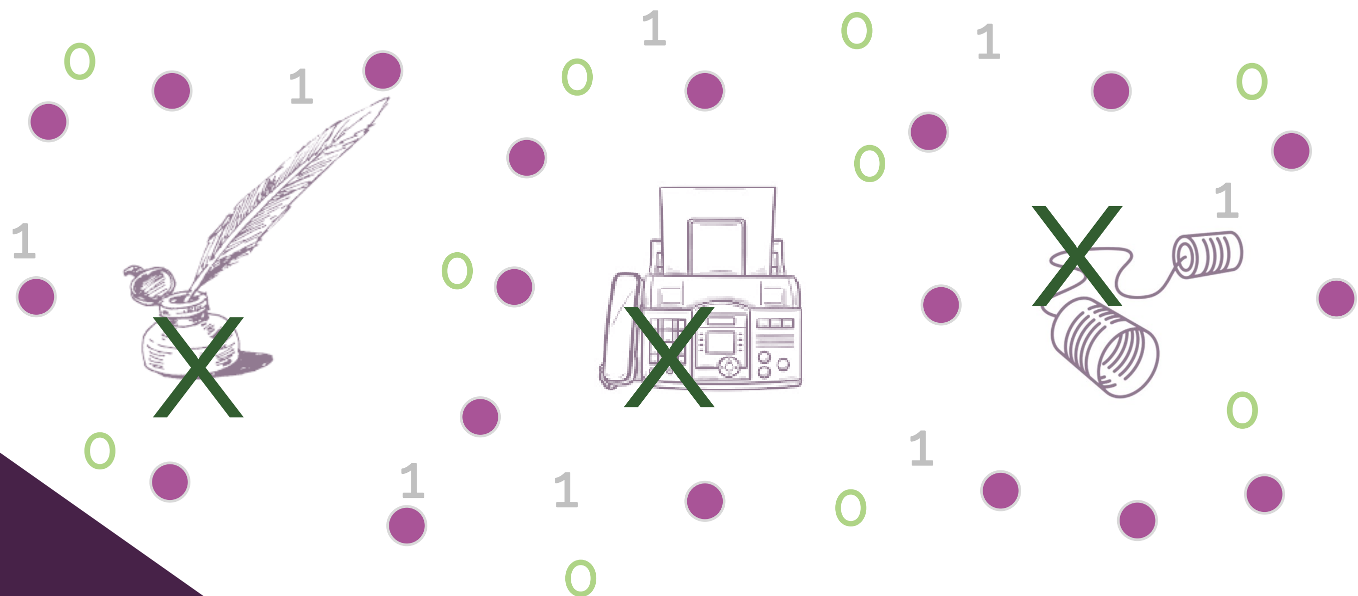
FOCAL POINT |

Building Up Digital Capabilities in Private Equity Portfolio Companies



Driving Growth in Private Equity Portfolio Firms With Technology

Co-Authors |

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The pandemic has accelerated the adoption of digital processes and tools. Changes in customer interactions, work protocols, and team collaborations brought on by COVID-19 have forced Private Equity deal teams and post-close operating resource groups to consider wider adoption of new intelligence gathering avenues for near-term due diligence and longer-term organizational capability build-up. One area of outsized impact is considering where the firm stands on its digital transformation trajectory and what other systems need to be put in place to achieve growth objectives.

As a starting point, the definition of digital transformation we have in mind:

Digital Transformation is *the adoption of digital technology to transform services or businesses, through replacing non-digital or manual processes with digital processes or replacing older digital technology with newer digital technology.*

Assessing and upgrading technology to meet strategic goals entails a deeper look into both internal user requirements (employee and contractor experiences) and external user needs (customer experience and supply chain partner requirements). This is at the center of building up a firm's digital capabilities to drive value.

