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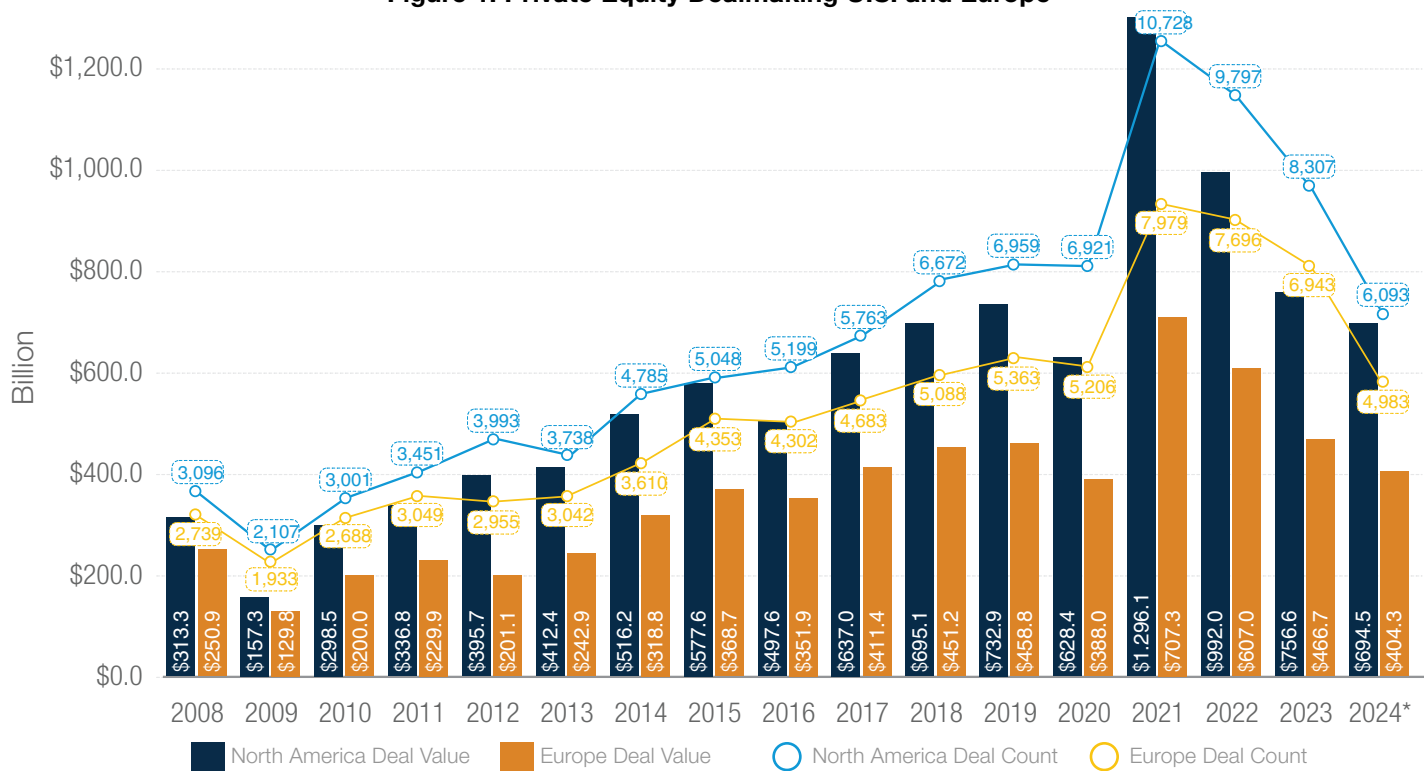
Going Big and Moving Fast:

How PE Firms in North America and Europe Are Adapting Value Creation to Market Pressures

Introduction

On both sides of the Atlantic, private equity (PE) firms have weathered similar storm clouds over the past three years. Amid the swiftest interest rate increase in a generation, funds are contending with a prolonged drought in the deals markets that is putting enormous pressure to exit portfolio companies, while making promised returns to investors much harder to achieve.

Figure 1. Private Equity Dealmaking U.S. and Europe



*as of September 30, 2024 | Source: PitchBook Data, Inc.

