TRIUMPH ADVISORY GROUP

STRATEGY | OPERATIONS | TRANSACTIONS

Private Equity Practice

Overcoming Supply Chain and Operations Challenges for Private Equity Firms and Their Portfolio Companies

Comprehensive Analysis and Solutions

Private equity (PE) firms play a pivotal role in the growth and development of numerous industries by acquiring, investing in, and managing diverse portfolios of companies. With high stakes and rigorous performance expectations, the private equity domain necessitates an in-depth understanding of challenges faced across sectors, including the supply chain and operations. Given the significance of just-in-time inventory management, optimized production systems, and efficient logistics in multiple industries, addressing supply chain and operations issues is crucial for both PE firms and their portfolio companies. This article will delve deeper into these challenges and propose strategies for their resolution.

Key Supply Chain and Operations Issues for Private Equity Firms and Portfolio Companies

1. Due Diligence and Risk Assessment

Before making an investment, private equity firms need to conduct comprehensive due diligence and risk assessments, which involve evaluating supply chain and operations management. A thorough risk analysis ensures that both the private equity firm and the target company understand the potential vulnerabilities associated with supply chain disruption, outdated operations, and the risks posed by market volatility and global economic factors (see Exhibit).

<u>Solution</u>

PE firms should establish and follow a systematic due diligence process encompassing all facets of supply chain and operations management in the target company. This evaluation can involve studying historical performance, identifying weaknesses, examining supplier contracts, assessing inventory management systems, and evaluating the overall operational efficiency of the business.

An in-depth understanding of the target company's industry, market position, and competitive landscape is crucial for identifying risks associated with external factors like regulatory changes, commodity price fluctuations, or transportation disruptions. Employing a risk mitigation strategy involving scenario analysis or stress tests can determine how different market conditions or disruptions impact the overall supply chain and operations.

By adopting advanced data analytics and digital technologies, both parties can better understand inherent risks and make informed decisions. Creating detailed risk profiles and mitigation plans during the due diligence phase can help set realistic expectations and define the post-investment actions required to address identified risks.

2. Supply Chain and Operations Integration

Post-investment, private equity firms need to harmonize their supply chain and operations with the portfolio company, ensuring smooth, efficient, and consistent production and distribution systems across the board. This integration process can be challenging, as it may involve dealing with different systems or processes used by each organization.

<u>Solution</u>

Aligning the supply chain and operations processes of both the PE firm and the portfolio company requires a comprehensive integration plan and open communication between both parties. The plan should cover areas such as inventory management, production processes, sourcing, logistics, and customer service. Regular meetings and progress reports can help facilitate transparent communication and address any emerging issues promptly.

Exhibit

Manufacturing Risks and Opportunities Summary

Risks	Opportunities
• Highly twined manufacturing processes/equipment/tools • Plant assets condition • Excess or inadequate capacity/capital spending for new volume • Union contracts/workrules • Fixed vs. variable costs • Recession scenario	• Shift to reduced Tier wage structure • Work rules changes • Headcount optimization • Productivity improvements • Manufacturing footprint optimization • Inventory optimization • Outsourcing none-core operations

Procurement Risks and Opportunities Summary

Risks	Opportunities
• Supply continuity risks • Loss of leverage due to carve-out (if company is a spin-off) • Raw material risks • Loss of purchasing expertise • Purchasing contract risk • Supplier incoming quality (maybe overlap with Quality & Warranty)	• Purchasing synergy (if company is being acquired) • Strategic sourcing potential • LCC sourcing potential • Improvements to purchasing organization

Product Engineering and R&D Risks and Opportunities Summary

Risks	Opportunities
• High amount of parent dependent IP/Patents • Loss of key engineers and their expertise • Current product pipeline disruption due to carve-out	• Engineering headcount reduction • Product portfolio optimization • Engineering footprint optimization • Off-shoring engineering services • Product complexity reduction

