Catalyzing Growth: Applying Private Equity Dynamics to Enterprise Businesses

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It is both an exciting and challenging time to be a business leader. There's so much change taking place across the global economy, whether that be macroeconomic uncertainty, interest rates, geopolitical forces that are pushing companies to rethink their supply chains, or technological change like generative AI. As a mentor once told me, great business leaders don't just think about how to survive change, they think about how to capitalize on such change to emerge stronger. As organizations grow and change to meet the new demands of the shifting business environment, they may want to look toward an unexpected source of inspiration: private equity funds.

Private equity (PE) has consistently outperformed public markets. It's easy to chalk this up to financial engineering and specifically the fact that PE often uses more leverage to boost equity returns. But I would argue that such quick dismissal misses broader lessons that business leaders can draw from that can apply to any ownership situation. The massive growth in PE has forged an industry that, though 50 years ago had its roots in financial engineering, is now one with well-developed playbooks utilized by more than 4,000 PE firms to drive value in their portfolio companies.

PRIVATE EQUITY

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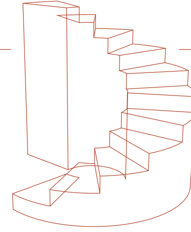
UNDENIABLE GROWTH

4,000
COMPANIES

26,000
COMPANIES



Whether you look at this growth in terms of the number or value of companies – in 2000, there were roughly 4,000 companies under private equity ownership; by 2023 it was more than 26,000 globally with $2.8 trillion in assets under management – the growth is undeniable. In the United States, there are more than three times the number of companies owned by private equity than are publicly listed, and when you include venture capital that number climbs to 10 times.

This highly competitive collection of companies has driven many different approaches, but a few macro lessons of the "PE playbook" are consistently applied by most firms. This playbook includes simple principles, executed relentlessly, to drive performance improvement. The first is alignment of an organization, from the owners and senior leadership to the most junior employees. Second is developing a clear, three-to-five-year plan to execute major initiatives to drive value in an organization. Third is aligning incentives around those initiatives. And finally, fourth is creating a sense of urgency instilled when PE firms invest in companies.

The value accelerants deployed by PE funds offer valuable insights into alternate strategies for business growth. From a disciplined approach to investment, operational efficiencies and risk management, this playbook can serve as inspiration for CEOs looking to enhance their businesses in the face of rapid change and uncertainty.

Alignment Between Management and Ownership

Leaders understand that strategy comes from the top, but what happens when the top does not agree on the path forward? The sports fans among us may have experienced the frustration of highly visible misalignment between management teams and ownership

groups — both in terms of strategy, but also engagement, which can be too little or too much. Sports dynasties are almost always borne from such alignment and supportive, engaged ownership. These owners seem to trust their front offices and coaches, resulting in longer tenures. Teams talk about a system of respect between coaches and ownership. In contrast, perennial underperformers frequently suffer from an obvious disconnect between ownership and management or owners who undercut their coaching staff. Coaching turnover is more prevalent, locker room discontent is more obvious and finger-pointing abounds. I use this example to illustrate the point because the popularity and high profile of sports often provide the casual observer more insight into the dynamics between ownership, management and the team than in most businesses.

However, the same dynamics play out in most businesses regardless of ownership structure. The dangers of misalignment among leadership can inhibit value creation, leading to lack of clarity on strategy, executive turnover, uncoordinated incentives and loss of employee morale.

While there are certainly many exceptions, what PE often does well is marry a professional ownership group that has expertise in owning rather than operating companies with a management team with shared financial goals. This structure lends itself well to alignment between ownership and management. While ownership cares about the success of the business and can draw on broad experience from owning successful companies, they usually don't have the skill and certainly not the time to run the company and overstep their role.

This structural alignment can be harder to achieve in some other ownership structures. For example, public companies have constraints around how they construct and compensate board members. However, even in this setting, some of the benefits of a PE ownership structure can be replicated. Board members and managers need to communicate specific expectations about roles, responsibilities and what type of support is helpful versus micromanagement. And companies should think carefully about all the tools at their disposal to create economic alignment. The more everyone wins together, the more likely companies will form constructive board/manager relations.

