

SMARTER PERSPECTIVE: OPERATIONAL EFFICIENCY

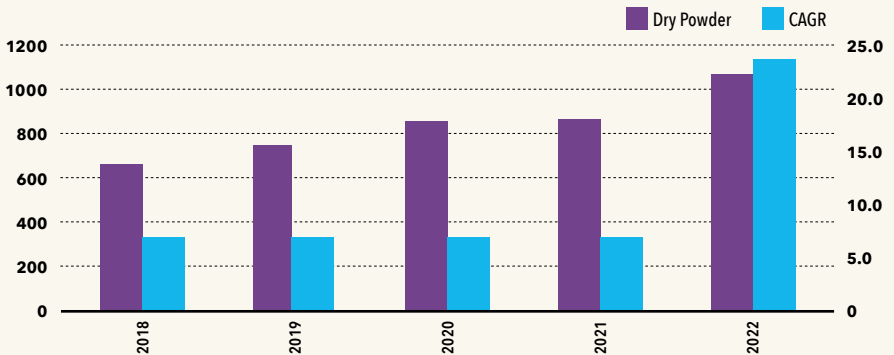
PE Firm and Portfolio Company Complexities Warrant Consultative Third-Party Operational Expertise

By The Experts at Hilco Performance Solutions

In this article we discuss the changing importance of portfolio company operational performance in creating returns for investors. PE firms seek companies with untapped growth potential, providing strategic capital and operational guidance to drive long-term success. Critical areas for value creation include: financial metrics, including better data for decision-making, talent management, strategic planning, operational EBITDA improvement, and organic/inorganic top line growth.

Whether large or small, private equity (PE) firms invest in companies that present opportunities for them to enhance business value over the course of an intended investment period. With this focus on value creation, PE firms are searching for companies with undeveloped growth potential and in need of strategic capital and operational guidance. These firms also actively participate in shaping the strategic direction of the companies in which they invest, as well, working closely with management to identify and pursue growth opportunities, enter new markets, develop new products or services, or pursue acquisitions or partnerships. By providing these capabilities, PE firms help companies navigate markets and position themselves for long-term success.

U.S. Available Dry Powder



Source: Preqin

PE Dry powder has notably increased over the past five years, particularly since mid-2022.

Recognizing that an organization is nothing without its people, PE firms traditionally depend on incumbent or new management teams, as well as retired executives, to gain operational advantage and bolster value creation efforts in portfolio companies.

As the PE universe has become more competitive, the standard for the level of operational improvements that must be made within portfolio companies has risen. This has led to large PE firms

building up their capabilities, both internally as well as through external partnerships. The expertise provided by these external operational advisors has the potential to build stronger and more sustainable companies through a variety of critically important improvements, most notably through data, operations, talent, and growth. These operational advisory teams coordinate learning across portfolio companies and the dissemination of best practices to maximize growth and profitability.

CRITICAL PIECES OF THE PUZZLE

Data and Financial/ Operational Analytics

When dealing with portfolio companies, particularly those in the lower middle market, we tend to see that more decisions than one might expect are still being based on gut instinct and legacy industry knowledge rather than on objective data inputs. While this may be acceptable during the entrepreneurial stage of a business, relying on gut instincts alone is no longer viable as a company grows, matures, and evolves. Instead, the focus must shift toward the use of data that can be useful to leadership and staff with less direct experience in the company (or sub-industry), to make well-informed decisions previously handled by subject matter experts.

Building a data-centric organization can be quite challenging, typically requiring extensive involvement and time working with internal databases to build accessible and useful information. These capabilities primarily fall under the purview of the CFO, who needs a deep bench both to ramp up and to take full advantage of that data in order to forecast and model financial information more accurately.

Talent

Talent is the backbone of any organization. Traditionally, PE firms have focused on executive-level talent, typically at the vice president level or higher. However, this top-heavy approach can create talent gaps as these executives move on. Having a deep talent pool has several benefits, including faster company growth with a cohesive structure, building a strong company culture that attracts more talent, and creating a talent flywheel. Strong talent helps drive bottom-line growth and increase exit multiples.

