

PE Operating Partners - Delivering a Winning Formula

Creating constructive strategies to engage, inspire and recognise
Operating Partners contribution to optimise value from every deal.

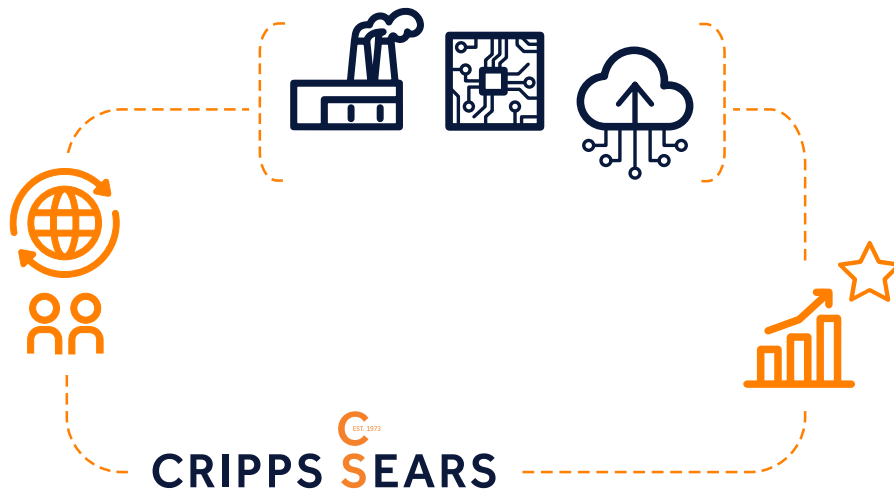


About Us

We are a London based global leadership advisory business. Through our executive search and assessment expertise, we create value for clients in the world of industrials, tech and digital transformation.

PE Operating Partners is the second in a series of White Papers that Cripps Sears is publishing.

If you'd like to know more about our business, please get in touch. There are contact details on the last page of this document.



Global dealmaking set records last year, with M&A volumes hitting US\$5.9 trillion. Flush with cash and buoyed by surging stock market valuations, over 62,000 deals¹ were struck in 2021. Private equity, which put record amounts of capital to work in 2021 and ended the year with funds totalling US\$2.3 trillion, 14 per cent higher than 12 months previously, is helping to drive this growth.

According to PwC, almost 40 per cent of deals in 2021 involved a PE fund, up from just over a quarter over the past five years, and the deals they're tackling are getting bigger, accounting for 45 per cent of total deal values compared to 30 per cent over the past five years.²

With investors typically paying a 37 per cent premium for revenue-rich targets, and an increased number of competitive bids³, there's growing pressure on the PE industry – as well as corporates and special purpose acquisition companies – to generate returns and demonstrate value creation. While climbing interest rates and now a war on the edges of Europe have yet to dent the appetite for further dealmaking, there is increased scrutiny on whether these big ticket deals are generating value.

The competitive nature of the money being raised by funds is shrinking margins and therefore the previous model where private equity could add value relatively easily through financial restructuring has almost disappeared. To enhance value and de-risk investments, Operating Partners are being sought for crucial deal evaluation, then taking board seats to ensure the deal thesis is executed as planned. They are required to bring value both pre-deal and post-deal.

This is where investors are expecting the Operating Partners (OP) to play a vital role, cutting through the noise of the pre-deal frenzy, assisting with due diligence and, post-acquisition, helping to implement changes that can deliver a turnaround and/or create real value.



¹ JP Morgan, January 2022 <https://www.jpmorgan.com/solutions/cib/investment-banking/2022-global-ma-outlook>

² <https://www.pwc.com/gx/en/services/deals/trends.html>

³ Research found a 37% premium to the median multiple for firms with expected revenue growth in the top quartile. JP Morgan, January 2022 <https://www.jpmorgan.com/solutions/cib/investment-banking/2022-global-ma-outlook>

Our research

To better understand this niche market, Cripps Sears undertook several months of qualitative research with private equity firms, infrastructure funds and Operating Partners. The picture that emerged is of an unstructured, ad hoc and often short term set of relationships that can prove unsatisfactory for both sides.

Often hired on a project by project basis, against a backdrop of urgency and stress, Operating Partners can feel they are parachuted into hostile territory with limited back-up – with their services ended almost as abruptly should a deal not pan-out as planned. One successful Operating Partner said “use and abuse” might be one best way to characterise the relationship. Others noted they have many offers crossing their desks every week: they can afford to pick and choose and often only opt to work with firms they think will be successful in a bid situation and can offer the right support.



Those firms that configure the right package – financial, professional and personal – will be able to secure the services of the most sought after OPs and increase the likelihood of delivering real value from the deals they strike.

Compensation and LTIP structures in funds are moving from simple deal related bonuses towards a more aligned equity investment, based on many performance variables from IRR to ESG and meaningful operational related targets being achieved.

Compensation

“Remuneration should be in line with the management team.”

Our research found a wide range of arrangements in place to compensate Operating Partners, influenced by a unique mix of circumstance, culture and competition. There is no doubt this can be a well-paid role:

- Our research found the typical per diem rate ranged from £1,000 to £2,000 rising to US\$3,000-US\$5,000 for US firms.
- Success fees were common, with win bonuses typically ranging from £50,000 to £200,000 but rising to seven figures for very large deals.
- Opportunities to Co-invest or Carried Interest, which provide the potential for longer term upside, vary from firm to firm, with ranges in 0.2-0.3% of deal with caps in place ranging from £1-5 million, depending on deal size.
- Fees for sitting on the board typically range from £40,000 to £80,000 per annum.

“I only take on deals where I can co-invest... that’s very important to me.”