Why do some firms lag behind their peers in consideration and adoption of their own digital transformation? Each firm has its own litany of reasons (or excuses). Several popular ones include:

- **Too expensive –** every firm is rightfully concerned about getting the most out of their technology expenditures and may not see a clear path to the return on investment they need to open the company wallet

- **Lack of awareness** – an organization may not know what technology options exist that may suit their business needs

- **Fear of complexity –** horror stories abound on technology integrations gone awry where the only sure thing delivered was the bill

- **Light on internal, technical subject matter experts –** some firms take a do-it-yourself approach to technology and bring on new technology upgrades only if their own team has the capacity or the interest to do so

- **"If it ain't broke, don't fix it" taken too close to heart –** some firm processes and tools seem to be working perfectly fine by Management's account and they are hesitant to rock the boat. However, this bit of wisdom does not earnestly consider the potential of efficiency and productivity gains for employees and experience-enhancers/frustration-reducers for customers and suppliers.

New Private Equity investments are complex transactions where historically sound diligence approaches involve assessing quality of earnings, IT maturity, operational due diligence, market studies, and talent management surveys formed the bedrock of diligence – with the investment decision further augmented by onsite management meetings, tours of key operations, and executive interviews.

The pandemic has changed the onsite portion dramatically. A firm's technology stack now must be viewed in terms of outdated technology (a business liability) vs. efficient technology (a strategic enabler).

A firm will need to have a much greater sense of their technological capabilities to enable growth drivers like customer experience (CX), personalized marketing, and automated operations. Migrating time-consuming, labor-intensive business processes to digital workflows will begin to play a much greater role in value creation planning and execution than even a year ago.

Assessing the scalability of the tech stack and alignment to a digital strategy should be fully assessed at diligence, or immediately after close. This near-term focus provides not only scalable technology options when add-on acquisitions are considered but also surfaces tech systems integration risks and data flow constraints the team must address. Smoothing out these operational concerns and empowering the team with pragmatic solutions customized to the business model will speed up how quickly the acquisition becomes accretive.

Technology's role in driving the business is at risk of standing in the shadows during the investment decision-making process in both middle market and large enterprises. A tech-focused operational due diligence rightfully includes both opportunities and risks within current technology assets while providing a road map for remediation and change more intimately aligned with growth goals. If only a cursory operational due diligence is applied, technology assets are not understood at the level of detail to include data lakes, cloud migration impacts, governance maturity, cybersecurity protection, and satisfaction of user requirements at the enterprise level. While lack of attention to these areas during acquisition is troubling, introducing add-on acquisitions as a way to growth—without providing a sound integration plan along with access to technical expertise and employee training programs—could lead to a messy, expensive acquisition assimilation timeline.

Post-close value creation methodologies and processes have historically assessed priority of initiatives across four areas:

1. Financial & operational reporting
2. Technology alignment to growth initiatives
3. Tech-enabled operations & supply chain optimization
4. Add-on integrations and continuous improvement

Across these four areas, there is an overlay of Human Capital Strategy and Talent Management to support these functional areas with the right people in the right seats.

Operational due diligence has historically focused on backward-looking and current period data. Trends analyzed during operational due diligence become performance improvement baselines grossed up with longer-term expected growth rates. Interesting technology initiative artifacts could range from enterprise resource planning (ERP) upgrades to data visualization and information distribution strategies to conversations of on-premises versus cloud-based architectures. The go-forward decision-making responsibility typically resides in the Chief Technology Officer (CTO) area working in conjunction with the functional groups. However, the real decision-making authority has become more interconnected with Finance-Human Capital-Growth interests as organizations employ more effective technologies to support their customers, employees, and vendor partners.

Traditionally, Finance & Accounting apply digital technology assets to go from a backward-looking view (such as: why is our 6-month trend in days sales outstanding going the wrong way?) to a forward-looking, proactive posture of execution (for example: customer experience data has guided us to reduce invoicing frustrations and payment constraints, thus driving cash conversion cycle from 75 to 60 days).

