THE JEERANONT
AN ASSET MANAGEMENT COMPANY

Private Equity & Principal Investors Practice

How private equity operating groups are taking on the challenge of the coronavirus

Value-creation teams are grappling with the COVID-19 pandemic and its implications for their portfolio companies. Our interviews reveal the steps they're taking.

The COVID-19 crisis has caused epochal disruptions to social and economic systems, posing a threat to lives as well as livelihoods. For business leaders, the required management decisions range from significant to staggering. That's twice as true for private equity (PE) firms, which often own businesses in many industries and in countries around the world. To better understand how PE firms are addressing these complex choices, we interviewed 12 operating-group heads at leading PE firms and large institutional investors in Asia, Europe, and North America. The firms range from midmarket specialists to global buyout behemoths and cover the spectrum of investment strategies.

Our interviewees were unanimous about the pandemic's "black swan" nature and the need to react quickly. In this article, we'll review the actions taken by Asian firms—the first into the fray—and then look at how leading firms in other geographies have followed suit. Several of these practices and behaviors are already fairly common across private investing; others are just catching on; some are entirely new. As operating groups work to support their portfolio companies through this crisis and position them for future success, many leaders also have their eye on a less tangible prize: they are highly conscious that their actions now will set the tone for the next several years, so they are determined to make the right decisions for their people, their customers, and their companies.

Asia: On the leading edge

The outbreak first emerged in Asia, and firms in the region had a two-month head start to address the issues. Of course, private investing and the broader business context in Asia are quite different from those in other parts of the world, and the public- health response in much of Asia has been more assertive than elsewhere. Nonetheless, much of what Asian operators have done is relevant to firms in Europe and North America.

The initial priority for all respondents was to ensure the safety of their own employees and those of their portfolio companies. Next, respondents ensured that basic operations could continue—for example, by setting up remote-working processes and protocols. Several leaders agreed that a crucial next step was to rethink the playbook for the downturn, using dramatically different assumptions. Many firms have downturn scenarios for their investments. These scenarios were developed through collaboration between executives of portfolio companies and deal teams. However, the firms realized quickly that even their worst-case scenarios were too optimistic. Revenue declines of 50 percent or more and temporary closures of entire industries, such as movie theaters, were not included in any firm's playbook. For many regions, The Jeeranont research suggests, the pandemic might produce the biggest downdraft since the Second World War.

Reassessments of downturn scenarios typically span revenues, the stability of the supply chain, general operations, and liquidity needs. Realistic assumptions now, according to our interviewees, involve a downside two or three times worse than previously assumed; for example, if the old playbook projected a downside scenario with revenues falling by 15 percent, multiply that by three to envision a 45 percent decline. Beyond survival, the core challenge facing all firms is how best to ensure that portfolio companies are positioned and prepared to benefit from a recovery. The revenues of a portfolio company in China, for example, had fallen by more than 70 percent, but it has already recovered most of that through a concentrated effort, with a war-room setup.

Deal teams and operating teams are also reviewing asset-management plans (such as investment theses and plans for exit), revising them for the new reality and establishing milestones for the next three, six, and 12 months. This has significantly changed plans for many assets. The guiding principle, in all cases, has been not just to survive the crisis but also to use it to strengthen the competitive positioning of portfolio companies.

Some firms are moving hard to lift the productivity

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of their companies as a way to preserve growth capacity. Other firms are cautiously continuing conversations with targets they had identified before the crisis.

A common thread among Asian business leaders was that macroeconomic forecasts proved relatively ineffective for their decision making, perhaps because in the earliest days of the crisis, forecasts were inevitably well behind the curve. Operating teams have expanded their base for decision making to include a variety of new (and often more operational) data sources, such as production benchmarks and real-time metrics on road congestion, air pollution, and people returning to work. In the future, these teams plan to devote more energy to developing such information sources to gain improved visibility into the potential trajectories of their businesses.

