KEYNOTE INTERVIEW

Standing out from the crowd

Private equity firms are laser-focused on differentiating their assets in a competitive exit market, say Ivan Lehon, Amy Daly and Neil McFerran from EY

Q As the operating environment begins to stabilise and dealmaking returns, are you seeing a shift from cost-cutting to growth?

Ivan Lehon: The ability to identify and rectify inefficiencies within industries and individual companies has always been an important return-generating catalyst for private equity. However, as the macro environment continues to stabilise, there is a heightened focus on using growth drivers such as pricing, product modernisation, sales force effectiveness, customer experience and the use of technology to boost revenue streams.

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In a recent EY survey, 68 percent of private equity-backed CEOs said they expect their revenues to increase in 2024, while 65 percent expect to boost profitability. This suggests that private equity firms are pulling growth levers even while they prioritise efficiency.

Neil McFerran: The focus now is on identifying key growth areas in the value creation plan and then mapping out the organisation and operating footprint that is required to execute on that plan. It may involve cost-cutting in specific areas, but what we are seeing less of is zero-based budgeting, with greater focus being put on the growth agenda. There is a real emphasis on the scalability of the cost base to deliver on the business plan.

There is also a more rigorous and robust approach to capital management in this higher interest-rate environment. More activity is happening around governance, and controls to help ensure that the return on investment is understood and tracked by deal teams, operating partners and management teams so that the capital is allocated in a way that achieves that return.

"There is a clear emphasis on making sure companies are prepared for exit in terms of how data flows through the systems"

IVAN LEHON

Q How should private equity firms be thinking about mobilising their growth plans post-deal in order to maximise effectiveness?

NM: An increased focus is being placed on capturing due diligence findings and turning them into a tangible action plan for the first 100 days of the investment. Deal teams, operating partners, and management teams are under significant pressure to quickly solidify plans as timelines have become increasingly condensed.

IL: Private equity firms are increasingly unafraid to pivot from one theory to another and remain nimble when it comes to the levers that they can pull. We are also seeing more focus on standing up transition teams at the company level to ensure that the right leadership, skills and bandwidth are in place to really drive through changes.

Q What opportunities are disruptive technologies such as artificial intelligence presenting for private equity firms and their portfolio companies?

Amy Daly: We recently carried out two surveys with our private equity sponsors and their portfolio companies that have confirmed what we are experiencing in the market. The first survey, conducted with 200 US-based private equity executives, found that the number one strategic priority for targeted investment in portfolio companies is emerging technology strategy and transformation, including the use of artificial intelligence and generative AI. The survey also highlighted an increasing focus on data transformation, which is a foundational precursor to a solid AI program that yields results.

We also canvassed 500 US-employed decision makers as part of our AI Pulse Survey. That survey showed that private equity was more likely to focus on acquiring companies with AI capabilities, hiring external AI vendors and forming AI-focused joint ventures and partnerships than its peer industries.

Private equity sponsors and their portfolio companies are also seeing a differentiated return on investment when compared to peers, as they seek to leverage AI to create operational efficiencies, enhance the customer experience and drive competitive advantage.

Q What do you see as best practice when it comes to leveraging AI's potential?

AD: There are four key areas of emerging best practices for private equity firms. First, they remain resolute on the use of ethical AI and as such need to ensure that governance frameworks are in place early and scaled as the use of AI is embedded across the organisation.

Secondly, they are determining the appropriate mechanism to evaluate and prioritise the large number of use cases now emerging, with a focus on selecting those that best align with a firm's value-creation strategies.

Next, they are looking at how data modernisation can be fully integrated into any AI approach, as data is the underlying fabric that makes AI work.

Finally, I would point to talent. There is a real war for talent when it comes to hiring individuals with AI skills and an innovative mindset. Putting talent at the forefront of AI strategies will be critical, as private equity firms will need to consider the speed, degree and enablement of change; the imperative for leadership alignment for AI strategies; and the agility of the learning and development programmes that will need to be designed, delivered and enhanced as AI and generative AI mature.

IL: It is important to note that AI isn't so much taking away jobs as making the workday better as companies use this opportunity to further tech-enable both 'back-office' and customer-facing business processes. It involves improving mundane tasks, enabling people to be more efficient, to work fewer hours, but also to develop more meaningful and enjoyable careers. Our most recent client successes indicate an opportunity for generative AI to make employees 40 percent more productive by simplifying and removing routine tasks.

Q Are you seeing any changes in the way that private equity firms are staffing operations roles, and what is driving that?

IL: Deal teams are one of the greatest strengths of private equity houses in terms of their ability to enter a company, do the analysis, and then develop value creation components of an investment thesis pre-deal or generate potential hypotheses for value creation during a holding period. But those individuals are typically generalists.

When it comes to operating partners, firms have taken a variety of approaches over the last 10-15 years. However, we are seeing a clear trend towards specialisation by both industry and function.

AD: In a recent audience poll of more than 150 operating partners, 57 percent indicated that the position and prominence of the operating partner would strengthen and become more specialised over the next three to five years. Furthermore, private equity firms are adjusting their talent acquisition programmes to engage operating partners in advisory roles. Firms are then able to leverage the operating partner's expertise in identifying growth opportunities and encourage them to influence value creation programmes that deliver sustainable cost agility at speed through the use of data and technology enablement.

NM: There are firms that are run by teams of senior operators and industry professionals. However, we are seeing two other models emerging in place of this model. The first features two or three senior generalists, with extensive functional capabilities sitting beneath them. Those specialists will cover areas ranging from supply-chain configuration to technology purchasing and organisational structure, for example. The second model that is beginning to gain traction involves private equity firms building what is almost an internal value consulting group with functional experts in areas such as procurement, supply chain and technology.

There is definitely a trend towards functional expertise rather than seniority. A majority of private equity firms are deliberating how they build out their operating teams versus what support they get from third parties.

> *"Private equity firms are approaching readiness assessments in a much more holistic manner"*
>
> **AMY DALY**

Q Clearly, the private equity industry is contending with a massive backlog of exits. How can private equity firms differentiate their assets in such a competitive market?

NM: There has been a market shift towards value-driven exits, which means there is a clearer focus on collecting high-quality transactional, operational and financial data at least 18 months before an exit process begins. This ensures that any friction during the due diligence process is minimised. We are also seeing top-to-bottom reviews on the delivery of the value creation plan over the investment's lifecycle, from revenue through to cost, cash impact and beyond, and examining what has been delivered. It is also important to provide evidence of the incremental value that remains in the asset that a secondary or tertiary sponsor can underwrite as part of their own value creation strategy.

AD: Private equity firms are approaching readiness assessments in a much more holistic manner and stress-testing various exit strategies to determine the no-regret actions that need to happen now, regardless of the type of exit or its timing. In today's environment, many of these no-regret actions are aligned to supply chain resiliency and network optimisation; trust and accuracy of financial reporting and forecasting; talent; and strategic alignment of technology deployment and enablement programmes.

IL: There is also an increasing focus on financial planning and analysis in the context of extended holding periods. There is a clear emphasis on making sure companies are prepared for exit in terms of how data flows through the systems, allowing management teams to make well-informed strategic decisions around everything from customers to suppliers, ultimately positioning the business optimally for sale. ■

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