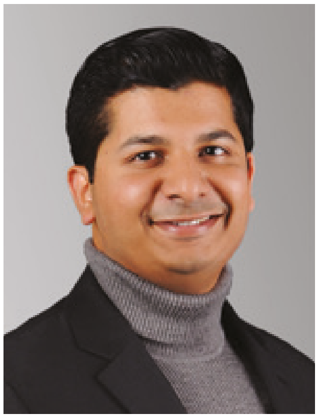
KEYNOTE INTERVIEW

Compounding value creation



For PE firms backing software companies, the secret to speeding up value creation is to make some key product portfolio decisions at the outset, says Persistent Systems' Punit Kulkarni

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Private equity firms will often tout their strategic patience. Compared with publicly listed companies that often live quarter to quarter, PE's ownership cycle affords them the time to rebuild and improve companies so they can thrive in the long term, even if the short term looks challenging. Still, no one mistakes this longer-term outlook as the kind that slows the pace at which GPs pursue their investment thesis. Indeed, private equity has made its name by delivering change at speed, often revitalising underperforming businesses in record time.

Yet while speeding up matters, it is only a virtue if it is married with strategy. This statement is true in every sector, but software companies can be especially prone to mistaking a fast pace for progress. *Private Equity International* discussed the need to underpin speed with strategic direction with Punit Kulkarni, vice-president at Persistent Systems, a service provider that partners with private equity firms to create value in their software-driven portfolio companies.

For Kulkarni, GPs can move fast effectively by developing a clear strategic direction at the beginning of the investment cycle, which can then have a compounding effect on value creation for the asset.

Q Change management begins with due diligence. What should operating partners be focused on when reviewing a potential investment in software or other digital opportunities?

We have worked with dozens of private equity firms and remain in awe of how well they can drive change at their portfolio companies, improving the products, operations and culture.

However, in this space, it is vital to take a hard look at the product portfolio and ensure a rationale for each product. In short, they need to realign the portfolio so that it caters to meet future customer demand. This process involves developing a thesis around what products are sustainable, what products need further development, and what products no longer belong in the company's future.

A great example is a private equity firm we worked with that acquired a software asset. The portfolio comprised high-performing brands and products, including several database and systems management solutions, but the private equity firm decided to drive the company towards a leadership position in the IT governance and resilience space. In this instance, the firm took the time to discern that the portfolio had an unrealised potential for this strategy and went after it.

Once that strategic direction is applied to the product portfolio, the next step involves pruning product branches that no longer make sense to the company's new approach.

Q Underperforming products might contribute to a company's new direction, while strategically irrelevant products might be the most profitable in the near term. How should operating partners look at those kinds of trade-offs?

There can be hundreds of different reasons to keep or lose a particular software offering, all of which may be valid, so you should take a comprehensive view of any product. That product may be underperforming but has the potential to be a market leader with additional investment and development. That is why it is essential to develop a strategic direction to help inform this portfolio alignment.

But that strategy cannot be the only metric either. Other considerations are just as valid. Let's say that the company has a hit piece of software that is incredibly profitable but might be irrelevant to the new strategy. These profits can finance the development of products that serve the new strategy and can therefore play a role in the company's future for now.

Another way to look at a particular product is through its existing customers. Perhaps the product is not a best seller, but it has an enthusiastic customer base, and those customers would be ideal buyers for the company's new suite of offerings. Why let those customers go? Keep them in the company's orbit with the current product so that the relationship is there to sell whatever comes next.

