Private Equity International

The A-Z of Value Creation

March 2020 • privateequityinternational.com

How to contact us

Senior Editor, Private Equity
Toby Mitchenall
toby.m@peimedia.com, +44 20 7566 5447

Senior Editor, Private Equity, Americas
Isobel Markham
isobel.m@peimedia.com, +1 646 380 6194

Senior Special Projects Editor
Graeme Kerr
graeme.k@peimedia.com, +44 20 3862 7491

Special Projects Editor
Louise Fordham
louise.f@peimedia.com, +44 20 7566 5440

News Editor
Adam Le
adam.l@peimedia.com, +44 20 7566 5437

Senior Reporters
Carmela Mendoza
carmela.m@peimedia.com, +44 203 640 7512
Rod James
rod.j@peimedia.com, +44 20 7566 5453

Senior Reporter – Asia
Alex Lynn
alex.l@peimedia.com, +852 2153 3148

Contributors
Amy Carroll, Victoria Robson

Managing Editor, Production: **Mike Simlett**

Head of Production: **Greg Russell**

Production Editors: **Daniel Blackburn, Adam Koppeser, Karl Shmavonian**

Copy Editors: **Eric Fish, Nicholas Manderson**

Art Director: **Mike Scorer**

Head of Design: **Miriam Vysna**

Senior Designer: **Lee Southey**

Designer: **Denise Berjak**

Head of Marketing Solutions, Private Equity Group:
Alistair Robinson
alistair.r@peimedia.com, +44 20 7566 5454

Subscriptions and reprints
subscriptions@peimedia.com

Customer Service
customerservices@peimedia.com

Editorial Director: **Philip Borel**

Director, Digital Product Development: **Amanda Janis**

Director of Research and Analytics: **Dan Gunner**

Managing Director, Americas: **Colm Gilmore**

Managing Director, Asia: **Chris Petersen**

Chief Commercial Officer: **Paul McLean**

Chief Executive: **Tim McLoughlin**

For subscription information visit
privateequityinternational.com

PEI

Private Equity International

The A-Z of Value Creation

ISSN 1474-8800 • MARCH 2020

Insight

2

Key trends
From analytics to zero-based budgeting, our A-Z demonstrates that value creation is a golden thread running through the investment cycle

EDITOR'S LETTER **6**

Analysis

11

Harnessing the potential of digital
Private equity firms are leveraging tech advances to drive transformative value creation, say SAP's Sean Epstein and Carlyle Group's Georgette Kiser

Enhancing the value of due diligence
Value creation starts in pre-deal due diligence, say Friederich von Hurter and Filip Debevc of PwC Germany **17**

The human capital challenge for private equity firms
Cultural fit is crucial to the success of projects. That's why the choice of consultant is vital for value creation, says Charlotte Gregson of COMATCH **22**

Reaping the benefits of RPA
Machine learning solutions can play a key role in any firm's value creation arsenal, with a minimum investment of time and resources, says RSM's Dave Noonan **28**

Last word
Value creation points of view **36**

A-Z

How we produced the A-Z
We worked with artist Lee Playle who sketched the images based on the suggestions of delegates at the Operating Partners Forum in London **7**

A is for analytics **8**
B is for buy and build **9**
C is for cashflow management
D is for digital **10**
E is for EBITDA **15**
F is for focus
G is for growth drivers **16**
H is for human capital **21**
I is for inventory reduction **24**
J is for joint ventures
K is for KPI tracking
L is for leverage **25**
M is for manufacturing footprint **26**
N is for net promoter score
O is for operating partner **27**
P is for pricing **31**
Q is for quants and data lakes
R is for revenue enhancement **32**
S is for supply chain optimisation
T is for time constraints **33**
U is for unvarnished reporting
V is for visionary approach
W is for working capital **34**
X is for multiples
Y is for your 100-day plan **35**
Z is for zero-based budgeting

Insight

Growth strategies **From analytics to zero-based budgeting, our A-Z demonstrates value creation is a golden thread running from one end of the investment cycle to the other. Here are six trends shaping its evolution**

1

It starts with a vision

A vision is essential. It is the guiding light that clarifies a business's financial goals and strategic objectives and determines the selection of value creation initiatives that will deliver them.

Having a vision "is a key part of being a good leader of a company and CEO", says Olof Faxander, head of the operational team at Nordic Capital. "If management and the entire organisation understand the overall vision and direction, everything is much clearer." Then, as "reality hits", it is easier to make decisions and the business can adapt its strategy, he adds.

"Having a visionary approach and leadership courage to hire the right people and give them the right tools and authority to make changes, means you have happier staff and better staff retention, and people go through the change curve quicker," says David Olsson, partner at advisors Beyond the Deal. "If you want to create value, productivity is the key. Getting everyone working smarter as opposed to just faster – that is going to increase the intrinsic value of your business." And that starts with honing a vision, even before the deal is signed.

45%

Percentage of PE dealmakers that realised value through revenue enhancement

10%+

Percentage of employees who left the company following completion in all deals where value was eroded

61%

Percentage of PE dealmakers that admit value creation should have been a priority from day one

57%

Percentage of PE dealmakers who say cultural issues hampered value creation

74%

Percentage of value-creating deals that delivered revenue growth

44%

Percentage of PE dealmakers that say value creation was a priority from day one

Source: PwC *Creating Value Beyond the Deal: Private Equity*

2

Pre-deal is critical

Embarking on the value creation journey on day one of ownership is too late. In a hotly competitive market where buyers are paying soaring multiples, GPs must use all the time they have available to find all the avenues of growth available at a target business. Increasingly, operating partners are involved in the initial sift of deals in the pipeline. Then, during diligence, the portfolio or value creation team can be found digging into the detail to identify potential value creation drivers. They also have a role to play in contributing to the ultimate investment decision. Their expertise helps GPs decide whether the price is worth paying, or indeed if the value creation levers are so strong it is worth paying even more. "Deal due diligence is not simply about creating a picture of the company at one point in time," says Friederich von Hurter, partner M&A integration at PwC Germany. "It now means collecting and interpreting numbers and providing advisory services to create and implement a [future-proof] plan."

Good people are essential

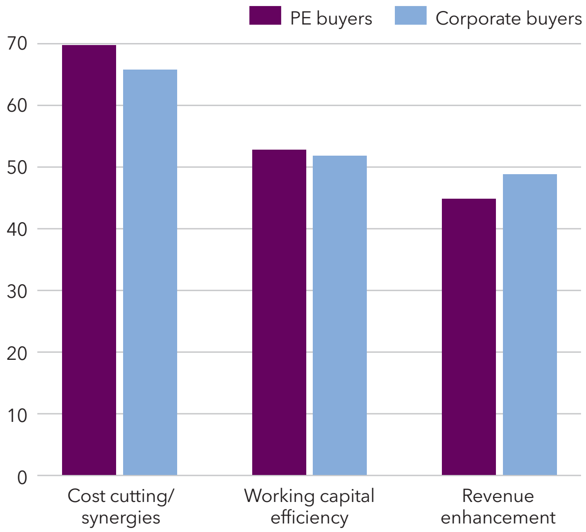
Although it is often difficult to place a specific monetary value on initiatives related to people, such as chief executive succession planning or refreshing organisational culture, GPs increasingly realise the benefits of getting people issues right; and the damage to value creation potential of getting them wrong. "If you don't enable things to go well around people, you can't achieve good financial outcomes," says Dawn Marriott, partner at Hg, where she heads the portfolio team. "Understanding the people dynamics and the organisational structure are very important to driving change and future value.

3

"You could have an average product and a world class team and I think you could still get a world class outcome."

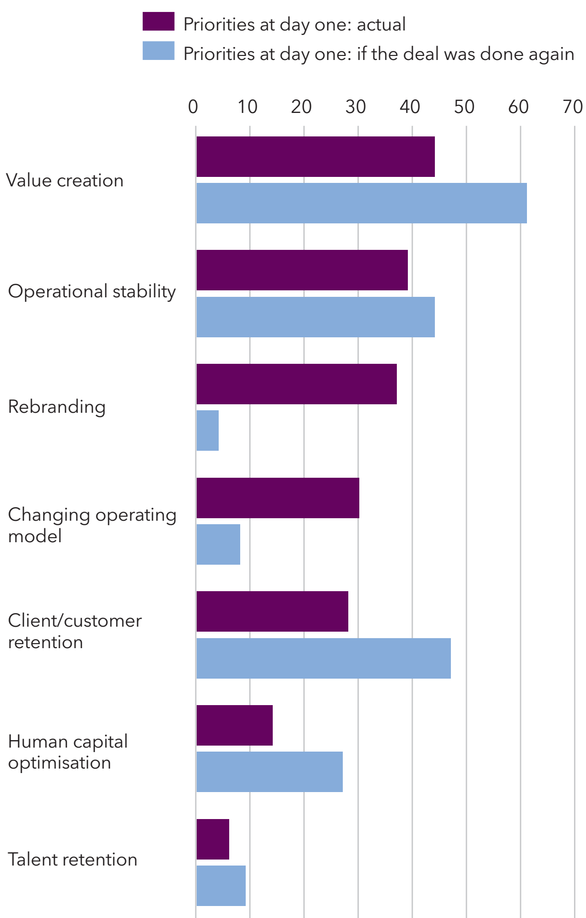
ECI investment director Duncan Ramsay agrees: "Staff retention, satisfaction and engagement is proving to be an ever more important and difficult challenge. Our experience is that there is a strong correlation between the strength of a business's culture and its success." This requires finding the right people with the right talent and skills and supporting and incentivising them, Marriott notes, adding the firm is spending more time on people issues than it was five years ago. The other area where Hg's focus has intensified is data and automation, she adds.

Percentage of deals in which value was realised by lever (%)



Source: PwC *Creating Value Beyond the Deal: Private Equity*

Value creation is a key day one priority for dealmakers (%)



Source: PwC *Creating Value Beyond the Deal: Private Equity*

4

Digitisation is everywhere

Digital disruption and transformation have permeated every business sector, presenting risks and opportunities GPs cannot ignore. "Digitisation is impacting all the businesses we work with – whether it is helping them pivot to direct digital marketing and communication with clients; or using data within a business for greater insight and efficiency; or using or developing software to improve performance or to sell as a product," says Gareth Whiley, managing partner at Silverfleet Capital.

So, where do you start? "Understanding the digital maturity of a company and relative threats to position from competitors and potential market disrupters is the first step in delivering successful digital transformation," says James Prebble, director at Palladium Digital. He adds that insights from digital due diligence can be used "in post-transaction planning to enable investors to accelerate value creation. Because of the scalability and immediacy of digital change, digitisation should be viewed as a strategic imperative for all private equity firms".

"Digitisation is an important lever for organic growth and productivity," says Alain Vourch, partner at Charterhouse Capital Partners, which is encouraging its portfolio companies to step up their investment in digital marketing and other tools to drive productivity, and also to ensure they have the right level of digital expertise.

