WHITE PAPER

How ERP Can Help PE Firms Standardize Their Portfolio Operations

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After a dip in private equity deals during the first months of the COVID-19 pandemic, the private equity markets rebounded in the second half of 2020. The year's global deal total of $582 billion was the highest since 2007, according to a report from the Harvard Law School Forum on Corporate Governance.

Yet, the private equity market has also shifted in some important ways, most notably with its embrace of special purpose acquisition companies (or SPACs) in 2020. These entities, which have no commercial operations and are formed specifically to raise money for acquisitions, raised more than $80 billion from nearly 250 SPAC IPOs during 2020, six times the previous high of $13 billion raised in 2019.

The SEC's evolving reporting requirements have slowed SPAC adoption in recent weeks, but market shifts like this are just one example of how PE firms continuously guard against economic uncertainty and risk as they plot exit strategies for their portfolio companies.

Given this landscape, it's clearly in the best interests of a PE firm to ensure they have the best possible data on the financial health of their portfolio companies. And yet, many private equity-backed companies have managed their businesses by relying instead on spreadsheets and a hodge-podge of solutions that solve discrete problems but don't work well together.

This isn't to suggest that such tools like QuickBooks and spreadsheets aren't viable alternatives for businesses operating on a shoestring budget. But the harsh reality is that it's only a matter of time before most companies realize these technologies can't scale with their business.

If portfolio companies have systems that can't scale, their growth potential is limited, and the private equity investors behind them suffer. Which is why private equity firms should be seriously considering bringing ERP into their portfolio companies.

Constraints Bring Pain

Consider the myriad ways that dependence on disconnected software and spreadsheets **handicaps the businesses** private equity investors are betting on. Those include:

- An inability to keep up with all of their financial and operational data, because spreadsheets only get bigger and more difficult to manage.
- Lack of visibility into core business processes.
- Difficulty transitioning off of existing parent company systems fast enough in M&A scenarios.
- No integration with forecasting and pipeline data.
- Lack of visibility into customer behavior.
- Limited reporting capabilities.
- Lots of manual data entry.
- Lack of workflow sophistication.

Those are hefty constraints placed on a company trying to accelerate growth—often faster than they ever have before. It also places a lot of constraints on PE firms that are trying to gain an accurate picture of the health of the portfolio company.

A former PE partner-turned-CEO recently discussed the coaching role that PE firms can play, noting: "Like coaches, PE funds conduct rigorous assessments of companies' performance on fundamental metrics (such as market share, customer churn, top-line growth, customer concentration and profit margins), provide objective appraisals of what's working and what isn't and allow access to the right resources necessary to drive accelerated improvements.

Providing those assessments is incredibly difficult without ERP solutions among portfolio companies. Here are **some of the negative outcomes**:

- The data that results from manual entry in multiple locations leads to unreliable KPIs and metrics, meaning that stakeholders really don't know how their businesses are doing.

- Redundant manual processes don't just lead to bad data; they sap the time and energy of staff that could be used on more mission-critical activities.
- All of this unreliable data makes it next to impossible to maintain compliance and control.
- Having to stitch together disjointed software solutions that don't integrate creates back-office dysfunction, with IT staffs chasing their tails trying to keep up.
- There's no mechanism with which to inject real-time feedback into sales, customer data, financials or inventory.

Finally, and perhaps most importantly, there are many ways reliance on spreadsheets and disparate system infrastructures can **directly affect PE firm profitability**:

- Carve-out readiness suffers, because it's difficult to sell a piece of a company or spin off a new business if there's no clear data on how that part of the company is performing.
- Additional transactions are piled onto the onboarding process, adding costs, complexity and potential challenges as PE firms and portfolio companies form their relationships.
- Just as a poor system infrastructure can lead to compliance and control challenges for their portfolio companies, it can also make it more difficult for PE firms to adhere to government regulations.
- It makes it substantially harder for PE firms to do their most critical job: Managing the inherent risk of their investments.
- All of this can negatively affect valuations when it comes time to exit.

