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Managing the route towards exit

01 Aug 2011. Source: AltAssets

According to Grant Thornton's Private Equity Barometer, 85 per cent of private equity executives expect to exit more than a quarter of their domestic portfolio companies in the next twelve months, with the overriding majority of exits expected to be via trade sales or secondaries, *writes Jana Klimecki, director of specialist leadership consultancy Tyler Mangan*.

These ambitions play into developments in the wider market, which, according to research from Prequin, has recently seen exits soaring with a record 309 sales worth more than $120bn in the second quarter alone.

Although 'lucky' exit opportunities can arise suddenly for high performing businesses operating in growth industries, most exits are carefully planned and highly anticipated. As one investor puts it, "PE deals are like a marriage, never go in without understanding how to get out".

In a challenging economic climate, investors and management teams have to fight hard to develop the growth track records, profitability levels and market propositions that can create exit opportunities and achieve acceptable return levels. With investors getting increasingly hands-on in supporting management teams strategically, and, operationally in moving the organisation forward, there is an increasing emphasis on leveraging all available levers for value creation throughout the deal cycle.

As financial sponsors prepare for exiting their investments, there are also a number of management factors to be considered to ensure that the value of the business is maximised and the appeal to buyers is high. Although management issues are often fretted over behind closed doors, not many PE-backed businesses are systematic in building the management capabilities and infrastructure to ensure they can command a premium at exit. Doing so requires a robust understanding of the strengths and weaknesses of the management team and its infrastructure, careful planning and a series of honest and often difficult conversations to ensure that expectations around exit routes are aligned across all stakeholders and that management 'exit ready'. This will avoid lengthy (and often costly) exit processes where potential buyers struggle to get comfortable with management issues such as the overreliance of the business on one or two key individuals, lack of experience in scaling the business further, and/or underperformance in certain areas.

So what are the questions that need to be addressed to ensure management is 'exit ready' and that the business can achieve a premium at exit? In our experience, having worked with over 30 teams over the last two and a half years, the questions broadly centre around management's values and motivation, capabilities and skills within the organisation, and the strength of the bench beneath the senior executives.

Values and motivations

It is critical to determine what the longer term expectations and motivations of key managers are, particularly when the expected exit is a secondary overreliance on key executives can be a serious issue for potential buyers. It is important to understand what timelines executives are working towards for themselves and if they would be motivated to 'go around the block again'. If key executives are interested in either stepping back or changing the nature of their involvement, the implications of such refinements need to be discussed overtly with all stakeholders. A clear contract needs to be put in place outlining their new responsibilities, decision making rights and overall targets as vague agreements such as 'I will come in less and let the new team get on with it', can lead to serious conflict and keep other managers from developing their full potential.

Management style and mindset

Working towards an exit will often require a shift in management mindset and style. For turnaround businesses this could, for example, mean a shift from cost control to growth and building the infrastructure to scale the business going forward. Managers who are good at 'stopping the bleed and rehabilitation' may be less adept at spotting growth opportunities and investing profitably in the future of the business. Clearly planning this required shift not only helps management get to grips with the new challenges, but also allows them to bring additional skills and capabilities into the business to support future managers ahead of time.

Skills and capabilities

Depending on the exit route and long term plans for the business, additional skills may be required to ensure it is well positioned for further growth. Common skills gaps in businesses often centre on international expansion, stakeholder management and people management. When preparing for a sale, it is important to map existing skills/capabilities against the future requirements of the business to assess how scalable the current management structure is. It is important to explore and to address questions such as whether the team could manage a business twice the size, implement key processes and professionalise current systems. A robust understanding of the skills and capabilities in the business can not only highlight gaps, but also draw attention to duplication and overlap within the current structures and allow for increasing efficiencies by refining roles and responsibilities.

Bench strength

Key drivers for future growth are the capabilities of the next layers of management. It is important to understand who 'really gets tasks done' and can take responsibility for moving the business forward. Many growth businesses we have worked with operate with a relatively flat, lean structure. Although such lack of 'fat' in the business is integral for cost control, it can lead to an overreliance on a small

number of individuals and a lack of further expansion capability within the business. Establishing clear succession plans for key managers is the first step to ensure individuals lower down the organisation are being developed to step into higher roles in the future. In addition, building scenarios around the future shape of the organisation can highlight requirements at lower levels, for example the need for additional regional managers or additional commercial support. This can be addressed ahead of time by developing and stretching those individuals with potential within the business, and/or hiring strategically at lower levels.

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