

Operational Expertise Makes the Difference

By Danielle Fugazy, August 26, 2015

Dealmaking has been going like gangbusters for private equity firms throughout 2014 and 2015. However, many experts believe that PE firms will have a hard time producing outsized returns from the deals they completed in today's market, where valuations are very high and leverage is abundant. To help portfolio companies achieve growth in all situations, but especially in today's environment, Advent International and Welsh, Carson, Anderson & Stowe have both developed extensive operating partner programs over many years.

What follows is an excerpt of a conversation with Conor Boden, head of portfolio board development at Advent International, and Tony Ecock, a general partner at Welsh, Carson, who is responsible for helping portfolio companies identify and implement initiatives focused on growth and operational improvement. They share insights into how operations professionals can add value and why they are important to investment strategies.

Privcap: Why do you think having operating partners is important?

Conor Boden, Advent International

Conor Boden, Advent International: There are many different definitions of what makes an operating partner. Advent defines them as senior ex-CEOs who act as independent advisors to Advent and the companies we invest in to support the development of the businesses. These people are not employees of Advent but work very closely with us on pre-close activity as well as post-close. They are experts in their sector. Our approach to creating value is to work with management teams to grow the portfolio company's earnings by increasing the top line or investing in operational efficiencies. We recognize the value the operating partner brings in helping us do that. It's a proven program we have had in place for 10-plus years. We have more than 60 operating partners around the globe and believe they are important to what we do.

Do private equity firms with operational expertise excel?

Tony Ecock, Welsh Carson: It's hard to tell with so many other contributing factors, but all else [being] equal, firms with operational expertise will excel going forward. Market multiples are at all-time highs, and you need to add value to your investments to earn competitive returns. We actually measure the contribution of our operating team, and we are satisfied that they have significantly improved our returns. But admittedly there is so much variety in private equity and so many other factors that influence returns, it is hard to prove that [contribution] at a general level across the industry.

The real proof is that limited partners are smart enough to know what to look for, and they are demanding more operational involvement at the portfolio level. As a result, most every PE firm has developed some in-house operational capability by now.

Has the role of the operating partner changed over the years?

Boden: It has changed in two respects: In the early phases of our program, operating partners were largely focused on working with specific companies post-close. These days, we work with them at least as much pre-deal. They are helping us think about the subsectors we should be looking at and where we can

deploy capital. They also help inform our thinking about certain sectors while offering sound advice, so it's more than just working with portfolio companies.

Tony Ecock, Welsh Carson

Ecock: It's changed significantly, because the sheer number of operating partners has grown. You have a mature industry built around the operational partner. They have significant experience and well-developed job specifications now. Some firms are on their second or third iteration of how to deploy these resources. You can now find operating partners with track records. It's really a well-established profession, and the growth is obvious. Consider our PEOPEN [Private Equity Operating Partner Executive Network] organization, which is made up exclusively of full-time on-staff operating partners; we had six people in 2008, and now we have 500. The field should continue to grow.

How has using an operating partner helped you achieve your goals with your portfolio companies?

Ecock: The clearest examples are in growth and cost efficiency, particularly in procurement. It's hard to quantify the precise impact on growth, but we can point to companies where we have helped them build sales forces or provided ideas and input to their new products and services, which have worked well. The company has to do the work, but the operating partner is supporting them. On procurement, we aggregate our purchases across 25 to 30 portfolio companies, which allows us to buy at much lower prices than the companies could buy for on their own. We have saved over \$100M in procurement costs on an annual run-rate basis. This is a huge win, and this money can be reinvested in growth initiatives.

Before we even consider buying a company, we ask, "How can we improve its value?" We begin with a formulated value-maximization plan. Then we look to the management team, with support from the operating partner as necessary, to move the business in the right direction.

Boden: It's been tremendously helpful. For example, in one situation, we worked with an operating partner and it helped us win the deal. We were coming in second during the process, and then the firm we were competing against started chipping away at the price and indicating that they wanted to remove some of the employees. The seller was pretty upset. Turns out he knew our operating partner—they were part of the same network—and he asked our operating partner, "What's Advent like?" Our operating partner told him that he had worked with us before and knew we invested in people and the business. That gave us credibility, and we won the deal.

Are there any sectors that lend themselves more to using operational partners?

Boden: We invest across five sectors and have operating partner relationships in all five of these areas. There is no sector where the model isn't viable, though it is less viable in some, such as real estate, where it's more about the asset play than about what a strong team can do operationally.

Ecock: All sectors in which PE invests have an operating component to them, so they all lend themselves to the input of qualified operating partners. The operating intensity is more dependent on the type of investment than on the industry sector. If you are doing turnarounds, you need more operating input and resources than you would, for example, need in a high-growth company that is tracking well to plan.

Operating performance is fundamental to all businesses. I can't think of a situation where a qualified operating partner could not add some value.

Are there any common strategies for improving operations?

Ecock: The key process we go through is to collaborate with management to develop the value-maximization plan. First and foremost, we are trying to nail growth to drive returns. There's only so much cost you can take out of the company. Whether it's improving the products and services or pricing products correctly or improving the go-to market approach, we have to find the growth, year in and year out. And sometimes that will come in the form of an add-on company that will support our vision for growth.

It's important to apply pattern recognition—to look for problems you have solved before—when pursuing companies. For example, if we can't point to work we have done for a company in a certain channel or geography, then we shouldn't enter into a deal with knowledge that channel or geography is important. There are a lot of things you can do operationally for a company, but you don't want to try new things with other people's money. You want to take risks you can overcome.

Boden: Ultimately, it's the management team that has to improve the business, and a strong team can make a huge difference. Still, you want to understand the market potential and the risk and give the team the support it needs to be successful. The core of everything we do is to ensure we have been backing a strong management team to create value in the business.

What are the characteristics of a strong operating partner?

Boden: We are looking for someone who is credible. That would imply that they have had success in their sector. We are looking for a rounded skill set and someone who is able to follow a clear strategy. We have to make sure we are getting things right. Our operating partners need to have an appetite to engage in the more detailed operations of the business to drive transformation. It's not just about putting together a strategy and handing it over to management. They need to engage on a weekly basis to help management with the challenges they will face.

Ecock: There are a lot of smart businesspeople; what differentiates a good operating partner is the ability to read the situation and partner with management and the investment team. You need to work with both of them well. A good operating partner needs to build trust and deliver results. A good operating partner prioritizes initiatives and helps management achieve positive change.

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