IT Risks and Opportunities Summary

Risks	Opportunities
• Insufficient IT infrastructure • Highly complex IT infrastructure • Service continuity • Insufficient services and service providers during transition • High carve-out one time/recurring costs • Post carve-out transition risks	• IT cost reduction potential • IT infrastructure simplification • Ability to find different service providers than parent company and get lower rates

Quality & Warranty Risks and Opportunities Summary

Risks	Opportunities
• High reliance on parent company's corporate expertise • Insufficient warranty coverage relative to parent • Lack of supplier quality management expertise • Insufficient warranty provisions for pending exposure	• Warranty cost reduction improvements • Improvement in quality management capabilities (corporate vs. plants) • Improvement in supplier quality metrics/process

SG&A (HR, Finance and Legal) Risks and Opportunities Summary

Risks	Opportunities
• Highly twined SG&A processes i.e. benefits administration, recruiting etc. • New functions requirements from scratch • High transition services costs • Loss of high skill employees and expertise (stay in corporate Parent)	• Savings from shedding "corporate tax" • Cost reduction opportunities • SG&A rationalization opportunities • Services demand management

When merging systems, there should be an emphasis on selecting the best practices from both the existing organizations. The primary goal should be to create a roadmap to update the systems, processes, and infrastructure used in the supply chain and operations management for the combined entity. This may involve working with external consultants and industry experts to ensure a smooth and efficient transition.

Companies should also ensure that employees are trained and equipped to deal with the new processes and systems implemented as a result of the integration. By providing appropriate training, communication channels, and change management support, companies can facilitate a quicker and more successful integration.

3. Cost Optimization and Efficiency

One of the primary goals of private equity firms is to improve the profitability and operational efficiency of their portfolio companies. Achieving this often involves implementing cost optimization and efficiency initiatives within supply chain and operations management. A challenge lies in attaining cost savings without compromising product quality or impairing the company's ability to meet demand. (see Exhibit)

Solution

To optimize costs and enhance efficiency, PE firms should focus on end-to-end supply chain and operations visibility. Leveraging digital technologies, such as IoT, data analytics, and artificial intelligence, helps identify areas for improvement and cost-saving opportunities.

Adopting lean or six sigma methodologies can be highly effective in improving efficiency and reducing costs across supply chain and operational processes. Lean manufacturing is primarily focused on reducing waste in various processes, including transportation, inventory, over-production, defects, and waiting times. Meanwhile, Six Sigma aims to minimize variability and defects through statistical and data-driven approaches. By training key personnel in these methodologies and setting up cross-functional lean/six sigma teams, companies can drive a continuous improvement culture and yield significant cost savings and efficiency gains.

Supply chain cost optimization initiatives should also focus on strategic sourcing of raw materials and components, improved inventory management, and more efficient transportation and logistics operations. Supply chain network optimization, which involves the evaluation and restructuring of facilities' placement, such as production plants, distribution centers, and warehouses, can also contribute to cost and efficiency improvements.

4. Operational Excellence and Best Practices

Achieving operational excellence and ensuring adherence to industry best practices contribute to the overall success and profitability of companies within a private equity firm's portfolio. Consistently implementing best practices can lead to a more robust and resilient supply chain, optimized operations, and better-informed decision-making.

Solution

Identifying and implementing best practices requires regular benchmarking of supply chain and operational performance against industry standards, competitors, and best-in-class organizations. Collaborating with industry associations, third-party consulting firms, and external experts provides access to the latest best practices and enables the organization to adapt accordingly.

