



GLOBAL PRIVATE EQUITY REPORT 2021

BAIN & COMPANY 

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Bain's work with PE firms spans fund types, including buyout, infrastructure, real estate and debt. We also work with hedge funds, as well as many of the most prominent institutional investors, including sovereign wealth funds, pension funds, endowments and family investment offices. We support our clients across a broad range of objectives:

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Due diligence. We help support better deal decisions by performing integrated due diligence, assessing revenue growth and cost-reduction opportunities to determine a target's full potential, and providing a post-acquisition agenda.

Immediate post-acquisition. After an acquisition, we support the pursuit of rapid returns by developing strategic blueprints for acquired companies, leading workshops that align management with strategic priorities and directing focused initiatives.

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Exit. We help ensure that investors maximize returns by preparing for exit, identifying the optimal exit strategy, preparing the selling documents and prequalifying buyers.

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There Is No New Normal

Dear Colleague:

What can one say about such an unusual, tumultuous year? Most numbers won't tell the story.

Whether you look at the value of deals done, exits accomplished, funds raised or returns generated, you will see data that is generally in line with the past few years' results. One figure that stood out to me was the number of deals transacted by PE firms, which was down about 1,000 in 2020 from recent levels. That has portents for 2021.

Total investment value last year was supported by ever-larger deals, not more deals. This fact is important because it means many GPs did not get the deals done that they had intended to in 2020. With soaring levels of dry powder, robust credit markets and recovering economies, 2021 deal markets promise to be incredibly busy. The sectors that have proven most resilient to the pandemic are familiar: technology (especially enterprise software), industrial goods (including building products and packaging), financial services (especially fintech and payments) and healthcare (especially services). These four broad sectors accounted for over 65% of all transactions last year and are set to host most of the action in 2021.

In this year's *Global Private Equity Report*, we look deeply into several other trends that are changing the PE landscape: the continued rise of ESG/sustainability, how firms are identifying the management and board talent required to successfully execute an investment thesis, the benefits and limits of virtual selling, and what to make of SPACs. Lastly, we peer into our crystal ball to look at evolutionary forces reshaping the PE industry itself and consider what the increasing specialization of firms and products will mean for the future of alpha generation and the classic buyout fund.

We hope you enjoy this year's report and look forward to gathering again when possible.



Hugh MacArthur
Head of Global Private Equity



The Private Equity Market in 2020: Escape from the Abyss

The industry showed great resilience in the face of Covid-19 and accelerated into 2021.

**By Hugh MacArthur, Rebecca Burack, Christophe De Vusser,
Kiki Yang and Johanne Dessard**

It was a year of massive disruption—and private equity emerged unscathed.

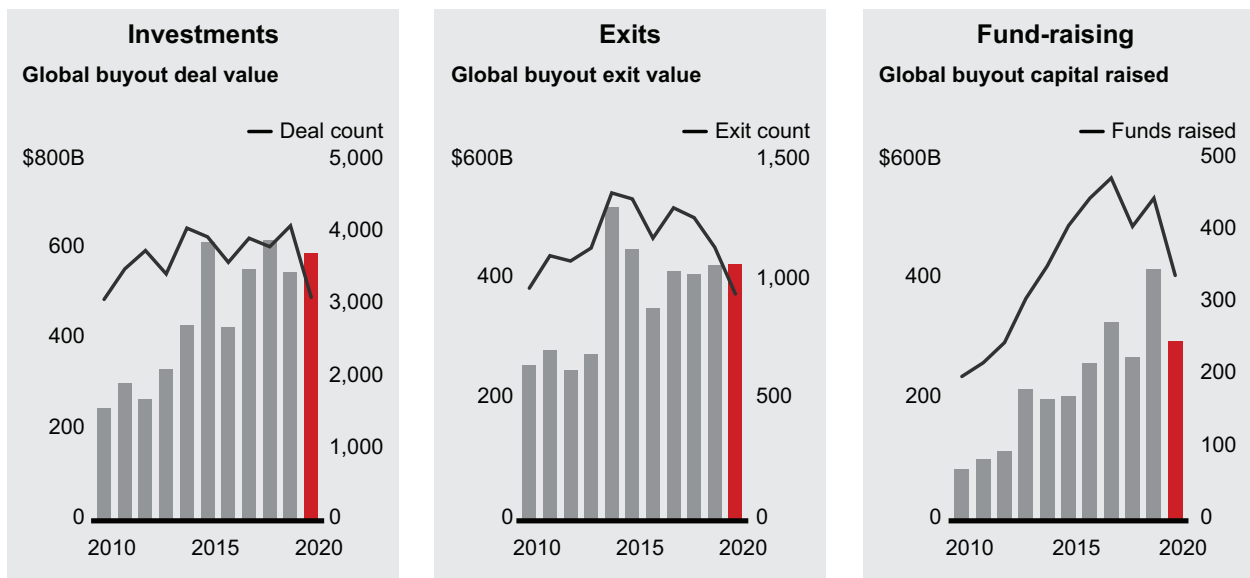
Despite the tragic Covid-19 pandemic and its global economic fallout, despite the Black Lives Matter protests and months of social upheaval, despite a bitterly contested US presidential election that ultimately led to an unprecedented mob assault on Capitol Hill, dealmakers kept making deals in 2020, while exits and fund-raising fell in line with robust five-year averages (*see Figure 1*).

Like much else across the global economy, private equity activity fell off a cliff in April and May as buyers and sellers alike absorbed the initial shock of government stay-at-home orders. But even as total deal count remained subdued throughout the year in most sectors, deal and exit value snapped back vigorously in the third quarter. In terms of putting large chunks of money to work, the year's second half ended up being as strong as any two-quarter run in recent memory (*see Figure 2*).

What's also evident is that the overall 24% drop in deal count during the year left plenty of unfinished business. Based on heavy global activity in early 2021, pent-up demand will likely have a strong positive impact on current-year deal numbers. All indicators suggest that funds will continue to chase deals in the sectors least affected (or actually enhanced) by the ongoing Covid-19 crisis.

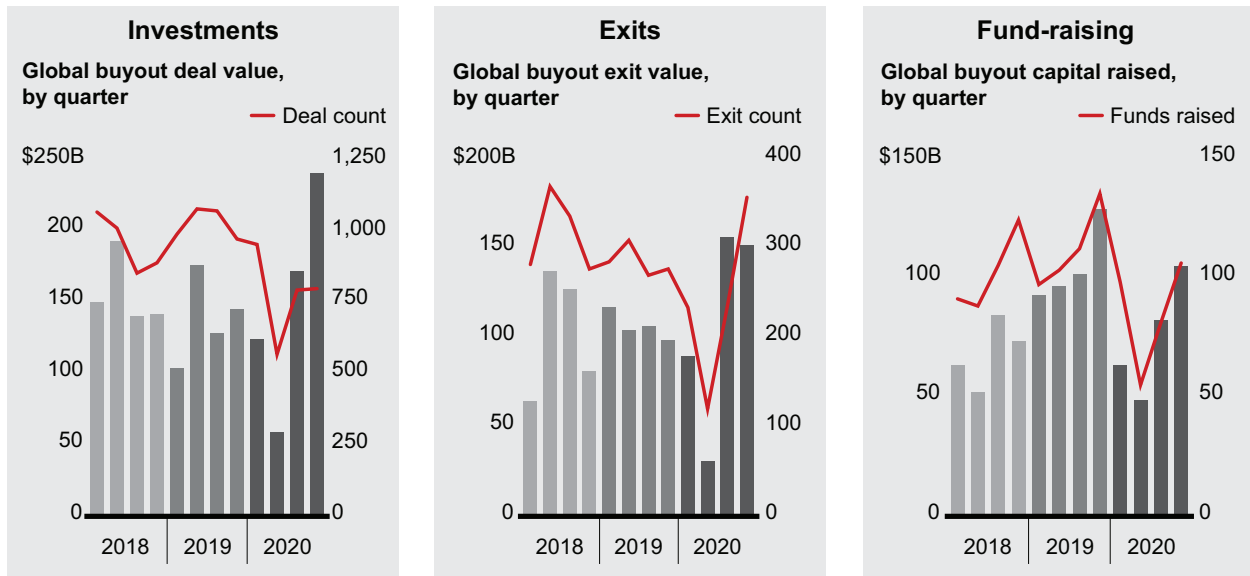
In some respects, the industry's quick rebound isn't surprising: One of private equity's enduring strengths is its ability to thrive during periods of economic disruption. Downturns typically offer PE

Figure 1: Despite massive disruption from Covid-19 and other crises, the buyout market held its own in 2020



Notes: Investments—includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that are completed or pending, with data subject to change; Exits—bankruptcies excluded; IPO value represents offer amount and not market value of company; Fund-raising—includes closed funds only and represents the year in which funds held their final close; buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds
Sources: Dealogic; Preqin; Bain analysis

Figure 2: PE activity across the board slowed abruptly in the second quarter but came roaring back in the second half



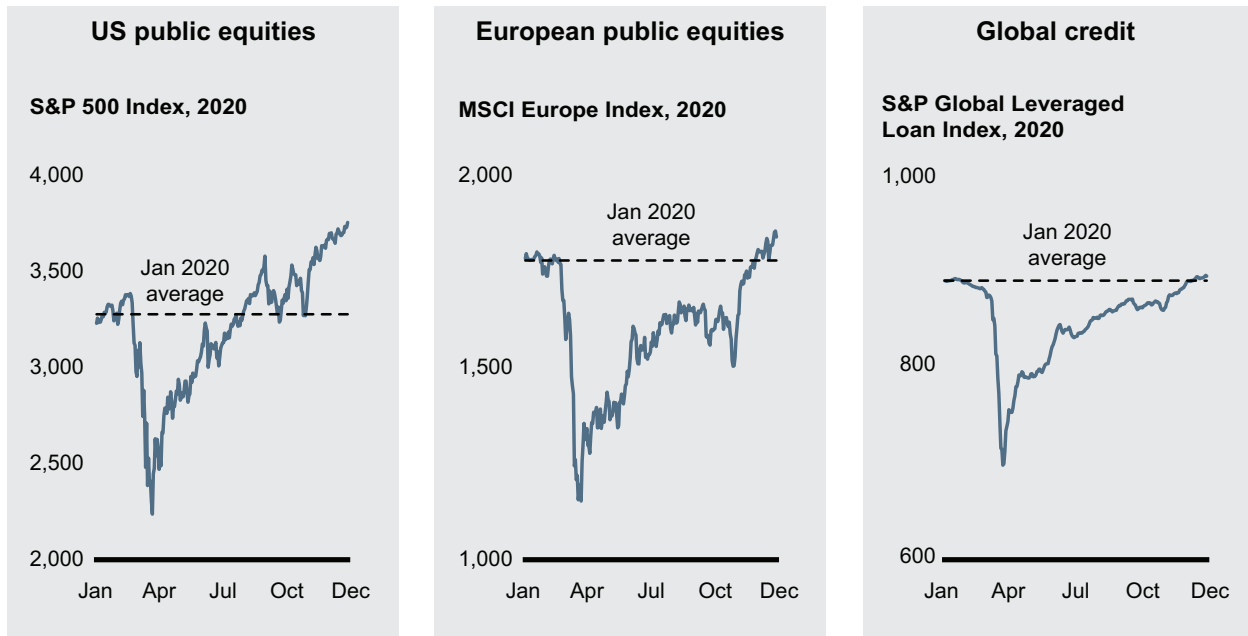
Notes: Investments—includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that are completed or pending, with data subject to change; Exits—bankruptcies excluded; IPO value represents offer amount and not market value of company; Fund-raising—includes closed funds only and represents the year in which funds held their final close; buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds
Sources: Dealogic; Preqin; Bain analysis

funds a relatively leisurely opportunity to find distressed assets and ride the cycle back up. This shows in the returns of fund vintages from the trough years following the last two economic downturns—2002 and 2009. They averaged internal rates of return (IRR) in the 17%–21% range, a healthy premium to the 16% long-term PE average.

But this crisis was different. While a short-lived opportunity for distressed investors produced deals like the multimillion-dollar recapitalizations of Wayfair and Outfront Media, the value window slammed shut quickly. Both global credit and public equity markets rebounded with blinding speed over the summer, pulling private asset prices (which are highly correlated with public equities) along with them. Consider that it took nearly seven years for the S&P 500 to get back to its precrisis high after the global financial crisis of 2008–09. This time around, the S&P reclaimed its losses within 150 days and finished the year 16% higher than where it started (see Figure 3).

This steep V pattern owes to several factors. First, coming into the Covid-19 crisis, private equity funds were bursting with dry powder. General partners were as eager as they’ve ever been to put money to work, and the explosive growth of special-purpose acquisition companies (SPACs) in 2020 added more than \$40 billion to the pile of capital chasing buyout deals (see “SPACs: Tapping an Evolving Opportunity”).

Figure 3: Hammered early by Covid-19 concerns, global equity and debt markets recovered their losses and then some within months



Note: As of beginning of each month
Sources: S&P Global; MSCI (Datastream)

Few were willing to make buy/sell decisions during the period of disorientation immediately following Covid-19's global spread. But the mood flipped when central banks in the US and Europe aggressively pumped trillions into the financial economy, easing liquidity concerns for firms and their portfolio companies (see Figures 4 and 5). That shifted attention from portfolio triage back to making deals.

The rapid stimulus boosted confidence that the malaise in the real economy would be temporary. It also made the flood of cheap debt available to fund transactions even cheaper. Rising asset prices and fears of a capital gains tax hike in the US, meanwhile, encouraged sellers to put assets on the market—particularly PE sellers transacting sponsor-to-sponsor deals. The net effect was a second-half surge in large deals that more than made up for the second-quarter drop in value.

The challenge moving into 2021, of course, is that the crisis is still very much with us and its economic impact remains extremely difficult to forecast. Although vaccines are on the way, Bain's Macro Trends Group projects that challenges to global economies are likely to persist through 2022, and the global regulatory response to this period of crisis could be significant.

This has several important implications for investors in 2021 and beyond:

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Figure 4: In response to Covid-related shutdowns, central banks acted quickly to backstop the markets by pumping trillions into the global economy

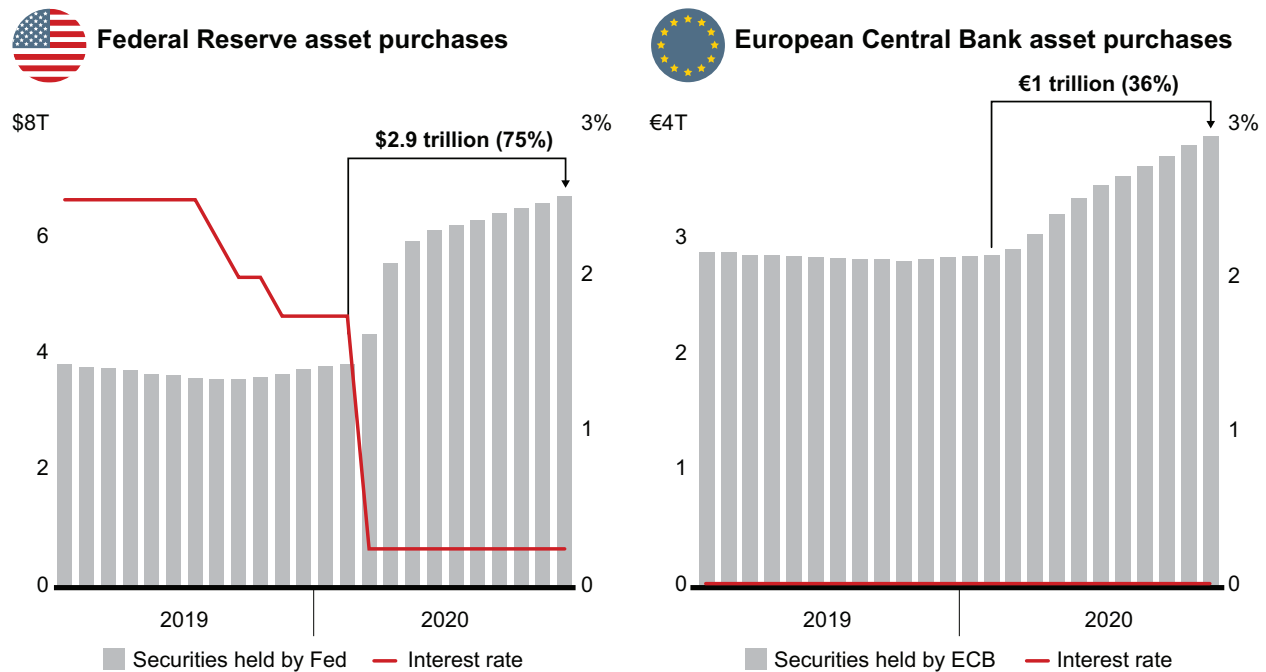
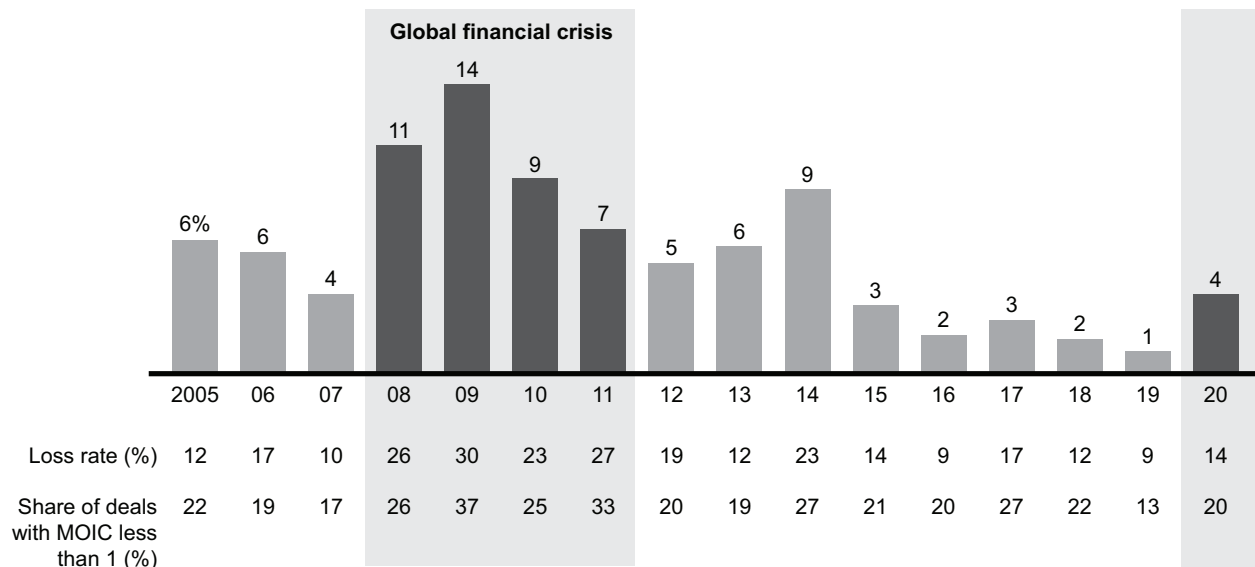


Figure 5: Rapid response from the central banks prevented the level of portfolio company distress we saw during the global financial crisis

Write-offs for buyout deals, by year of exit



Notes: Write-offs are poor-performing investments that are classified by the investment manager as unrecoverable and usually considered a complete loss; loss rate is the ratio of loss on defaulted deals (total value to paid-in of less than 1) and total contributions to all deals; MOIC is multiple on invested capital; includes fully realized global buyout deals with more than \$50 million in invested capital; excludes real estate and infrastructure deals
Source: CEPRES Market Intelligence

- **The game might not be over for value investors.** The great unknown in the wake of the Covid crisis is how long fiscal and monetary policy can hide any underlying structural damage to economies around the world. Eventually the stimulus will wash away, which could remove vital support from sectors that have relied on it. Past downturns tell us that a V-shaped recovery can quickly turn into a W. That could bring down valuations in certain sectors and create the kinds of distressed opportunities that evaporated so quickly in 2020.
- **Today's valuations leave little room for error.** Soaring asset prices in sectors like technology mean that multiples for deals getting done today are at or near record highs. The simple math says that GPs buying companies at these prices will have to generate more value if they are to make good on return expectations—and they will have to do so in a highly volatile and uncertain business environment. A Bain analysis of hundreds of funds in which we coinvest shows that multiple expansion and revenue growth (not margin improvement) are by far the biggest drivers of PE returns. Funds will have to find ways to improve that mix if they aim to replicate the returns they've posted over the past decade.
- **Deep sector and subsector expertise has never been more important.** The better you know the sectors you are investing in, the better you'll understand how they are going to change and how you can take advantage of it. Firms need in-depth intelligence on how the recovery will unfold in a given sector and where the ground has shifted. Many industries have changed fundamentally in the wake of Covid-19 in ways that can alter profit pools. Customer expectations may have evolved; disruptive innovations may have been pulled forward. The firms that can spot change first and build those insights into the PE value chain will have a distinct advantage in the post-Covid future.
- **PE firms need to accelerate their plodding transition from analog to digital.** Private equity remains a highly labor-intensive, paper-driven industry. The pandemic held up in high relief how inefficient this is. Not every meeting with investors or portfolio company management has to involve a flight, a hotel room and two days' turnaround time. Interactions can be faster, more frequent and equally effective on Zoom. PE firms have become expert in diagnosing the need for digital change at their portfolio companies. Becoming more competitive in the years ahead will mean bringing those lessons home.

A major element of going digital will be excellence in using tools and analytics throughout the private equity value chain. Before Covid-19 hit, the most effective firms were already deploying artificial intelligence, big data, web-based analytics and other technologies to make smarter, faster decisions about companies and their prospects. Over the past year, they've learned that these tools can lead to significantly deeper insights into how industry patterns are shifting, where disruption is coming from and whether their portfolios are prepared for whatever is coming next. Digitally aided due diligence is rapidly becoming table stakes.

It's safe to say that nobody saw what was coming in 2020. Yet the industry managed to find a way forward. Here's how the year unfolded in terms of investments, exits, fund-raising and returns.

Investments

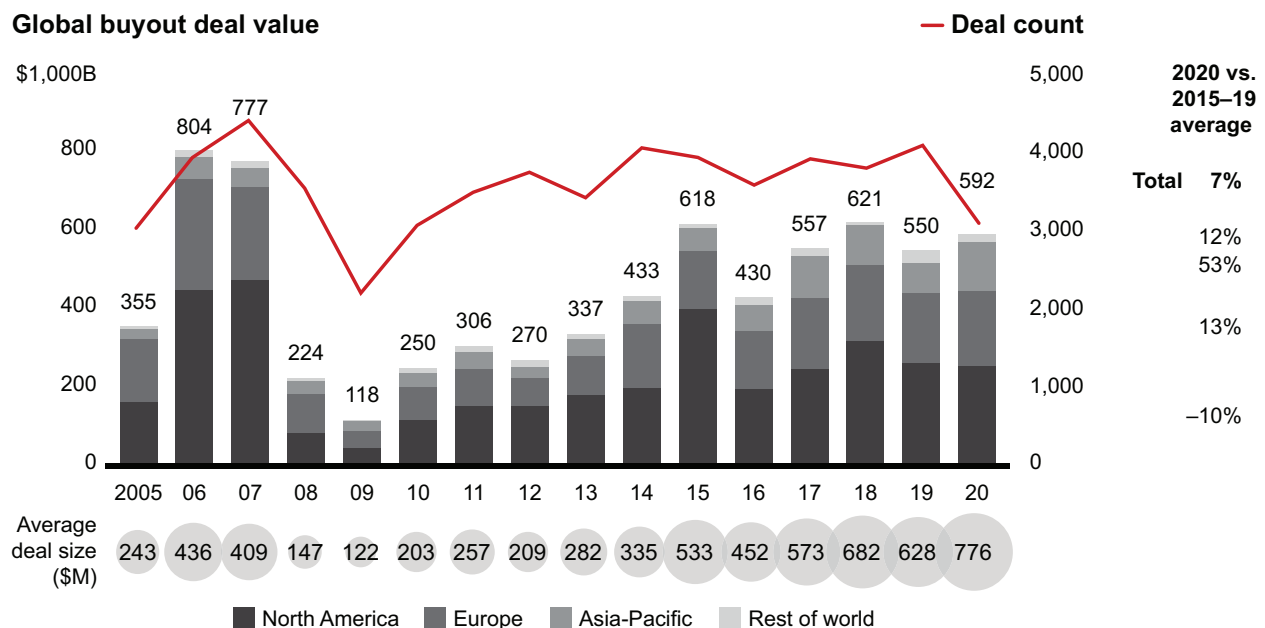
Having rebounded impressively from a dismal second-quarter performance (North American deal value alone was off 85% from the same quarter a year earlier), the global industry sprinted to the finish in 2020, generating \$592 billion in buyout deal value. That was an 8% jump from 2019's performance and 7% higher than the five-year average of \$555 billion (see Figure 6). A full \$410 billion of that total came in the third and fourth quarters as GPs raced to put money to work. Confidence reigned that central bank stimulus would prop up the global economy long enough for the worst of the Covid-19 pandemic to pass.

Covid did have a pronounced negative impact on global deal count, as the number of buyouts fell 24% to around 3,100 in 2020, from 4,100 in 2019. With the exception of the technology and telecom sectors, the number of deals slumped across the business landscape compared with the five-year average. The retail, consumer, and media and entertainment sectors were among those taking the biggest hits.

This drop in deal numbers was dramatic, but it is likely to be temporary. Due diligence activity around the world was as strong as it's ever been in early 2021, suggesting that many of the deals postponed amid the pandemic chaos will eventually get done. That should provide a structural scaffold under 2021 activity.

