Private Equity: Unlocking the Value of Culture

by Joe Hunt

There's one definite amid all the uncertainty in the marketplace right now -- the private equity industry needs to find a path forward to navigate the turbulence.

Before COVID-19, private equity was a competitive industry with more firms vying for the same assets in an overabundance of dry powder. Firms needed to find a way to differentiate themselves among a sea of investment companies and were beginning to fully realize the impact of human capital as the single most important lever.

Then, the challenges of the pandemic forced many private equity investors to reassess their appetite for certain risks and adjust their overall approach to underwriting. It also further underscored the urgency of firms carving out a distinct advantage in the market -- something that set their firm apart from the rest.

This reassessment produced several new elements within the rubric of private equity investment underwriting criteria. One such key element is workplace culture.

And for good reason -- intentionally cultivating a strong workplace culture can help investors unlock tangible business results. Culture is the unique way an organization delivers for its customers, empowers its employees and ultimately defines its purpose.

Among U.S. employees, 40% strongly agree that the mission or purpose of their employer makes them feel their job is important. By moving that ratio to 80%, corporations can realize an 85% net profit increase over a five-year investment period and increase employee engagement by 50% over a three-year period.

And that final benefit -- the increase in employee engagement -- is a value-creation lever that affects a multitude of second- and third-order key performance indicators and business results.

During a crisis, many leaders understandably focus their resources and time on cutting costs and managing working capital. In doing so, they pull resources and attention away from their most critical asset: their people. This is a grave misstep, because organizations can only improve employee engagement and in turn, business outcomes -- by investing in their work culture.

To mitigate this friction, private equity-backed management teams need their sponsors' support to highlight the importance -- and financial impact -- of investing in their people during times of crisis. In private equity, where the human element of the workplace was already regarded as a secondary concern before the pandemic began, that support is all the more critical today.

It doesn't take long for systemic under-allocation of resources toward human capital to quickly erode enterprise-level value creation strategies. On the other hand, strong employee motivation, cohesion and buy-in have the power to significantly drive value creation efforts. By focusing on creating an engaged workforce, companies can enjoy distinct business outcomes, including heightened customer ratings, productivity, sales and profitability.

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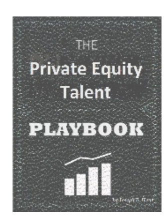

Culture as a Competitive Moat
A strong, infectious culture is a differentiator in the marketplace. Culture is the foundation on which customer relationships are built and maintained. It is no coincidence that culture is also the means by which organizations attract and retain highly talented employees.

There is no question the best cultures attract the top 20% in a given talent pool. It naturally follows that employees who strongly connect with their organization's culture also consistently outperform benchmarks.

And in a marketplace with so many unknowns, the value of employees consistently delivering high performance is a worthwhile path toward organic growth and successful integration of acquisitions. Amid turbulent markets, the efficacy of an organization's culture is a means of minimizing future loss.

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In periods of disruption, with countless factors far beyond the control of the boardroom, private equity investors should explore value creation and retention levers that *are* within their control. The Hunt Group doesn't just fill key executive roles for our clients, when enabled, we work to help them identify and drive tangible business outcomes as a result of effective human capital management.

Finding Opportunities for Improvement

We recently placed a Chief Supply Chain Officer with a global CPG manufacturer, who organization's supply chain and production leaders were operating at target levels, but when benchmarked against industry peers and world-class manufacturing operations, they fell far behind.

After the placement, we were invited to work on a team to conduct a qualitative and quantitative review of multiple business variables. After the review, the team identified multiple opportunities, two of which are highlighted below:

Managers and leaders were underused and in need of stronger leadership methods. For example, managers entered the production floor only when there was a problem or their approval was required. We recommended having regular conversations with employees, translating the strategy more transparently and provided talking points that would lead to more productive and dedicated employees in addition to addressing production problems. By having more frequent conversations with front-line staff and supervisors, managers would be more aware of employees' feelings and behavior (i.e., how well they live out the workplace culture).

We also studied a select group of high-performing managers and identified eight behaviors these managers consistently demonstrated -- all eight depended on communication for successful execution. Given this and our finding that up to 70% of the variance in employee engagement can be attributed to the manager, the manager's role in organizational success is clear.

The cost of missing that opportunity? In a global climate where 85% of employees are not engaged or are actively disengaged at work, the economic consequences of this lack of engagement are approximately $7 trillion in lost productivity.

Identifying strengths and weaknesses within a corporate culture and then linking them to specific business outcomes and KPIs, provided tangible means for firms to unlock their value.

There was a misalignment in incentives between different departments and performance metrics. For example, production leader incentives focused solely on the number of units produced. They did not take into consideration the number of defects, a key incentive metric for quality leaders and ultimately a driver for workplace behavior. The result: To many finished products were rejected, had to be reworked and worst were shipped when they should have failed in testing due to the lack of focus on quality during production. Leaders from the respective departments were "finger pointing" and in constant disagreement due to these conflicting self-interests. The company identified this misalignment and the leadership made revisions to the incentive structure.

The manufacturer saw an average annual gross margin improvement of 1.23%, resulting in roughly $89 million in annual savings. The company also saw a 40% decrease in customer complaints.

At a time when so much is uncertain, companies would be wise to take advantage of performance drivers that are within their control. Company culture is one such lever that results in substantial dividends -- for employees, for business outcomes and for the portfolio company's bottom line.

About the Hunt Group

The Hunt Group is the leading human capital and private equity advisory specializing in consumer goods & services, diversified industrial and related professional services markets. We apply our market mastery and expansive executive network to the human capital realm, working with multi-nationals, PE, private, and family-owned companies. We partner with investors throughout the deal cycle to help them Invest in, Grow and Exit their portfolio companies by appointing senior operating executives (CEOs and Direct Reports), Chairs and Outside Directors with Private Equity DNA. Our industry and functional vertical connections and engagement guarantees we're in the know, have broad insight and full access to the best talent in the marketplace. Our mission is to create and exponentially grow accretive value for all client stakeholders.

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