Private Equity

Private Equity Value Creation

How to face the challenges of the current private equity environment

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INSIGHTS

//01

The competitive market environment forces investors to work on value creation more systematically and intensively than in the past.

//02

Growth is evaluated as the most relevant value creation factor and its future importance is expected to increase even more.
The most important factors driving top-line growth are digital revenue streams, pricing, and market expansions.

//03

Increased direct engagement with portfolio companies and more direct contact with company managers can serve as key instruments for realizing value creation.

01

Challenges of the current private equity environment

The historically attractive asset class of private equity is burdened by high competition among investors. Record-level "dry powder" enhances transaction valuations and endangers the realization of required rates of return. Investors are forced to strive for additional value creation efforts to succeed in this challenging environment. The new Porsche Consulting study focusing on the most relevant value creation levers and instruments provides insights on how to tackle the challenges and make the most of the current private equity environment.

Historically low interest rates, penalty interests, soaring real estate markets, and the search for alternative asset allocations—many developments in the financial world currently fuel the exceptional boost of private equity investments. The global private equity assets under management skyrocketed in recent years. As we look towards 2025, this development is even expected to accelerate, causing equity transaction prices to rise. However, investors still need to deliver their required rates of return. In this environment, the simple "buy low/sell high" paradigm no longer works. Private equity investors need to intensify value creation in their portfolio companies. This publication provides the core insights and lessons from a Porsche Consulting market survey among mid-European private equity investors who were interviewed about their current and future value creation strategies. Before presenting the main insights, the current private equity environment has to be assessed in more detail.

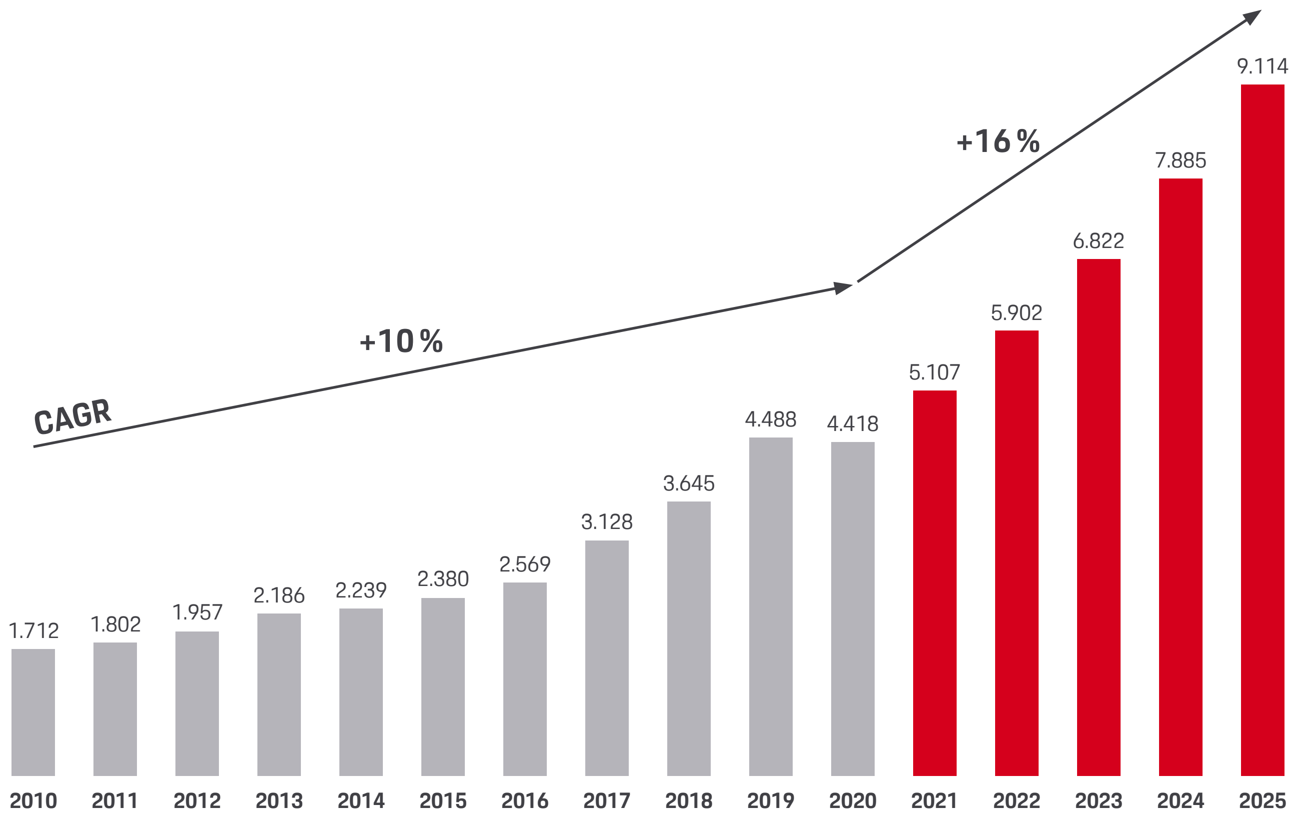

Figure 1. Global private equity assets under management demonstrated 10% compounded annual growth over the last 10 years.[1]

Between 2019 and 2021, the aggregated amount of global private equity deals doubled. Although the COVID-19 pandemic slowed this development slightly during the first half of 2020, it was followed by an immediate recovery in the second half of the year. With an aggregated deal amount of almost 500bn USD during the first six months of 2021, the market development remains unimpressed by the still ongoing pandemic. A long-term growth rate over the past 10 years is reported at around 10 percent compounded annual growth rate (CAGR).[2] Future surveys expect this trend to continue at a global CAGR of at least 11 percent until 2025.[3]

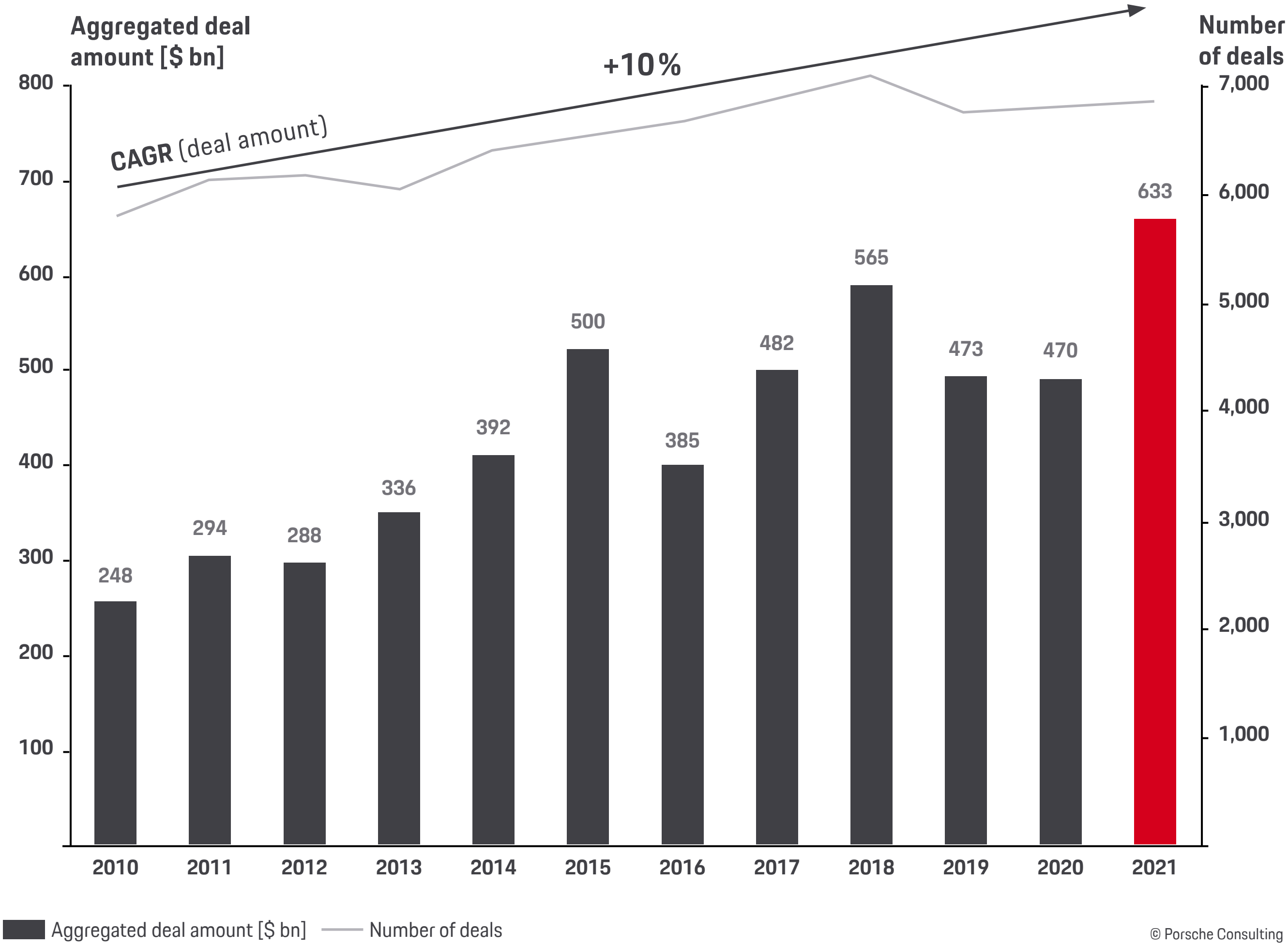

Figure 2. Development of the private equity transactions from 2010 to 2021[4]

