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The New Role of the "Corporate Operating Partner"

And Why 2018 Will Be Its Breakout Year

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The Change Afoot

In a quiet fashion, over the last couple of years, we at Lancor have seen momentum build in support of a newly created C-suite role: one that fundamentally shifts the focal point for change across businesses of all sizes. The actual title varies by company and by industry, but in our experience, the person's mandate is the sure giveaway. CEOs are hiring senior leaders to run dynamic transformation programs across all areas of their businesses in an effort to mimic the success seen in the private sector when Private Equity firms transform their portfolio companies. These executives are the mirror image of Private Equity Operating Partners, except for the publicly traded sector. This article examines why 2018 will be the year when the "Corporate Operating Partner" enters our business management vernacular.

For over 15 years, as an executive search firm focused on serving the Private Equity industry, Lancor has worked with the top global firms as they engineer change across their portfolio companies. More specifically, we have established the headhunting industry's leading practice for recruiting Portfolio Operations executives in the PE space. We simply have more experience recruiting Operating Partners than any other firm in the market today. Given the depth of our relationships in this niche, we occupy a perch from which we can spot trends as they begin to take shape. The most interesting of these has come in the form of the "Corporate Operating Partner".

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Introduction

Perhaps it was inevitable that best practices would cross-pollinate between the public and private settings. For years we have seen this move in the direction of public company processes and systems being adopted in the private sector. Examples like GE Six Sigma and the Danaher Business System spring to mind. However, over the course of the last few years, with the mounting evidence that the Private Equity "playbook" for company transformation is legitimate, we have seen an uptick in public companies copying those strategies.

Closely-held private companies have always embraced the theory that change could be more aggressively pursued given their ownership structures. And in fact, many managers leading publicly traded corporations would agree that they do not have the liberty to move as quickly as they otherwise might given the quarter-to-quarter focus that the financial markets place upon them.

In many cases financial buyers are successful in take-private transactions because they can convince the management teams that, while under the private structure, the opportunity to create enhanced value is significantly higher and more attainable. Private Equity firms feel conviction in paying a premium for a publicly traded company because they know that once the ownership consolidates they have an opportunity to move that enterprise valuation quickly and aggressively.

For the last 20 years or so, the path to increasing a company's enterprise value was inherently tied to the role played by the Private Equity firm's Portfolio Operations Group. These transformation specialists were deployed directly inside the portfolio company and tasked with solving some of their most perplexing problems. Often times the necessary changes were both structural and cultural. These leaders worked hand-in-hand with management teams to tackle the big strategic issues facing a company. And given the now private nature of the business, they had the liberty to take risks which could equate to higher returns on investment.

Over time, many of these strategies and approaches became institutionalized across specific Private Equity funds, who became known for their operational prowess. With repetition, the probabilities for success continued to increase. Ultimately, in some cases, this resulted in the formulation of a Private Equity firm's "playbook" for transformation. These methods and tactics were guarded and viewed as the secret sauce for why one investor's success might be more predictable than their competitor's.

Along the way, the Operating Partners who were at the intersection of this change effort took on a higher level of importance. As one client put it, "PE Operating Partners in a relatively short period of time get a masters class on transformation that they would never see in the publicly traded arena." As such, their skills became quite refined and much sought after.

Activist Investors Press for Change and Public CEOs Crave Help

Probably the most striking evolution that has occurred in public company ownership has been the increasingly aggressive positions taken by Activist Investors. When NYSE bellwethers like P&G, General Electric and Whole Foods Market are under attack by groups like Trian Partners and Jana Partners, it's clear that no publicly traded company is safe from the activists' crosshairs. Many CEOs have found themselves playing defense versus the activists who agitate for change in their businesses. It is not surprising that one strategy to repel aggressive hedge funds is to copy elements of the Private Equity "playbook" that seem to work so well.

In its February 2017 Global Private Markets Review, McKinsey & Company noted the strong position that Private Equity held across the globe. In 2016, firms received $625 billion of new capital from their investors; and the industry's assets under management metric reached a record $4.7 trillion worldwide. This asset class and ownership structure is now every bit as legitimate as anything else in the world.

CEOs of publicly traded companies took notice of what was going on inside the world of PE. They watched with envy as these private companies were able to drastically remake themselves and emerge as healthy businesses optimized for competing in the 21st century economy. Moreover, they could insulate themselves from the attacks of activists. When CEOs examined what strategies and tactics they could borrow from the PE world to emulate those outcomes, the Portfolio Operations team came squarely into focus.

