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INSIGHTS

Change Agility: The New Mandate for Private Equity

Private Equity has seen another strong year in 2018, a year buoyed by continuing investor confidence and overarching positive fund performance. The current economy, in combination with profuse available dry powder and an overarching M&A environment on pace for a $3T+ year, creates strong opportunities heading into Q4 2018 and the first half of 2019.[1]

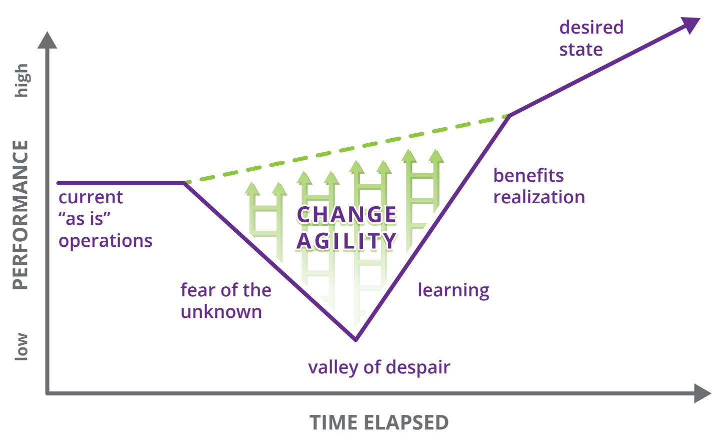
However, unpredictable headwinds loom on the horizon. Unparalleled shifts are occurring across markets, industries, and geopolitical locales. For Private Equity firms, opportunities for lucrative deals and transactions continue to arise as firms seek to both acquire new portfolio companies and exit aging ones. But deal costs are correspondingly rising. These costs, in combination with growing global uncertainty in the face of a late economic cycle, increase the risk of newly acquired portfolio companies being unable to achieve growth goals. Private Equity-backed organizations are faced with a critical challenge: how can organizations continue and accelerate day-to-day value creation, while also positioning for long-term scalability?

Historically, the first 100 days are the period in which Private Equity firms lay the strategic foundation for newly acquired portfolio companies. Leadership teams are consolidated, the strategic vision and plan are defined or redefined to align with organizations' value proposition, and innovation opportunities are discovered. The trajectory for success is, by all appearances, defined.

Too often, however, a key component is missing in the first 100 days, as Operating Partners and leadership teams are developing the strategic foundation for a newly acquired portfolio company. No matter the quality or quantity of growth and operational improvement opportunities identified during due diligence, a growth trajectory requires change. This change is typically significant, rapid, and multidimensional (organizational, operational, and cultural), all while portfolio companies strive to continue tending to day-to-day operations and customer needs.

Without developing change agility as a core competency in response to this rapidly accelerating change, Operating Partners and leadership teams will inevitably see a deceleration of strategic execution.

CLOSE THE GAP WITH CHANGE AGILITY



Based on a model originally developed in the 1960s by Elisabeth Kubler-Ross

[1] Wylie Fernyhough, et al., "PitchBook 2Q M&A Report", PitchBook.

Change agility as a core competency entails accelerating through the natural productivity decline caused by sudden internally and/or externally created change.

Change leaders recognize that, though this productivity decline is a natural component of major change, it may ultimately derail successful strategic execution. Therefore, change management efforts must center on clearly preparing for and driving transformation across leadership, functional areas and business units, and individual stakeholders. By aligning and equipping stakeholders, change leaders can drive effective transformation and cement change agility as a core competency. Strategic execution, in tandem with effective change management, is six times more likely to meet or exceed objectives. Yet executives agree that the lack of change management skills is the primary barrier to successful strategy implementation, and over 29% of organizations react too slowly when implementing transformative strategy, missing opportunities and failing to mitigate emerging risks.[2]

In our partnership with Private Equity firms, we find that it is in the failure to rapidly align and implement strategy where transformational momentum deteriorates. Between 60% and 70% of organizations struggle to implement strategy, with over 40% citing failure to align as a primary factor in failing to execute successfully.[3] In short, organizations are not agile enough to successfully navigate the changes required to both drive rapid value creation and scale for future growth. This ultimately has impacts on both top and bottom-line growth.

In order to successfully increase the change agility of portfolio companies, Private Equity Operating Partners and organizational leadership teams must do the following: set the pace of change, provide clarity to the organization, and constantly realign from the top of the organization down to the front lines.

60-70%

Of Organizations Struggle to Implement Strategy

40%

Cite Failure to Align as the Primary Factor for Failure

SET THE PACE OF CHANGE

First things first: the leadership team must set the pace of change. In partnering with leadership, Operating Partners have an opportunity to define the strategic plan and corresponding scope of change in the short, mid, and long-term. A component of this definition process is creating a clear, compelling vision for the future, one that can be communicated across the firm again and again.