The reason total deal value rose in 2020 while volume slipped was a 24% increase in average deal size to \$776 million. That reflects the ongoing concentration of the PE industry—bigger funds have to

Figure 6: While the Covid crisis depressed buyout deal count in 2020, a jump in average deal size boosted global investment value



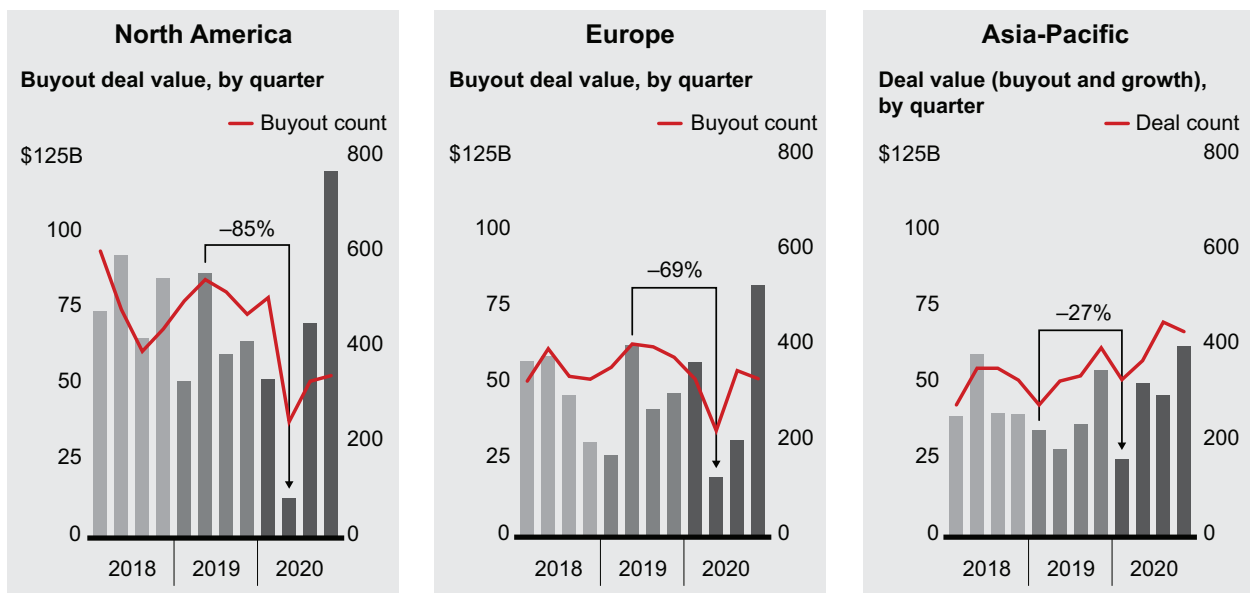
Notes: Includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that are completed or pending, with data subject to change; geography based on target's location; average deal size calculated using deals with disclosed value only
Source: Dealogic

do bigger deals to move the needle for investors. Banks also made more financing available for large deals than for smaller ones. In a jittery market, they were most comfortable lending to well-established GPs acquiring large, stable targets.

How deal activity unfolded regionally in 2020 was largely a function of where Covid-19 struck and when. The Asia-Pacific region saw the biggest impact in the first quarter as China wrestled with containing the initial outbreak of the virus. North America got slammed in the second quarter but managed to recover by June. Europe was slower to rebound as activity lagged in both the second and third quarters. It roared back in the fourth quarter, however, and European firms finished the year relatively strong (see Figure 7). Amid the ups and downs, private equity managed to increase its share of total merger and acquisition value, capturing 16% globally.

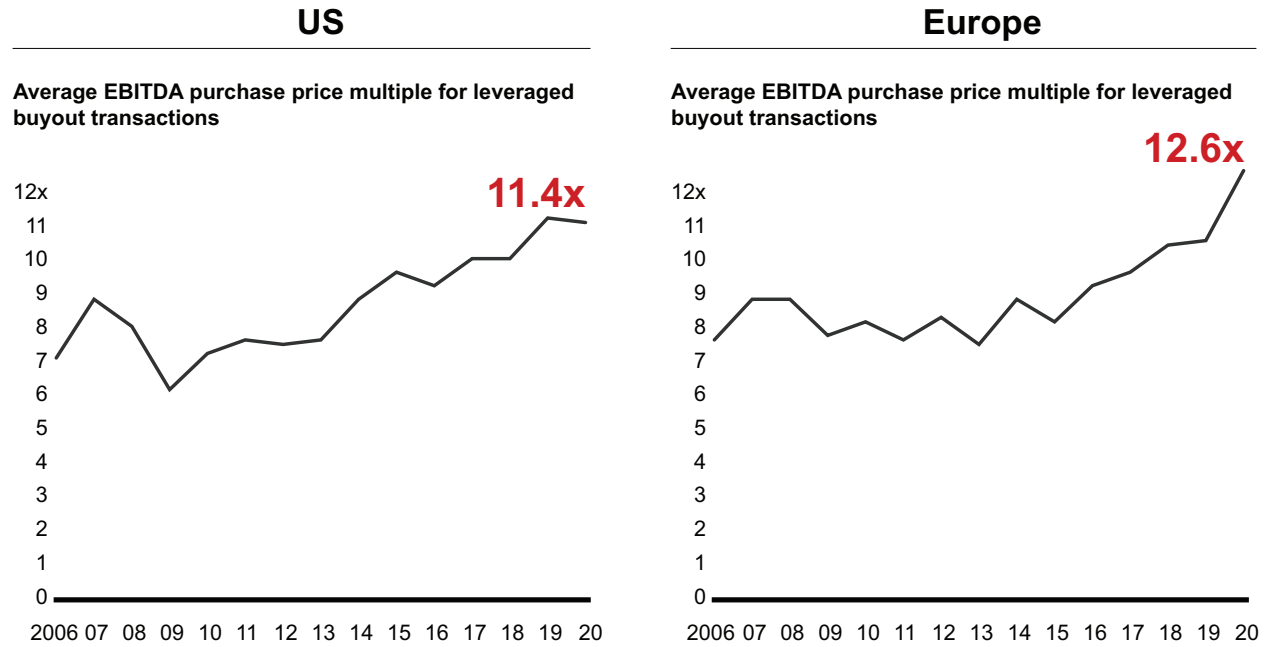
Sky-high asset prices are by far the biggest challenge facing PE investors. According to a December 2020 Preqin survey, investors see asset valuation as the most significant challenge in trying to generate strong returns. Amid heavy competition and a flood of investment capital—both debt and equity—buyout multiples continued to defy gravity in 2020, averaging 11.4 times earnings before interest, taxes, depreciation and amortization (EBITDA) in the US as of year-end and a record 12.6 times in Europe (see Figure 8). As a measure of how hot the market was, around 70% of US buyouts priced above 11 times EBITDA (see Figure 9).

Figure 7: Asia-Pacific markets felt the Covid effect first, but by the second quarter it had spread globally



Notes: North America and Europe—includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that are completed or pending, with data subject to change; geography based on target's location; Asia-Pacific—includes buyout, growth, early-stage, private investment in public equity, turnaround and other deals; excludes real estate and infrastructure
Sources: Dealogic; AVCJ; Bain analysis

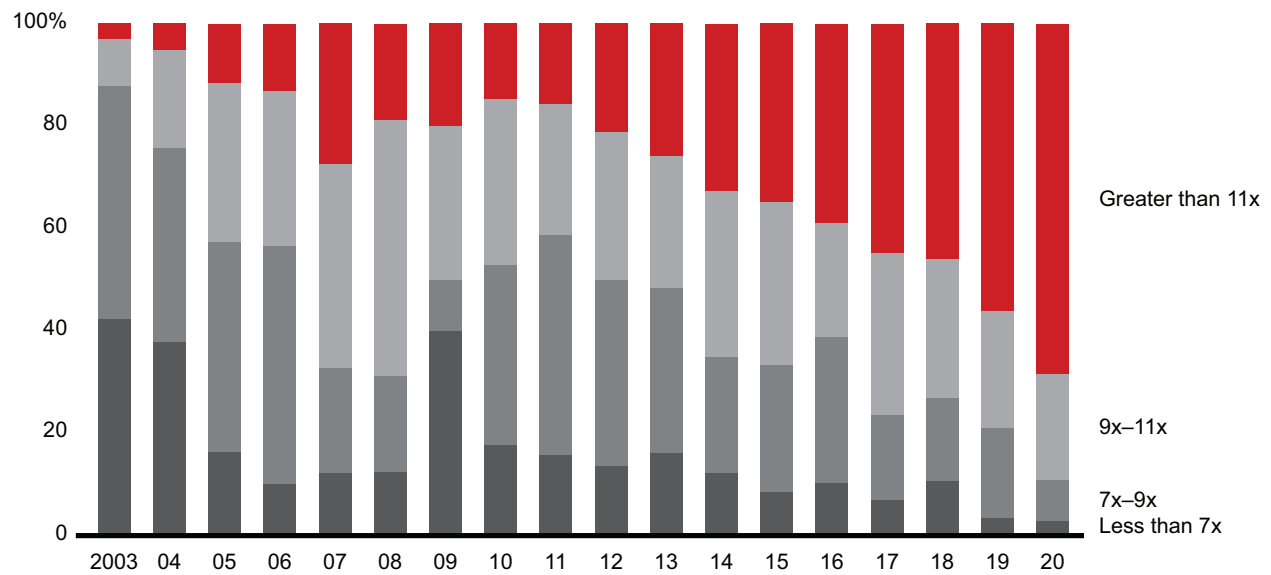
Figure 8: Deal multiples in the US and Europe are at or near record levels, putting added pressure on GPs to produce growth



Source: S&P LCD

Figure 9: More than two-thirds of all US buyout deals had purchase prices of more than 11 times cash flow

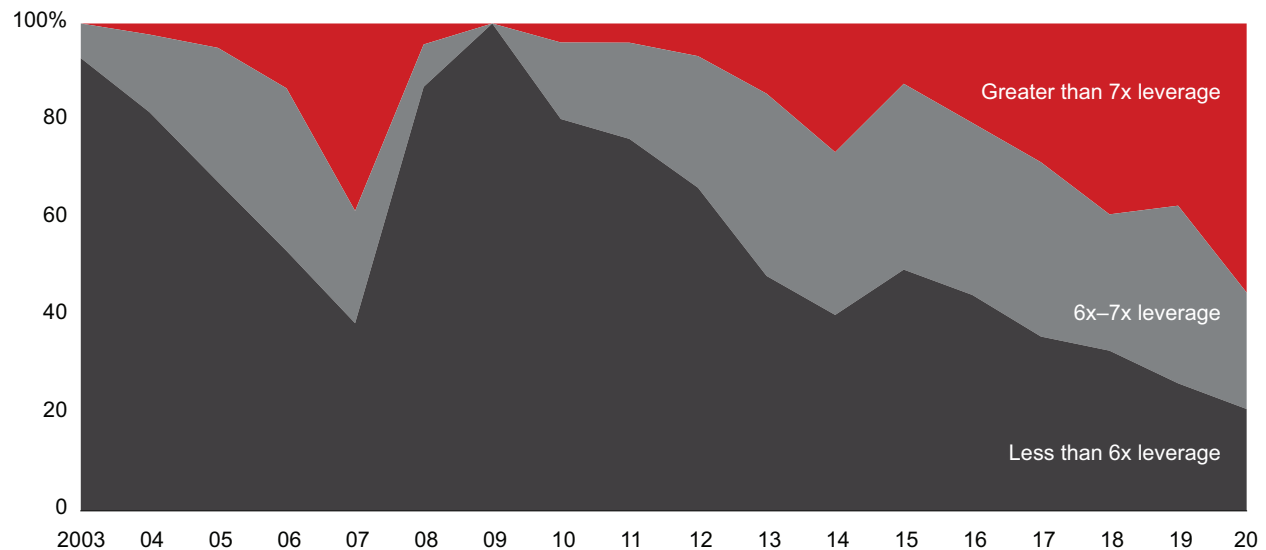
Average EV/EBITDA purchase price multiple for US buyout deals



Note: Includes deals with disclosed purchase price and leverage levels only
Source: Refinitiv LPC

Figure 10: Buyout leverage ratios have been trending upward for years, and the pace accelerated in 2020

Share of US leveraged buyout market, by leverage level



Source: Refinitiv LPC

Multiples rose across industries in 2020 but were especially buoyant in the sectors most immune to Covid-19 (such as payments) or those that benefited from the pandemic (like technology). What amounted to a flight to quality meant private equity targeted companies that could support more debt, and banks were happy to supply it. Despite the deep uncertainty surrounding the Covid-19 economy, debt multiples shot up in 2020, with almost 80% of deals leveraged at more than 6 times EBITDA—traditionally the level at which federal regulators start to raise eyebrows (see Figure 10).

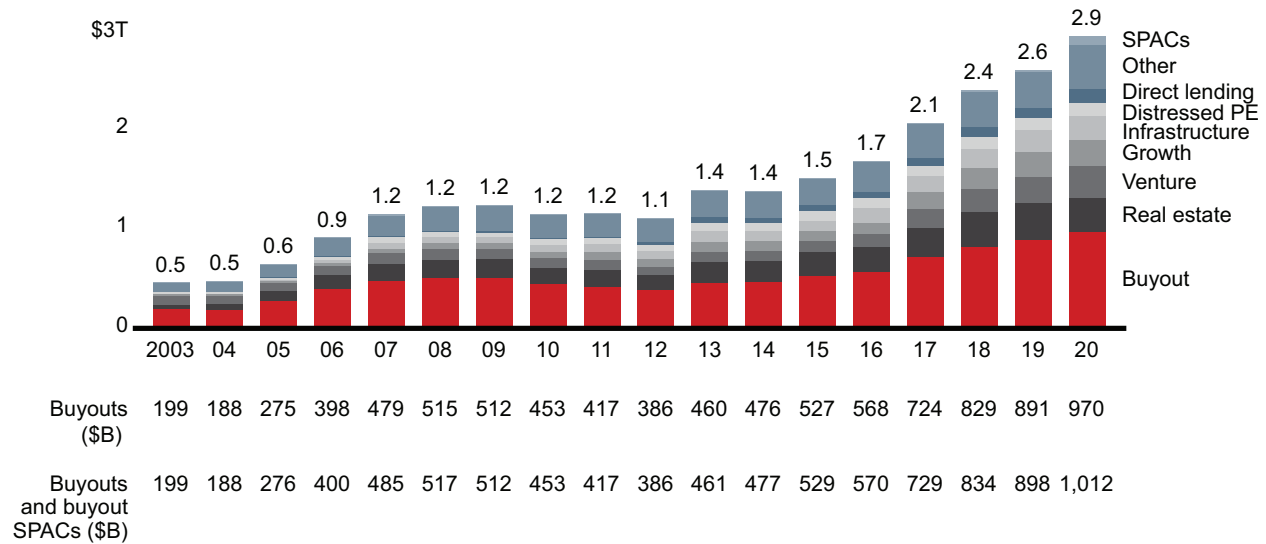
These dynamics have been at play for several years, as limited partners continue to pile money into the industry faster than GPs can put it to work. Unspent private capital overall, including that committed to venture, growth and infrastructure funds, has grown in stair-step fashion since 2013 to almost \$3 trillion, with around a third of it attributed to buyout funds and SPACs (see Figure 11).

Buyout dry powder is also at record levels, which is certainly a factor in rising price multiples. But there is little evidence to suggest that buyout funds are under undue pressure to put money to work. While the buildup of unused capital in the overall alternatives market can induce vertigo, the growth in buyout funds has been much more subdued (see Figure 12). The average age of buyout capital remains under control, and the amount in reserve equates to around two years' worth of investment, far less than in the years following the global financial crisis (see Figure 13). Dry powder is an issue but not a cause for alarm.

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Figure 11: Global dry powder has been stacking up for almost a decade and set another record in 2020

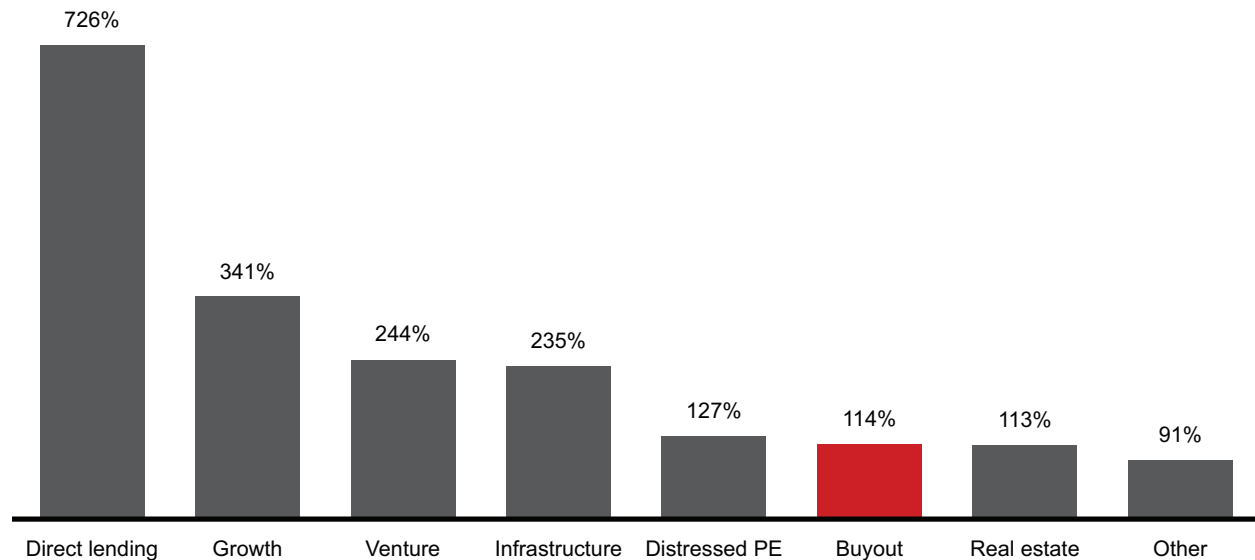
Global private uncalled capital, by fund type



Notes: Other includes fund-of-funds, secondaries, natural resources and mezzanine; buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds; SPACs fund-raising used as best proxy for SPACs dry powder; buyout SPACs estimated as approximately 50% of total SPACs directed to buyout deals; discrepancies in bar heights displaying the same value are due to rounding
Sources: Preqin; Thomson Reuters; SPACInsider; Bain analysis

Figure 12: While buyout dry powder has been growing steadily, capital aimed at other alternative asset classes has been piling up faster

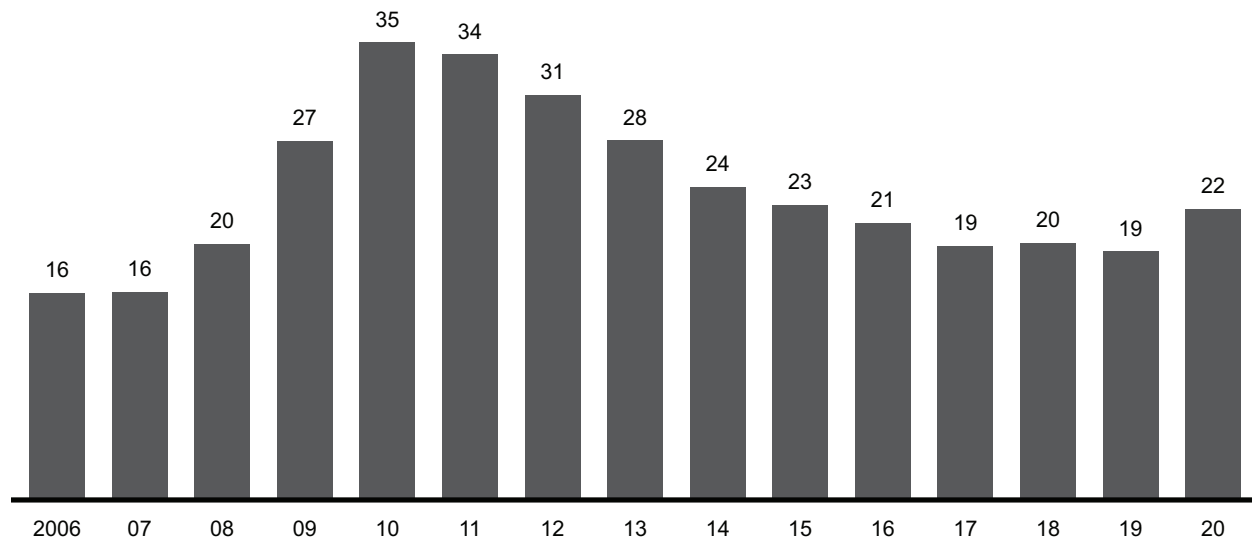
Growth in dry powder, 2020 vs. 2010, by fund type



Notes: Buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds; includes SPACs
Sources: Preqin; Thomson Reuters; SPACInsider; Bain analysis

Figure 13: The average age of dry powder held in buyout funds increased in 2020 but remains well below levels seen in the last downturn

Average age of global dry powder (months)



Notes: Includes buyout, balanced, coinvestment and coinvestment multimanager funds; average age of dry powder estimated as a weighted average of dry powder by vintage year, going back to 2000; buyout funds assumed to have seven years to deploy
Sources: Preqin; Bain analysis

Amid the chaos that defined 2020, PE funds showed remarkable resilience. Given the length of the economic expansion leading into the year, most firms had been carefully preparing for an impending recession by focusing on the economy's most durable seams. Entering the pandemic, however, was like stepping through the looking glass. Traditionally recession-resistant sectors like retail health clinics suddenly turned toxic as stay-at-home orders halted movement overnight. Meanwhile, many of the cyclical sectors that tend to tank in a downturn—home improvement, recreational vehicles, gardening retail—took off like a shot.

The ability to pivot quickly became the key to survival for many portfolio companies. In February 2020, RVshare, a fast-growing peer-to-peer RV rental marketplace, took on a \$50 million investment from Tritium Partners to fund growth. But just a few weeks later, the pandemic hit with full force and business tanked amid a wave of rental cancellations, which drained cash from the balance sheet. That forced the executive team to scramble for ways to both retain existing customers and find other sources of revenue.

The company cut a deal with Ikea's TaskRabbit to disinfect every rental before and after the contract period. It began renting vehicles to doctors and utility companies for emergency use. Then, as the summer wore on and camping became a last refuge for the millions forced to cancel more exotic vacations, the company's fortunes shifted again. Business accelerated and bookings soared. In October, the company raised another \$100 million investment from KKR.

Creative triage was common. Bain Capital's Apex Tool Group used 3-D printing to make hundreds of face shields for healthcare workers. L Catterton's ClassPass marketplace launched a new service that enables fitness and wellness providers to live-stream classes and manage appointments through the ClassPass app and website. Edison Partners' Suuchi pivoted from its core business of providing supply chain optimization software for the lingerie and baby clothing sectors to building a new revenue stream in personal protective equipment.

Entering the pandemic was like stepping through the looking glass. The ability to pivot quickly became the key to survival for many portfolio companies.

Some of the changes companies are making in response to Covid-19 will outlive the pandemic; others will not. Deciphering the new normal and reacting accordingly will be a major challenge for portfolio companies in the months and years ahead. One thing the pandemic has highlighted is that broad sector definitions aren't that useful anymore. Developing proprietary investment theses and generating strong deal pipelines increasingly will depend on specialized industry knowledge and nurturing proprietary networks of experts and advisers.

Consider healthcare. It is well known that telemedicine and nonhospital care models took off during the pandemic, and PE investment followed. Deals involving outpatient and home care companies more than tripled to \$3.9 billion in 2020.

But other, less obvious areas also popped. Life sciences companies that make tests and tools saw huge increases in business as governments and providers scrambled to offer more Covid-19 testing. The same was true for any company that sells tools for vaccine researchers or technology that enables scientists and pharmaceutical companies to collaborate. Indeed, one longer-term effect of the pandemic has been to expose ways in which clinical trials can be improved to rely less on physical interactions. That is opening opportunities for businesses that provide services like remote patient diagnostics and monitoring.

At the same time, healthcare sectors that usually hold up well in a downturn faced increased pressure in 2020 because of delays in elective procedures. Hospitals, ambulatory surgery centers and retail health clinics all suffered, though the impact varied by sector and company. For these businesses, the question is, how long will the Covid effect last, and what will the long-term effects be?

Overall, the number of deals in healthcare held up quite well in 2020. But placing the right bets required real-time understanding of Covid-19's impact, subsector by subsector, and knowing which

of those impacts might alter a company's trajectory in the future, with both upsides and downsides to consider.