This might mean hiring a chief digital officer, putting in place data infrastructure and analytics or upgrading cybersecurity. "It's a big item during our onboarding phase," says Vourch.

5

Data and analytics top the agenda

Closely tied to digitisation is the potential for data and analytics to power value creation.

Often, these two sources of additional business insight are left untapped by entrepreneurial business owners who are unaware the data (and its potential) exists, or, have not had time or capabilities to unearth it.

"We believe the opportunity to create value through data is now greater than it has ever been before," says ECI's Ramsay. "The volume of data generated globally continues to double every two or three years, with the capacity to store this data rocketing and the associated costs of that plummeting."

Prebble adds: "Today's best performing companies are utilising data and supporting technologies to drive operational excellence, sales and marketing efficiencies and improved customer experience, generating significant returns for their investors."

It is also critical to the deal process itself. Data allow a GP to "understand proof points or opportunities to do better", says Marriott.

"Whether we are focused on a potential investment or we are looking at how we help a company run itself better, the data team are extensively involved," she says.

6

Being responsible is a must

"If you want to talk about trends, ESG is one of the strongest right now to drive long-term value," says Faxander. Consideration of environmental, social and governance impacts and risks filters throughout the value creation process, from assessing a deal to improving governance and operational best practice to positioning a business at exit for potential buyers.

An example of ESG's reach is GP focus on improving ESG within the supply chain. "Private equity is leading the way in bringing this [attention to ESG in procurement] to small to mid-size growing companies," says James Bousher, senior manager operations performance at consultants Ayming.

"For them the focus has never been ESG. It's been growing the company. Private equity's influence is stabilising and will allow them to focus on reassessing the value stream risk element and the social good and positive externalities."

Martin Calderbank, managing partner at Agilitas Private Equity, adds: "When done properly, investing responsibly can aid the defensibility of a portfolio and be a powerful value creation tool.

"There are different ways of achieving this, but at Agilitas we do it by only backing companies where positive societal or planetary purpose and shareholder value are fundamentally aligned." ■

Editor's letter

The cog in the value creation engine

Graeme Kerr
graeme.k@peimedia.com

When we decided last year to produce an illustrated A-Z of Value Creation, we knew exactly who to turn to for help: the operational specialists who gather each year at our Operating Partners events in London, New York, San Francisco and Singapore. Amid fierce competition for assets and higher purchase price multiples, operating partners have become a major cog in the value-creation engine. Their number has soared and they are the acknowledged specialists in just what it takes to transform a portfolio company.

So, when we set up stall at the 2019 Operating Partners Forum in London to ask delegates what each letter should stand for, we knew we were in the hands of experts. There are real insights here as to what is required to clarify a business's financial goals and deliver on strategic objectives.

> "Operating partners are increasingly involved in the due diligence process"

Pre-deal is crucial. Operating partners are increasingly involved in the due diligence process, digging into the detail to identify potential value creation drivers. "Deal due diligence is not simply about creating a picture of the company at one point in time. It now means collecting and interpreting numbers and providing advisory services to create and implement a [value creation] plan," says Friederich von Hurter, partner M&A integration at PwC Germany.

Their specialist knowledge is valued, too – especially in digitisation, data and analytics.

The human side also matters. Our conference sessions on value creation related to people issues – such as chief executive succession planning or refreshing organisational culture – are some of the best attended, so it's no surprise to see human capital here.

And, unsurprisingly, environmental, social and governance is also a theme in the A-Z, especially in the supply chain.

All in all, it's a great read – and wonderful fodder for discussion at our operating partners events. If you haven't attended one of them, they are recommended for the insights they provide into the detail of how to generate growth at a portfolio company. Attendance has soared, so much so that we are adding a fifth global event in Germany in September.

Hope to see you there,

Graeme Kerr

New York
130 West 42nd Street
Suite 450
New York
NY 10036
T: +1 212 633 1919

London
100 Wood Street
London
EC2V 7AN
T: +44 20 7566 5444

Hong Kong
19F On Hing Building
1 On Hing Terrace Central
Hong Kong
T: +852 2153 3240

Private Equity International
Published 10 times a year by PEI Media. To find out more about PEI Media visit **thisisPEI.com**

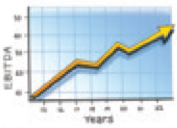
Printed by Stephens & George Ltd
stephensandgeorge.co.uk

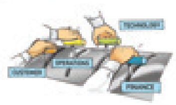
FSC
www.fsc.org
MIX
Paper from responsible sources
FSC® C013417

The A-Z of value creation









The term value creation is so prevalent in the private equity industry that it's easy to forget what we really mean by the phrase.

That's where the *A-Z of Value Creation* comes in, *writes Graeme Kerr*.

Produced at our Operating Partners Forum in London, the A-Z gives one of the most comprehensive rundowns of the nuts and bolts of value creation that you are likely to find.

To create the A-Z, we worked with Brighton-based artist Lee Playle who sketched the images based on the suggestions of delegates at the conference. The resulting two-metre by three-metre illustrated A-Z wall became one of the talking points of the forum, with operating partners eagerly offering their thoughts as to what the letters could denote.

Some letters, it's fair to say, were easier to decide than others. There was close to unanimous agreement that H should stand for human capital. A recent PwC survey found 83 percent of deals that lost significant value saw between 21 and 30 percent of key talent leave the business. "Staff retention, satisfaction and engagement is proving to be an ever more important and difficult challenge for businesses," says ECI's investment director Duncan Ramsay, who highlights the strong correlation between the strength of a business culture to its success.

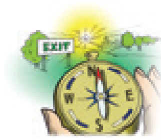
Few could argue either about letters such as B denoting buy and build (often the best way to create value in fragmented markets, says Carl Nauckhoff, senior principal and head of investor relations at Investindustrial) or D for digital transformation which is "changing the way we do business", says Alex Mathers of Inflexion Private Equity.

In many ways, though, the real value of this A-Z came when the delegates were forced to delve a little deeper and offer suggestions that went beyond the most often used terms. So F came to stand for focus ("The one word that truly captures the power of private equity," says Oliver Gardey, head of private equity fund investments at ICG Enterprise Trust), and V for visionary approach ("If you don't have that, the risk is huge that you will get distracted along the way, especially in the environment we're in," says Alain Vourch, partner at Charterhouse Capital Partners).

Completing the wall in two days was as much a creative and logistical challenge as anything – just producing 26 images in 48 hours was, Playle admitted, one of his toughest-ever gigs – but the resulting content goes a long way to demonstrate the multi-faceted approach to value creation that the modern private equity firm needs to adopt. ■

















Illustrations: **Lee Playle**

Analytics

Enormous increases in computing power, cloud computing architecture and inexpensive storage, mean the sheer quantity of data available to companies today is growing exponentially.

The increased sophistication of artificial and machine learning technologies means data can be analysed to produce ever greater insights. Private equity firms are investing heavily in the operational resources required to exploit this trend.

"Today's best performing companies are utilising data and supporting technologies to drive operational excellence, sales and marketing efficiencies, and improved customer experience, generating significant returns for their investors," says James Prebble, director at digital consultancy Palladium Digital.

As private equity firms face soaring asset prices and heavy competition for deals, analytics can be used in due diligence to help understand the target and uncover its true value. It can provide clarity on key business drivers including where the company is growing, customer segments and how they are changing. Once the deal is completed, analytics can be used to identify value creation opportunities, uncovering areas of potential improvement.

Many firms are already using scraping tools to extract and analyse data from the web to evaluate customer sentiment or obtain competitive data on product pricing or selection, for example. Analytics can also be used to optimise digital marketing, evaluate traffic patterns, and crucially, predict how disruptive new technologies or business models may change the markets in which they are operating.

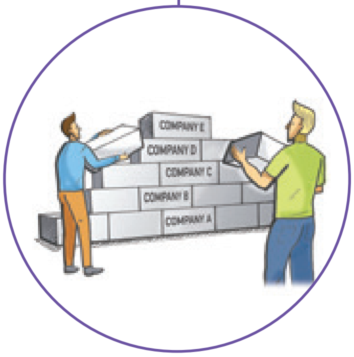
Furthermore, analytics can provide immediate feedback on the drivers of key performance variations across sales, margin, cost management and cashflow, to support real-time decision-making.

Outside help

The use of analytics in private equity remains nascent, with the majority of firms still tapping into external expertise. However, some larger firms, such as Oak Hill Capital and Blackstone, have hired dedicated data analytics teams, and managers everywhere see analytics as a key to value creation.

ECI Partners recently built a lead-scoring model to assist a portfolio company in allocating its sales resources to the leads with the highest chance of conversion and the highest potential lifetime value, explains the firm's investment director, Duncan Ramsay. "In other recent projects, the team has built churn propensity models," he says. These allow the portfolio company to assess segments of the customer base most susceptible to churn and to intervene to reduce the likelihood of this.

"We believe the opportunity to create value through data is greater than ever before. The volume of data generated globally continues to double every two or three years, with the capacity to store this data rocketing and the associated costs plummeting – despite fears over the future of Moore's Law. What's more, rapid advances in data science and artificial intelligence mean the insights that can be generated from this data are becoming ever more valuable. Whether you think that it is the new oil or not, the rise of data cannot be ignored."



Buy and build

High entry multiples mean buy-and-build strategies have soared in popularity, supporting business transformation with access to new geographies, in addition to cost savings through synergies and the rationalisation of support functions.

The increased size of the company can also allow for enhanced leverage opportunities and better position the business for a trade sale or IPO, as well as commanding a higher multiple on exit.

Indeed, the success of the private equity buy-and-build model has been exemplified by the consolidation of the veterinary and dental industries in recent years. One of the biggest veterinary players, AniCura, backed by Nordic Capital, was acquired by Mars Petcare in November 2018.

"Buy and build is a key method of potential value creation through gaining scale in a market, accelerating new market entry or moving into adjacent products or services," says Gareth Whiley, managing partner at Silverfleet Capital. "We can be of particular help to our portfolio companies by sourcing, structuring and executing add-ons, especially internationally, if they don't have the in-house expertise."

For a buy-and-build strategy to work, however, firms need to be investing in highly fragmented markets. They also need to identify a stable platform company to act as a building block for growth. A strong pipeline of targets and stable environment in which to pursue them is also important, as is consistent free cashflow to finance deals and repeatable financial and operational models.

"In a fragmented market the best way to create value is often through buy and build, particularly for a services business where the alternative of opening new points of sales is typically slower," says Carl Nauckhoff, senior principal and head of investor relations at Investindustrial. "It is important that the original platform has the right quality and systems and a management team with experience of integrating acquisitions, although in some cases management may need to be reinforced."

Cashflow management

Cashflow is the single most important financial factor determining a company's success or failure.

Great products and revenue streams are useless without processes designed and managed efficiently to spin off cash.

