The First 100 Days: Crafting a Value Creation Plan

TODAY, A 100-DAY PLAN IS AN OFF-THE-SHELF PRODUCT SUPPLIED BY MOST ADVISERS. BUT THAT IS PART OF THE PROBLEM

OPX | PARTNERS

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CHAPTER 1

Introduction

A key finding from OPX Partners' white paper 'Active Ownership in the Private Equity Industry – A Key to Superior Returns' was the importance of the first 100 days. PE firms need to move quickly to step into their role as active owners, if only to validate their hypotheses from the due diligence. These first 100 days is the best – some of our 50+ interviewees said only – time to craft a plan for realizing the full value creation potential of the acquisition.

That moment when a deal closes is, however, in many ways a difficult time to set said plan. Any fatigue from the acquisition process needs to be replaced with the energy that comes from plotting the course towards a bright new future together with new owners. All this while complex financial (and operational) requirements must be navigated.

We have, time and time again, found that there are two approaches that work. Sometimes, a classical, top management-driven strategy process is the best way to unite management and the organization around the winning themes and activities for the next three to five years. At other times, however, pragmatism dictates putting that process off for a few months – and instead simply starting the sprint with a few well-chosen no-regrets moves[1].

However one gets there, a value creation plan (VCP) process should be started during the first 100 days. And once it is in full swing, our core belief is that it is, at its most basic, a people question. Creating the identified value requires a plan with deep roots in the organization. People must agree to the plan, and people must – crucially – execute on the plan. Securing this ownership is not easy.

We firmly believe that any external supporting party must understand the reality described above: That it is inherently difficult to craft a plan that bridges the strategy-execution gap[2]. A VCP must never have as its highest expression a board-level slide deck. Today, that is an off-the-shelf product. But reaching full potential requires that much more.

To get there, some very common pitfalls must be avoided, and we begin by discussing these (Chapter 2). Crafting a VCP requires a structured process that leads to alignment and commitment around a realistic and trackable plan; the key here is pulling all the levers (Chapter 3) through an integrated approach that off-the-shelf providers have difficulty delivering (Chapter 4). Lastly, it needs to ensure that everyone — owners, board, and management — contributes to challenging and refining the VCP and, subsequently, realizing the full potential of the company (Chapter 5).

1. One distributor we worked with could, at acquisition, agree on only three things: That pricing was unstructured, that stock management was a disaster, and that no one had time to devise a new strategy. 12 weeks later, pricing and stock management were under control, and the owners and management were comfortable enough to tackle the strategy question

2. In fact, this is the reason why OPX Partners recruits top tier management consultants with line management experience

CHAPTER 2

Why do value creation plans fail?

This brief perspective is a follow-on to our report 'Active Ownership in the Private Equity Industry – A Key to Superior Returns,' in which we presented a perspective on the most important tools for creating value throughout the portfolio company life cycle. The 50+ interviewees universally pinpointed a holistic Value Creation Plan (VCP) as one of the most important tools for active ownership and value creation.

Developing a VCP during the initial ownership phase is something of an industry standard. It provides owners with an opportunity to validate the investment thesis and take on an active ownership role by getting to know the company, evaluating the management, and establishing a plan with built-in accountability.

Establishing a VCP has two main objectives:

1. The plan itself: Ambitious, clear, implementable, and value-creating, as well as
2. Alignment and commitment: All stakeholders must be prepared to execute on said plan

This should sound obvious and simplistic, but the seasoned executives and PE professionals we interviewed stressed how often companies fail to deliver on one or both objectives.

Rarely are the reasons for this to do with the substance of the plan itself. Any portfolio company can produce a plan with the right components: A board-level deck, detailed backup slides, financial models, and initiative trackers. Templates for these components are available off-the-shelf, and junior associates from any consultancy are perfectly capable of filling them in.

Rather, the reasons for failing to deliver a VCP that promises full potential have to do with the process. Focus is hard to come by during the busy post-closing period. When time is in short supply, management can be insufficiently challenged to come up with bold targets, and the organization is frequently insufficiently challenged to come up with details. A plan to do 'what we are already doing, just more of it' can be the result, even in the face of emerging business opportunities that are already sensed. Perhaps worst of all, there can be a misalignment on ambition and details between the many stakeholders: Owners, the board, top management, line management, and the broader organization.

In our experience – for self-evident reasons – but also according to the PE professionals we interviewed, the best way to handle these challenges is to engage a third party to drive and support the VCP process.

