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Operating Blueprints

Key to Managing PE Portfolio Companies in Volatile Markets

By Faisal Hoque

Private Equity funding may have had its heyday prior to the bust of 2008, and may never again attain its \$58 billion peak of 2007. And while technology and consumer goods are strong sectors, middle-market PE firms are being dashed about on the waves of global market volatility. PE management is faced with a double-edged dilemma: What new opportunities should they move forward on? Which portfolio companies should they be planning exits for?

While the PE industry has changed a great deal since the days of Georges Doriot, portfolio management styles have not. The industry still places the greatest emphasis on financial analysis vs. operational capabilities. While they are essential, the thinking is based on decades-old methods – quarterly reports and balance sheets, to be specific – which are insufficient for understanding, tracking, and governing the corporate performance of today's volatile market. To be more specific:

- Operating managers often work in relative isolation from the market and its operating functions, producing the familiar myopia and flexibility the job requires
- Executive leadership often has limited ability to guide and oversee operations because of inconsistent access to key information
- Boards and investors often have a limited view of ongoing operations, lacking the perspective or information needed to understand how to guide portfolio management

Operating managers are tasked with growing the business and reporting clear sailing up the lines of management. It's tricky navigation, especially when cost containment is driving so many decisions today. Lowering costs is important, but it must be factored into an overall business strategy. In today's increasingly volatile and unpredictable business environment, there are a number of new and emerging operating challenges that must be addressed. Some of the most critical are:

- Accurately evaluating growth potential, while balancing organic against inorganic growth
- Developing sustainable processes to reach or exceed revenue growth goals, cut costs to preserve recurring dividends, and protect top- and bottom-lines for portfolio companies
- Implementing strategies for building sustainable brand recognition,

in concert with building brilliant management teams

- Demonstrating progressive, provable, repeatable results to executive leadership, the board, and investors that will sustain the firm today and tomorrow.

Saying, "But this is how we've always done business" isn't sufficient for today's challenges. That's the old seat-of-the-pants model. Establishing specific objectives and applying reliable performance indicators are keys to a manageable process. To that end, every PE portfolio business ought to be using transparent operating blueprints that connect the dots between financial reporting and actual business operations in order to accurately represent such information on behalf of an organization.

Why create an operating blueprint? It provides two strategic enablers:

- 360o Enterprise Models (business, process, organization, technology, etc.), the ability to visualize the end-to-end business goals and execution strategies before beginning costly and often irreversible strategy implementations. These models create the opportunity to ask "what-if" questions and test scenarios that help vet problems and issues early on.



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- Impact Analyses and Scenarios, with which to alter factors, create multiple output scenarios, evaluate the end-to-end impact of each scenario, and arrive at the optimal solution.

An operating blueprint allows principals and management to work together based on converged intelligence of market opportunities, execution capabilities, and business model differentiations.

No contractor would build a house without blueprints, and the PE portfolio management operational structure and processes are no different. The old 20th-century methods of “guesstimation” must be replaced with precise metrics and provable outcomes.

These operating blueprints should include the following set of ongoing analyses:

- Business models and market positioning
- Growth strategy and execution capabilities
- Governance and organizational models
- Process and technology
- Investment allocations
- Business dependencies and scenarios
- Capabilities needed to innovate, change, and efficiently operate against a set of financial indices

Properly implemented, operating blueprints allow PE fund managers to:

- Maximize ROI at an earlier stage in the fund lifecycle of each portfolio company, and collectively across the entire fund
- Increase transparency between a portfolio company and the PE fund
- Brings large-cap business process improvements to the small-cap mindset of many PE portfolio companies

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- Prioritizing and guide improved performance, value, and sustainable growth.

Clearly, new ideas, strategies, and management tools are essential as the PE business changes. In today's volatile market, the success for an enterprise is often driven by its ability to recognize significant challenges and immediately identify the strategic imperatives necessary to address them.

While nothing new, accomplishing such goals in today's global climate requires new organizational structures, creating and sharing new kinds of business knowledge, understanding and applying emerging socio-economic models, and developing repeatable, reusable transformational processes.

The operating blueprints provide the basis for a predictive, sustainable business plan for managing these challenges and opportunities for growth and success in the future.

Faisal Hoque is the founder of SHADOKA and other companies. He is an internationally known entrepreneur, thought leader, and was named as one of the Top 100 Most Influential People in Technology. A former senior executive at GE and other multi-nationals, Hoque has written five management books, established a research think tank, The BTM Institute, and become a leading authority on convergence, innovation, and sustainable growth. His latest book, The Power of Convergence, is now available. (c) 2011 Faisal Hoque