Failure to adequately manage cash brings many businesses to the door of turnaround specialist Endless, says the firm's managing partner Garry Wilson. "Many profitable companies need my help at short notice because they haven't managed their cash properly, which is crazy. [It is] such basic stuff and one of the things that private equity firms have learnt how to do very well. Every cent generated from better management of working capital during our ownership goes straight to value. Everyone talks about EBITDA and wants to see the P&L, but for me it is cash generation and funds flow every time."

In addition to simple survival, cash is required for capital expenditure programmes, ranging from new manufacturing facilities to office space or developments in new technology. Cash is also critical for transformational acquisitions. Without cash, growth-related investments suffer and a company can fall behind the competition.

"For many portfolio companies, there is scope for us to assist in creating value by optimising cash dynamics, and our experience can be helpful," says Andrew Backen, partner at Equistone Partners Europe. "This can include adding specialist finance and treasury expertise from our network, investing in systems and processes, and ensuring the company's banking facilities are a good fit. Our investment in Small World, an international money transfer provider, is an example, as the company seeks to manage its flows of cash around the world ever more effectively as it realises strong growth."

Digital transformation

Digital transformation is now a fundamental driver of operational performance enhancement in private equity-backed businesses.

This can include a combination of new technologies such as big data analytics, high performance computing, artificial intelligence, machine learning and the Internet of Things, to name a few.

The pace of innovation is astonishing. PE firms and their portfolio companies have taken note. "This next wave of change including increased and more intelligent automation will fundamentally change the workforce. We have to prepare for that," says Georgette Kiser, operating executive at the Carlyle Group. Advances in AI and predictive analytics are extremely important for companies to embrace and harness. Sean Epstein, senior vice-president and head of private equity at SAP, says: "This, plus the coupling of operational and experience data to make smarter decisions, improve business models and delight customers is a game changer."

Alex Mathers, assistant director in the digital team at Inflexion Private Equity, says: "Digital transformation is changing the way we do business across B2C, as well as B2B businesses and even in so-called traditional sectors such as industrials.

"This includes the front office – how and where we identify and win new customers and make them more loyal. And also the back office, even down to fundamental business models and ways of working."

The transformation process begins early in due diligence, adds James Prebble, director at Palladium Digital, a digital consultancy for private equity. "Understanding the digital maturity of a company, relative threats to position from competitors and potential market disrupters is the first step in delivering successful digital transformation," he says. "Post-deal insight from digital diligence can be used in post-transaction planning to enable investors to accelerate value creation. Due to the scalability and immediacy of these changes, digitisation should be seen as a strategic imperative."

The process involves setting up systems to merge the best of the digital and physical worlds, such as tracking the customer experience to personalise marketing campaigns. In a manufacturing business, data analytics could manage assembly line flow to minimise waste or predict maintenance.

"Digitisation is impacting all the businesses we work with – whether it is helping to pivot to direct digital marketing and communication, using data within a business for greater insight and efficiency, or using or developing software to improve performance or to sell," says Gareth Whiley, managing partner at Silverfleet Capital.

"As technology pervades every industry and absorbs them into the digital economy, digital transformation has become a tool driving value creation," adds Paul Guély, managing partner at Arma Partners. "GPs can buy a business in an 'analogue' industry and invest capital and expertise to build out a proprietary tech platform, organically or through acquisitions, that delivers and differentiates its core service. This positions it to achieve a higher valuation multiple at exit, irrespective of earnings growth during the hold period."

KEYNOTE INTERVIEW

Harnessing the potential of digital

Private equity firms are leveraging tech advances to drive transformative value creation, say Sean Epstein, SVP and head of private equity at SAP, and Georgette Kiser, operating executive at the Carlyle Group

Q What kinds of digital innovation bets are private equity firms making across their portfolios right now?

Georgette Kiser: Digital transformation is extremely important to us at Carlyle. Around two years ago, we brought in Boston Consulting Group (BCG) to help us determine how to employ technology to drive value across our portfolio companies. What we found was that transformation starts with cultural change – getting people to understand what digital really means and what it can do for you. As our deal teams have become more educated on digital innovation, they are increasingly working with portfolio company CIOs to think strategically about their user experiences and how to leverage technology to make those experiences better.

SPONSOR
SAP

A great example of this was with MacDonald's in China. We implemented a digital strategy to transform how kiosks are used to place orders, which transformed and improved its food delivery models and added real value to the company. Another interesting example was with market research company Claritas, which we acquired in 2017. The strategy there was to help the firm move from using out-dated marketing techniques to digital marketing, which we achieved through acquisitions. Claritas acquired three companies in a three-year period to meet those objectives, which showed that digital transformation does not always have to happen organically. And as a result of those acquisitions, the Claritas $1 billion market research addressable market has transitioned to a $25 billion digital marketing addressable market.

Sean Epstein: There are a couple of areas of late where we are seeing PE firms placing cross-portfolio bets on digital technologies. One is cross-portfolio company spend management and supplier data analytics. We have worked with a few dozen firms in the last 12 months to help them to take all their portfolio companies' data to create a spend cube and then leverage advanced analytics to compare unit costs, evaluate payment terms, and review supplier effectiveness in aggregate. Firms have been able to leverage the economies of scale across their network to get better terms, more competitive rates and to allow portfolio companies to better select preferred suppliers.

The other area where we are seeing a lot of funds get more active is around experience management technologies. Firms are using a very data science-driven approach to evaluating companies during due diligence to assess customer, brand, product and employee sentiment. In fact, many of the large strategic consulting firms have also embedded this capability into their due diligence services. They are then also comparing sentiments between portfolio companies to look for best practices and identify leading indicators of areas for improvement through that data.

Q Is that level of tech deployment only really an option for mega buyout houses?

SE: No, many strategies don't cost a lot and don't take long to execute on. From a supplier management perspective, for example, even if you are a mid-market private equity firm, this is still extremely relevant. There isn't a private equity executive out there that wouldn't want to strip 10 percent of indirect spend out of portfolio companies in a non-emotional way. This isn't about laying people off. It's not shutting down a business unit. It is just smarter procurement given the overall spend across a firm's portfolio. On the experience management side there are some very simple ways to get started and approaches to comparing information across the portfolio and at all stages of the investment lifecycle that can immediately produce benefits and reduce risk cross-portfolio.

Q How do private equity firms prioritise their digital strategies?

SE: Everything starts with the investment thesis, rather than with digital transformation as a standalone strategy. The nature of the digital transformation will vary significantly, depending on what that thesis is. For example, if you are buying a business as an acquisition platform with the objective of acquiring a dozen other businesses across Europe, then your digital priorities will stem from that. The focus will be on putting in the digital infrastructure necessary to deal with cross-border supply chains, for example, as well as multi-language and multi-currency capabilities.

> *"Everything starts with the investment thesis, rather than with digital transformation as a standalone strategy"*
>
> **SEAN EPSTEIN**
> **SAP**

> *"Change starts at the top. The CEO and CFO need to buy into the transformation which can involve a significant investment upfront, but the value add at the end can be huge"*
>
> **GEORGETTE KISER**
> **Carlyle Group**

GK: You start with the investment thesis and from that develop a business strategy. Within the business strategy, there might be different ways in which you can leverage digital technology or theories on how to drive the business differently.

I tend to think that there are four ways, fundamentally, in which to address digital change. First, there are cultural, organisational changes that must be implemented. Second, there are operational changes, which often represent low-hanging fruit. Third, are business model changes. Fourth, the big one, is what I refer to as domain changes. Just think of Amazon, for example, which began as a retail company and then went into the cloud space. Amazon Web Services now represents over 50 percent of the company's profits. Whichever way you address those four areas, it all starts with the investment thesis and business strategy.

Q To what extent are firms exploiting digital potential to the max with these full domain changes?

SE: I think about this in terms of digital transformation light versus digital transformation heavy. Digital transformation light will take place in just about every investment. It is the 'keeping the lights on' layer of digital – it is housekeeping. But then you see a private equity-backed company we have worked with that was recently purchased with the intent to fundamentally turn its business model upside down. The company leased heavy assets, air compressors. As the industry was evolving, the firm decided that they could significantly improve the value of this business if they began leasing the air instead of the compressors. I call that digital transformation heavy. Georgette may call it domain change. The strategy required that in addition to deploying advanced analytics and intelligent machines, they also had to redesign and re-evaluate almost every part of their business processes – how they sell, who they hire, what services they provide, how they go to market, how they price their products and services, etc.

Q What are the biggest challenges that firms face when executing digital transformation?

GK: The biggest challenge definitely involves people. Change starts at the top. The CEO and CFO need to buy into the transformation which can involve a significant investment upfront, but the value add at the end can be huge. Once you have executive management on board, the other big issue is talent. You need to have people with the knowhow to leverage these new technologies. If not, you face a big problem.

SE: I agree. No digital transformation happens without getting the people piece right. Going back to this mega firm that had such great success with the spend cube, that firm had to find innovative CFOs that didn't see this process of aggregating all their

Q These days, every company is potentially a technology company. But are some industries more ripe for digital transformation than others?

GK: Information technology companies are ripe. Finance companies are ripe. Professional services companies are ripe. Then you have other industries such as manufacturing and distribution, healthcare and construction, which are really catching up. In those industries, technology can be more about physical robots streamlining processes than software.

SE: I would add that there is still huge room for improvement in the retail space. The more that the experience economy grows and the more that people feel entitled to disparage a business with a Tweet, YouTube video or Instagram post, the more important it becomes to engage. It happened here recently in Washington, D.C. A family-run restaurant went out of business a couple months after an angry customer shared a video of a dirty plate on various social media platforms. When I was growing up if I had a bad meal we would tell our closest friends, now you can go viral and a business can be ruined in an instant.

There is real potential, therefore, to embed technology in order to do a better job from an experience perspective – not just providing a better experience but listening and learning from your employees and customers. People are willing to tell you anything about your business, products, prices or brands if you make it simple enough. In retail clearly, but beyond, we are particularly excited about this whole category of experience management and what it affords companies from a value creation perspective.

indirect spend as being big brotherly, but rather as a tool for improving their business.

So, they found these trailblazing CFOs and piloted the project with around 10 percent of their portfolio companies. They then shared the results at their next CFO conference and, unsurprisingly, there was not a CFO in the room that did not raise their hand to get on board in year two. Instead of forcing change down their throats, they found a way to demonstrate success. Now 85 percent of their portfolio companies are inputting information into that spend cube and the firm runs a shared service company to help all their investee businesses with procurement.

Q This idea of leveraging the network seems to have advanced significantly in recent years. Has this happened in parallel with the growing prominence of the operating partner function?

SE: A decade ago, only around a dozen private equity firms had strong operational teams. Those teams would complain about not having a seat at the table. They have that seat now. I was speaking to a firm recently where the operating team has two votes on the investment committee. That simply did not happen 10 years ago.

GK: The other big change is definitely the shared service layer that has been put in place. There will be a digital expert, an IT leader, an HR person, all with teams below them that we, as operating executives, can work with. All the major private equity players have a shared layer now, which is really important for leveraging the portfolio network.