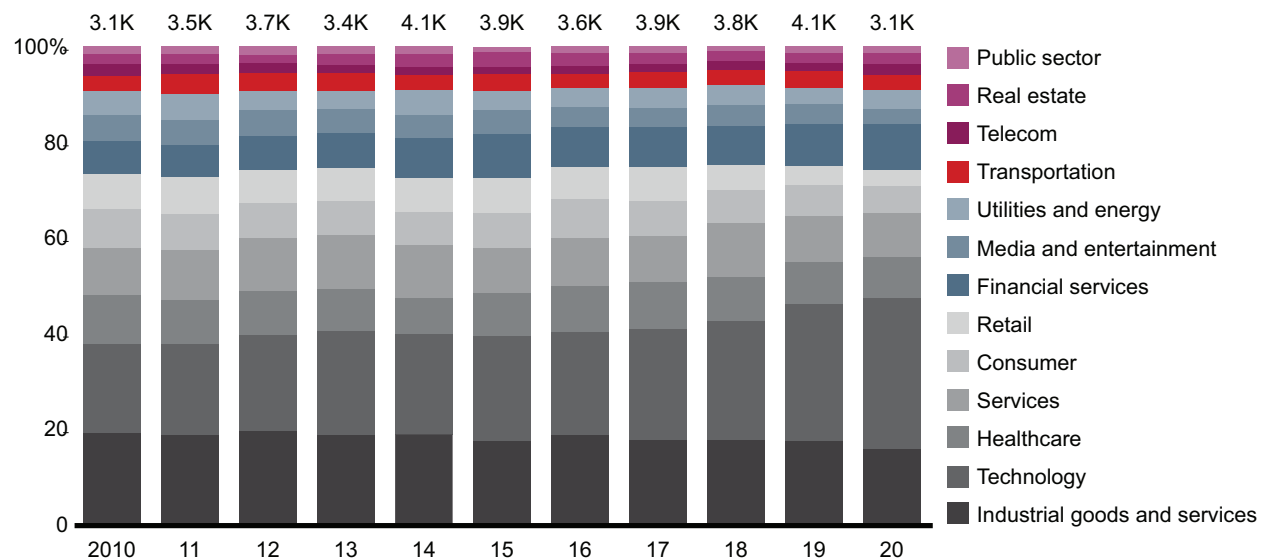
The broad technology sector attracted the most PE investment in 2020 (29% of total buyout deal count globally, 32% including fintech), with several subsectors standing out (*see Figures 14 and 15*). Funds gravitated toward SaaS-based businesses with particularly sticky business models, like vertical software. Gaming got a big boost from a single deal, a \$1.5 billion funding round for Epic Games led by KKR, Baillie Gifford and BlackRock.

The financial sector also drew significant private equity interest despite the slumping economy, which typically hits the sector hard. But here again, subsector dynamics mattered. Insurance didn't see much activity, while the payments sector was on fire (as we predicted last year). The secular shift to digital payments that was already well underway got a Covid-19 boost when retailers and consumers alike backed away from cash in favor of cards and other forms of online payment. Deals involving payments companies made up 24% of total financial services/fintech investment value in 2020, up from 16% the year before.

Given that we are still battling the Covid pandemic, the expected strong deal activity in 2021 will likely follow these same patterns. We would expect to see subsectors immune to Covid-19—or given new momentum by the pandemic—continue to attract interest, while hard-hit areas like hospitality, retail

Figure 14: The technology sector continues to attract the most attention from PE investors, and its share is expanding

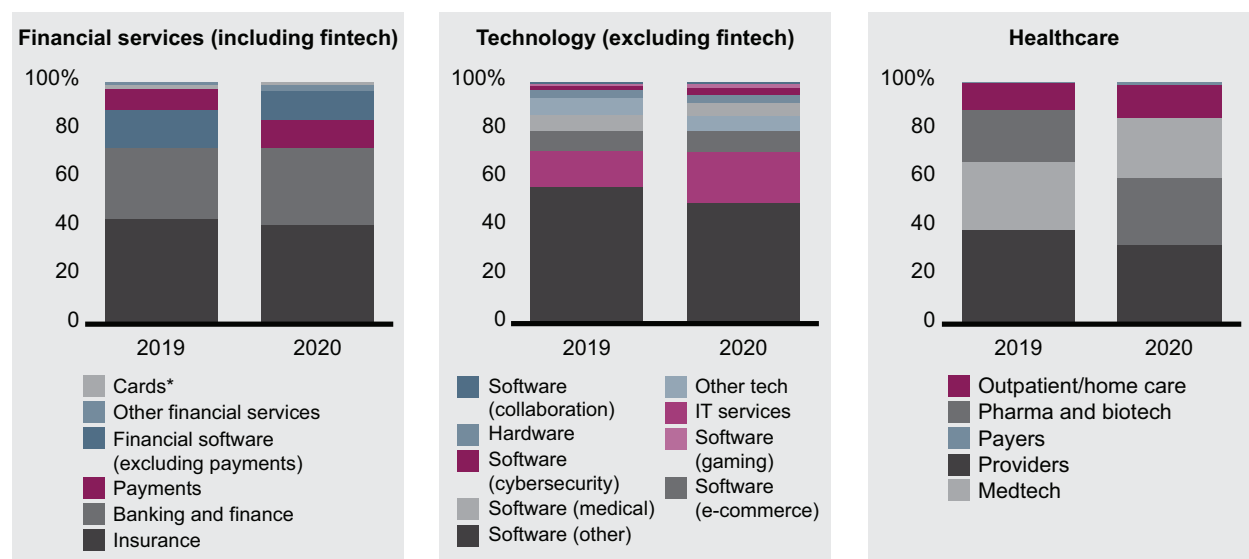
Share of global buyout deal count, by sector



Notes: Includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that are completed or pending, with data subject to change
Source: Dealogic

Figure 15: Within the most popular industry groups, investors tend to cluster in particularly attractive subsectors

Global buyout deal count for ...



* Primarily debt collection services

Notes: Includes add-ons; excludes loan-to-own transactions and acquisitions of bankrupt assets; based on announcement date; includes announced deals that are completed or pending, with data subject to change

Sources: Dealogic; Bain analysis

and energy may provide rolling opportunities for distressed investing. Amid the continued disruption, private equity firms may need to fundamentally shift their sector emphasis to succeed in this disjointed market. As we've noted, deep subsector expertise has never been more important.

Exits

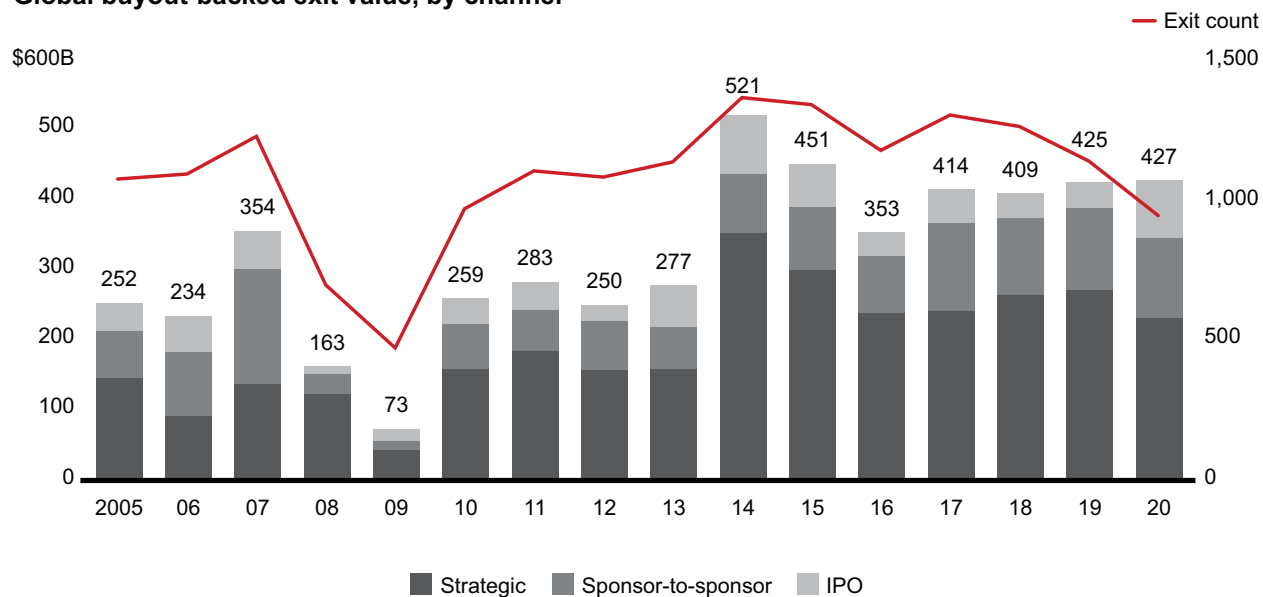
Exit activity in 2020 followed the same pattern as investments. Both buyers and sellers hunkered down when the Covid-19 pandemic hit in the spring, and second-quarter activity went into a skid. But exit value picked up in the second half, as revived price multiples and the threat of a tax-law change in the US gave sellers ample incentive to put companies on the market—particularly big ones. The number of exits trailed 2019's total, but owing to an increase in deal size, global exit value hit \$427 billion in 2020, on par with 2019 and in line with the five-year average (see Figure 16).

Once again, strategic buyers provided the largest exit channel. Sponsor-to-sponsor deals held up well, and initial public offerings increased by 121% to \$81 billion as public equity markets soared. Firms also leaned heavily on partial exits, as GPs sought to keep a stake in attractive assets rather than have to hunt down new prospects in a highly competitive deal market. Overall, the median holding period for companies exited in 2020 was 4.5 years, slightly higher than in 2019 but in line with the five-year average (see Figure 17).

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Figure 16: Exit count declined in 2020, but value was in line with the five-year average thanks partly to IPO growth

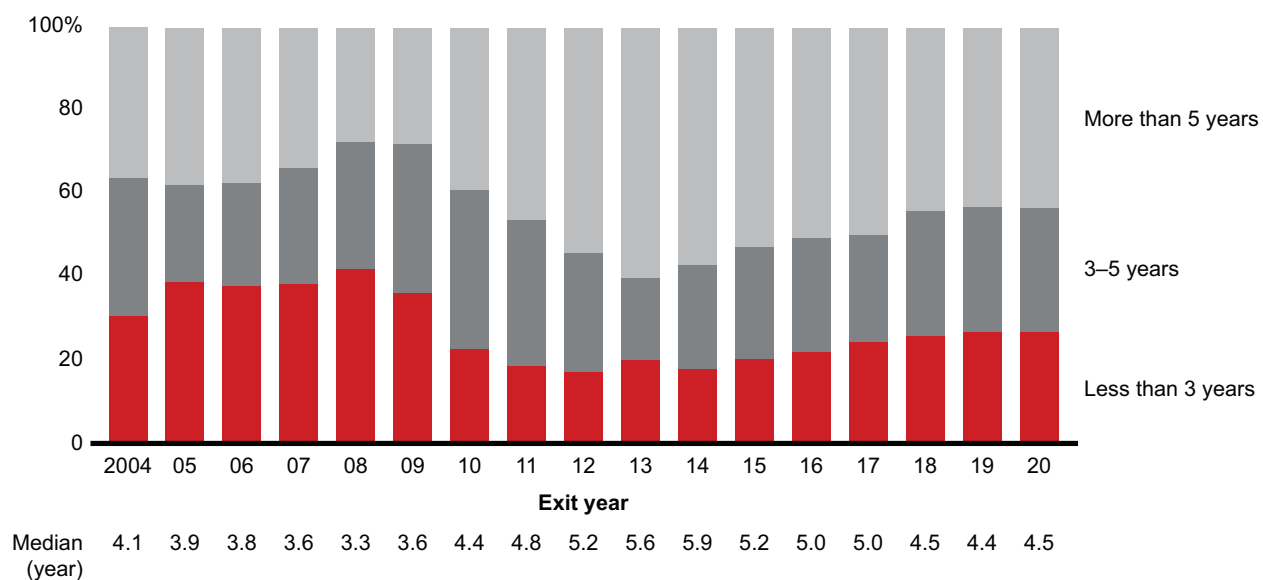
Global buyout-backed exit value, by channel



Notes: Includes partial and full exits; bankruptcies excluded; IPO value represents offer amount and not market value of company
Source: Dealogic

Figure 17: The median holding period for exited assets didn't change meaningfully from previous years

Global buyout-backed exits, by length of time held in fund portfolio



Notes: Includes buyout, public-to-private, special situation and turnaround investments, as well as exits through IPO, merger, sale to GP/management, trade sale or unspecified exits; excludes partial realizations, except for IPOs
Source: Preqin

Fund-raising

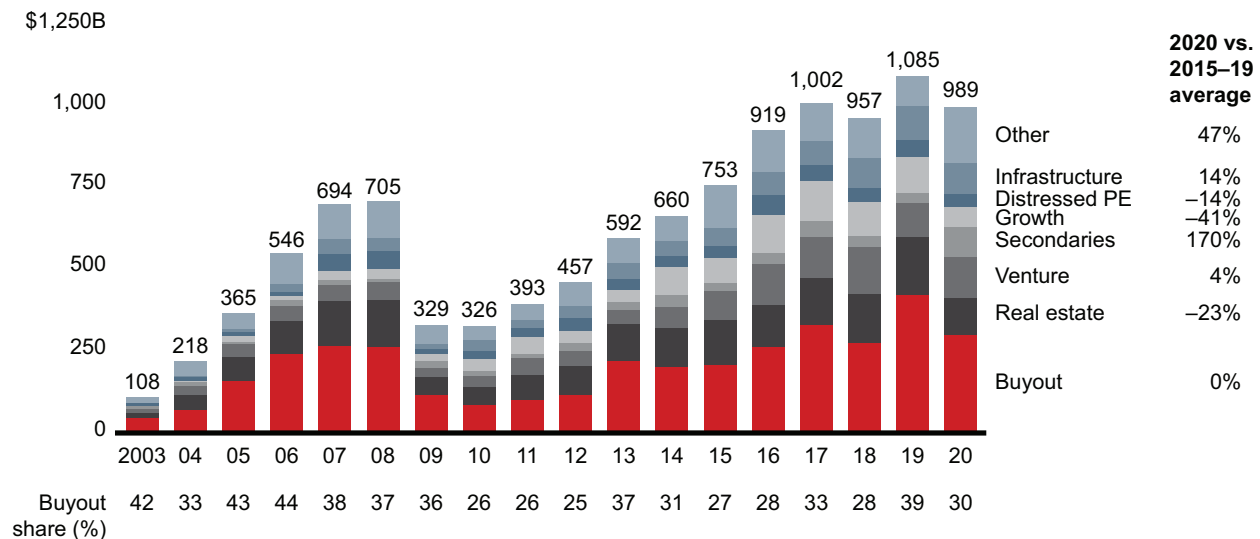
It's hardly surprising that many GPs were afraid Covid-19 would put an end to the past decade's golden era of private equity fund-raising. But those fears turned out to be unwarranted. Global fund-raising of \$989 billion was a decline from 2019's all-time record of \$1.09 trillion (see Figure 18). But it was still the third-highest total in history, and if you add in the \$83 billion raised for SPACs, it was the second highest. All told, the industry has raised almost \$5 trillion in capital over the past five years. Buyout funds alone raised about \$300 billion in 2020, or \$340 billion if you include SPAC capital aimed at buyout-type targets, estimated at \$41 billion (see Figure 19).

It's clear that LPs continue to view private equity as a haven in the storm. Institutions did take a pause in April during the first peak of the Covid-19 crisis but quickly got back to business during the summer. According to *Private Equity International's* December 2020 LP Perspectives Study, around 80% of LPs are confident private equity will continue to perform in 2021, and close to 40% say they are underallocated to the asset class. The vast majority plan to either increase or maintain their commitments in 2021 (see Figure 20).

As enthusiastic as LPs are, however, they are becoming increasingly picky about the funds in which they invest. A flight to quality in 2020 benefited large, well-established funds most (see Figure 21).

Figure 18: Although fund-raising declined across almost all fund types in 2020, the global total was still the third highest ever

Global private capital raised, by fund type

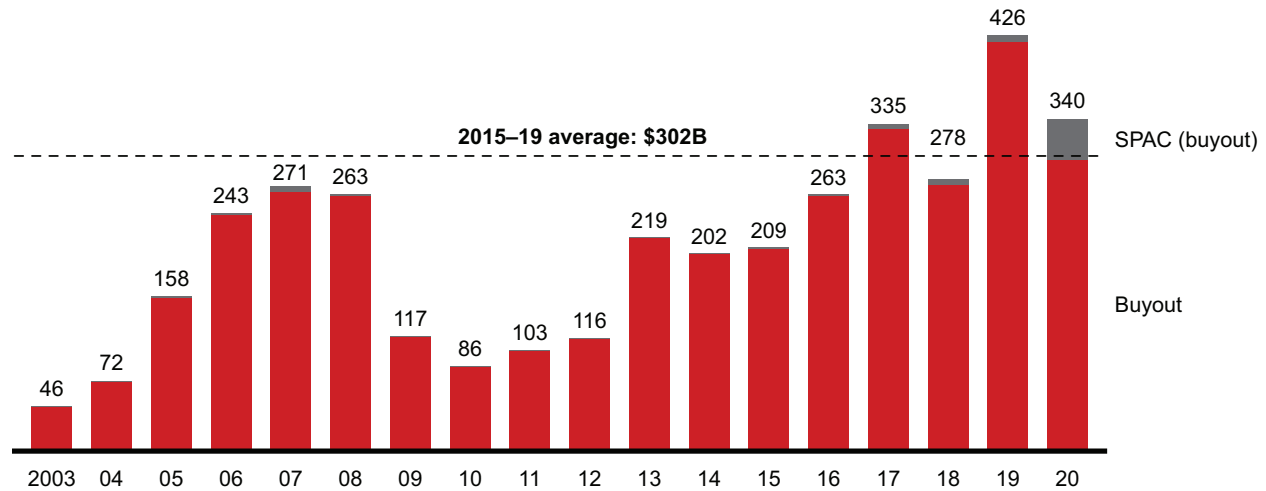


Notes: Buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds; includes funds with final close and represents the year in which funds held their final close; other includes SPAC fund-raising (as measured by IPO fund-raising volumes), private investment in public equity, hybrid funds, mezzanine and natural resources; distressed PE includes distressed debt, special situation and turnaround funds; excludes SoftBank Vision fund
Sources: Preqin; SPACInsider; Bain analysis

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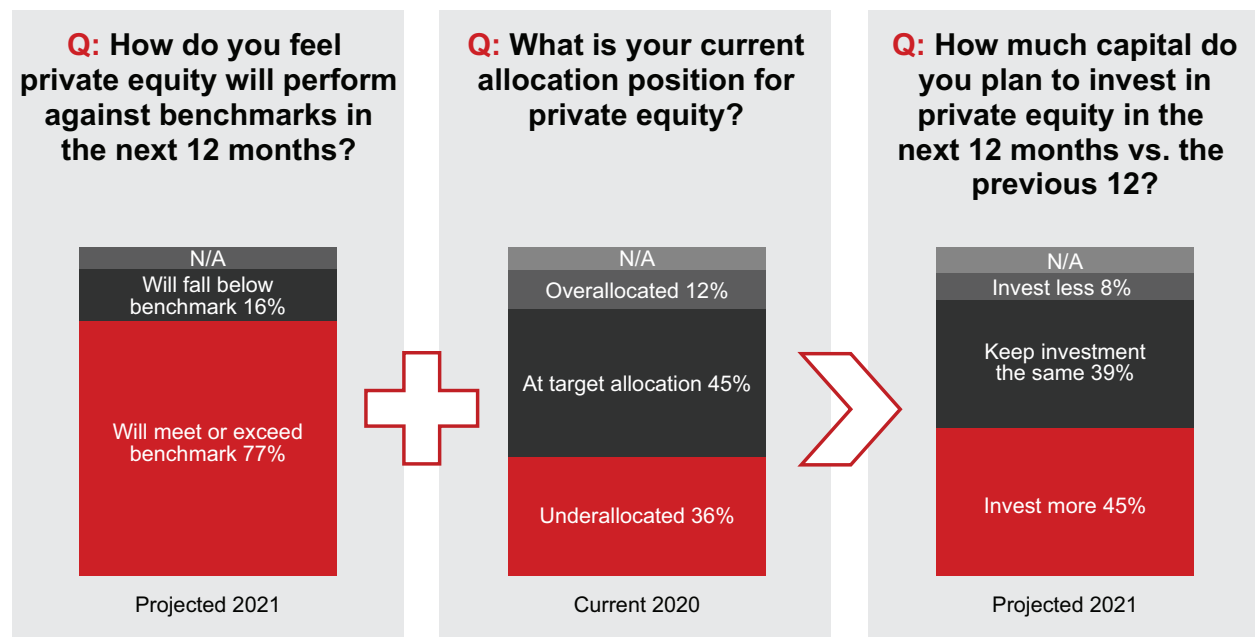
Figure 19: Buyout fund-raising exceeded the five-year average when you factor in SPACs aimed at buyout-type targets

Buyout and buyout SPAC private capital raised (\$B)



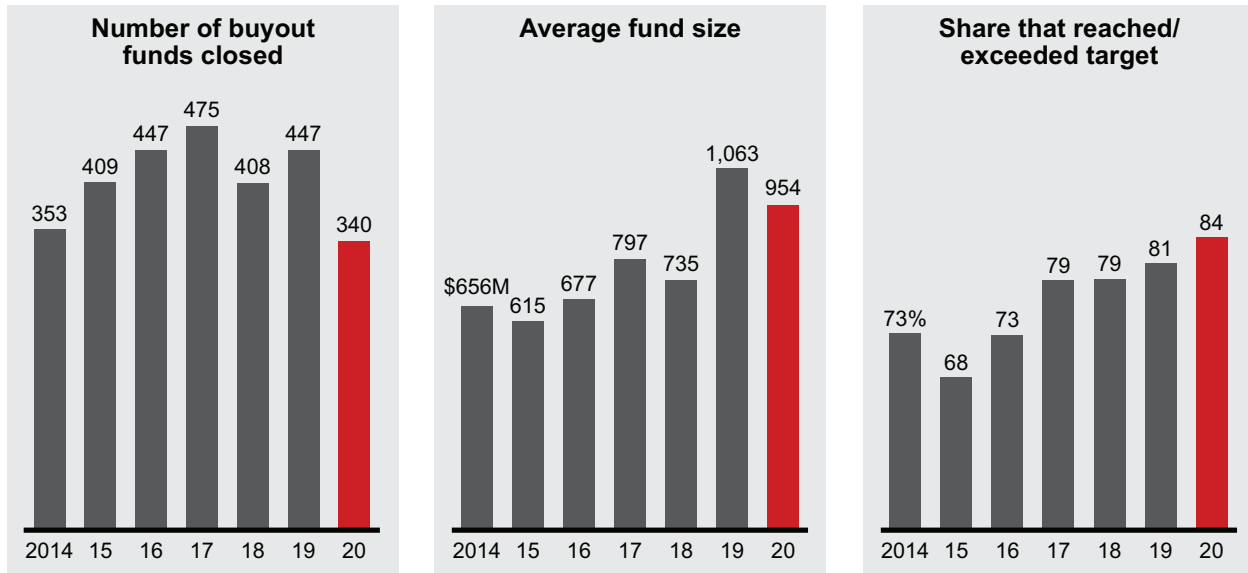
Notes: Buyout SPACs value estimated as 50% of total annual SPACs value, based on analysis of approximately 85 SPACs that closed transactions in the past five years in the Americas; SPACs fund-raising measured by IPO fund-raising volumes; buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds; includes funds with final close and represents the year in which funds held their final close; five-year average calculated from combined buyout/buyout SPAC totals; excludes SoftBank Vision fund
Sources: Preqin; SPACInsider; Bain analysis

Figure 20: LPs remain sanguine about private equity performance, and most plan to maintain or increase commitments



Source: *Private Equity International*, LP Perspectives Survey 2020

Figure 21: Fewer funds closed in 2020, but those that did skewed large and raised more than they had targeted



Notes: Number of buyout funds closed represents all buyout funds closed, including those for which the value of final funds raised is available; average fund size is total funds raised across all buyout funds for which the value of final funds raised is available, divided by the total number of buyout funds for which only the value of funds raised is known; share that reached/exceeded target includes all buyout funds that closed in the respective year for which both the fund-raising target and value of final funds raised is known; buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds
Sources: Preqin; Bain analysis

Fewer funds closed overall, but those that did skewed large. On average, funds seeking \$5 billion or more in assets closed within six months and 18% above their initial target. CVC, for example, raised \$24 billion for its Capital Partners Fund VIII in five months and beat its initial target by 22%. By contrast, smaller funds with experience took an average of 14 months to close (see Figure 22).

The exceptions to this pattern were funds with a crystal-clear focus. US-based Symphony Technology, for instance, closed its \$2 billion Group IV fund in just under six months and was 33% above target. Montefiore Investment raised €850 million in three months with a focus on France. Even a first-time fund like South Korea's BNW Investment was able to raise \$160 million (32% more than it intended) within five months for a fund focused on high-growth, technology-enabled industrial companies.

LPs also showed interest in long-hold funds. Cove Hill raised \$1.5 billion in long-hold capital, despite having yet to exit any of the investments made with its initial \$1 billion long-hold fund raised in 2017.

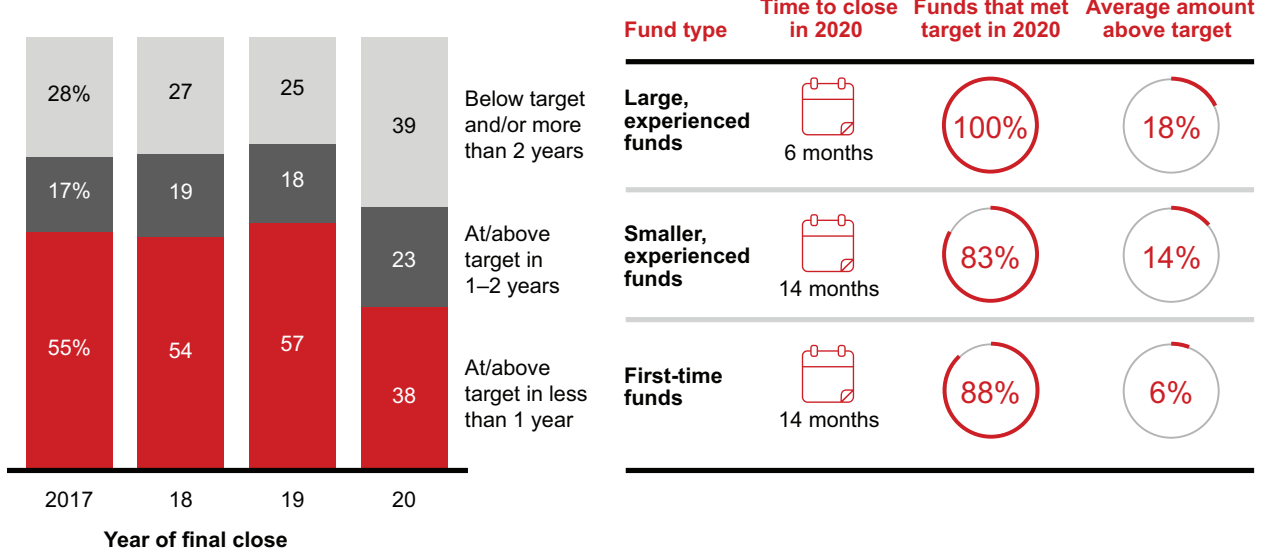
Returns

By all indications, private equity weathered 2020's perfect storm without taking a hit to returns. Looking at 10-year annualized IRR, funds have so far avoided the kind of damage suffered in the global financial crisis (see Figure 23).

