MBS Intelligence

Responding to Covid-19

A new talent landscape, and a new role for private equity?

Contents

Executive Summary

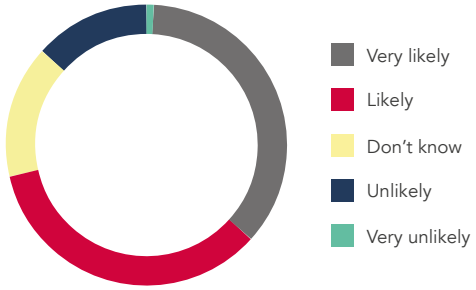
Consumer-facing businesses globally have been disproportionately impacted by Covid-19 and its fall-out. Traditionally a sector offering superior returns for private equity (PE) houses, funds are now being challenged as never before to provide additional support, guidance and – in some cases – capital to their consumer assets.

In order to better understand the specifics of how Covid-19 has impacted private equity-backed businesses in the consumer-facing sectors, during May and June 2020 The MBS Group has had conversations with partners and investment directors at more than 100 leading private equity houses investing in our sector across Europe – together with a selection of portfolio Chairs and CEOs of their portfolio companies.

With some exceptions, our discussions confirmed that most consumer businesses have faced disruption at a never-before-seen scale and severity. Despite this, however, our conversations with funds were overwhelmingly positive, largely indicating that:

- PE funds have an appetite to invest in the sector and predict high levels of innovation in the future;
- Investment Directors and Chairs have been pleased with the performance of their executive teams through the crisis; and
- CEOs feel that Covid-19 has deepened the relationship between themselves, their colleagues and their funds.

How likely are you to invest in the consumer-facing sector in the next 12 months?

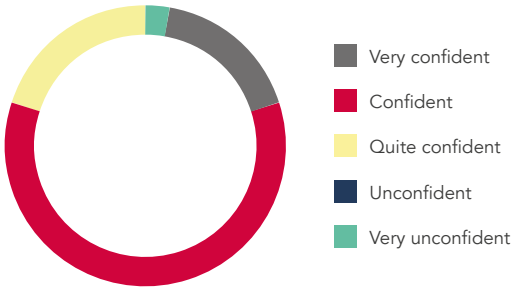


Appetite for investment

We found that a majority of private equity houses saw opportunity amid the disruption of Covid-19. 69% of funds said they were either 'very likely' or 'likely' to make an investment in the consumer-facing sector in the next 12 months. Only 3% of funds said they were 'very unlikely' to make an investment. A full sector analysis can be found on page 22, but the areas of specific interest are: digital, beauty, food and homewares. Funds have mixed opinions on the areas hardest-hit by the crisis, such as travel, leisure and retail. Many funds said they were interested in acquiring asset-heavy businesses.

Executive leadership during and beyond Covid-19

How confident are you that your current leadership team is equipped to face the long-term challenges of Covid-19?



Crises are a good test of leadership capabilities. As part of our conversations with the funds, we asked whether the executive teams of their portfolio businesses had performed well during Covid-19, and how confident they were that their current teams were equipped to face new long-term challenges brought on by the pandemic. The responses were largely positive, with 17% of funds reporting that they were 'very confident' in their executive teams and 60% reporting that they were 'confident' in their executive teams. The vast majority of Chairs also reported that their executive teams were very well equipped to guide their businesses through the next phases of Covid-19 and beyond.

Fund leadership during and beyond Covid-19

We also asked Chairs and CEOs how supportive the funds have been during Covid-19. Almost all individuals told us that their funds had been very supportive during the crisis. Almost all reported that the funds had increased informal engagement with businesses – and in particular, had given specific support to CFOs stepping in to aid with renegotiating covenants and leveraged banking relationships, and in some cases to speak to banks on behalf of businesses. A full analysis of fund leadership can be found on page 37.

Fund outlook

We asked the generalist and the consumer sector-specific funds whether they thought their outlook would change in the coming months. Given the disrupted nature of the consumer sectors, perhaps somewhat unsurprisingly, we found that generalist funds predict that their activity in the consumer-facing sector will likely decrease as a direct result of Covid-19, and they will shift their attention to other sectors. However, none of the consumer-focused funds we spoke with indicated that they will diversifying out of the sector and into other industries.