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The Corporate Operating Partner

We slowly began to see a wave of momentum for the adoption of Corporate Operating Partners in the publicly traded sector. Our clients and candidates were starting to field calls from heads of human resources of publicly traded businesses to discuss opportunities inside those companies. In addition, there have been occasions where publicly traded CEOs have called us to counsel them on the proper set up of this function. Of course, in some fashion, various elements of this role already exist in (many times) multiple executives on a management team. The idea is to take this proven concept of Private Equity Operating Partners and re-pot it into the public company context.

There is a legitimate comparison to be made between the trending Corporate Operating Partner role and the more traditional Chief Change Officer or Chief Transformation Officer. At a foundational level, regardless of title, the focus on this type of outcome is a novel pursuit, and the centralization of responsibility is good because it helps to avoid fragmentation of initiatives. However, if done correctly, this role is not simply an extension of the duties of the CHRO or CIO. (One would rarely ever see the ownership of these initiatives in the PE context vested in a CHRO or CIO.) A company cannot have a sitting executive simply “babysit” this important outcome. Moreover, a CEO needs to be able to fire this person for underperformance without decimating another vital function in the company.

We have seen large logistics companies and large retailers look at this role as a means to more effectively deal with the disruption to their industries that came about because of Amazon. We have seen industrial product businesses and contract manufacturers seek this kind of talent because of the globalized nature of competition today. We have seen B2C companies and retail banks want this capability to more effectively market and cater to the quickly changing consumer landscape. In essence, if a company truly believes that it constantly needs to be reinventing itself so that it does not suffer an untimely demise (ex. digital files and the recording industry) then this is a topic that demands some consideration at the next Board meeting. If an industry is going through disruption, one can argue that it’s negligent NOT to create this capability.

What do Corporate Operating Partners do?

There are a variety of ways to utilize the Corporate Operating Partner. In some cases, the mandate may be rather narrow and defined through either a function or a particular business unit or geography; in other cases, the mandate can be quite broad and unstructured. In the latter case, it requires a great deal of forethought and planning to ensure that the person can be successful.

We have seen models that resemble a SWAT team created to fix things related to strategy, process and cost improvement, shared services, and governance issues. Sometimes they serve as an internal replacement to what would have typically been done by external strategy consulting firms. We have seen situations where this capability might report into a head of strategy, the CFO, the Chief Administrative Officer, or some other business unit President. Naturally the most desired reporting line is directly back into the CEO of the company. It is that executive level sponsorship which creates the environment for success.

One interesting way to create this role is to have the candidate and the CEO jointly write their own "Activist letter" to the Board of Directors. Of course, it requires trust and transparency because no sacred cows should be spared. Typically, the recommendations made by an Activist are all things that existing management know should be up for discussion. Formalize the role as an integral part of crafting the mandate and put it up for debate with the broader Board of Directors. In actuality, going through an exercise like this will shine a light on those who truly embrace their fiduciary duty to the company versus those whose self-interest dominates their thinking.

Keep in mind that these roles are only ever meant to be temporary in nature. There would be a finish line at which time all parties are clear in understanding that the mandate has ended. The Corporate Operating Partner should not be under the belief that they have an open-ended time frame within which to deliver results. Operating Partners work inside the Private Equity context because PE typically looks to exit an investment around a five year time horizon. Thus, every quarter is critical. The Corporate Operating Partner must work with the same sense of urgency. This also removes any perception that this person is a rival to the management team.

Once the role is set, the Corporate Operating Partner must take advantage of all possible tactics to mitigate the risk of failure. This is a multi-dimensional examination of not only the business itself but also of the interpersonal relationships that are required to achieve success. As one of our Private Equity clients remarked, "Deals happen because the terms are right, and the negotiation was well executed. But on the operational side, progress is only made through influence born out of mutual respect for one another. Human relationships matter at the portfolio company." The same applies in the publicly traded context.

Get out on the road and meet the people. The action does not typically occur at HQ; it occurs out in the field where the business meets its clients and customers. Pitch your transformation plan to the rank and file on whose participation you will rely. Create advocates for your plan and the desired outcomes with the people who can most readily translate plans into action. Walk them through your vision for how you expect to monitor progress and measure success. These important elements should not come as a surprise nor should they be last minute developments.

All that being said, the rules of engagement need to be succinctly laid out to the business' managers: The Corporate Operating Partner is their best friend until he/she concludes that they need to be their biggest enemy, i.e. they have concluded that the manager is part of the problem. This is where the sponsorship and support of the CEO become critical. PE Operating Partners are successful because they are a representation of the ownership of the company. Their power is assumed. In the Corporate Operating Partner context, the power is derived from the CEO. Thus, there must be a visual show of support in order to make this engagement successful.

