Perspectives on private equity operating resources

Jay Bartlett
May 12, 2016
Research context
In 2014, we interviewed LPs to understand their perspective on operating resources

Limited Partner (LP) perspective
September 2014

<table>
<thead>
<tr>
<th>What we did</th>
<th>Key findings</th>
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<tr>
<td>► Interviewed 25 LPs across various fund types</td>
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<td>► Asked four key questions:</td>
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<td>► What is the LP’s awareness and understanding of operating resources?</td>
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<td>► What operating models are available and what are the prominent types?</td>
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<td>► Do LPs believe there is a superior approach to operating resources?</td>
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<td>► How do LPs react to the different characteristics of the operating models?</td>
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<td>► Recognizing most General Partners (GPs) can no longer “make it on the buy,” operating resources are being utilized more and more to generate investment returns</td>
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<td>► LPs do not believe there is one superior operating resource model for GPs to adopt; they want to understand the alignment of the operating resource structure with the firm’s investment strategy</td>
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<td>► While there is not one right model, some LPs do have opinions on the various levers that can be pulled, for example:</td>
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<td>► LPs prefer full-time resources versus bench players and want to see aligned incentive through investment in the fund or the company</td>
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<td>► LPs believe operating partners should be deployed early on in the deal life cycle, to justify their cost and set them up to add value on Day 1</td>
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<td>► LPs want transparency in the way operating resources are compensated, and how any costs are allocated to portfolio companies and/or as extra fees</td>
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**Research context**
This report presents findings from follow-on research investigating the perspectives of GPs and CEOs

### GP perspective
**May 2016**

- **Who we talked to**
  - Interviewed ~10 GPs at lower mid-market and middle market private equity (PE) firms

- **What we asked**
  - What roles do your operating resources play for your CEOs? How has that changed over time?
  - What type of background and expertise do you seek out for operating resources?
  - How do you evaluate and compensate your operating resources?

### CEO perspective
**May 2016**

- **Who we talked to**
  - Interviewed 30+ portfolio company CEOs
  - Owning private equity firms ranged from lower middle market to mega cap
  - Portfolio company industries included:
    - Technology
    - Health care
    - Human capital management
    - Financial services
    - Consumer goods
    - Industrials

- **What we asked**
  - Where have you seen operating resources from a PE firm be most effective?
  - What “level” of resources are most useful to you?
  - What background/skill sets are most valuable?
  - Are operating partners more likely to encourage you or to slow you down?
  - Do you feel that you are the “primary customer” or do you see the operating partner as an extension of the board or financial backer?
  - Do you trust the operating partners you’ve worked with?
Agenda

► Evolution of private equity operating resources
► The private equity-backed CEO perspective
The evolution of private equity has dramatically increased the importance of operational improvements to create value.

Source: Goldman Sachs, BCG-IESE estimate
The “conventional wisdom” is that the role of the operating partner is to be a driver of value creation

Operating partner
(noun /əpə-rāt-ing,part-nər/)

“This is the guy who can probably add the most value inside your portfolio, but no one listens to him. Ever.”

“The portfolio CEOs think he’s trying to take their jobs, and your partners don’t quite know what to do with him because he doesn’t find deals for them.”

“While he’ll get a lot of attention at your annual meeting, he rarely sees the light of day the rest of the year.”

“But if you want to know what’s really going on at your firm, get a couple bourbons into him the next time you are out at a portfolio company together. He’ll tell you everything.”
This role for operating resources has evolved and will continue to evolve as private equity groups continue to pull this growth lever.

Private Equity Groups Focus on Operations to Combat Lean Returns
January 14, 2014

“Joe Healey, senior client partner and private equity practice leader of Korn Ferry, says limited partners are reducing fees paid to private equity groups and funds are getting smaller, causing firms’ profits to shrink. Private equity firms are no longer getting deal fees as they did in the past, and are holding onto portfolio companies longer than they used to, which also reduces returns … Korn Ferry is working with a number of private equity groups to find these individuals, Healey says. ‘As a firm, we’ve had 15 or more operating partner searches in the last year.’”