Q What about the risks associated with technology? How do you identify and mitigate those?

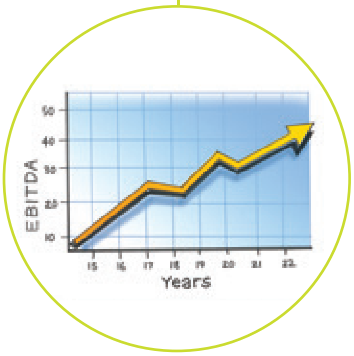
GK: I love technology and I think what is happening in the digital world is exciting, but there are a lot of risks to consider, particularly around human capital. As we are transforming the way businesses operate and make everything more efficient, we need to think about how we ensure people who have jobs today, have jobs tomorrow. How they continue to have the skills they need for a changing technology environment.

Data privacy is another concern. As we collect more and more data, and increasingly use artificial intelligence and machine learning to manage that data, we need to think about data privacy and intellectual property risk. As the world changes, these ethical concerns will arise, and we need to be ready to deal with them.

Q What will the next wave of digital transformation look like?

GK: Obviously we have 5G on the way and all of the implications for the Internet of Things (IoT). That connectivity, when it does occur, is going to be incredible for enabling digital strategies going forward. If you consider 5G in conjunction with Wi-Fi 6, the speed at which we will be able to process data will be transformational.

As understanding of these existing technologies grows, we will be able to do more and more with them. With machine learning, we will be able to process larger data sets and drive change from that information. Blockchain is also becoming more 'real' with use cases in food safety, for example, and asset management. Is there new technology on the way? Undoubtedly. Can I predict what it will be right now? No. But I do know that all these existing technologies will mature and will increasingly prove enablers for value creation. ■



EBITDA

EBITDA is one of the most critical metrics for private equity investors because it directly reflects value creation.

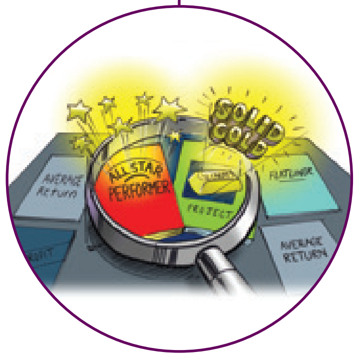
Furthermore, EBITDA is a fundamental cornerstone of private equity valuations, both on entry and exit, and therefore can be closely linked to returns. EBITDA is also an important metric in private equity because it is used to indicate a private company's debt load. If EBITDA is too low, a company cannot service its loans.

For each of these reasons, private equity firms meticulously pursue operational changes that will support EBITDA margin enhancement throughout the life of their investments.

There are two principle routes to EBITDA optimisation. Most firms will pursue them simultaneously. The first is increasing sales income. This can be done through pricing strategies or by boosting demand through marketing or the creation of new goods or services. The eradication of discounts, meanwhile, often represents the lowest hanging fruit.

The second route to EBITDA optimisation involves decreasing the cost of goods sold through a tactical analysis of every expense and ways in which these can be cut.

"We never lose sight of the fundamental tenet that EBITDA is a proxy for cash. In a leveraged environment, with debt to service, and the opportunity to enhance returns through cash generation, it's key to understand the quality of EBITDA in terms of conversion to cash," says Edward Taylor, associate director of portfolio management at Inflexion Private Equity. "We take a very close look at any cashflows post EBITDA. For example, challenging working capital dynamics, ongoing exceptionals or products that require significant research and development spend that is being capitalised."



Focus

Private equity firms are highly focused about the operational enhancement tools that they choose to employ in any given situation.

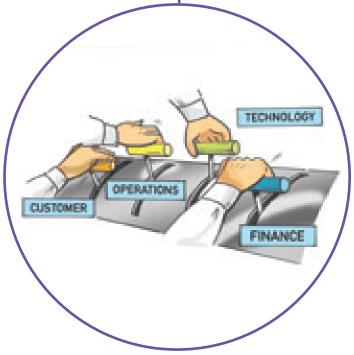
Experience has shown that attempting to tackle too many areas of improvement at once can stretch management too thinly and produce poor outcomes.

These areas of focus will be identified during due diligence and implementation will be critical to the 100-day plan. Working capital control and the adoption of more sophisticated pricing strategies are typical examples of areas private equity sponsors will choose to focus on early in the life of a deal.

Transformational acquisitions or international expansion, meanwhile, may be identified as key areas of focus for later in the investment cycle, once the business has been optimally positioned for this more radical change.

"Making sure the management team remains focused on key levers of change in a business is critical, and is especially important for smaller companies where resource constraint means if you try to do too much, you run the risk of not delivering on those areas that can really drive value," says Bryan Turner, independent transformation director.

"Focus is one word that truly captures the power of private equity," adds Oliver Gardey, head of private equity fund investments at ICG Enterprise Trust. "There is a relentless focus that pervades the private equity model, whether it's in the diligence process or when managing complex strategic and operational change at portfolio companies."



Growth drivers

Private equity firms can no longer lean on multiple expansion for returns. Slowing economic growth has weakened the potential for relying on multiple arbitrage.

Equally, cost-cutting opportunities have typically already been baked into inflated asset prices or have been captured by a previous private equity owner.

The emphasis has therefore fallen on the ability to relentlessly drive top-line growth through commercial acceleration programmes, which can impact on exit multiples. According to Bain & Co, there is a median return on investment of between 20 and 30 percent when firms focus on commercial acceleration, rather than cutting costs.

Typical growth drivers include: incentivisation programmes to improve sales team behaviour and performance; pricing strategy; marketing initiatives; expansion into new markets and refocusing on the most profitable segments, while moving away from poorly-performing areas.

As Friederich von Hurter, partner, M&A Integration at PwC Germany, points out: "In nearly all cases there is low-hanging fruit. A fresh perspective can identify drivers that management and the owner do not have on their agenda."

Implementation teams

Hiring technical or functional expertise, developing new products and services or revamping the business model are also useful levers. Strategic acquisitions are key and have a potentially transformative effect.

This will often fall to operating partners or specialist portfolio management teams to implement. Such teams have proliferated greatly since the financial crisis. At ECI Partners the commercial team helps companies with bespoke projects ranging from improving the onboarding process for new clients, to identifying acquisition targets that will help them enter new markets, says the firm's investment director, Duncan Ramsay. "By including our commercial team in a pitch process, we can demonstrate early on to management teams how we can add value to their business."

Digital transformation remains one of the most potent growth drivers, with meaningful impacts on operational improvement and, ultimately, returns. "The technological changes over the past decade have driven substantial growth in new business models and led to significant value creation, even with relatively weak growth in the major economies," says Oliver Gardey, head of private equity fund investments at ICG Enterprise Trust.

Despite the value these growth drivers can provide, however, PwC's recent *Creating Value Beyond the Deal: Private Equity* survey found only 45 percent of private equity dealmakers realise value through revenue enhancement, compared with 49 percent of deals completed by corporates. Furthermore, while 74 percent of value-creating deals delivered revenue growth, this value lever still received less focus than cost cutting and work on driving working capital efficiency, suggesting a real opportunity for firms that seek to differentiate themselves based on their growth strategies.

KEYNOTE INTERVIEW

Enhancing the value of due diligence

Value creation starts in pre-deal due diligence, say Friederich von Hurter, partner, M&A Integration, and Filip Debevc, senior manager, Deals at PwC Germany. And the role of the advisor does not stop there

SPONSOR
PwC

Q What information are clients looking for in pre-deal due diligence and how is your scope of work changing?

Friederich von Hurter: Previously there were separate tax, legal, operational and financial due diligence books usually compiled by different advisors and the challenge was to combine all this information, identify dependencies, and how it is linked together. There has been a shift to developing a value creation story that ties all the information together and describes how change is possible. Deal due diligence is not simply about creating a picture of the company at one point in time. It now means collecting and interpreting numbers and providing advisory services to create and implement a future-proof plan.

This process runs in parallel with the deal. As a consultant, you check the usual hygiene factors and basic assumptions while developing your value creation hypothesis, which you then check is realistic with regards to dependencies and legal restrictions, etc. The value creation story is reflected in the final investment decision. The reports we deliver serve also as manuals for management by describing what to do in the future and how. That is why we say value creation begins in due diligence.

Filip Debevc: Pure due diligence work looks at historical performance and existing plans to identify issues and risks within the target's business model and operations, in their go-to-market strategy and so on, and benchmarking. Typically, that work is completed and then stored. Now, as advisors, we are asked to solve problems and issues that have been discovered and to provide mitigation strategies for risks identified, as well as consider synergies and other benefits. The scope of due diligence is broadening. It is not just paperwork. It now includes the implementation path for a business plan of strategic value.

Q Where is the pressure for this additional insight coming from?

FD: On the buyside, we see very competitive auction processes. This enables sellers to supply limited documentation and unanalysed data. Usually, private equity buyers take this data and conduct the analysis work themselves to identify value creation potential. This is carried out without communicating their findings to the sellside or disclosing what they have priced into the transaction value. Conversely, we now see vendors preparing materials that spell out possible future improvements, which they have not pursued for whatever reason. This means they can price this potential into their target value.

FvH: Whether on the buyside or sellside, overall, the effort put into undertaking due diligence is increasing in order to gain a better understanding of complexity drivers, to argue a value creation story and to explain high multiples. From a sellside perspective, with larger businesses, vendors usually compile their own due diligence report. It is an opportunity for the seller to thoroughly describe the target. We are in bullish markets and as a lot of good targets have already been sold, vendor due diligence helps the seller to argue their price ambitions.

Q How frequently are commercial and operational due diligence included in the pre-deal process?

FvH: Each case is different. If the business does not have any operations, then clearly operational due diligence is not required. If it is a top line-driven project, then commercial due diligence comes into focus. The bigger the target and the proportion of the portfolio it represents, and therefore the risk to the investor, the more frequently these two are performed.

More recently, due diligence work has begun to stretch across different areas of expertise, from assessing EBITDA improvements and future profitability right down to the cash level, as well as including to look at topics such as legal entity footprint optimisation.

Q Are there specific synergies you typically identify?

FvH: Synergies differ depending on the industry. What is more important is that we have a structured approach to identify and value them by considering the entire value chain, starting at procurement and ending at after-sales services, and including support functions.

"Consultants, advisors, and investors are increasingly realising that by overlooking data some value is being left behind"

FILIP DEBEVC

"The interesting thing about synergies is that in order to understand them, you need to know yourself and the target. You need to know what to leverage the synergy from"

FRIEDERICH VON HURTER

The interesting thing about synergies is that in order to understand them, you need to know yourself and the target. You need to know what to leverage the synergy from. In procurement, for example, if you want to combine two supplier contracts, you need to know your own and the target's procurement arrangements to come up with an estimation.

FD: We recently worked on a transaction where the seller identified potential synergies with a prospective buyer after conducting outside-in work on the buyer. With a picture of possible synergies, the owners were able to tell the buyer that they believed the business was more valuable to them and therefore, they had to pay more. Sellers are becoming more informed earlier in the process because they know there might be additional value available to them.