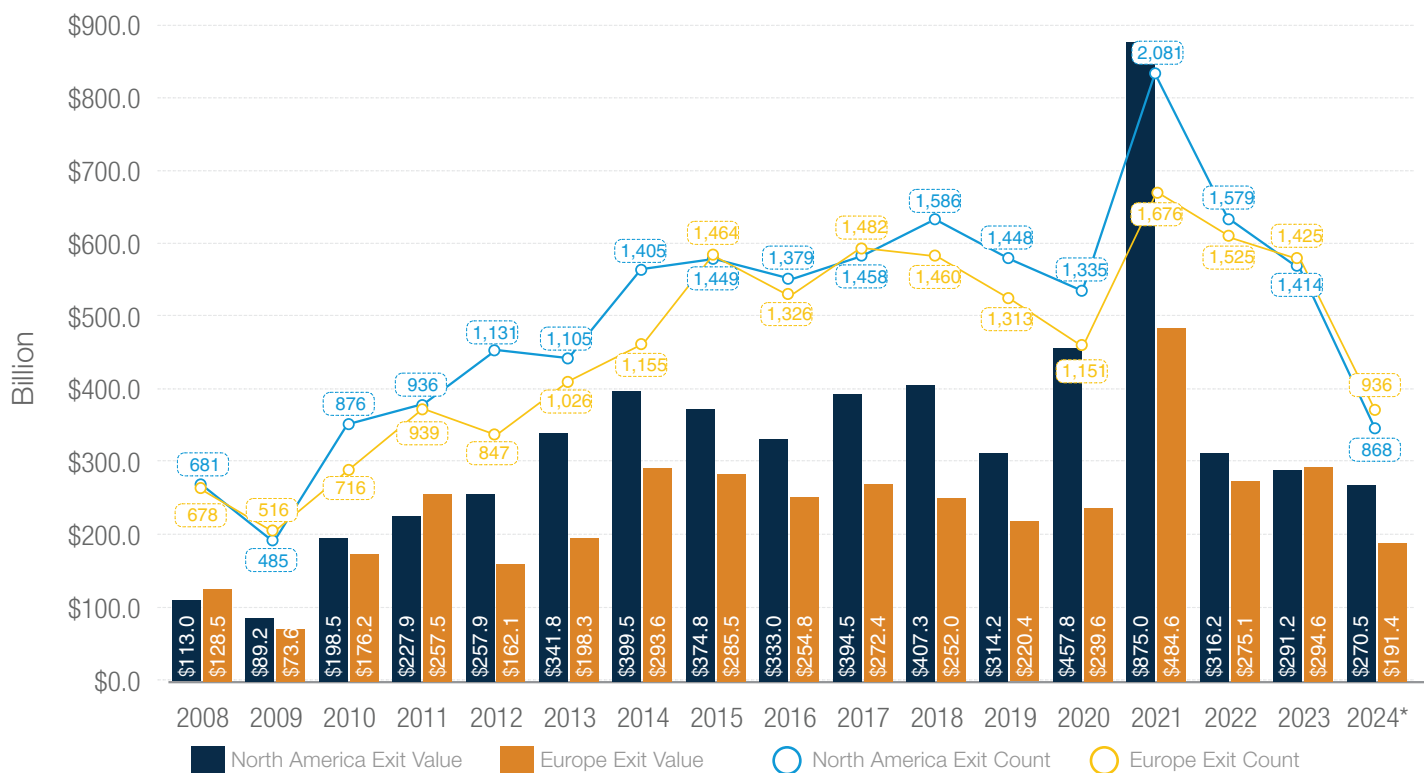
At Alvarez & Marsal (A&M), working with PE clients across North America and Europe, we've seen firsthand how these powerful market forces are reshaping nearly every aspect of the industry, from diligence to value creation and exit strategy.

Our exclusive survey of PE executives in these two key markets offered insights into how these dynamics are playing out on the ground. The findings reveal a new degree of sophistication being applied to traditional value creation initiatives, particularly around topline growth, margin expansion and cost efficiency. One example is how AI and data now play a pivotal role in these efforts, with PE firms feeding large pools of data into algorithms and prediction models to identify opportunities for operational improvements faster, in areas such as pricing, product portfolio enhancement, revenue diversification, customer engagement, and more.