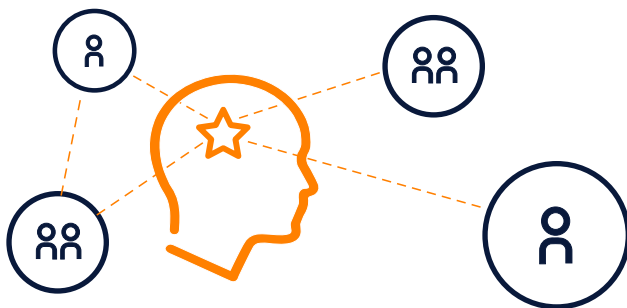
There’s a clear desire for Operating Partners to share in the upside at exit, with opportunities to co-invest a must-have incentive for some we interviewed. However, the OPs interviewed for this research were not solely motivated by financial rewards and stressed the delicacy of structuring remuneration, so it doesn’t create undue friction with the existing executive or management team. Money is not the sole driver for these business relationships.

Structuring the relationship

There is no homogenous industry structure for managing relationships with OPs. Only a few funds, such as EQT, have an established bench or network of retained OPs. Some firms expressed concerns that establishing a network of retained advisers would load additional costs that may have no tangible return. “It can’t be a cost for a cost’s sake” said one, indicating that some PE funds have yet to be convinced that OPs add value to the process.

“I prefer being tied into one firm and having a longer term, more holistic relationship.”

Yet given that the highly successful Operating Partners we interviewed feel the best work happens when they’re part of a team and feel consulted and supported, it’s a reticence that may prove costly. Indeed, without a clearly defined strategy, this ad hoc approach to OPs may prove self-defeating from the start by failing to attract and motivate the best talent.



“I prefer being tied into one firm and having a longer term, more holistic relationship, where I’m involved in helping to select the target,” said one successful OP, who has board-level offers crossing his desk at least twice a week. “Otherwise, it feels like a very haphazard, very opportunistic on/off role. Now I only work with teams I think will be successful.”

Relationships matter

“I was made to feel like a consumable. It was quite a jarring transition.”

Operating Partners are keen to work with high calibre teams. Those that are retained by a firm and are regularly consulted and supported, with opportunities to attend wider work events as part of the team, were convinced this model delivers the best results. In this capacity, they are able to provide insight at key moments, identify opportunities and provide meaningful interventions that might otherwise have been missed had they been kept at arm's length.

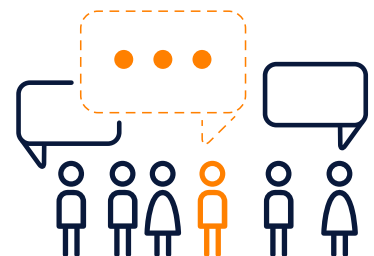
“I feel very supported and valued by the organisation,” said one, currently growing a potential multi-billion dollar opportunity. “The role has expanded and I’m constantly being asked if I’m happy with the situation or if I’m getting pulled too thin. I feel very invested in this now.”

While this professional courtesy is much appreciated, some Operating Partners share horror stories of their experiences with some PE firms. “My first experiences were with a private equity group that were badgering me to work with them,” recalls one former CEO, now a sought after OP in the energy sector. “But there was a lot of swagger, a lot of cancelled meetings and I was made to feel like a consumable. It was quite a jarring transition.”

“It can feel a bit use and abuse because that’s the way they work. You have to have the type of personality where you don’t mind too much.”

This cuts both ways, however, with successful Operating Partners required to have the self-awareness of their place in the team and the limitations of their new role. “You have to recognise you’re not the boss or the decision maker anymore,” said one. “You have a different standing in the organisation so sometimes you need to limit your share of voice, listen to different opinions and share your insight in a constructive way.”

Another pointed out that this is not a role for those who want to spend their days on the golf course. “It’s hard work – you need to do your research, travel, attend meetings, solve problems. It’s not Champagne Charlies trading off their name or past glories – you have to add value.”



What matters most to Operating Partners

“It’s very rewarding... you’re using all that experience and knowledge built up over your career to play your part and make a difference.”

While the right financial package can be highly attractive, it seems the clincher is the work itself. These are very senior individuals with multiple pulls on their time but highly incentivised to work with high calibre teams and make a positive contribution. In this, their interests are aligned with those of the firm.

“It’s very rewarding,” says one. “It’s real self-validation because you’re actually using all that experience and knowledge built up over your career to play your part and make a difference”

Another agreed. “That moment when you flag up a problem but you can also bring a solution to the table...it’s very rewarding.”

The Cripps Sears View

Experience, insight and influence are increasingly in demand to work out an effective game plan to resolve problems and capture value-adding opportunities.



We see demand for former C-suite executives with blended experience (M&A, P&L, Operational, Financial and Commercial) across a specific industrial sector is highly attractive, particularly if they have previously worked within the private equity environment.

First time Operating Partners do have to adapt to the principal investing approach, which can take 12-18 months, but once they have aligned and the trust is built, the loyalty is valued by the business who will use the OP transversally across other portfolio companies and deals.

At Cripps Sears, we help firms identify individuals with the unique skill set to add value at every stage of the deal lifecycle and can advise on how best to structure relationship to ensure both parties feel rewarded and inspired by the outcome. Long term relationships, underpinned by sensibly structured compensation packages with the right degree of upside, are key to finding the right formula for success and securing a competitive edge when it counts most.

Contact

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Methodology

We undertook qualitative research with a wide range of PE groups and investment funds. We also interviewed highly successful Operating Partners in the UK and overseas. This research took place between July 2021 and February 2022.



Next White Paper

Executive compensation within fund portfolio companies.