



PRIVATE EQUITY RELATIONS TEAM

How digital transformation can be a game changer for private equity playbooks

With the increased competitive pressure of today's private equity ecosystem, data-driven digital transformation strategies are key when it comes to delivering operational performance improvements and driving top-line growth across the portfolio. For private equity firms, digital transformation does present a fair share of risks, but the opportunities it can bring far outweigh the potential downsides—especially as technology continues to disrupt markets and transform businesses. Today's vast amounts of data are driving significant boosts in analytics capabilities, dramatically enhancing a firm's ability to conduct investment due diligence and to improve the performance of existing investment companies.

To attract new capital, private equity oftentimes emphasizes the firm's ability to drive investment value through operations-related improvements. The challenge now, with the increased competition of more than 8,000 PE firms worldwide is: How does each firm continue to create a competitive advantage in the marketplace?

“ One of the problems is that private equity firms do not have formalized digital strategies in place. Private equity firms need to start with having their own definition of digital. Most private equity sponsors are looking to improve EBITDA through digital but they start from scratch every time.”

BRAD HALLER

Director at West Monroe Partners

Firms have been responding to this by setting up dedicated operational “value creation teams.” However, many firms are still struggling to articulate how these teams can add value to portfolio companies and effectively communicate what differentiates them from competing firms. Some firms are going a step further and making digital transformation a central facet of their core competencies—all with the goal of driving sustainable investment value.

What do we mean by “digital transformation?”

Digital transformation, also referred to as digitalization, is a combination of high-value digital technologies and methodologies that seek to “transform” a business with artificial intelligence (AI), machine learning, the internet of things, data analytics, high-performance computing, big data, blockchain, mobility, cybersecurity, and cloud-based solutions. All of these technological areas fall under the digital transformation umbrella, and offer tremendous advantages over the Excel spreadsheets and manual processes used by a significant number of PE firms and portfolio companies today.

Leveraging the large amounts of data associated with digital transformation provides PE firms unprecedented insights into untapped sources of operational performance improvement opportunities and related profits. Data-driven insights and decisions bring tremendous advantages over the more subjective decision-making that historically takes place with firms. It is a known fact that in today’s environment, 80% of the data an organization uses to make strategic decisions comes from outside their four walls. We are finding that the best products and services are not getting selected because companies are not taking advantage of new technologies and are being disrupted by those companies that do.

Four steps a private equity firm can take today to digitally transform its operating philosophy and model:

- 1.** Build internal data management capabilities and expertise that focus on the collection and aggregation of data. PE firms can approach this by fostering the organic development of internal expertise, and can (and should) augment this through relationships with select technology partners.
- 2.** Don’t attempt to boil the ocean. PE firms need to take a very pragmatic, measured approach to building this capability into the firm’s core operating model. Identify a starting point (one area) that represents a significant technology shortcoming that could represent a substantial value creation opportunity.
- 3.** Bring subject matter experts into the firm that understand these emerging technologies and have the backgrounds and experience to advise the firm’s management team.
- 4.** Manage the cultural and communication challenges associated with going down the digital transformation path, and be transparent in communicating progress as well as failures. Capitalize and leverage on lessons learned and incorporate those lessons into the fabric of the firm’s operating model.

Digitally transforming a firm's investment portfolio

PE firms can start taking action now by thinking about and incorporating digitalization at the investment due diligence stage. Luckily, there are steps a firm can begin taking as they look to digitally transform their portfolio companies. Example opportunity areas include:

- Leveraging digitalization to drive co-creation of products and services through technology with by collaborating with customers, suppliers, and partners.
- On the manufacturing side, PE firms can look at whether vendor and supplier evaluations are automated and consistently reviewed from a data analytics perspective to continuously optimize elements of the companies supply chain.
- Evaluate opportunities where production processes are online and integrated to provide real-time visibility into ongoing manufacturing and production, identifying bottlenecks and areas where workflows can be optimized.
- Opportunity areas exist on the logistics side of a business, where companies can automate the tracking of supplies to effectively lower inventory levels and maximize working capital.
- Transforming and refining via automation of a company's sales processes using systems and data to track steps during the customer journey—helping tailor and personalize messaging, campaigns, and solutions for prospective customers.
- Digitizing areas of the manufacturing process like supplier management, procurement, and delivery logistics in order to enhance efficiency and overall operating performance.
- Pursuing data analytics and artificial intelligence opportunities to more efficiently manage an assembly line, minimizing waste and better managing the flow of parts or ingredients with a much higher degree of predictability and accuracy.

“ Technology allows you to better monitor and analyze the volume and value of portfolio company operating data in real time.”

BRADLEY FISHER

Partner, Data & Analytics Lead, KPMG

The real value of digitalization is tied to the benefits it brings to the interactions a company manages and maintains with its customers. Effective digitalization (the use of innovative technologies) supports the tracking of customer satisfaction that informs and drives more tailored approaches to selling and servicing both prospective and existing customers. This data-driven approach informs a much more intelligent, targeted, and personalized approach to building a company's brand and marketing their products and services.

During the due diligence phase, a PE firm should be assessing a company's ability to respond to and provide efficient financial reporting in a timely fashion. Automating the analysis of financial data through digitalization will allow a firm to make more informed decisions on the feasibility and profitability of new products and services, as well as the underlying business models for their investment targets.

What are the risks a PE firm needs to be aware of when going down the digital transformation path?

The data that is collected and aggregated when leveraging these technologies is only as useful as a firm's ability to gather and analyze the data in real-time. Understanding the story the data is telling isn't the “magic”—it's understanding how to leverage that story into actionable plans to drive value. This can be very challenging for firms who are under-invested in system infrastructure, knowledge, expertise, and resources committed to doing this. It can easily turn into a time-consuming and expensive endeavor when the approach is half-baked.

Digitalization's impact on EBITDA

The ability to make well-informed decisions is a big factor impacting EBITDA. An operating partner or a portfolio company organization that has the ability to collect and analyze real-time data and use it to drive operational and customer-based decision-making will be infinitely more successful than those making decisions based on gut instinct or legacy data.

Tackling PE firms' greatest upcoming challenge

As firms look to integrate new tools and approaches into their core best practices, they will be confronted with major cultural shifts and will have to uphold ongoing commitments to the management of internal processes and digitalization efforts. But it's worth it: A well-managed digital transformation strategy and plan can provide tremendous competitive advantages and put a firm in a first-mover advantage.

The pot of gold at the end of the rainbow is that strategic acquirers of a PE firm's portfolio companies are more likely to pay higher multiples for successful digitized companies due to the fact that are simply easier and faster to analyze and integrate.

“ We leverage proprietary data analytics tolls to derive enhanced and actionable insights at deal speed.”

RICK WRIGHT

Advisory Principal, Digital Transformation Lead, KPMG

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