FOCAL POINT |

Creating Value Despite Ambiguity

Driving Growth with "Less Than Perfect" Information

Co-Authors |
Steven Koinis, Managing Director, Private Equity, Catalyft LLC
John Bova, Transformation and Operational Excellence Leader, Private Equity and Portfolio Firms

The 21st Century has delivered monumental situations requiring business leaders to drive transformational change in some very risk-heavy settings with less than perfect information.

- **2001** 9/11 terrorist bombings in USA
- **2007-8** global financial and middle market credit crisis
- **2020+** COVID market responses *(adjusting customer journey interactions and supply chain management while most employees work from home)*

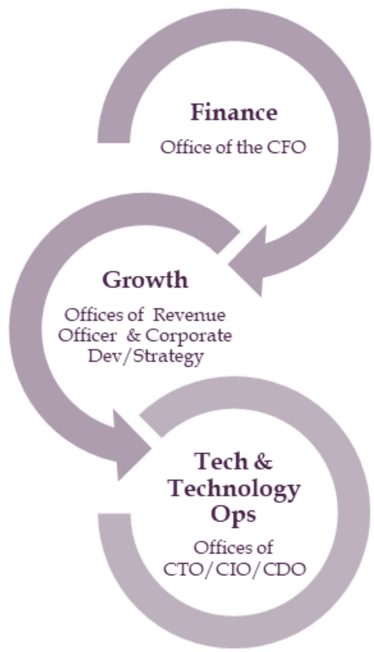
As companies think about the annual budgeting and planning process against the backdrop of unusual social and economic challenges, firms must consider how these "black swan" events impact the ability to survive at the very least and, at best, what needs to be done differently to drive innovation, growth, and resilience in a risky, ambiguous environment. New executive leaders have had to onboard quickly *(these days mostly remotely),* build consensus on limited initiatives and drive organizational performance within complex circumstances and without decision support clarity. Consistent threads running through these high-impact 21st Century events are leaders have had to get out of their comfort zones, become more creative in developing growth options and more agile in their collaborative decision-making to provide higher returns. The ability to manage ambiguity, applying ever-evolving information in every decision, has created new, more nuanced, more experimental intellectual capacity requiring agile teams to embrace new solutions, test new tools, and think through initiative prioritization differently.

Whether growing or struggling, COVID-induced market responses pose added challenging times in Private Equity-backed companies because most Middle Market portfolio companies generally have grown under the leadership of a founder or family business-type organizational structure and have not had the time or resources to professionalize Management. Too busy running the firm. Professionalization hallmarks we have in mind include developing a long-term financial strategy with an experienced CFO, building up in-house talent management and training, embedding a continuous improvement mindset across functional groups, adopting & integrating productivity-enhancing technologies, deploying data analytics across the organization to manage and adjust business models, and thinking through 1 to 5 year plans with more creative operating contingencies.

Necessity still remains the mother of invention. Facing ambiguous decisions helps facilitate leaner processes and a more engaged teaming dynamic when leaders must consider wide swings and question Sacred Cows. Some weightier questions include:

- What if 50%+ of your work force must be permanently remote?
- What if multiple constraints emerge in the supply chain or strategic partnerships immediately end?
- What if cash conversion cycle time increased by 20%+?
- How to assimilate new add-on acquisitions without being on site? How to align company cultures? Build the Management Team? Keep customers happy in transition? Integrate technology systems and reporting?
- How would you furlough, reduce work force, or hire by 20% in time to meet financial expectations?

If we consider Private Equity Value Creation through a traditional *Finance-Operations-Growth* construct, we learn some new applications in thinking and execution that help us with breakthrough planning in ambiguous environments.



Finance | As the planning process for 2021 begins, all critical success factors (employee talent, data, reports, trend analysis, and ultimate ownership of the plan) flow through the CFO's office. More recently, the trend toward zero-based budgeting has become a more widely-used approach in the planning process.

Zero-based budgeting *is a repeatable process that organizations use to rigorously review every dollar in the annual budget, manage financial performance monthly, and build a culture of cost management among all employees.*

The biggest ***difference*** *between* ***zero-based budgeting*** *and* ***traditional-based budgeting*** *is that capital is not allocated to business units based on previous spending. Instead,* ***zero-based budgets*** *start at* ***zero****, with all business units inside a company* ***competing*** *for each dollar when the new budget is made.*

This approach can be a valuable tool in Year One of a new Private Equity investment—when understanding Finance's organizational influence and how Management thinks through priorities and disciplines are needed.

Growth | What if you applied the spirit of zero-based budgeting to other areas beyond Finance? Thinking of revenue generation in terms of a build up from zero, this approach encourages Management to consider questions such as:

- How are customer accounts managed?
- How are sales compensation and incented behaviors impacted?
- How are existing clients versus net new logos viewed?