In addition to the actual private equity transactions that are taking place, there still is a lot of "dry powder" in the market looking for investment opportunity. In fact, the allocated capital ready for investment in private equity transactions more than doubled to around 2.690 bn USD between 2017 and mid-2021.[5]

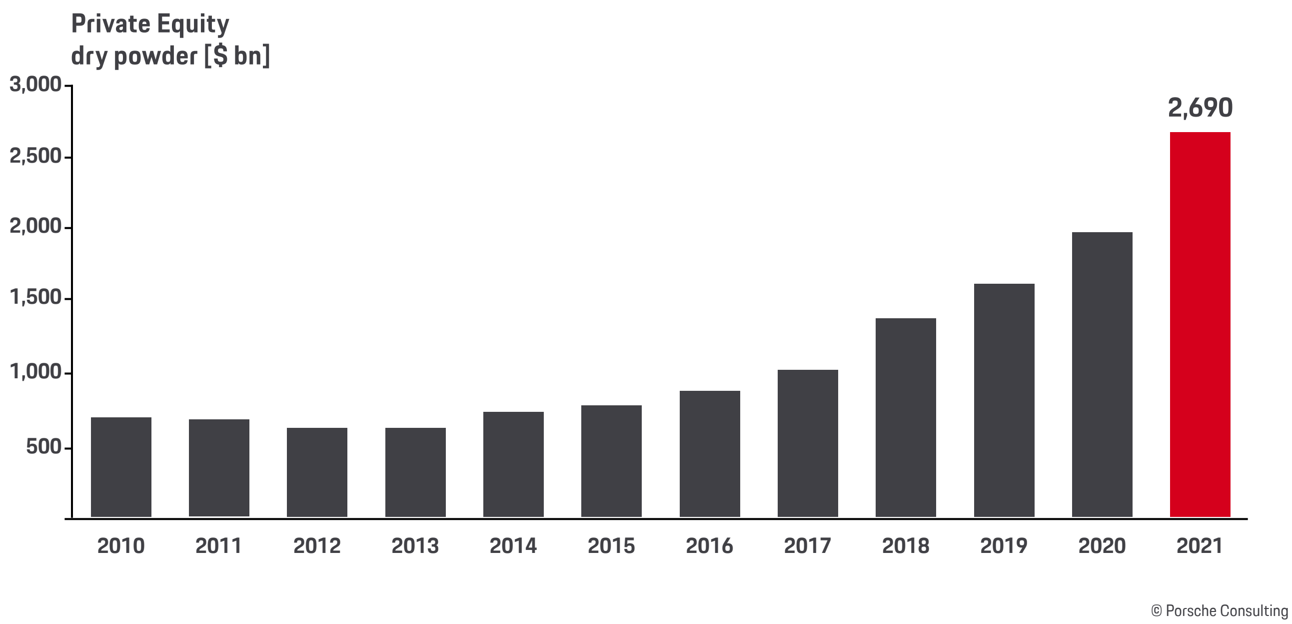

Figure 3. Global private equity dry powder reached a record level in 2021.[6]

The combination of record volumes of available private equity capital and acceleration in transactions have left their marks on the recent deal prices. Over the last decade, an overall increase of transaction multiples could be observed. While EBITDA multiples saw some consolidation—around thirteenfold in North America and tenfold in Europe—between 2020 and 2021, worldwide development still indicates an increasing development.[7] The increasing capital of private equity investors face little or even no growth at all in available target companies to invest in. In today's market environment, unallocated capital is the commodity and investment opportunities the scarce resource.

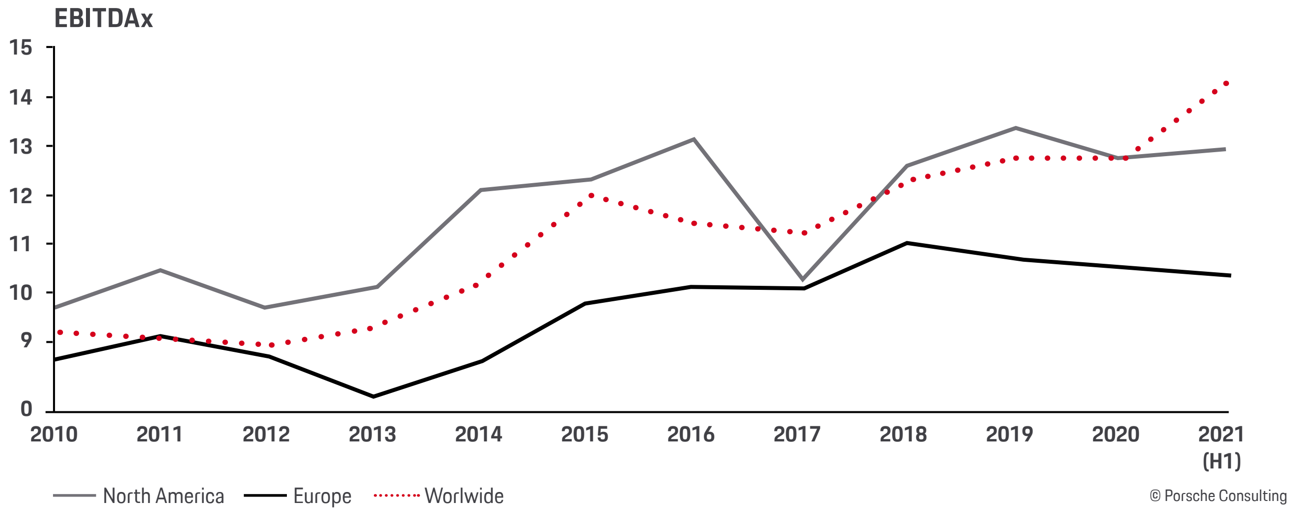

Figure 4. Development of the private equity transaction multiples North America, Europe and worldwide from 2010 to 2021.[8]

This market environment leads to serious challenges for private equity investors. Not only are they facing increasing difficulties to find suitable target companies, but having found great targets, the competition with other bidders (also strategic ones) is getting more and more intense. Selling parties, investment banks, and M&A boutiques are aware of this situation and keep on pushing prices in stringent transaction processes. This again results in a lower number of attractive deals. To compensate for high entry prices, private equity investors are often lured into ambitious investment cases. In the end, this results in taking high risks to finally realize the required rates of return, which are typically somewhere around 20 percent[9] p.a. To mitigate this risk, investors face the challenge of recognizing value creation strategies differently than they did a couple of years ago. In order to support investors in tackling the challenges ahead and designing resilient strategies, the following survey provides insights on the actual behaviors and future strategies of private equity investors in value creation.

The core questions that will be answered are:

What are the most relevant value creation levers for private equity investors and how do they realize them?

02

Survey target: Insights on private equity value creation strategies

The major objective of this survey is to deliver insights on how to best cope with the described challenges in the market. It thereby focuses on two main questions: first, what are the most relevant value creation levers for private equity investors? And second, what kind of private equity instruments are most fruitful?

To answer the first question, it is crucial to take a look at the wide range of value creation levers. Value creation levers in this context include strategic and operational levers. Purely financial levers such as restructuring balance sheet liabilities or using leveraged buyout transaction structures to gain on deleveraging are not considered. This is deliberate, since scientific studies—for instance by Professor Bernhard Schwetzler and Lennart Bachmann from HHL Leipzig[10] and Professor Ann-Kristin Achleitner from TU Munich[11]—have proven that financial levers deliver only a minor contribution to the overall value creation. The levers hence answer the question "what to work on."

Private equity instruments in this context include working methods, behaviors, arrangements, or mechanisms investors apply to collaborate with their portfolio companies in order to realize value creation. Here, the instruments respond to the question "how to work on it."

In addition, both core questions were investigated with two time horizons, the first being the actual situation. Beyond this, the survey asked for a future trend estimation of market participants. Current relevance was assessed on a 1 to 5 scale between "not relevant" and "highly relevant", whereas the future trend was rated as "decreasing", "increasing", "flat", or "no opinion." The market survey took place between July and September 2021 and was followed by structured interviews on key findings with selected survey participants. Based on professional experience, scientific studies, and upfront interviews with participating investors, the survey structure suggested five value creation levers, nine instruments for realization and allowed additional suggestions. The value creation levers were then detailed with additional questions and room for comments on more precise factors fostering the value creation levers. All survey participants acted as Private Equity investor executives either in deal teams or value creation functions. With regards to investment sizes, the survey included all three types of investor classes: small cap investors defined as typical enterprise value investments of lower than 100m Euro, mid cap investors (between 100m Euro and 1bn Euro enterprise value) and large cap investors (enterprise value investments larger than 1bn Euro).

TODAY → IN THE FUTURE

What? What are the most relevant value creation levers for private equity investors?

How? How can private equity instruments best support value creation realization?

Figure 5. Survey focus is on value creation levers and instruments to realize these levers

03

Survey results and interpretations: Insights on value creation levers

Providing market insights regarding the current relevance and future trend estimation on the five predicted value creation levers: growth, cash, efficiency, strategy, and valuation.