Private equity investment over the past five years

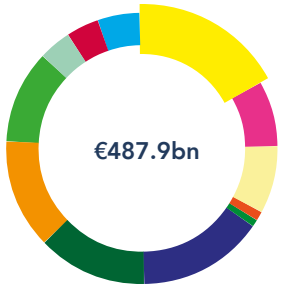
Covid-19 has significantly disrupted the private equity sector. Pre-crisis, however, the European private equity market enjoyed a period of growth between 2014 and 2019.

Looking back across most sectors, the European private equity market has been buoyant over the last five years. Activity reached a peak in 2018, surpassing 2007's record levels with 2,168 deals worth a total of €262bn. Since 2018, transaction volume and value has edged down slightly – and at the beginning of 2020 (before the full impact of Covid-19 had been felt in Europe) a PwC survey found that private equity investors were still overwhelmingly positive about future investments in Europe.

The last five years have also seen a change in private equity management style, as funds ensure value by putting more emphasis on portfolio engagement, creating long-term, sustainable partnerships with portfolio businesses. Indeed, this has been amplified over the last few months as funds have leveraged their capabilities to guide their businesses through this crisis.

European private equity investment over the past five years

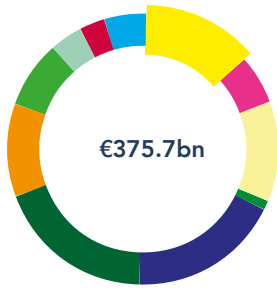
European buyout value, split by industry: 2014-2017



- Consumer / Leisure 17%
- Transportation 4%
- Construction 4%
- Real estate 5%
- Finacial services 8%
- Pharma, medical and biotech 8%
- Agriculture 1%
- Defence 1%
- Industrial chemicals 4%
- TMT 13%
- Business services 13%
- Energy, mining and utilities 11%

Figure 1 source: Private Equity Trend Report: PwC Study 2020

European buyout value, split by industry: 2018-2019



- Consumer / Leisure 13%
- Transportation 4%
- Construction 3%
- Real estate 5%
- Finacial services 6%
- Pharma, medical and biotech 12%
- Defence 1%
- Industrial chemicals 18%
- TMT 19%
- Business services 11%
- Energy, mining and utilities 8%

Figure 2 source: Private Equity Trend Report: PwC Study 2020

Compared with other sectors, consumer-facing businesses have seen a fall in private equity investment in the last five years. According to research undertaken by PwC, the consumer-facing sector represented 17% of European consumer buyout value between 2014 and 2017, and 13% between 2018 and 2019. Despite this, however, the same report showed that 46% of private equity firms in February 2020 said they were looking to invest in the consumer sector in the next two to three years.

Private equity activity in the UK's consumer-facing sector

Year	Volume of transactions	Value of transactions (£)
2015	36	13.05bn
2016	25	11.38bn
2017	38	6.35bn
2018	43	19.98bn
2019	34	19.94bn

Source: MBS research

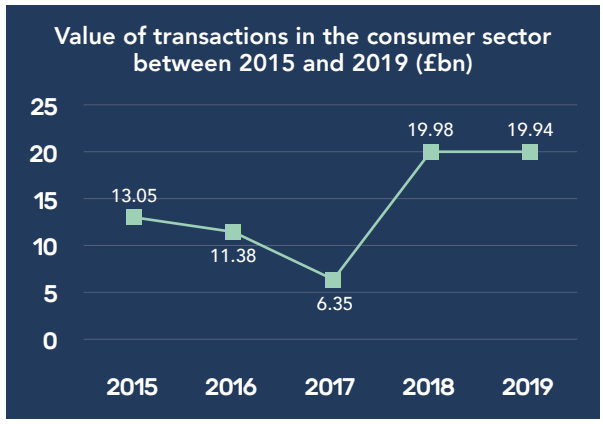


Figure 4 source: MBS research

Over the last five years, our analysis shows that the value of UK transactions has increased in the consumer-facing sector, in part driven by a small number of large deals in 2018 and 2019.

In 2018, for example, Silver Lake acquired the property marketplace Zoopla for £2.2bn and Siris Capital bought a stake in the travel commerce platform Travelport for £3.1bn. In 2019, Blackstone's £4.5bn acquisition of the Madame Tussauds and Legoland owner Merlin Entertainment boosted transaction value significantly.

Sub-sector analysis

The graphs below indicate the distribution of private equity investment within the consumer-facing sector in the last five years. Key areas of interest have been hospitality, travel and leisure (HTL), internet and commerce, retail, food and drink and fashion.