Global Private Equity Report 2021

Figure 22: Fewer funds hit their target quickly, but larger funds had an easier time of it amid a flight to quality among LPs

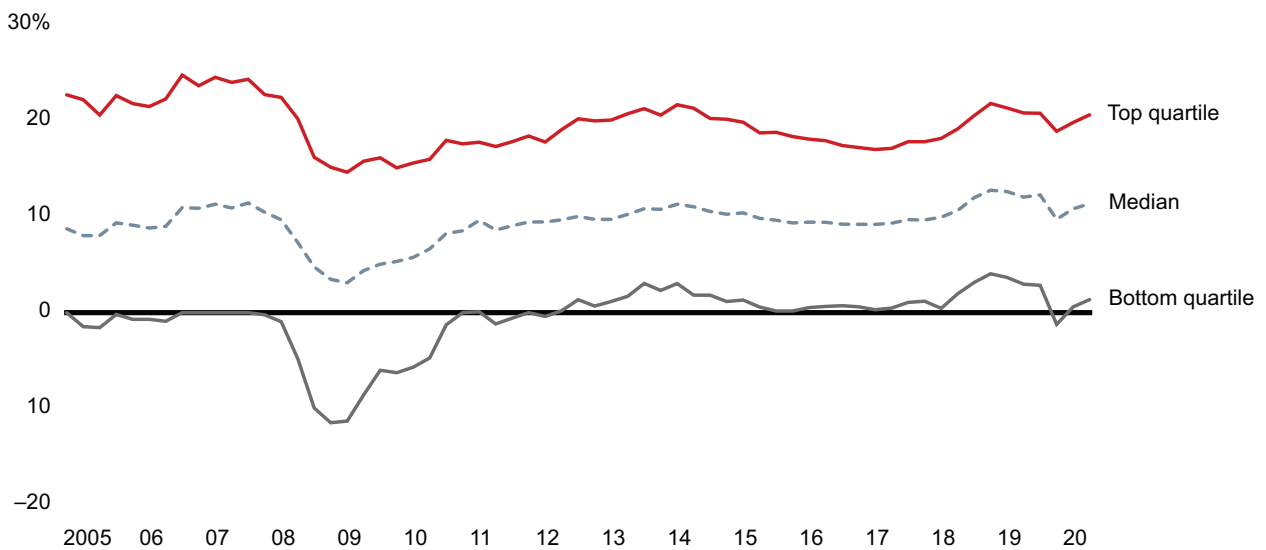
Percentage of buyout funds closed



Notes: Percentage of buyout funds closed includes all buyout funds that closed in the respective year for which both the fund-raising target and value of final funds raised is known, as well as the time taken to close the fund-raising; buyout includes buyout, balanced, coinvestment and coinvestment multimanager funds; excludes real estate and infrastructure funds; large, experienced funds are those with more than \$5 billion in assets, excluding first-time funds
Sources: Preqin; Bain analysis

Figure 23: Private equity returns have so far powered through the Covid-19 crisis

10-year annualized IRR for global buyouts



Sources: State Street Private Equity Index; State Street Global Markets

It helped to some extent that GPs were already preparing for an end to the record-breaking, decade-long recovery cycle that followed the global financial crisis. But the biggest difference between then and now was the massive government stimulus that buttressed the economy against the worst Covid-19 could dish out. While many sectors saw real damage, many others went untouched thanks to the central banks, and that helped investors maintain or even improve performance across the board.

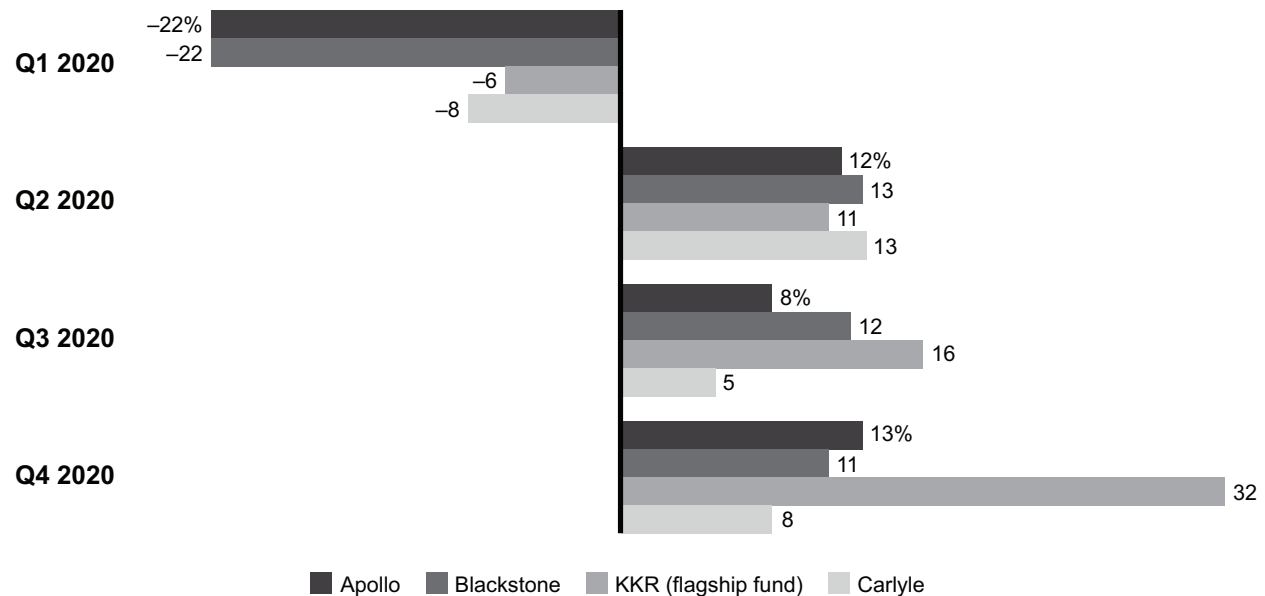
With the exception of the first quarter, when spooked investors ran for the hills, publicly traded PE firms fared well (see Figure 24). More broadly, while GPs exited fewer deals in 2020, those that did produce exits generated multiples on invested capital of about 2.3 times, slightly above the five-year average (see Figure 25).

The global industry continues to outperform other asset classes over most time periods. The exception has been US-based fund performance, which has converged with public averages over the past decade (see Figure 26). This owes largely to the public market's remarkable surge in value since the global financial crisis—an anomaly compared with the long-term average. History suggests that public equity performance will eventually revert to the mean.

What's becoming increasingly clear is how variable PE performance has been across sectors and sub-sectors. While technology and business services have soared in the current cycle, the consumer, health-

Figure 24: Publicly traded PE firms took a major hit in the first quarter but recovered quickly as the year progressed

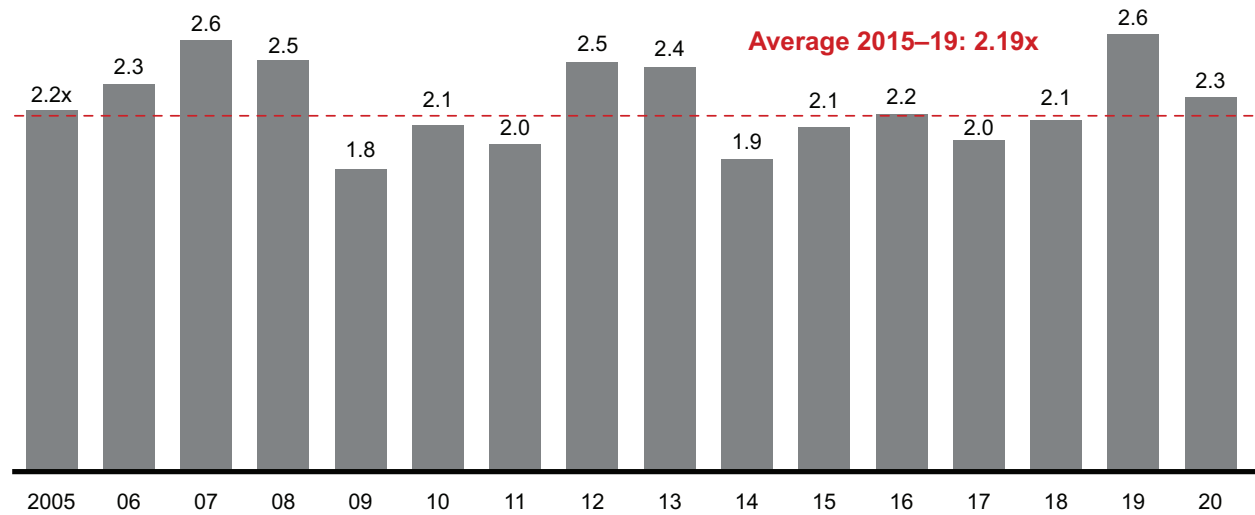
Firms' PE valuation change vs. previous quarter



Source: Company quarterly earnings call presentations and transcripts

Figure 25: Realized returns in 2020 compared favorably with the five-year average

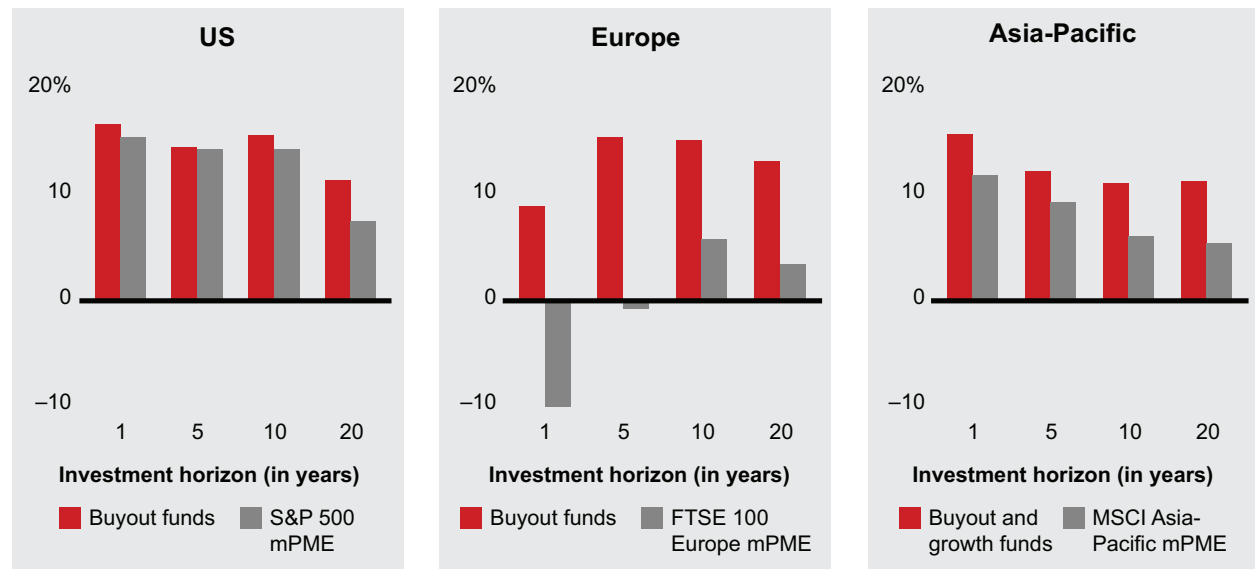
Gross pooled MOIC, by year of exit



Notes: MOIC is multiple on invested capital; includes fully realized global buyout deals with more than \$50 million in invested capital; excludes real estate and infrastructure deals
Sources: CEPRES Market Intelligence; Bain analysis

Figure 26: Buyout funds have outperformed public markets around the world over the long term, but returns have started to converge in the US

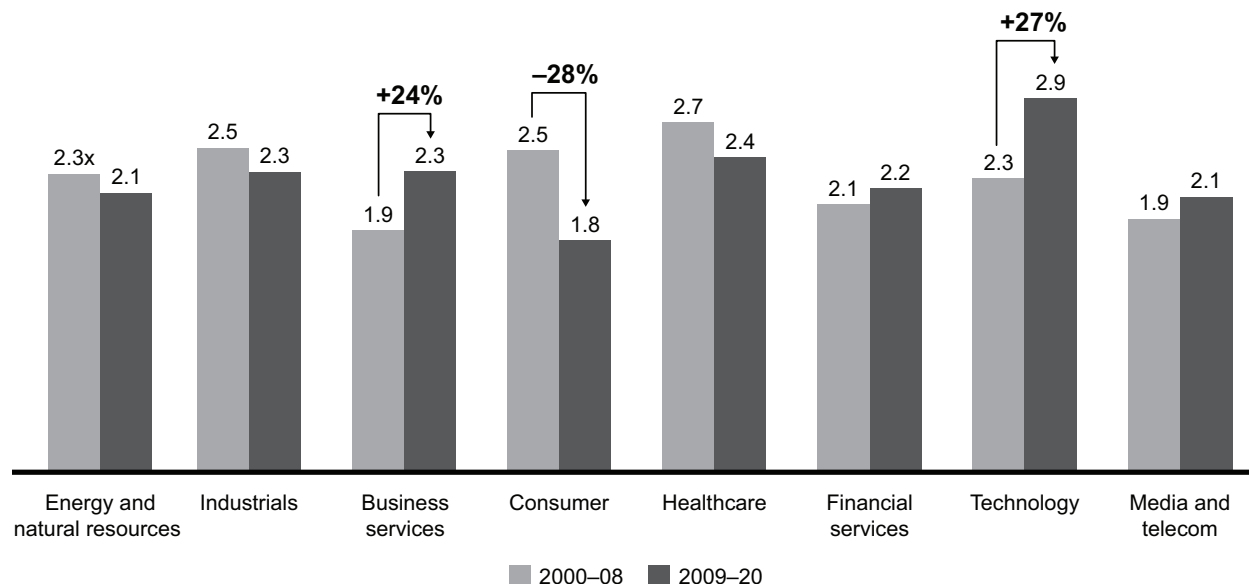
End-to-end pooled net IRR as of Q3 2020 for ...



Notes: Data for US and Asia-Pacific calculated in US dollars; data for Europe calculated in euros; Europe includes developed economies only; Cambridge Associates Modified Public Market Equivalent (mPME) replicates private investment performance under public market conditions
Source: Cambridge Associates

Figure 27: Performance across sectors has been highly variable, both in absolute terms and relative to the previous cycle

Median MOIC, by sector and investment year



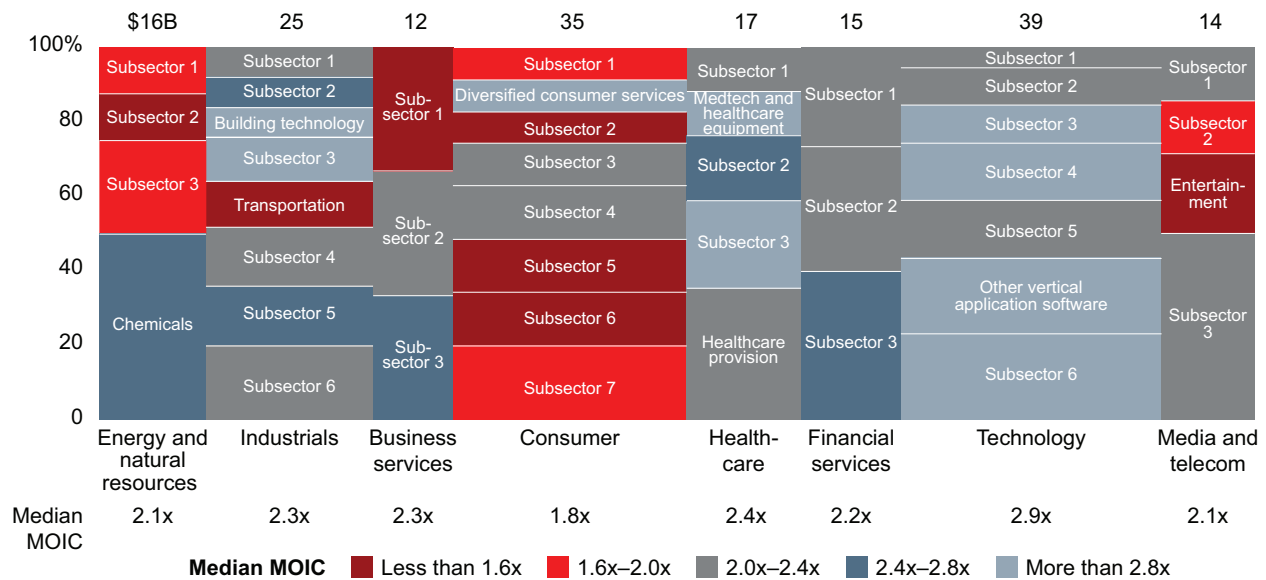
Notes: MOIC is multiple on invested capital; includes fully realized global buyout deals with more than \$50 million in invested capital
Sources: CEPRES Market Intelligence via DealEdge; Bain analysis

care, industrials and natural resources sectors (including energy) have fallen off (see Figure 27). There has also been wide variance in performance among deals focused on subsectors of broader industry groups (see Figure 28).

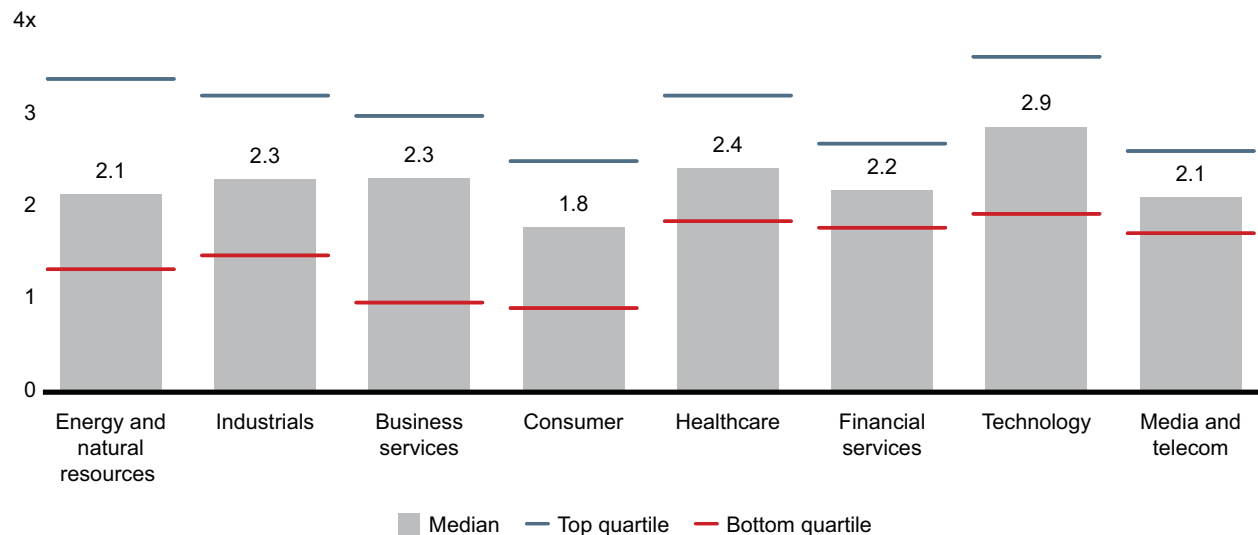
This isn't to say that simply playing in the right sector is the secret to strong returns. Sector dynamics are not to be discounted, but the choice of company within a strong sector is still more likely to determine deal success. The gap between top-quartile performance and bottom-quartile performance in technology, for instance, has been wide over the past decade. In the otherwise lackluster energy and natural resources sector, top-quartile returns outpaced those of sectors with higher median performance (see Figure 29).

The message is clear: Winning investments exist in every industry. Finding them and creating real value requires both deep knowledge of sector dynamics and a clear thesis describing how a given company can take advantage of them.

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Figure 28: Deal returns have also varied widely within a given sector**Global invested equity capital, by sector**

Notes: MOIC is multiple on invested capital; based on fully realized global buyout deals with more than \$50 million in invested capital, with original capital allocations between January 1, 2009, and December 31, 2020
 Sources: DealEdge; Bain analysis

Figure 29: Sector choice is important, but top-tier performance still comes down to picking the right company**Median, top- and bottom-quartile MOIC, by sector**

Notes: MOIC is multiple on invested capital; includes fully realized global buyout deals with more than \$50 million in invested capital, with original capital allocations between January 1, 2009, and December 31, 2020
 Sources: CEPRES Market Intelligence via DealEdge; Bain analysis



The Expanding Case for ESG in Private Equity

Customers, employees and limited partners are demanding more sustainable, socially conscious corporate behavior. PE firms that can deliver are reaping the rewards.

By Axel Seemann, Dale Hardcastle, Deike Diers and Jacqueline Han

Until there is consistent data establishing a positive link between ESG investing and financial returns, there will always be skepticism among private equity investors. That's just the way the industry is wired.

We've all seen the anecdotal evidence that companies can actually “do well by doing good” when they adhere to environmental, social and corporate governance (ESG) standards. But no matter the ownership model, there is reluctance to dive in headfirst, and PE firms face a unique mandate to produce substantial returns quickly.

ESG is broad and amorphous, notoriously hard to define. We lack time-tested standards for measuring either results or impact. That, not surprisingly, leads to muted enthusiasm among some firms and check-the-box efforts among others. Very often, it seems, firms skew toward the “E,” putting new labels on cost or efficiency initiatives that they would have implemented anyway. As *Institutional Investor* put it in a June 2020 headline, “Private Equity Makes ESG Promises. But Their Impact Is Often Superficial.”

This clearly isn't always the case. TPG, for instance, has enthusiastically adopted ESG principles both internally and within its portfolios. It is also a leader in launching impact funds and made a high-profile announcement in January that former US Treasury Secretary Hank Paulson would join the firm as executive chairman of TPG Rise Climate, a new fund focused on climate-related investments. At the same time, signatories to the United Nations' Principles for Responsible Investment (PRI) jumped 28% last year and now number more than 3,000 institutional investors and PE firms, representing a staggering \$103 trillion of assets under management.

Yet a closer look at the numbers suggests that real commitment to ESG is less monolithic. While the PRI signatory list includes 431 PE firms from around the world, only 16 of them disclose ESG's impact on financial returns, according to *Institutional Investor*, and only half use ESG principles in monitoring more than 90% of their portfolio companies.

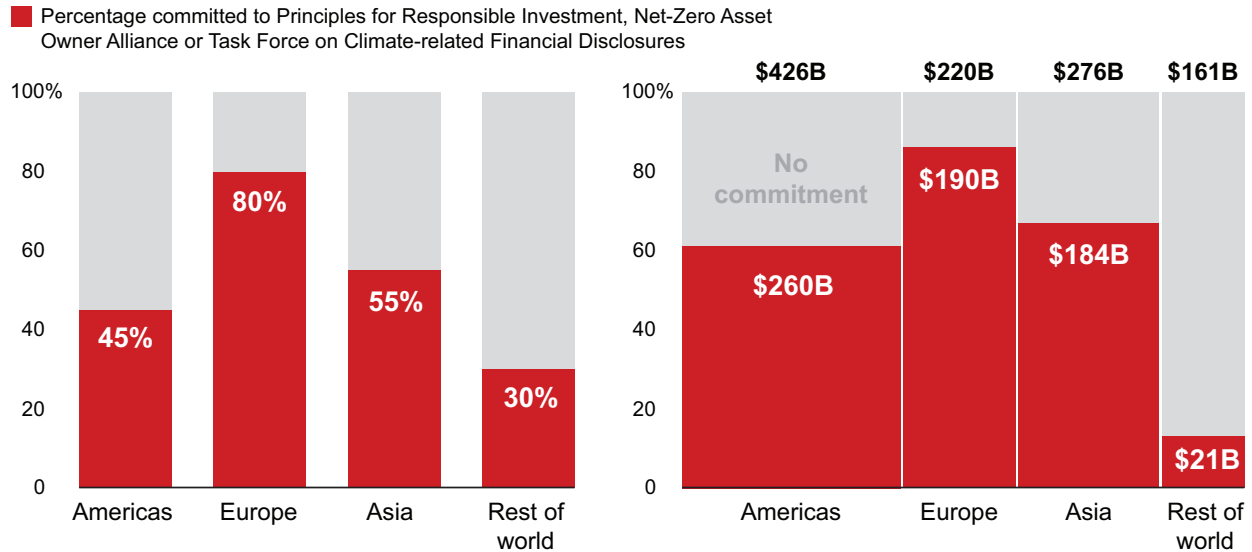
There's also a wide gap in adoption between the PE industry in North America and that in Europe. While 80% of the top 20 EU-based institutional investors have committed to either the PRI, the UN's Net-Zero Asset Owner Alliance or the Task Force on Climate-related Financial Disclosures, less than half of the top 20 North American institutions have done so, and many of those are based in Canada (see Figure 1).

