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What Private Equity Strategy Planners Can Teach Public Companies

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The role of Private Equity firms has fluctuated over the last decade. A number of funds have struggled post-GFC, others have found support as investors chase yield in a low interest rate environment, and a range of alternative models including family offices have emerged.

Despite these changes, a number of PE firms have survived and even thrived. A recent McKinsey & Company **article** argued that public (listed) companies could learn a lot from the strategies of successful PE firms, with the key assertions as follows:

1. **Being Private Helps.** A major advantage for PE firms is more freedom to invest in long-term projects. PE firms can make capital intense investments that may not generate substantial returns in the short-term, without pressure from analysts and investors to hit quarterly (or in Australia, half-yearly) earnings expectations.

2. **Communication is Key.** It is significantly harder for public companies to gain support for long-term projects due to the sheer size of the public investment community. In order to gain support for such projects, messages need to be communicated convincingly to shareholders, with clear goals and metrics to track the success of the investment. This can be harder to achieve across a larger investor base.

3. **What is Used to Measure Success.** PE firms collaborate with new investee companies, developing a long term business plan which includes:
   - Discussing and agreeing the business strategy;
   - Developing a set of KPI's and management incentives; and
   - Identifying short-term strategies to take advantage of current advantages.

   PE firms have the freedom to develop a set of KPI's which focus on longer-term value creation. In contrast, public companies may be forced to focus on short-term KPI's in order to satisfy various stakeholders.

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4. **Financial Flexibility.** Public companies typically need to balance the competing priorities of funding existing business units (maintenance capex), seeking new, EPS accretive investment opportunities, and paying dividends to shareholders. This can result in missing potential opportunities and / or underfunding projects that have a good long term return.

   PE firms have more flexibility around investing in different kinds of businesses within the same fund. This may limit their ability to achieve economies of scale and vertical or horizontal integration, but fewer constraints allow them to assess each investment opportunity on its own merits rather than according to what it adds to existing investments.

5. **Corporate Governance.** The structure of PE firms allows for each portfolio company to have its own Board of Directors. Each Board is able to focus on its own business, and specifically address that business's critical strategic, organizational and operational issues. In contrast, public companies have one Board which often oversees a wide variety of business units, particularly in large, diversified companies.

   The article suggests that the PE model could be emulated in public companies by appointing advisory boards incentivised on the value creation of individual business units.

6. **Developing M&A Skills.** Public companies seek to develop skills in M&A, but often don't have sufficient time or resources. An effective M&A strategy requires proper identification of strategic targets, commercial and financial diligence, assessing synergy targets, and discipline in determining the appropriate purchase price.

   Private equity firms by definition are experienced in all of these areas. Adopting some of the practices employed by M&A firms may help private companies to better identify M&A targets, as well as ensuring proper integration, capital decisions such as refinancing and paying dividends, making bolt on acquisitions, and selling investments are the right time.

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If you want to learn more about how to use M&A to drive a step change in your business, please contact the team at InterFinancial.

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