Middle Market Methods™

Value Creating Solutions in Private Equity

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www.middlemarketmethods.com jalanier@middlemarketmethods.com 770-806-8768

Next Year and Beyond!

By John A. Lanier

Introduction

Buzz Lightyear delighted us in *Toy Story* with his motto is "To infinity, and beyond!" Buzz was forward focused, but his timeframe was a bit too "out there" to appeal to private equity investors. However, Buzz was onto something that is highly relevant to the investment hold period. The pros call it "foresight."

Consider the eerie accuracy of George Orwell's *1984*. Although published in 1949, it reads like it was released last week! Then, too, Anthony Burgess' *Clockwork Orange* and John Naisbitt's *Megatrends* gave us compelling future glimpses. Crystal balls would be nice, but no forecast is flawless and no future is predestined. One practical take-away from these axioms is the wisdom of reading reputable authors whose vocation entails studying the "tea leaves" for clues that portend future possibilities. This thought segues to the purpose of this newsletter installment: the value of strategic foresight to private equity investments.

Strategic foresight is focused at least a decade into the future.

The difference between strategic foresight and strategic planning is timeframe. The foresight timing window is at least a decade into the future. So, what exactly does a decade do for an industry whose hold period is typically three to five years? The short answer: plenty. For example, Royal Dutch Shell used the technique to anticipate the ramifications of the eventual Arab oil embargo of 1974. Shell's consequent preparation competitively catapulted them to a position of strength amid an industry caught flatfooted.

Deal teams tend to be more foresighted during the diligence phase of the transaction; however, they may not recognize their routine in that context. While crafting the investment thesis, deal teams scrutinize among constants, trends, issues, and events that impact enterprise value. Accordingly, upon closure, the initial investment thesis has considered highly relevant variables over the foreseeable future. Moreover, some firms embrace the best practice of a proximal post-close strategic planning session to vest the broader leadership team with ownership of the investment thesis. The mantra is “operationalizing the investment thesis.” Relative to diligence, this process yields four interesting C’s: *confirmation* of diligence, *clarification* of diligence, *complement* to diligence, and *contradiction* of diligence. In the course of this process, the leadership team is encouraged to adopt the Larry Bossidy and Ram Charan axiom of the vital few initiatives around which execution resources are mobilized and focused.

The initial strategic planning milestone memorializes the execution roadmap. Hence, the leadership team should be off to a good start—but that only covers year one. The plan’s relevance atrophies as time introduces increasing unknowns to the operating environment. What about years two and out? To wit, the cheese moves!

Three things should—but tend not to—happen for years two and out. First, the leadership team should adopt an annual strategic planning process. Second, they should punctuate the process with specific foresight techniques. This does not double the scope of the strategic planning session. Indeed, some parts of the strategic plan need not be repeated, but rather refined.

The third thing may be viewed as mortar for the bricks of planning and foresight: horizon scanning. This should commence in the second quarter post-close and continue in perpetuity. Horizon scanning rigor routinely critiques the strategic plan relative to the investment thesis. The STEEP framework undergirds the process: social, technical, economic, environmental, and political. In short, team members should be allocated one of the categories and identify sources of information, e.g., media, to scrutinize investment thesis integrity. For example, *Wall Street Journal* opinions do a good job of translating the political into the practical. On a quarterly basis, the team should meet and review their findings to make prudent adjustments to the plan. By adopting the horizon scanning technique, the team accomplishes two critical objectives: avoiding tunnel-vision, myopia, and groupthink; and assimilating good critical thinking skills going into the next strategic planning cycle.

Foresight discipline bridges the present to the future.

The symbiotic relationship between foresight and planning begs further clarification. The typical initial two-day strategic planning off-site process should be modified in years two and beyond as follows: day one for foresight and day two for planning reflective of foresight anchoring. The reason should be obvious: longer-term foresight should affect shorter-term planning. Think of this as a lighthouse effect for navigational guidance. In preparation, attendees should: (i) review the past strategic plan, (ii) revisit the quarterly horizon scanning summaries, and (iii) read specifically targeted material. The benefit of these “homework” assignments will be clear upon encountering the foresight agenda described below:

- reviewing industry constants, trends, issues, and events;
- performing STEEP analysis on the prevailing strategic plan;
- compiling a list of critical thinking questions whose answers assuage the anxiety of execution uncertainty (Note: The questions may not have discrete answers.);
- scrutinizing the two most prominent critical thinking questions into first, second, and third order consequences;
- using Kurt Lewin's force field analysis to explore enabling and restraining forces affecting fruition of the two predominant critical thinking questions;
- developing axes of uncertainty with the Bill Ralston and Ian Wilson technique to yield four "extreme futures" (Note: Think of this in terms compass quadrants: northeast, southeast, southwest, and northwest.):
- brainstorming from the extreme futures to inventory expected, plausible, and surprise execution scenarios;
- developing leading indicators for the extreme futures that alert the team to validation and or course correction;
- assigning low, medium, and high probabilities of realizing the major components of the *existing* strategy for each extreme scenario; and
- identifying the consequent major take-aways for the subsequent strategic planning discussions.

Foresight is a value-creating differentiator.

Having digested this foresight process in day one, the team is now prepared to approach day two with insight for a robust strategic planning session. No doubt, the foresight insights will refine the major strategic deliverable priorities congruent with Michael Porter's outline: organic growth, acquisitive growth, and scalable operational efficiencies.

In summary, the benefit of planning, punctuated by foresight, enhances enterprise value. Potential suitors dislike surprises as much as private equity deal teams dislike them. Consequently, buyer diligence at the investment exit may impress the purchaser that the leadership team has steered the company in a specific direction based on a reasoning process designed to illuminate options and plot flexible approaches. Moreover, the strategy reflects perspective beyond—and not just to—the exit. Indeed, foresight may be a rigor that the purchaser has not exercised in its history, yet may be convinced to adopt!

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