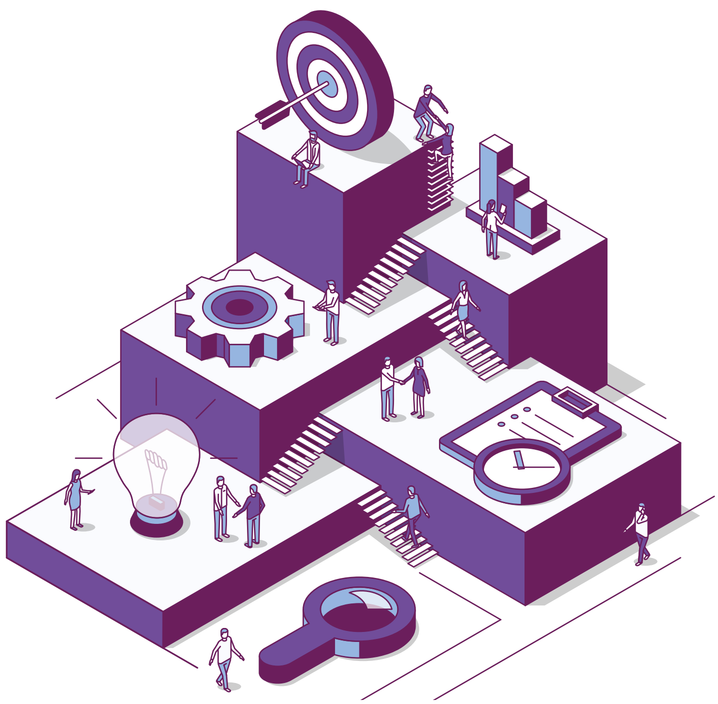
When I refer to portfolio alignment,

Q Once the private equity firm has developed its strategy, what should it do next to speed up its value-creation efforts?

It is a matter of ensuring that the entire team buys into the new strategic direction. When I say team, I am referring to everyone playing a role in the value-creation effort. That means the private equity firm, its operating partners, the portfolio company management and staff, and any outside partners or specialists that are tapped to be part of the effort.

At the top of the list must be the portfolio company management. No doubt the private equity firm and its operating partners are on board, but GPs must sell the leadership and staff on that strategic vision. The last thing anyone wants at this juncture is to find the company's best developers and leaders are leaving because they don't understand where the enterprise is headed.

It is not hard, as the strategic vision usually involves a better, more rewarding work environment. Still, GPs should not take it for granted that the portfolio company, either its senior leaders or best staff, understands this. We have seen firsthand how projects can fail because of a disconnect between the private equity firm and portfolio company management.



"Functionality can never be isolated from customers. Their engagement, satisfaction and interest need to inform the value of any product"

"The way to think about these specialists is as part of the symphony that an operating partner is conducting"

I am really arguing that the private equity firm should build the right ecosystem for the company's future, with the right mix of resources, capital, customers and products for that direction. Not every product is there for the strategy, but to serve the company as it makes the strategic shift.

Q To get portfolio alignment right, does the GP also need to look closely at the products themselves, beyond their purpose and performance, to gauge if the technology will continue to work as promised?

Absolutely. We often undergo this kind of product analysis, looking at an entire suite of offerings and applying a quadrant. In the quadrant, the lower right is underperforming products on their way to becoming irrelevant. In the upper left are the products already solidly performing with an enormous runway left.

However, it is vital to understand that functionality can never be isolated from customers. Their engagement, satisfaction and interest need to inform the value of any product.

Q How can GPs support portfolio company management to facilitate the timely and effective execution of a value-creation strategy?

GPs have long been partnering with operating partners with tremendous experience and expertise. Often these operators end up playing coach to the portfolio company CEO and management team to great effect, but there is always room for specialists to serve the project with their own focus and talent.

The way to think about these specialists is as part of the symphony that an operating partner is conducting. They have the industry expertise to know the best violinist, the best oboe player, and so on, even if they don't play that instrument. So, they tap these specialists to execute their specific roles as competently as possible.

The strategy is sheet music, and everyone else is trying to produce the most outstanding performance of it. That means tapping the best talent available and letting the specialists do what they do best, whether it is product engineering, talent acquisition, or a new customer relationship management solution.

Q When it comes to product development and engineering, what should operating partners be looking for in these 'musicians'?

It starts with looking at that strategic direction and the goals that emerge from it. Do they want to expand the product portfolio or modernise a product and, in doing so, go to market faster, with a grander scale and such? Regardless, as they look at potential partners, they should offer at least four core capabilities.

Number one is the ability to modernise with development best practices, complete with hyper scalers, artificial intelligence, machine learning and the like. Second is the ability to sustain a product. For those product branches that need to be trimmed and not pruned away, they need someone to keep the lights on and keep those customers, ensuring that the partner has the skin in the game to maintain customer satisfaction.

Third, they should offer professional services to help all the products better serve the customer. Finally, they should be global, with a diverse geographical footprint, so they can help build solutions that can expand beyond their current borders.

Most software assets are mid-market. In this sense, private equity is best served with a mid-market partner that can offer the right level of flexibility, attention, expertise and capabilities it requires. The mid-market player can stay at the private equity firm's beck and call, delivering what the firm needs to give the most remarkable performance of that 'music' it wrote for the future of the portfolio company. ■