Workforce & Organizational Research Center®

Thinking Beyond The C-Suite Pays Off — Well, At Least Sometimes

Human Capital Management in Large Private Equity Value Creation

AT A GLANCE

In 2023, the Ford Foundation Mission Investments team supported research investigating the value of human capital. This project, conducted by the Workforce & Organizational Research Center (WORC), sought to examine the extent to which human capital management plays a role in value creation plans at large private equity firms, specifically those with more than $5 billion in assets under management (AUM).

The most important finding of this research is that human capital management in large private equity firm value creation is all about the C-suite — until it isn't. Where lower-level workers are the fulcrum for executing a specific value creation strategy for a deal, large private equity firms may pay particular attention to human capital management at the bottom of the org chart.

There is an opportunity for the job quality field to catalyze private equity firms to optimize human capital management by developing a playbook for deals where lower-level workers are critical to value creation. This research suggests that investigating and building case study evidence from innovative private equity firms whose primary investment thesis centers on improving job quality beyond the C-suite is a pathway to achieving this goal.

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About WORC

The Workforce & Organizational Research Center (WORC) is a woman-owned social enterprise dedicated to catalyzing a thriving economy where every worker has a job worth having.

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Background

The Evolution of Private Equity

Private equity (PE) firms seek profits by investing in and reshaping companies using a wide variety of strategies. The ultimate objective is to sell each portfolio company to a competitor or another PE firm — or to take it public. Since securing its foothold in the late 1970s world of finance, private equity has transformed over the years, with PE firms gradually increasing their levels of involvement in the daily operations of their portfolio companies.

In 2016, the *Harvard Business Review* published an influential article by Dave Ulrich and Justin Allen, "Private Equity's New Phase," distinguishing three stages of this evolution: 1) buy and sell, 2) buy and hold, 3) buy and transform.[1]

The 1990s: "Buy and Sell"

Using a real estate metaphor, Ulrich and Allen describe this early incarnation of private equity as the equivalent of house-flipping. PE firms would identify and buy a fixer-upper company, make brutal changes by slashing jobs and ruthlessly cutting costs, and then resell the company for a profit. This was the era of leveraged buyouts and the so-called "corporate raider" (think Barbarians at the Gate, the *New York Times* #1 bestseller).

The 2000s: "Buy and Hold"

At the start of the 21st century, the landscape shifted as some firms recognized the opportunity for greater returns by — to continue the real estate metaphor — essentially treating the company like a rental property and improving it just a bit beyond slapping on a fresh coat of paint. PE firms introduced a minimum number of tried-and-true leaders who would swoop in and change management practices to bring the company up a notch before it was sold.

The 2010s to Present: "Buy and Transform"

Ulrich and Allen equate the current state of PE to an even more strategic real estate development industry. Firms buy a dilapidated house and do a gut rehab, turning a company with good bones into a desirable business that can be sold for a handsome profit thanks to seriously boosted capabilities and much stronger financials.

The Rise of the Human Capital Operating Partner

Today, it's estimated that, on average, more than 50% of a company's value is attributable to intangible assets.[2] As a result, financial engineering may no longer be enough to drive PE value creation and returns. In some cases, PE firms have turned to alternative strategies, including an emphasis on leadership and human capital management (HCM) more broadly.[3]

To achieve this goal, PE firms began to create positions variously titled talent partner, chief performance officer, or human capital operating partner. The role gained prominence in 2017 following publication of a *Harvard Business Review* article[4] and the trend has gained momentum since. PE industry group Private Equity International (PEI) hosted its first forum targeted toward human capital operating partners in 2022 — and attendance doubled at its second forum in 2023.[5]

In managerial and organizational scholarship, human capital management is generally recognized as an impactful and multifaceted approach to driving business improvements and returns through a variety of strategies, running the gamut from executive search to implementing employee engagement mechanisms. However, scanning the PE landscape, many of these practices don't appear widespread yet.

Research Findings

In 2023, the Ford Foundation Mission Investments team supported several research projects investigating the big-picture value of human capital. Our project sought to understand the extent to which HCM plays a role in value creation plans at large PE firms, specifically those with more than $5 billion in assets under management (AUM).