Castanea Partners names new operating partner
February 3, 2014

BelHealth names new operating partner
August 28, 2015

Former American Tire distributors CEO Joins Soundcore as operating partner
April 19, 2016

Satori Capital hires new operating partner in health care
April 8, 2014

MPM Capital adds new MD to team
September 15, 2015

Aequitas Capital beefs up advisory board with new addition
November 17, 2015

Pamplona appoints new operating partner
November 10, 2014

TPG hires former Asurion CEO to run operations group
November 16, 2015

Brawn joins GenNx360 Capital as an Operating Partner
March 22, 2016
While there have been some that claim operating resources don’t drive value, there are a large number of well-respected and successful private equity firms who believe in the power of this resource.

Operating partners lack the expertise to help nascent, fast-growing companies.
► “Rarely does an operating executive bring the specific experience, or the range of experiences, to address the broad array of situations and challenges portfolio companies face.”

Generalist operating partners don’t provide significant value to the portfolio company.
► “If I’m an entrepreneur trying to grow my organic dog food brand and need help determining if the packaging should be red or purple, recyclable or biodegradable, 5-pound bags, or eight-ounce servings, the last person I want to turn to for help is an operating partner with ‘general’ industry knowledge and general knowledge of how to operate a business. As a CEO myself, I’ll tell you ‘general’ advice isn’t very helpful.”

Operating partners bring significant expertise to which the firm would otherwise not have access.
► “Our operating partners are able to successfully transfer their C-suite experience to the high-level, change-oriented thinking of the PE world. These professionals add great value in the diligence process, assist with strategic planning, and often supervise portfolio company initiatives post close. Additionally, our operating partners bring propriety deals that are not being marketed, to our attention.”

Generalist resources have had a breadth of experiences that make them an even more valuable partner.
► “As a value-focused PE firm, we look for seasoned operating partners who are often prior CEOs and COOs who can leverage their expertise to our benefit. Moreover, our operating partners come with very specific industry experience and a history of working with companies in preferred size ranges.”

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1 Ryan Caldbeck, “Private equity’s dirty little secret: why operating partners don’t make sense,” PE Hub, 7 July 2015.
<table>
<thead>
<tr>
<th></th>
<th>GPs see many benefits of operating partners</th>
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<tbody>
<tr>
<td>1</td>
<td>Operating partners add consistency and structure</td>
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<td>“We buy family companies with not as much capital, and we see our role as bringing structure and discipline to bring the company to the next level. Our operating partners have built businesses before, and they’re helping us create the next level of structure.”</td>
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<td>2</td>
<td>Having more smart people is better than having fewer smart people</td>
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<td></td>
<td>“Why wouldn’t I want to have another smart person looking at the business and spending time with the company?”</td>
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<td>3</td>
<td>Operating partners free-up time for deal partners to focus on deals</td>
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<td>“Our use of operating partners came to be because the deal professionals were spending time in the portfolio, which was adding value, but taking time away from doing deals.”</td>
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<td>4</td>
<td>Operating partners offer a different perspective on the business</td>
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<td>“I’m a big fan of them. Whether it’s our group or an independent outsider, they bring a different view of the world to the table and I think that’s important. I’m a big believer that if you can bring different skill set, different perspective, that’s value add and I can leverage them differently.”</td>
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Source: Parthenon-EY interviews, April 2016 (n=9)
There are as many models for types of operating resources as there are private equity firms ...