In the first place, the survey indicates an overall increasing trend with future relevance for every value creation lever. This means that investors are in general becoming more attentive in terms of the value creation levers of growth, cash, efficiency, strategy, and valuation. The competitive market environment with large amounts of available dry powder and resulting high transaction valuations forces investors to work on value creation more systematically and intensively than in the past.

"Efficiency programs were used heavily in the past and during the COVID pandemic. Looking into the future, we expect economies to pick up again and by that giving us tailwinds to realize growth." (Survey participant)

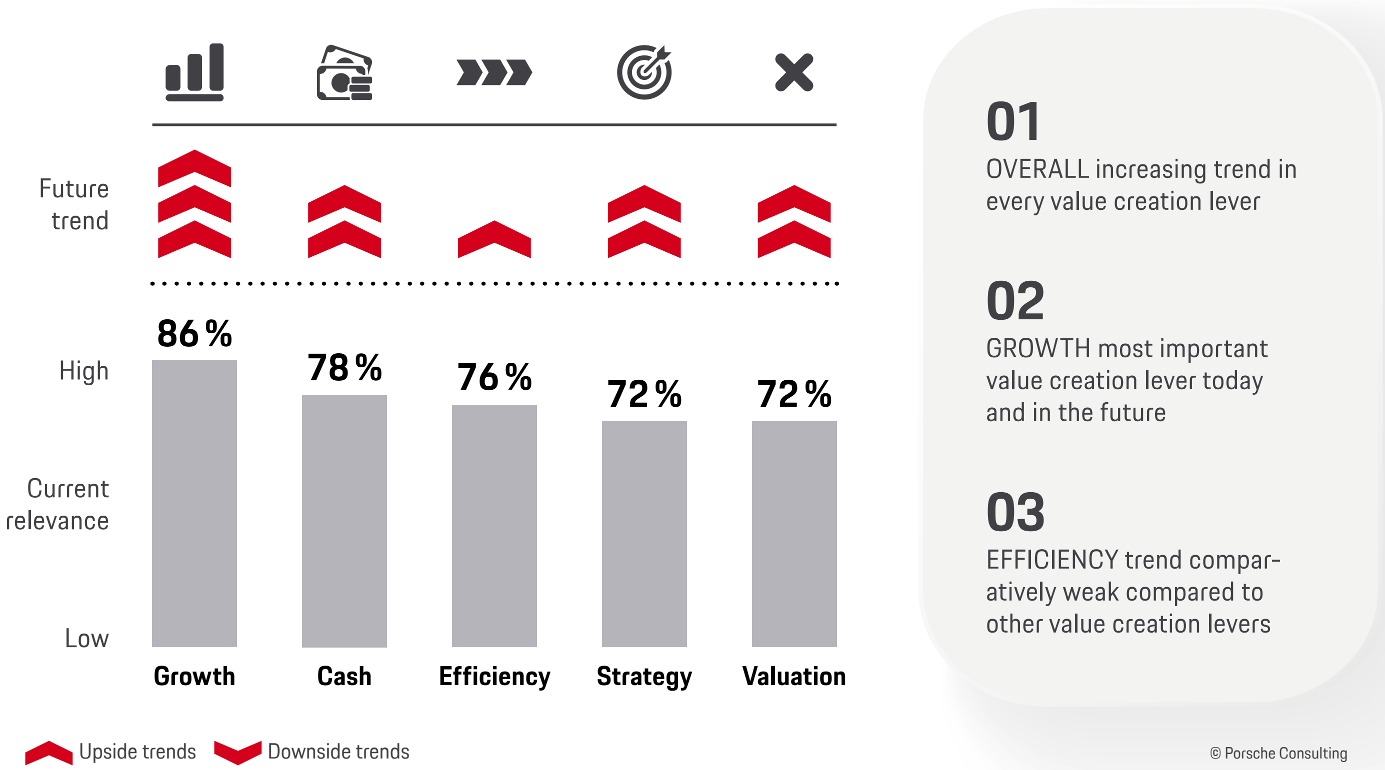

Figure 6. Ranking: Among the five value creation levers, growth is ranked the most important by the survey participants

Before taking a look at each of the five levers in more detail, two surprising results worth emphasizing will be presented. First, growth to increase top-line revenues was evaluated as the currently most important value creation lever. Participants noted that this has been true for years and is not expected to change. It needs to be understood as "profitable growth" to deliver value creation. It is remarkable that growth is also considered the lever with by far the highest future increasing relevance. 73 percent of all survey participants expect growth to become even more important for value creation in the future. Among small-cap investors, the future relevance for growth even scored 75 percent consensus. This implies that especially smaller portfolio companies can create higher valuation impacts by reaching top-line growth than by solely improving cost and bottom-line effects. When it comes to large-cap investors, one survey participant draws the connection between growth and IPO as exit channel with attractive valuation levels. "We are striving more towards IPO exits at the moment and need our portfolio companies to outperform their competitors in terms of growth to increase the chance for successful IPO stories." Participants further noted that growth at present is especially seen for investments in life science, driven by fundamental growth of existing markets, better market penetration, or new market developments.

73 %

See increasing trend for value creation through **GROWTH**

Second, the trend for the future importance of efficiency turned out to be weakest among all value creation levers. Efficiency addresses cost reductions and, hence, bottom-line improvements. This trend was equally low among all sizes of investors, no matter if small-cap or mid- and large-cap. This outcome might suggest that efficiency measures have already been exploited in recent years with little additional value improvement potential expected. "In large-cap, we see a high number of secondary or tertiary buyout transactions," one investor noted. "In those cases, pure efficiency levers have already been pulled before and leave only little additional value creation potential. We clearly need to strive for growth to justify high transaction multiples."

Two other survey participants interviewed in more detail agreed that they are very cautious regarding personnel efficiencies. Even though they act in very different company sizes (small-cap and large-cap), both report significant challenges to retain existing talents or acquire new ones. "We are clearly witnessing an employee market at the moment. Therefore, we are currently focusing more on hiring the right talent than on finding the last ounce of efficiency."

01 | GROWTH

The most important value creation lever, growth, can be split up into several growth factors with the top three being digital revenue streams, pricing, and market expansion.

Further growth factors such as sales excellence, product portfolio expansions, service excellence, or planning excellence lag behind.

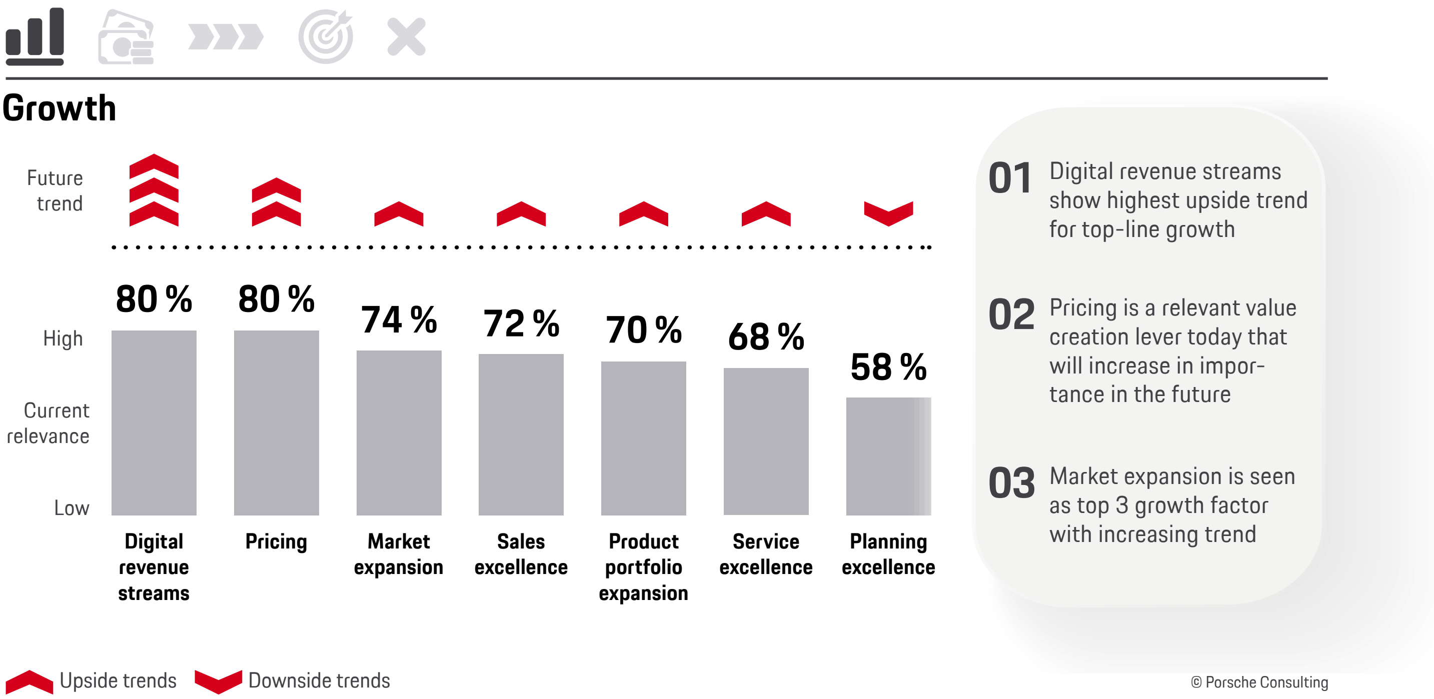

Figure 7. Survey results on growth: Digital revenue streams and pricing are seen as the most important growth factors

Digital revenue streams ranked number one in both current relevance, and future trend. Seventy-five percent of all participants even expect its future importance to increase. "We see digital revenue streams as the flavor of the year," one large-cap survey participant stated. And moreover, "Differentiation by industry sectors is key here. It is extremely important in any B2C business model. In the B2B environment we see great potential if digital channels allow direct access to end customers."

