Valitas Capital Partners

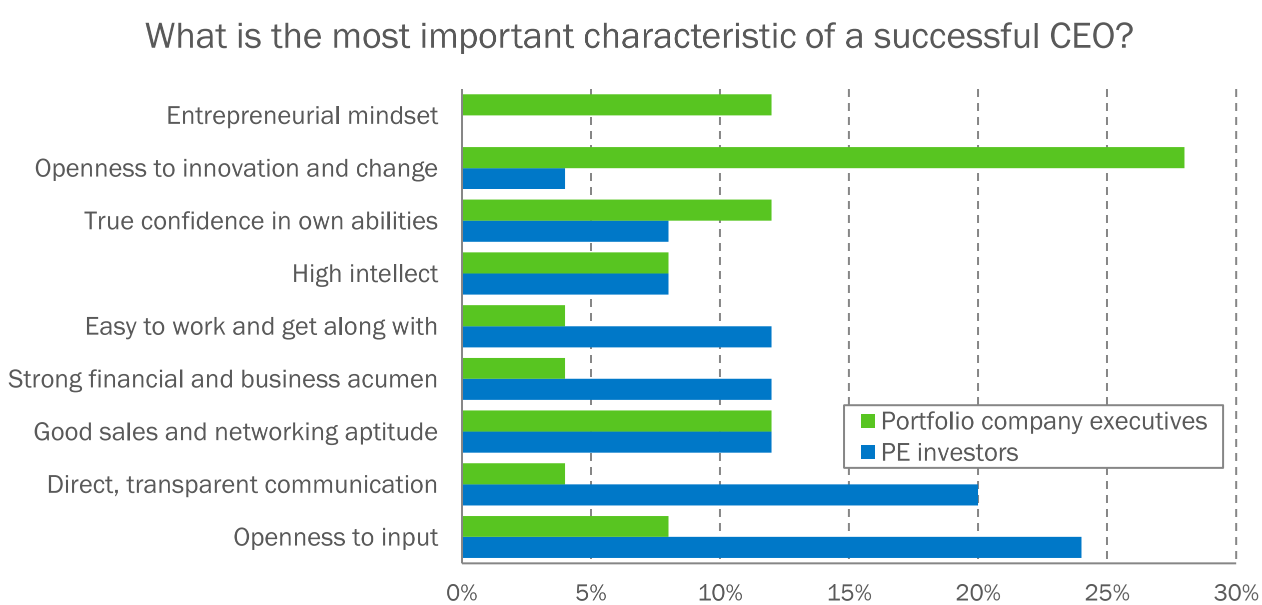
Valitas Insights: Private Equity and Portfolio Company Management

Private equity has remained one of the most reliable asset classes amid recent challenges in the market. However, PE investors still need to be vigilant in order to retain their competitive position going forward. The management team of the portfolio company is crucial to a successful partnership. A recent Mergermarket report surveying 25 middle market PE firms and 25 company executives across North America revealed several key insights on this issue, and we thought it is worthwhile to share some of their findings.

Creating a Leadership Blueprint for Assessment

When evaluating portfolio companies, the natural tendency is to place an emphasis on the product and the business model. PE investors often develop highly detailed growth strategies to evaluate a deal, but seldom do the same for the management team.

One main reason behind the lack of an appropriate assessment tool in this respect is the lack of uniformity between PE firms in desirable management team characteristics. Therefore, creating a universal standard can be difficult. Some of the most sought after qualities include openness to feedback or guidance and a direct communication style.