PE funds are also rebalancing their acquisition target focus as part of their response strategy, shifting away from heavy industrial business that are too exposed to raw material, labour and energy inflation. Instead, they are prioritising business service and asset-light business models. We're seeing a strong emphasis from clients on scaling service-oriented businesses to boost profitability; a key example is the expansion of aftermarket services such as maintenance, inspection and repair, within manufacturing companies that may be struggling with input price fluctuations.

Another striking trend we've seen concerns the expanding scope and accelerated timing of value creation. PE funds are clearly moving towards bigger initiatives and earlier deployment, driven by mounting pressure to boost value for portfolio companies and secure successful exits. In our North American survey, the majority of respondents indicated they are pursuing large-scale transformation or capability expansions within their portfolios.

Figure 2. Private Equity Exits



*as of September 30, 2024 | Source: PitchBook Data, Inc.

They are doing this with a renewed sense of urgency, with most respondents starting the value creation process in pre-deal and diligence phases and carrying on these activities through the first 100 days post-acquisition. This immediacy underscores the higher pressure faced by North American funds on the interest rate front, with the Fed adopting a slower pace of rate reductions compared to the European Central Bank. Growing expectations of a shallower rate-cutting cycle in the U.S. will likely intensify the need for quicker and more aggressive value creation strategies.

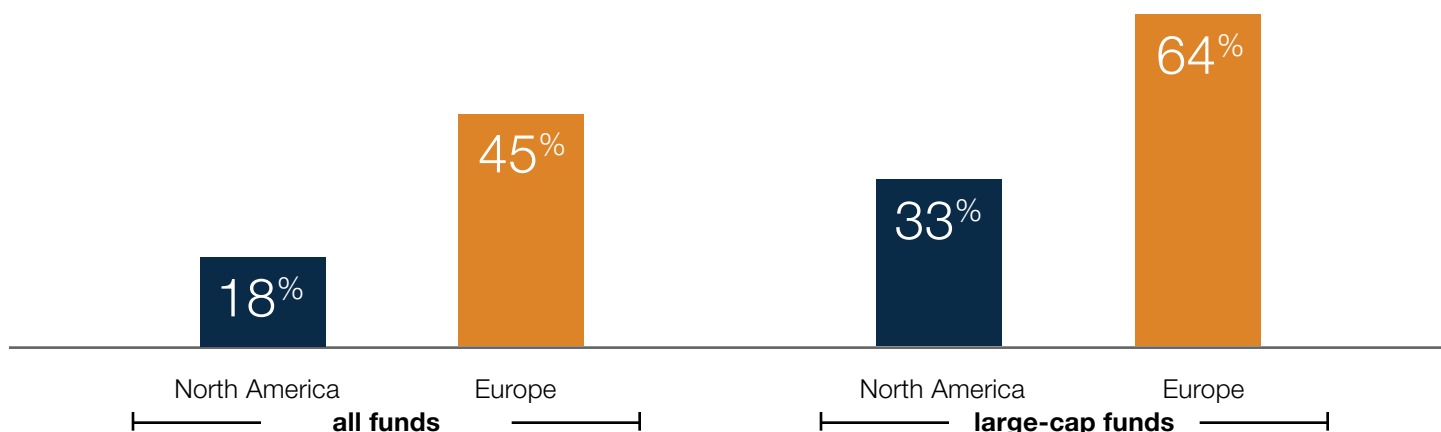
AI and data take centre stage

AI and data is being used similarly in both regions to power transformation. Over 95% of respondents in the surveys see digital initiatives as critical for success in value creation. However, the level of maturity of such initiatives seems to vary between the two markets, especially when it comes to AI.

In Europe, 45% of respondents across fund sizes reported already using AI in post-acquisition value creation plans, compared to just 18% in North America. While overall adoption is lower in North America, megafunds in the region are leading the way, with 33% of respondents in this group currently deploying AI in portfolio company operations, and another 33% planning to implement the technology this year or next. The same trend of larger funds outpacing other fund tiers is seen in Europe.