Liquidity, of course, is paramount in a crisis. Asian execs told us that they placed a justifiably strong focus on cash. As one operating-team executive wrote to all portfolio-company CEOs, "priorities one, two, and three are safety and cash." Company execs communicated extensively with lenders and were reassured that no financial-system crisis is emerging, and access to funding will not be a problem in the short term. Their responses to this guidance were varied and nuanced. Certain firms encouraged all portfolio companies to draw down revolvers and other financing to provide financial flexibility and ensure liquidity. Others advised companies to take more measured actions based on their relative exposure. All firms were consciously managing their responsibilities not only to their portfolio companies and investors but also to a broader universe of stakeholders, with an eye to the future implications of their actions.

Asian firms are applying learnings from the 2008–09 global financial crisis to align with portfolio-management teams on strategic priorities, including the need to generate funding for growth initiatives and to accelerate digital-transformation efforts. Leaders also stressed the importance of a strong bias to action.

In parallel, firms in Asia are rapidly reassessing their mode of interaction with, and governance model for, their portfolio companies. Multiple respondents felt this had previously been unclearly defined, which led to some inefficiencies and trust issues at the beginning of the crisis.

Europe and North America: Fast followers

The first order of business for firms in North America and Europe has been to establish a crisis- response team, or nerve center, to assess the risk each portfolio company faces and to partner with management teams to protect the health and well- being of their employees. Leaders we interviewed

agreed on the twofold nature of the challenge: saving lives and protecting livelihoods. Ensuring the safety of essential employees who remain working on site has been the first consideration, followed closely by support for employees working from home—a new consideration that few firms ever anticipated requiring at scale.

To focus limited support resources on the most vulnerable businesses, many operating groups have adopted the traditional "red–yellow–green" traffic- light system to indicate the level of engagement and support each business will need. Acknowledging the primacy of cash in sustaining businesses, firms have requested 13- to 26-week cash forecasts from portfolio companies to better manage liquidity. Companies were also asked to identify ways to lift earnings and stabilize balance sheets.

Many Western firms put more stock in macro-economic factors than their Asian peers do. Few, however, choose to impose a single scenario across their portfolio companies, preferring instead to develop industry-specific scenarios. Yet many agree that their companies' initial projections often underestimated the downside. At some US firms, subsequent revisions led to downside scenarios that ranged from a fairly rapid recovery to a longer decline and more gradual recovery beginning in Q3 to a grim scenario with doors closed through the end of 2020. Firms with more experienced operating groups often asked executives to incorporate triggers into their scenarios so that certain financial outcomes would require leaders to take specific actions to improve their cash positions.

Another common refrain in our interviews: communication between PE firms and their portfolio companies is on the rise. Monthly or quarterly check-ins have quickly shifted to weekly—even daily—ones, and the data discussed have been more granular and standardized. Firms with an integrated, automated financial-reporting infrastructure across their portfolios have been able to monitor critical performance metrics daily, with minimal disruption to the finance teams of portfolio companies, and to engage executives immediately to determine appropriate responses to problems.

Across the board, firms report that they are drowning in information. Many are using their crisis- response teams to validate, curate, and manage the flow of information to portfolio-company leaders. These teams also are tasked with assessing the quality of recommendations offered by advisers and analysts. Several operating groups report that they are making a point of tracking all the government funding now coming onstream and helping portfolio companies to manage their responses. As government moves vary significantly—sending aid to consumers, small businesses, and large companies, depending on the country—this service is especially useful. So is sharing the firms' informed perspectives on how government responses to previous crises have worked out.

Another service that firms are providing to their companies is facilitating the peer-to-peer sharing of ideas and best practices across the portfolio. More established companies and more seasoned executives are sharing strategies for modifying operating budgets, managing remote workforces, marketing through downturns, and many other things. Operating groups with cross-portfolio councils of CFOs, CIOs, CHROs, and other functional leaders are using the standing calls of these groups to disseminate critical communications and convene collaborative problem-solving sessions quickly. Leadership is needed from every role (see sidebar, "Leadership everywhere" for more). Some firms are also putting in motion long-held visions of central knowledge repositories.