These board members are highly engaged and are sitting in the foxhole with management to drive key initiatives forward. That relationship is a two-way street: A 2022 NACD survey found that 59% of respondents cited quality input from the management team as being the leading driver of exceptional board performance. Successful public boards, regardless of size, are those that have great relationships between management and ownership and who have mutual understanding and alignment of where the business stands and what it needs to achieve. Management must push for an engaged board with the right incentives and clear input that will empower management to perform the way the board demands.

3-5 Initiatives in 3-5 Years

There is always a lot of discussion around the costs and benefits of different ownership types, specifically around the perceived timeframe of

the ownership group. Leaders often bemoan the quarterly pressures placed on public companies and some tout the value of long-term capital such as Berkshire Hathaway. Most PE firms have a ten-year fund life and an average investment hold period of three to five years, though the current average hold for PE firms is north of six years — a semi-structural constraint given the average fund life.

Great business leaders appreciate that regardless of ownership structure, focusing on building long-term, sustainable value while accounting for shorter-term pressures is the way to maximize shareholder value. One benefit of PE firms' structural hold period constraints is that they often develop three-to-five-year value creation plans. This timeframe is long enough to allow for real investment, but also near-term enough that organizations can develop momentum around these plans. I would argue that every company should develop value-creation plans with a similar time horizon. These plans can fit into a longer-term plan or account for quarterly pressures but also give management and ownership something concrete on which to measure themselves. After the company achieves that plan or approaches the end of the time period, managers should re-underwrite the business and put in place the next plan. When done well, these plans are usually simpler with only three to five concrete and quantifiable initiatives. Plans that can be shared throughout the organization and are easily understood help focus the organization and drive alignment. This repeating process creates a flywheel of value creation by galvanizing the entire company toward specific initiatives at specific times.

Three to five years is long enough to avoid the value-inhibiting pressure created by the need to meet targets in an unrealistic timeframe,

but it is also short enough that an organization can create momentum among its leadership. Within this window of time, leaders have a realistic opportunity to make strategic investments and see their impact, such as implementing new technology, building new teams or spinning off non-core business units – all decisions that might have short-term impacts on the balance sheet but that could unlock long-term profitability.

While setting realistic timelines is helpful, it's also important for companies to be specific about what the goals are over that period. I'm a big believer that most successful companies have a clear and targeted set of initiatives – often no more than three to five – that are ambitious enough to move the needle and add value. The companies that win are those where the entire organization, from ownership down to the most junior levels of the company, really understands what these company-wide initiatives are and what they can be doing to drive value. A short list of initiatives that everyone understands is a lot easier to work toward than a large, fragmented one. That's because big initiatives can get lost with everything else on the to-do list. When strategic plans get translated into what individuals are doing every day, initiatives can lose their order of magnitude – which means, if there are more initiatives, teams naturally focus on the ones that are easier and might not move the needle. Owners don't want management teams focused on these small wins; they want leaders focused on the few, often more challenging things that are really going to add value.

Paring these initiatives down is often a challenge for large enterprises. I've seen companies have success by starting off planning with a long list of all possible initiatives – as many as leaders in the business can come up with. Management then puts these initiatives on a matrix of value impact versus difficulty, whether in resources, time or investment. From there, leaders can distill down to the most impactful initiatives that are more likely to be achieved. It's critical that management then communicates these initiatives in a manner that clearly outlines to all stakeholders the identified priorities. One of the things PE does well is being disciplined to cut off initiatives that will be distractions, making conscious decisions to be extremely frugal with how energy and time are focused.

These initiatives will vary from company to company depending on the need. In some businesses, it may be about driving sales growth or product management; in others, reducing costs or margin improvement. In large enterprises, these initiatives may be driven largely by decisions at the board level – another reason clear alignment and engagement between the board and management can stimulate results.