Generating digital revenue streams enhances overall company development, as traditional hardware products or services are becoming more and more digitalized. Value-added data and digital services are often seen as opportunities to generate new income streams with smooth scaling models.

However, there are several obstacles visible, as another survey participant argues: "Even if we have defined promising digital business models in our portfolio companies, the biggest hurdle is to find the right people with relevant experiences to convey digital business model ideas and concepts into real life. As one example, we fostered a B2B online shop project with the intention of fully digitalizing our offer-to-order process. The clients can now configure their solution online and send their order directly to our sales department. However, this is just a starting point and there is still a long way to go before the entire fulfillment process is fully digitalized." Another participant mentioned cybersecurity as a major obstacle in general and, in particular, with regard to digital business models.

Pricing is commonly mentioned as a rather traditional growth factor. Yet it ranked second in terms of future relevance. It is especially attractive since price increases in most cases directly impact bottom-line effects. A small-cap investor even ranked pricing as the most important growth driver from his point of view: "It is a typical finding that portfolio companies underestimate their actual pricing power." However, pricing needs deliberate adjustments to specific markets, products, and customers to not be offset by declining market shares. Especially in smaller companies that focus on cost-plus pricing, value-based pricing approaches with sophisticated pricing models for specific demand situations are rarely optimally applied before investors foster to optimize them systematically. Pricing can also be applied in combination with product portfolio enhancements and/or consolidations and market expansion strategies.

Market expansion approaches were classified as the third major growth factor, with a lower but still significant upside trend. This factor includes development of new market or customer segments or entry in new geographic regions. One interpretation of this outcome is the simple causal reason of growth capital. This means that new equity capital through private equity investors can be used to finance market expansion activities. In addition, some investors emphasize that they actively support market expansions of their portfolio companies based on previous experiences and access to, e.g., Asian or Chinese market experts or distribution channels.

02 | CASH

As cash turned out to be the value creation lever with second highest actual relevance, it can be broken down into three major factors: first, liquidity management, which is mostly commercially driven through accounts receivables, accounts payables, or customer advance payments. Second, capital expenditures optimizations, which are mainly influenced through asset management and investment/divestment strategies. And third, inventory management, which covers raw materials, work in progress, and finished goods. Since intentionally financial levers were not within the scope of this survey, any effects from financing cash flow were not considered.

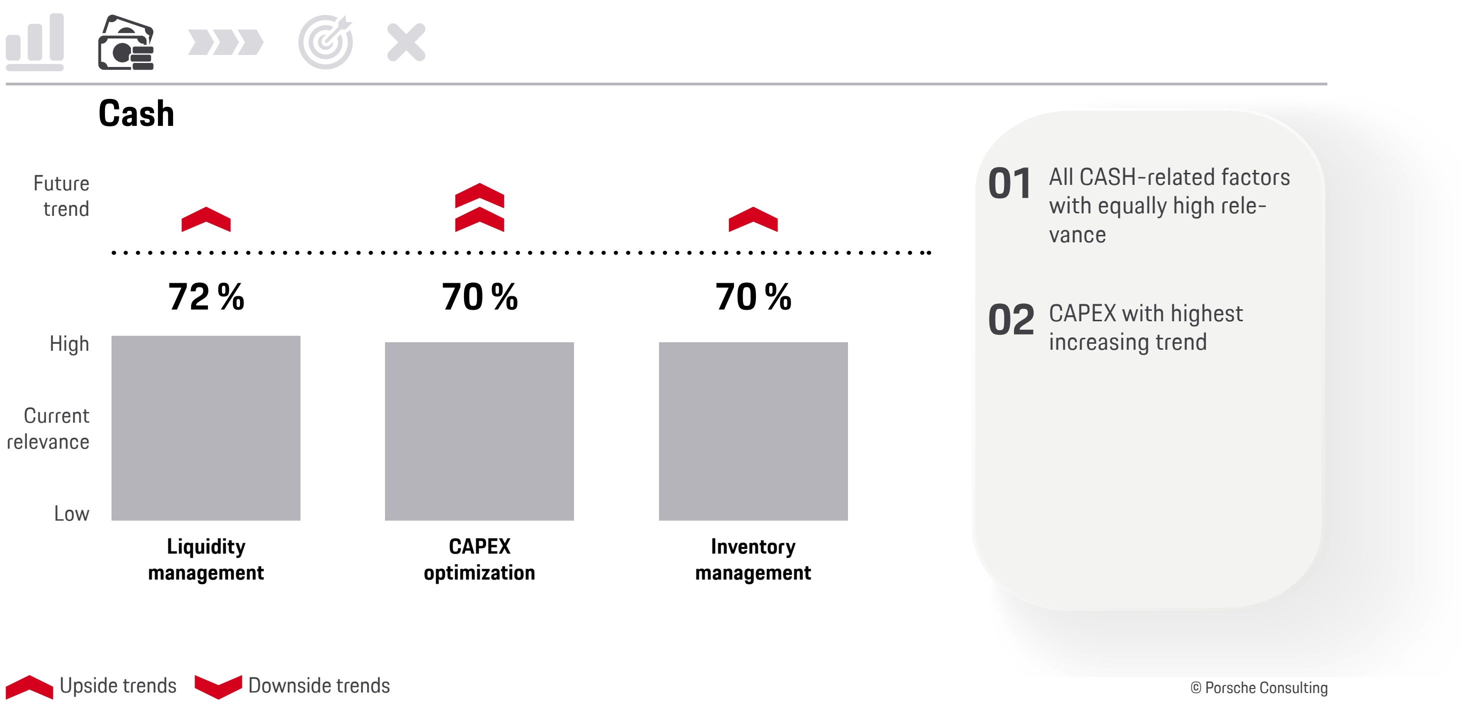

Figure 8. Survey results on cash: All three major factors have equally high relevance

None of the three factors stood out significantly in terms of current relevance. Since CASH is needed to finance GROWTH, this observation is in line with the high and rising importance of top-line improvements. In terms of future importance, CAPEX optimizations scored highest, with 41 percent of the survey participants expecting increasing importance and 59 percent expect at least flat future development. CAPEX needs to combine accurate streamlining with top-line planning and future output requirements. Misalignment results in either unutilized assets or delivery constraints, leading to unrealized top-line potentials. A recent Porsche Consulting project proved that aligned revenue and CAPEX plans play a critical role in exit strategies. The integrated planning justified the vendor's business case assumptions and convinced the designated buyer to continue with purchasing negotiations.

03 | EFFICIENCY

As mentioned before, efficiency delivered the weakest future trend. However, a more detailed look towards single factors that typically account for efficiency generates interesting insights. Indeed, not all factors of efficiency scored low values among the survey participants. Material cost optimizations turned out to be the most important optimization element today, with a strong increasing future trend. This result can be backed by several hypothesis. First, top-line growth aspirations and material cost optimization can support each other via increasing purchasing power. Second, many companies currently face supply chain challenges with regard to availability and delivery times of raw materials. With semiconductors ever-present in the media, similar challenges can also be seen for "simpler" raw materials such as wood components or sheet metals. Supply chain shortages in some cases result in headwinds of increasing purchasing prices, which companies need to address through material cost optimizations. In known cases these optimizations try to reduce regional material dependencies or investigate the future potentials of new production technologies such as 3D printing or industrialization of former specialized materials such as fibers for higher volume production. Besides commercial or technological material cost optimizations, engineering lays the foundation to optimize material cost. Cost and value engineering initiatives can serve as suitable approaches to address that.