An analysis of ESG performance among PE firms by EcoVadis, a leading global supplier of business sustainability ratings, shows that portfolio companies owned by US-based firms trail those owned by EU-based firms by 12 points. Yet even in Europe there is ample room to grow. Looking at sustainability factors only, the great majority of EU-owned portfolio companies haven't launched meaningful initiatives (see Figure 2). And the broader corporate world isn't much further along. EcoVadis data shows that PE-owned companies and corporations are pretty much neck and neck when it comes to ESG maturity scores in both the US and Europe.

Figure 1: Limited partners in Europe lead the world in committing to global standards for responsible and sustainable investment

Top 20 institutional investor funds

Top 20 institutional investor fund values



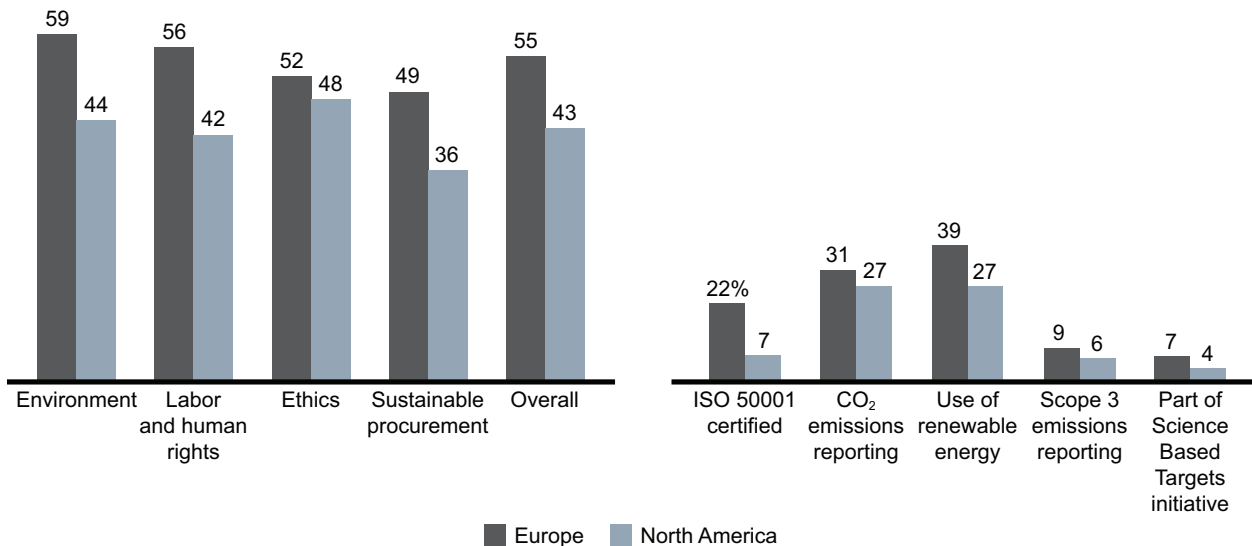
Notes: Excludes funds of funds; includes all other investors with a known allocation to private equity; Asia excludes Australasia; PE allocation amount for some investors not available

Source: Preqin, accessed June 2020

Figure 2: European LPs have embraced ESG much more eagerly than those in North America, but there's still room to grow

EcoVadis scores by ESG-related categories (2017–H1 2020, large companies)

Share of portfolio companies taking environmental measures (2017–H1 2020, large companies)



Sources: EcoVadis; Dealogic

A building wave of change

So is ESG one of those particularly persistent investment fads that will eventually fade away? We wouldn't bet on that any more than we'd bet *against* the historic groundswell of global concern around climate change, social upheaval and corporate responsibility. What's made the PE industry successful in the past is its ability to anticipate future currents of value creation and to think more broadly about how they will reveal themselves. We believe this is one of those moments.

Sensing that broader economic forces are rapidly changing behaviors and attitudes, many firms aren't waiting for ROI studies to prove out before banking on ESG. A growing segment of the industry believes that investments in sustainability, social welfare and good governance require a different calculus for now—at least if they want to get ahead of the game.

In the few short years since ESG appeared on the scene, the industry has tended to view it as a sideshow—something good to do *in addition* to a fund's normal business of buying and shepherding companies. Some firms have actually segregated these efforts into discrete funds wholly devoted to impact investing, where the goal is to generate social or environmental impact at market-rate returns (*see Figure 3*).

As ESG matures, however, the firms leading the charge—mostly in Europe—talk less about discrete, segregated ESG initiatives and more about delighting customers, gaining market share, engaging

Figure 3: Leading firms see ESG as a core part of creating value and mitigating risk



Source: Bain & Company

Figure 4: Stakeholders of all kinds want companies to be more sustainable, socially conscious and well governed



Sources: Capgemini; HP; Edelman; EQT; Bloomberg; European Commission

employees and creating the best work environment. As with sector expertise or technology acumen, they have come to consider ESG a core part of what differentiates them as competitors, baking ESG principles into sharpening due diligence, building stronger value-creation plans and preparing the most compelling exit stories.

Private equity has always focused on governance risk and increasingly sees the value in cutting costs through sustainability. What's changing is firms' growing awareness that environmental, social and governance issues are highly interrelated and that the biggest benefits over time accrue to companies that balance efforts between all three.

The desire to contribute to a better world is certainly a motivator, but the rationale is all business. These firms recognize that consumers, regulators, employees and sources of capital are energized by the notion that investors can and should use their economic clout to address the many existential crises we face as a society. Each of these groups is ramping up demands for change and, in many cases, rewarding it (see Figure 4).

Consumers. Survey after survey shows that consumers—especially the surging wave of millennials and post-millennials—are flocking to companies that they believe act responsibly. “Doing the right thing” may be an imprecise concept, but consumers clearly know it when they see it. Increasingly, it is becoming a critical element of customer loyalty, as measured by Net Promoter Scores.

A 2020 Capgemini survey of 7,500 consumers and 750 executives globally found that 79% of buyers were changing their preferences based on sustainability. At the same time, only 36% of organizations believed consumers were willing to make these changes. This disconnect is surprising given that companies clearly see a payoff when they buy into the shift in behaviors. A full 77% said sustainability initiatives increased customer loyalty, and 63% have seen a revenue uptick.

What's clear from the data is that capturing the favor of these ESG-minded consumers has enormous upside. Nielsen estimates that, in the US alone, buyers will spend up to \$150 billion on consumer packaged goods viewed as sustainable by 2021.

CVC is one of the firms that speaks less about ESG in isolation and more about using it to create value. As managing partner Jean-Rémy Roussel said in a recent episode of Bain's *Dry Powder* podcast, "It's not a trade-off, it's not a risk management/litigation issue, it is not conformance to regulation. It is a unique opportunity."

CVC has developed a systematic approach to embedding ESG and corporate social responsibility initiatives into its value-creation plans, with the specific goal of improving market share and increasing deal multiples. The approach is rooted in the belief that private equity's traditional focus on boosting EBITDA is actually less effective than focusing on customer loyalty and employee satisfaction, which ultimately generate more value and therefore higher multiples. When CVC buys a company, one of the first things it does is collect hard data on customer and employee satisfaction. It then helps management figure out how to target six key areas—customer focus, simplification, human capital, communities, environment and governance—to improve performance.

A good example of how this works is CVC's 2017 acquisition of Żabka, a Polish chain of franchised convenience stores. In diligence, CVC identified a number of ESG-related efficiencies and savings. It replaced refrigerants in 2,200 stores and took other measures to reduce annual carbon dioxide production. It reduced the weight of the packaging for one of the chain's sandwich brands, eliminating three tons of plastic waste. At the end of 2020, it launched a more comprehensive program to reduce CO₂ by at least 5% per year and reach net zero by 2050. It is currently investigating the most credible way to offset CO₂ production at the company level.

The big upside was reengaging with customers to grab market share in a largely stagnant industry. As Żabka studied how to optimize the assortment in its stores, it saw that consumer tastes had shifted dramatically away from typical convenience store fare. The company worked with suppliers to source healthier and more responsible ingredients for its products. It became the first retailer in Poland to use 100% recycled plastic bottles in its branded beverages. It started taking the market lead in selling plant-based food products, hailing their "triple benefits": customer health, environmental friendliness and animal welfare.

Corporate social responsibility also became increasingly core to the company's ethos. Żabka now trains employees and franchisees to sell alcohol more responsibly and to recycle more effectively. It has set up programs to eliminate food waste by transferring surpluses to food banks. The company

runs career development programs for employees, and it funds scholarships and internships for children from disadvantaged backgrounds.

The results have been impressive: Loyalty and satisfaction scores have soared among customers, employees and franchisees. That led to 20% annual revenue growth from 2017 to 2020, while gross margins increased by 3.9 percentage points. The chain added 652 new stores in 2019, and employment has risen sharply. Social responsibility initiatives have raised the company's profile across Poland, and a broad corporate campaign to communicate these values and successes has embedded a new sense of purpose throughout the organization.

Employees. As Żabka has discovered, a commitment to sustainability and social responsibility is rapidly becoming essential to attracting and retaining key talent. Research shows that employee loyalty increasingly hinges on a belief that they are working for a company with a nobler mission than just churning out quarterly earnings. A global HP survey of 20,000 workers in 2019 found that 61% believe sustainability is mandatory for companies (on par with diversity and inclusion), and nearly 50% said they would only work for a company with sustainable business practices.

At Unilever, which has made a major public commitment to sustainability, about half of all new employees entering from college say the company's ethical and sustainability policies are the main reason they wanted to hire on. A sense of mission leads to greater satisfaction, which in turn leads to higher productivity.

Limited partners. One reason ESG is top of mind for PE firms around the world is that a growing number of LPs are demanding it. According to the 2020 *Edelman Trust Barometer Special Report: Institutional Investors*, 88% of LPs globally use ESG performance indicators in making investment decisions, and 87% said they invest in companies that have reduced their near-term return on capital so they can reallocate that money to ESG initiatives. As noted above, European LPs have demonstrated more commitment to ESG than their counterparts in North America, but the biggest institutions in the US and Canada, including the CPP Investment Board, CDPQ, CalPERS and the California State Teachers' Retirement System, are firmly on board.

For general partners, this means that ESG is fast becoming a central factor in raising money. CVC's Roussel, for instance, said that one-fifth of the LPs invested in the firm's recently closed Fund VIII required an audit showing evidence that ESG was part of the firm's decision making during both due diligence and ownership. CVC has commissioned EcoVadis to undertake annual assessments of its portfolio companies to demonstrate how ESG maturity has improved under its ownership.

Bankers. Despite the lack of evidence linking ESG to returns, a growing slice of the financial world assumes that sustainable, socially responsible companies are less risky. As a result, PE firms are finding ways to monetize their ESG strategies by lowering their cost of capital. EQT, for instance, launched two ESG-linked subscription credit facilities in 2020 worth €5 billion, with interest rates that decline if the firm performs well against a set of ESG indicators. Firms like Investindustrial and KKR have developed other financing vehicles with ESG incentives or targeted uses. In late 2019, Jeanologia, a

Carlyle-owned company that creates clean technologies for jeans manufacturing, agreed to a loan with a rate tied to water savings.

Per Franzén, cohead of the EQT Private Equity Advisory Team, calls the shift to credit-linked facilities “a game-changing moment” for the private equity industry: “By linking sustainability objectives to hard incentives, we are really challenging ourselves and the portfolio companies to fully embrace the potential of sustainability.”

Regulators. If ESG-linked credit facilities are the carrot, regulation is the stick. One reason European firms are addressing ESG more urgently than their US counterparts is that EU regulators are on the case. The EU Taxonomy, a landmark initiative aimed at channeling private capital into sustainable assets, will take effect in December 2021. It will force asset managers in the EU to disclose their share of taxonomy-aligned assets under management, inevitably creating an incentive to raise that share to remain competitive.

By contrast, US regulators are headed the other direction—at least for now. The US Department of Labor in November 2020 issued a rule discouraging fiduciaries from using nonfinancial (read: ESG) principles in screening pension investments.

Taking the lead

This push and pull between skeptics and believers is typical of game-changing moments. The market, of course, will eventually decide the case, but momentum is building in powerful places. While the top 20 LPs in the US on average may be less inclined or incited to join their global counterparts in committing to ESG, fund-raising is a global business, and GPs still face firm pressure from investors to show progress on these issues. Meanwhile, the firms in the lead are building ESG investing into a differentiating capability. They are convinced it will give them an edge in a PE market that has never been more competitive.

What does it look like to build ESG into the value-creation cycle from beginning to end? Consider EQT’s approach in 2016 when it bought AutoStore, a Norwegian maker of warehousing robots that is headquartered on a remote fjord, a six-hour drive from Oslo. The warehouse industry had limited focus on environmental or workplace issues at the time. But the firm and management saw an opportunity to change the conversation with AutoStore’s flagship robot, which automates retail warehouses by wandering through a compact shelving system, picking and packing.

EQT anticipated two ways it could create value at AutoStore. First, the firm would encourage the company to address its own footprint with a series of cost-saving initiatives aimed at decreasing consumption and reducing carbon emissions. Second, it would focus the company’s marketing on sustainability and workplace quality. AutoStore’s robot already used less energy and was significantly quieter than any other product on the market. But the management team and salesforce weren’t hitting those value arguments in their sales pitch.

EQT's perspective came from the top of the firm—one of its primary investment themes is that sustainability attributes are increasingly becoming key purchasing criteria in any industry, and the Auto-Store deal team was convinced warehousing was no different. To bring the company's leadership on board, it launched a set of value-creation initiatives linked to sustainability and put a regular reporting function on the board agenda, tying environmental concerns to governance. The company also launched a project to determine if the robot's sustainability features were a point of differentiation among customers. The answer was yes.

ESG isn't about doing good for good's sake; it's about recognizing what customers and other stakeholders really want and turning that into a strategy that creates tangible value.

Leadership directed the company's R&D lab to make its robot even more sustainable and worker friendly. By switching from a lead-acid to lithium-ion battery and increasing the share of recyclable components, engineers significantly reduced the carbon footprint of the product while maintaining its remarkable energy efficiency. (The robot uses one-tenth the energy of a vacuum cleaner.) By running in the dark, it also reduces energy usage within the warehouse.

Armed with a much improved next-generation product, the company then retooled its communication strategy to focus on sustainability and savings alongside the robot's impressive technical abilities. The new message resonated loudly with customers globally. During EQT's ownership, its global installations grew by 2.5 times, the number of installed robots tripled, revenues quadrupled and EBITDA increased by 4.5 times. And the social impact was significant: During ownership, global employment doubled, including in the small village where the company has its headquarters and is an important contributor to the local economy.

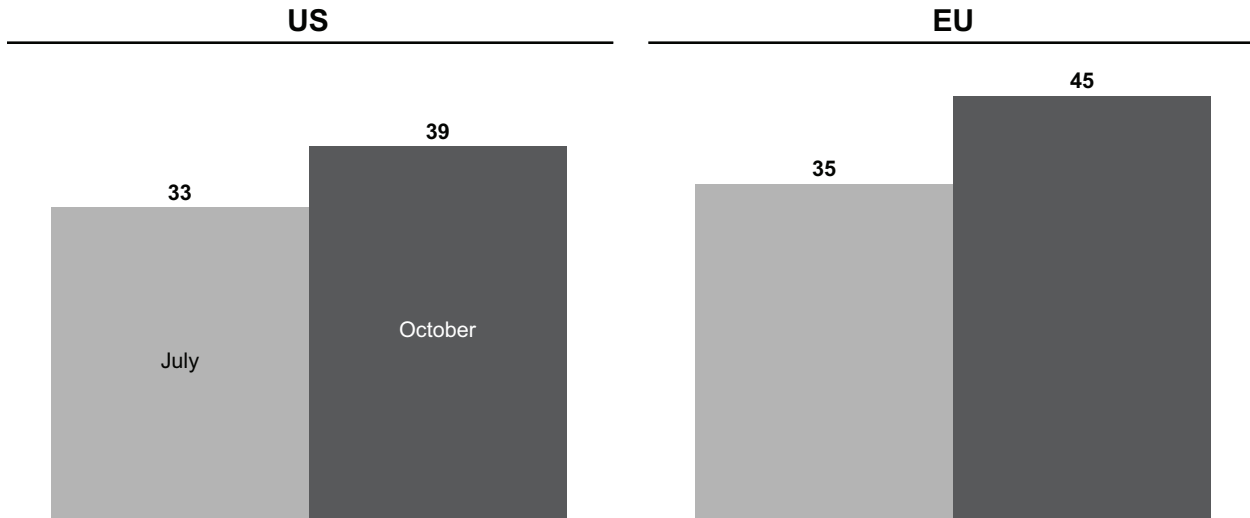
EQT's insight was that, even in a hard-bitten B2B industry like warehousing, sustainability matters. ESG isn't about doing good for good's sake; it's about recognizing what customers and other stakeholders really want and turning that into a strategy that creates tangible value. Funds are finding that ESG issues that weren't necessarily a factor commercially a few years ago are now front and center. And Covid-19 has only accelerated the pace of change. A Bain survey of more than 12,000 consumers in the US and EU showed that 44% agree or strongly agree that sustainability will be even more important in the wake of the pandemic (see Figure 5).

The message is gradually sinking in across the PE industry. During a recent refresh of its value-creation plan for a paper company, a PE firm identified a potential 3- to 5-point EBITDA uplift tied to a series of sustainability initiatives, including revamping its product lineup in a sustainable way. Responding to consumer demands for products easier on the environment, the company plans to rapidly expand

Figure 5: In the wake of the Covid-19 pandemic, consumers are embracing sustainability more than ever

“Buying socially responsible brands is more important to me than it was before Covid-19”

Percentage of respondents who agree or strongly agree



Sources: Bain/Dynata US Covid-19 Consumer/Shopper Survey, mid-July 2020 (n=1,597), mid-October 2020 (n=2,268); Bain/Dynata EMEA Covid-19 Consumer/Shopper Survey, mid-July 2020 (n=7,826), mid-October 2020 (n=9,982)

its 100% recycled products and those made from alternative fibers like cotton. That will give it time to tap a set of lucrative new markets by developing paper-based alternatives to plastics in products like transparent-window envelopes and composite packaging.

Sustainability is becoming a central theme in its marketing and changing the company’s positioning globally. The plan anticipates that revenue growth—and avoided revenue loss—will be the biggest contributors to improved results (see Figure 6).

The opportunity even exists in industries you wouldn’t expect. ESG value creation seems obvious in “clean” or socially conscious sectors—electric vehicles, alternative energy, education, healthcare and so on. But GPs are recognizing that the next buyer will often pay a higher multiple for a company in an environmentally questionable industry that has become more sustainable and responsible than its competitors.

Investindustrial has developed a potent franchise in sustainable investing partly by finding—and fixing—companies like Polynt-Reichhold, a specialty chemicals player with some 40 manufacturing facilities globally. Through various sustainability measures, the company reduced its carbon intensity to a level approximately 40% below its best-performing peers. A global shift to LED lighting shaved 400 megawatt-hours of electricity usage per year. Improving insulation on its storage tanks in Norway saved 800 megawatt-hours annually.

Figure 6: One PE owner plans to use ESG initiatives to boost cash flow at a recently acquired paper company

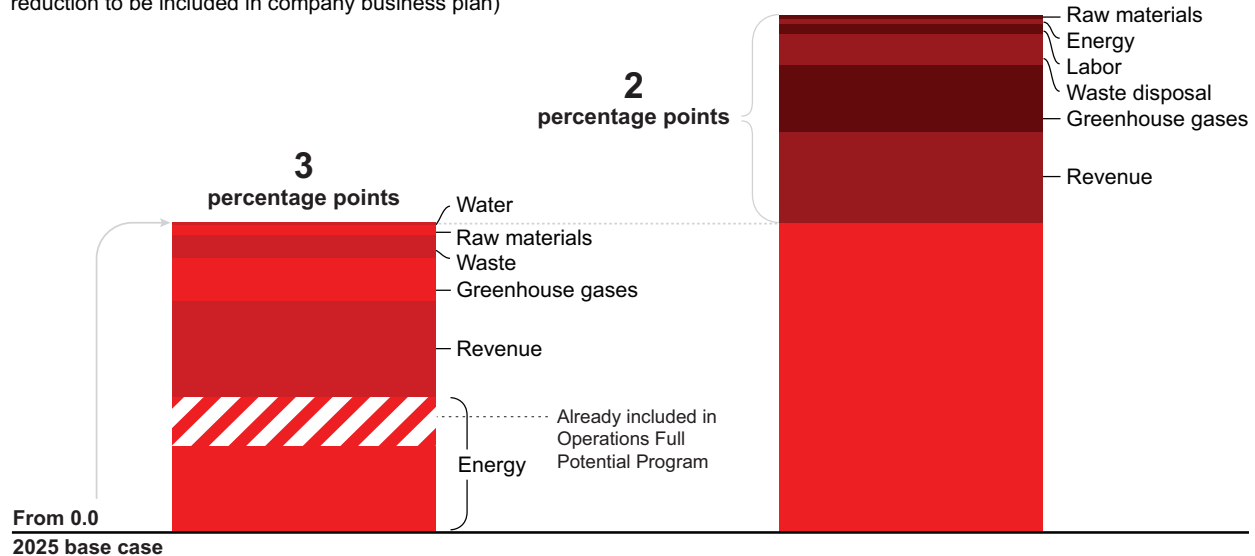
Potential increases in EBITDA through ESG contributions to ...

Value creation

(added value through revenue growth and cost reduction to be included in company business plan)

Risk mitigation

(avoided costs to be included in sensitivity/risk scenarios)



Source: Bain & Company

The quest for a winning ESG formula

While ESG investing has crawled out of its infancy, it remains early days. Even the leading firms are still figuring out where to play and how to win. One thing is already clear, though—making it work takes the same level of commitment and ambition firms devote to developing any new differentiated capability.

In our experience, the firms getting it right have a few things in common:

- **Clear definition, alignment and ambition.** ESG can mean a lot of things, so it is critical that firms define what it means for them and build on that. Winning firms also go well beyond lip service by securing alignment around their chosen ambition, starting with the investment committee and extending to individual portfolio and deal teams. Setting up a central ESG team and hoping for the best is not a recipe for success.
- **Focused execution.** Different companies in different industries need to apply ESG differently. What's important is to pick a few things that really matter and move the needle in those areas. Increasing diversity or reducing the carbon footprint are good places to start, but it takes real commitment and execution to produce results. It's also important to build on early wins to communicate success and expand the scope.

- **Full integration.** Capturing the true value of ESG requires embedding it along the entire PE value chain, from due diligence through ownership to exit. While it might not be an investable theme in all deals, it certainly should be a consideration in every diligence. The most effective firms treat it as a capability. They strive to make ESG second nature—an integral part of value creation. Simply tracking random KPIs isn't enough. Firms need to have a value-creation strategy specific to their industry and customer base.
- **Capability investment.** Most firms that have adopted ESG have started with risk mitigation and compliance issues. Taking the next step to value creation requires adding capabilities to identify, track and manage ESG risks and opportunities effectively. Firms also need to learn how to take advantage of sector-level ESG experts, partners and other ecosystem resources to support value-creation plans.
- **Measurement of results and continuous improvement.** As with anything else, getting better at ESG investing relies on continuous learning and not waiting for the perfect answer. Firms that have built a track record of ESG value creation have been willing to experiment and then develop winning approaches into playbooks and repeatable models that lead to consistent results. That means establishing clear measures of year-over-year continuous improvement and setting up processes to roll up and monitor ESG performance across the portfolio.

Skepticism around ESG will persist as long as we lack empirical evidence that it pays off. Devising the right measures will take time and creativity. That said, ESG is rapidly moving to the center of how many firms view the value-creation process as they pick up and follow what the market is telling them.



A Left-Brained Approach to Portfolio Company Talent Decisions

Your value-creation plan holds the key to building
management teams that can deliver results.

**By David Waller, Courtney della Cava, Kristin Schroeder and
Rolf-Magnus Weddigen**

Getting talent decisions right—especially at speed, across dozens of portfolio companies—is one of the stiffest challenges private equity firms face. The experience of one PE-owned company in the packaging industry is typical of what can go wrong.

For a deal predicated on reigniting revenue growth, the new owners developed a detailed value-creation plan (VCP), laying out a strategy to aggressively expand national accounts. Because it required new sales leadership, the company quickly hired an accomplished industry veteran, with high hopes that he could jump-start the commercial organization.

Instead, he stumbled badly. The new hire had a strong record within the packaging industry of increasing sales, which on the surface seemed exactly what the company needed. But beyond experience, the new owners and management hadn't fully considered the nuanced set of capabilities and motivations a candidate would also need to accelerate performance in this particular situation.

The sales chief had succeeded in the past with a hard-driving, command-and-control style, which was like oil and water with the packaging company's culture. He ended up alienating sales reps who had grown up in a highly decentralized, entrepreneurial organization. The mismatch ultimately threatened to derail the entire deal.

There are innumerable reasons why talent decisions like this go awry. But firms with the highest success rates have something in common: They are highly disciplined about linking talent decisions to the explicit requirements laid out in the VCP. This may sound obvious, but it is a principle rarely applied either rigorously or consistently. Done right, it follows a clear sequence:

- Having laid out a deal hypothesis and examined talent issues in due diligence, PE investors align with management—and align quickly—on a VCP that details the value-creation strategies essential to generating attractive returns.
- This includes a repeatable process to define the key roles explicitly linked to those strategies and clear, measurable objectives for each role. That information then leads to precise job descriptions that spell out the unique set of experiences, capabilities and motivations required for success.
- The right talent may already be in place or the company may have to recruit people (either internally or externally). But defining needs based on a clearly stated set of value-creation objectives is essential to diagnosing and filling gaps. It also determines the specific targets and milestones leadership needs to gauge progress and measure success.

