The seven sins of post-deal strategy – and what to do about them

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Why is there a problem?

More mid-market investors are formalising their post-deal interventions into value creation plans (VCPs) aimed at more explicitly demonstrating the elements needed to build medium-term value. That is to be generally welcomed since it reduces the risk of trying to handle complex change by intuition. However, a succession of projects where Catalysis was asked to assist with struggling investees over the last 12 months suggests that investor approaches can suffer from blind spots that start to look like a pattern.

It is worth noting that all the companies involved demonstrated strong growth in the years prior to purchase, appeared to offer a significant commercial opportunity. They were planning to enhance their management teams and had appointed well-experienced chairman together with investor support.

The companies (and investors) will remain anonymous, but the argument below is constructed using of a collective identikit, since most themes were present, although in different combinations. Clearly, they are not a representative sample of mid-market investees in any absolute sense. We were called in because they had become problem cases. However, none seem to have been regarded as marginal cases at the time of investment, so their difficulties represented a genuine surprise to those involved.

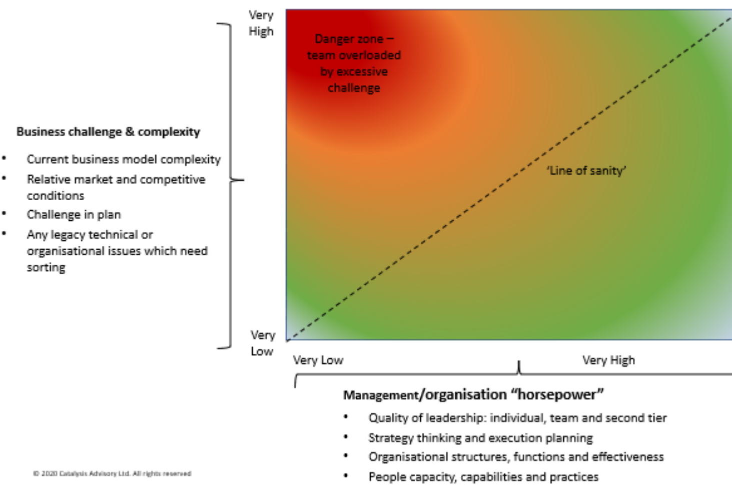
It is, of course, easy to be wise in hindsight and easy as an outside observer to pick fault with decisions made by board teams who are juggling multiple priorities with flawed information and insufficient time. So, it should be observed that:

- Catalysis was involved with some of the cases during due diligence and were involved, to one extent or another, in some of the judgement calls and decisions. Getting those right is difficult, and there are lessons in the stories below for us as much as other players.
- In my work as a non-executive director in the UK and abroad, I recognise that most of the sins described below are ones that I have committed myself at some point.

In other words, this note is offered as a collegial reflection on why this area is difficult rather than criticism from an ivory tower.

A persistent bias

From the perspective of the Catalysis framework that maps levels of challenge and complexity against team and organisational traction, we observe companies exhibiting a persistent top left bias, i.e. trying to handle too much with too little resource or even ability. The problem is that the further a company deviates from the "line of sanity" (marked on the graph below), the harder it is to make progress, and the slower strategic initiatives seem to progress.



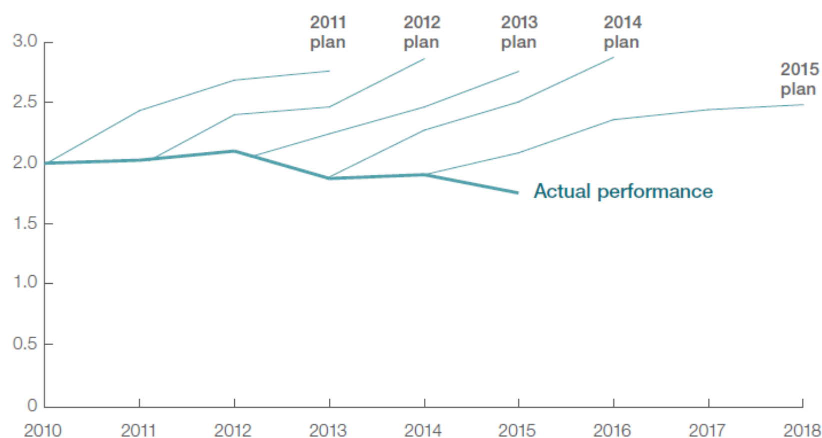
Our work trying to measure this trade-off over the years – both pre- and post-deal - and assessed both by ourselves and by management teams across many tens of companies, suggests a strong non-random pull to the north-west of the line of sanity. In other words, it appears like there is a clear structural bias in boardrooms which seems to make it hard to escape the threatening effects of this imbalance.