The majority of mid-market funds, in both North American and Europe, are still discussing the first areas of AI application. This apparent delay may be because portfolio companies of mid-market players are often smaller and as such lack the data infrastructure needed for AI solutions.

Figure 3. Funds already using AI in post-acquisition value creation plans

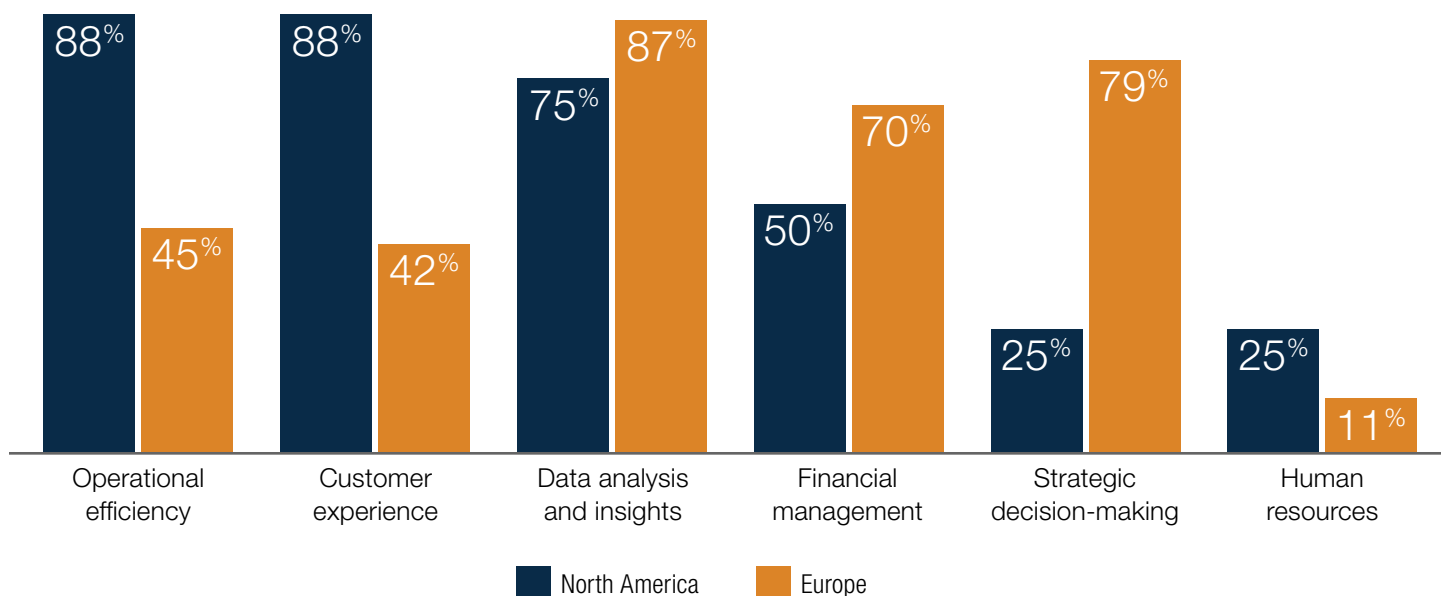


Source: A&M survey

In contrast, many larger funds, particularly in Europe, have established dedicated digital functions within their operational performance teams to support digital programmes at their portfolio companies. The buzz around generative AI has definitely added momentum to this trend, putting the leading PE houses in a race to find solid use cases for the technology throughout their investment journeys.

Our survey also indicates differences in AI use cases across the two markets. In Europe, the most common applications are in market insights and competitor analysis, followed by strategic decision making. In contrast, North American funds are more focused on use cases that enhance operational efficiency and customer experience, with strategic decision making playing a less prominent role.