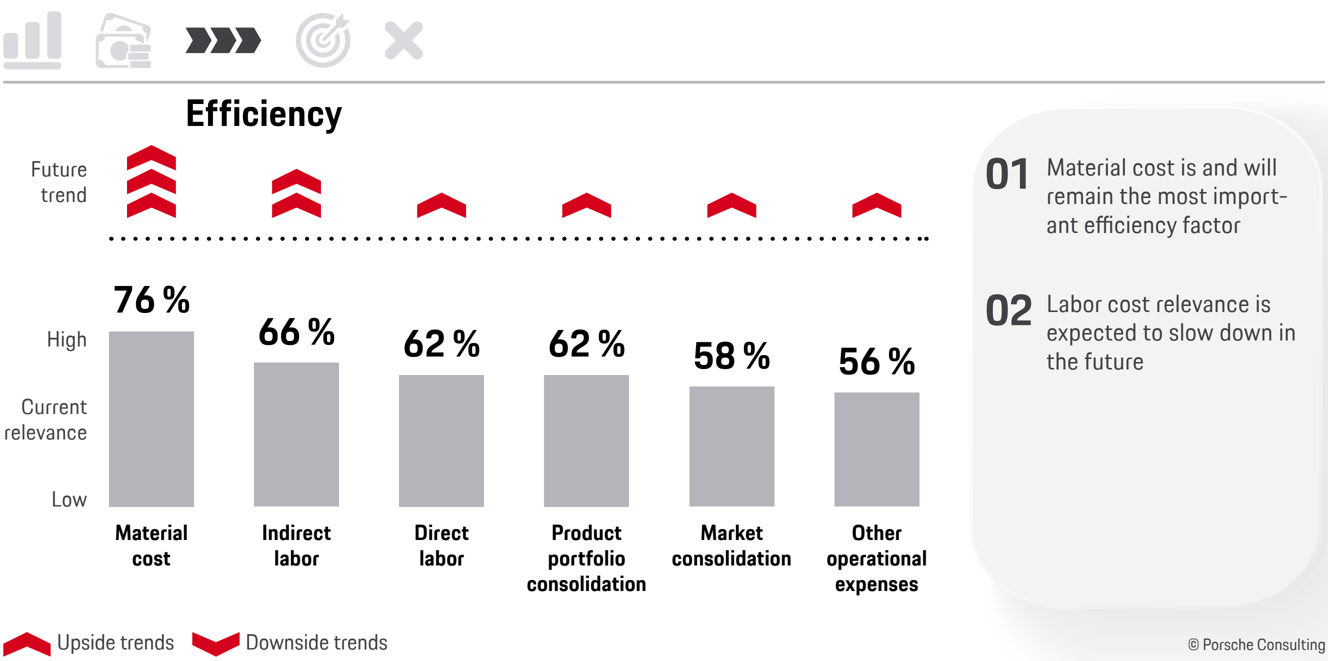

Figure 9. Survey results on efficiency: Material cost is seen as most relevant lever with strong future increase

In contrast to material cost, optimizations of personnel expenses in both direct and indirect areas are expected to decrease in terms of future importance. This result on the one hand contradicts the sometimes publicly drawn picture of job-cutting private equity investors. On the other hand, it goes in line with the mentioned importance of top-line growth and war for talents as in many cases the workforce is essential to drive and realize revenue increases and output expansions. As indirect labor cost optimizations score slightly stronger in current relevance than direct labor, programs to streamline overhead functions, investigate automation, outsource, or centralize repetitive tasks in shared service centers are likely to be continued. The chief investment officer of a mid-cap investor adds another important aspect to the topic of personnel: "Digitalization and further automation through artificial intelligence will impact personnel expenses and lower their overall future importance; however, while the "people" cost block is losing importance, the availability of the right skilled people is becoming the key game changer in a transition."

04 | STRATEGY

Corporate strategy decisions can be used to leverage value creation. The survey indicates that there is one dominating factor in corporate strategies at the moment: sustainability. All survey participants agree on the expectation of its rising future importance. It is obvious that sustainability has become a crucial strategic challenge for companies—across all industries. It is not only the Paris Climate Convention or the EU climate targets that call on companies to act. Social responsibility is also at the center of attention, particularly when it comes to ensuring human rights along global supply chains.

"We see twofold trends here. First, we are pushed by our investors to fulfill ESG rating requirements. And second, more sustainable products and supply chains are expected to outperform unsustainable ones when it comes to customer acceptance and buying criteria." (Survey participant)

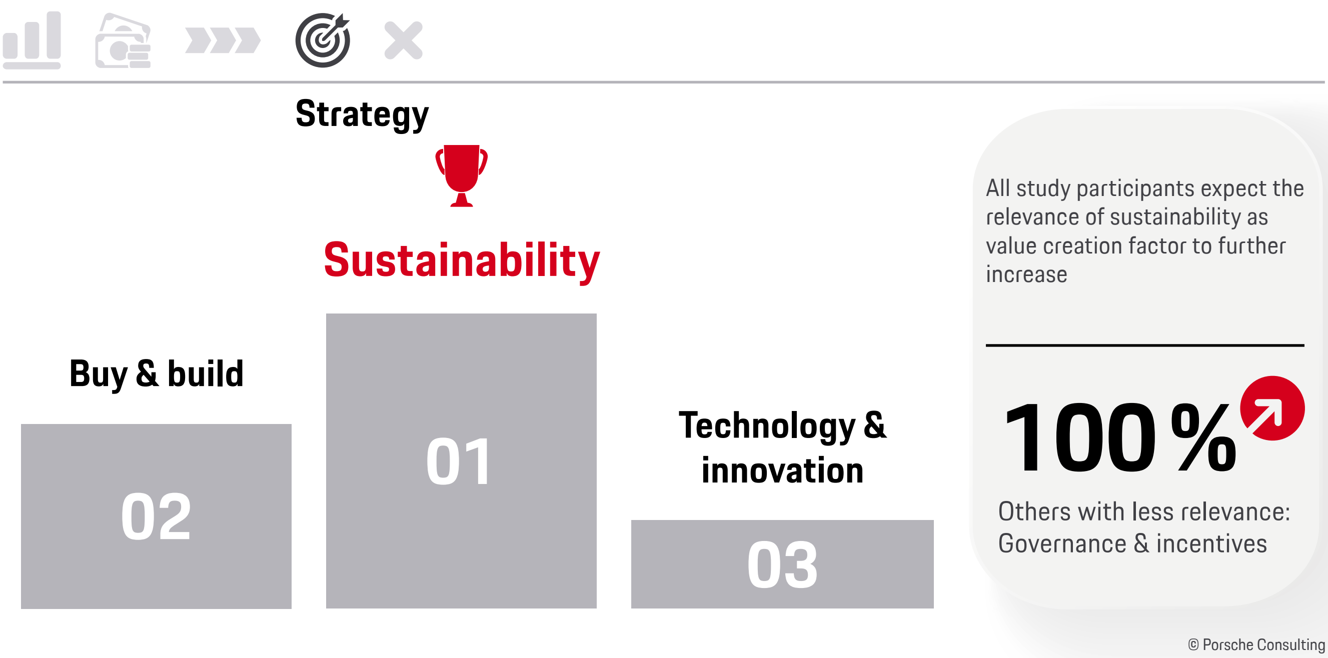

Figure 10. Survey results on strategy: Sustainability is the strategic factor with highest future importance

With respect to private equity, two aspects are likely to cause this conclusive result: First, ESG ratings and regulatory reporting requirements as investment criteria for fund investors have evolved to "must-have" mainstream.[12] Meanwhile, ESG requirements on fund level are actively driven towards portfolio companies. And the task is quite clear: sustainable action and economic success must be reconciled. Several survey participants agreed on the strong pull from funds-of-funds or other institutional investors when it comes to sustainability requirements. "In our latest fundraising due diligence, we had one institutional investor sending in a dedicated team of three ESG specialists," one survey participant relates. "And their criteria due diligence outcome had the importance of a go/no go in the end."

Second, developing more sustainable business models, products, and processes is seen as an additional lever to increase value, e.g., as part of an equity story during the exit process and respective vendor valuations. This is often backed by sustainability strategies, a more sustainable product portfolio, or R&D pipeline, sustainable go-to-market strategies to retain and attract customers, or ensuring more sustainable supply chains. One investor emphasizes the connection between sustainability and actual EBIT effects: "Pure green washing is gone. We can nowadays combine sustainability measures with actual cost savings, e.g., with regard to reduced CO2 consumption, decreased energy costs, solar panels and public subsidies or depreciation effects for new buildings, to name only a few." Frankly speaking, this perspective was not equally shared among all participants. One mid-cap investor in contrast stressed that among his portfolio companies, he sees few actual benefits from sustainability measures. In his view, sustainability is solely driven by regulatory requirements and highly dependent on the fund investors (institutional investors vs. high-net-worth individuals or family offices). Similarly, one large-cap participant claimed not to believe in higher exit multiples due to more sustainability in portfolio companies. It appears as if the private equity industry basically believes in the strategic trend of sustainability but has not yet developed a common view on what this really means for value creation.

Besides sustainability, buy and build and technology and innovation were mentioned as further factors with significant strategic value creation relevance. Pursuing buy and build strategies scored stronger among small-cap investors. This can be explained by the hypothesis that the chance for active market consolidation is larger in markets with many smaller players than in already consolidated large-cap environments. Additionally, some small-cap investors very actively promote platform building strategies to differentiate themselves.

05 | VALUATION

The value creation lever of valuation has been introduced to cover factors independent from any top-line or bottom-line financials. It therefore focuses on reasons to increase valuation multiples between entry and exit in a ceteris paribus situation. Why are investors able to buy a company for eight times EBITDA and resell it five years later for 12 times EBITDA, although the underlying fundamentals have not essentially changed? The number one answer to this question was the factor of repositioning. It significantly outscored other factors in both current relevance and future trend.

When talking about repositioning, it needs to be acknowledged that within the usually limited investment horizon of five to seven years, only a few investors and companies manage to perform a real product portfolio repositioning. Depending on the respective R&D cycles, it can easily take up to ten or more years until companies succeed with a fundamental product portfolio repositioning in the market. Having said that, repositioning during the typical investment horizons rather focuses on communication and branding of portfolio companies. In conclusion, this manifests in equity stories and vendor presentations during exits and needs to be applied thoroughly. "Simply putting lipstick on a pig doesn't work," was the pictorial example one survey participant used. "A successful repositioning requires credibility and backing by actual measures, e.g., product portfolio adjustments."

