PRIVATE EQUITY PERFORMANCE IMPROVEMENT

# Step 2 on Transforming Branch-Based Business Operations: How to Migrate the Ideal Model

Disseminated labor-intensive service businesses, or branch-based businesses, are often ripe for EBITDA improvement regardless of market conditions. However, an extended economic slowdown will exacerbate their operational weaknesses of inherently high fixed costs and low level of process excellence/standardization.

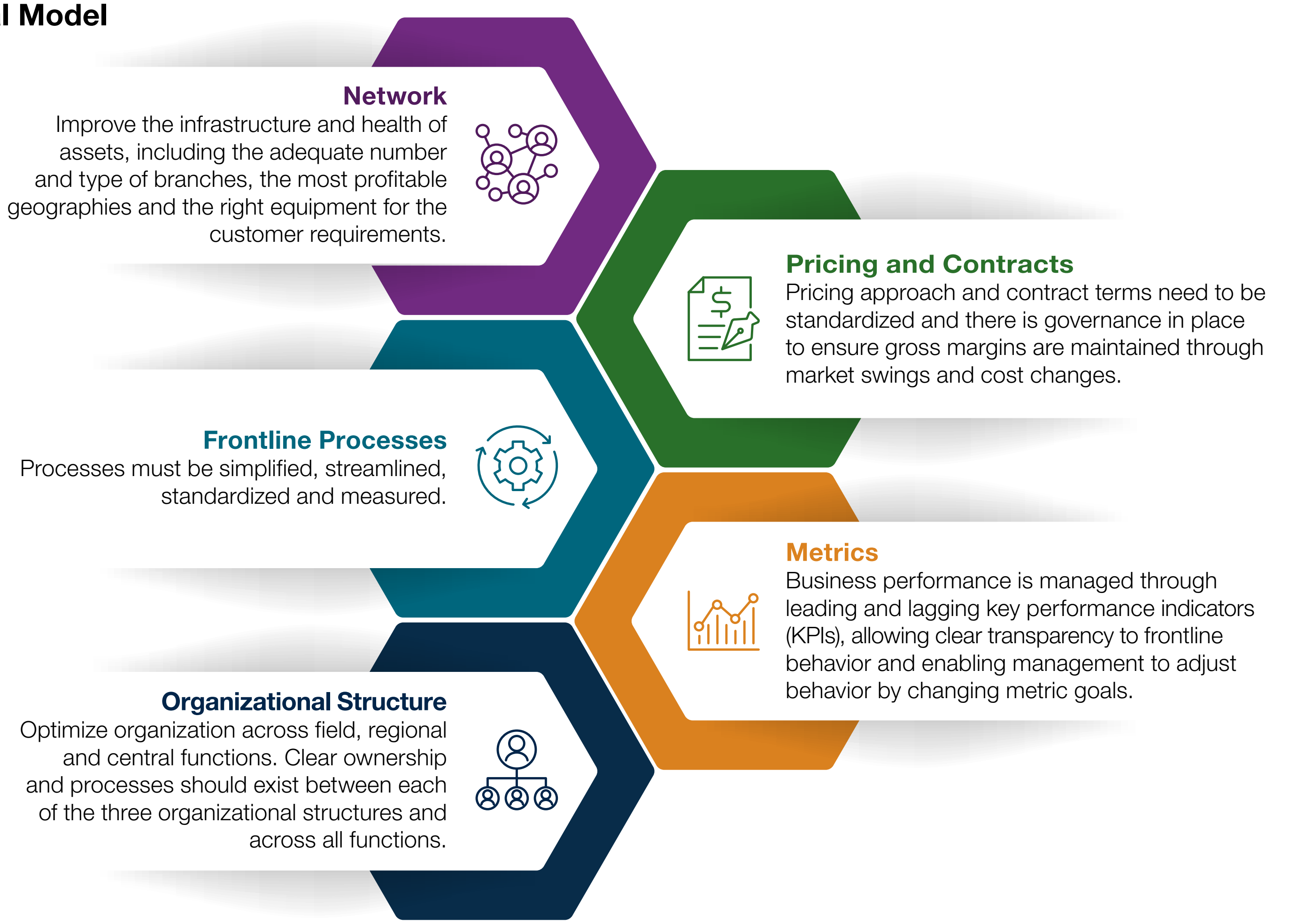
This series covers the three steps that private equity (PE) funds need to take to transform the operations of the branch-based businesses in their portfolios. The first article detailed how to identify and build an ideal operational model. This second article outlines how best to migrate to the new model. The third article will detail how to make these changes sustainable amidst market swings, how to innovate and how to build for growth.