In due diligence, identifying synergies now also includes how to implement them. This has become part of the investment decision and hence the financing decision. This means we now provide banks, as well as investors, with due diligence reports on potential synergies.

Q Compiling information on value drivers such as synergies requires access to sensitive data. How do you manage this?

FvH: Previously, advisors on the buyside would simply process data supplied by the vendor, like a fact book shared in a data room. Nowadays, almost every project has a dedicated 'clean team' that has access to commercially sensitive, confidential data that has typically not been shared previously. This team needs to have the ability to calculate value drivers such as synergies, which they would not be able to do if they were limited to publicly available data. We used to see a clean team on about 10 percent of transactions. Now it is more like 60 percent. Their presence is proof of the growing complexity of the due diligence process.

Q The deal is signed. Then what happens?

FvH: In phase two, you bring the plan to life. In any transaction, you need a deal captain to guide the process from the beginning. This is someone who understands all aspects of the extended due diligence and has the ability to convert it into value creation, while keeping an eye on the bigger picture. After the deal closes, it is crucial that deal leaders, the operating partner or portfolio team member and advisors stay on the deal as long as possible to leverage the insights gained and mitigate the risks identified.

FD: Most of our private equity clients are aware of the benefits of this enhanced approach to due diligence. If they stop the process as soon as the transaction is signed, they lose traction. Private equity firms do not want to directly manage a company, but they are also buying the management team, so it is very important they have a good one. In our experience, this team, which has moved from being on the sellside to working for the new buyside owners, is very happy to receive the observations and ideas that came up in due diligence, including the books and models. For instance, in one deal, we had a chief information officer who was not aware of cyber security risks that were included in our report. That was a quick win. We have also seen this apply to mid- and long-term improvement measures.

From the sellside perspective, even if you decide not to proceed with a disposal, you can take advantage of this approach. Earlier this year, a client decided to pull back and not divest a business. Typically, all of the work we had carried out would have been viewed as sunk costs but that was not the case. Through due diligence and the identification of potential improvements, our client learned a lot about themselves. They started implementing the proposed solutions and mitigation actions.

Q What are the key growth drivers?

Friederich von Hurter: It is case by case, however, in nearly all cases there is low hanging fruit. A fresh perspective can identify drivers that management and the owner do not have on their agenda. Surprisingly, there is very often scope for improvement in procurement. Rebooting established relationships would generate better results. You do not have to adjust much in the operating model or implement many changes because this involves people and contracts can be quickly changed. It is more of a value driver than people expect.

We are also sometimes surprised by the lack of digitisation. We know because we implement them, that there are digital tools available that are easy to implement. Related areas in IT where we typically see improvement potential include software applications and licence management. People are not taking sufficient care. For example, they buy a licence and do not terminate applications that are no longer used, or they do not conduct a strategic cost review of their IT landscape.

Another factor is cleaning up the legal entity landscape. Sometimes an international business has built up a large footprint of legal entities that require tax, auditing, and regulatory filings in each jurisdiction, as well as cash management. Deciding to close some of these offices results in complexity reduction, which can ultimately lead to cost improvements over two to three years. The impact of this is hugely underestimated.

Q What skills does an advisory team need to execute this work?

FD: You cannot perform analysis on a value creation approach by simply conducting desktop exercises. You need to have implementation experience, interact with clients and lead integration work. If you do not, post-merger integration projects and synergy estimations cannot have a profound impact. That is why we are not a pure due diligence team, but also have staff with operational expertise who can switch roles to contribute to the implementation of the plan.

Q What contribution can 'Big Data' make to value creation?

FD: Consultants, advisors and investors are increasingly realising that by overlooking data some value is being left behind. There could be much more forward-looking analysis done with digital tools that we see in the market today. However, you cannot use this tool if the data is not available.

Almost every company is allocating a significant amount of manpower and budget to increase data collection and analysis to better understand procurement and manufacturing processes, or generate improved predictive maintenance analytics, for example. During a transaction, companies in particular industries, like tech startups, typically provide a good amount of data that we can use to understand value drivers such as the strength of a business's client base and the rate of sales conversion. Yet some traditional industries still lag behind. Businesses are aware that the data exists, but it is not being taken into account and sufficiently analysed. From a sellside perspective, this means they are not aware of the value potential of the data they hold. From a buyside perspective, they are not putting the data on the table and scrutinising it. ■

Human capital

Portfolio company leadership, talent development and culture are playing a more important role in driving operational performance and value creation.

At the same time, leadership issues, talent gaps and ineffective management teams can significantly hamper growth and impact returns.

As a result, the majority of private equity firms have now hired heads of talent of some description, who work with the management team to develop a 100-day plan for human capital, alongside the operational and financial plans, and who will help implement these strategies.

Importantly it is not just a question of hiring and firing. Maintaining and building upon a successful company culture is critical. According to PwC's *Creating Value Beyond the Deal: Private Equity* survey, 57 percent of dealmakers say cultural issues thwart value creation, while in every deal where value was eroded, more than 10 percent of employees left the company following completion.

"Staff retention, satisfaction and engagement is proving to be an ever more important and difficult challenge," says Duncan Ramsay, investment director at ECI Partners. "Our experience is there is a strong correlation between the strength of a business's culture and its success. This understanding led us to create our own people toolkit that portfolio companies can employ with the support of our in-house commercial team."

Research shows that companies with strong values and a culture employees buy into tend to have happier workers, lower staff turnover and stronger growth. Ramsay offers two examples in ECI's portfolio. "Moneypenny and B2B price comparison website Bionic have both been feted by *The Sunday Times* as two of the best companies to work for, precisely due to their strong cultures," he says. "Perhaps it is no coincidence that these two businesses have also been ranked as two of the UK's fastest growing."

Firms typically approach human capital within a company with assessments of the chief executive and senior management, together with structures and decision-making processes, as well as surveys of staff morale. Firms may then invest in executive coaching or consultancy support, or make strategic restructuring or hires.

It is important firms act quickly on top talent. Hesitation, according to Bain & Co, can be a major source of value loss as it often results in unplanned replacements to correct suboptimal performance. However, it is important to also nurture middle management and staff further down the line.

Meanwhile, the open talent economy, in which technology enables firms to connect and work with professionals across borders, is reshaping traditional management strategies. "Firms need to become smarter and rethink their approach to human capital in the open talent economy," says Charlotte Gregson, managing director at COMATCH, an online marketplace for management consultants and industry experts. "Perhaps surprisingly, the digital economy has made human capital more important. Assembling and deploying the right team to deliver growth and transformation is the new alpha."

EXPERT COMMENTARY

Cultural fit is crucial to the success of projects. That's why the choice of consultant is vital for value creation, says Charlotte Gregson, managing director, COMATCH, an online marketplace for industry experts

The human capital challenge for private equity firms

The term human capital has been around for decades. Some trace it all the way back to Adam Smith, although most point to economists Gary Becker and Theodore Schultz who in the 1960s believed it could be leveraged, as with other forms of capital, to increase quality, quantity or efficiency.

Today it is more common to talk about developing and accessing talent. However, the fact remains that managing people, their skills, experience, motivation and contribution is a critical element in business success. In today's digital economy, businesses face a wider set of challenges, higher levels of complexity and accelerating change. It has changed the type of human capital we need, and the tools which we use to access and manage it.

At the same time, the 'talent' being managed has transformed. Many of today's workers are neither looking for, nor content with, a 'job for life'. They want flexibility, variety and the opportunity to pursue their own interests both within and around the work context. Sometimes this is referred to as a 'portfolio career' where individuals choose to do several things at the same time, balancing, for example, remunerative work, with emotionally rewarding charity volunteering.

SPONSOR
COMATCH

Technology has provided the means for many to set themselves up as independents with the ability to be selective about where, when, and for whom they work. Loyalty to a single organisation is declining whilst ethics are increasingly a factor in project and client selection. So human capital has become less about attracting, retaining and deploying people within your organisation and more about identifying, and partnering with the right skills and talent to deliver projects and growth where and when needed.

Against this background, the importance of human capital in delivering returns for private equity investments has only increased. Creating value in portfolio companies has evolved as debt-backed financial engineering, restructuring and cost-cutting have all seen diminishing returns as the opportunities for quick wins have been effectively used up. These approaches offer less competitive advantage than previously and it is simply harder to generate returns using these levers alone.

Today, private equity firms are holding portfolio companies for longer with the focus on transformation. Growth is created through entering new markets, exploring new ways to exploit assets, new business models and the huge gains expected from digital transformation. All of these require specific skills and expertise that frequently cannot be found in the portfolio company. Private equity can add value by accessing the right human capital and bringing it to bear on acquired businesses. Increasingly human capital really is at the heart of value creation. But, can private equity firms access the talent they need and are they best placed to manage the increasingly broad range of expertise needed to deliver growth in today's economic landscape?

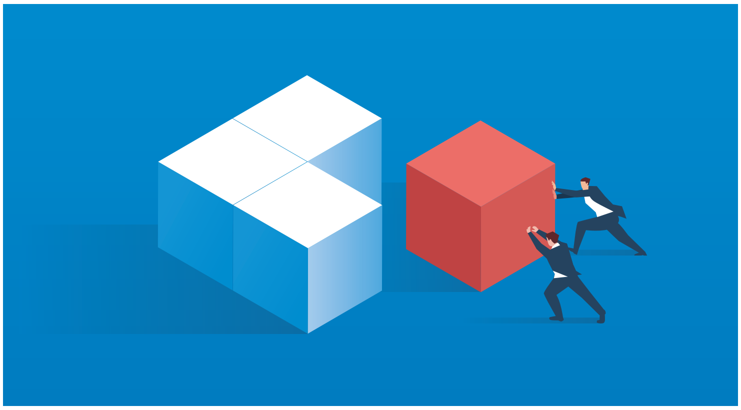
Different approaches

Private equity firms are becoming smarter and rethinking their approach to human capital within the open talent economy. What do you do when you don't directly employ the consultants you need to create value? How can you attract the right people, when the 'right people' must exhibit an increasingly diverse range of expertise and experience? Is it necessary, advantageous or even possible to employ all the talent you need?

Many have come to the conclusion that they don't need to maintain a full-time bench to cover every eventuality. Instead, private equity firms are establishing networks of alumni and associates which they can use to find talent when needed. Others have different approaches, for example partnering with entrepreneurs across their network to access digital skill sets.

Not only do these approaches give firms access to a far wider skill-base than they could viably maintain with a full-time workforce, but they only need to engage with, and pay, individuals when they have work for them to do. Importantly, for the development of human capital, it allows private equity firms to stay in close touch with valued consultants who want more flexible, portfolio careers.

There are drawbacks. It is not simple to create and manage these loose networks of associates. Simply having a spreadsheet of names and numbers is not a scalable or robust solution. Even buying or building sophisticated AI-driven software to match individuals with roles does not provide the whole solution. Deploying human capital means deploying people, and to do that well you need to know individuals and appreciate their 'fit' with others in the team, and with the portfolio company with which they are working.