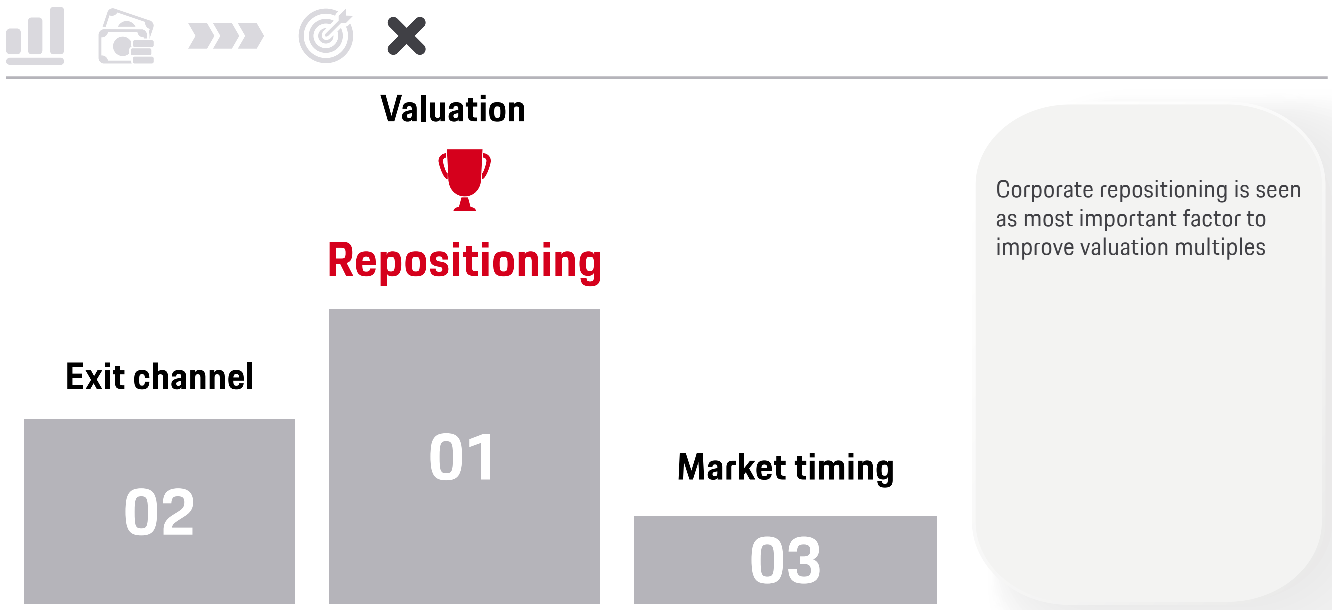

Figure 11. Survey results on valuation: Repositioning seen as most important factor to foster valuation increases

> "We are positioning our portfolio companies more in the direction of digital or tech players—in some cases, with a strong emphasis on green tech or renewable energies." (Survey participant)

Recent investment successes, for example, showed that former old economy players were repositioned and sold as technology or green tech companies. This is well in line with sustainability as a strategic factor and digital revenue streams as a growth factor. In terms of sustainability, repositioned companies appear more attractive backed by green deal equity stories and future revenue expectations. Imagine a rather "old economy" producer of aluminum ladders for construction work that is also equipping the interior of wind turbine towers with metal staircases. Based on a growing global demand for wind power, it seems reasonable to reposition this company as a "green tech supplier" rather than as a "construction equipment provider."

Another recent example was a medium-sized company with very specific, technological material capabilities and two main divisions addressing two major markets. One division focused on conventional industrial applications, e.g., on mechanical engineering or electrical equipment. The second targeted life sciences and medtech. Quite obviously, valuation multiples for life science and medtech companies tend to be larger than for industrial suppliers these days. The investor and the top management team therefore strengthened the life science/medtech division as part of the corporate strategy and used targeted communication campaigns to rebrand the company more towards these markets. However, the company's fundamental structures or operating models remained unchanged. Quite similar effects can be reached through repositioning companies as digital players. Additional digital business models fuel the vision of top-line scalability and future growth.

Other valuation multiple drivers mentioned were the choice of exit channel (e.g., IPO exits) or market timing. Both drivers are expected to remain on a medium level of relevance with only a small increase in future relevance.

After having taken a look at the five value creation levers in more detail and having analyzed their components, the next chapter will provide key insights on the concrete instruments that facilitate value creation.

04

Survey results and interpretations: Insights on value creation instruments

No realization of value creation levers without respective instruments

The findings of the survey gave interesting insights on "what to work on." However, those value creation strategies alone will most likely not yet deliver the required rates of return for private equity investors. The complementary second dimension of value creation is "how to work on it." The survey therefore asked for relevant instruments in order to support the value creation realization. Private equity instruments in this context include working methods, behaviors, arrangements, or mechanisms investors apply to collaborate with their portfolio companies.[13] As a survey result, all instruments were sorted by current relevance and future trend. A short overview of the nine most relevant value creation instruments will be given in the following paragraphs.

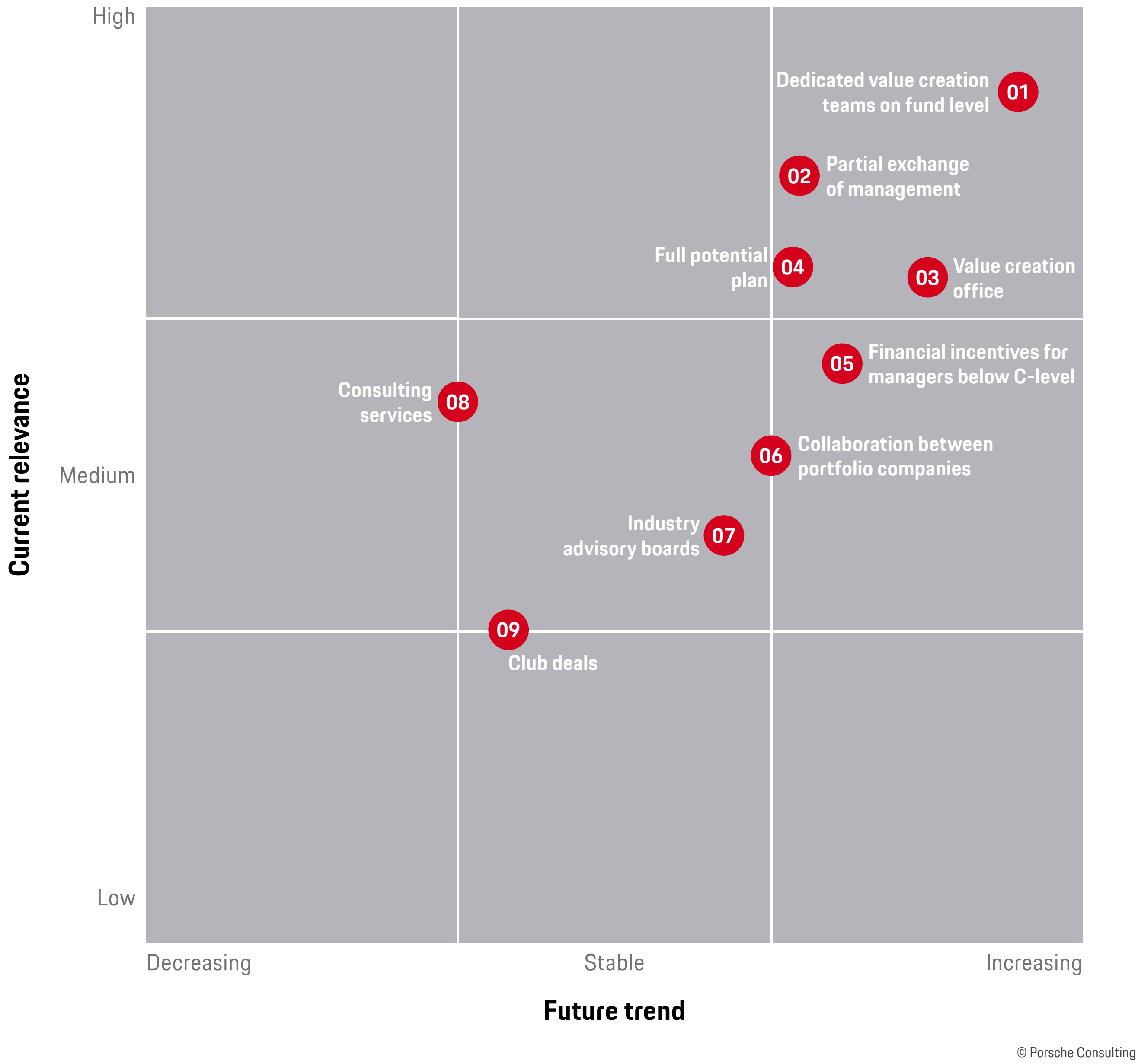

Figure 12. Survey results on value creation instruments: Top three instruments show increasing direct engagement of investors in portfolio companies

01 Dedicated value creation teams on fund level

In recent years, private equity investors have built up value creation teams besides the typical deal teams to actively engage with portfolio companies on value creation. Members of these value creation teams are typically equipped with many years of management experience in consultancies or large-scale corporations. Hence, this trend can be seen as an active insourcing of external consulting services. Some investors even employ interim managers on the fund level and send them to their portfolio companies to strengthen C-levels. One mid-cap investor emphasizes this strategy as follows: "Just relying on multiple arbitrage is not working anymore. You need to get your sleeves up and work with the portfolio company on cost and cash flow as well as on adopting a business towards real customer demands." A large-cap survey participant points out the degree of value creation in portfolio companies: "A ten percent cost reduction can be realized by any of our portfolio companies without our support, if necessary. We see high demand for support when it comes to holistic transformation programs."