Exhibit

Major Functional Due Diligence Assessment Topics

Manufacturing	Procurement	Product Development & Engineering
• Management manufacturing cost baseline • Plant assessments (PP&E) • Labor cost diligence • Productivity improvements • Capacity sufficiency for projected volumes • Manufacturing footprint optimization (Outsourcing, Make/Buy) • Volume impact (Fixed vs. Variable cost base) • Inventory optimization/obsolescence • Manufacturing capital spending comparison against peers	• Management purchasing cost baseline • Purchasing contracts diligence • Supply continuity risks • Raw material market exposure • Purchasing organization capability • Strategic sourcing potential • LCC sourcing potential • Loss of leverage due to carve-out • Combined purchasing power leverage	• Management PD/Engg cost baseline • IP/Patents diligence • Product portfolio and pipeline review • Engineering budget and headcount sufficiency against peers • Engineering footprint optimization • Engineering off-shoring services • Engineering tools assessment • Loss of capabilities due to carve-out

IT	Quality & Warranty	SG&A
• Sufficiency of IT infrastructure against peers • Assessment of IT costs/budget against peers • Service continuity • Contract transition • Carve-out one time/recurring costs • Post carve-out transmission risks	• Quality management capabilities (corporate vs. plants) • Warranty cost comparison against peers • Quality plan review • Warranty exposure review • Supplier quality metrics/process	• SG&A comparison vs. peer group • Transition services • SG&A rationalization opportunities

PE firms can establish cross-company knowledge-sharing platforms or networks where portfolio companies can share their successes, challenges, and best practices. This facilitates continuous improvement and innovation across the portfolio.

Creating a culture of operational excellence within a portfolio company helps drive long-term success and value creation. This requires establishing a clear vision and strategy that aligns with the company's objectives and values, empowering employees to engage in continuous improvement efforts, and committing to investing in the resources needed to support operational excellence initiatives.

5. Talent Management

Managing a successful supply chain and operations function necessitates a skilled and knowledgeable workforce. Talent management challenges include recruiting, retaining, and developing employees with specific skills to oversee and optimize the supply chain and operational processes in a rapidly changing business environment.

Solution

To bridge the supply-and-demand gap in talent management, PE firms and their portfolio companies should invest in comprehensive training and development programs. By partnering with educational institutions for internship placements, they can attract and mentor promising talent. In-house mentorship and continuous learning opportunities enable employees to stay abreast of industry trends and develop the necessary skills to excel in their roles.

Offering market-competitive remuneration packages and growth opportunities can attract and retain talented professionals. Additionally, creating a positive work environment that fosters open communication, teamwork, and an inclusive culture is essential for retaining key talent. PE firms should prioritize diversity and inclusion to foster an innovative and dynamic work environment beyond hiring; companies should also invest in initiatives that promote diversity in leadership positions and decision-making roles.

6. Environmental, Social, and Governance (ESG) Considerations

Environmental, social, and governance (ESG) factors are increasingly vital for investors and portfolio companies, with a growing emphasis on supply chain sustainability and responsible business practices. Alignment with ESG priorities contributes to a company's long-term value creation and resilience.

Solution

PE firms should establish clear ESG guidelines and integrate them into every aspect of supply chain and operations management. This includes reducing waste, optimizing transportation modes, working with suppliers committed to sustainable practices, and promoting safe working conditions and proper governance structures.

Comprehensive reporting and disclosure systems can help track the progress of ESG initiatives, ensuring transparency and accountability. Engaging in industry forums, conferences, and knowledge-sharing platforms can facilitate continuous learning and improvement in ESG performance.

Effective ESG management also requires the identification, measurement, and mitigation of risks in the supply chain and operations. This could involve mapping the sustainability risks associated with raw materials or components and working with suppliers to develop more sustainable solutions. Transparent reporting and communication around ESG issues at the portfolio company level are also essential for attracting and maintaining investor confidence.

Conclusion

Private equity firms and their portfolio companies must address several supply chain and operations issues to achieve long-term growth and development. Addressing challenges such as due diligence, risk assessment, supply chain integration, cost optimization, operational excellence, talent management, and ESG considerations is essential for driving value creation, resilience, and profitability across industries.

By employing advanced digital technologies, adopting industry best practices, and fostering collaboration throughout the firm and its portfolio, private equity firms can create optimal solutions for all parties involved. In doing so, they contribute to business resilience, operational efficiency, and lasting growth across industries.

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