Prevalent digital upgrades along the investment timeline

Due Diligence

- Data Rooms, Data Hierarchy & Warehousing
- Data Normalization Approaches
- Customer and Supplier Surveys and Service Level Agreements
- Tech Assets & Licensing Agreements
- Tech Stack Risks and Opportunities
- Operational & Financial Reporting Capability Assessments
- Current Technology Initiatives

Acquisition

- Operational & Financial Trending | Data Visualization
- External and Internal User Requirements
- Management Planning & Performance Review Tools (ex. Workflows, Dashboards, etc.)
- Project Management Office (PMO)
- Key Systems Integration Needs (ex. ERP, CRM, HRMS, S&OP, etc.)
- Tech Training Programs and On-Demand Resources
- Legacy Tech and SaaS Subscriptions – Keep, Cut, or Trade Up
- Digital Technology Road Map

100-Day Plan / **Talent Development**

- Data Warehousing and Information Flow Reconfiguration
- Operational & Financial Dashboard Development + Distribution Channels
- Talent Management Systems (Recruiting, Hiring, Training, Promoting)
- Customer Experience (CX) Data and Digital Touch Points
- Time and Materials | Enterprise Resource Planning Systems | Sales & Ops Planning
- User Permissions and Workflow Management Systems
- Digital Asset Management (DAM)
- Web-Based Communication and Collaboration Software (ex. Slack, Teams, Zoom, Jira, etc.)

Sales & Marketing Build-Up

- Customer Relationship Management (CRM) System
- Omni-Channel Customer Service Capabilities
- Front-End and Back-End E-Commerce Platforms
- Sales & Marketing Content Management Systems (CMS)
- Digital Products & Services Marketing Collateral | Educational Materials
- Pricing, Compensation, and Profitability Analytics
- Customer Journey Mapping and Analytics

Products & Services Innovations / **Operations & Supply Chain Optimization**

- Innovation | Concurrent Engineering | Rapid Prototyping Digital Collaboration System
- Intellectual Capital | Engineering Diagrams | Process & Procedure Digitization
- Internet of Things (IoT) | Real-Time Analytics Upgrades
- Data Visualization | Business Intelligence (BI) Software
- Artificial Intelligence (AI) Applications (ex. robotics, digital customer assistants, behavioral algorithms, etc.)
- Supply Chain Optimization Software (ex RFID programs, fleet management, vendor managed inventory, demand sensors, etc.)

Acquisition Integrations & Continuous Improvement

- Updated Technology Integration Road Map | Acquisition Assimilation
- Knowledge Management System (KMS)
- Tech Maintenance and Continuous Improvement Approach
- Iterative Tech Ecosystem Review – Keep, Cut, or Trade Up
- Tech Subject Matter Expertise – Build Internally or Hire Externally?
- Technology Sampling and Experimentation | Beta Tests
- Cross-Portfolio Technology Applications

Finance organization and operations leadership can drive other levers through the digital maturity journey. For example, employee experience improvement can have a cost reduction impact via workflow automation optimization and less frustrated employees moving on to greener pastures. All through a firm's own digital transformation journey. Technology tools become value enablers when growth plans are aligned with user requirements, systems integration risk & rewards, optimized work processes, on-demand employee training, and timely tech cost-benefit assessments.

The organizational mindset of technology investments has opened up to incorporate more data sets and perspective - changing from accumulated hardware and software licenses residing within the internal confines of the firm and moving to understanding customer-centric, personalized buying journeys, sharing market analytics with vendor partners, and demanding performance metrics access at any time and on any device. Proliferating technologies, especially all the recent software-as-a-services (SaaS) offerings, provide more options and avenues for growth. But the burden of choice is not without its own problems (analysis paralysis, integration issues, subject matter expertise shortages, buying a Cadillac when you really need a Chevy, etc.)

With private equity ownership holding periods of portfolio companies increasing, there are great opportunities to leverage the initial operational due diligence findings to create a comprehensive post-acquisition value creation road map with a holistic view of the awe-inspiring contribution a specific digital transformation trajectory plays in taking care of customers, employees partners, and investors.

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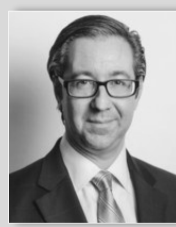
Steve leads the Private Equity Practice for Catalyft LLC, a practitioner-led, boutique operating partner firm focused on strategy implementation and operational improvements in Middle Market businesses acquired by Private Equity, investment firms and Family Offices. Steve has held several senior executive 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. Steve speaks conversational Greek, German and Arabic.



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John is a 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. John has a BA in Economics from Fairfield University and his MBA from Pace University.