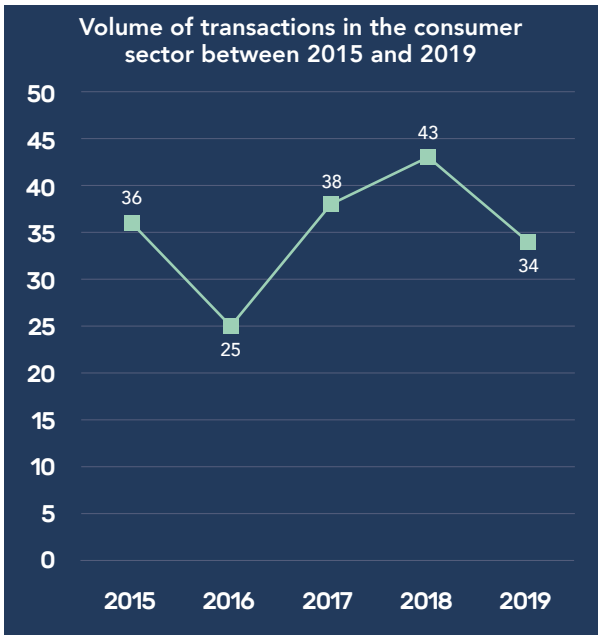


Figure 3 source: MBS research

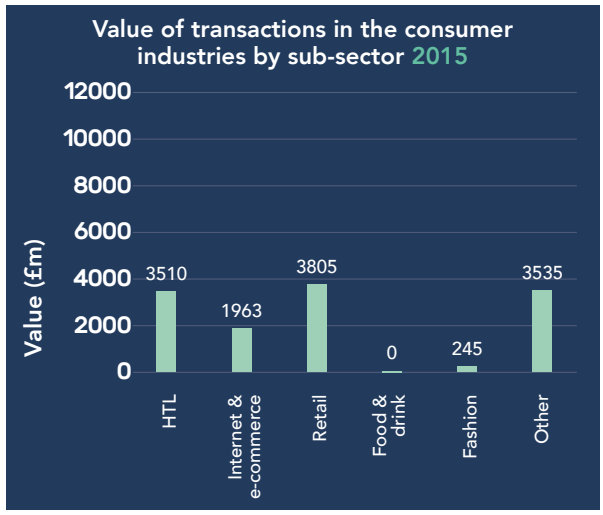


Figure 5 source: MBS research

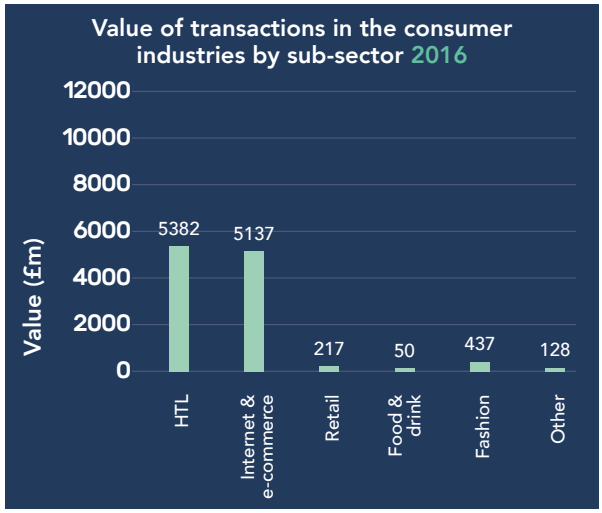


Figure 6 source: MBS research

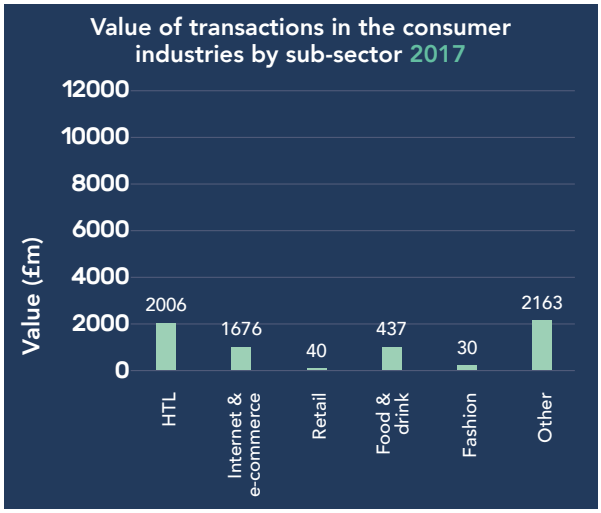


Figure 7 source: MBS research

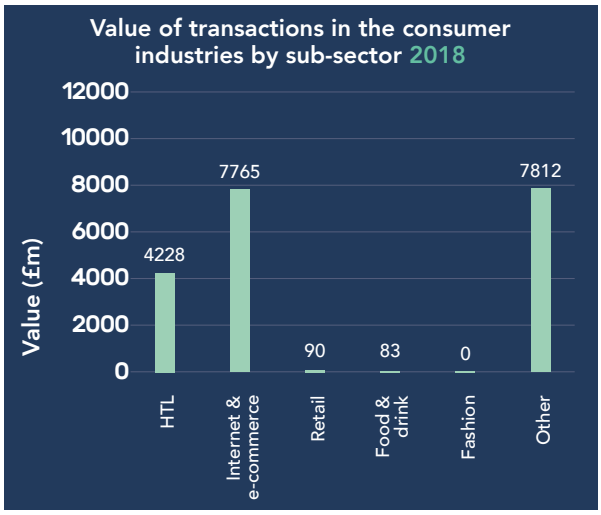


Figure 8 source: MBS research

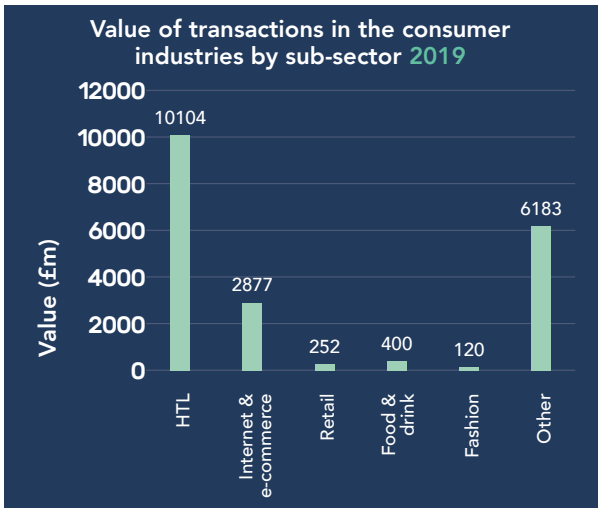


Figure 9 source: MBS research

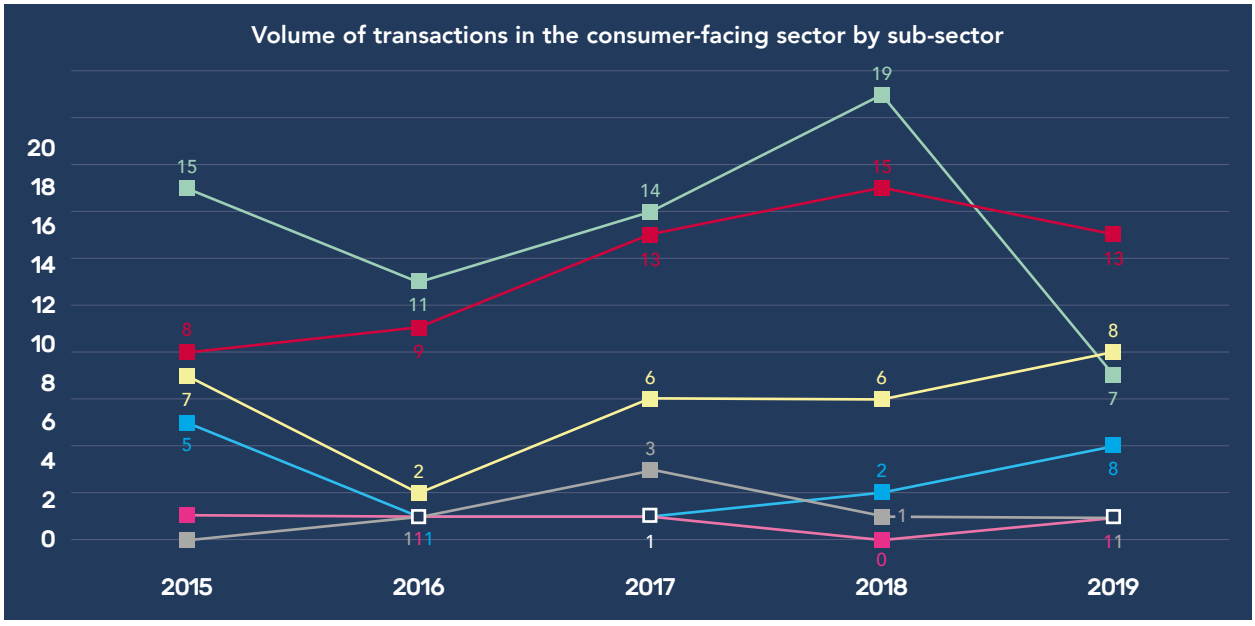


Figure 10 source: MBS research