Strategic Planning and Operations

As Dwight D. Eisenhower once said, "Plans are useless, but planning is indispensable." Strategic planning

is an area that is too frequently underestimated by organizations. This can result in time consuming and costly complications, particularly regarding acquisitions. All too often, we see emotions and gut instincts get in the way of proper deal-making, resulting in deals that fail to meet expectations. Having a strong acquisition playbook and a well-thought-out, forward-looking operating model are crucial to business survival and growth. Together, these help ensure that strategic plans execute efficiently and that all business areas align towards the same goals. Perhaps most importantly, they reduce the risk of disappointment.

Organic and Inorganic Growth

At the end of the day, creating a strong positive return is the goal for any portfolio company, and growth is the driving force behind it. There is, however, always a risk that inorganic growth through acquisitions will not live up to expectations. In fact, according to the Harvard Business Review, most studies have shown that somewhere between 70 to 90 percent of all acquisitions fail. This is in part due to preventable errors made by companies in tandem with PE firms during both the diligence and integration process. Organic growth is also frequently a challenge to achieve. Internal operating partners often do not possess the precise skill set matched to a portfolio company's needs and a because it typically takes a multi-person team to jump start such an effort, a firm's resources may be too limited or may be allocated elsewhere and unavailable for the hands-on involvement needed to drive operations forward over an extended time frame.

EXTERNAL OPERATING PARTNERS AS A SOURCE OF VALUE CREATION

All companies have a common set of advisors which includes accountants & lawyers. The advisors of a company that recently completed a transaction will have strong familiarity with the company and its operations. It is tempting to

Potential Areas of Operational Partner Expertise

Key Areas of Assistance

- ▣ Data & Financial/Operational Analytics
- ▣ Talent Sourcing/Interim Leadership
- ▣ Strategic Planning/Operating Model
- ▣ Operational Improvements/Lean Enterprise
- ▣ Inorganic & Organic Growth Strategy/Execution

think that these typical advisors, fresh capital, and a new management team will generate strong returns.

The reality is that while things look new, the company will often stagnate by trying to force growth out of outdated industry practices. Companies require a fresh perspective to thrive. Many PE firms are building operational capabilities (or partnering with companies to provide these capabilities) to bring better processes and go to market strategies to their portfolio companies. PE portfolio companies use external advisors with experience in, among other areas, enterprise diligence, data analysis and visualization capabilities, supply chain, procurement, talent management, and lean manufacturing.

At the end of the day, creating a strong positive return is the goal for any portfolio company, and growth is the driving force behind it. Inorganic growth can be easy to achieve with funding, but there is always a risk that acquisitions will not live up to expectations. When acquisitions fail, it is often due in large part to unchecked biases and mistakes made throughout the process. To mitigate these risks, an unbiased third party can be engaged to provide support and help make decisions that are in the best interest of both the PE and portfolio firms. This can supplement internal capabilities, lead to an increase in value creation, and a decline in disappointment at all levels of the organization.



ABOUT HILCO PERFORMANCE SOLUTIONS

Hilco Performance Solutions (HPS) is a management consulting company focused on middle market business transformation. We help companies simplify and streamline business processes and improve operational efficiency, enabling them to better compete and gain market share in an increasingly interconnected economy. HPS is part of Hilco Global, the world's leading diversified financial services firm operating over twenty businesses and specializing in asset valuation, advisory, monetization, capital solutions and corporate finance (via our investment banking affiliate Hilco Corporate Finance) to both distressed and healthy businesses. This enables us to act knowledgeably in a general contractor-like capacity for PE firms, assisting in every step of the acquisition and value creation process from diligence through transaction and ongoing operational improvement.



Additionally, HPS has gained extensive special situations professional advisory experience working in lockstep over the years with our sister company, Hilco Commercial Industrial (HCI), a quasi-private equity shop within Hilco that deploys capital strategically in both commercial and industrial businesses. This experience and relationship can prove highly valuable for PE firms, as it provides a proven, built in capability for monetizing and executing within the middle-market industrial space. Lastly, our close working relationship with Getzler Henrich, a Hilco Global Company and leader in the restructuring space for more than fifty years, brings further added value and knowledgeable resources to our PE clients. We welcome the opportunity to discuss your firm's needs and any challenges you may be facing with prospective or existing companies within your portfolio. We are here to help.