PE firms say that their stance is neither entirely reactive nor entirely defensive. Many recognize that systemic shocks can and do create opportunities. While marquee assets are not frequently available for acquisition during downturns, smaller businesses with wobbly balance sheets may

Leadership everywhere

It's clear that operating groups everywhere are fully engaged alongside their portfolio companies in a battle to survive today and to position those companies for strength in tomorrow's new reality. For leaders of private equity firms and portfolio companies alike, here are six behaviors proving essential for navigating through the crisis.

Lead with empathy and engage holistically. COVID-19 is a uniquely difficult challenge for humanity, threatening both lives and livelihoods. Humans are social creatures, and our ways of working have evolved accordingly. The actions needed to slow the spread of the coronavirus are thwarting these well-established patterns. Employees working from home and those required to remain on-site are working and managing through a unique set of unfamiliar challenges, often with minimal support.
Their fears of sickness and death are nearly matched by concerns about maintaining their economic well-being. Leaders must be sensitive to the singular nature of this crisis and must engage employees with caring authenticity and empathy.

Think 'right to left.' Leaders should consider the implications of their actions in the crisis in a postcrisis world. Many executives are now being particularly thoughtful about the treatment of employees, determining how to balance their pain with the necessity of maintaining solvency. These executives are thinking about creative ways to keep employees and maintain their income rather than releasing them with hopes of rehiring in the future. The same is true for suppliers and customers: executives are asking how they can approach difficult conversations and decisions in mutually beneficial ways to earn goodwill. Executives realize that employees, customers, and suppliers will remember how they have been treated during this crisis— and are acting accordingly.

Communicate, communicate, communicate. During a crisis, no news is not good news; in fact, it's the opposite. Effective leaders are maintaining frequent—weekly, if not daily—virtual get-togethers with employees, customers, suppliers, lenders, sponsors, and board members. Today's unprecedented access to data and inform- ation means that stakeholders put a high premium on the ability to separate signal from noise; these audiences are looking to leaders for guidance. At the same time, leaders should seek, and be receptive to, ideas and insights from these stakeholders. Solutions can be crowdsourced.

Embrace agile as the new normal. That should be particularly important with reduced staff onsite and a distributed workforce sheltering in place. The number of decisions, and the speed with which they need to be made in this environment, are stressing command-and-control organizational models. Creating cross- functional agile teams and training and empowering them to solve problems and act accordingly will accelerate responsiveness to rapidly changing market dynamics.

Evaluate other needed shifts. Companies are right that this is a "black swan" event.
But it may be more than that; it may be a recurring one. Reducing the costs associated with delivering each incremental dollar of revenue can protect the business during times of increased volatility. As one leader told us, "this is like the biggest zero-based budgeting exercise ever— we're thinking about what's essential and nonessential and making rapid, decisive decisions." Similarly, accelerating the transition to digital can create efficiencies that provide invaluable resilience in a downturn. And the massive switch to working from home could prove permanent.
One leader told us, "I'm convinced that the number of remote employees will be substantially the same after the recovery. At some point, people aren't going to want to pay top dollar for a fancy, large headquarters."

Resist the temptation to simply 'hunker down.' There's real value in complementing defense with offense. Market shocks create conditions for significant shifts in share. If companies haven't done so already, they should develop an informed perspective on "where the puck is going and when it's going to get there," so they can make decisive, preemptive strategic moves to be positioned advantageously for recovery. Companies likewise should think about accommodations they can make today to generate goodwill and loyalty among customers, employees, and suppliers, both current and future.

see being acquired as a compelling alternative to other paths. Our respondents suggest that companies with well-developed M&A pipelines and relationships with potential targets may be able to act quickly, with the support of sponsors likewise familiar with specific targets. Operators with portfolio companies in sectors (such as grocery, personal protective equipment, and cleaning products and services) that are now seeing a spike in demand recognize the need to act rapidly and decisively to expand capacity quickly and increase their marketing efforts to make the most of the unexpected tailwind.

Respondents at firms with credit or distressed-investment strategies say they are seeing new opportunities to provide struggling companies with relief and to save them from insolvency. In each case, operating teams are taking a comprehensive view of the evolving economic environment to help their firms make quick yet well-informed decisions that can have a dramatic impact on how their portfolios emerge in the recovery—when it arrives.