Buyouts

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GPs with growth-oriented capabilities will create most value: TPG's Raj

Nehal Raj, co-managing partner of TPG Capital, says operating teams are still in the 'early days' of specialization.

In the post-2021 deal market, value creation has returned to center stage.

In an interview with Buyouts, Nehal Raj, co-managing partner of TPG Capital, TPG's private equity arm, makes this case, arguing the importance of growth-oriented operating capabilities and the need for greater specialization in operating teams.

How key is value creation in today's market?

It's critical. But it's important to define the type of operating improvement we're talking about. Often, operating improvement is assumed to be about the margin opportunity – how can I take a 20 percent margin business and make it a 40 percent margin business – looking to cost management as the primary lever.

That has been an important skill set, but it's commoditized. It is priced into most assets, meaning it's assumed private equity firms will look for efficiencies when they buy a company.

That capability is not enough to differentiate or, more importantly, create, lasting, healthy businesses.

Growth is hard and is increasingly scarce in today's environment. In 2021, everyone was assuming things were going well and there was plenty of growth in the economy. Now, with higher-for-longer interest rates, growth is harder to obtain.

Private equity firms with operating capabilities that accelerate the growth of a portfolio company are going to create the most value. This growth-oriented operational skill set is going to be the most differentiating factor for value creation going forward.

Are private equity firms typically able to do this?

It's not as easy as looking around a table and saying, "Let's make growth happen." If you want to drive growth, you need to resource around it and ensure that you have a structure where your operating team is set up to succeed.

Historically, private equity operating teams functioned as separate units run by former consultants who were generalists. The deal team would do a deal, something would go wrong, and they would call ops.

The old model of "call the internal consultant" no longer works. In order to drive growth, we believe operating team members need to be integrated with sector-based investment teams and come from these respective sectors.

TPG's operating approach is an extension of our investment strategy, which focuses on driving transformational growth in specific sectors. For example, we hire healthcare operators from the healthcare sector who are fully integrated with our healthcare deal team.

These executives have highly specialized experience across market leaders like Abbott, Amazon, Activision. As a result, when they engage with portfolio company executives, they've lived in their shoes and can be real partners to management in making the business better.

If you think about the evolution of the deal team in private equity, most firms have migrated from a pure generalist model to one which is sector-oriented. It's the same change that we expect to happen on the operating side – it's just happening with a lag.

Over the next five or 10 years, I expect operating teams are going to be just as specialized as deal teams have become. We're still in the early days of that shift.