Leaders must honestly assess their organization's current maturity when it comes to change acceptance and execution. Is the organization already reasonably agile, or are teams set in their ways and fearful of change? Depending on this assessment, leaders will want to set a pace that is realistic for their organization. Fast is not always the right tempo by which to successfully execute change efforts. Leaders must structure initiative timing so as to minimize human capital fatigue, technology limitations, and/or process bottlenecks. This requires ruthless prioritization, with an emphasis on what critical initiatives will be of maximum value. In setting the pace, leadership should plan to monitor, learn, and iterate, measuring success and communicating it back to the team. Organizations may adapt to change slowly at first, but the pace of change will accelerate as change agility grows.

[2] The Economist Intelligence Unit, "Why Good Strategies Fail: Lessons for the C-Suite", March 2013. See also: Donald Sull, et al. "Why Strategy Execution Unravels – and What to Do About It", Harvard Business Review, March 2015.

[3] Ibid. Note: statistics on strategic execution vary, with some indicating as low as 3% of companies successfully implementing strategic plans. See also: Greg Bustin, "Why Most Company Strategic Plans Fail", Forbes, 9/15/2014.

PROVIDE CLARITY TO THE ORGANIZATION

Once leadership has formulated a clear, compelling, and aspirational vision for future change, leaders must communicate and keep communicating this vision and corresponding strategy across the organization. According to a recent Gallup poll, 59% of employees do not know what their organization stands for, much less where the organization is going.[4] Cascading the vision and strategy throughout the organization drives energy, enthusiasm, and ultimately accountability by encouraging clarity and transparency.

In combination with the vision and strategic plan, leadership must determine and communicate what is changing and what is not changing. For example, the firms core values and purpose are unlikely to shift significantly, even as transformational efforts are underway to grow, scale, optimize, and drive value creation.

CONSTANTLY REALIGN

Even when the pace of change is determined, and the vision and scope of change is communicated clearly and consistently, there is still a key function to be performed by leadership: change alignment (and realignment).

Alignment has a half-life. Even if consensus has been created and change agility fostered, inevitably doubts, roadblocks, and issues arise. In addition, actually implementing the strategic plan will trigger an evolutionary process, as new opportunities and issues arise. In order to pursue the long-term vision, while capturing quick wins and navigating pitfalls, leadership must focus on constantly aligning their organization around the shared mission, vision, strategic plan, and corresponding goals.

First, identify change champions throughout every level of the organization. Continuous innovation is often driven by the frontline employees. High performing organizations cite their employees as a top five source of innovation.[5] Empower change champions to advocate for the change, illustrating the value of the future state vision consistently to their direct reports and peers. This creates deep change acceptance over the long-term, with change champion behavior often becoming contagious as successes are achieved and communicated.

Second, it is important to keep tabs on the impact of change on the organization across functions and roles. Consider what motivates teams, how they are experiencing the change, and the level of commitment they exhibit in executing change. In our partnership with Operating Partners and portfolio companies, we find it is important to remove the silos between change management efforts and program efforts. Too often, change management is labeled an "HR" effort and not linked to day-to-day strategic execution. Combining the two ensures the strategy is executed while change is adopted. Both are required for success.

Finally, it is critical to capture, catalog, and celebrate quick wins as the change effort launches. Transformation can be painful, but quick wins will alleviate growing pains and provide anchoring points for teams to push forward toward the future.

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4 Vibhas Ratanjee, "Focus on the Positive: A New Approach to Change Management", Gallup, 8/2/2018.

5 CB Insights, "State of Innovation 2018".

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THEORY TO ACTION

Consider these concepts in action. Ankura partnered with a growing Private Equity-backed healthcare client implementing key transformation initiatives as a component of their strategic plan. In our partnership, it was critical to clearly define what was changing within the organization and what was not changing in order to build change agility as a core competency. First, we worked with the organization to define its core values (what was not changing). Only then did the organization roll out its transformational strategic plan, including organizational restructuring (what was changing). Communicating to the team that the core values would not change gave a sense of context and security in the face of the upcoming transformation. Transparency also put a stop to fearful rumors created in the face of the unknown.

As the future-facing transformational initiatives and corresponding reorganization were rolled out, the approaching changes were communicated clearly and consistently. These initiatives were rooted in the organization's vision for the future, and they focused on what the organization saw as the key opportunity to disrupt the market and drive the firm's unique capabilities to new clients. These initiatives were not open ended. Rather, the organization set forth on an initial 90-day sprint to drive early change while iteratively determining the next critical activities necessary to scale and drive value creation. By setting the pace, providing continuing clarity, and aligning around a clear, consistent vision and change message, the firm was able to saturate change agility across the team. When the organization polled its team, survey results indicated that 90% of those polled recognized how their execution efforts were ultimately driving change, in connection with the organization's stated core values.

CONCLUSION

In our partnership with clients across industries and growth stages, we constantly hear one thing loud and clear: change is hard, but change is the new normal. Organizations must execute in the face of disruption in order to stay competitive. Firms will only succeed in launching change initiatives and innovation efforts by adopting change agility as a core competency. Operating Partners have a unique opportunity to support firm leadership as they formulate and communicate a winning strategy, while also driving execution by setting the pace of change, providing clarity to the organization, and consistently driving cascading alignment via the leadership team outward to frontline employees. In this way, Private Equity-backed growth organizations can position for a continuing strategic advantage, operational success, and financial value creation, in the face of continuing disruption.

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