Our hypothesis is that this structural bias has been generated by the seven sins below together with the blind spots which appear to cause them, and these can all be spotted through certain symptoms.

A. The symptoms

There are a series of issues these types of companies often exhibit. They are listed below from most to least visible from a non-executive director perspective:

1. The business isn't hitting its planned figures. Older investees exhibit a pattern like this (illustration taken from the book 'Strategy Beyond the Hockey Stick' by Bradley, Hirt & Smit - New York 2018) with hope and disappointment recurring on a yearly basis.



The business can enter a vicious cycle whereby under-performance leads to contract breaches, the need for cost-cutting, higher levels of formal reporting, a short-term focus and the consumption of increased management and non-executive director involvement.

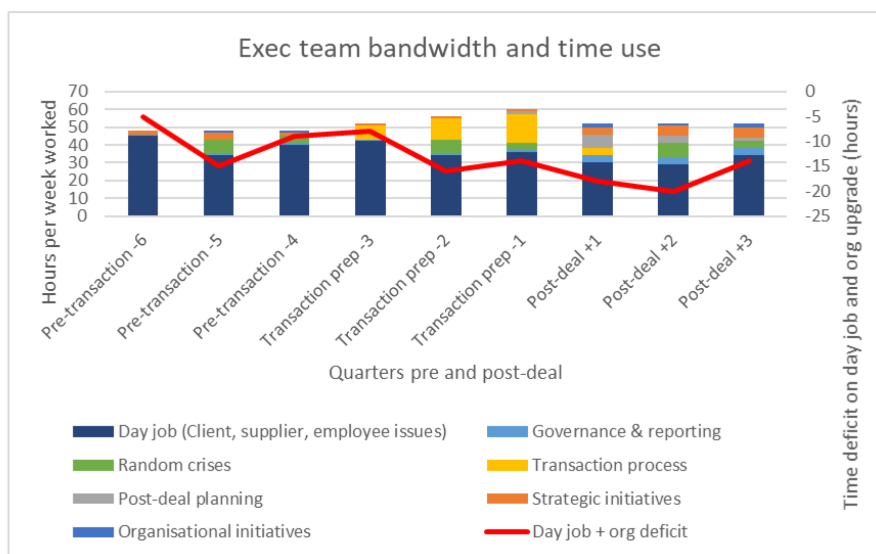
2. The board finds itself repeatedly talking about the same, unresolved issues.

3. The upbeat management team who appeared in pre-deal management presentations appears to have become ineffective and demoralised. The team isn't gelling well, a blame culture is appearing, internal communication diminishes ('what people don't know they make up'), decision-making is seen as sub-standard (dithering) and the second-tier management is seen far too weak to delegate to. One or more business functions are seriously under-performing. Key systems and processes appear to look like tangible constraints. The illustration below shows the organisational issues that management teams found most problematic across tens of companies.

