The art of prioritisation

Creating value in private equity portfolios

By Jana Klimecki

The economic volatility of the past few years has made growth difficult even for robust and well-run businesses. This has led to an acute focus on thinking more creatively about how private equity-backed businesses can be supported to allow them to compete in the ever more competitive marketplace.

With bank debt still hard to come by and the worrying lack of an economic tailwind driving growth, private equity investors and management teams are having to work harder than ever to create value throughout the deal cycle.

Long gone are the days when the clever financial structuring of a business was considered to be more than half the battle; today that seems to be a mere starting point for value creation. The change, however, has not occurred overnight. Since the early days of the financial crisis it has been slowly creeping into our consciousness and taking root. Now, more than ever, we are beginning to realise that something more is needed and we are seeing investors adopting new and innovative practices to create value in their portfolios.

Over the last few years, more and more businesses have had to focus their resources on optimising their operations, increasing their efficiency and cutting back on costs wherever possible. However, many businesses that have managed to 'shed the fat' successfully in this way and could now be considered efficiently run, still struggle to meet their targets and achieve the all-important top line growth.

As a result, many investors and management teams have begun to seek to explore alternative ways for value creation. There are several routes open to them. One of the ways is to look for acquisitions or buy-and-build strategies to achieve growth. Figures from data provider Dealogic show that, even in the face of a continuing tightening of credit conditions, firms across Europe increased their buy-and-build activity last year, with the total value of deals rising from $5.3 billion in 2010 to $8.6 billion in 2011. The latest *Sunday Times* Deloitte Buyout Track 100, which was published in February this year, reports that one third of its featured businesses have achieved growth through acquisitions. This number is up from the same period in 2011's Buyout Track results.

In terms of achieving organic growth, private equity-backed businesses are working equally hard.

Amongst the businesses we come across, we find that many are engaged in a plethora of value-creating initiatives which range from better management of their virtual presence

and re-branding, to product development and innovation and service improvement. For most businesses, it is not the lack of opportunities for value creation that seems to be the main challenge, but rather the ability to focus, to prioritise effectively and then execute on the initiatives that are going to deliver the biggest uplift.

One of the CEOs we have worked with has outlined the problems facing smaller organisations. He says, “We identified so many areas where there was the potential for improvement during the due diligence phase. We put together a very ambitious and exciting value creation plan but then we struggled to focus on what was most important. We are a small and nimble business and we found ourselves buried in new initiatives without the capability and capacity to deliver on them.”

In many cases, prioritisation of value creation plans is based on the levels of investment that each initiative requires as well as the likely benefits they are expected to deliver.

Often the assessment of the internal capacity and capability to deliver is less thorough than that carried out for the external equivalent. The end result here is that management teams are left distracted and struggling with too many items on their to-do lists and consequently unable to execute any of them properly due to a lack of specific internal capabilities.

As another of our clients, a CEO of a midmarket business, who had found himself in just such a situation, elaborates: “We made it a rule that for every new item added to our plan we scrapped another. We have a somewhat flat management structure and we struggle for senior resource so every time we took on a new project other things fell off our radar. We have got a lot better at this now and we are adamant to do just a few things, but brilliantly.”

In our work we have found that businesses which focus on building the specific capabilities to deliver on their value creation plan from within their teams, and those which carefully prioritise work in light of their internal capacities, are usually far more effective in executing their key objectives and thus are better prepared to drive growth.

So what does it take to build the capabilities required and prioritise effectively to deliver on value creation plans?

Develop clear objectives

It is fair to say that most businesses have a well-developed strategy and a clear understanding of where they want to go. However, it is also not uncommon to find that while the majority are run with a focus on measuring progress towards their financial targets, many of them are doing so without a clear articulation of the key internal objectives that will get them there, nor do they have the criteria or processes in place to measure them properly.

The development of clear, measurable objectives is vital. As one of the financial directors we have worked with notes: “We have put a lot of work into identifying the three key things we absolutely need to do to keep us in the game as well as the three things that will help us within our marketplace. We now review and measure our progress within these areas religiously and structure all of our reporting that way.”

Communicate objectives and define clear accountabilities

Time and again we come across numerous businesses that have struggled to communicate strategic content to their workforce. For some reason, this seems to be particularly true for businesses operating within the private equity arena. It never ceases to surprise us how often middle managers are found to be operating with relatively little awareness of how their work contributes to the overall business objectives and how their performance drives overall value creation.

Our research has found that businesses that manage to clearly articulate their overall strategic objectives to their workforce, and who understand how to cascade clear accountabilities to measure performance at all levels, are the ones that have a much greater awareness of their internal capacity and are more successful in focusing their internal resources on what matters most.

Identify key capabilities within the organisation

It follows on that a greater degree of clarity around key objectives and accountabilities allows for greater visibility around the required capabilities within an organisation. A detailed analysis of what capabilities are required to deliver the desired results can enable the organisation to develop a properly focused programme either for building the necessary skills internally, or for hiring such capabilities externally throughout the deal cycle.

In developing capabilities, the primary focus should be not only on defined technical skills, but also on softer aspects like ‘collaborative working’ or ‘creative thinking’. As one manager of a private-equity backed business explains: “The next buyer is going to be interested in our innovation story, they will be looking for our ability to drive product innovation continuously in our highly competitive market. We have a couple of very creative individuals on board, but we will also need to spread the risk and ensure that we have a ‘full bench of innovators.’”

Ultimately, in today’s uncertain market, creative thinking, combined with a clear understanding of how best to deploy the capabilities within a business, is more central than ever. In order to succeed in this market, private equity-backed businesses need to prioritise. Creating value is not an impossible feat and it is those organisations which truly master the art of prioritisation that will achieve it.

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