In addition, the involvement of value creation teams can become a key deal criterion in transaction phases. One small-cap investor explains: "The collaboration between company managers and value creation teams during the transaction can serve as an indicator for the future willingness and commitment to actively work on value creation together. We refrain from deals where management is not open to change." Ultimately, this instrument is evaluated with the highest current relevance and expected to gain further importance in the future.

02 Partial exchange of management

The second-highest relevance as an instrument to foster value creation is seen by partly exchanging portfolio company managers—if required. However, the future trend for this instrument is not increasing as steeply as for some other instruments. Participants emphasized that underlying investment decisions are typically closely associated with a convincing management team that is incentivized in transactions through their own investment stake, sometimes even enlarged through sweet equity components or value creation bonuses. Therefore, the exchange of management is often seen as an unpleasant decision and certainly not the first investor intervention. However, these participants also acknowledged that they sense a tendency of less patience with underperforming managers.

03 Value creation office

Not to be confused with value creation teams on the fund level, value creation offices in portfolio companies typically act as the driving and tracking force for value creation initiatives or projects in portfolio companies. They usually report directly to CEOs or CFOs and act as an extended arm of the investor. To accelerate value creation, these offices typically set up tight program structures and enforce transparency on the current status of initiatives, visible financial impact, and forward-looking effects on budget plans. They also tend to act as sparring partners to n-1 or n-2 managers in the companies. This instrument scored high in today's relevance and is expected to gain further future importance as well.

04 Full potential plan

Typically drawn up at the end of transaction phases between signing and closing or as one of the first steps after private equity investors have closed deals, this instrument analyzes and establishes a holistic picture of all value creation levers to be pulled and initiatives or projects to be launched. Full potential plans are typically created in close collaboration between investors and the top management team of portfolio companies. They are used to prioritize initiatives and define a timely road map of value creation initiatives. It is seen as highly relevant as value creation offices but with future trend that is increasing slightly less.

05 Financial incentives for managers below C-level

Financial incentives for C-level or board members are in most cases part of the transaction structure, especially in management buy-out or buy-out situations. The survey therefore took these types of incentives for given and specifically asked for the relevance of additional value creation incentives for managers below C-level. These incentives should not be confused with already existing bonus payment models. It rather summarizes equity share programs, stock options, mezzanine capital instruments, or performance-based loan structures specifically designed to resolve agency conflicts between middle management and investors. This instrument turned out to have medium current relevance but an increasing future trend.

06 Collaboration between portfolio companies

This instrument includes ideas such as bundling purchasing volumes, building shared service centers, establishing client-supplier relationships, or exploiting common sales channels across different companies under the same private equity shareholder structure. Not surprisingly, this instrument scores higher relevance among small-cap investors compared to mid- or large-caps.

07 Industry advisory boards

Former senior managers or entrepreneurial individuals serve as advisors to investors and portfolio companies. Sometimes even used to attract future portfolio companies in transaction phases, this instrument scored medium relevance and a slightly increasing future importance.

08 Consulting services

A medium current importance but slightly decreasing future trend was mentioned with regard to use of external consulting services. This result indicates that improvement concepts and implementation projects are being insourced, which is in line with the increasing importance of dedicated value creation teams on fund level and value creation offices in portfolio companies. Survey participants in this context mentioned that they tend to decrease the use of external consultants for conventional project management office support or off-the-shelf improvement projects, e.g. procurement spend cube optimizations or business process management. In contrast, very specifically focused consultants gain importance, e.g. when it comes to resolving technical productivity issues in production or deploying robot process automation solutions in larger administrative scales.

09 Club deals

This instrument can be used in case more investors acting as a team see higher chances to generate the required rates of return for a certain transaction in comparison to standalone investors. The range of answers for this instrument showed the highest spread among all instruments using the entire bandwidth. This indicates that certain investors actively look for club deals, e.g., in later-stage venture capital financing rounds or with respect to large-cap transactions, whereas others do not see any benefit from club deal structures at all. One of the most recent large-cap examples of such club deals is the takeover of the former ThyssenKrupp elevator business by Advent International, Cinven, and the RAG foundation, summing up to a transaction volume of 17.2bn euros. Another recent club deal example was a growth finance transaction for the intellectual property software and service provider Questel, which involved the already engaged investors Eurazeo, IK Investment Partners, and RAISE, plus the newly entering shareholder Paragon Partners.

Recommendations: Focus on three major outcomes

The survey provides interesting insights on current market behaviors and future trends. Three outcomes have to be highlighted and will be complemented by Porsche Consulting recommendations.

In order to focus on the most significant results, the following three outcomes deserve a more detailed presentation:

GROWTH was evaluated as the most relevant value creation factor and its future importance is even expected to increase the most among all factors. In more detail, the survey identified digital revenue streams as the major driver for GROWTH. The key question is how to develop and harvest the digital revenue stream.

With regard to the value creation factor STRATEGY, sustainability scored an outstanding result with all survey participants agreeing on the increasing future importance of sustainability. The key question is how to convert sustainability from a strategic buzzword into real-life impacts.

When it comes to value creation instruments, the survey results show that private equity investors increase their direct engagement and operational involvement in portfolio companies through value creation teams on fund level, value creation offices in portfolio companies, and partly through the exchange of management. The key question is how to foster collaboration between those three stakeholder parties, as this is crucial for value creation.

Digital revenue streams as a major growth driver

The survey identified digital revenue streams as the most relevant growth factor. Many companies are indeed following this path. However, only a few have managed to convert digital revenue ideas into significantly real P&L numbers thus far. As a little piece of advice, nine imperatives can be followed to master the transformation journey towards digital revenue growth.

Imperative 01: Start by assessing the suitability of digital revenue streams as part of your corporate strategy, for your customer base, product market saturation level, and competitive rivalry. Leverage insights from other comparable industries that can provide analogies.

Imperative 02: Successful transformations require a clear ambition level and a shared-purpose idea supported throughout the top-level management. Clearly defined long-term ambition levels linked to a concise north star statement provides orientation for your organization.

Imperative 03: Exploring digital business models that highly depend on your customers. Introducing new digital business models is a change process, for your company and the customer. Co-creation based on well-established relations and a deep knowledge of your customers' operations are keys to assess incurred risks that must not exceed the created value for customers.

Imperative 04: Starting from the defined strategic goals, a structured process to identify, prioritize, and co-create digital revenue streams is key. An integrated product-service portfolio road map highlights interdependencies for successful execution and interlinks with your existing (classic) product portfolio.

Imperative 05: Design your partnering strategy and leverage third parties to extend or improve your value proposition or help you scale in a platform ecosystem. Also include time to market in your considerations since many digital solutions are technically already available and can be adjusted to support your digital revenue stream ideas without being developed from scratch.

Imperative 06: Break your ambition level down into a stringent steering metrics cascade. This gives direction and provides a mechanism for alignment via KPIs on the strategic, tactical, and operational level. Leverage them in your communication, target setting, and to foster autonomous decision making at the lowest level possible.

Imperative 07: Design a dedicated organizational and structural setup with C-level anchoring to foster digital revenue streams. If digital business is a key pillar of your strategy, this should also be visible in your organizational chart with short reporting lines and direct escalation to the board level. Along the develop-sell-deliver logic the necessity of a central vs. decentral footprint and interfaces to the product business are the core considerations.

Imperative 08: Transform your sales capabilities and gradually upskill your salesforce. Build up dedicated resources for (digital) service and innovative business model sales. Gradually transform your sales DNA starting by upskilling service, then product/salesforce via suitable training concepts.

Imperative 09: Introduce innovation accounting along a structured stage-gate innovation process. Metered funding of teams that must show progress helps foster speed, continuously review the digital revenue innovation portfolio, and kill endeavors before they become zombie projects that consume time and budgets.

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01 Make digital revenue streams part of your **corporate strategy**	**02** Set the right **ambition level** and provide orientation for your organization	**03** **Explore digital business models** and apply co-creation with customers
04 Use a **structured process** to identify, prioritize, and co-create digital revenue streams	**05** Design your **partnering strategy** and leverage third parties	**06** Break your ambition level down into a **stringent steering metrics** cascade
07 Design a **dedicated organizational** and structural setup with C-level anchoring	**08** Transform your **sales capabilities** and gradually upskill your salesforce	**09** Introduce **innovation accounting** along a structured stage-gate innovation process

Figure 13. Porsche Consulting recommends nine imperatives for realizing digital revenue streams

Sustainability as a major driver for strategic value creation

The survey showed overwhelming agreement among all participants with regard to sustainability as the most dominant factor for strategic value creation. A successful sustainability strategy is based on the integration of structures, processes, and culture. Four key elements set the stage for companies to undergo successful transformation to sustainability: sustainability milestones, sustainability dimensions, Sustainable Development Goals (SDGs), and operational directions.