Power to the portfolio

One important aspect of successful human capital management in private equity is often overlooked: the impact of consultants on the portfolio company.

Many traditional, family-run businesses are allergic to the concept of outside consultants. Cultural fit is crucial to the success of projects, this is particularly the case for organisational transformation. Our experience suggests SMEs are more open to individuals, or small teams of independent consultants who bring real experience of a sector to the business. Ideally, we recommend that portfolio businesses are the ones to make the final selection of the consultant they want to work with.

Outsourcing human capital

One option is to outsource the management of these associate and alumni networks to third parties dedicated to their development. Some recruitment firms are moving into this space, and they bring a broad knowledge of the market and the practice of placing people with firms. Other players, including COMATCH, have come from the consulting profession, and so have a better understanding of the business of being a consultant and the cadence of independent consulting projects.

The advantages are plain. Managed networks take on the complexity of building and maintaining a consultant talent pool, managing availability whilst cultivating relationships, staying in touch, and developing an understanding of the individuals within it. As a result, these marketplaces have access to wide and deep pools of global talent. Consultants join because they provide interesting work from a number of sources and the flexibility to choose the projects and clients that they want to work with. Our own research among consultants reveals that 86 percent say this flexibility over which projects to take is important or very important to them.

For private equity firms it is important to find consultants that not only have the right expertise but also the correct personality and work ethic to be effective in the portfolio company. The independent consultant route to human capital management ensures this is the case because consultants self-select the work they want. This flexibility also allows individuals to further specialise if they wish and to hone particular skills, iterating learning from one project to the next.

The world of work has changed, but effective management of human capital remains at the heart of driving growth in businesses. Perhaps surprisingly, the digital economy has only made human capital more important. New expectations, demands and ways of working have changed the shape of human capital. Effectively assembling and deploying the right team with the skills, capabilities, experience, and personality to deliver growth and transformation is the new alpha. ■

Inventory reduction

Inventory requires an investment of valuable cash. The faster a business can convert a customer order to a cash payment for goods sold, the better their cashflow and long-term profitability.

Just-in-time inventory management, negotiating reduced supplier lead time, eliminating obsolete inventory, optimising order size and purchasing frequency, and centralising inventory control are all favoured strategies. But inventory reduction must be implemented with care.

"Many understand the working capital benefits, but few understand how carefully this needs to be approached," says Kent Robinson, operations partner at HKW. "Companies need a 'shock absorber' to deal with fluctuations in customer orders, product supply, and all of the variations to normal demand patterns. Because of this, any inventory reduction plan should carefully consider where this shock absorber is going to shift.

"Understanding demand fluctuations back to the source of variability, minimising that and then deploying the appropriate shock absorbers, can be a helpful model to make sure the business keeps performing as customers expect while reducing inventory."

Joint ventures

Joint ventures can represent an efficient means for a company to spread costs and risks, as well as achieve economies of scale.

They can also enable companies to gain access to new technologies or customers and improve speed to market, agility, synergies and diversification without a significant financial outlay.

Private equity firms will often turn to JVs in Asia in particular, given the regulatory constraints in some markets, as well as the dominance of large family businesses and state-owned enterprises that can make acquisitions complex.

These deals are not without their challenges. Legal structuring and personal chemistry can both undermine the strength of the JV, as can a lack of business plan alignment. Joint ventures require strong governance and active management in order to succeed. There should also be a clear exit plan in place from the outset.

Nonetheless, by exploring all the available value levers within the JV, including customers, suppliers, processes, staff, technical expertise and government relations, joint ventures can be a highly effective route to operational performance enhancement and value creation.

KPI tracking

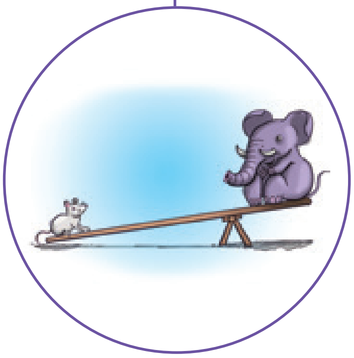
Transformational business plans must be implemented rapidly, and meticulous tracking of KPIs is essential to ensure the business remains on track.

This is key for private equity firms, which work to tight deadlines, typically holding assets for around five years.

Of course, not all KPIs will be met, but that is not necessarily a bad thing, according to Kent Robinson, operations partner at HKW.

"I've never been in or around a business that is satisfied with its operational performance metrics; that thinks it has it 'nailed' and is satisfied with its operational performance as measured by KPIs. Good. That's how it should be," Robinson says.

"The value of KPIs is never about achieving perfection, it is about the process: agreement on what is important to measure; engaging the organisation in the collection process; periodic review to talk about operational performance; and open discussion about successes and failures. That's what you're going for. Like golf, business is not a game of 'perfect', and as long as the organisation agrees on where the bogeys (or double, triple or quadruple bogeys) are occurring, you are top tier in your KPI tracking."



Leverage

Private equity typically finances between 60 and 80 percent of an acquisition with debt, so firms naturally seek to instil a focus, and urgency, in management teams when generating cash, monitoring spending and other real-time financial metrics.

Leverage can work together with other operational improvements by imposing strict management discipline. Cash is viewed as a scarce resource and capital is allocated accordingly. Paul Bail, head of European debt advisory at Baird, says financing in leveraged buyouts creates a trade-off between return for equity providers and the credit risk of the borrowing company. He notes that leverage can create value due to "a lower cost of capital versus equity and the borrower being able to both service the debt, and, through cash generation, reduce the credit risk in the business over time".

"The debt creates increased focus on the business in respect of interest cost and cash generation. Typically, this results in operational improvement and often improvements in working capital management. With improvements in financing documentation, borrowers often have increased flexibility, including acquisition and capex lines to facilitate the strategic plan of the business."

Certainly, leverage can be key to driving growth. "It is an important tool in creating an efficient capital structure," says Philip Edmans, the partner who leads debt strategy and lending relationships at Inflexion Private Equity. "For us, value creation is about accelerating sales-led profit growth. This can be driven organically, through launching new products and services, growing internationally or investing in operational improvements.

"Another key feature of our toolkit is mergers and acquisitions, as it can help drive a step change in growth. In both, leverage can be beneficial – through creating additional firepower to finance acquisitions or capital expenditure and having flexibility to invest in operational improvements and expansion. A supportive lender that appreciates our management team's vision is crucial. Having no leverage can also be the most appropriate approach. From the outset, we work closely with management teams to create the path for value creation. Our lenders are often impressed by the rigour with which it is developed and monitored against."

Leverage remains a hot topic as it is a key driver of both returns and leveraged buyout valuations, says Jacco Brouwer, managing director and head of European debt advisory at Duff & Phelps. He adds leverage has become more difficult to calculate based on reported EBITDA and acquisition debt levels, as loan documentation increasingly permits EBITDA add-backs for acquisition synergies and reorganisations. "Baskets in debt documentation permitting other types of debt, whether on- or off-balance sheet, have also complicated calculations," he says. "This is particularly the case for larger mid-market deals, syndicated loans and bonds. While leverage remains a critical component in determining financial returns, sponsors are, therefore, becoming increasingly focused on operational improvements, buy-and-build strategies or even transformational change to drive returns."

Manufacturing footprint

Manufacturing footprint optimisation is a strategic priority for any private equity firm operating in the manufacturing space.

This is particularly the case with the prospect of a downturn on the horizon. Manufacturing footprint optimisation can be an effective means of significantly reducing costs and improving operations, for example by shifting production to a lower cost jurisdiction.

It can include any combination of equipment moves, volume transfers and plant rationalisations. It also allows companies to markedly reduce supply chain cost and complexity, increase utilisation and improve EBITDA.

Nonetheless, manufacturing footprint optimisation can be challenging when basic cost and demand assumptions are changing as rapidly as they have in recent years. Risks include changes in local and global demand, currency exchange rates, labour and transportation costs or even trade regulation. Getting manufacturing optimisation wrong can be an expensive mistake.

Indeed, it is the flexibility of the manufacturing footprint that often proves most important. Flexibility may take a number of forms, for instance, the ability to adjust overall production volumes up or down efficiently or to adapt the timing of production by shortening lead times. A flexible footprint can also be achieved through a company's dispatch optimisation, and its ability to adjust the country or facility from which products or parts are sourced in order to minimise the total landed cost in any given market condition. When companies build in these sources of strategic flexibility, they can respond tactically to risks such as changes in local demand, currency levels, labour rates, tariffs, taxes and transportation costs.

Net promoter score

'Know your customer' is a key business tenet and finding out what they think about you is a supporting principle.

A basic way to extract this customer feedback is to survey them on how likely they are to recommend a business's products and services to calculate a net promoter score (NPS). This number serves as a proxy for customer satisfaction, loyalty and the value they place on the offering.

NPS is a useful tool to gather sentiment on topics such as product development, pricing or customer service. Its true benefit is not telling a business what it is doing right, but where it lags. "It's a means to locate problems and make improvements," says Olof Faxander, head of the operational team at Nordic Capital.

Then the business's task is to systematically address its NPS drag factors to improve its overall business proposition and boost customer retention. David Kirby, partner at Livingbridge, says: "When you make an investment decision, if you had a choice as an investor between a business that was really good at finding customers and not very good at keeping them, versus a business that was a bit mediocre at finding them but good at keeping them because they offered a great product or service, and great support, I'd always take the latter."

Belief in the value of a business's product or service sits at the heart of an investment decision. However, Kirby warns using NPS methodology is not always fool proof as customers typically never recommend some offerings. For example, people recommend films but generally not cinemas, which would generate a low NPS. "But that does not mean that cinema business is good or bad – you need to consider the context," he adds.

Operating partner

Operating partners are prolific. Most firms have them, but the model differs across the industry.

For some managers, 'operating partner' still refers to the occasional involvement of an external industry specialist or advisor to aid the deal team in key aspects of a company's transformation. For many more, the concept now describes portfolio or operating teams of in-house professionals directly accountable for value creation.

Portfolio or operating teams typically include a mix of people with specific industry backgrounds, functional specialists and former management consultants. Increasingly, they perform a key role in contributing to pre-deal due diligence and value creation planning, devising value creation 'toolkits' and other work toward the investment decision. Post-deal, after assisting bringing the new acquisition on board, they take a leading role in its operational transformation and growth initiatives.

At its most evolved, the operations or portfolio team works closely with the deal or investment team and is similarly incentivised. "We try to make sure there is organisational alignment and to achieve a blended team," says Dawn Marriott, partner and head of the portfolio team at Hg. She adds: "Whether from an operating or an investor background, [we try to ensure] that the teams collaborate, because that will drive value."

Alain Vourch, partner at Charterhouse Capital Partners, echoes this. "The portfolio team works in an integrated way with the investment team to support management teams in the value creation agenda. This triangle needs to work well together."