Just as top management cannot abdicate their responsibility to set the tone and constantly push for more, line managers cannot duck away from the need to continuously explain, detail, and iterate on their parts of the whole. But both parties can be given considerable support. An integrated approach builds and aligns the plan iteratively as it maximizes potential by working up and down the organization.

This argument extends all the way to the Board and the owners. They have a big role to play in terms of challenging management and creating accountability, and aligning these parties is also crucial.

Leverage external support to:

- ❑ Allow management to balance focus between VCP development and running the company
- ❑ Maintain a high pace throughout the VCP process
- ❑ Get an unbiased view on the situation and potentials
- ❑ Facilitate alignment between the owners, board, management, and organization
- ❑ Gain external expertise on key areas

Our most successful investments have always been those where everyone was aligned on a few, simple, and clear goals. Where we dared to focus

- Industrial advisor

CHAPTER 3

The value creation levers are well known…

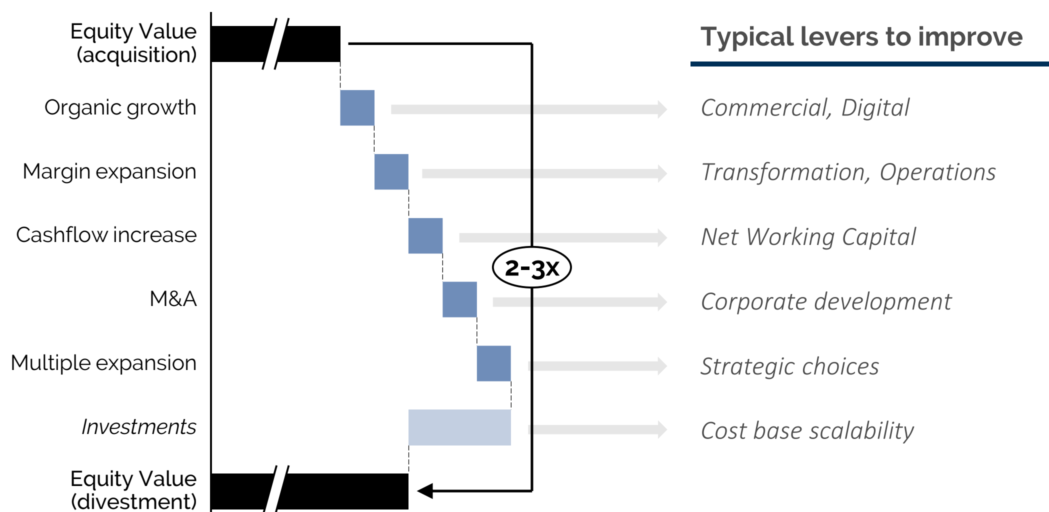
While the details will always be complex for any given industry and any given company, there are relatively few levers that actually create equity value.

More insidiously, there is not always a complete understanding within a top management team of what creates value for a private equity exit. For example, a management team under PE ownership for the first time may not grasp the importance of free cash flow and its connection to covenants, nor how powerful a lever net working capital is to address it.

That said, there are typically five major areas in which the value creation potential will be found:

1. Organic growth, typically associated with Commercial or Digital levers,
2. Margin expansion, typically from Transformation or Operational levers,
3. Cashflow increases, which are most often addressed with net working capital improvements,
4. M&A activity, typically driven by the owners, CEO, and corporate development function, and
5. Multiple expansion, which typically comes down to strategic choices valued by investors in the sector.

Against this backdrop, minimizing the needed investments by ensuring cost base scalability can be a powerful additional lever.



CHAPTER 4

…but the key to *realizing* the value is an integrated VCP process…

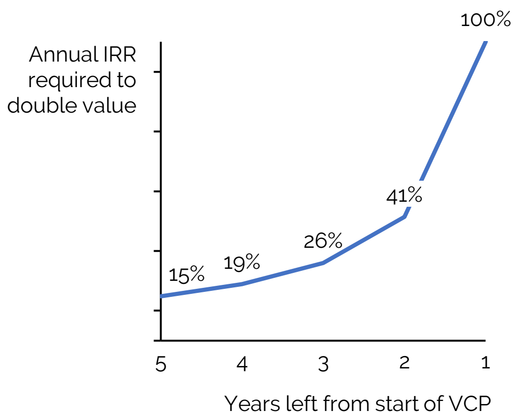
Making a Value Creation Plan (VCP) is a complex endeavor. There are many stakeholders, many inputs, many required outputs, and a large number of activities and iterations that are needed to secure alignment.