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Ultimately, internal executives are the best advocates for the transformation. Their storytelling opens doors to other parts of the business. When the role starts to string together some wins, the team will be pulled into the situations where it can do the most good, which will continue to perpetuate its place within the enterprise until it finally reaches its agreed upon goal.

What can Derail Success?

Unfortunately, what looks like a rather straightforward mandate for the Corporate Operating Partner is actually fraught with complications and political land mines that may be hard to navigate.

Private Equity Operating Partners are generally successful in creating change because they have developed a skill set and a user interface which does not overtly threaten the positional power of the portfolio company CEO or management team. Great Operating Partners are successful because they understand how to use influence and nuance in achieving the desired outcomes. They are there to empower the management teams and to facilitate them to a greater destination for the business. If a CEO or business unit President believes that an Operating Partner is actually angling for their job, they will naturally resist any involvement from that person. Thus, in order to effectively achieve the goal, Operating Partners must not only be set up for success via the design of the role, but also must be mindful of the human element in the interaction with the company executives.

Do not let an attitude persist that the internal transformation team is a second-class citizen to the teams from McKinsey, Bain, etc. Those firms have great reputational advantage and are wonderful marketers of their work. That being said, a CEO needs to prop up and advocate for the internal capabilities. The internal group should be far more effective because, in the truest sense, they must live with the results of the strategies that they deploy.

When recruiting someone into this Corporate Operating Partner role it is tempting to position it as someone who could potentially be a CEO successor. Many Heads of HR will believe that they need to offer this carrot in order to attract the best talent. Unfortunately, by doing so, they are actually undercutting the person's opportunity to be successful in THIS ROLE, and likely hiring someone who is not committed to the reasons the role was created in the first place. Putting them in the succession plan immediately creates internal personal conflict with the senior leaders on whom they will rely for success. This condition should be avoided if at all possible. Moreover, if a major reason that they agree to take on this mandate is because they have their eyes on the corner office, then it will be hard for them to divorce that goal from the unbiased and authentic decision making that this role actually needs to be successful.

Remuneration is another key element to success in this role. Though this may come off sounding wrong, you want this person to have a mercenary type mentality to the work they do. As such, loading them up with an outsized chunk of equity is a perfect tool to align them in a concentrated way with the company's stock price.

Who are the Corporate Operating Partners?

Many of the Partners at Lancor spend much of their time convincing top tier executives to consider making a career switch into an Operating Partner role. For many executives, this is a confusing thing for them to consider because it takes them off of the career track that they have been pursuing for a long time. That said, based on a combination of factors, a certain subsection of the candidate pool recognizes that a role like this is their highest and best use. Having interviewed literally thousands of prospects for these roles over the last 10+ years, some patterns emerge which indicate a readiness and willingness to make this kind of move. Of course, having a client who has properly thought through the pitfalls of poorly designing this role makes the headhunter's job much easier. Hopefully there is flexibility in the design phase which empowers the client for success.

It should be noted that a CEO may find that someone on their existing management team has the capability set to move into this role and deliver the intended outcomes. In some ways, that may be a preferable path given the person's knowledge of what works in the company's culture.

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We believe that conservatively there are 600 to 700 portfolio operations professionals globally in Private Equity. We try to understand their industry and functional strengths to properly direct them across our client base. It is an ambitious and surprisingly mobile workforce. Just like any other executive, Operating Partners are commercially minded and invest a great deal of time in their careers. Just like any CEO or CFO, they want to be put in the best position to succeed professionally and economically. There is no reason to believe that a well-crafted Corporate Operating Partner role would not be attractive to a set of high functioning individuals. There is ample evidence in the market to suggest reasons to be optimistic.

2018 and Beyond

Just as it took the better part of a decade for the role of the Operating Partner to institutionalize itself across most of the PE industry, the role of the Corporate Operating Partner still has a long way to go. In many ways, companies will experiment with it, and get it wrong. But many deployments will stand out as the "state of the art" for how to utilize these talented people.

For many years, we saw very few lateral moves from one PE firm to another for Operating Partners. But then, as time passed, and the market matured we saw mobility in the candidate pool as they sought to optimize their personal situations. We can envision a similar evolution for the Corporate Operating Partner. Keeping in mind the temporary nature of a role like this. At some point, we expect to see professionals moving into these roles in a serial fashion and building the capability faster and more effectively in their second and third stints in the role.

We estimate that we are likely in the early days of this trend taking hold. For Private Equity, we saw a rapid uptake on the role following the financial crisis of 2008-09. Hopefully we won't need a similar macro condition to be the springboard for this capability set in the publicly traded markets.

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