That's where ERP systems come in, and the good news is that they're now accessible for growing and midsized businesses, and this presents a huge opportunity for private equity firms.

ERP: The Tonic to That Pain

Among the benefits PE firms can expect an ERP solution to deliver to their portfolio companies are:

- Unified data and real-time reporting.
- Faster, easier growth and expansion, both domestically and internationally.
- Ability to manage multiple product lines.
- Faster integration of add-on transactions.
- Enhanced customer experience.
- Improved compliance and control.
- Rich integration with other departmental apps (financials, HCM, PSA, SCM, Ecommerce, CRM).
- Support for multi-language, multi-currency, multi-country tax compliance and multi-subsidiary management.

As powerful as these benefits are to any single company, they become even more compelling when a single ERP platform is deployed across a private equity firm's portfolio, bringing cost benefits and added data consistency.

To that end, during a 2020 NetSuite webinar, Jim Milbery, a partner at boutique private equity firm ParkerGale, said that the firm had seen first hand how an integrated, closed-loop ERP system brings continuity and value to its portfolio.

While private equity firms can't always strongarm their portfolio companies into adopting ERP, their influence is clear. Ernst & Young maintains that PE firms have a unique opportunity to drive adoption of technology like ERP in their portfolio companies. Projects like these within any organization require executive buy-in and guidance to push these initiatives forward, especially when facing challenges like departmental silos, employee anxiety, lack of technical expertise and other factors that tend to push implementing an ERP system down the priority list.

"NetSuite is our standard platform for accounting and financials within our portfolio. Not only does it transform our portfolio companies operationally, but it also helps us attract top talent and leadership. The best CFOs are excited to work on a world-class platform." Jim Milbery, Partner, ParkerGale

This is where PE firms can step in. Since they already possess significant decision-making influence throughout their portfolio operations, private equity players can issue leadership mandates and offer their expertise in driving enterprise-wide change and ensuring that an ERP implementation delivers the desired objectives.

Why PE-Backed Companies Need ERP

With that backdrop, let's look at five reasons private equity firms should consider championing ERP throughout their portfolios.

- Reason 1: Easier Exits. If there's one reason that should get PE firms' attention, it's this. A private equity investment is all about the exit; it's the moment when all of the hard work pays off. And there's a lot that goes into determining the exit value of a portfolio company, factors such as track record, maturity, team, sales pipeline and the ability to innovate.

  More than anything, acquirers and public markets want to be able to see the potential of a company. And that means having a clear picture of how that company is performing, the forecast for its performance, and the knowledge that it will be able to meet demand regardless of growth rate.

  It's also important to note that the constantly evolving reporting requirements for IPOs, SPACs and M&A deals put a premium on being able to access years of financial data and reports easily and transparently. The earlier PE firms establish ERP systems in their portfolio companies, the fewer headaches they'll experience come exit time.

  ERP systems provide the end-to-end visibility and scalability to deliver that insight, and they simplify the significant due diligence that precedes an IPO or an acquisition, making it easier for public markets and prospective acquirers to accurately assess a company's potential.

- Reason 2: Standardized Business Processes Portfolio-Wide. The benefits of standardization are clear in a single organization. When managing numerous organizations at once, standardization becomes even more compelling.

  Standardizing a portfolio on a common ERP system significantly boosts a PE firm's ability to measure costs, track growth, improve operational efficiency and reach profitability goals. By instituting a standardized, real-time platform to assess the health of portfolio companies, PE firms can make quicker and more informed decisions. They can also get a more timely and accurate picture of product quality.

  ERP enables PE firms to unify reporting across their portfolios and maintain a more coherent understanding of portfolio health and performance. It empowers them to create simple workflows that can be rolled out across the portfolio, making it much easier to determine portfolio value.

  Having access to accurate and timely data also provides greater control and visibility into core business processes. A comprehensive ERP system increases the accuracy, efficiency and speed of reporting, and provides a holistic snapshot of a PE firm's entire portfolio.

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Put simply, it allows them to manage their portfolio as if it were one organization.