The honeymoon syndrome

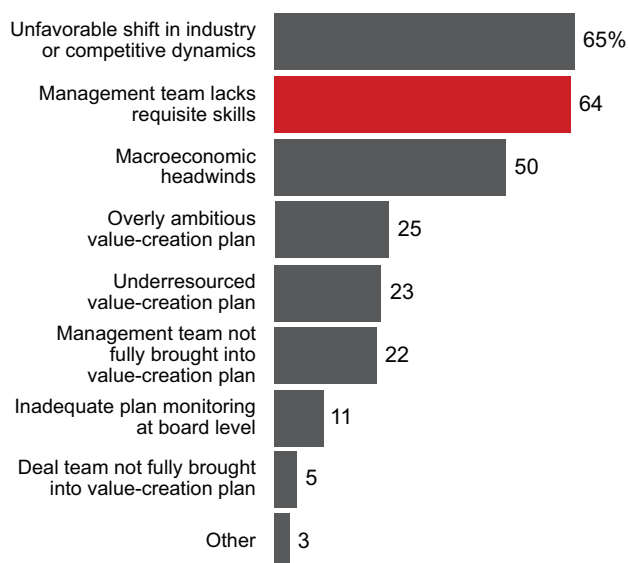
A recent Bain/Hunt Scanlon survey of 122 PE professionals shows that firms are well aware that management is critical to deal success (*see Figure 1*). Yet they too often lack a consistent, repeatable process for making talent decisions swiftly. The natural tendency at the end of a long deal process is to utter a sigh of relief, clink glasses with management (virtually these days) and let things ride for a

Figure 1: The quality of portfolio company management is the most-cited reason for deal success and second-most-cited reason for deal failure

What are the main sources of deal success for recent exits you have had?



When exits were not as successful, which of the following reasons apply?



Note: Respondents could select up to three answers

Source: Bain/Hunt Scanlon survey of PE professionals, October/November 2020 (n=122)

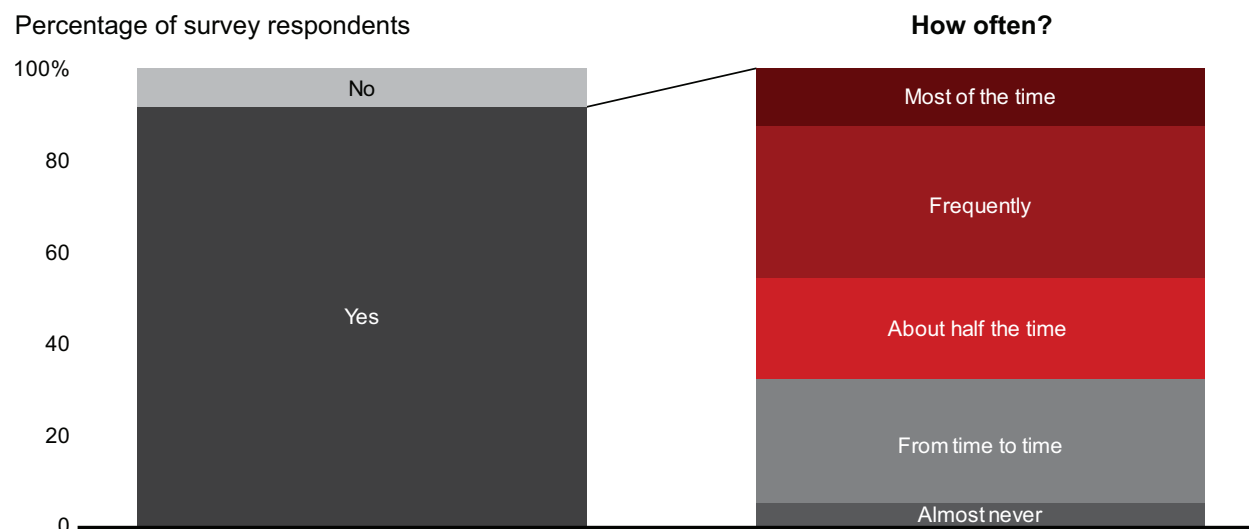
time. Many deal teams say they hesitate to make changes because they want to give existing managers a chance to prove themselves. Others take the “devil you know” approach and are wary of rocking the boat with management changes at a critical time.

The cost of hesitation, however, is high. An overwhelming 92% of survey respondents said that waiting too long to take action on talent issues had resulted in portfolio company underperformance over the past five years. Almost 70% indicated this happened in at least half of their deals (*see Figure 2*). Deal teams are especially wary of changing CEOs—93% view such a move as risky or highly risky, and a majority have done it in fewer than half their deals. Yet when they do take action, it is broadly successful 75% of the time.

Recognizing the problem, firms have invested steadily over the past several years to raise their talent game. In addition to partnering with best-in-class executive search and assessment firms, general partners have been hiring portfolio talent professionals to assess and build new management teams, diversify boards, cultivate executive networks and otherwise support companies across the portfolio. But it isn’t easy. Most funds have one, maybe two, dedicated talent professionals and a long list of portfolio companies to work with. What’s often missing, starting in due diligence, is a rigorous process applied consistently at the deal level to define requirements for generating anticipated returns.

Figure 2: PE professionals overwhelmingly agree that waiting too long to make management changes results in company underperformance

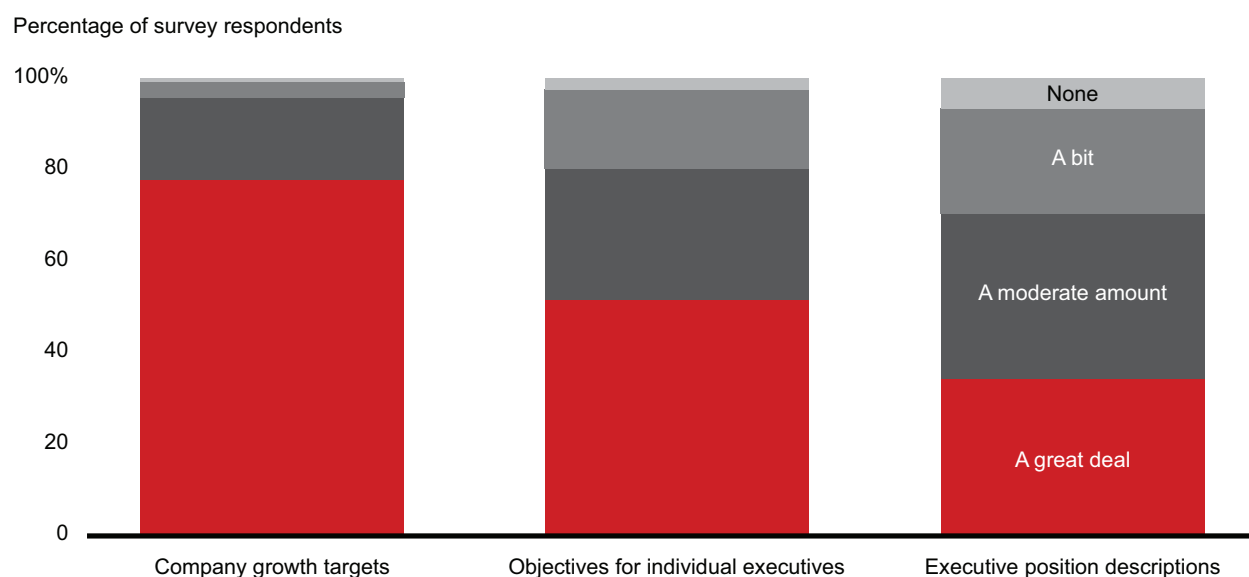
Has waiting too long to make management changes resulted in portfolio company underperformance within the last five years?



Note: Most of the time=more than 80% of the time, frequently=60%–80%, about half of the time=40%–60%, from time to time=20%–40%, almost never=less than 20%
Source: Bain/Hunt Scanlon survey of PE professionals, October/November 2020 (n=122)

Figure 3: While PE firms routinely use the value-creation plan to set growth targets, they are much less likely to translate it into job descriptions and objectives for executives

How much weight does the VCP have in shaping each of the following?



Source: Bain/Hunt Scanlon survey of PE professionals, October/November 2020 (n=122)

This is curious when you consider the meticulous attention private equity firms bring to all other aspects of dealmaking and value creation. Firms are surgical in breaking down balance sheets and revamping supply chains to wring out cost efficiencies. They invest heavily in market research and analytics to determine revenue opportunities and scrub commercial organizations to improve go-to-market capabilities.

Yet while close to 80% of our survey respondents said they use the VCP to set growth targets, only 34% said they link objectives to clear and actionable executive position descriptions, and only half said they use the VCP to set objectives for individual executives (*see Figure 3*). Many firms, in other words, see the VCP as an indispensable guide for planning—except when it comes to determining specifically who they need to execute those plans.

Linking talent to aspiration

Why the disconnect? The answer most of the time is that people issues—both at the C-suite level and below—are complex and hard to measure. Because personalities are involved, the challenge is widely viewed as art more than science. That's precisely why the firms that excel at talent decisions do their best to take subjectivity out of the process by using a highly analytical, left-brained process analogous to underwriting other essential aspects of the deal.

A rigorous, analytical approach makes talent decisions easier on everybody because it eliminates ambiguity about what's required to win.

Starting with the specific return objectives laid out in the VCP, they work backward to create a fact-based, strategic set of talent requirements. This demands answers to a few key questions:

- What roles and functions are critical to delivering on this specific plan?
- What are the explicit, quantified goals those executives will have to achieve over the short and longer term?
- What experiences, capabilities and motivations must each executive have in order to execute and generate these results?

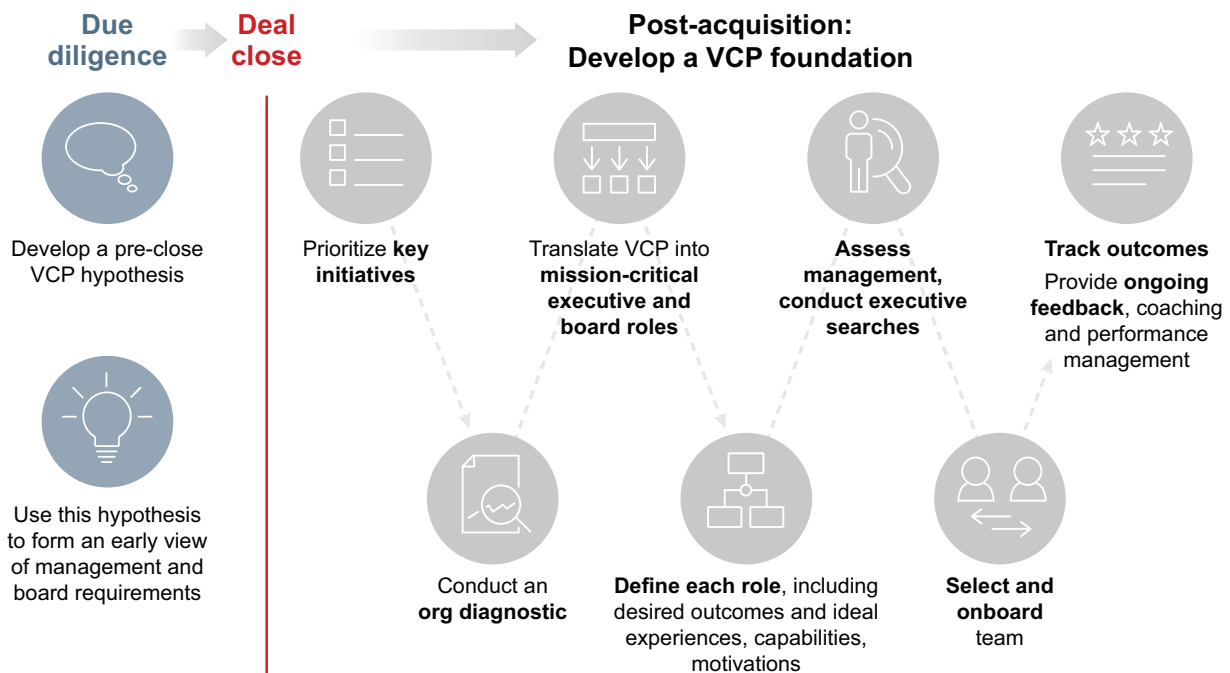
A rigorous, analytical approach makes talent decisions easier on everybody because it eliminates ambiguity about what's required to win. By definition, a strong VCP requires a company to do something new, something it hasn't done before, and the skills needed for that may or may not exist within

the company already. The most relevant inquiry isn't whether incumbent portfolio company leadership has done a good or bad job of taking the company from point A to point B. What's essential is to be crystal clear about what it will take to get to point C and deliver on the value-creation plan. That shifts the conversation from personalities to precise goals and requirements.

When Berkshire Partners bought kids' apparel company Carter's, for instance, the company had historically sold directly to consumers through its own stores. But the new VCP required it to expand distribution into Walmart, a channel Carter's didn't fully understand at the time. Serving Walmart profitably would mean increasing service levels and reducing cost by moving supply chains to China and Mexico. To ratchet down the risk, Berkshire and management augmented the board by hiring the former CEO of Sara Lee, who had deep experience selling to Walmart and the right mix of capabilities and motivations to help Carter's make the transition. The company also hired several supply chain experts to buttress the organization with the right skills.

The most effective deal teams begin to think about the talent a company will need during due diligence. The VCP (ideally created within six months of close) confirms those requirements, forming an essential link between the full-potential strategy and the talent strategy. Teams should already be using the plan to create detailed role profiles and scorecards that give the company (and its advisers) the information they need to make assessments (see Figure 4).

Figure 4: Tightly linking the VCP to talent strategy can accelerate value creation and mitigate risk at every stage of the investment life cycle



Source: Bain & Company

This process may confirm that the existing management team is fit for purpose and ready to go with minor adjustments. But it may demonstrate that the company needs to create important new roles or look outside to find the right capabilities. The company, the firm and their advisers must know exactly what they are solving for so they can move expeditiously to build the optimal team.

The experience trap

Without a precise, mission-driven definition of the talent you need, the tendency is to overindex on past experience. If growth through a new digital marketing strategy is what you're after, then surely someone who has made that happen in the past is a strong candidate. That may be true. Yet as we saw in the packaging company example, if that person lacks the capabilities and motivations required for success in a specific situation, then you may be headed for trouble. As the operating partner of portfolio talent at one firm put it: "There is a tendency among our deal and operating partners to evaluate candidates based on IQ and past experience, but this doesn't capture many aspects of leadership that are essential for success in very nuanced portfolio company situations."

Because deal teams often lack clear definition around the roles that are critical to delivering value, they are imprecise when defining the required mix of experience, capabilities and motivations.

It's hardly news to search firms that finding the right candidate involves more than just evaluating past experiences. But a recruiter's output is only as good as the input he or she receives from the hiring manager. Because deal teams often lack clear definition around the roles that are critical to delivering value, they are imprecise when defining the required mix of experience, capabilities and motivations. Precision, however, can make all the difference.

When Carlyle spent \$3.2 billion to acquire the industrial packaging group of Illinois Tool Works in 2014, it was a typical carve-out. The firm knew that capturing value would mean building or augmenting a number of key functions, especially procurement. The new company, renamed Signode, manufactured and distributed plastic, paper and metal packaging. Generating savings (direct and indirect) from these commodities was central to the deal thesis.

To win, Signode created a new role for a global procurement officer and found a seasoned executive who had deep experience negotiating with raw materials suppliers. But to deliver on the VCP, he needed much more than that. He also had to build a global team that could execute effectively in a collaborative, decentralized environment across both direct and indirect sourcing categories. He had to be comfortable with a PE firm's sense of urgency and have the emotional intelligence to understand

the delicate balance of pushing the envelope to generate savings quickly, but in a way that wouldn't alienate suppliers and disrupt production.

As it turned out, the executive helped Signode find significantly more savings than the investment thesis anticipated. The lean procurement capability he built was an important contributor to Carlyle's strong return on equity when it exited to Crown Holdings four years later.

Solving the puzzle

Very often, the best solution is not the most obvious one. In most cases, linking the VCP to leadership requirements is like finding the right pieces to a jigsaw puzzle.

When one firm acquired an industrial company in 2017, leadership was a clear problem. Over the next three years, the company cycled through two CEOs, leaving the organization whipsawed between strategies and struggling to align on the VCP. As the board and the new owners began to look for a new leader to stabilize the situation, they saw a lot to like in the company's incumbent chief financial officer. But it wasn't clear he had everything the VCP called for in the CEO role.

Part of the job was to execute on a set of commercial, operational and M&A objectives aimed at spurring profitable growth. All felt that, with the right coaching, the CFO could step up to those challenges. Promoting from the inside also had the advantage of avoiding disruption at a time when the Covid-19 pandemic put a premium on continuity. The problem was that the VCP also anticipated exiting through an initial public offering, after which the owners would likely retain a stake for at least 18 months. The CFO had no experience taking a company public, opening the deal up to execution risk.

The most effective firms are always asking: Is this the right match for the particular job we need to do? If not, what's the risk of moving forward?

By breaking down the full set of challenges and mapping each one to an executive or board role, an unorthodox solution emerged. The company's board chairman had ample experience guiding companies through the IPO gauntlet and was willing to take on an executive chairman role to both manage the process and coach the new CEO through it. In many ways, this was the best of both worlds. The company could continue to groom a promising executive, and the new owners could rest assured that all exit options remained available.

Firms find that linking roles and responsibilities to the VCP naturally opens the search aperture to the most relevant set of characteristics. The experience bias tends to dissipate as teams think more deeply about how roles intersect within the organization and how a person's mindset and values

might mesh within an existing culture. The most effective firms are always asking the same question and seeking alignment on the answer: Is this the right match for the particular job we need to do? If not, what's the risk of moving forward?

Sometimes experience is actually the least important factor. When a PE firm recently acquired a global aftermarket parts and services provider, a critical aspect of the VCP was increasing revenue of a key business unit based on the strength of new product introductions. Making that happen would involve transforming the unit's go-to-market model by building new sales channels and beefing up the commercial organization. The challenge was that nobody on the existing team had done anything like that before at scale.

What the company did have, however, was an especially promising executive who the CEO believed had the right stuff to step into the challenge. The new owners agreed this executive had high potential, and they used a fine-grained role description derived from the VCP to set up the right scaffold to support him. This involved identifying the specific areas in which he needed development and setting very specific short- and long-term objectives. Clear expectations, support from management and evaluations at every step of the journey would keep the executive on track. It also could assure the new owners that they had made the right decision in elevating him.

The real risk in most talent situations is not placing educated bets on promising people but moving forward based on incomplete information. That slowed down progress when the leaders of a PE-owned retail chain sought to lay the foundation for accelerated growth. While the company had expanded steadily under previous ownership by opening and acquiring new locations, due diligence showed that the next phase of growth would require a much more sophisticated approach to marketing—one that would increase the flow of new customers while sharply reducing acquisition costs.

Early on, the company hired an executive to lead the marketing function who had strong experience generating sales growth through traditional media. Once the VCP took shape, however, the new owners saw a ripe opportunity to improve marketing effectiveness by shifting the company's media buy online and targeting ads at the company's key demographic groups in the specific geographies where it had locations. There was also upside in sharpening the company's online presence.

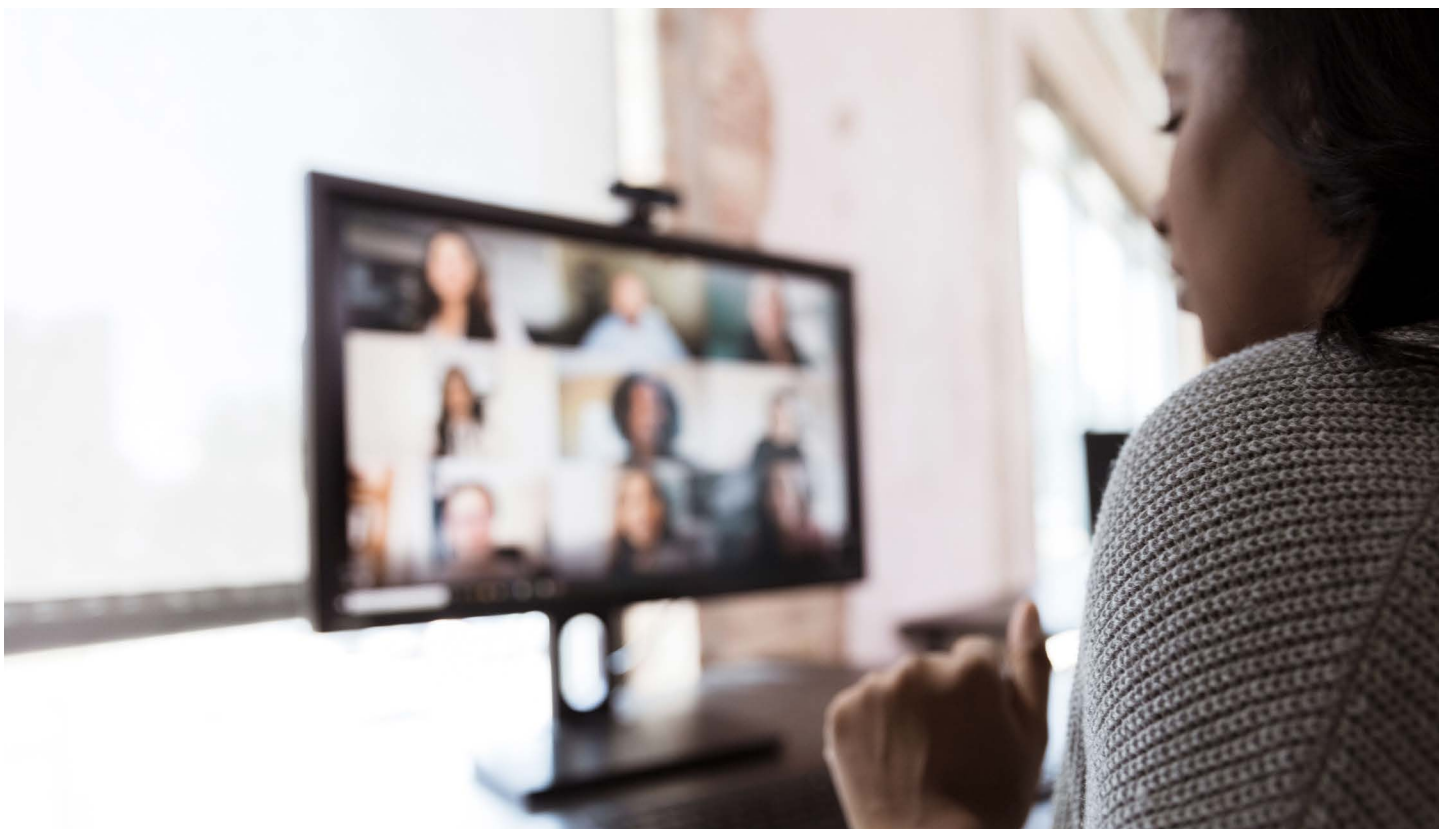
Adding digital competency required doubling the marketing staff and creating a major new role for a digitally savvy chief marketing officer. This person would not only have to dramatically alter the traditional media plan but also manage a digital team, build cross-functional processes and sharpen the customer experience—all while operating in an accelerated, high-pressure private equity setting. A key part of the job was managing change in advance of accelerating growth, building a solid new foundation to support the more aggressive double-digit revenue ambition. That would require the full slate of transformation competencies: redefining roles, breaking old habits and winning buy-in among a wide variety of stakeholders.

Once the company put an external hire in place, equity value creation took off. The new CMO quickly delivered against a highly specific set of outcomes prescribed by the VCP, drawing up an 18-month

marketing roadmap with clear metrics, redesigning the org chart, building cross-functional cooperation and hitting specific customer traffic and efficiency targets. The only regret for the company and its owners was that they hadn't moved faster to define what they really needed.

As the data from our survey shows, hesitation and poor people decisions can spell the difference between deal success and failure. This is especially true in an upside-down post-Covid world, where a combination of record deal multiples and deep economic uncertainty leaves little room for error.

Capturing full potential when it comes to talent management means replacing gut decisions with a systematic, analytical approach to identifying needs and filling gaps, starting in due diligence and running throughout the ownership period. Anything less is leaving money on the table.



Capturing the True Value of Virtual Selling and Sales Plays in Private Equity

Underwriting revenue growth *and* cost savings will be critical post-Covid. Here's a powerful way for private equity firms to achieve both starting day one of ownership.

By Chris Dent, Mattias Geise, Mark Kovac and Tom Whiteley

There's no doubt that Covid-19 has changed how most companies think about selling. With commercial organizations around the world forced to work from home, companies have discovered, often to their surprise, that getting on planes and shaking hands isn't the only way to make a sale—and maybe not even the best way. Zoom meetings and remote demos work just fine much of the time. Many customers, it turns out, actually prefer a virtual approach.

Yet it would be a mistake to assume that a few virtual tweaks to a portfolio company's selling model is enough to create lasting value. The truth is, the most successful virtual strategies are just one part of a disciplined go-to-market model that blends virtual and field sales tactics with a set of prescriptive sales plays designed to focus reps on their most productive opportunities (*see Figure 1*).

Private equity owners tend to shy away from significant change in the frontline sales organization—especially early on in the ownership period—because they worry about disrupting revenue flows. Particularly in low-growth businesses, a lot of deal teams assume that revenue is what it is: “We’re in a 2% to 3% growth industry and that’s not going to change.”

