

PRIVATE EQUITY INTERNATIONAL

OPERATIONAL EXCELLENCE SPECIAL 2018

This year's award winners

The questions LPs need to ask

Preparing for a downturn

The rise of operating partners

How diversity drives value

...and more

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Meet the judges

An influential panel of industry experts from across the three regions assessed the relative merits of the submissions

Americas

STEVEN KAPLAN

University of Chicago Booth



Steven Neil Kaplan is the Neubauer Family Distinguished Service Professor of Entrepreneurship and Finance at the University of Chicago's Booth School of Business. His research focuses on private equity, venture capital, entrepreneurial finance, corporate governance and corporate finance. He is co-creator of the Kaplan-Schoar PME (Public Market Equivalent) private equity benchmarking approach. *Fortune* called him "probably the foremost private equity scholar in the galaxy". He co-founded the entrepreneurship programme at Booth, helping start its New Venture Challenge competition, which has created over \$10 billion in value from companies like GrubHub and Braintree/Venmo.

MICHAEL McKENNA

Alvarez & Marsal



Michael McKenna is a managing director of Alvarez & Marsal's Private Equity Performance Improvement group. He works with private equity investors across the transaction lifecycle to identify and execute transactions, accelerate portfolio company performance and provide a smooth investment exit. His primary area of focus is finance operations, driving improvements in working capital management, accounting and treasury operations, and reporting and analytics.

JONCARLO MARK

Upwelling Capital Group



Joncarlo Mark is the founder of Upwelling Capital Group, a registered advisor that provides advisory and capital solutions to institutional investors. Prior to forming Upwelling in 2011, he was a senior portfolio manager at the California Public Employees' Retirement System, where he was responsible for investing in global private equity partnerships and direct investments, with a portfolio that exceeded \$48 billion of exposure. In addition, from 2007 to 2010, Mark served as chairman of the board for the Institutional Limited Partners Association.

Asia-Pacific

VERONIQUE LAFON-VINAIS

Hong Kong University of Science and Technology



Veronique Lafon-Vinai is associate professor of business education in the School of Business & Management of The Hong Kong University of Science and Technology, where she is the executive director (career development and corporate outreach), associate director of both the undergraduate and World Bachelor in Business programmes, and a project director of the MSc in Global Finance programme. Lafon-Vinai is a seasoned financial market professional with over 20 years of banking and capital markets experience.

LIAN HOON LIM

AlixPartners



Lian Hoon Lim is a managing director with AlixPartners. He has more than 25 years of experience in all aspects of operations improvement, including sales and distribution, manufacturing, procurement, product development, overall supply chain management and transportation operations. He has consulted to the automotive, electronics, consumer goods and chemicals industries and held management positions in electronics, shipping and logistics industries in South-East Asia and Greater China.

IVO NAUMANN

McKinsey & Company



Ivo Naumann is a partner with McKinsey & Company where he leads the Private Equity and Institutional Investor practice as well as the RTS service line, a special unit that delivers a proven approach for transformational change, for Greater China. Naumann has more than 20 years of experience in supporting shareholders and management to restructure and improve performance of underperforming businesses in Asia. He has acted in multiple management roles and served on various boards of directors in China, Japan and South-East Asia.

EMEA

MILES GRAHAM Metro AG



Miles Graham is an operating partner at Metro AG, a €37 billion revenue, Frankfurt-listed food wholesale business that has adopted a private equity-style operating model.

He has been in private equity for 20 years, serving as president of 3i portfolio company John Hardy, which he restructured and sold to L Catterton, and was director and head of active partnerships at 3i Group, where he oversaw improvements across a \$6 billion portfolio of 100 companies. He spent five years in McKinsey & Company's private equity practice, and is a non-executive director of Age Checked Ltd and the Operating Partners Group.

LUDOVIC PHALIPPOU University of Oxford



Ludovic Phalippou is a Professor of Financial Economics at the Saïd Business School, University of Oxford. He specialises in private equity funds and focuses on issues such as risk management, liquidity and measurement of returns.

Phalippou's research in this area has been published in leading academic and practitioner journals.

“Each year
the entries
continue
to get better

Michael McKenna

KATJA SALOVAARA Ilmarinen



Katja Salovaara has been a senior PE portfolio manager at Ilmarinen since January 2000. Ilmarinen is a mutual pension insurer based in Helsinki, managing €47 billion. Currently 6

percent of the assets are invested in private equity. Before joining Ilmarinen, she worked at the Shell UK Pension Fund in London analysing private equity funds and monitoring a global private equity portfolio with over \$1 billion of commitments. Prior to that, she was an investment analyst in the European team at private equity specialists Pantheon Ventures.