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<thead>
<tr>
<th>Types of operating partners</th>
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<td><strong>Level</strong></td>
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<tr>
<td>- Retired CEO</td>
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<td>- Peer-level resource</td>
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<td>- Junior analyst</td>
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<tr>
<td><strong>Type</strong></td>
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<tr>
<td>- Advisor</td>
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<tr>
<td>- Partner</td>
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<tr>
<td>- “Arms and legs”</td>
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<tr>
<td><strong>Skill set</strong></td>
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<tr>
<td>- Generalist</td>
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<tr>
<td>- Industry expert</td>
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<tr>
<td>- Functional expert</td>
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| **Background**             |
| - Operator                 |
| - Consultant               |

| **Working style**          |
| - Mentor                   |
| - Doer                     |

| **Purpose**                |
| - Strategic                |
| - Tactical                 |
“There are so many models of operating resources, from large staffs to individuals or smaller groups, and from operating executives to the gray-hairs with substantial experience. For us, our philosophy is to maximize our operating partner model to match the types of companies we invest in.”
– GP, middle market private equity firm

“Our use of resources is driven by the needs of our firm and the needs of our CEO. Ours is not the only model out there; it is the one that works for us.”
– GP, lower mid-market private equity firm

“As a generalist fund, we need people that can be deployed across the portfolio.”
– GP, middle market private equity firm

“As we went narrow and deep and more focused in industries, it made sense for us to align ourselves with folks who came out of those industries. That’s what worked for us.”
– GP, lower mid-market private equity firm
These are just a few of many models of operating resource deployment …

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<th>Board-level mentors</th>
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<td>► Internal “project-based” consulting firm (senior executives</td>
<td>► Typically board members whose role may include being</td>
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<td>who look like deal partners, mid-level managers, junior</td>
<td>executive mentors and coaches</td>
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<tr>
<td>resources)</td>
<td>► Sourcing talent and deals through industry networking</td>
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<td>► Include industry, operational and functional experts</td>
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<th>Functionalist specialist</th>
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<td>► Operating resources who infuse financial and operational</td>
<td>► Functional experts in a set of specific areas (e.g.,</td>
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<td>discipline into portfolio companies</td>
<td>sales, technology)</td>
</tr>
<tr>
<td>► Tend to be generalists with wide experience but a specific</td>
<td>► Provide targeted support and advice on specific</td>
</tr>
<tr>
<td>mandate for discipline</td>
<td>functional areas</td>
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but in order to add value, the deployment of operating resources must match the private equity firm’s investment strategy regardless of the model they choose.

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<tr>
<td>Allows this firm to provide sufficient resources to enact change in large and complex businesses</td>
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<td>With a history of purchasing smaller companies, the addition of process allows this firm to scale</td>
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<td>▶ Functional experts in a set of specific areas (e.g., sales, technology)</td>
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<tr>
<td>▶ Provide targeted support and advice on specific functional areas</td>
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<tr>
<td>With investments in similar-stage companies in a small number of verticals, this model allows this firm to provide scalable expertise</td>
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<tr>
<td>Believe they have great people running their companies already (management) who can benefit from additional advice and coaching</td>
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Operating resources can be viewed very differently within private equity firms, likely due to the role the operating group plays in the firm.

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<tr>
<th>Role</th>
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<tr>
<td><strong>One-off advisors</strong></td>
<td>“We used to have a couple of OPs with full-time exclusivity that we paid a salary. That model didn't work because our business is so episodic. <strong>Now we have OPs that we pay a smaller fee to be more strategic, as an advisor to our CEO, and not full-time or exclusive to us.</strong>”</td>
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<td><strong>Resources on retainer</strong></td>
<td>“We purposely designed our program so that the industry executives would not formally be part of our firm. <strong>They are not employees; they are independent contractors.</strong>”</td>
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<td><strong>Small internal teams</strong></td>
<td>“As we have grown and the need for operating improvement to generate return has grown in the current investing environment, we needed to build our capacity and improve in this area … we are investors and not operators, so it was important to find an operating resource that fit this philosophy and culture.”</td>
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<td><strong>Large internal “consulting” teams</strong></td>
<td>“Their work is on a specific company with set goals or help they are supposed to provide. <strong>We have a large pool of operating resources who definitely need to be thought leaders but are not equivalent to the deal team.</strong>”</td>
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<tr>
<td><strong>Large internal “deal-equivalent” teams</strong></td>
<td>“We think about our operating resources as full team members who are no different than the other partners. We encourage teamwork and collaboration, and see no advocating of certain deals vs. others.”</td>
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Source: Parthenon-EY interviews, April 2016 (n=9)
This translates into how the operating resources are evaluated and compensated