The impetus for this exploration came from our interest in the well-studied business impact of human capital management, specifically financial returns associated with improving job quality for lower-level workers.

We wondered whether large PE firms were leveraging this mechanism to achieve superior returns in ways similar to industry-leading smaller funds, such as HCAP Partners and Two Sigma Impact.

Informal conversations suggested that wasn't the case. We frequently heard fund managers and investment professionals indicate that broad application of HCM in PE has not gained traction and never extends beyond the C-suite — it's all about executive search.

With decades of rigorous human capital management research pointing to so much potential value that can be realized with broader HCM strategies, we wondered if PE, an industry with a laser focus on generating returns, could really be overlooking such a powerful lever for improving financial outcomes. To find out, we conducted 12 interviews with leaders at seven leading, large-scale private equity firms, including the BlackRock Impact Opportunities Fund and TPG, and found that there is, in fact, more to the story.

Our research sought to understand the extent to which human capital management plays a role in value creation plans at large private equity firms, specifically those with more than $5 billion in assets under management (AUM).

Human Capital Management in Private Equity: It's Complicated

Our research findings suggest that the state-of-play of human capital management in value creation plans at large private equity firms is ... well, complicated. Many of our study participants asserted that some PE firms lean into HCM as a strategy for value creation:

> **"[Our firm has] proven analytically that the determinant between a great deal and a good deal, the number one factor is to get the macro right. The number two determinant is the quality of the management team. And so, in our firm, and I say this in all sincerity, human capital management is everybody's job — deal partners, operating partners — we are all spending an immense amount of time on that topic."**
>
> *Human Capital Operating Partner*

That said, other study participants suggested that talk of leveraging human capital appeals to PE firms primarily as a strategy to burnish their public image. In the words of one study participant:

> **"Look, the ROI in the finance function is clearly established ... HCM is softer, it's messier, it's not low-hanging fruit — it's more challenging. [Investment professionals] don't come in having experience in that ... but, nobody's going to want to tell you that they don't do jack here, right?"**
>
> *Fund Manager*

This fund manager was a staunch believer in the power of leveraging human capital further down the org chart to generate superior returns and felt confident that, regardless of what participants told us as researchers, this practice is not widespread in the PE industry.

Turns out, he was right — our research suggests that applying HCM further down the org chart is rare; however, there were cases where "nonbelievers" had adopted these practices.

> **"From time to time, we will get involved [beyond the C-suite] but in a thimbleful of cases."**
>
> *Human Capital Operating Partner*

It's All About the C-Suite, Right?

What we heard before beginning this investigation turned out to be true — our participants confirmed that, while HCM is common in value creation plans at large PE firms, the focus does indeed most often stop at the C-suite.

> "[PE deal teams] are all going to have issues figuring out what the key human capital components are to enabling the value creation plan. It's arguably concentrated at the C-suite just because that's where we can hopefully have reach and access. We then count on the [leadership] to run the company and drive deeper into the organization."
>
> *Human Capital Operating Partner*

We found that deal team resources and efforts are typically dedicated to vetting a portfolio company's leadership team and, where needed, headhunting for suitable replacements.

> "I think everyone would say to you, 'Oh yes, human capital is a value creation lever,' and they would be thinking of it as having the right management team in place to run the company."
>
> *Human Capital Operating Partner*

The most important finding of this research is that human capital management in large private equity firm value creation is all about the C-suite — until it isn't.

When we dug deeper, a more nuanced story emerged

As we probed with participants, some could point to specific deals where their PE firm had become more deeply involved in solving human capital challenges in partnership with portfolio company leadership teams. We found that the unique characteristics of each investment and portfolio company were determinants of the level of deal team involvement in HCM.

> “What really matters in the investment thesis is which key roles are associated with disproportionately driving that value. So, if it’s a healthcare services business and revenue cycle management is critical to the business, [we focus on] who’s in that role because our business pivots on our ability to be able to employ that portion of the workforce.”
>
> *Human Capital Operating Partner*

That said, the industry verticals that were the focus of the PE firms mattered, too.