This model clearly shows how much more engaged private equity firms now are in creating value at their portfolio companies. No longer just occupying a board seat as an operating partner, now during the implementation of the value creation plan, portfolio team members could be deployed full time at the portfolio company.

Key to the role's evolution, and GP perception of its value, has been rising amounts of capital targeting private equity and subsequent competition for assets. Having operational expertise is a differentiator.

"What a PE house has to do between entering a deal and exiting four years later, is very different to 30 years ago when you backed a decent team, put in a non-exec chairman and enjoyed the ride," says Andrew Ferguson, partner at Baird Capital. "Now it is much more focused on how a [private equity] house brings value, given you have a high market price for an asset, a limited timeframe and have to meet return aspirations."

Skills and experience are key. "Operational value creation comes from understanding the skills your team brings and backing companies where your firm is the logical partner," says Martin Calderbank, managing partner at Agilitas Private Equity. "While the Agilitas team has a number of transformational specialists, we're all operational investors. Being focused in approach and selective in the companies to back allows skills to be honed and for replicable, consistent means of creating value to be developed."

KEYNOTE INTERVIEW

Reaping the benefits of RPA

Machine learning solutions can play a key role in any firm's value creation arsenal, with a minimum investment of time and resources, says RSM's Dave Noonan

A great deal of the discussion surrounding artificial intelligence in private equity concerns its revolutionary potential, and without question that can be exciting and worth examining. But that focus can serve as a distraction from what machine learning solutions can do right now for GPs and their portfolio investments.

Those solutions might not be smart enough to replace the deal team just yet, but their ability to automate and continuously improve processes and procedures can have a real impact on the bottom line at portfolio companies.

We sat down with Dave Noonan, principal with RSM's private equity consulting practice, to discuss what Robotic Process Automation solutions can provide the industry today.

SPONSOR
RSM

Q How should GPs be thinking about RPA solutions?
RPA solutions are another lever of value creation GPs can pull, and one they use at various times during the investment cycle. Whether they're doing a carve-out or an add-on acquisition, or merely looking for synergies at a given target or platform, RPA solutions can drive additional cost out of the business.

In my experience, private equity firms have done a stellar job at driving operational efficiencies through various process improvements, but RPA solutions and related technologies can create even more efficiencies, and with an AI component, these technologies continue to improve all by themselves.

Q What kind of processes can these RPA technologies best automate and improve?
Any processes that are largely manually driven, that are frequently executed and require access to more than one system to complete. Any process where there are multiple iterations, such as new employee onboarding, where a new worker has to set up their ID and desktop interface so they can access all the relevant systems.

Things like accounts payable and accounts receivable, where we see a ton of activity because it's usually manually driven: an invoice hits someone's desk and has to be recorded in one system and approved through another. This process is time-consuming, repetitive and easy to automate.

Q So RPA solutions automate these functions, but beyond that, how do they improve these processes?

The digital bots doing the work now aren't like their human predecessors; they don't take coffee breaks or leave at six to go home. They work 24/7, 365 days a year. And the AI component learns how to execute this process faster and more efficiently as it goes along. But there are limits here. If the company has a bad process at the beginning, AI won't necessarily fix it all by itself, at least at the moment.

It's why our recommendation is to take a "process first" approach, so GPs make sure they have the right process infrastructure in place, the right organisational structure to manage the function, and then apply the appropriate tools to drive and sustain efficiency. It can improve almost any process, but there has to be a base level of competence to those procedures at the start.

Q Where should GPs begin to automate? How do they evaluate where automation can have the biggest impact?

"Where do we start?" is probably the most frequently asked question that we get. And I think GPs need to look at the process attributes of particular functions, say accounts receivable. Maybe there's a big AR department and the outcomes aren't great, with DSOs being unnecessarily extended. The next question is how easily such systems can be accessed via a technology platform.

Basically, it's about deciding if it's worth doing, or even feasible to do. And we find with accounting, HR and some sales functions, there are a number of places to leverage these solutions to great effect. Say, within the sales department, we've seen RPA reduce the close cycle from 30 days down to only 18.

Q What kind of upfront investment in time and money should GPs expect to make in these kinds of RPA solutions?

Most of our clients will have glaring places where RPA solutions make sense, say the finance or HR function, and we'll get to work quickly. The complexity of the job will always influence the timing and cost, but in general they can get started on the low end, inside 45 days and for between $25,000 and $50,000.

"Private equity firms have done a stellar job at driving operational efficiencies through various process improvements, but RPA solutions and related technologies can create even more efficiencies"

Our process is a four-step approach. First, there's an initial assessment of process environment, of the quantitative and qualitative aspects of a process, and whether they should do an automation project. Second, we'll do a quick pilot programme on one of those processes. Once that's completed, we will move on to the other relevant processes and as we dig into that, we train the user group so they can move it forward themselves.

Q How do you quantify the ROI on these types of investments?

Reduction of headcount is the most visible and immediate return on investment. That can prompt some scepticism among current employees. If a portfolio company has a large accounts payable team and this automation solution might remove 50 percent to 75 percent of that staff, there can be pushback.

But headcount reductions aren't the only ways these bots deliver value. They can free up the current staff to do higher level work, like strategic initiatives, which might be more interesting than those very repetitive manual processes. And those processes will continue to improve thanks to an AI component that will be looking for new efficiencies long after the last worker went home.

Q How should GPs vet service providers in this space? How important is it that a service provider has experience implementing RPA solutions within a given industry?

Industry experience can help understand the infrastructure, but with this technology, functional expertise is probably more crucial than market expertise. The work that these solutions are automating in accounting, HR, supply chain and sales are broad disciplines where the fundamental processes are very similar.

However, within those broad categories, the service provider should have specialised teams devoted to continually improving those broad categories. That's pretty much table stakes at this point. If a service provider can layer specific industry experience atop that, even better. Of course, it's also a matter of the service provider offering references and case studies to help the GP select the right fit for the firm.

Q Once a GP has begun using RPA solutions, how can they stay current to ensure they're deploying the best possible tool? Or does the AI evolve all by itself?

Those machine learning bots can improve processes all by themselves, but there's always the possibility that some other solution will prove a massive leap forward. There are some options to tap outside consultants that can provide some independent analysis and advice on whether an upgrade is warranted, but I do think GPs can do their own homework online.

The truth of the matter is today's bots are quite powerful, and do plenty without looking for the next best thing. For now, RPA solutions are still cutting edge. ■

Pricing

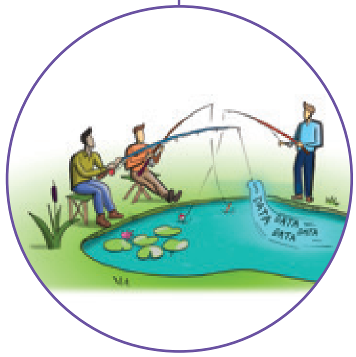
Pricing is a core driver of revenue growth. However, management teams are often extremely wary of changing it.

"Pricing is often one of the most challenging topics for management teams to tackle, because it's complicated and doesn't fall squarely into the remit of one particular team," says David Kirby, who leads the growth acceleration team at Livingbridge. "If you are a founder, you've spent so long building relationships with customers that the fear of losing [them] can be a barrier. Often with SMEs, pricing is a subject that's never been on the table."

However, this fear is based on a misconception that a pricing strategy means putting prices up, Kirby says. "Often this is not the case; it's about fundamentally understanding the value you are creating for your customers or other stakeholders, and how aligned that is with the value you are extracting. Some of your customers would have paid more. Your task is to find out who," he explains.

"Pricing is tricky and I've seen many projects where pricing at first glance looks very, very difficult to do anything with," says Olof Faxander, head of the operational team at Nordic Capital. "But when you start to think about it creatively you find a lot more avenues."

He cites Nordic's realised investment in Danish shipping business Unifeeder as an example. Nordic was able to adjust pricing at the business, where contracts were competitively tendered, by identifying areas where it could charge additional fees, for instance for customer-caused loading delays. The result "greatly enhanced the profitability of the business", says Faxander. The customer response? "They understood the logic in the pricing model because it focused on the added value and not only on the additional costs."



Quants and data lakes

The jargon can be confusing. There are data lakes, warehouses, pools and even swamps.

A data lake, like a warehouse, describes a repository of large volumes of data ready to be extracted and interrogated to answer business-critical questions. A dedicated analytics function "typically doesn't exist when we invest", says David Kirby, partner and leader of the growth acceleration team at Livingbridge.

Consumer-facing e-commerce businesses are typically ahead on collating data, while B2B service providers lag, says Kirby. Data may be dispersed across different software and systems, including CRM, finance and HR functions, and is often not aggregated. SME businesses can also miss out on realising the wealth of data at their disposal because they have not had the "time, capability or imperative to understand what's going on under the hood from a data perspective", he says.

When investing in a business, helping them build this capability is "foundational to everything else that follows", Kirby says. "This means getting the purest form of data and then starting to surface it to make it available across a business. Then it can start answering questions that management never thought it would be possible to answer."

Collecting data also has direct commercial applications. Charterhouse Capital Partners assisted exhibition operator Comexposium to put in place a data lake to upgrade the business's digital marketing, says Charterhouse partner Alain Vourch. This gave it "the ability to generate more qualified leads for exhibitors and better match visitors' expectations", he says, which was key to the business that the GP sold in March 2019.

Revenue enhancement

Scaling revenue, along with improving margins and driving profitability, sits at the heart of value creation.

Powering top-line growth requires a hands-on approach to address a range of topics from pricing to sales effectiveness, to product and services mix to research and development, as well as business development: finding new customers, marketing and brand enhancement.

It is a meaty task and the benefits may take a while to surface, posing the risk that these initiatives are abandoned in favour of more immediate gains. Yet the rewards can be hefty. "We break the revenue process into its individual components, addressing existing clients and prospective ones," says Andrew Ferguson, partner at Baird Capital. "If you can improve all of that by 5 percent, that accumulates to a significant improvement in revenues."

It requires multi-tasking. "Revenue enhancement is most powerful when undertaken on a multi-dimensional basis, consistent with the unique and fundamental qualities of the business," says Martin Calderbank, managing partner at Agilitas Private Equity. He cites the example of portfolio company Recover Nordic, which operates across the Nordic region to provide emergency response services to help mitigate the impact of water and fire damage.

"We helped management with multiple avenues of business transformation, including organic geographic and service range expansion, the use of information systems to improve efficiency and service quality, and strategic acquisitions to enter new markets," Calderbank says.

The result? "These initiatives saw Recover Nordic average 9 percent organic growth per year under our stewardship, with profits more than quadrupling," he says.

Supply chain optimisation

Streamlining a supply chain means juggling many moving parts.

This includes cost savings and spend, sourcing and outsourcing, market disruption and business continuity, analytics and digitisation, regulation and globalisation, to name a few. Increasingly, GPs are concerned with an additional set of complex considerations: environmental, social and governance risks.