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<td>One-off advisors</td>
<td>“We view our ex-CEO OPs as usually really wealthy so getting wealthy isn’t the goal. We give them $50K; we give them options for aligning us, and we allow them to put as much money in the company as they want … If you’re taking on risk or in the business of managing risk, you get paid differently than executing on projects.”</td>
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<tr>
<td>Resources on retainer</td>
<td>“We pay them a retainer that ranges from high five figures to low six figures annually. That’s the price we pay to get their attention and have their share of mind.”</td>
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<tr>
<td>Small internal teams</td>
<td>“Our operating partner is philosophically a part of the team. He has economics that mirror similar levels on the deal side.”</td>
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<tr>
<td>Large internal “consulting” teams</td>
<td>“These guys don’t need to be comped like deal partners. We compensate at their opportunity cost, and make it clear to people that this is not an equal-partner track and that they should think of this job as a three- to four-year stepping stone. Their comp goes up 4%-5% per year and is not terribly variable.”</td>
</tr>
<tr>
<td>Large internal “deal-equivalent” teams</td>
<td>“Our operating resources are compensated with salary plus a bonus, plus carry on a deal-by-deal basis.”</td>
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Source: Parthenon-EY interviews, April 2016 (n=9)
While some GPs feel that the operating partner model is a fad, others cite real value and see a path for this model to continue in the future.

There are some GPs who perceive operating partners as a fad …

► “My macro-level cynical view is that operating partners are a ‘flavor du jour.’ For many years it was sourcing, and now it has migrated to operating improvement where folks are looking for ways to differentiate in a high price environment to get extra bits of alpha.”

► “Operating talent has come into focus recently but seems like a little bit of a fad. Dan Rasmussen showed data that money is made on the buy, so maybe we should be focusing on how to find resources that can help buy well.”

… but others cite the real value the model has brought to their investments

► “I think there is that flavor of the day thing, but a group like us believes in operating partners. We have them on the board and have a whole operating team. I’m cynical too, particularly when I see funds with a lot of operating partners who just want to act as if they’re differentiating to their LPs, but I actually do think there is value in the model.”

► “In our history, an operating perspective has been a fundamental part of our approach to investing.”

Source: Parthenon-EY interviews, April 2016 (n=9)
Operating partners serve multiple constituents whose motivations and mandates can conflict. Portfolio company CEOs may have a different opinion on the value of operating partners.
Agenda

► Evolution of private equity operating resources
► The private equity-backed CEO perspective
Our questions

1. **Value of operators**
   What value can operating resources add for the CEOs?

2. **Types of operators**
   What kind of operating resources do CEOs find most effective?

3. **Effectiveness of operators**
   How can operating resources work most effectively?
Operating partners serve as advisors, interpreters of the private equity firm’s needs and, occasionally, as additional resources

Think through critical issues in the business

► “You need more help at the senior level because there are strategic issues and survival issues you’re trying to address every day. You need more senior people helping you then because you need quick turnaround.” – CEO, consumer goods company

► “The highest value … is someone I can talk to: here’s the situation, how do you think about it, how do I think about it? They bring that general knowledge to bear.” – CEO, consumer services company

► “You can get close with people and you don’t share the same amount of anything with people that you’re not comfortable with. People work for people and with people and I would go back to a very experienced former CEO.” – CEO, transportation company

Translate private equity firm’s needs and market dynamics

► “I have had situations when I am at odds with the financial guys, and having an operating partner is huge to be an intermediary between them. They can translate to people that have never run businesses.” – CEO, human capital management company

► “It’s nice to have a bridge between you and the private equity firm.” – CEO, consumer services company

► “[An operating partner who] is constantly in the debt market, understands it intimately, knows what will be attractive, from a debt portion that to me has been very valuable. I didn’t have that skill set and neither does any of my team.” – CEO, financial services company