> “It’s important to understand how you make money, right? In many businesses, that frontline interaction is what drives profitability and drives the success of the investment. So, businesses where they’re more heavily reliant on that frontline interaction, you really want to understand how those individuals are rewarded and compensated and that [frontline workers] are aligned with the overall strategy.”
>
> *Ladell Robbins, Managing Director*
> *BlackRock Impact Opportunities Fund*

The unique characteristics of each investment and portfolio company were determinants of the level of deal team involvement in human capital management.

While there were exceptions, most interviewees who could provide specific examples of HCM extending further down the org chart were operating partners who had extensive human resource experience prior to entering the PE industry. Deal team members and fund managers were more likely to speak about HCM in broad terms. This dynamic points to the critical role that human capital operating partners play in creating value, particularly when the cost of turnover is high and compromises operational objectives, including customer retention.

Snapshots from the Front Line

Whether focused on enhancing an organization's sales function to capture a larger customer base or retaining healthcare providers to reduce costs and improve patient care, PE deal teams catalyze returns at their portfolio companies with varied value creation plans. These value creation strategies are critical in determining how far down the org chart HCM extends.

Portfolio company leadership teams struggling with workforce issues that impede their ability to achieve value creation goals may trigger deeper PE firm involvement. In these cases, PE deal teams will prioritize HCM beyond the C-suite as workers in these particular positions become the fulcrum of the strategy's success.

Human capital operating partners play a critical role in creating value, particularly when the cost of turnover is high and compromises operational objectives, including customer retention.

Sometimes It's the Truck Drivers

For some businesses, a fleet of qualified frontline workers is imperative to daily operations. One of our interviewees provided an example: an environmental services company that depends on finding and retaining reliable, licensed truck drivers. Without these drivers, there would be no business. He noted that retaining these employees is a critical business priority, unlike, for example, lower-level administrative staff, whose skills could more easily be replaced or outsourced. As a result, their HCM efforts include a focus on understanding the lay of the land with retention and recruitment of truck drivers and improving these jobs.

"We have [an environmental services] business where we have a lot of route drivers that are picking up [materials] and distributing it. That was a big discussion topic because that business pivots on our ability to be able to employ that portion of the workforce.

The turnover rate, the average wage, the benefit structure matters for that segment of the workforce. [Do we look at] turnover among other front line roles? Unlikely at the fund level and we count on the company to be on top of those issues."
Human Capital Operating Partner

Wanted: Consistent Care for Developmentally Disabled Kids

When it comes to healthcare services, finding and replacing essential frontline staff is expensive. By way of example, one of our study participants cited a chain of care centers for children with developmental disabilities. She noted that a lack of good, entry-level workers can compromise the quality of care, which affects customer retention, which in turn affects the bottom line. Her solution was to institute new HR practices to ensure that frontline caregivers with their own young families were less inclined to take unplanned days off, and more motivated to stick with the company over the long haul.

"I was very concerned that the entry-level position had what I thought was pretty high turnover ... we asked a lot of questions about recruitment and retention.

[When turnover is high, kids] are not making any progress. It's very frustrating [for parents].

We've done a lot of things and continue to do a lot of things to bring turnover down, by screening better, onboarding better, making changes to the training program. We've put in recognition programs. We're doing more town halls for them to feel connected to the business.

It's still a journey, but absenteeism has improved and retention continues to work its way toward our goal."
Human Capital Operating Partner

Sometimes It's the Sales Team

Extending HCM beyond the C-suite can also reach down into the middle of the org chart. As one of our study participants explained, a PE firm might attack turnover in the sales organization when these employees are the fulcrum for the value creation strategy. Assessment of turnover among sales team members could lead to better identification and vetting of candidates, optimized training, improved compensation packages, and the creation of a more rewarding sales culture — in other words, achieving both improved sales and better jobs. In a case like this, understanding turnover across the entire company, including the bottom of the org chart, wouldn't be a priority.

"Does the deal team homogeneously look at what the overall turnover rate of the company is? Probably not.