ANTOON SCHNEIDER Boston Consulting Group



Antoon Schneider is a senior partner at The Boston Consulting Group and leads the Principal Investors & Private Equity practice in London. He has advised leading principal

investors and more than half of the 50 largest private equity firms globally on a range of deal sourcing, due diligence and firm strategy projects. He has also worked extensively with their portfolio companies on 100-day value creation planning and operational improvement projects, and has deep experience in corporate strategy and M&A.

GENERAL PARTNERS

‘Everybody talks a good game...’

... but what are GPs really doing to drive performance? LPs must be prepared to ask some tough questions, says **Joncarlo Mark**, a former senior portfolio manager at CalPERS

Joncarlo Mark is used to looking beyond the hype of general partners. As a senior portfolio manager with the California Public Employees’ Retirement System, he was responsible for investing in global private equity partnerships and direct investments, with a portfolio that exceeded \$48 billion of exposure. He left CalPERS to set up investment advisor Upwelling Capital Group in 2011 and is one of the judges of this year’s Operational Excellence Awards for *Private Equity International*. He tells Isobel Markham why operational improvements have become the benchmark with which to measure a GP’s capabilities.

Q When did you first start seeing private equity firms pitching their operational capabilities?

There’s always been GPs positioning themselves as operationally-oriented in some

fashion, whether they boast about their operational backgrounds or ability to find good operators to run companies.

However, the implementation of operational expertise and value-add has accelerated exponentially over the last 15 years. It’s driven by the efficiency of the market. The bottom line is 15 years ago you were paying high single digit multiples in a traditional buyout. Today, average leverage in mid-market buyouts is six times, and purchase price multiples are well into the double digits. Whereas in the past, I think it was easier for GPs to make money on the buy, the efficiency of private equity – as so easily identified through the pricing – has made it much more difficult for private equity to just think they can buy a company cheap and sell it at a higher multiple.

What that means is you still are back-ing management but the low-hanging fruit of buying cheap has gone away. Now even before you buy the company you have to have a real clear vision of what needs to happen operationally and how to execute on that.

Q Is the 100-day plan still in play?

The traditional line you hear is the 100-day plan but it may be a two-year plan or it may be the first 30 days or the first six months. I don’t think it’s just the 100-day plan any more; companies aren’t fixed in 100 days and their value hasn’t been maximised in 100 days. The operational element, whether it’s driven by an internal operating

team that the GP brings to the company, or the company or its management using their network resources or a combination, is more relevant than before. More than ever there really has to be meaningful operational improvement for the GPs to meet the return expectations of their investors.

Q How do LPs diligence operational capabilities?

That is the exact objective of the course I teach at the ILPA Institute called ‘A Framework for GP Value Creation’ – helping enlighten LPs on the kinds of questions they need to ask managers, management teams and other people involved in the diligence process.

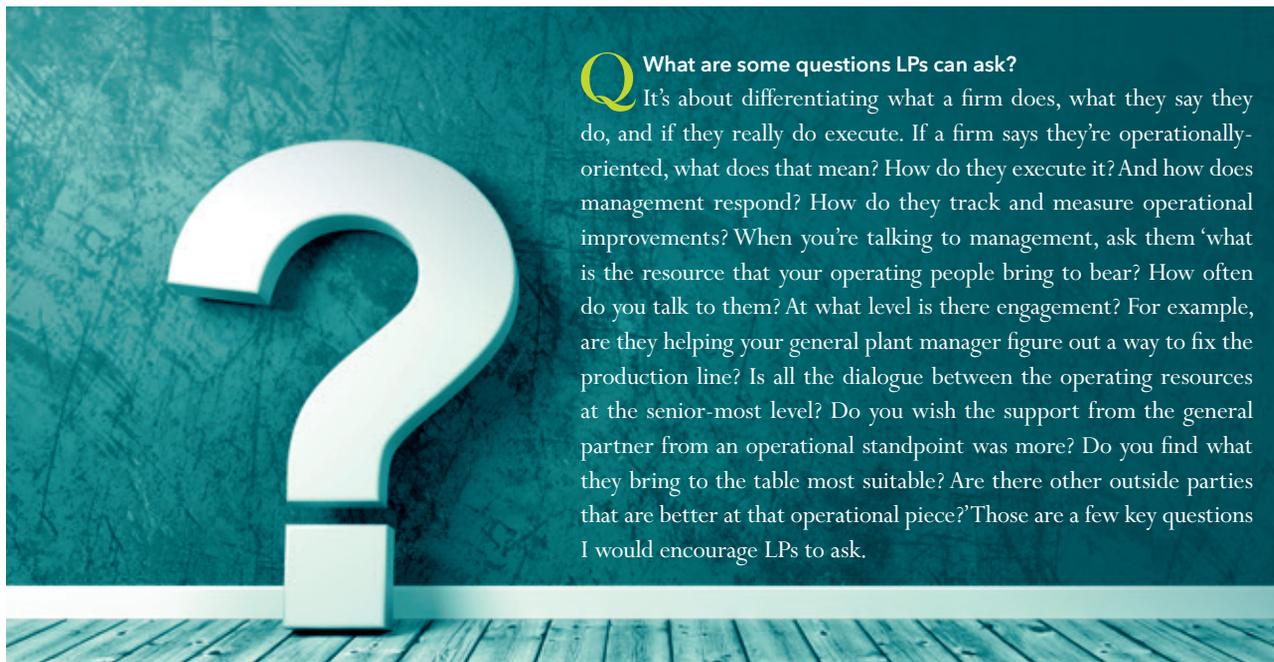
Everybody talks a good game – it’s really understanding what that means. It can’t just be ‘we have a group of operating partners that are affiliated with our firm’. That looks good, but almost everyone has that these days. It’s really identifying the exact work.

