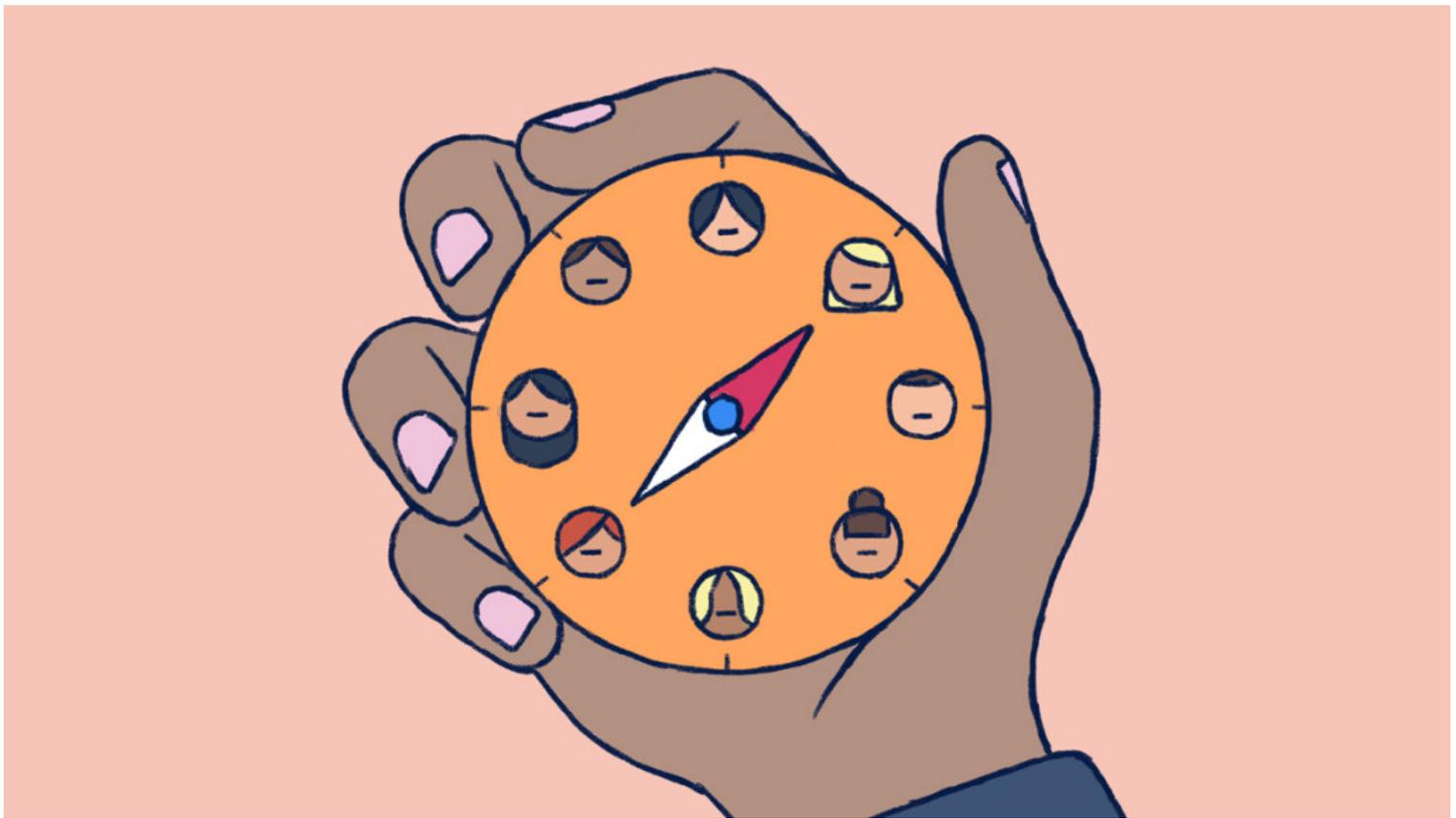


TALENT MANAGEMENT

# PE Firms Are Creating a New Role: Leadership Capital Partner

by Dave Ulrich and Justin Allen

AUGUST 11, 2017



Vincent Tsui for HBR

During the last 20 years, private equity (PE) investors have assumed an increasingly influential role in business, with publicly traded firms dropping from about 7,500 to 3,800. Today, large private equity firms not only buy and sell (phase 1), buy and hold (phase 2), but buy and transform (phase 3). This third phase has led to large private equity organizations governing their assets in a unique way.

In phase 3, successful portfolio transformations require financial discipline that is not an event, but a pattern; strategic clarity that is not a direction, but a commitment; operational excellence that is not a tool, but a mindset. Making these shifts requires increased attention to organizational governance around three domains: talent, capability, and leadership. To focus that attention and transform the companies in their portfolios, PE firms are establishing a new role that we call a *leadership capital partner* (LCP). Our research suggests that over half of PE firms now have one or more individuals tasked with playing some form of this leadership capital partner role. We interviewed roughly 30 LCPs to get a sense of how this new role is shaping up.