Domain	STEP Category	Question	Score
People	Capabilities and competencies	As SMT members, we take the time to invest into our skills as senior managers	-0.3%
		As SMT members, we receive enough mentoring/coaching support to help us improve how we play our roles	9.8%
		All managers provide frequent constructive performance feedback	24.7%
	Capacity and scalability	As SMT members, we have sufficient time and resource to play our proper role	1.8%
		We are developing enough people internally to become tomorrow's new managers	12.2%
		We have sufficient staffing levels for current demands	18.1%
		All managers take the time to work on automation or process improvement of current activities	20.4%
		We are well-prepared to handle the level of expected stretch on our SMT	21.2%
Organisation	Organisation framework	Our company avoids the confusion of overlapping roles, responsibilities and reporting lines	13.9%
		Our company has effective processes to sort out possible bottlenecks to company success	20.5%
		We have created performance metrics for employees aligned to the company's key metrics	22.5%
		Customer feedback is shared across the whole business	23.1%
	Organisational effectiveness	Collaboration and information flow between departments is adequate	12.7%
		Management time and attention are being used as effectively as reasonably possible	19.4%
		There is an adequate structure of meetings across all departments and teams of the business	20.1%
		SMT meetings are sufficiently compelling and productive	20.3%
		Decisions within our company are always followed up	22.7%
Strategy	Execution planning	We have engaged all employees with our strategic plan	8.3%
		All managers know what strategic projects colleagues are working on	21.7%
		SMT meetings usually address an explicit agenda of strategic projects	22.7%
		Our strategic plans are backed up by identified and available resources (financial and people)	23.2%
		As SMT members, we take the time to improve wider organisational effectiveness to underpin our growth strategy	24.4%
		We have clearly identified how we will address the internal barriers to our strategy	24.5%
	Strategy thinking	We spend serious time analysing the needs of customers in our target segments	11.6%
		As SMT members, we have considered trends outside of our direct industry	14.5%
		We know how well we perform financially compared to our competitors	17.4%
		As SMT members, we have clearly defined what market opportunities are outside our company's focus	17.7%

4. Good people keep leaving the business, whereas new hires don't seem special.

5. Above all, the CEO and wider team are all complaining about lack of time, feel that they are constantly in fire-fighting mode, and worry that they are not looking after clients, employees and stakeholders properly. Talking to CEOs about their use of time, they describe how things have changed over recent quarters. The illustration below is only a model but would look very familiar to CEOs we enter discussion with.



The key point here is that for months before and months after a transaction, the executive time available previously for undertaking those things that underpinned growth previously (i.e. looking after clients, dealing with internal issues) has become significantly diminished. The implied shortfall in time used that way creates 'organisational debt'. This, on the one hand, impedes short term performance and on the other, medium-term value creation, acting in precisely the opposite direction to the new strategic plan.

Another way of thinking about this is through the more familiar trade-off between urgent and important issues, where urgent tends to win. In the case of mid-market investees, the investors and chairman can push certain requests into the urgent box without necessarily having awareness of the cost of ignoring the 'important' side of that equation.

B. Seven sins of Private Equity strategy and Value Creation Plans

1. Not absorbing due diligence

Transaction processes generate great quantities of data and explanation at considerable cost. There are three issues with taking benefit from this:

The content of due diligence leans much more heavily towards historical and current issues, rather than insights which will assist the formulation of future strategy.

Once the diligence report has served its initial purpose of informing and validating the transaction, traditionally, little time is spent interrogating the same data for actionable points. The exception tends to be points from financial due diligence and legal due diligence which end up transformed into a snagging list for (mostly) the financial director (FD) to deal with.

Insights from one workstream are frequently not connected to those in other workstreams, whereas in reality, they are just different aspects of the same 'three-dimensional reality'.