Source: Mergermarket Group

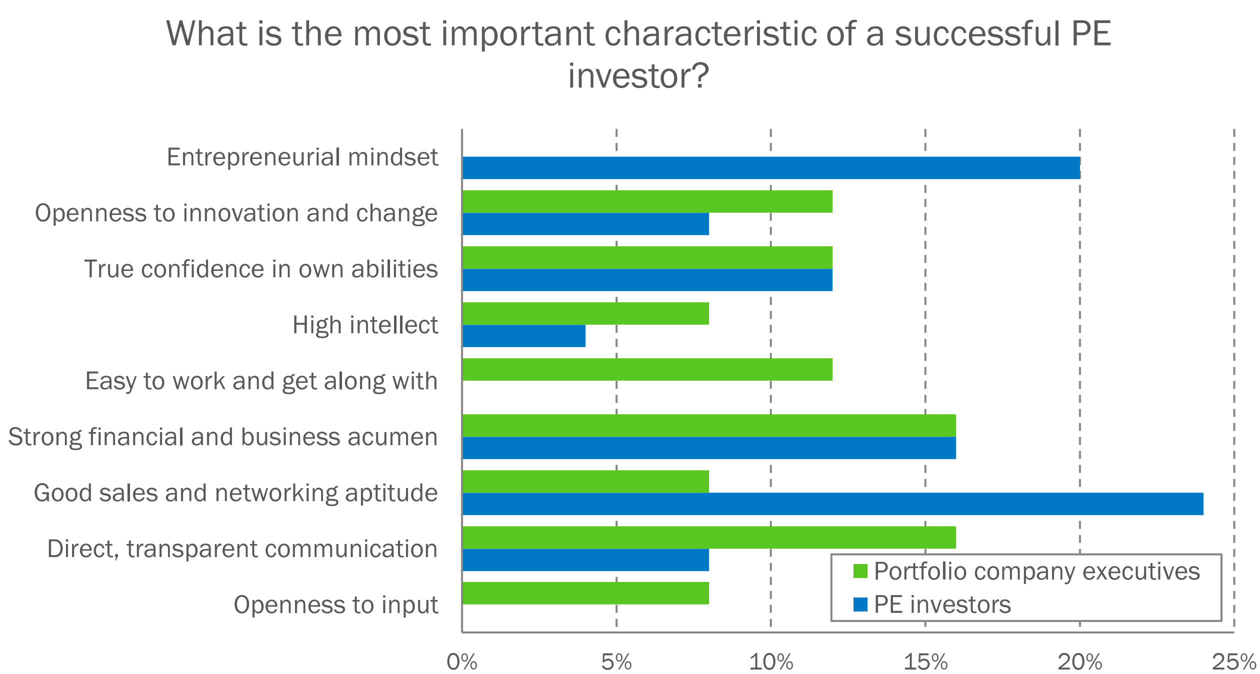
Why should this matter to you? Whether you are a PE investor or a founder, you can combine these insights with your own preferences to develop customized leadership blueprints that allow you to find the ideal partner.

The survey has also shown what investors value is quite different from what operating executives value. In contrast to PE firms, leaders at portfolio companies believe in openness to learning and innovation the most. This broad divergence can hinder effective communication.

To bridge this gap, various measures can be employed to help evaluate the portfolio company's leadership style. Many PE investors find external assessments to be the most effective and predictive of post-deal performance. Such mechanisms often reveal that the COO and CFO are the least qualified among the management team. Investors would be well-served to allocate their due diligence efforts to these areas.

Understanding How Portfolio Companies View Investors

Any successful partnership requires mutual effort. Therefore, effective portfolio company management requires an understanding of the portfolio company's needs. The following conclusion may seem counterintuitive: while potential portfolio companies look for the exact same skill set (direct communication, openness to change, and strong business acumen) as what PE firms value in CEOs, PE investors do not see themselves the same way.



Source: Mergermarket Group

Per their own perception of the role, a good networking aptitude and entrepreneurial mindset are what makes a successful PE professional. Thus, investors should make sure they get on the same page with portfolio companies regarding future expectation. Nevertheless, the importance of personality fit is apparent during the transaction process and that such fit determines whether the deal closes.

Now, what kind of partnership do portfolio companies want? The survey results tell us that portfolio companies are looking to obtain more diverse knowledge, experience, and viewpoints from PE investors, who can actively help expand their network.

Interestingly enough, this diverse perspective is often seen by investors as a byproduct of past partnerships. A recent Deal Law Wire article also highlighted the recent trend of PE firms specializing their knowledge in targeted industries. The takeaway here is to manage expectations before signing a deal, and align interests to ensure success in the long run.