The firms that excel at helping portfolio companies push revenue growth beyond the industry average rely on two linked management approaches that can produce change quickly:

Figure 1: Done right, virtual sales serves customers better and more efficiently at a lower cost

Advantages of deploying virtual sales



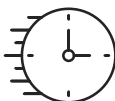
Happier customers



Lower cost



Higher productivity



More time selling

Typical company findings

Three of four target customers find virtual sales to be as effective as in-person sales

Virtual sales reps cost 50% less than field reps per customer served

Virtual reps can cover three to four times as many accounts as field reps

Virtual reps spend 30% to 40% of their time with customers vs. less than 25% for field reps

Source: Bain & Company

- They determine whether a portfolio company or potential target has the right mix of virtual and field sales—recognizing that virtual channels are increasingly effective for even the most complex, drawn-out sales processes.
- They sharpen the execution of this increasingly virtual approach by adopting play-based selling techniques that prescribe how to orchestrate resources and increase the quality of coaching.

Moving with conviction is the key to making these changes with a minimum of disruption. Firms need to underwrite these moves in due diligence and hit the ground running when the ownership period begins. Change takes time, but virtual and play-based selling can rapidly bring discipline to the most unruly sales organizations, generating measurable results now and building a strong revenue story at exit.

Developing a virtual edge

Though Covid-19 has accelerated adoption of virtual sales, these strategies have been around for years. Traditionally, firms have viewed them as a low-cost way to address and service lower-value accounts. Indeed, within field-dominated sales organizations, virtual sales teams are often seen as second-class citizens.

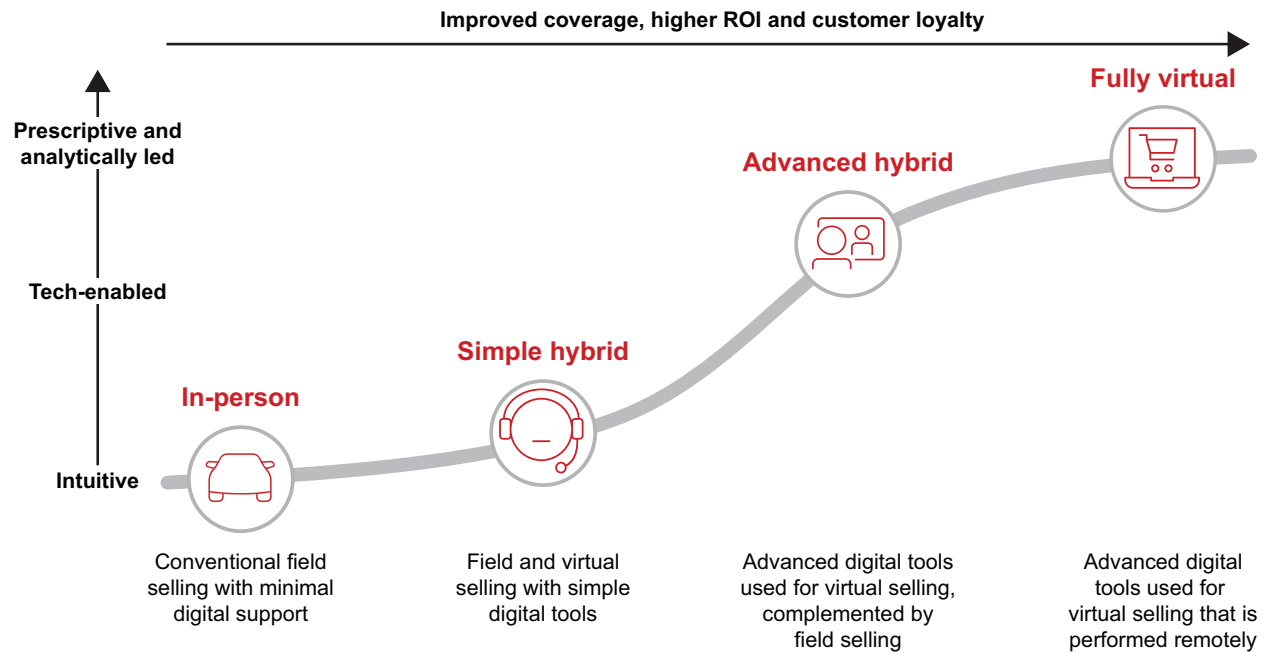
The optimal balance of virtual and field sales provides self-service or remote interactions when appropriate and in-person service when high-touch expertise makes sense.

But that was changing even before the pandemic. Armed with increasingly sophisticated and affordable digital tools, B2B companies have been steadily shifting to virtual channels, even for complex buying cycles that require careful choreography (*see Figure 2*). Companies that do it right are constantly chasing the optimal balance of virtual selling and field sales—one that provides self-service or remote interactions when appropriate and in-person service when high-touch help or expertise makes sense.

Traditionally, for instance, a sales rep and a product specialist are joined at the hip in selling big-ticket technology systems to enterprise clients. Increasingly, however, companies are keeping the product specialists in-house, allowing managers to assign them on a case-by-case basis to answer questions and do product demos for the most important deals. That makes the entire sales process more nimble and responsive while also trimming cost.

For one data storage and solutions business, adopting virtual techniques transformed its ability to cover the market effectively. The company was a mature player in a relatively sleepy sector, so revenue

Figure 2: Companies are adopting virtual selling approaches to reach customers in a more effective and efficient way



Source: Bain & Company

growth depended on expanding share of wallet with existing customers and winning more new accounts. The problem was that sales reps had too many accounts to serve well and were traveling constantly. Only a fifth of their day was actually spent selling.

The new owners built a sales model that blended field and virtual tactics. They then deployed inexpensive but powerful technology to increase productivity. Using an analytics tool to prioritize the most promising accounts based on their potential spending, the company trimmed the client list for each field rep by half and reassigned accounts more logically based on geography. It then added a new inside sales development role to support the field by taking over repetitive tasks like quoting and drumming up new leads. Small and midsize customers, meanwhile, shifted to a separate inside sales team.

The new inside team got several tools to improve their chances. To make prospecting more productive, the company deployed ZoomInfo linked to a Salesforce CRM system. A sales engagement platform automated customer outreach and made reps smarter by, for instance, keeping track of who downloaded a white paper so they could follow up. The company also invested in a call analytics system to learn from what the most successful sellers were doing. It uses voice recognition technology to analyze which topics reps discuss at which point during a sales call and then compares that data to outcomes to identify winning formulas.

So far, so good. The new structure has reduced the field reps' travel by 60% and dramatically increased the time they can spend with their most important customers. It also opened a new spigot of highly qualified leads to enrich time spent prospecting. Among midmarket and small customers, the virtual model positioned the company to capture a large untapped opportunity while cutting the cost of acquisition significantly. (Inside sales reps cost 50% less per account than field reps.) Most important, it makes the company's customers happy; when surveyed, three out of four said they prefer a virtual sales channel.

The sales organizations that create real value build sales plays that prescribe the optimal mix of virtual and field sales for any given situation.

The notion that customers prefer the hand-holding of dedicated salespeople is one of those myths that tend to discourage wider adoption of virtual sales. When Bain teamed with Dynata to survey more than 300 B2B buyers and sellers in the US, UK and Canada, the responses blew up four of these misconceptions.

- **Myth 1: In-person selling works better than virtual selling.** Buyers clearly don't think so. Echoing the results from the data storage company, some three-quarters of them agreed, or were neutral, that virtual interactions are just as effective for complex products. Most customers simply don't need or want in-person interaction all the time.
- **Myth 2: Only small deals or accounts are appropriate for virtual sales.** One-third of respondents have bought or sold products priced over \$500,000 using virtual channels. Company size also has no bearing on the willingness to interact digitally—buyers at both large and small organizations are willing to engage virtually.
- **Myth 3: Moving to virtual would be disruptive.** Respondents reported that half of their sales interactions already took place virtually, not in person, before the pandemic. The top reasons: faster, more frequent communication at lower cost. For many of these companies, the opportunity is to optimize the model, not start over.
- **Myth 4: Shifts to virtual selling during the pandemic will revert after the crisis.** About 80% of respondents believe there will be a sustained increase in virtual interactions.

One challenge that too often gets overlooked amid the myths is change management. Not surprisingly, taking virtual selling up the value chain often requires making sure the executive team knows how to manage the sensitivity this can cause within the organization. In our survey, 55% of sellers at the VP

level or below said field reps would be demoralized or quit if asked to change to a primarily virtual model, while only 25% said they would be excited.

What's critical is to involve the sales reps and managers from the start in designing a new model, cocreating a process that raises the company's sales metabolism. The key message is that deploying the right people through the right channels at the right point in the buying process will result in more sales—and that's in everybody's interest.

Running the right play

While getting the mix of virtual and field sales right is essential, it's not sufficient. Reaching full potential means spelling out in a repeatable way how the model should work depending on the specific circumstances. That's where prescriptive sales plays come in.

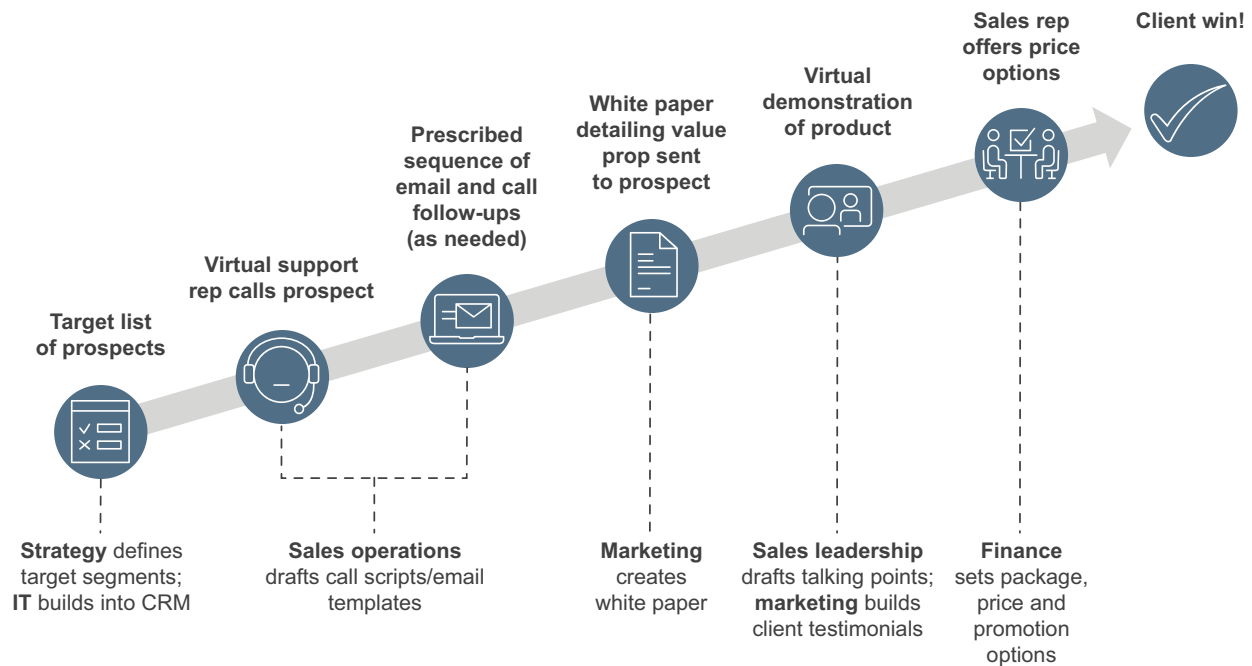
New PE owners often find that the typical target company's approach to sales is too scattershot. Most companies these days spend heavily on their CRM systems and other forms of sales enablement technology, but few use it effectively to build advantage. Instead, salespeople are often overwhelmed with administrative tasks. They spend a fraction of their time on actual selling activities. Coaching is often ad hoc and infrequent.

While getting the mix of virtual and field sales right is essential, it's not sufficient. Reaching full potential means spelling out in a repeatable way how the model should work depending on the specific circumstances.

Prescriptive sales plays build the kind of discipline that leads to more consistent execution. A sales play is a targeted program designed to increase the pipeline and revenue for a specific commercial objective (see Figure 3). It sets the cadence of the sale, defining how sales reps, experts and others reach out to customers and in what sequence. The play orchestrates resources across functions, supplying all marketing content, messaging and other sales collateral. It also serves as the basis for regular coaching and evaluation, defining key performance indicators and providing dashboards to monitor them.

The idea is to create repeatable models that not only can be deployed again and again, but can be readily adapted as conditions change. This unique combination of precision, repeatability and adaptability is a departure for most sales organizations, which historically have relied more on the entrepreneurial spirit of individual sales reps or a handful of vaguely defined campaigns to drive revenue. PE funds have discovered that play-based selling is a repeatable approach they can apply across the portfolio, much as they use proprietary playbooks to cut costs and reconfigure working capital.

Figure 3: Sales plays take a prescriptive, cross-functional approach to give customers the experience they want



Source: Bain & Company

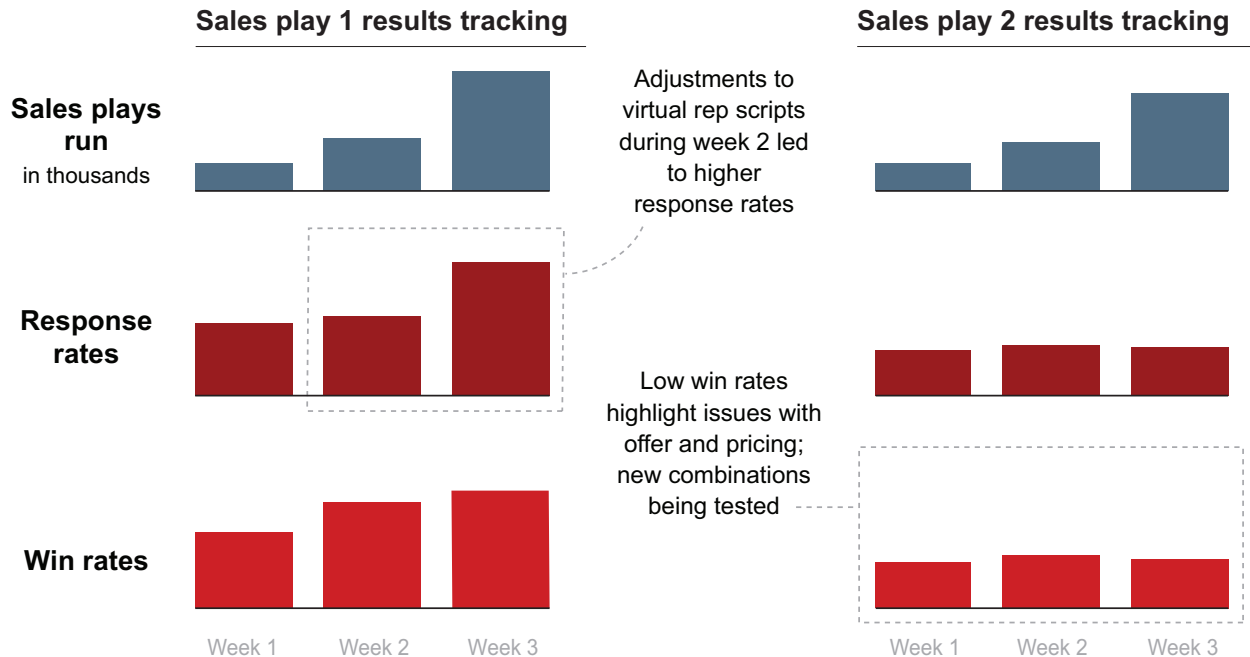
When Platinum Equity bought Cision for \$2.7 billion in early 2020, accelerating sales momentum was a pivotal part of the deal thesis. Cision’s global cloud-based public relations platform lets clients target journalists and social media influencers from a broad database with multichannel press releases. It then provides analytics to measure results and gain audience insights. Given the size of the deal, Platinum was intent on getting off to a strong start. It partnered quickly with company leadership to help Cision accelerate sales.

Central to that effort was a plan to turn Cision’s commercial organization into a “sales play factory.” The goal was to shorten the process of designing plays to a week or two (it can take months at some companies), while constantly honing each play through a regular test-and-learn process (see Figure 4). The company set up a cross-functional team to determine which plays to focus on, the right steps for each play, what marketing content and training materials the team should use, and a list of other elements important to the sale.

The new system allowed Cision to rapidly deploy plays aimed at engaging new customers, winning back old ones, managing renewals and upselling to new services. The process not only helped sharpen execution but also made the sales team think harder about what customers really wanted from them.

When it came to renewals, for instance, the company recognized that it wasn’t enough just to knock on the door once a year and ask customers to reup. Instead, the sales play used advanced analytics

Figure 4: A play-based approach lets companies like Cision monitor conversion metrics across plays and adjust on the fly



Source: Bain & Company

and risk-scoring models to identify which customers weren't getting the most out of their software, and then prompted reps to offer them new training or other forms of help. The result: Renewals jumped 10% to 20% to a new high.

Besides adding rigor and consistency to the sales process, the play-based system provided a much richer environment for coaching and learning at Cision. By laying out clear checkpoints and expectations, the system created a regular cadence of high-quality opportunities for managers to review each rep's progress, solve problems and prod them along when necessary. The test-and-learn emphasis allowed the company to use what it was seeing in the field to adjust plays on the fly. Management instituted nightly debriefs to see what was working or not, and each week the cross-functional team would pull up data to see what resonated with clients and produced better results. All of this led to more productive interactions with customers.

Companies that make sales plays work rely on several key enablers:

- **Quantifying opportunity at the customer level.** Most companies can give you a rough sense of market size. But do they know what each customer or prospect can really spend? By using analytics to create a "money map," providers can capture how much individual companies spend across

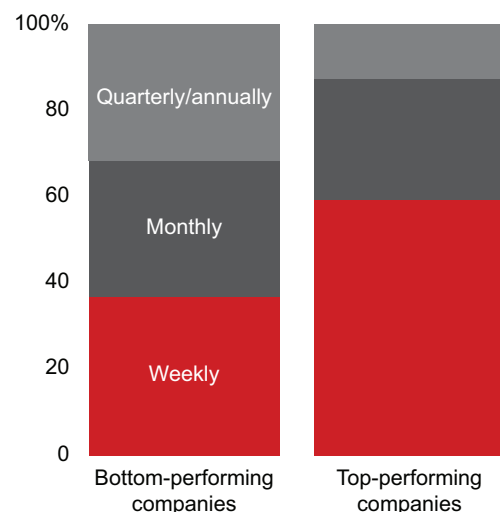
major categories and quantify where and how much potential customers can increase spending by category. That analysis focuses portfolio company sales teams on where the money is really flowing.

- **High-velocity deployment.** Defining and launching plays rapidly is critical. So is adjusting them through a regular test-and-learn process like Cision used. That starts with setting up a cross-functional team drawn from product management, marketing, sales enablement and frontline sales reps. These specialists take the money map analysis, add the latest intelligence from the field and design plays that refocus capacity on the richest opportunities. The team often operates out of a “win room”—a nerve center meant to measure results against key metrics and to quickly adjust plays based on constant feedback and learning.
- **High-quality coaching.** Sales plays give frontline management a regular opportunity to coach reps (see Figure 5). They can rigorously track the deployment, progress and performance of each play and use weekly one-on-one meetings to help solve problems and hone execution. Reps at companies that sustainably grow revenue and market share are 61% more likely to have consistent weekly one-on-ones with their manager than reps at lagging firms, according to Bain and Dynata’s survey of B2B sales reps. Those meetings focus on deal strategy and coaching, in contrast to the focus at lagging firms: process and administration.

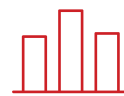
Figure 5: A play-based system creates regular opportunities for managers to coach their reps

How frequently do you meet with your manager for scheduled coaching?

Percentage of sales reps



The play-based coaching advantage



Tracks reps against **tangible, objective metrics**



Provides **high-velocity, ongoing coaching** enabled by a continuous flow of data and feedback



Gives managers and reps an iterative approach for **creating and adjusting play-based actions**

Notes: Top-performing companies are among the top 15% in revenue and share growth over the past three years; bottom-performing companies are in the bottom 15%
Source: Bain/Dynata Sales Management Routines Survey, April 2020 (n=262)

At a time of unprecedented uncertainty, the right combination of virtual selling and prescriptive sales plays adds clarity. It delivers unambiguous, practical guidance to the front line by identifying the company's most critical opportunities and laying out the clearest, most efficient path to capturing them.

The right combination of virtual selling and sales plays offers unambiguous, practical guidance to the front line.

It's true that changing the status quo isn't easy. But as new owners, private equity firms have the mandate to get it done across their portfolios—and to get it done quickly.



SPACs: Tapping an Evolving Opportunity

Here's how the controversial explosion in special-purpose acquisition companies is unfolding.

By Brian Kmet, Mike McKay and Thomas Olsen

The only thing that multiplied faster than SPAC IPOs in 2020 were heated opinions on the market spectacle, both pro and con. On the pro side: Special-purpose acquisition companies, or SPACs, are proving to be a speedier, more certain way to take a company public. Con: The economics heavily benefit the sponsor and redeeming IPO investors while significantly diluting nonredeeming public shareholders.

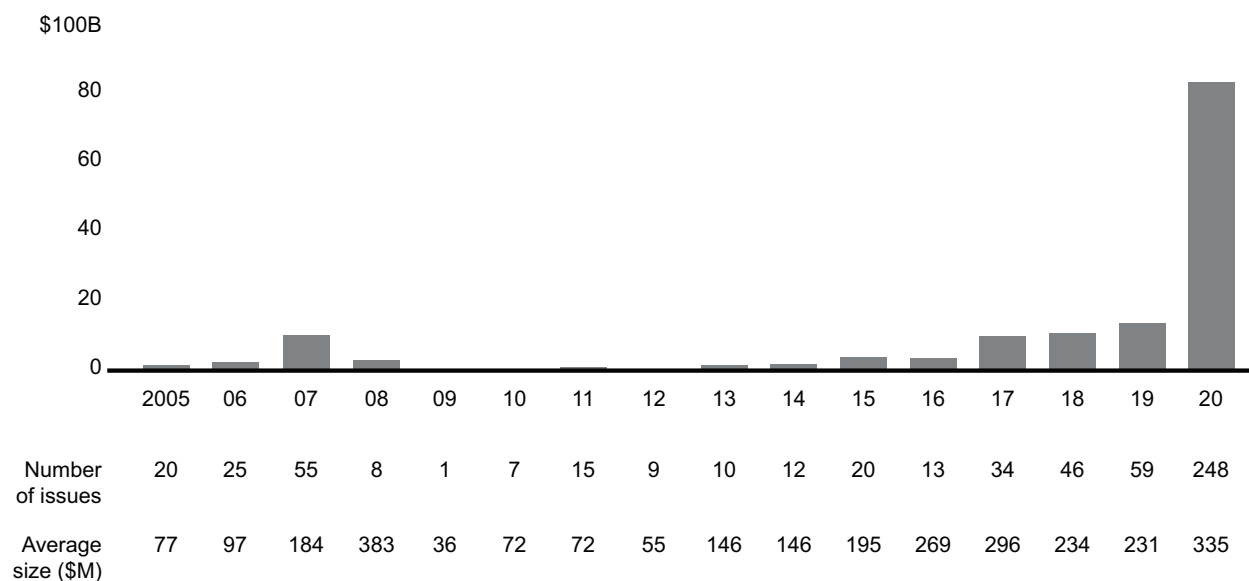
What's indisputable is that SPACs are red hot. Having died out after the global financial crisis, these vehicles found new life a few years ago and then exploded back onto the financial scene in 2020, raising a stunning \$83 billion in fresh capital, more than six times the previous record set just a year earlier (see Figure 1). The momentum carried over into 2021, with 91 SPACs raising another \$25 billion in January alone.

Private equity firms and hedge funds have jumped in enthusiastically on the sponsor side, with well-known funds raising around \$20 billion in 2020. Since 2015, two of the most active PE sponsors, The Gores Group and TPG, have separately raised a total of \$4.82 billion through 11 SPACs. Apollo raised \$1.45 billion with three SPACs over the six months ending in January 2021. PE funds have been active "sellers" to SPACs as well. In one of 2020's biggest transactions, Blackstone and CVC took Paysafe public in a SPAC-facilitated deal worth \$9 billion.

The backdrop for this upwelling of SPAC interest is the ongoing surge in the public equity markets coupled with a long decline in the appetite for traditional IPOs. Public company multiples are at or

Figure 1: What started as a trickle turned into a flood of SPACs in 2020 as sponsors raised \$83 billion

SPAC IPO capital raised



Sources: Thomson Reuters; SPACInsider

near all-time highs, yet the number of listed companies today is half of what it was in 1996, and IPOs are down 85% since then. More and more companies are balking at the cost, hassle and uncertainty of the typical IPO process. SPACs and other innovations like direct listings are starting to fill the void.

A structure with issues

SPACs are shell companies with no operations that raise capital through an initial public offering and then use the proceeds to fund one or more mergers that form the basis of the ongoing public entity. They typically have 18 to 24 months to find an acquisition target and often draw in other sources of financing along the way—most often, private investments in public equity (PIPE deals).