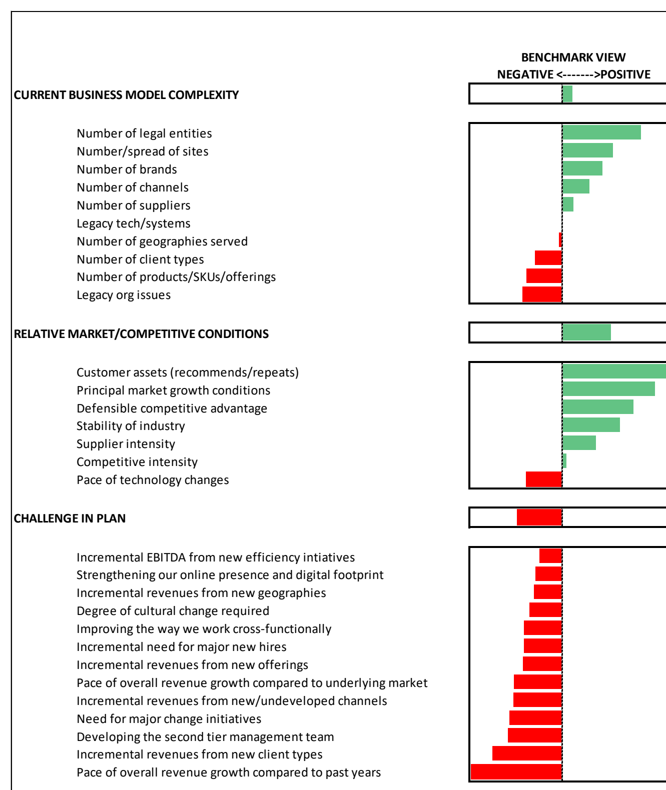
2. Misunderstanding the nature of strategy

Post-deal strategy processes often seem implicitly, if not explicitly, to involve a

(i) 'Christmas list' of goals we would like to achieve
(ii) wordy strategy document which takes a lot of effort, but probably doesn't get used much thereafter
(iii) set of financial forecasts

There may be some kind of 'Strength Weakness Opportunity Threat' (SWOT) analysis, a perhaps somewhat 'poetical' values and mission statement and a phasing plan. However, the first two don't seem to play any substantive role, while the third mostly provides a justification for the forecasts. Clearly, some sense of what we want to do, some written conclusions, and a view of the financial future would all be useful. However:

- The written plan is usually too long (in one recent case, a chairman encouraged an over-stretched team to produce a 14,000-word document) and isn't designed to help the team run the business better.
- When separate value creation plan templates are introduced by investors, time pressures can mean that filling them in becomes more important than thinking about the difficult trade-offs which lie under the surface.
- Everyone always agrees that the strategy should be focused. However, it somehow always ends up including at least twice as many initiatives as it should.
- 'Strategy' isn't really strategy unless it grapples very seriously with external challenges (markets, competitors, suppliers, technology etc), business model complexity and team and organisational constraints. Understanding those things allows the starting point and landscape of the strategic journey to be tuned and then reflected in prioritisation and sequencing. The illustration below offers a collective view from some sixty senior teams about:
    - where they see the issues in their business models are (note the concern about legacy organisational issues)
    - their external environments and, therefore,
    - the severity of the stretch involved in different kinds of growth plan elements (most teams know that they are trying to step up the pace of revenue growth in particular).



3. Failure to consider organisational inertia

Team and organisational issues tend to get insufficient attention during strategy examination processes. This is not only because people's definitions of 'strategy' tend to implicitly exclude them (as per the previous point) but also because they are not easy to see and adjust. When people issues do get raised, they tend to be all about top team appointments (e.g. the new financial director), moving reporting lines on organisational charts or adding headcount. While those things are all valid topics for discussion, they miss much that is probably more relevant to scaling the business successfully, for example systems, processes and business functions; management and people practices; legacy working practices; coordination mechanisms and team steps. Those things are like the submerged part of an iceberg: mysterious, bulky and intractable.