The transformation path towards sustainability is structured by six milestones. The starting point is (1) a determination of position and the definition of the strategic framework with the (2) corporate vision. This is put into concrete terms by deriving (3) objectives and (4) the associated initiatives and measures (e.g., reducing CO_2 emissions by 45 percent at all plants by 2035, achieving 20 percent product recyclability, increasing biodiversity in a factory by 70 percent by 2025). Establishing (5) suitable structures and framework conditions at the company and designing a company-wide control and management process enable the initiatives to be put into practice and the transformation to proceed on a continuous basis. Ultimately, (6) establishing a sustainability culture is an essential factor for success, in combination with comprehensive change management, intensive employee engagement, and a new culture of leadership "WEadership".

"WEadership" refers to the close involvement of employees by managers in sustainability activities—instead of setting top-down guidelines, the management process refers more to social aspects in order to be able to use employee motivation and commitment in a goal-oriented manner. Acceptance, willingness to change, and co-determination rights are important drivers in sustainability transformation.

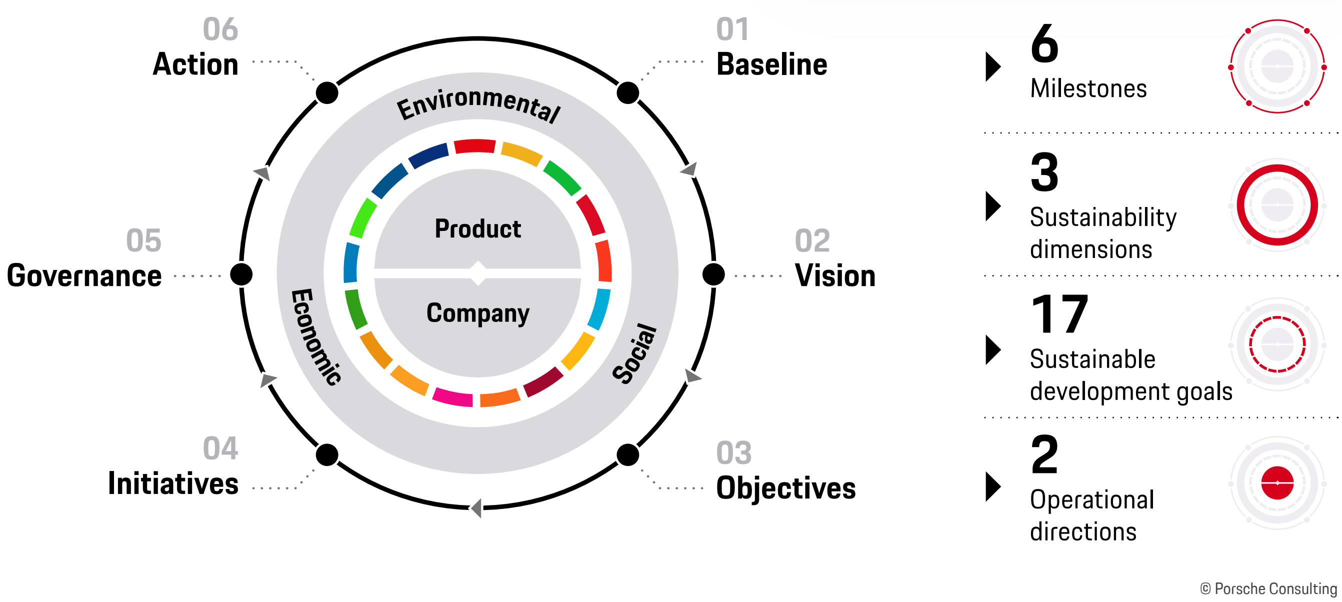
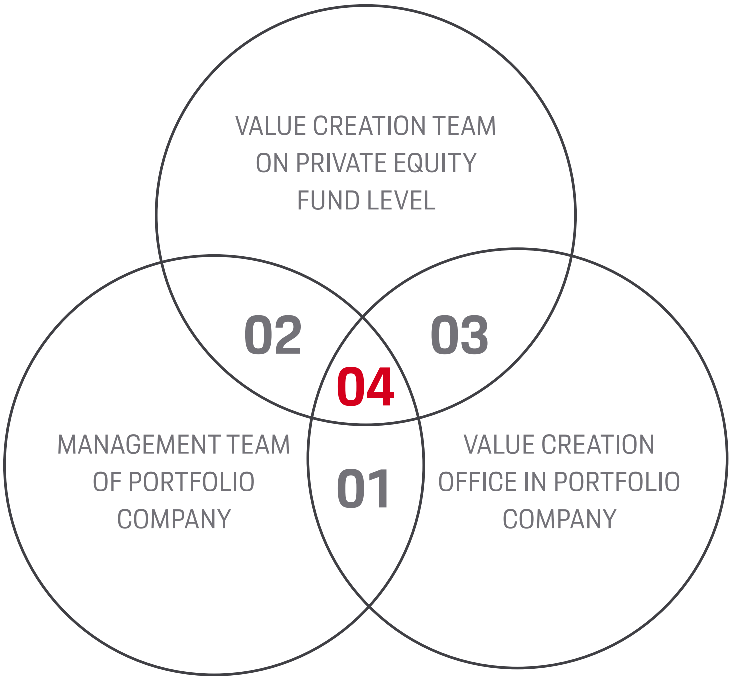


Figure 14. The Transformational Approach towards sustainability is structured by six milestones based on the Sustainable Development Goals (SDGs)

Collaboration between value creation teams on fund level, company management, and value creation offices

When it comes to value creation instruments, the survey results show that private equity investors increase their direct engagement and operational involvement in portfolio companies through value creation teams on fund level, value creation offices in portfolio companies, and partly through the exchange of management. The collaboration between those three stakeholder parties is crucial to realize value creation.



01 Stringent implementations but not necessarily in the direction of private equity shareholder value creation

02 Clear ambition and strategy towards value creation but lack of transparency on implementation plan and progress

03 Clear value creation ambition, strategy, and transparency but missing management commitment to realize implementation

04 Fully aligned value creation ambition and strategy with strong management commitment and clear transparency

Figure 15. An aligned value creation strategy results from collaboration between value creation teams on fund level, company management, and value creation offices.

Misalignment between those three parties apparently slows down value creation. A key recommendation is therefore to clearly define roles and responsibilities among these groups. This is especially important if a portfolio company is entering private equity ownership for the first time. General levels of authority are most likely defined through shareholder and management contract(s). However, the actual way of working between those new-to-each-other parties in many cases leaves room for unclarities or misunderstandings. The same is true when value creation offices are set up for the first time. Typical questions include: What are their general roles and responsibilities? Do they take away responsibilities from other departments in terms of general business planning or strategic workforce planning, for instance? How much decision power are they awarded with, or will they act as an advisory body instead? How will the value creation office interact with members of the middle management—as a tracking and driving force or in a content-oriented support function?

Weak value creation offices overload middle management functions with additional reporting bureaucracy and little prioritization to set the right value creation focuses. Examples of portfolio companies with a three-digit number of relevant middle management people who are burdened with an almost equally three-digit number of individual value creation projects that all run in parallel have proved to not progress as required from the investor's perspective. Strong value creation offices, on the other hand, foster a focused prioritization on improvement implementations, ensure the required top-management support for committed middle managers, and provide honest transparency on missing commitment or progress in the organization.

Future outlook: "Survival of the fittest" or "everyone takes a seat"?

Based on large capital allocations, the competition among private equity investors is at a record level. This is driving transaction prices and the need for more active value creation in portfolio companies. The survey gave detailed insights what type of value creation strategies are en vogue. Since private equity investments most typically follow five- to seven-year time horizons, this is roughly the time frame when value creation needs to ultimately materialize.

Whereas some market observers believe that private equity funds deliver their investors' expected rates of return, others are convinced that the profitability of this asset class will suffer from strong competition and the high entry prices. Will private equity funds with active portfolio company engagement and successful value creation prosper and "survive as the fittest" or will the vast majority of funds achieve its return targets, proving that still "everyone takes a seat" in this competitive environment? Despite the different possibilities that might occur, the study has proven the great potential and opportunities of the different value creation levers and instruments—especially growth and an efficient sustainability strategy—and provided strategies for investors how to cope with the current challenges of the market.

In Brief

01 Growth is being evaluated as the most relevant value creation factor—its future importance is even expected to increase further.

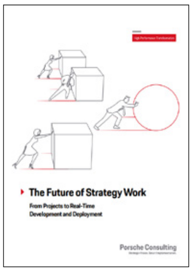
02 Labor cost optimizations in the direct and indirect workforce are expected to decrease in future relevance. Gaining and retaining talent is key. This contradicts the sometimes publicly drawn picture of job-cutting private equity investors.

03 The private equity industry believes in the strategic trend of sustainability but has not yet developed a common view on what this really means for value creation. Whereas some see it as a need to fulfill ESG rating requirements, others see in it a chance to create direct financial impact.

04 The survey indicates increasing direct engagement of private equity investors in their portfolio companies, e.g. through dedicated value creation teams on fund level, the partial exchange of managers, or the use of value creation offices in portfolio companies.

05 In order to not neutralize each other, roles and responsibilities among value creation teams on fund level, company managers, and value creation offices need to be clarified. An aligned collaboration between those parties is needed to boost value creation.

Further reading



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Appendix

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