► “You don’t always have the time to understand exactly every other cutting-edge company out there and the PE people may actually know where the funds are flowing from a VC perspective or PE perspective. It can be valuable to know how the market is valuing these new approaches.” – CEO, distribution company

Resource to lead projects and initiatives

► “Let’s roll up our sleeves together and figure out what we need to do to achieve that goal. The best, most mature people demonstrate that behavior.” – CEO, industrial company

► “[Our operating partner] was very helpful in building clarity, getting thoughts aligned, working with me to create different work groups, and really put in motion all the necessary things … he would have been able to help me drive this.” – CEO, health care company

► “They’re always there for introductions, acquisition strategy, potential partnerships, very deep on the research side.” – CEO, technology company

Source: Parthenon-EY interviews, April 2016 (n=31)
However, there are certain behaviors that can irritate CEOs

- Act as CEO
  - “If they want to do my job and be hands-on, then they should save money and let me go.”
    - CEO, financial services company
  - “There needs to be the fundamental understanding that I am the CEO of the business. I am running the business and they have to follow me. Either that or replace me.”
    - CEO, human capital management company

- Stifle creativity
  - “They’ll stifle [sparks] because they’d have to go back to the real decision maker every time we come up with a new, good idea.”
    - CEO, industrial company
  - “All they did was stifle growth and creativity … an operating partner is bent towards a lack of non-transformative collaboration.”
    - CEO, financial services company

- Focus on numbers rather than people
  - “When the phone rings with [my operating partner] I hesitate to pick it up … it’s ‘you have to cut more costs’ – it’s never about the people.”
    - CEO, transportation company
  - “They see their job as compiling a report to send back to the PE firm that you may or may not see and, in that case, it is very difficult to build trust.”
    - CEO, management technology company

Source: Parthenon-EY interviews, April 2016 (n=31)
Depending on the needs of the company, operating partners can fall along a spectrum of being highly strategic to maintaining a more tactical approach.

- **Can enable creativity by bringing fresh perspectives**
  - “Fresh set of eyes, to be a fresh thought partner, and provide input because she’s seen multiples of other companies. That different knowledge and diversity of thought can add a lot of value. I refer to that as challenge.”
    – CEO, industrial company

- **Can help a CEO weigh the pros and cons**
  - “The best ones do both well … They give you a good way of risk weighting it, and I think that assessment is the powerful part.”
    – CEO, industrial company
  - “I’m endorsing again [the] perspective that you need to match the operating model to the investing model and that should dictate the emphasis.”
    – CEO, health care company

- **Focusing on tactical issues is particularly important when companies struggle**
  - “[The OP] was challenging us to not get overly creative … [He] had to peel me back and it was very helpful because it forced us to acknowledge that he needed a tactical [plan] to get the company ready to sell in two-three years.”
    – CEO, education company

**CEOs sometimes resist this “help” in the short run, though it is likely beneficial in the long run.**

Source: Parthenon-EY interviews, April 2016 (n=31)
Our questions

1. **Value of operators**
   What value can operating resources add for the CEOs?

2. **Types of operators**
   What kind of operating resources do CEOs find most effective?

3. **Effectiveness of operators**
   How can operating resources work most effectively?
Operating partners draw on a variety of experiences to provide CEOs with a breadth of knowledge

**CEOs’ desired operating partner expertise**

- No preference
- Consulting experience
- Operating experience

Consulting backgrounds provide strong financial acumen and an ability to analyze a wide variety of issues.

► “He helped me with a lot of issues that we were working through from technology to sales growth and he supported me … from the consulting perspective” – CEO, financial services company

Experience running a company allows operating partners to understand the complexities of the people side.