Some private equity firms are incredibly heavy-handed in their operational engagement at a portfolio company, to the point that it may create some friction with the management team – which can be good or bad. Others are primarily financial buyers, they have a network of operating people they can tap but they’re not so engaged. In these cases they’re probably buying more healthy, growth companies and really just getting behind the CEO to drive performance. Then there’s people in the middle that want to be a resource to management and help execute, but do not want to tell management what to do, because at the end of the day the CEO and the senior team is accountable for the plan.

Where the operational value-add role might be most important is in the development of the plan as opposed to its execution.



Mark: LPs need to be prepared to probe



Q What are some questions LPs can ask?

It's about differentiating what a firm does, what they say they do, and if they really do execute. If a firm says they're operationally-oriented, what does that mean? How do they execute it? And how does management respond? How do they track and measure operational improvements? When you're talking to management, ask them 'what is the resource that your operating people bring to bear? How often do you talk to them? At what level is there engagement? For example, are they helping your general plant manager figure out a way to fix the production line? Is all the dialogue between the operating resources at the senior-most level? Do you wish the support from the general partner from an operational standpoint was more? Do you find what they bring to the table most suitable? Are there other outside parties that are better at that operational piece?' Those are a few key questions I would encourage LPs to ask.

If you find a firm that is more of a financial buyer that has the right people either on their team or in their broader network of executives, that may be as effective as the firm that's got 100 operating people.

Q Do LPs have concerns about the costs associated with operational resources, particularly affiliated entities?

Some firms, for good or bad, treat operating partners like investment partners. It's very important that the operational people demonstrate, if it's an internally-driven piece, that indeed they're value-add. These are the kinds of questions an LP is going to want to ask. Did you find the affiliated operating team to be productive? Where were they strong, where were they deficient? LPs are acutely aware that affiliated operating partners or external consultants are a cost to them at times.

Sometimes operating people are salaried employees and it's just all rolled into the management fee. The real potential conflict is 'X portfolio company is paying the affiliated operations firm to do operating consulting work or is engaged at a personnel level; could that company find better operational

support at more value as opposed to utilising the GP's affiliated entity?' That's a process of reporting; what's the outcome? How has the company performed?

Theoretically the investment management team is more aligned with the LPs because if the company doesn't do well, it doesn't matter whether or not the affiliated entity made money on it – their economics are driven by the overall investment performance.

Q Are there any new frontiers of value creation we're just beginning to see firms explore?

One is geographic value creation; today, even middle market firms are much more global, or are certainly transatlantic. How does the market in Italy or Spain compare with that company trying to develop a business in the US? What are the nuances in labour relationships in Germany and how do those compare with opening up a facility in Mexico to support a global company?

Another is aligning management. If everyone agrees that getting the right managers is critical to executing an operational plan, then how do they do that? How do

GPs attract the right managers? Here we are focusing on operational value add, but maybe one of the more important things is the reputation of the general partner to be able to attract the right CEOs. Because the CEO community is pretty close so there are few secrets that a prospective CEO can't pick up with a few phone calls in the market. If a firm has a bad reputation, CEOs are probably going to be reluctant to work for that manager. How does the general partner attract the best? You can always pay people, but I think the most successful executives want to work for people who have a reputation for supporting CEOs and providing the appropriate resources – not being overbearing and being someone they can work with when things maybe don't go well.

One of the big developments that's occurring is the development of internal HR departments at the GP: dedicated hiring of HR professionals whose sole job is to find talent for their portfolio company managers. That's a huge development, particularly if one believes that the most value a GP can add is through backing great management teams. ■