- Reason 3: Reduced Risk. As mentioned above, not having an ERP system makes it monumentally difficult for PE firms to stay on top of risk, perhaps their most important role. They're responsible for ensuring the future value of the investments they're safeguarding, and as such, they need a clear view of the risk landscape. ERP provides this in a number of ways.

  For starters, good ERP systems—especially those that run in the cloud—offer out-of-the-box, enterprise-grade data security. With ERP, PE firms can rely on a single, authoritative data source, providing assurances that the data they're seeing is accurate and timely.

  These solutions also provide role-based system access to ensure that employees can safely access data and functionality crucial to their position with pre-defined permissions. Cloud-based vendors also give users the ability to access this data anywhere while employing round-the-clock monitoring tools, controls, policies, and reporting to meet crucial audit and security standards to guard against risk.

  What's more, with today's cloud-based ERP systems, IT maintenance is actually reduced by transitioning from simple software and spreadsheets. With the vendor managing IT issues, PE firms and their portfolio companies are freed up to spend more time monitoring and tweaking the business. The combination of accurate and timely data, holistic visibility, built-in data security and freed resources also eases governance and compliance efforts, and the generation of required certificates.

- Reason 4: Rapid Expansion. This is where ERP really sings. As the opening of this paper presented, the ability to scale is often the motivating force behind ERP adoption, and there's a reason for that. ERP software provides a foundation for managing growth. With it, an organization can easily manage multiple product lines, flex with changing supply chain conditions and benefit from faster and cleaner onboarding of acquisitions or new subsidiaries.

  Some ERP systems support multiple currencies, multiple languages and multi-country tax compliance, making them key tools for global expansion. And today's cloud-based ERP makes this even easier by removing the need for IT infrastructure to be established in new locations. All that's needed is a computer and an internet connection.

- Reason 5: Reduced Financial Close Period and Audit Preparation. One of the most common challenges for organizations prior to adopting ERP software is closing the books in a timely fashion. It's not uncommon for it to take weeks for a company to pour over QuickBooks entries and spreadsheets while trying to wrap up a quarter. With a good ERP system, that's often reduced to hours.

  ERP systems offer financial staff real-time data to work with, minus the detective work. A unified reporting structure across the portfolio simplifies this process, and pre-built reports slashes the time required to assemble and format the necessary data. Eliminating manual data entry further slashes closing times.

  A strong ERP system also provides full control over roles, assignments and permissions, ensuring the integrity of the data, and that all accounts are auditable.

Finding the Right ERP Fit

This paper has presented numerous ways ERP systems can help private equity firms and their portfolio companies improve performance and grow. But choosing the right ERP software is also crucial.

Mid-to later-stage companies that have been acquired by a PE firm or raised significant capital face numerous challenges, such as infrastructures that no longer meet their needs, poor data quality and transparency, hiring challenges, on-boarding logjams and an inability to expand globally.

These companies often have complex organizational structures and lofty growth objectives, which leaves little room for operational inefficiency. What they need at first is a strong financial foundation to maintain transparency and develop a base for which to expand with capabilities like financial management, item management, and the automation of procure-to-pay and order-to-cash.

They need basic features, such as dashboards for various roles, such as controller, executive management, purchasing and accounts receivable, sales, inventory management and administration. They need common metrics, such as revenue recognition, financial reports and process controls.

They need something that can support a growing footprint, with more locations and larger numbers of customers now, while preparing for localization and multi-currency needs, as well as other functionality to support global expansion.

In other words, the ideal ERP system for a private equity-backed company is one that can grow with it, providing the scalability and flexibility to lead it through various stages in its maturity.

Since 2011, nearly two-thirds (63%) of technology companies that have undertaken an IPO were running on NetSuite ERP as they did so. A lot of those were private equity-backed companies, and with good reason: NetSuite's cloud-based software is designed to do just what they need: Grow with them seamlessly, from acquisition into mature global player.

For more information on how ERP can help private equity firms and their portfolio companies, visit www.netsuite.com/pe.