PRIVATE EQUITY PERFORMANCE IMPROVEMENT

Challenge 2025 for PE – Actions That Matter Now

"I would rather hunt the bear than the bear hunt me."

Recently, Miriam Gottfried of The Wall Street Journal wrote a well-received article about the private equity industry.[1] Her message — "Go big or get back to basics" — resonates. However, we believe that there are far more proactive steps than implied in this article that our PE fund clients in the middle market as well as the large cap funds can be taking.

For too long, private equity (PE) firms have kept underperforming portfolio companies on life support, waiting for economic conditions to improve or hoping for organic turnarounds. But 2025 is the year for decisive action. The era of patience is over — PE firms must demand accountability, implement aggressive value creation strategies, and bring the hammer down on inefficiency and failed performance improvement.

Investors' patience has been founded on the premise that there will be lower interest rates, improved supply chain stability, lower material and labor costs levels, greater global stability, labor force recruiting and retention stabilization, a tack on investment, internal merger, or some other Hail Mary. PE must conclude that issues surrounding these failed expectations will continue for the foreseeable future. PE firms must learn to aggressively remediate underperforming companies. Those that do will thrive in our new world.

The Problem: A Legacy of Prolonged Underperformance

We have found that few performance improvement programs developed in the last two years have actually been implemented. This lack of execution has compounded inefficiencies and stalled value creation across portfolio companies. Companies are accepting mediocre results.

Since the pandemic, many PE firms have been overly lenient with struggling assets, extending timelines, providing capital infusions and waiting for external factors to turn in their favor. However, macroeconomic uncertainty, tightening credit markets and rising investor expectations leave no room for passive management. Portfolio companies must either perform or be restructured—there is no middle ground. We have seen "smashco" concepts become more commonly looked at in underperformers – for example, putting two underperformers together to share the G&A. This is almost always a bad idea and a distraction from the core operational issue. The company must generate growth, margins and cash to survive.

[1] Miriam Gottfried, "The New Survival Guide for Private Equity: Go Big or Get Back to Basics," The Wall Street Journal, February 16, 2025, https://www.wsj.com/finance/investing/private-equity-fundraising-struggles-408bfe14.

The Call to Action: What PE Must Do Now

1. Drive Relentless Execution

- CEOs and leadership teams must be held directly accountable for delivering tangible, measurable results.
- Monthly performance reviews should shift from merely reporting financial results to action-driven accountability. Transparency and candidness must be embraced by the board and management.
- Non performing assets must be addressed, replaced, or restructured immediately. Time is not your friend.

2. Reassess Portfolio Strategy

- Companies that cannot achieve target performance must be considered for divestiture, or rapid restructuring. The sooner this is understood, the better it is for the investors. Denial buys nothing.
- If injecting new capital is necessary, re-diligence the business to ensure a clear path to profitability.
- Focus capital on assets that can scale and generate strong EBITDA growth.
- Exit non-core businesses and underperforming sectors—no more emotional holds. Shrink to grow is a viable strategy, allowing firms to focus on core strengths and drive sustainable profitability.

3. Demand Operational and Commercial Excellence

- Implement zero-based budgeting to eliminate inefficiencies and force discipline. Right size the company to the downside case. You can rebuild new muscle.
- Redesign supply chains, renegotiate contracts and restructure debt aggressively.
- Invest in automation and AI-driven efficiencies to drive margins upward.
- Focus on profitable businesses—customers, channels, products and segments—to drive sustainable growth.
- Develop strong Sales, Inventory, and Operations Planning (SIOP) capabilities to be nimble and effective when cost changes occur.

4. Enforce Financial Discipline

- Cash generation must be embedded as a culture into each company. Cash flow management must be the top priority for all functions within the company—debt service, liquidity and working capital require daily visibility.
- Aggressively reprice debt and manage leverage, given rising interest rate risks.
- Portfolio CFOs must act as enforcers, not spectators—real-time financial insights are non-negotiable. Deeper than that, the entire finance organization must learn to work with their operational counterparts to help drive results and provide transparency. Financial IQ must improve across the company.

5. Improve Governance and Stakeholder Engagement

- Introduce independent board members to oversee value creation or restructuring efforts.
- Ensure governance structures promote transparency, accountability and strategic execution. Ensure all committees - Compensation, Compliance, Audit - regularly meet and work toward the goals.
- Strengthen board oversight to drive disciplined decision-making and long-term value creation. More frequent interactions are likely needed, but more importantly, the Board must push to transparency and candidness of the conversation. This is more than a fist on the desk. This takes relentless focus on creating a relationship that allows for good decision making.
- Engage key stakeholders, including lenders and other financial partners, to align restructuring efforts and optimize outcomes.

The Risks of Inaction

Failing to act now will result in:

- Fewer options to resolve potentially solvable issues along with an increased financial impact of those issues and the solutions.
- Increased portfolio write-downs as financial underperformance compounds.
- Limited exit opportunities, leaving firms unable to return capital to LPs.
- Increased risks to the board.
- Competitive disadvantage, as stronger PE firms take aggressive action and capitalize on the market's hesitancy.

Conclusion: 2025 Is the Year to Lead, Not Wait

PE firms that continue to delay tough decisions will pay the price. Now is the time to bring the hammer down—demand performance, enforce discipline and drive value creation with urgency. The alternative? Falling behind in an industry where only the bold survive.

There is no viable alternative to action at this point. Only immediate, aggressive, thoughtful action is acceptable.

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