Figure 4. Main use cases of AI in post-acquisition value creation

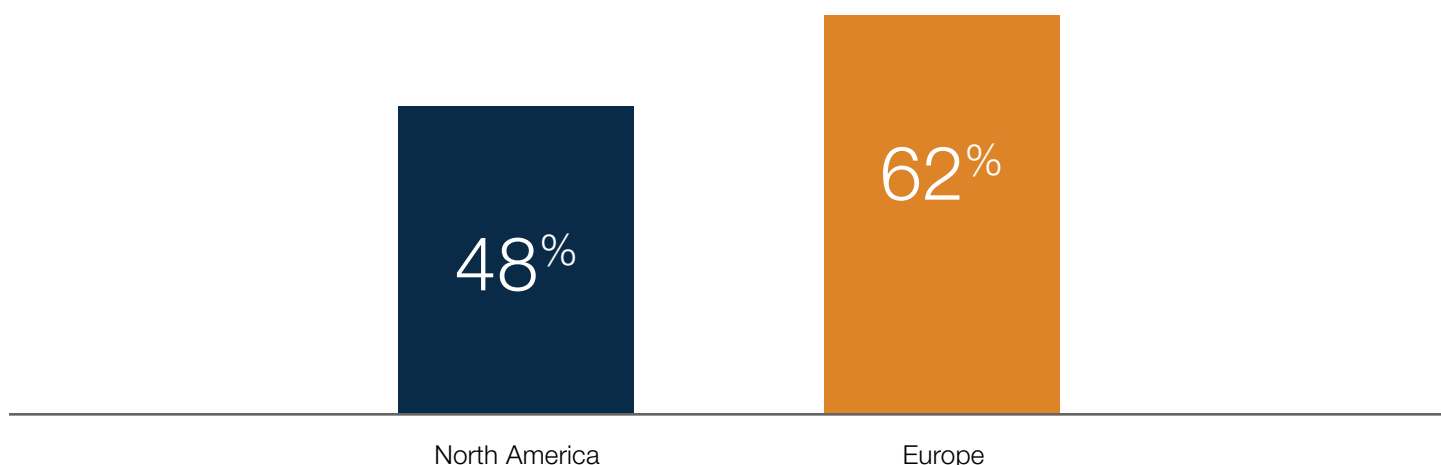


Source: A&M survey

Another common trend the survey revealed is the growing reliance of PE firms on the organic expansion of their portfolio companies, as buy-and-build – the top growth strategy of the past decade – has become much harder to execute. PE houses in Europe and North America are now overwhelmingly favouring organic growth as a value creation strategy in the current climate. Among North American funds, the most common activities for achieving this are internal improvements and revenue expansion within the portfolio companies. Interestingly, smaller firms are more likely to rely on revenue generating initiatives than their larger counterparts, with 29% of mid-market focused on revenue-only strategies, compared to 13% of large-market firms and 20% of megafunds.

Value creation strategies appear to be largely converging across the two largest PE markets globally, with subtle differences emerging in areas such as AI use cases, where North American funds tend to prioritise tactical applications in operational efficiency. The notable exception is ESG, where the survey found that approaches diverge more significantly.

Figure 5: Funds reporting a positive impact of ESG credentials on performance of portfolio companies



Source: A&M survey

For example, only 48% of North American survey respondents agree that improved ESG credentials positively impact the long-term performance of portfolio companies, compared to 62% of European respondents. The finding aligns with our experience in the ground, where we observe that PE efforts to comply and build value creation around ESG are significantly stronger in Europe than in the U.S. This reflects Europe's longstanding leadership in ESG, as the region continues to lead the way in legislation and investor appetite for ESG investments globally, while in the U.S. this agenda has backtracked more recently. That said, megafunds in North America are generally more aligned with the approach of European peers, with a higher percentage of respondents in this group acknowledging the impact of ESG, compared to those at smaller funds.

Contacts



STEFFEN KRONER

MANAGING DIRECTOR
EMEA

skroner@alvarezandmarsal.com



MARKUS LAHRKAMP

MANAGING DIRECTOR
U.S.

mlahrkamp@alvarezandmarsal.com



TILL PRINZ

MANAGING DIRECTOR
EMEA

tprinz@alvarezandmarsal.com



ANIL KUMAR

MANAGING DIRECTOR
U.S.

akumar@alvarezandmarsal.com



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