Improving those things often requires sustained effort for little immediate gain but end up determining the ability to scale up. Moreover, even the apparent quick wins, like hiring new people, take longer to produce benefit than expected because:

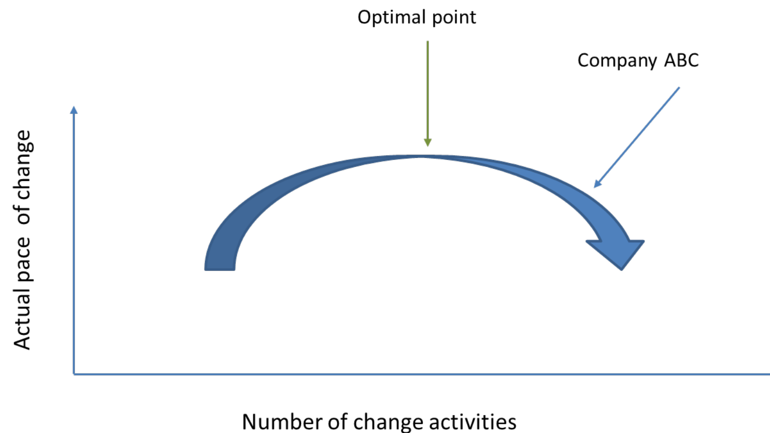
(a) the effort involved in role definition, recruitment/selection, on-boarding and training consumes management resources before it adds to it

(b) unless an interim is being appointed, a new senior hire may well take six months to put into place and another couple before they are fully up to speed with the business

(c) if the success rate of new hires is not great, this implies a performance gap, a period of uncertainty, and then a new appointment process.

4. Confusing change activity with change results

There can be an unfortunate tendency to talk about ambition as a value, which becomes more admirable as it grows in scale. In reality, ambition slips quickly into delusion if not considered alongside the ability to execute. The illustration below offers an explanation why. Change efforts deliver good benefits to a point, but then diminishing returns and then actual value destruction.



Many founder-owned businesses can suffer from an entrepreneurial disinclination for formal planning and strategy, and investors are keen to provide more structure through VCPs. Goals and initiatives are identified and teams, keen to demonstrate their ambition to the funders who have given them their confidence, tend to sign up to more than they should do. Part of the problem is that whereas it is relatively easy to assess the effort in a single initiative, it can be very hard to assess the cumulative effect of multiple projects.

The illustration reflects the fact that, while a few initiatives may increase the achieved pace of change, more than a handful overwhelm the capabilities and resources of management teams and actually cause realised change to reduce. The reality is that the resource available for change projects is usually very limited – and the lack of attention to scalability early on means that there is little prospect of it growing in the first year. Consequently, VCPs risk moving teams from one form of reactivity (instinctual entrepreneurial ways of doing things) to another (overloaded managers who are forced to become short-sighted in order to try to cope with fragmented priorities).

5. Trusting targets and incentives too much

Linking the remuneration of individuals and teams to financial rewards, and aligning those with investors, is a powerful tool in the private equity armoury. However, the literature on incentives is replete with warnings about the unintended consequences they can produce – precisely because they are powerful. The most frequently cited issues are encouraging managers into a tunnel vision, especially looking at mostly financial/quantitative measures, and short-sightedness (or even perhaps cheating) in trying to hit them, regardless of the implications for actual value. Consider two illustrations of this:

(a) Research on mission-driven rather than profit-focused companies seem to suggest, counter-intuitively, that the former end up producing higher levels of profitability than the latter. The cause appears to be that the mission-driven organisations have taken a longer-term view of their plans and their wider stakeholder focus reduces tunnel vision.

(b) I have seen a couple of cases where teams, faced with their equity submerging, have been willing to take much higher risks than investors would want because their returns' matrix has diverged significantly. A 'death or glory' strategy can seem rational when normal routes to financial return seem unattainable.

6. Rushing key people decisions

Research on executive level appoints generally finds that about half of all appointments end up not satisfying the hiring manager. The cost in money, time and opportunity can be major. We all tend to be too vague, optimistic and biased in our recruitment and selection practices. Those problems probably get worse under the time pressure-created post-deal. The issue applies as much to chairman appointments as to executive ones – with candidates being selected for their positive characteristics with less attention to potential problems or lack of fit. VCPs which assume that CEOs and all chairmen will beat the odds in making key appointments are probably being over-optimistic.