Getting execution right is typically as important as the change program design itself. The three keys to Step 2 (Migration to the Ideal Model) are to ensure to 1) make the five key operational decisions for the change, 2) sequence the transition correctly and 3) build a robust and disciplined governance to ensure sustained success.

## Step 1 Recap: Build the Ideal Model

The first article in this series outlined the main components of the ideal model, as depicted in the below graphic.

### Ideal Model



## Step 2: Migrate to the Ideal (focus for this article)

From our experience as operators focused on disciplined execution, three components are critical for the migration:

1. Making the right **Operational Decisions**
2. **Sequencing** the Transition correctly
3. Applying the proper **Governance** throughout the transition

## Key Operational Decisions

Companies' leadership oftentimes makes strategic board-level decisions but then fails to define the next level of operational decisions. These operational decisions set the guidance for the company to execute effectively. Collectively they answer the questions on how to achieve and sustain the end goal:

- Do all the decisions and progress along the journey achieve the vision?
- Who is responsible for achieving the result?
- How can we bring simplicity through the complexity of the frontline?
- Can we innovate in our reporting, systems, tools to accelerate change vs. being hindered by platforms that slow down the change progress?
- How do we ensure the change is sustainable?

| Focus Area for Decision | Issue | Operational Decision |
|---|---|---|
| **1. Vision / Challenge** | Settling for incremental changes for which improvements often erode over time. | Set challenge targets for gross profit, corporate SGA, field SGA and front-line efficiencies to drive structural changes. |
| **2. Accountability / Alignment** | Without alignment on accountability of customer, revenue, costs and branch EBITDA, companies' cultures become one of finger pointing, indecisiveness and inaction. | Assign the fundamental structural ownership and accountability to key areas, be overt with disciplined cadence of actuals to targets on those specific KPIs by executive through branch manager. |
| **3. Frontline vs. Support / Clarity** | Unclear roles of frontline and support creates ineffective delivery, poor functional interconnectivity, generally higher costs and lower customer retention. | Correctly define activities the frontline entrepreneurial owners run vs. the functional scale activities at central/ regional level. |
| **4. Tech / Accelerate** | Complicated overreporting to HQ, systems installed that don't match frontline needs, and not utilizing the data inherent in the customer-installed base. | Executives should lead tech reviews/ decisions, should be balanced with business and tech leaders, conducted early in the transition for both platform systems and innovation tool additions. |
| **5. Continuous Improvement / Sustainability** | Many programs get de-prioritized during execution, don't finish the full vision or fall short of the results, many times due to lack of continual discipline to achieve the vision using metrics to drive behavioral change. | Create a role/staff for operational excellence that is strong in analytics, works closely with executives and the program team, and is dedicated to the program change to continuously improve the structure of the ideal model, which ultimately drives sustainability. |

## Transition Sequence

Great execution of an average strategy is most times much better than poor execution of an excellent strategy. Some companies either skip execution steps of the ideal model or transition in the wrong order. Either can mean the program will be no more than a distraction.

The plan shouldn't be simply a large series of actions. Senior leadership has to be involved in the transition sequence to ensure the program aligns with other business initiatives and business market seasonality. Many times this involves untangling layers of complex costs put in place over years, particularly in roll-up strategy-built businesses. The best programs have a clear rationale for what components will be restructured in what order, with a critical path mindset.

Through our experiences with transforming branch-based businesses, we have found it best to consider this sequence of restructuring. (See graphic.)

### 3. Provide Lean Support

- Structure non-field functions to deliver support that is lean, at-scale and only to provide what the branches require.
- Define cross-functional processes with a RACI matrix to ensure "connective tissue" exists for all functions to operate together efficiently.
- **Result:** Enable the field branch operations and sales to focus entirely on local activities of employees and customers.