However, when, for example, scaling the sales organization is an important part of the investment, we will look at the cohorts of the sales reps. When were they hired? How long have they stayed in the role? How many turned over? How quickly does it take for them to be productive?"
Human Capital Operating Partner

Next Steps

The Business Case for Human Capital Management Beyond the C-Suite

Decades of rigorous managerial and organizational science research demonstrate strong correlations between making lower-level jobs better and improved business results.[6] Whether it's the cost of worker turnover eating into profitability or a lack of alignment between worker incentives and organizational goals dragging down revenues, targeting HCM at lower-level jobs can impact both sides of the balance sheet.

Our findings indicate that large PE firms understand and leverage the business case for taking an active role in improving lower-level job quality at portfolio companies when there is a very clear line between these roles and the specific value creation strategy for a particular deal.

Where lower-level workers are the fulcrum for executing a specific value creation strategy for a deal, human capital operating partners and deal teams at large PE firms may pay particular attention to HCM for those jobs. Thus, HCM at large PE firms extends beyond the C-suite and down the org chart — all the way to lower-level workers. Sometimes.

Our findings indicate that large private equity firms take an active role in improving lower-level job quality at portfolio companies when the business case is central to achieving value creation goals — in other words, in some, but not all, deals.

Catalyzing Private Equity to Optimize the Human Capital Fulcrum Beyond the C-Suite

Research by BCG and the ESG Data Convergence Initiative has found that PE firms are becoming increasingly efficient at creating new jobs at their portfolio companies.[7] It's estimated that private equity firms employed approximately 12 million workers in 2020,[8] up from nearly 9 million in 2018.[9] This rise in job creation points to an opportunity for private equity to leverage HCM in myriad ways.

The human capital operating partners, fund managers, and investment team members who participated in our study represent leaders in leveraging human capital management. They brought expertise that enabled them to activate strategies to make frontline jobs better to achieve value creation goals.

It seems likely that there are PE deal teams who lack the expertise of the participants in our study. It's possible that, in certain cases, they may be leaving money on the table due to a lack of knowledge of effective HCM strategies that impact lower-level job quality for better business results. Reinventing the HCM wheel is inefficient and PE firms are averse to inefficiency.

As a result, the job quality field is uniquely positioned to catalyze PE firms to optimize HCM in value creation, as noted by Jobs for the Future in their February 2024 report, "Private Equity Holds the Key to Creating Quality Jobs for Millions."

Our research suggests that identifying criteria and developing a playbook for deals where lower-level workers are at the fulcrum of value creation is a critical first step. Building rigorous case study evidence from innovative private equity firms whose primary investment thesis centers on improving job quality beyond the C-suite is a powerful pathway to achieving this goal.

Reinventing the human capital management wheel is inefficient — and PE firms are averse to inefficiency.

Where lower-level workers are the fulcrum for executing a specific value creation strategy for a deal, private equity deal teams may pay particular attention to human capital management for those jobs.

Appendix A: Research Methods

For this exploratory study we used purposive snowball sampling (a non-probability sampling technique) to locate key informants from private equity firms with a firm size criterion of ≥$5 billion AUM.

As shown in the table below, 12 semi-structured interviews lasting 30-45 minutes were conducted between April and July 2023 by a single interviewer.

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Private Equity Firm Role	Number of Participants
Fund manager	**4**
Investment team member	**2**
Human capital operating partner	**4**
Other related roles	**2**
	12 Total

Exploratory research calls for qualitative methods as researchers seek to "uncover and understand what lies behind any phenomenon about which little is yet known," and to gain novel perspectives on known phenomena.[10]

The ongoing interplay between data collection and data analysis, a characteristic of qualitative research, resulted in our reaching saturation (the point at which themes and ideas expressed by respondents repeat themselves) after conducting 12 interviews with respondents from seven private equity firms including the BlackRock Impact Opportunities Fund and TPG.

In this study, grounded theory methods facilitated concurrent data collection and analysis that enabled themes to iteratively emerge from the data. Three researchers with advanced degrees in social science research independently conducted data analysis and subsequently triangulated insights to articulate cumulative findings and validate results.

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