner concept in the Americas and Europe, to ascertain the perspectives of 50 managing partners/operating partners and senior directors on the use of the operating partner concept. From that survey, we learned that approximately half of all middle-market and larger PE firms utilize operating resources internally, and most PE firms are working with various third parties to achieve improved operating results. Now this begs the question, **how effective are these operating resources in creating incremental value?** This year, we dove into this theme with a new survey aimed at taking PE’s pulse regarding current methods of utilizing operating resources and the barriers preventing PE firms from driving more value in cost reduction and cash flow from portfolio companies. The survey specifically focused on the role of operating partners, asking how and when they are involved in the process and what financial impact their involvement has on value creation.

Methodology

The survey was carried out over a 2-month period in April and May, 2018 and consisted of an online questionnaire supported by face-to-face interviews with 50 operating partners in N America and Europe. The survey group was made up of full-time employees whose role is dedicated to creating and driving operational performance in portfolio companies, as well as part-time operating advisors and operating teams.

Summary of Findings

- The over-arching finding from the survey is that while the use of operating resources is relatively high and continues to grow, the measurable effectiveness of these resources is unclear. We may not truly understand the alpha – or the incremental value creation result – until we have more time to observe these recent vintage fund performances
- Most PE firms surveyed believe direct initiatives within their teams are capable of driving a higher level of cost reduction, cash flow and/or growth in portfolio companies than is currently achieved
- However, lack of skilled resources available in house, time constraints and difficulties getting CEO/management cooperation are cited as among the chief barriers preventing PE firms from driving more value in cost reduction and cash
- 60% of respondents either lack, or are unaware of, a formal process for resource evaluation. This is mainly due to operating groups heavily relying on their networks and word-of-mouth, as opposed to using data-driven results when selecting a third-party resource
- 92% view individual portfolio company performance as the key performance metric





Detailed findings

A lack of skilled resources means internal performance frequently falls short of expectations

The majority of PE firms believe direct initiatives within their teams are capable of driving a higher level of cost reduction, cash flow and/or growth in portfolio companies than they currently achieve.

Operating partners are seeing a gap between how much cost reduction, cash flow and/or growth in portfolio companies is directly driven by initiatives with their team and where they think it could be. Most are saying less than 30% of cost/cash reduction is directly driven by initiatives, although they think the value potential should be more around 30-50%.

76% believe value potential should be closer to **30-50%**

Lack of appropriately skilled and qualified resources, time constraints and difficulties getting CEO/management co-operation are major barriers preventing PE firms from driving more value in cost reduction and cash flow.

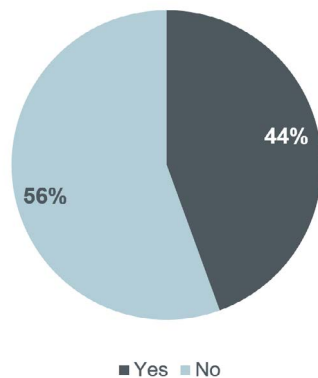
There can be little doubt that finding the right talent and skilled resources continues to be a significant concern for many PE firms trying to drive more value and improved operational performance. The challenge is the competing initiatives that inevitably exist in every firm to drive continuous improvement on cost and working capital. Those efforts are always in play but are often a secondary issue for the CEO, whose primary focus tends to be on growth.

“Resource constraints, both at the company and within our firm are barriers preventing us from driving more value in cost reduction and cash flow as an operating group.”

Operating Partner, Global PE firm

“This confirms what we are seeing in the market, that many PE firms do not have the processes or the tools they need to evaluate their employees.”

56% of respondents either lack, or are unaware of, a formal process within their organization for resource evaluation. This confirms what we are seeing in the market, that many PE firms do not have the processes or the tools they need to evaluate their employees. This makes measurement of success challenging.



Only 44% have a formal resource evaluation process





There is clear delineation between the role of operating partner and deal partner

The areas of focus that are viewed as most important for operating resources are strategic guidance, tactical support and performance monitoring, with due diligence, financial planning and deal support further down the list.

This confirms that operating partners recognize natural boundaries between their role and those of financial planning and deal support, which are owned by the deal partners. Strategic guidance is a common role of operating partners, particularly those with significant industry experience. The operating team provides tactical support rather than driving transformational change across their portfolio companies. Performance monitoring frequently falls under the remit of the operating team to enable proactive identification of any issues during the investment lifecycle. Due diligence, on the other hand, is typically the focus of deal partners and other players within the private equity firm.

“Operating partners recognize natural boundaries between their role and those of financial planning and deal support, which are owned by the deal partners”

	Overall Rank
Strategic guidance	1
Tactical support within the portfolio	2
Monitoring portfolio company performance	3
CEO coaching	4
Due diligence	5
Financial planning	6
Deal support	7

Portfolio company performance is the key metric for operating partners

Specific portfolio company performance is the key performance metric in the vast majority of cases (92%). Operating resource compensation is predominantly tied to performance, with EBITDA, fund development and value creation also listed as key performance measures.

It's common for operating partners to have their performance primarily driven by the financial performance of investments. Measuring performance and taking action accordingly is a natural process, although it often stops action from occurring proactively to prevent performance dips or accentuate performance.