When creating these initiatives, it is useful to think in terms of the overarching vision and projected outcomes leaders have for their organizations – for example, a 10-year or longer horizon compared to the three- or five-year mark. Is the company going to be inherently more valuable and add value for shareholders? The key in PE that makes sense for many types of businesses is that, after owners and management get to the end of that initial medium-term value creation plan they set out at the beginning of

an investment, they reevaluate, re-underwrite and begin the process again with a new set of initiatives based on where the business landed. Even if the PE firm intends to sell the business at the end of its hold period, good PE firms know that to have a successful exit, they need an attractive value growth plan for the next buyer.

Aligning Incentives

PE firms are historically very good at aligning incentives. That alignment means management and the team members who can really drive value in organizations understand what it means for them personally when they achieve their goals – and what their equity benefits are going to be given company performance.

By tying profit improvement to bonuses and/or equity incentives, employees can meaningfully benefit from growth and equity value. That's why incentive programs are often among the first things PE owners implement following a transaction. For example, KKR implemented an employee ownership program for the more than 800 employees at CHI Overhead Doors. When the company was sold, the shared equity arrangement meant all those employees benefited for the work they directly contributed to operational improvements. When done well, these financial incentives are significant to the individual and explained in a way that helps management and employees clearly understand what it means for them financially when they achieve the value creation plan.

Of all the components of the PE playbook, incentive alignment might be the toughest one to implement in public companies. For public companies, there might be compensation constraints around incentives they can put forward, but the more common organizational dilemma is motivating different teams in different divisions of large companies if the main tool is enterprise-wide equity incentives that are aligned with the results leaders are looking for. Some of these teams may only touch a small portion of the initiative. The PE playbook would argue that if incentives must be divorced from enterprise goals, though, maybe that division should not be part of the business and should be spun out. However, there are few downsides to effective, well-aligned incentives. Management and employees are motivated by incentives, and the better leaders can make people understand what it means for them when they execute against the plans that they have laid out, the more successful they are going to be.

Driving Urgency

A transaction is one of those moments in a company's lifecycle where, suddenly, the same job an employee was doing yesterday feels different. When managed well, transactions can create renewed urgency and drive for employees to perform their daily work better and explore new ways to do it.

PE firms are famously skilled at driving that urgency following an acquisition, capitalizing on the transition to encourage employees to approach their work with a different focus. The focus of this urgency is usually placed on that medium-term plan, and, often, firms will kick off their three-to-five-year plan with a company-wide town hall to direct the

business toward these initiatives and start all employees off with the same set of expectations.

Frequently, PE leaders will instill a period of rapid transformation to jumpstart the initiatives of the three-to-five-year plan with a tangible, executable 100-day plan kicked off at a town hall-style meeting. This method is highly repeatable – and something companies can restart every time they create a new medium-term plan.

This same type of "transaction" event can be achieved in any organization. Companies can find creative ways to create that sense of urgency through similar initiatives, like kicking off a 100-day plan, hosting town halls and starting longer-term plans. The key is to drive employees at all levels to recognize that something is different today than yesterday that causes them to approach their work differently.

When implementing this type of urgency at the enterprise level, leaders must be conscious to decouple their initiatives from the quarterly planning cycle. Board-driven quarterly obligations mean management may adjust its planning to meet those rolling requirements. While necessary, these shorter-term key performance indicators may be distinct from the focus on building sustainable value over a longer period.

A Playbook for Profitability

PE assets have long outperformed public equities, and leaders can no longer attribute that success solely to financial engineering – there is more to PE, otherwise we wouldn't have the growth we see.

From catalyzing a sense of urgency and aligning incentives to synchronization of leadership and identifying clear initiatives to execute in a defined period, it's not about making complete pivots but harnessing the potential the business already has to drive value.

The leaders who can capitalize on this growth, especially now, will benefit, regardless of the ownership structure of their companies. Anytime there is an acceleration in the pace of change from macroeconomic forces, geopolitical factors or shifting technology, business owners and managers have the opportunity to re-underwrite their businesses, find new opportunities to unlock growth and identify what practices they can adopt to succeed in that environment. The PE playbook might not apply in its entirety to every organization, but leaders may look to it to find innovative approaches and inspiration to unlock new paths to value creation to future-proof their organizations.

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