► “General experience with the ups and down of business, [someone] who knows when to get involved is the most helpful … a good generalist with people skills would be the most helpful” – CEO, transportation company

Source: Parthenon-EY interviews, April 2016 (n=31)
CEOs often cite operating experience as most helpful for multiple reasons

- **They understand the position of the CEO**
  - “Operating partners without the CEO experience are hampered – they can maybe provide some advice but are not as valuable.” – CEO, distribution company
  - “My team benefit[ed] most from those OPs because … [he] had enough experience that they genuinely understand the challenges of day to day.” – CEO, education company

- **They understand what motivates people**
  - “They’ve seen it all and done it all so working through many of the issues from a personnel standpoint is where I found value.” – CEO, health care company
  - “The good ones know how to motivate. There is a difference between those who are critical and those that motivate you.” – CEO, manufacturing company

- **They often find it easier to build rapport**
  - “It is difficult for an entrepreneur or a CEO to ever get on a close page with an investment professional with no operating experience and the ability to transfer experience to value is what gains the trust.” – CEO, insurance company
  - “His recent experience of running a business, he played back to me several times … He knows what I was going through; I was surprised at how comforting and positive that made the actual relationship.” – CEO, human capital management company
Industry or functional expertise is not necessarily required for CEOs to find value from the operating partner

Many firms hire functional expertise externally, but in some cases a functional advisor can dive into a specific area of weakness within the firm.

- “[Our operating partner] really helped drive our real estate model and understood how that worked in retail. It’s been an explosive force.” – CEO, consumer services company

Industry experts are valued for their industry contacts and knowledge of the market.

- “You don’t always have the time to understand exactly every other cutting edge company out there and the PE people may actually know where the funds are flowing ... It can be valuable to know how the market is valuing these new approaches.” – CEO, financial services company

CEOs value generalists for their fresh perspectives and holistic approach to problems.

- “The generalist is good at certain things – framing complex issues into bite-size portions to digest and join the dots.” – CEO, technology company
- “The entire team has benefited from his insight into similar businesses but not identical. [They’re] helpful because we can see different aspects of our business through a different lens.” – CEO, education company

Source: Parthenon-EY interviews, April 2016 (n=31)
The needs of the portfolio company often dictate the most useful expertise of the operating partner

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<tr>
<th>Level</th>
<th>When to use</th>
<th>Benefits</th>
<th>Drawbacks</th>
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<tbody>
<tr>
<td>Functional expert</td>
<td>► Investing in companies at a similar stage, with similar functional development needs</td>
<td>► Can quickly address functional issues (e.g., technology, finance) ► Can step in when specific skills are needed quickly</td>
<td>► Experience may not be specific enough for the situation ► CEOs often already has these contacts in their rolodex</td>
</tr>
<tr>
<td>Industry expert</td>
<td>► Investing in complex industries where specific knowledge is needed ► Bringing in a CEO who is new to the industry</td>
<td>► Intuitive understanding particularly helpful in complex industries ► Knowledge of industry deal flow for M&amp;A opportunities ► Understanding of what is best in class or cutting edge</td>
<td>► CEOs see themselves as the expert so can find this quality redundant ► May tend to adhere more to a certain perspective or method than a generalist would</td>
</tr>
<tr>
<td>Generalist</td>
<td>► A strong management team is in place ► Multiple issues/opportunities in the business</td>
<td>► Bring a fresh perspective ► Act as a sounding board across multiple facets of the business ► Frame complex issues and provide perspective</td>
<td>► Lack of industry expertise may inhibit ability to be helpful, particularly early on ► Experience may not be deep enough to be valuable to CEO</td>
</tr>
</tbody>
</table>
Most CEOs appreciate an advisor as an operating partner, which can be complimented by other resources and relationships.

**CEO’s desired operating partner expertise**

<table>
<thead>
<tr>
<th>Relationship type</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Junior analyst</td>
<td>20%</td>
</tr>
<tr>
<td>Ex-CEO</td>
<td>60%</td>
</tr>
<tr>
<td>Peer</td>
<td>20%</td>
</tr>
</tbody>
</table>

**Junior-level resources** are seen as the “arms and legs” that can help with complex analysis and are able to provide significant leverage.