7. Unbalanced governance

The theoretical concept of boards in a growth company context is that they should help an ambitious CEO think more roundly about the critical strategic decisions they need to make. They should bring a voice of realism in the consideration as to how those decisions will be executed. In practice, things go wrong surprisingly frequently in various ways (these are all real examples):

- Investors who influence key appointments in favour of what they want (e.g. an FD who understands private equity and good reporting), rather than what the business might need (perhaps an FD who brings more experience of internal change and system improvement).
- Non-executive directors who monopolise the time of the CEO to such an extent that there is too little time left for managing the business.
- Likewise, non-executive directors who only want to talk with a CEO and FD, thus disempowering the rest of the executive team who feel left out of key decisions thus being shut out from insight into the messy realities of the company.
- Allowing VCPs to become a top down, corporate style requirement rather than a co-created plan which everyone believes in.
- An emphasis on additional financial (and other) reporting, even at the cost of other things the team might have been doing with the same increment of time.
- Excessive ad hoc suggestions and ideas which are perceived as instructions by some management teams – thus being dragged away from the real strategic priorities.

C. Blind spots which cause the sins

Lying behind the 'sins' above are habits of mind which, unchanged, make it hard to improve things:

- Ignoring the odds. Surprising numbers of business objectives don't work out as hoped. Published research on initiatives such as cost reduction programmes, lean (for example, 5-S) system rollouts, major IT projects, mergers and acquisitions find that only a minority achieve their objectives. McKinsey & Co research on large American companies has found that the odds of a company moving from middling performance to top quintile over a ten-year period is about eight percent. Therefore, any growth strategy needs to be truly exceptional.

- In the world of high growth firms (HGFs), the odds are not obviously better. In one huge study of 48,000 HGFs (defined as companies with over ten employees which grow at 20% for three consecutive years) only 37% grew in the period after their initial burst of growth. The rest either stagnated (17%), shrank (40%) or died (6%). It is true that other research suggests that a decent proportion of those who cease growing may grow again at some future point, but the point is that sustaining growth is difficult.
- We probably all know at one level that the odds are stacked against success. Nonetheless, we tend to act as if the odds weren't relevant, remaining overly confident and optimistic (like the 90% of drivers who tell pollsters they are above average). Psychologists tells us that informed people are even more confident. As they gather data to support their hypotheses, their conviction in their forecasts grows. Perhaps we internalised an old self-help slogan like *'Whatever the mind can conceive and believe, it can achieve'.*
- Optimising what is visible. Private equity investee planning usually suffers from a surplus of outcome data (e.g. sales results, operating metrics, financial information) and a serious dearth of data about causes (e.g. customer sentiment, competitor moves, organisational health, management resources). That can result in making decisions depend too much on detailed but only partially relevant considerations.
- Missing non-linearity. One of the problems of spreadsheets and organisational charts is that they can lull us into believing that their two-dimensional appearance is how things work in real organisations. In practice, both causes and effects can be less predictable, i.e. business model complexity, resources available for change, unintended consequences.

All these issues are more likely to be exacerbated when strategy and planning are carried out in a rush. It is when those in the boardroom are trying to simultaneously build shared relations (thus reducing the likely levels of mutual challenge) and the person leading the strategy process may be more focused on trying to get to an answer with a reasonable degree of consensus, rather than digging into complex causes and probabilities and reaching a conclusion which may be less uplifting.

D. Conclusion: What to do about the sins?

The attempt in recent years to make post-deal process more systematic is a welcome one.

Making the considerable efforts going into VCPs pay off, however, requires spotting where inaccurate assumptions, knowledge gaps and impatience can undermine the achievement of the assumptions being pursued.

Reducing the likelihood of these blind spots and sins doesn't require major process or other changes but rather tweaking of elements within existing approaches:

- Adopting the right mind-set. To take proper account of the odds while remaining positive, I would encourage an attitude of optimistic paranoia. What lies behind that is the assumption that the price of successful ambition (as opposed to delusion) is the constant awareness that things are likely to go wrong and therefore need identifying and fixing. The greatest exemplar of this mind-set was Andy Grove, the driving force of Intel, who laid out his management approach in *'Only the Paranoid survive'*. One implication of this attitude is to be very suspicious in the mid-market if anyone using hubristic language, i.e. setting standards at 'world class' levels or talking about 'destroying' the competition.

