



OMNIGENCE ASSET MANAGEMENT

**Operational Alpha in
Private Equity: Moving
Beyond Leverage to
Lasting Value**

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EXECUTIVE SUMMARY:

Private equity has evolved. Where once financial engineering and leverage were the dominant tools for driving returns, in a world of higher interest rates, greater competition, and compressed multiples, operational alpha – the value created through hands-on improvements in portfolio companies – has become the new frontier. The future of PE belongs to those who can generate operational alpha, not just transact, and have the tools to enable it (including real-time data, AI, automation, and lean systems). Forward thinking firms are institutionalizing continuous improvement as a core capability. Recent research confirms the shift: ~70% of PE firms now view operational improvements as their primary value driver, with ~65% highlighting it explicitly in discussions about value creation.

- Operational alpha now drives most of the value creation in PE, especially in mature and competitive markets.
- Leverage and multiple arbitrage are less effective due to rising interest rates and entry valuation pressures.
- Real-time operational data, automation, and digital integration enable PE firms to identify inefficiencies faster, intervene earlier, and scale improvements.
- Top-performing firms institutionalize continuous improvement, hiring operators and building in-house ops teams to work alongside portfolio companies.
- Vanguard's 2024 outlook on U.S. PE shows this trend over time: From 1984–2000: ~36% of value came from operations, ~49% from market multiples, and ~15% from leverage. By 2008–2018: ~50% from operations, ~28% from multiples, <10% from leverage.

THE DECLINE OF FINANCIAL ENGINEERING:

Traditional PE value creation relied heavily on enhancing returns by borrowing at low rates, material multiple expansion as public markets re-rated sectors upward, and one-time SG&A trimming. Increasingly, this approach is not a dependable source of returns:

- Interest rates have normalized (~5%+ in 2025), limiting cheap leverage.
- Valuation multiples are compressed or flat across many sectors.
- Proprietary deal flow is harder to source.

DEFINING OPERATIONAL ALPHA:

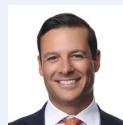
Operational alpha refers to the increase in enterprise value driven by tangible improvements in a company's operations—distinct from leverage or financial re-engineering. Vanguard data shows that since the 1980s, operational improvements have risen from ~36% to about 50% of total PE value creation, while leverage's contribution dropped to under 10% in the 2008–2018 period. Operational alpha manifests through a variety of initiatives, including:

- Revenue growth through pricing, cross-selling, and channel expansion
- Margin expansion via process optimization and cost control
- Working capital and cash conversion improvements
- Technology adoption and digitization
- Talent upgrades and leadership development



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THE TOOLS OF MODERN OPERATIONAL ALPHA:

What are the key components of modern operational alpha systems, and how are leading firms implementing them?

- Real-Time Data & Dashboards: Integrated ERP, CRM, and inventory systems now provide live metrics on everything from throughput to churn. PE firms use KPI dashboards to track operational performance daily, enabling real-time course correction. *"We don't wait for monthly reports anymore. If inventory spikes today, we know by end of day."* Matt Barr, Director Arvore Partners
- AI & Predictive Analytics: Demand forecasting, churn prediction, dynamic pricing, and lead scoring driven by ML models. Enhanced customer segmentation and workflow automation.
- Lean & Six Sigma: Firms implementing lean processes can drive 20%-30% efficiency gains in manufacturing and service ops within 18 months.
- Embedded Ops Teams: Firms like Vista, KKR, Arvore and Insight Partners deploy internal value creation teams, often former CEOs/COOs and technologists, to overhaul operations.
- Alignment via KPIs: Bonus structures tied to key operating metrics, not just financials.

INSTITUTIONALIZING OPERATIONAL EXCELLENCE:

Systems and processes are key to repeatable operational improvements. Funds should develop repeatable playbooks through process mapping, standard SOPs, digital transformation playbooks. Most successful firms are building IP around what works in their market segment. Operator-led funds (e.g., Arvore Partners, Shore Capital) are increasingly outperforming their peers in the lower middle market as talent and operational alpha IP are increasingly more important than simply access to capital.

IMPLICATIONS FOR LPS AND THE PE LANDSCAPE:

Operational capability should be evaluated with the same rigour as historical IRRs. What processes, KPIs, and personnel does the fund bring post-close? Smaller funds with deep sector knowledge and ops expertise may outperform mega funds relying on financial arbitrage.

CONCLUSION:

Operational alpha is not a buzzword, it is the future of private equity. As the tools of financial engineering lose their edge, real value must come from improving what is bought. The firms that thrive will be those who do not just acquire assets, but enhance them systematically, measurably, and sustainably. In the years ahead, PE firms that fail to embed operational systems and real-time data fluency risk falling behind.

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