- “Some of the junior folks on the team are extremely helpful as around-the-clock brains. The crazy ones that do [an] unbelievable amount of work in short periods of time … that can be very valuable.” – CEO, industrials company

**Former executives** are valued by CEOs for their experience and play an advisory role.

- “A retired CEO would be a benefit in terms of been there done that. They’ve had the time in the seat … It’s a different level of understanding.” – CEO, technology company

**Peer-level operating partners** can become true strategic advisors and allies for the CEO.

- “I would want someone who is different and who has been in different experiences. We may see things differently and then have an open conversation about our different perspectives. I want an operating partner to be a peer. They are part of my personal board of advisors. I am always looking to get better and what a gift to have someone to talk these things through and who can relate and has been in the same situations.” – CEO, technology company

Source: Parthenon-EY interviews, April 2016 (n=31)
## Each level of operating resources offers different benefits to the CEO

<table>
<thead>
<tr>
<th>Level</th>
<th>When to use</th>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
</table>
| Junior analyst | ► Need to augment current resources, especially on a temporary basis  
► Not able to afford to hire on their own | ► Provide needed analytic horsepower  
► Can provide leverage for quick decision-making based on data | ► Less experience  
► May have a preconceived idea of the answer  
► More connected to the private equity firm than the company |
| Ex-CEO       | ► Need a role model for CEOs who are founders or lack experience          | ► Experience and expertise allow them to guide CEOs                      | ► Less involved in the day to day  
► May be more “stuck in their ways” when providing advice  
► Mentorship cannot be assigned |
| Peer         | ► Need a resource to help drive growth by supporting the management team | ► Provide fresh perspectives on strategic issues coupled with tactical help in more pedestrian matters  
► Are often skilled at serving as intermediary between CEO and private equity firm | ► Sometimes do not have the experience or authority to provide meaningful help on strategic issues  
► Can get too deep in running the business |
Our questions

1. **Value of operators**
   What value can operating resources add for the CEOs?

2. **Types of operators**
   What kind of operating resources do CEOs find most effective?

3. **Effectiveness of operators**
   How can operating resources work most effectively?
Effective operating partners have authority to make decisions from the private equity firm and are invested in the success of the portfolio company

<table>
<thead>
<tr>
<th>Effective</th>
<th>Not effective</th>
</tr>
</thead>
<tbody>
<tr>
<td>“They need to have <strong>authority</strong> … it’s up to the private equity firm to decide how they empower their operating partner to make ‘yes’ decisions and approve budgets and investments.” – CEO, manufacturing company</td>
<td>“If there’s no trust, I never want to see them … because they’re <strong>not bringing value</strong>.” – CEO, health care company</td>
</tr>
<tr>
<td>“I came to this thing from Day 1 saying we have <strong>shared incentives</strong>, shared equity and shared vision.” – CEO, industrial company</td>
<td>“If every decision an operating partner is making always leads back to the lead equity partners as they’re just a <strong>puppet</strong>, then I can see where a CEO would disengage.” – CEO, human capital management company</td>
</tr>
<tr>
<td>“They have to be <strong>invested in the relationship</strong>. They have to learn the business… [and] care about the people they’re working with and care about their success.” – CEO, financial services company</td>
<td>“I call them <strong>handlers</strong> … You only get that designation if you were not helpful and just doing what a conduit would.” – CEO, consumer goods company</td>
</tr>
</tbody>
</table>

Source: Parthenon-EY interviews, April 2016 (n=31)
These “effective” operating partners are able to bridge the gap between employment by the private equity firm and the mandate to serve portfolio companies.

**Bridging the gap**

Effective operating partners are transparent and open with both the private equity firm and the CEO …

- “They give me an insight into how the private equity firm is looking at their investment and returns. Not every private equity firm looks at it the same way.”
  – CEO, financial services company

- “The notion of an operating partner is well intentioned … and helps break down the wall a little bit.”
  – CEO, financial services company

- “If you’re transparent about the business, then you shouldn’t be afraid. That gives you the ability to be the ultimate customer.”
  – CEO, consumer goods company

… but they also understand the importance of the relationship they have with the CEO

- “It’s worked out well and [the trust] allows for free-flowing conversations – I don’t have to worry about couching things. It’s more in terms of a handshake situation instead of receiving and sending messages back and forth.”
  – CEO, consumer services company