OPX Partners has significant experience from supporting this process, and we believe there are two open secrets: Getting started early and using an integrated approach.

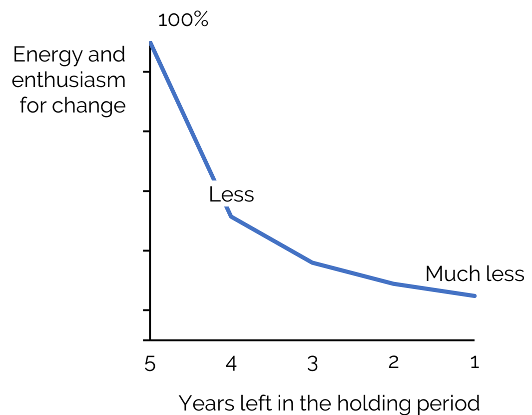
Getting started early might seem like banal advice, but there are any number of excuses to delay a VCP. Typically, they boil down to 'there is too much else going on.' Our interviewees were adamant, however, that delaying the VCP process never improved matters. Instead, the delay typically caused the other initiatives to proliferate in an unprioritized fashion, and, two years in, there were even more distractions.

Get started early: Doubling the enterprise value of an investment requires it

The IRR needed rises dramatically in a slow start…



…as the ability to create meaningful change falls



That said, we have seen two approaches to getting started early that appear to work equally well. The first is simply to mandate a top-down process to set a VCP, come hell or high water. The second is more subtle: Find a few no-regrets moves and back them to the hilt. Use that work to get to know management and the company, and build the trust needed to kick off a holistic value creation process sometime in the first few months of the holding.

Once the process is started, however, the key is to run it in an *integrated* fashion while ensuring that the final VCP is *bespoke*, *focused*, *detailed*, and created with an eye towards *execution from Day One*.

Integrated: To run an integrated VCP process is at once simple to explain and difficult to do. It needs to integrate all parts of the organization, and it needs to do so by making sure that they are involved. The diagram envisions a series of V-shaped 'bounces,' and the desired dynamic is this: Top management sets challenging goals, and line management backed by trusted lieutenants responds with the best plan they can muster to meet said goals. The next iteration either refines the goals or refines the plans and, in the meantime, new ideas are constantly generated by the iterative nature of the process. Eventually, the goals and plans converge on a VCP that the entire organization is aligned on, committed to, and proud of.

Bespoke: The VCP process must be adapted to an individual company's unique situation, and maintain a supreme sensitivity to an organization's execution capacity. There are no right answers to which people must be involved, which questions tackled first, or how rapidly to push through the process. Once the VCP is completed, however, there must be handshake agreements up and down the organization that the plan is executable. Securing this is far more art than science.

Focused: 'More of everything' rarely makes for good strategy, and so it is with Value Creation Plans. Tough choices should be made, and, in the end, a few prioritized action areas should be clearly articulated, and every member of management should know why they are prioritized. If sacred cows are to be slaughtered, this is the time for it.

Detailed: A detailed plan is not one which contains a thousand details, though it probably will. Rather, it is one that is clear on what is to be done, who is to do it, and what the financial impact will be. Initiative charters, financial forecasts, and a tracking mechanism all need to be in place before a plan can be considered detailed.

Execution from Day One: Executing on a Value Creation Plan is what will realize the holding's full potential. CEO commitment may be the most important single factor, but two features make a VCP ready to be executed on from Day One: Quick wins and handshake agreements. Handshake agreements between the key stakeholders – potentially after a coming re-organization – ensure that all parties know what is expected of them. (Here we note that it may be sufficient to secure a 'disagree but commit,' but the line manager in charge must always agree to the executability of their part of the plan.) Quick wins baked into the plan then allow for a flying start, building momentum and enthusiasm crucial for completing the race.

Portfolio companies far too often try to do too much, and that is a mistake

- PE professional

Lastly, we will note that choosing the right partner for a VCP process can make or break the effort. PE professionals that we interviewed were quick to point out that a seasoned third party very often provided many benefits. Facilitation of the process and an unbiased view of how it was unfolding, as well as the additional horsepower helping both top and line management, were seen as very valuable. In some circumstances, specific expertise was also brought in by a third party.