Like a zero-based budget approach for Finance, Sales & Marketing leadership are considering the lifetime value of customers and client(s). Actions to be taken on this approach include understanding customer requirements, extrapolating needs from surveys, reviewing the empathy mapping and client experience simultaneously, allocating internal resources dedicated to Voice of the Customer, and developing customer reward programs. This path entails a "clean white board" approach to the overall value of the customer to the firm. It's a powerful but complex tool to consider because deconstructing a sales organization may force multiple challenges like customer interaction models, pricing, compensation, and new market development to the surface. In a year like 2020, it may make more sense for a company to deconstruct last year's planning, rebuild it with a new approach, reassess KPIs and move on for 2021.

Technology/Tech Ops | This area is usually a place where budgets are developed for technology upgrades, asset acquisitions for tech ops, and go-forward technology architecture. This is also a place where technology expenditures are in danger of moving away from user requirements. For a new Private Equity portfolio company, key concerns include month-end reporting, technology integration and training expenditures, "current state" data governance/management programs, and scalability of all enterprise software. An additional overlay would be cloud migration maturity and cybersecurity programs. A zero-based mindset would require the organization to think how each layer of technology hardware and software drives value creation. If the stakeholders, users, and those who make those decisions cannot defend the continued maintenance, licenses, and long-term value in its use, then it goes. This may also aid later conversations and decisions per cloud migration and stacking initiatives to address the technology deficit that comes from having a collection of older software and policies that no longer support growth and value creation thesis initiatives.

Overlay of Human Capital and Digitization | While these two areas have not historically been the focus of traditional value creation areas, they are critical to success. Could the zero-based budgeting construct hold value in these areas too? For digitization, it should be viewed as a lever within growth like revenue/client review, compensation and KPI development. Digitization does have Technology/Tech Ops alignment. A first step would be to move from IT due diligence to a "future state" roadmap and then add in digitization pillars outlining how the tech stack provides value and growth in customer experience, employee engagement experiences and overall thesis alignment of accretive valuation across the investment timeline.

Human capital assessment and review starts with what the "new normal" is doing to employee experience and assessment of current state organizational chart. Private Equity ownership does create dynamics and questions within an organizational chart that must be addressed or allowed to evolve until a decision is required versus one that may be rushed. Aligning a "future state" to value creation through a human capital strategy will be needed to match near-term and long-term talent requirements with profitable growth. Introducing this approach while driving value in a world of ambiguity may be too much to ask of some C-suites. Specific Human Capital assessment pathways need to be considered early and adjusted with the annual planning process.

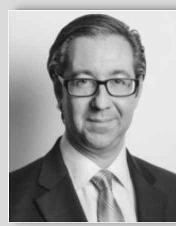
Middle Market leadership in PE-backed companies have always had challenges to address – now made more difficult in a 21st Century world where cataclysmic events, proliferating technology, and market disruptions outside of Management's control impact growth/success or mediocrity/failure. A level-setting of the PE fund's growth thesis with the portfolio company's tribal knowledge and industry expertise need to be married quickly upon acquisition and revisited often as the firm grows.

Circumstances may require an organizational bootcamp or trapped value analysis to align organizational expectations, update the company's Strengths-Weaknesses-Opportunities-Threats (SWOT) analysis with latest investment goals, agree on the go-forward tech stack with relevant KPIs, and craft internal & external messaging to accelerate transformation. Through timely organizational questioning, analysis of knowledge areas, and certainly some uncomfortable conversations regarding concerns, the leadership team can see more opportunistic pathways despite ambiguous environments. Overcoming challenges supports more agile risk mitigation plans for the future. Capitalizing on opportunities creates stronger alignment with Private Equity ownership as well.

About The Authors

Steven Koinis

Steve leads the Private Equity Practice for Catalyft LLC, a practitioner-led, boutique operating partner firm focused on strategy implementation and operational improvements in Middle Market businesses acquired by Private Equity, investment firms and Family Offices. Steve has held several senior executive positions with the sovereign wealth fund Abu Dhabi Investment Company, Huron Consulting Group, and as C-level executive and Board member of private firms in the US, Europe and Middle East. He earned his MBA from Harvard Business School and has two Bachelor of Science degrees in Mechanical and Materials and Metallurgical Engineering from University of Michigan, Ann Arbor and speaks conversational Greek, German and Arabic.



John Bova

John is a Transformation and Operational Excellence Leader in Private Equity Firms and Portfolio Companies. John has played many roles in the private capital space over 30 years Including senior executive to fast growing middle market companies, Independent Sponsor, PE and Family Office Advisor and Consulting Practice Leader.