- Setting reasonable up-front expectations. Management teams often stick with too-high targets post-deal, partly because they feel they should live up to numbers put forward by their

corporate finance advisers and because they want to display suitable ambition to their investors. This issue can be accentuated if the strategy discussion doesn't include the people who will be held accountable for delivery. Moreover, too little account is taken account of the very frequent reality that post-deal there is a drop in performance after months of relative neglect by managers who have been sucked into the transaction process. That effect is doubled when covenant structures assume that the business will not only maintain its current results but significantly improve them in the first year. Better to be too pessimistic than trigger a disruptive covenant reset.

- Making due diligence roundtables a standard item pre- or post-deal
- Getting non-executive directors, management and key DD providers together to discuss cross-disciplinary questions (rather than asking each provider to run through their reports sequentially) increases the chances that key insights and action points will be identified. Ending that session by mapping the cumulative portfolio of projects sets up the starting point for the first board strategy workshop.
- Ensuring visibility of organisational 'horsepower'. If due diligence hasn't already provided a robust view of the strengths and weaknesses of the organisation and its ability to deliver and scale up, obtaining that insight through questionnaires or interviews (including with second tier managers who tend to be less optimistic than the top team) is probably essential input to strategy workshops.
- Getting the post-deal timetable right. Pushing ahead with post-deal strategy sessions before the team have had a chance to reconnect with their organisation after the transaction and reforecast short-term performance risks talking about strategy in a bubble of unreality. Likewise, trying to have honest conversations before trust has been built between management, chairman and investors risks managers putting on an act (usually optimistic) to please their new financial backers rather than being fully open. Waiting a couple of months may produce better results for everyone.
- Injecting challenge into the strategy process. Overcoming the bias towards collegiality and optimism in the strategy process requires one or more devil's advocates. My experience is that many investors and chairmen would rather not play that role. One option is to involve a facilitator who takes on that mandate. The other is to build in a specific mechanism for examining conclusions with more sceptical eyes, e.g. a scenario where we imagine that our strategy has failed miserably and we ask ourselves why it would have done so. This allows for countermeasures, checkpoints and early warning mechanisms.
- Being brutal on priorities. My best acid-test for a healthy strategy process is that it involves agonising decisions about which priorities and initiatives are killed altogether or pushed back far enough so that the top two or three items have space to be worked on properly. More than a handful of initiatives probably condemns the strategy to delay and the management team to a tiring and reactive pattern of work.
- Ensuring scalability. Very few companies at the time of transaction are ready to scale sustainably. Consequently, most companies probably need their most urgent priority to be organisational upgrade or transformation, with clear accountability and measures to make sure it is given as much attention as more exciting commercial and financial initiatives.
- Checking governance, metrics and incentives for unintended consequences. Appointing and setting these three things is more art than science and so, in line with optimistic paranoia, the

best assumption must be that the best guess method by which they were installed probably leaves imperfections which need to be identified and addressed. There can be merit in applying the pre-mortem approach – asking why they are likely to fail or create new problems. More importantly, feedback needs to be gathered from time to time to see where imperfections are becoming apparent so that tweaks or changes can be made.

- Improving the batting average on key appointments. There are multiple well documented issues with selection decisions, and plenty of good advice, but some light touch ways to improve matters include:
    - Looking in finer detail at what the organisation needs from the role.
    - Separating why candidates may not be the fit for what is needed, even if they are excellent in general terms.
    - Ensuring that different interviewers look at different aspects of candidates rather than all carrying out general discussions.
    - Carrying out most references before an offer is made – and talking to them on the telephone with exploratory and not just a confirmatory style.
    - Inserting a challenging 'wash-up' after interviews and, of course, carrying out an advanced screening on the appointment.
    - Sensitising investors and chairmen to the existence of the seven sins issues and blind spots.