Ensure the following:

- ❑ Drive a process that leads to alignment and commitment
- ❑ Focus on a few prioritized actions with measurable targets
- ❑ Include quick wins in the plans
- ❑ Establish a solid tracking mechanism
- ❑ Take the company's execution capacity into account
- ❑ Choose the right partner

” Finding the right external support is important. You need the right people. Individuals with experience and know-how that both understand the business and can manage people through a difficult process

- PE professional

” Overinvesting in execution capability, whether internal or external, always makes sense in order to get a good start to the ownership

- PE professional

CHAPTER 5

...and ensuring that *everyone* helps realize maximum potential

Reaching full potential means that everyone has a role to play. One of the areas in which standardized and off-the-shelf products fall down the hardest is in continually securing alignment all the way up to the owners, thereby giving everyone the chance to challenge and push the thinking throughout the process. Only when the owners, board, and management know where to push – and the organization has detailed plans as to how – will a portfolio company's potential be maximized.

The component we most often find missing is a deliberately simple tool for iterating scenario-based financial forecasts for the holding period. A baseline for the financial development and then, for the major initiatives, a slider which can toggle the likely outcomes. It fills a few key functions, the thinking behind which we unpack below:

- *Bridging* the LBO[1] model with the subsequent Value Creation Plan
- *Summarizing the initiatives* which will really move the needle
- *Giving initiative owners full ownership* of the structured data they present upward
- *Enabling a dynamic view* of scenarios that might unfold

Bridging the LBO and VCP: PE companies will make an investment armed with a very detailed (if partially outside-in) financial model built around a few value creation hypotheses. Clearly communicating expectations around these and validating or rejecting the hypotheses as the detailed plan is built with the organization requires a way of working that starts with the LBO assumptions and builds on them collaboratively throughout the process.

Summarizing initiatives: Senior executives are busy people. And it is easy to get bogged down in details. Given that there are seldom more than a dozen things which will really move the needle (i.e. materially affect results over the holding period), having one place to gather all of those initiatives is crucial. Too often, we hear that a company's financial forecast is 'solid,' only to learn upon a follow-up question that an initiative that is still on the drawing board, and which will fundamentally alter the cost base, is 'too difficult to integrate into the current model.'

Understanding the big picture is a constant battle, but always worth striving to do

- Industrial advisor

1. Leveraged Buy-Out

Giving initiative owners full ownership: Behind every financial forecast is a detailed model, and the art and science of building this model is how initiatives are detailed and quantified. In short, how they come to be understood. Too often, however, the need for consultants to assemble the final view of the big picture means that initiative owners lose some of the ownership needed for them to truly commit to a target. A combination of templates, to make it clear which data are needed, with scenarios, to allow flexibility in showing what might happen, ensures that key analyses are done while allowing initiative owners to show their conclusions in their own way.

Enabling a dynamic view: With just 10 initiatives that can each result in a worst-case, base-case, or best-case outcome there are 310, or over 59,000, possible combinations. These cannot all be analyzed in depth, but a business intelligence software setup with sliders allows owners, board members, and the management team to play around with the combinations they see as most likely. This enables alignment on where the major risks are.

This tool thus constitutes the last piece of the puzzle during the VCP and, indeed, for the duration of the holding period: Keeping what some PE firms refer to as the 'troika' as aligned, active, and contributing through a shared view of the financials as the management and organization are kept through an integrated approach to creating the VCP. We know of no better way to reaching the elusive goal of realizing full potential.

What is tracked at Board level gets done. Far too often companies have a much broader agenda of 'strategic business development initiatives', that the Board is only vaguely aware of. In my experience it is better to cut such initiatives, or elevate them to Board level to ensure they get enough focus.

- Industrial advisor

About OPX Partners

OPX Partners is a Nordic management consulting firm. We support our clients in solving complex strategic and operational problems, from diagnosis to implementation – across a range of business topics.

Our approach has been shaped through working extensively with PE-owned companies across a variety of industries. Our approach is characterized by 3 factors:

Smart: By bringing experienced teams that know, and have first-hand experience of the problem at hand, but also have top-tier management consulting experience, we can hit the ground running, quickly understand and design the solution, and then move into implementation mode.

Pragmatic: Our extensive line experience and senior teams
ensure that solutions are pragmatic, implementable and
tailored to the client's specific environment.

Collaborative: We take a partnership approach with our clients and are normally present on the ground for the duration of the project, and especially during implementation to help ensure successful change. We work together to build our clients' capabilities and ensure ownership at all levels and functions of the organization.