“Revenue generation, direct cost reduction and cash flow growth are ranked as the three most important areas of focus for performance improvement initiatives, closely followed by executive development.”

92% evaluate specific portfolio company performance

Revenue generation, direct cost reduction and cash flow growth are ranked as the three most important areas of focus for performance improvement initiatives, closely followed by executive development. Supply chain functions (logistics, operations, procurement) were, somewhat surprisingly, ranked as only relatively unimportant. Not recognizing the value potential of improving the end to end supply chain is leaving tens if not hundreds of millions of dollars on the table.

Almost all investment theses have growth as the primary driver of value creation. Cost and cash are critical components as well, either funding working capital or creating EBITDA uplift, which by itself has a multiple and can also fund growth.





	Overall Rank
Revenue generation	1
Direct cost reduction	2
Cash flow growth	3
Executive development	4
Customer-focused initiatives	5
Working capital	6
Indirect cost reduction	7
Manufacturing Operations	8
Logistics	9

This result demonstrates an awareness of the significant part played by individuals on the ground, a view that was confirmed in our one-to-one interviews with PE company executives:

“ You need the right individual on the ground to lead change efforts alongside a sound business system; accountabilities, measured, follow-through etc. Overall, it’s easier to cost savings, but harder to achieve growth objectives ”

Operating Partner, Global PE firm

The relatively low importance given to supply chain functions was somewhat surprising and indicates a significant lack of understanding and expertise in many portfolio companies relative to supply chain and/or operations leadership. Companies are often purchased without this strength or may lose it during the M&A process. It’s very common to see this gap but, with the focus on growth, it only gets the attention it deserves if the value creation plan relies on it as a priority over front-end investment. Moving up the maturity curve in supply chain capability has to be tied to company growth objectives, and recognition of the importance of resources. Many organizations are low on the maturity curve and therefore don’t realize the potential gap in performance.

Average length of performance improvement initiatives is between 4-6 months

The average length of a performance improvement initiative is between 4-6 months and yields, on average, between 1-20% EBITDA improvement with results taking around 1 year to impact financial statements. The main focus of these initiatives is revenue generation, cost reduction and cash flow growth.

This aligns with the more tactical performance improvement initiatives performed by operating partners. The focus of these initiatives is consistent with revenue generation, cost reduction and cash flow growth. A TVO™ transformation project across supply chain and operations would typically take longer to complete but yield a higher return with accelerated results.

Past experience and client references are deciding factors to use third parties

Operating partners typically bring in third party resources to support due diligence and improve data analytics and IT capabilities, as well as to support supply chain and operations improvements. When selecting a third-party partner, past experience and client references are deciding factors.





Specialty expertise, supported by the experience and references, is almost always the most important criteria. A belief by the PE industry and the portfolio companies that the unique elements of their business drive business improvement design is common. One opportunity missed may be recognition that general management, leader and organization improvement skills, and overall management operating disciplines drive huge results in almost any industry, and often can be better applied without industry technical paradigms. Operating partners typically bring in third party resources to leverage deep expertise and industry experience in order to accelerate change and drive increased value creation within their portfolio companies.

Conclusion

The importance and value of operating partners continues to grow within the PE marketplace and it is clear that operating partners are driving value. However, not as much value is being driven as desired and there are some difficulties in measuring performance. While an increasing number of firms are coming around to the idea of using operating partners to drive value, there is a distinct lack of clarity around what model is the most effective.

“We need to work with someone that will enable success and create a real impact. We look to partner with results-oriented consulting firms.”

A growing focus on value creation to achieve returns has forced PE firms to evolve their skills set. Investors demand results and want to know how the PE firm plans to deliver them. Do they have an operating partner and, if so, what value are they driving? The challenge, as survey results support, is finding the right individuals with the right experience on the ground.

“Private Equity is going through some changes. Many of the firms we work with have created an operating partner role, but they are struggling to get it quite right and measure performance.”

Mark McTigue EVP Private Equity, Maine Pointe.

About Maine Pointe

Maine Pointe is a global supply chain and operations consulting firm trusted by many chief executives and private equity firms to drive compelling economic returns for their companies. We achieve this by delivering accelerated, sustainable improvements in EBITDA, cash and growth across their procurement, logistics and operations. Our hands-on implementation experts work with PE executives and their teams to rapidly break through functional silos and transform the buy-make-move-fulfill supply chain to deliver the greatest value to customers and investors at the lowest cost to business. We call this Total Value Optimization (TVO)™.

Our Private Equity Leaders



David Jadwin
Executive Vice President,
Business Development
djadwin@mainepointe.com



Mark McTigue
Vice President, Private
Equity, North America
mmctigue@mainepointe.com



Joe Esteves
Vice President, Private
Equity, North America
jesteves@mainepointe.com



Mark Kirstein
Vice President,
Europe
mkirstein@mainepointe.com

To discuss the insights raised in this paper or to find out how we can help accelerate value creation across your buy-make-move-fulfill supply chain, email info@mainepointe.com.

Telephone:
+1 617.273.8450 (US)
+41.52.630.25.55 (Europe)