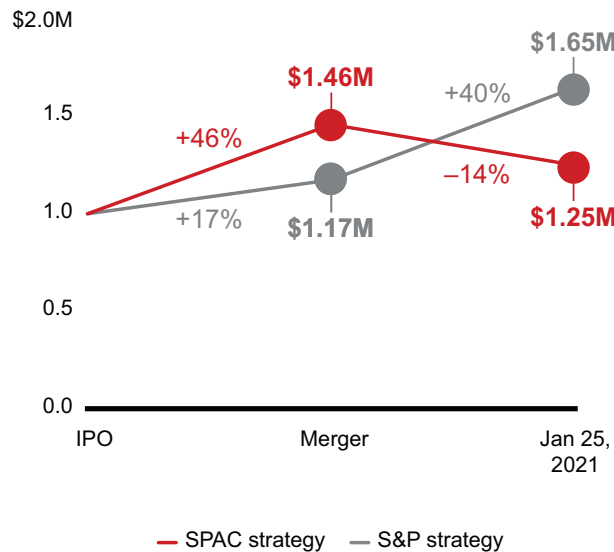
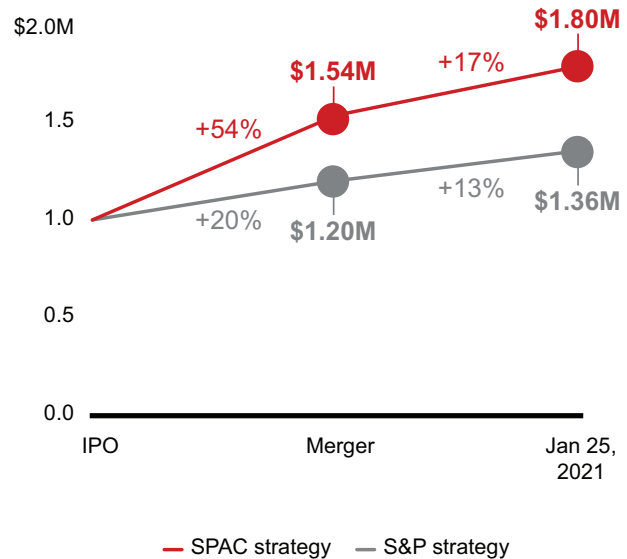
SPAC returns seem to be improving in aggregate, but individual performance is highly variable, and any gains are skewed to the premerger period.

IPO investors get a share of stock, usually worth \$10 at the start, and partial warrants to buy additional shares at an exercise price of \$11.50. In return for funding what is essentially a blank check, investors have the option to get their initial investment back while keeping the warrants. And if the SPAC times out, they automatically get a refund, plus interest.

The economics of this arrangement are highly attractive for sponsors. That's another big reason activity spiked in 2020. Typically, the SPAC sponsor receives 20% of the equity (known as the “promote”) for a token capital contribution. The sponsor pays for underwriting and other fees, but the endeavor is largely risk free as long as the SPAC entity completes a merger. Even if the postmerger share price sinks, the promote offers a large cushion against losses. If the price goes up, the warrants sweeten the deal.

The initial investors in these IPOs, meanwhile, have their own rich incentives. Dominated by a group of hedge funds known as the “SPAC Mafia,” they use SPACs as a source of free warrants and rights. According to research by Stanford Law professor Michael Klausner and NYU School of Law professor Michael Ohlrogge, these funds redeem or sell their IPO stock before target mergers are consummated 97% of the time, on average, but retain and trade the warrants, leading to returns greater than 11% in the deals studied. Redemptions commonly leave the SPAC with only 25%–50% of the capital it initially raised. To fill in the gap and build enough additional capital for a larger acquisition, SPAC sponsors usually turn to PIPE financing to get transactions over the line.

The research by Klausner and Ohlrogge shows that while sponsors and the SPAC Mafia profit handsomely in these arrangements, longer-term shareholders, on average, have not. Looking at completed

Figure 2: SPAC shares perform significantly better premerger than postmerger**2016–19 (58 SPACs): S&P strategy wins****2020 (63 SPACs): SPAC strategy wins**

Sources: SPACInsider; Bain analysis

mergers between January 2019 and June 2020, the research shows that SPACs lost 12% of their value within six months of the merger, while the Nasdaq rose roughly 30%. After 12 months, the average drop was 35%.

We took our own look at the data for all 121 SPAC mergers from 2016 to 2020, comparing their end-to-end performance (pre- and postmerger) to equivalently timed investments in the S&P 500 through January 25, 2021. We found that SPAC returns seem to be improving in aggregate, but individual performance is still highly variable, and any gains are skewed to the premerger period.

We looked first at the 58 SPACs that completed mergers between 2016 and 2019 (see Figure 2). If you split a \$1 million investment evenly between them, you'd have an aggregate \$1.46 million—or a 46% gain—by the merger dates. Equally timed investments in the S&P 500 would yield an aggregate \$1.17 billion, suggesting that the SPAC strategy is superior. Postmerger, however, the story takes a sharp turn. By January 25 of this year, SPAC performance had fallen off 14%, leaving you with \$1.25 million, while the S&P soared 40%, boosting your investment to \$1.65 million.

The 63 SPACs completed in 2020 show some improvement, but it is still early days; 60% of them transacted their mergers in the fourth quarter, making it difficult to draw close comparisons with

SPACs that have traded postmerger for longer. A \$1 million investment split evenly between the 2020 cohort would have given you an aggregate \$1.54 million by the merger date (vs. \$1.20 million for the S&P strategy). Postmerger, however, the SPAC strategy holds up much better, producing \$1.80 million by January 25 (a 17% gain) vs. \$1.36 million for the S&P strategy (13%).

Notably, 68% of the superior SPAC performance among the 2020 cohort came premerger, when trading is dominated by hedge funds. It's also true that the bulk of the postmerger gains through January 25 can be attributed to a small minority of high-flying deals such as Betterware (+324% postmerger), Open Lending (+173%), HighPeak Energy (+165%), DraftKings (+165%), Diginex (+139%), MP Materials (+116%) and Eos Energy (+107%). A full 40% of the 2020 SPACs, meanwhile, lost an average of 32% postmerger.

All of this validates the SPAC Mafia strategy: Buy at the IPO and earn risk-free gains by selling winners and redeeming the rest for cash. Then hold onto warrants to capture additional risk-free gains from the few—but extreme—postmerger winners. For longer-term or postmerger shareholders, SPAC performance falls off substantially.

Real-time evolution

Can a structure like this endure to play a meaningful long-term role in the capital markets? Despite the problems, there are several compelling reasons to believe it can.

More exposure to long-term company performance will dial up the pressure to focus on more than just closing a deal and moving on—an attitude that has plagued SPAC deals in the past.

First, there's a clear market need—companies and investors are clamoring for alternatives to the traditional IPO. Second, the Klausner/Ohlrogge research shows that returns for SPACs run by established, high-quality managers have been significantly better than the average, suggesting that growing professionalism may improve results. Finally, market pressure is already forcing sponsors to structure SPACs in new ways that make them more equitable for all stakeholders and focused on long-term performance. That may eventually create a more stable ecosystem.

SPAC structures are evolving in two important ways:

- Amid heavy competition for companies to bring public, sponsors are sweetening deal terms to both reduce dilution overall and to align stakeholder incentives longer term. On the extreme end, Bill Ackman's Pershing Square Tontine Holdings has no promote. Other SPACs—like Executive

Network Partnering Corporation and Periphas Capital Partnering Corporation—are embracing a new structure called CAPS, innovated by Evercore. This structure starts with a lower promote (5%) that can grow over time if the stock performs. Some SPACs are even requiring redeeming IPO investors to surrender their warrants or rights.

- Capital structures to augment the initial IPO funding are also shifting. Rather than relying solely on third-party PIPE dollars, some SPAC IPOs are including large forward purchase agreements underwritten by well-heeled sponsors who precommit to filling any capital void left by redemptions. SPACs sponsored by Apollo, Starboard Value and Dragoneer, among others, have featured large forward purchase agreements.

As these trends play out, SPAC sponsors will have more exposure to long-term company performance, both through the initial at-risk capital and the forward purchase agreement. That will dial up the pressure to focus on more than just closing a deal and moving on—an attitude that has plagued SPAC deals in the past. In the current overheated environment, any likely target with a public-company profile has SPAC sponsors lining up at the door. To win, successful sponsors will have to balance their effort across three equally important jobs.

Sponsors trying to capitalize on long-term incentives need to assemble the right team, align around a value-creation hypothesis predeal and implement the right value-creation initiatives, building an equity story that resonates in the public markets.

Find a deal and get it done before the clock strikes midnight. SPAC sponsors are getting significantly better at this. From 2006 to 2010, the SPAC success rate in finding deals was 50%. That rate jumped to 85% in the 2016–18 time frame. As encouraging as that is, the volume of SPAC IPOs in 2020 and early 2021 was like nothing the industry has ever seen, dramatically increasing the competition for targets. The front-runners will be the SPACs that come to market with a strong point of view on what they want to buy and hit the ground running with a focused search. That requires robust sector screening to get a jump on potential targets.

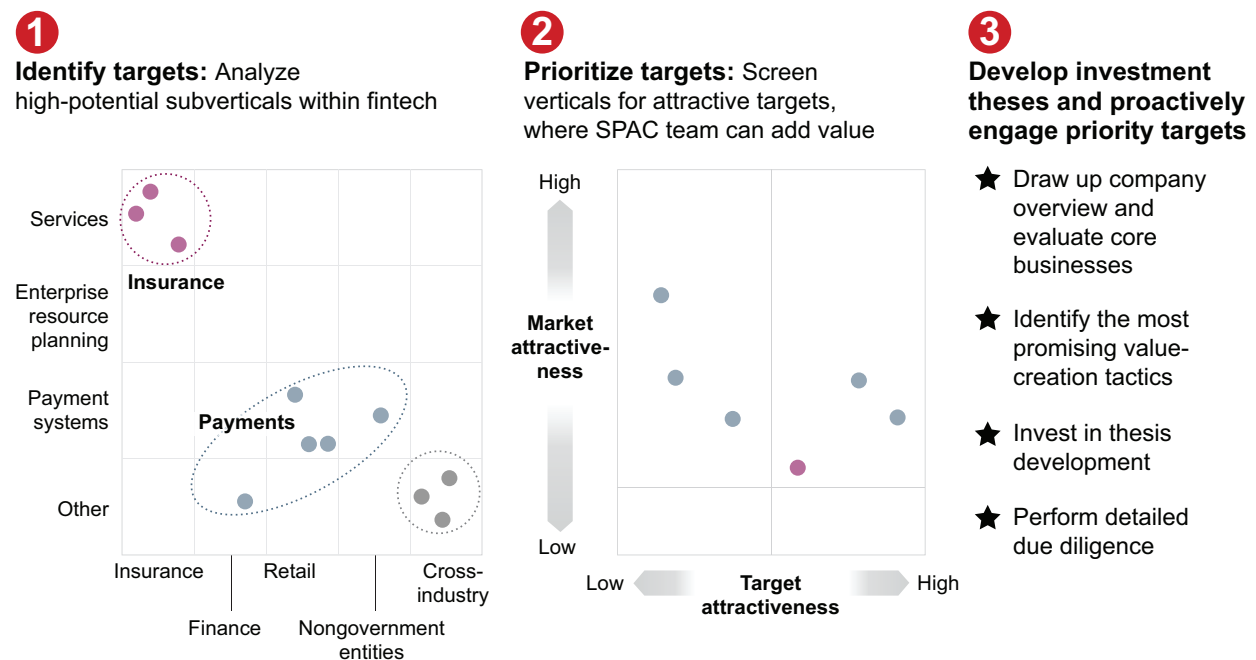
Pick a good company that can excel in the public markets long term. Of the 121 SPAC mergers we studied, more than 60% have lagged the S&P 500 since their merger dates, with 50% trading down postmerger. Over 40% of the 121 stocks were trading below their \$10 IPO price as of January 25. These are troubling data points, especially as the incentives for SPAC sponsors shift toward rewarding

long-term performance. As pressure to produce share appreciation grows, sponsors will have to bring stronger due diligence capabilities to the party to analyze and vet their highest-potential targets. The big wins will involve underwriting ways to turn a good company into a great one.

Boost performance through management expertise, talent networks and world-class value-creation planning. With hundreds of SPACs in the market, price discovery on any given asset will be very efficient. Top returns will eventually accrue not just to great deal people but to those who know what to do with companies once they buy them to boost the share price. Sponsors trying to capitalize on long-term incentives need to assemble the right team, align around a value-creation hypothesis predeal, and then work closely with management (and outside help when needed) to structure and implement the right value-creation initiatives, building an equity story that resonates in the public markets.

For one PE-backed SPAC focused on the fintech sector, this process began with an extensive early-stage effort to identify, screen and evaluate potential targets (*see Figure 3*). Even within the narrow fintech focus, there was substantial value in framing and prioritizing the most attractive seams within the sector and then using both analytics and industry experience to fully capture specific trends and identify sources of alpha.

Figure 3: For a SPAC focused on fintech, finding the right acquisition required a robust approach to identifying, prioritizing and evaluating targets



Source: Bain & Company

With external support, the deal team segmented targets based on product or service offering and customer base (fintech software, payments solutions, etc.) and then ran market screens focused on multiple success factors. That led to an analysis of each high-potential target, focusing on the company's operations, management and prospects. This level of clarity before the IPO allowed the SPAC team to focus its approach and align on a differentiated pitch to targets. That let them move quickly in the offering's aftermath to approach the highest-potential targets with a convincing value-creation hypothesis calibrated to produce immediate upside in a hot market for public equities.

Whether SPACs persist or flame out will surely hinge on performance. Increasingly, that will depend on whether professional managers can come to dominate the battlefield. As the incentives shift from short-term dealmaking to longer-term performance, the game is changing. The edge will go to sponsors who can screen the best targets and underwrite the most compelling value-creation plans.



Have Classic Buyout Funds Run Their Course?

Increased specialization in private equity is challenging funds to define where the next phase of growth will come from.

By Hugh MacArthur and Mike McKay

For more than 30 years, buyout firms have stood at the center of the private equity industry. For the last 10, that position has been slipping.

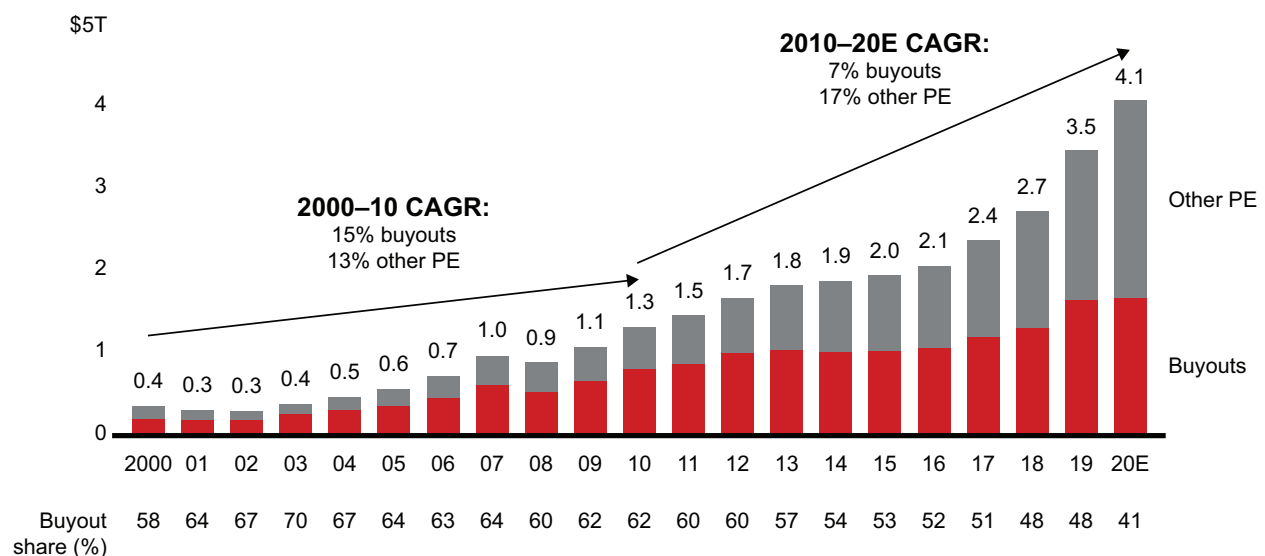
While assets under management (AUM) held by buyout funds grew 7% compounded annually during the industry's historic expansion over the past decade, other private equity asset classes grew more than twice as fast. Investors piling into categories like growth, venture capital and distressed assets have powered 17% annual growth in nonbuyout alternatives since 2010, building to an estimated \$2.4 trillion in AUM by the end of 2020. Buyouts are still the industry's single largest category, but their share of assets is shrinking. Buyout funds held 41% of global private equity AUM in 2020, down from 62% in 2010 (see Figure 1).

Growth within the buyout category has also shifted significantly. For the first two-thirds of private equity's relatively brief history, the industry was shaped by the classic buyout fund, one geared to hunt for value in a number of industries and sectors with a diversified portfolio. Since 2010, however, these classic funds have been losing share to specialists—firms that have carved out clear areas of expertise and exploited them aggressively, including hyperfocused subsector funds, growth funds, ESG specialists, long-hold funds, etc. The share of capital raised for classic funds has slipped from a recent peak of 80% in 2013 to 56% at the end of 2020 (see Figure 2).

Market forces are driving the shift. Amid fierce competition for targets, some general partners have developed specialized capabilities to generate the kinds of proprietary insights that win multibidder

Figure 1: Buyout fund growth has slowed as more and more capital flows to other private asset classes

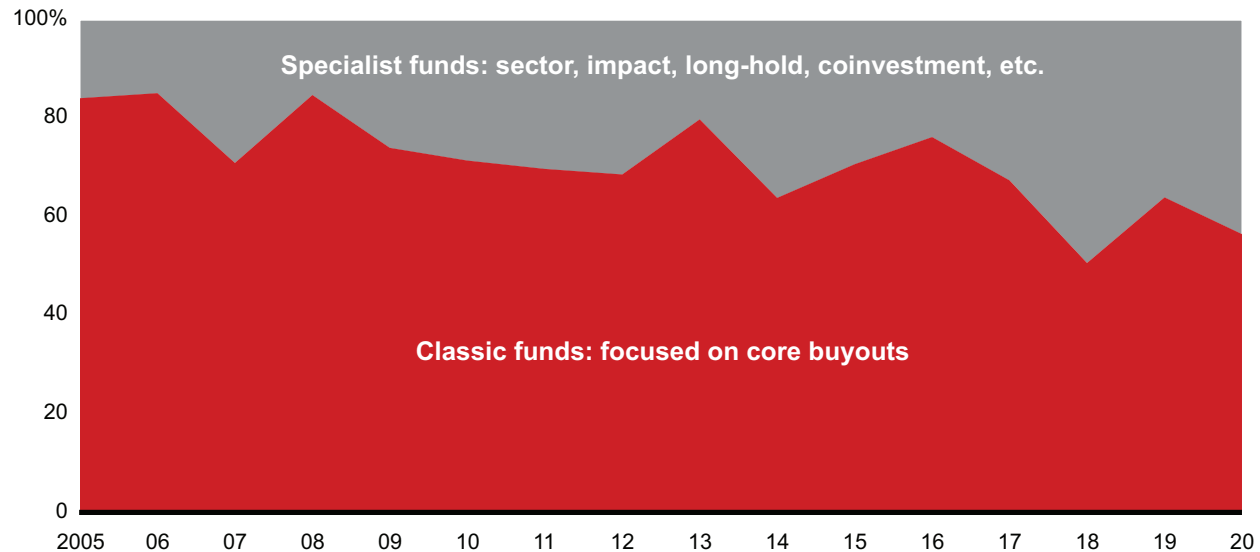
Global private equity assets under management (as of year-end)



Notes: 2020 estimate based on H1 data linearly extrapolated; other PE includes venture capital, growth, fund-of-funds, distressed and other investments
Sources: Preqin; Bain analysis

Figure 2: Within the buyout category, funds with classic strategies are losing ground to specialists

Buyout fund capital raised, by year closed and type of focus



Note: Classic funds defined as buyout funds with a diversified focus across sectors and no specific differentiators on where to play
Sources: Preqin; Bain analysis

auctions. At the same time, limited partners have become more discerning with their strategies. Having once pursued a straight-ahead PE allocation, LPs are now looking to plug specific holes in their alternative asset allocations or address specific requirements (such as sustainability standards) from their stakeholders. One result: Investors are funneling more capital to GPs that offer something different through both performance and focus.

Extending this trend line out another 5 or 10 years strongly suggests that classic buyout funds may have a harder time attracting new capital than they have in the past. That's prompting many firms to ask themselves a fundamental strategic question: How do we increase the value of our business over time?

The uncomfortable middle

For years, the path to alpha was clear. Adding value to the general partnership meant raising a bigger fund and doing more buyouts wherever you could find the best opportunities.

As the industry grew and became more crowded, firms developed expertise in certain industries or geographies while honing value-creation models. But the evolution was relatively slow and the market relatively forgiving; lower average multiples meant it was easier to underwrite risk and recover quickly

when firms got it wrong. As long as they performed and continued to raise capital for bigger and bigger funds, full steam ahead.

The last five years or so have been a different story. Unprecedented growth in AUM, fierce competition for assets and chronically high price multiples have turned up the heat on firms to find deeper insights, develop a better playbook and attract the best talent. That and a growing preference for specialization among LPs have led to a rapid expansion of innovative new fund types. Sector funds have given way to even more focused subsector funds. LPs are pouring money into growth equity funds, tactical opportunity funds, long-hold funds, and ESG-focused and impact funds. Even the recent explosion in SPACs reflects the scramble for targeted solutions. It's not that there's a need for more capital. What the market is craving are clever new ways to find and create value.

This presents a special challenge for classic buyout firms in the market's middle. On one flank, they are competing with diversified giants—funds like Blackstone, KKR and Carlyle that have permanent sources of capital, products in most segments and the resources to launch new ones with minimal risk to the business. On the other, they face innovative new funds that are scrappy, entrepreneurial and hatched with differentiated strategies specifically tailored to current fund-raising trends.

These specialists are hitting the market in a steady stream. London-based Corten Capital, for instance, raised \$435 million in 2020 (27% more than it targeted) for a portfolio narrowly focused on technology-driven B2B services. Formed by a team of two ex-Warburg dealmakers and two successful technology executives, the fund specifically seeks out entrepreneurially managed companies that provide mission-critical services and software solutions that are deeply embedded in customer workflows.

Another example is Cove Hill Partners, which launched in 2017 as a long-hold fund focused on only two sectors: consumer and technology. Having raised more than \$1 billion in September 2017 after just three months on the road, it raised another \$1.5 billion in July 2020, despite the fact it had yet to sell a company from the original portfolio or produce a realized return.

Decision time

This landscape presents many buyout firms with a set of important questions. First among them: With asset prices sky high and in no danger of falling, how can we continue to generate attractive returns unless we find a differentiated advantage, especially now that many LPs expect it? Moreover, how are we going to pay for it? Unlike the largest firms that can shift investment and resources to a new strategy without taking much risk, investing in a new product and building new capabilities can be a bet-the-firm decision for a midsize player. That's not easy, especially when performance is still holding up.

Making a bold move, however, can transform a firm's business. Consider Vista, which in 2000 started as a \$1 billion fund focused on buying legacy software companies and making them more efficient. Recognizing that staying ahead in this red-hot industry would require deeper expertise, Vista expanded

its horizons over time by moving into asset-class adjacencies within the sector that would help the firm participate in the complete software growth cycle.

Since 2010, it has launched several growth-equity funds to capture opportunities among rapidly growing adolescent software companies. In 2014, it expanded beyond equity to create a fund to supply credit solutions to enterprise software, data and technology-enabled businesses. It also launched a public equity long/short fund focused on tech, media and telecom companies. In January 2021, it raised \$2.4 billion for a new long-hold fund that offers investors extended investment periods and long-term, consistent dividends.

With asset prices sky high and in no danger of falling, how can we continue to generate attractive returns unless we find a differentiated advantage?

This diversification within the software sector—which began when Vista asked itself, “How can we grow and add value to the general partnership?”—has created a software specialist with few industry peers. By radiating out and creating a distinctive ecosystem of private-market products, Vista has found an edge in one of the most attractive and competitive sectors in the global economy. The firm now has more than \$73 billion in assets under management, and in September 2019 it closed its seventh fund, worth \$16 billion. Its growth and success have inspired a number of other technology specialists, many of whom are scaling fast.

Two other good examples of classic buyout firms that prospered as specialists are Audax Group and Roark.

Audax has become a tightly focused buy-and-build specialist. Since 1999, it has raised more than \$9 billion aimed at acquiring middle-market companies clustered largely in three specific industries—healthcare, technology and business services. That has involved investing to build a team that is expert at finding the right acquisitions and adding on legal and financial teams capable of processing transactions quickly. The result is a firm that can move faster and more insightfully than others to create value through multiple arbitrage: finding promising platform companies and rolling up low-multiple acquisitions to build a company with a higher multiple.

Roark developed a focus on investments in consumer and business services companies, with a specialization in franchise and multilocation business models. It has acquired 90 franchise or multilocation brands across industries, from restaurants (Arby’s and Jimmy John’s) to auto care (Maaco and Meineke). The firm has become expert in supporting brand growth, improving store execution, structuring franchise economics, and avoiding the many duds that either don’t stand out from the crowd or have limited growth prospects. Its distinctive approach has attracted \$20 billion in AUM.

Avoiding stall-out

Bold moves like these begin with the realization that what worked over the past 20 years may not work as well in the coming 10. A market that clearly favors differentiated expertise requires firms to carefully assess what is going to make them stand out.

Firms that have successfully charted a new path for growth in the coming decade follow a logical sequence. They first define (with facts) where the firm is now, spelling out its core repeatable model for generating value. From that starting point, they focus their strategic inquiry in five areas:

- How can we adopt new products and adjacencies that capitalize on our strengths?
- Which sectors or subsectors are we prepared to go deep on—and really mean it?
- How can we use data, digital and advanced analytics to transform how we find and evaluate targets?
- What is our value-creation playbook, and is it both digitally enabled and distinctive?
- What is our ESG strategy, and do we truly understand how shifting consumer and employee motivations are changing the calculus for success in almost every industry?

Private equity investors have built an industry on the principle that hewing to the status quo is rarely a formula for creating new value. For many classic buyout funds, decision time is fast approaching.

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