## **The LCP's Role in the PE Firm**

Most of the LCPs we studied began with the task of ensuring the PE firm itself had the right talent, culture, and leadership, and then moved on to do the same for portfolio companies.

As PE funds have become more like firms, they've required more attention to talent and leadership, and to ensuring that both deal teams and support teams can function at the highest possible level. PE firms have different cultures, ways of working, or identities and LCPs help articulate this culture throughout the PE firm and to potential investors in the firm.

LCPs also make sure that the right partners are hired, and that they're incentivized and supported correctly. Many LCPs come from a search background where they have demonstrated expertise in talent identification and acquisition.

LCPs also increasingly participate in fund-raising meetings with deal teams. One prominent leadership capital partner said that in the fund before he arrived, out of 60 presentations to potential wealthy limited partners only two included rigorous discussion of talent, leadership, and capability. After his arrival, he participated in 90% of limited partner presentations to demonstrate to potential investors that the firm would pay the right price for, and be able to transform, the companies they acquired. Limited partners appreciated the firm's attention to organization issues as part of their presentation.

## **The LCP's Role with Portfolio Companies**

As LCPs have proven their ability to transform the talent practices of the PE firm to the fund's managing partners, they're then tasked with doing the same for portfolio companies.

LCPs are increasingly involved in the decision of which firms to acquire. Evaluating leadership capital has always been a critical component of due diligence for deal teams. Increasingly, in addition to the standard interviews and team meetings conducted by deal teams, PEs are conducting more sophisticated, data-driven evaluations of a target's leadership and

culture risks and opportunities. Many LCPs are either conducting this work themselves, or they are responsible for vetting and managing external due diligence consultants to oversee this work.

Once a firm is acquired, the LCP often facilitates the transformation process. The time it takes to turn a company around is most often a function of the firm's ability to transform talent, leadership, and capability. A company *turnaround* focuses on costs and can often be done through financial reengineering and cost cutting measures. A *transformation* requires more fundamental changes in the organization culture, management processes, and talent. LCPs can help architect a transformation by answering why transformation is required, what the transformation look like, how to make the transformation happen, and who to involve in it.

To facilitate transformation, LCPs also often conduct an audit of the leadership and culture in portfolio companies. In our research we have found that leadership has a 10 to 15% impact on financial performance and a 25 to 30% impact on market valuation. One PE executive told us that the hold time for transformation can be cut in half with the right leadership in place, but it often took them far too long to assess, identify, and implement the right leadership. In one PE company, they claimed that 60 to 70% of the acquired company leadership teams had to be replaced for the company to be transformed. About 20% of the CEOs had to be changed twice. Consequently, the best LCPs conduct annual leadership and culture audits of portfolio companies to establish a performance baseline and prioritize actions management teams must take to accelerate growth.

Across the portfolio of companies, the LCP sets the tone and builds a common culture and is often responsible for hiring the HR leaders in them. LCPs bring firm-wide insights to activities like vetting or hiring CHROs within portfolio companies, encouraging leadership and organizational innovation in portfolio companies, and sharing best practices and learnings across portfolio companies. One way they do this is through knowledge-sharing councils among Chief HR Officers; these councils often meet 1-3 times per year and exchange ideas, tools, and experiences. The LCP is the curator of this group and may even specify which tools and systems portfolio companies should use.

LCPs also participate in divestiture negotiations. As PEs move to sell off firms in their portfolios, establishing the values of "intangibles" like leadership and culture has become essential for securing favorable divestiture pricing. LCPs can use the results of their annual leadership and culture audits to demonstrate continual improvement in the portfolio company's talent, capability, and leadership, and instill increased confidence with buyers that past positive financial results are will continue sustainably in the future.

While there is still a lot of experimentation in the LCP role within PEs, when LCPs bring discipline to talent, leadership, and capability, they deliver enormous value. The lessons learned from these early adopters have wide relevance for all investors in capital markets who want to increase their returns by quantifying the market value of leadership. Additionally, while the advent and establishment of the HR Business partner role (which we documented 20 years ago) is the legacy and foundation for this new LCP role, the body of LCP work is becoming an innovation incubator for new HR practices and competencies. As such, the LCP role has significant implications for HR's next agenda across industries and geographies.

---



**Dave Ulrich** is the Rensis Likert Professor of Business at the Ross School, University of Michigan, and a partner at the RBL Group. He studies how organizations build capabilities of leadership, speed, learning, accountability, and talent through human resources.

---

**Justin Allen** is a partner at Ulrich Allen Leadership Capital, LLC., an investment diligence advisor. He is also a Principal with the RBL Group, a consulting firm specializing in leadership, organization design, and strategic HR.

---

**This article is about TALENT MANAGEMENT**

**+ FOLLOW THIS TOPIC**

Loading...

Loading...