Translation of the German Article "Anspruchsdenken und Selbstreflexion der Private Equity-Gesellschaften" by Raoul Nacke, published in **Venture Capital Magazin** *on 10.12.2021.*

Transaction factors in the private equity segment

Expectations and self-reflection on the part of private equity companies

We live in turbulent times: digitalisation and the sustainability debate are having a direct impact on the private equity market. Two effects can currently be observed: private equity funds have more and more capital at their disposal, and digitalisation and the global sustainability debate are reducing the market of interesting takeover targets.

Companies whose business models are not robust enough to accomplish the necessary transformations or which are subject to strong cyclicality tend to be avoided by investors. Instead, investors are more likely to concentrate on companies whose content follows global trends. Classic industrial enterprises are only attractive if their business model demonstrates a "future-proof" approach. Automotive suppliers who are not yet demonstrating a swing towards e-mobility are suffering particularly badly in this respect. Consequently, funds with a growing amount of capital behind them are competing for a reduced number of companies, with the result that prices are inevitably rising.

Growing expectations

Consequently, the pressure on private equity funds to invest swiftly is increasing. At the same time, an EBITDA multiple of 12 is no longer an exception in future-oriented segments. Accordingly, expectations of value creation – i.e. the targeted increase in the value of the portfolio companies following the takeover – are growing. Making deals will continue to be the priority in future too, but the investor will no longer win the deal solely via the price.

Empathy is playing a bigger role

Suitable partners qualify themselves by getting involved with the content and business of the portfolio company and actively engaging in value creation. In addition, empathy in dealing with the actors involved, especially the stakeholders who are selling, plays an even bigger role, especially in the small and mid-cap segment. Not all private equity players are equally well equipped; the profession is still under the influence of former investment bankers and management consultants who were primarily socialised in the perfection of corporate data analysis. Private equity funds should ask themselves whether they have a suitable in-house team that can contribute to a substantial increase in the portfolios' value. Large-cap funds mostly use a structure based on operating partners, who currently do the groundwork for the deal teams but whose status must increase in future.

Characters dominate

In mid and small-cap funds it's usually the transaction side that dominates; there is a lack of people who have already successfully implemented transformations and have a track record in genuine value creation. Some mid-caps have adapted their business model and cooperate extremely closely with the management of their portfolio companies in terms of content, resulting in temporary partnerships. In such cases, characters who have already proven that they can "do transformation" dominate – usually former CEOs. One effective tool – which has already established itself as part of portfolio management teams' stocktaking process – is a management assessment within the private equity team. The main goal is to gain awareness not just of how the expertise is distributed but of the strengths and weaknesses in one's own team as well, with the aim of being able to balance them better.

Conclusion

The criteria utilised for internal assessments of private equity companies are different than those for assessing a portfolio CEO. The goal is to balance the expertise in the investment team in such a way that deal making and value creation are equally well represented. Conducting a stocktaking in one's own ranks always means overcoming a psychological hurdle. Nonetheless, nowadays it should be part of any organisation's development repertoire; and that includes private equity companies too. Ultimately, it's a question of a shift in the expertise required – away from "buying" and towards "buying and doing". In future, it will not be enough to rely exclusively on the expertise of the CEOs installed in the portfolio companies.

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