Talent Transformation: The Value Driver in Private Equity

There's a new trend brewing in the private equity world. Long gone are the days of simply buying companies, making wholesale changes and then flipping them for a profit. Leah McGillivray-Palko and Ian Brenner explore value creation through talent management—strategically transforming leadership and talent across the entire portfolio.

Buy, gut, flip, repeat. When you mention private equity (PE) firms, this is typically the first thing that comes to mind—they gobble up companies, swiftly restructure them, load up on debt, and make key personnel changes. It's a story all too familiar.

However, times are changing.

After several decades of continuous expansion, PE has now become a dominant source of capital in Canada. Case in point, we saw a record-breaking year of investment from buyout and PE investors in 2018, with 345 transactions collectively valued at $37.2 billion.

Yet, as the PE sector matures in Canada, new challenges have emerged. Market metrics in recent years have become stretched to multiples last seen before the great recession, making it harder to grow the portfolio by simply buying smart. At the same time, hold periods for investee companies have increased, and operating groups are increasingly resource and time challenged.

The solution? Value creation through talent management.

Talent Management as the Value Driver

Gone are the days when cost-cutting and financial leverage offered up the low-hanging fruit for unleashing value. More and more, the focus is turning to the creation of sustainable value through talent management, not just in operations at the investee level, but as a core competency at the portfolio level.

This necessitates a change by PE firms in the way they should approach talent and leadership. It means actively assessing, transforming and upgrading the management capabilities within each acquired organization, starting the process early, and driving it from the top.

Enter the Human Capital Partner

The desire to take ownership for talent across the PE portfolio has led to the emergence of a new role—the human capital partner (HCP). As a liaison to the operating companies, the HCP centralizes the PE firm's human resource activities around everything from corporate culture and policy, to talent sourcing and acquisition, as well as acting as a repository for critical workforce data and analytics. It's through the HCP that the PE firm can:

- communicate and infuse the culture throughout the portfolio
- develop strategic workforce plans
- set the governance structure for boards and committees
- compile a database of available talent market metrics
- establish compensation philosophy
- analyze and implement workforce analytics

First and foremost is getting the culture right on issues of fairness, inclusion, teamwork and pay equity. For workforce analytics, a centralized HCP is the best way to deal with the expense, complexity and fast changing nature of market information. It can also enable a continuous and consistent learning platform where data can be archived and analyzed for hiring decisions throughout the portfolio.

In addition, the HCP is in the best position to standardize guidelines for governance across investee companies and prepare would-be IPOs or exits by recruiting independent directors andsetting compensation and striking committees.

Overseeing talent management from the apex ensures consistency through the organization, sharing of information, and quick action where needed. Many human resource functions require scale in order to absorb the expense involved, which encourages PEs to administer the services from one platform that can be accessed by all management groups.

Furthermore, communication flow can go in both directions. The HCP sits at a pivotal junction for multi-directional learning, by receiving and adapting the lessons learned at each of the operating companies, for deployment throughout the portfolio of investee companies.

Transformational Leadership

Success in building in-house teams comes from placing transformational leaders in a position to execute the necessary organizational changes. Indeed, the hold time for transformation can be cut in half with the right leadership. However, this requires leadership willing to adopt a *talent-to-value* approach, where talent strategy is focussed on finding and leveraging the value creators. It also demands that attention go beyond just the C-suite and other high-visibility positions, since the most promising roles that drive and enable value can exist across the organization and at varying levels within the management structure.

Building differentiated capabilities also requires leaders who comprehend the recent evolution in how work happens. In the disrupted workforce, with the move away from traditional hierarchies towards a focus on the task or project, specialization and efficiency are attained by tapping freelance, contract and joint venture structures, where diverse and emerging talent sources often reside.

The Importance of Early Activism

The best results are obtained by identifying gaps in talent and organizational design as early as possible. In the PE context, this often means deploying human capital management during the due diligence phase, when the investment thesis is put to scrutiny. This is the time to define those mission-critical roles and capabilities needed to execute on the plan.

Furthermore, the change-of-control stage is the legitimate time to assert the acquirer's mandate for bold change. To this end, the HCP should be involved with the deal team to decide which acquisition targets to pursue. And the responsibility continues after closing, when the HCP can audit the leadership and culture in the new portfolio company and work to transform it by bringing in new talent and sharing best practices among firms throughout the portfolio.

An Imperative and an Opportunity

Private equity has always been about adding value that can be measured in financial terms—investors demand that management find all means possible to achieve maximum returns upon exit. While capital structure and cost containment have natural limits, talent management presents a vast opportunity to create real value by transforming leadership and talent across the portfolio and orchestrating it at the portfolio level.
After all, it's not what you buy, it's what you build.

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