### 2. Standardize Front-Line Sales and Operations

- Streamline, simplify and standardize frontline employee processes.
- Field validate designs to define processes before network-wide rollout.
- Group geographies and services into “archetypes” with similar needs.
- **Result:** Define the scale and scope of the base business operations.

### 1. Right-Size Network, Products and Services

- Be aggressive to exit branches, products or services that are unprofitable after all potential performance improvement levers are evaluated.
- Do this first to define the foundation and infrastructure of the business.
- Don’t let this linger, don’t "kick it down the road." Hoping the branch will recover is not a decision.
- **Result:** Size the business correctly which informs the organizational structure decisions.

## Transition Governance

Transitioning without the proper structure can be worse than making no change at all. Programs at many companies fail to build a robust transition structure, e.g., to resource the transition properly or track the impacts all the way to the P&L or involve the field appropriately.

Transition governance comprises the key element to structure and manage, to effectively migrate from current state to the designed ideal state.

The below graphic depicts the key elements to get right when going through the transition.

## Elements of Effective Transition Governance

| | | |
|---|---|---|
| **Rollout** | **Pace** | Advance the transition with a mechanical and detailed program plan with check gates and adjustments at each stage. |
| | **Sponsor** | Coordinate the resources if/when the transition gets difficult to ensure operations are all aligned, rather than having fingers pointed at the program team. |
| | **Pulse** | Keep a pulse on the organization with a periodic, simple survey of frontline employees and supervisors to understand how management changes are impacting operations and customers' changing needs. |
| | **Dashboard** | Maintain a dashboard of the ideal model program changes to score change progress, change adherence and change effectiveness. |
| **Product** | **Validation** | The first phase of execution should be field testing and validation across a variety of different geographies. The field testing will prove the value, inform adjustments to the design, align the field staff to increase adoption, help prioritize, inform how to gain sustainable adherence to the changes and provide insight into the networkwide rollout. |
| | **Technology** | Weave new technology and tools into offerings, constantly test concepts in pilots, and ensure they deliver ROI and are not just a "new shiny thing." |
| **Team** | **Ownership** | Engage the organization at the branch level. Bring some top branch managers and regional leaders into the program transition as initiative owners. Each main deliverable should have individual and executive ownership and accountability. |
| | **Transparency** | Communicate changes to the front line. The field will be less resistant if leaders communicate the logical rationale of the changes. |
| **Business Management** | **Timing** | Align the changes to off-peak season to minimize disruption of the business. |
| | **P&L** | Ensure the changes get executed and benefit to the P&L is achieved. |
| | **Balance** | Continue to run the business while the company changes the business. |

**Key Takeaways:**

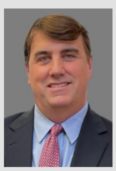
- Getting the execution right can be just as critical to program success as the program design itself.
- The first key to Migration to the Ideal Model is to ensure to define and communicate the five operational decisions for the change. Those are: 1) Vision/challenge, 2) Accountability/ alignment, 3) Frontline vs. support/clarity, 4) Tech/ acceleration and 5) Continuous improvement/ sustainability.
- The second is to correctly sequence the transition moves and workstreams.
- Finally, ensure the business has effective transition governance.

## How A&M is Helping Clients Apply This Guide

Incorporating these takeaways to programs greatly increases the odds for success and program sustainability. PE funds have a significant amount of investment in the business service sector. Over 50 percent of Alvarez & Marsal's top PE fund clients house service and disseminated businesses in their portfolios. A&M's Private Equity Business Services-focused group has deep, hands-on experience supporting PE funds with branch-based businesses, both pre- and post-acquisition.

Utilizing third-party support to guide the transition of change programs greatly increases the branch-based business's value, adoption and sustainability while reducing the time to impact EBITDA and the risk and disruption to the ongoing business.

## Key Contacts:

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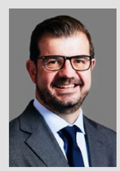

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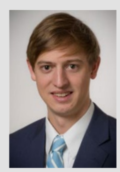

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