- “I know how he got paid, but I thought there was a certain level of confidence we had to work on things before we escalated it to the PE partners.”
  – CEO, financial services company

Source: Parthenon-EY interviews, April 2016 (n=31)
Trust is the crux of a productive relationship between the CEO and the operating partner

Level of CEO trust in operating partner

- **Totally**
- **Somewhat**
- **Undetermined**

Source: Parthenon-EY interviews, April 2016 (n=31)
A CEO’s trust in an operating partner can be engendered in a myriad of ways

Operating partners can build trust with CEOs by …

1. Demonstrating commitment to the company’s success
   - “I got to trust [our OP] as a partner to me because he understood our most important issue. We trusted and believed that he had value.”
     – CEO, financial services company
   - “Trust is borne of two things: 1. Does the person have the competency to deliver what you need, and 2. Do they have the motivation to help you?”
     – CEO, technology company

2. Proving their value to the CEO
   - “They build my trust by providing true guidance – whether it’s strategic or more tactical aspects.”
     – CEO, education company
   - “It’s being in the trenches with me at the beginning that can help me build that trust. Someone who knows the angst and helps me build that trust.”
     – CEO, industrial company

3. Connecting with the CEO on a personal level
   - “They need to pass the drink a beer test – you’re in business together so you have to have some level of alignment.”
     – CEO, human capital management company
   - “Off-sites where you work in the morning and have drinks in the afternoon give you a better understanding of the people you’re working with. It’s important to get to know the person beyond the balance sheet.”
     – CEO, industrial company

Source: Parthenon-EY interviews, April 2016 (n=31)
Sowing the seeds of trust can begin early in the deal process, which also helps align expectations throughout the engagement.

**Before the deal**

- “As the CEO of a small business, I wasn’t quite sure what to expect. Understanding expectations and outcomes, those were all key things for me … They were very clear during the courting process of how they would work.”
  – CEO, technology company

- “Before the deal went through, I [said], ‘I want to know what the rules are. How do you want me to play the game?’”
  – CEO, human capital management company

**At the beginning of the relationship**

- “You can create trust in the beginning if you’re open, you’re honest, and you set the rules of the game up front and you set those expectations.”
  – CEO, financial services company

- “I think [my operating partner] early on was helpful in helping me understand the expectations of the PE partner.”
  – CEO, financial services company

**Throughout the engagement**

- “It’s most important for the operating partner to be aligned with the CEO’s vision. If the alignment is not there, it can lead to disconnect.”
  – CEO, consumer services company

- “The operating partner is close enough to what is going on but not inundated with activity such that they don’t keep sight of the goals that we are driving for. They can keep us aligned on the big things.”
  – CEO, technology company

Source: Parthenon-EY interviews, April 2016 (n=31)
CEOs report that the most important characteristics of operating partners are that they are trustworthy, smart and good listeners.

“What are the characteristics of an operating partner that make them most effective?”

Source: Parthenon-EY interviews, April 2016 (n=31)
About Parthenon-EY
Parthenon joined Ernst & Young LLP on August 29, 2014. Parthenon-EY is a strategy consultancy, committed to bringing unconventional yet pragmatic thinking together with our clients’ smarts to deliver actionable strategies for real impact in today’s complex business landscape. Innovation has become a necessary ingredient for sustained success. Critical to unlocking opportunities is Parthenon-EY’s ideal balance of strengths – specialized experience with broad executional capabilities – to help you optimize your portfolio of businesses, uncover industry insights to make investment decisions, find effective paths for strategic growth opportunities and make acquisitions more rewarding. Our proven methodologies along with a progressive spirit can deliver intelligent services for our clients, amplify the impact of our strategies and make us the global advisor of choice for business leaders.

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Contact us
Jay Bartlett
Managing Director,
Co-head of Private Equity
jay.bartlett@parthenon.ey.com
+1 213 977 8799
Executive Assistant:
Dominique Clervil
dominique.clervil@parthenon.ey.com
+1 617 478 7046

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