James Bousher, senior manager, operations performance at consultancy firm Ayming, sees a number of GPs and chief procurement officers at private equity-owned businesses grappling with integrating ESG into a supply chain strategy. To retain control of risks and grasp the opportunity requires resources, time and effort, he notes.

For CPOs often focused on savings targets, recognising the value of ESG requires a shift from short-term decision making to longer-term procurement planning, Bousher says. "Some [initiatives] go hand in hand," he adds, pointing to using slimline packaging that cuts costs and benefits the environment.

For others, the benefit is not as obvious as the additional cost. "GPs need to encourage their portfolio companies to make conscious decisions based on ESG," says Bousher. This includes introducing sustainability targets throughout the supply chain, in addition to conventional commercial milestones.

The issue of ESG is particularly pertinent "if you're in consumer goods where it's absolutely essential that you maintain very high ESG standards", says Olof Faxander, head of the operational team at Nordic Capital. "If you don't, it can cause enormous damage to that investment." On the flip side, if ESG issues are managed well across all industries, businesses can accrue significant benefits, Faxander says, which include customer appreciation and product differentiation.

Time constraints

With a self-imposed investment horizon of three to five years dictated by a fund's life cycle, time pressure is literally part of the deal. And it begins way before signing.

"The time constraints in a deal process are huge," says David Olsson, partner at advisors Beyond the Deal. As GPs look to acquire, the risk to value creation is that they do not spend sufficient time pre-deal looking at synergies and the business's operating model and how to change it, he says. "Proper pre-deal planning means you can be more effective post-deal."

"Time is our most precious resource and something that we always need to treat as a scarcity," notes Olof Faxander, head of the operational team at Nordic Capital. "A key thing that ensures that you use time in the best way is preparation."

This means doing your homework so post-deal you can prioritise and focus to make the most of the time available. "For me, management is key, because you can have a great plan but if you don't connect that to great management you aren't going to get great results and it always takes a while [to find the best people]," he says.

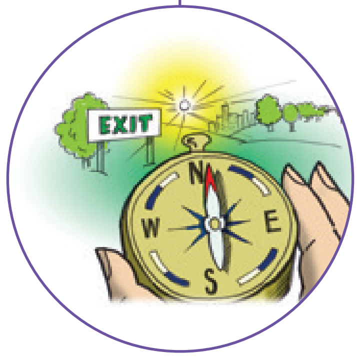
Unvarnished reporting

Not only is consistent reporting that tells the full story a central element of effective governance, it is fundamental to accurate data collection and performance measurement.

"We want to have complete transparency around performance because that is how you make the right decisions on what to do next from a strategy and execution point of view," says David Kirby, partner at Livingbridge.

"Transparency is absolutely key," adds Alain Vourch, partner at Charterhouse Capital Partners. "Ultimately, what gets measured gets done." This applies to financial and operational performance KPIs, he says.

"We often find that improving the financial transparency and operating cadence/management processes of smaller-mid-market companies is a significant value creation lever," says Andi Klein, investment advisory professional at Triton, responsible for the firm's Smaller Mid-Cap Fund. To do that the team works with "management to develop rigorous management, accounting and financial analysis practices to improve transparency and efficient and effective processes to influence business developments," he notes.

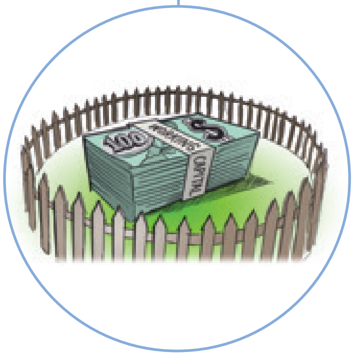


Visionary approach

Everything starts with the vision. It is the cornerstone of any value creation plan.

The vision includes understanding where you want to take the company in terms of its market position, business model, organisational structure and geographical footprint, says Alain Vourch, partner at Charterhouse Capital Partners. "The vision is going to be your compass. If you don't have that, the risk is huge that you will get distracted along the way, especially in the environment we're in, and even more so for a buy-and-build strategy that includes many add-on acquisitions."

Despite its central importance, articulating a vision might be entirely new for a business. "In our experience, some smaller and mid-market companies may not have a clear strategy, or may have outgrown their existing strategy, resulting in a lack of direction and reduced growth prospects," says Andi Klein, investment advisory professional at Triton, where he is responsible for its Smaller Mid-Cap Fund. The task then for the GP is to work with the management team to create a value-creation blueprint.



Working capital

While operating partners zoom in on top-line growth and profitability, working capital can often be overlooked.

Filip Debevc, senior manager, Deals at PwC Germany, says: "Working capital due diligence is becoming standard to protect capex and cash management. The focus is moving below EBITDA and top and cost line improvements. However, companies often do not put working capital on the agenda."

By broadening the scope of pre-deal due diligence to include working capital, investors are in a better place to identify and manage cash flow risks and make capital expenditure decisions once the business has been acquired. "If your business is growing its top line by 10-20 percent per annum, it's sucking up a lot of cash into debtors," says Andrew Ferguson, partner at Baird Capital. "[Working capital] is a constant issue that small to mid-size businesses really struggle with as they grow."

Keeping a close eye on the business's terms of trade and debtor book are necessary to effectively manage the working capital cycle and to ensure that it does not lengthen, as is monitoring intra-month cycles to guarantee that funding is available to mitigate swings in cashflow. The quality of customer relationships, being clear on contract terms and enforcing them while making it easy for clients to pay, as well as assigning roles and responsibilities within the business around working capital, are key to ensuring invoices are paid on time. Bad habits can be hard to break.

"The devil is in the detail," says Ferguson. "Make sure you know who, when and where to send your invoice."

3x... 5x... multiples

Deal multiples hover at historic highs thanks to a seemingly unstoppable flow of capital into private markets, but overpaying for an asset remains a prevailing risk.

That poses a significant threat to value creation and investor return expectations. Whatever price a GP pays today they will have to receive more at exit.

One way to mitigate the risk of overpaying is to expand the scope of due diligence. "The effort put into undertaking due diligence is increasing in order to gain a better understanding of complexity drivers, to argue a value creation story, and to explain high multiples," says Friederich von Hurter, partner, M&A Integration at PwC Germany.

By identifying internal value drivers and external factors determining the scope for future growth – market conditions, size and the degree of the business's market penetration – the portfolio team (and its advisors) can contribute to the price assessment. This is not simply to indicate if the asset is too richly valued, but also to give the deal team the confidence to pay more if the growth potential is there, says Dawn Marriott, partner and head of the portfolio team at Hg.

"Value creation and how you build it starts when you consider the deal," Marriot adds. "Operators apply a real-world lens, and from experience they can say, that's not a viable value creation plan, it's too ambitious or, conversely, it's not ambitious enough. With some intervention and support, maybe the business could go twice as fast." And that is an opportunity GPs would not want to miss.

Your 100-day plan

Clarity is key when it comes to the 100-day plan, but it should be underpinned by measurement points.

"People have very different approaches regarding the 100-day plan," says Alain Vourch, partner at Charterhouse Capital Partners. Whether a GP calls it a 100-day, strategic or value creation plan, roadmap or blueprint, or onboarding, it is evident that, "early in the deal you need a clear plan with a set of value drivers that everyone understands, supported by robust action plans and clear milestones", says Vourch. "That is a key success factor."

Dawn Marriott, partner and head of the portfolio team at Hg, agrees. "You need a starting point and real clarity around your vision, your strategic goals and financial objectives and timeframes and measurement points along the way. That's how you engage a large group of people," she says. "The timeframe depends on complexity. The value creation plan doesn't start on day one. It starts when you start to consider your investment."

In devising the plan, "you need to go back to first principles and ask what's the rationale for the deal and how does that translate to valuable objectives, benefits and synergies and what is the operating model that you need to realise that?" says David Olsson, partner at Beyond the Deal. "You have to have a process that measures and monitors the value you are trying to create, otherwise, it's just hope."

And some managers devise a number of plans. The team running the Triton Smaller Mid-Cap Fund develops 365-day and four to five-year plans together with management. This involves a "strategic and operational review to develop and stretch the potential of the business and assess whether we need to draw in additional capabilities and resources to execute the strategy and plan", says Andi Klein, investment advisory professional at Triton with responsibility for this fund.

Zero-based budgeting

Effective budgeting is behind a range of business-critical decisions from resource allocation to funding.

Zero-based budgeting, a method that constructs a budget for every new cycle by reassessing each business division's needs and costs, has been prevalent in government and non-profit organisations. Now, it has made its way into the private sector. And increasingly, it is a GP's budgeting technique of choice.

In a nutshell, zero-based budgeting means "building a budget from the ground up using a very granular approach", says Andrew Ferguson, partner at Baird Capital. "It's an exercise where private equity can be quite helpful in guiding a business. It gives a more realistic view and holds people to account."

Putting together a budget as if a business has never had one before rather than tweaking the last cycle's numbers requires looking with fresh eyes at revenue assumptions, talking to the sales team and clients, reassessing the sales pipeline and re-examining operating, sales and employee costs.

A zero-based approach is more time consuming and labour intensive than budgeting compiled on expected performance, and involves more data collection, paperwork and skill. But the benefits are numerous: a more efficient allocation of resources; greater incentive to find more cost-effective ways of operating; better intra-business communication and alignment with objectives; less possibility of inflated budgets and waste going unnoticed. Critically, this process bestows ownership of budget targets onto the team that provided the figures and holds them accountable for meeting them.

Value creation points of view

“We believe the opportunity to create value through data is now greater than ever before”

Duncan Ramsay, investment director at ECI Partners, which recently built a lead-scoring model to assist a portfolio company in efficiently allocating its sales resources

“We often find that improving the financial transparency and operating cadence/management processes of smaller-mid market companies is a significant value creation lever”

Andi Klein, responsible for the Smaller Mid-Cap Fund at Triton, where the team works with management to develop rigorous accounting, management and financial analysis practices

“For us, value creation is about accelerating sales-led profit growth”

Philip Edmans, partner at Inflexion Private Equity, says leverage can be beneficial in both creating extra firepower to finance acquisitions and in facilitating operational improvements or expansion

“The value creation plan doesn’t start on day one. It starts when you start to consider your investment”

Dawn Marriott, partner and head of the portfolio team at Hg, stresses the need for clarity around strategic and financial goals when developing a value creation plan

“The vision is going to be your compass. If you don’t have that, the risk is huge that you will get distracted along the way”

Alain Vourch, partner at Charterhouse Capital Partners, on why vision is a foundational component of any value creation plan

“Operational value creation comes from understanding what skills your team can bring and then focusing on backing companies where your firm is the logical partner”

Martin Calderbank, managing partner at Agilitas Private Equity, who advocates for a focused approach to company selection in order to develop a replicable means of creating value

“Pre-deal planning means you can be more effective post-deal”

David Olsson, partner at Beyond the Deal, says insufficint pre-deal planning is a risk to value creation