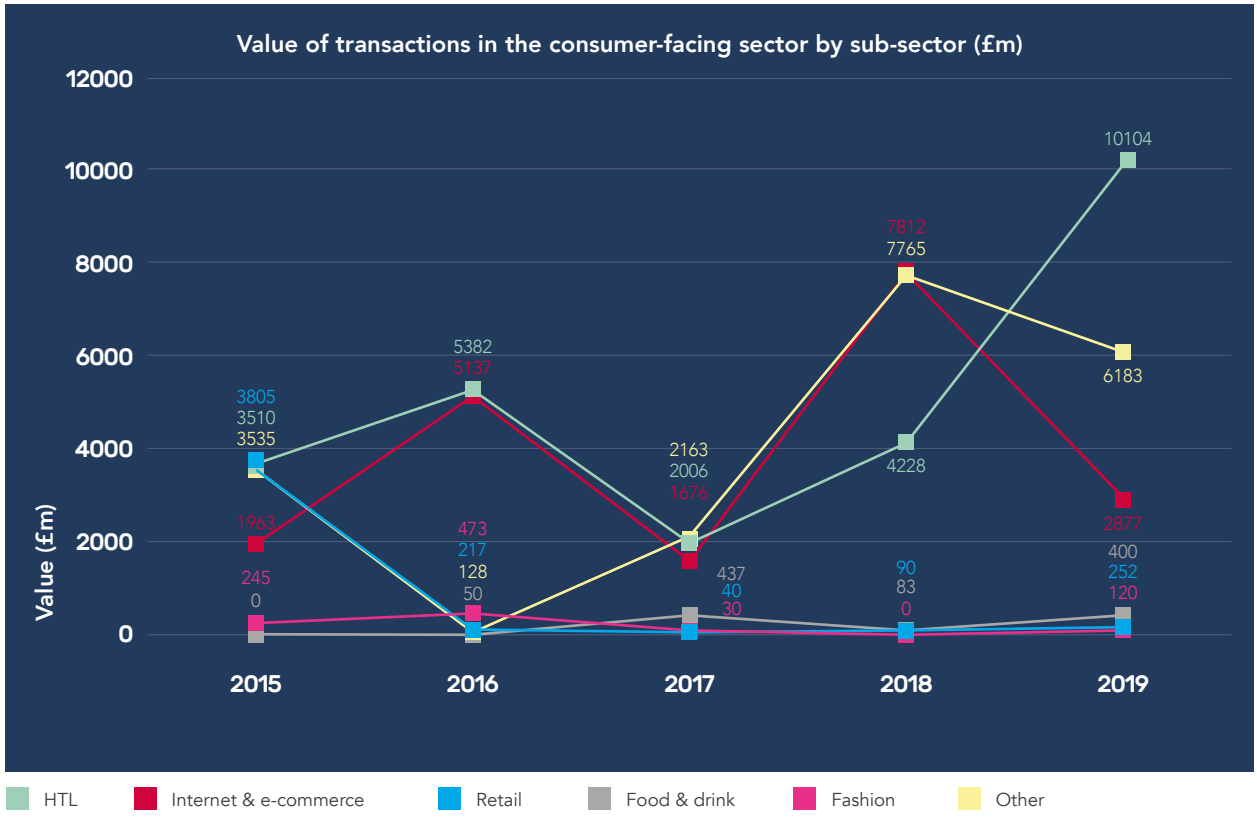


Figure 11 source: MBS research

Spotlight on digital

Over the past five years, digitally-focused private equity investments have increased at pace. In 2015, 22% of all UK deals in the consumer-facing sector were in internet and e-commerce businesses. By 2019, however, that figure had risen to 34%. Staggeringly, our research has shown that, of the consumer-facing transactions made so far in 2020, 77% have been in the internet or online retail space.

Shifting trends in HTL

Hospitality, travel and leisure have been a core area of investment for UK funds in the last five years – with a gradual shift over this period from casual dining-focused assets to more experiential leisure.

Between 2015 and 2017, for example, 40% of all UK private equity transactions were in leisure businesses. The casual dining space was particularly active in this period, and there was a flurry of activity including investment in high street chains Leon, Cote and YO! Sushi. Additionally, during this period, holiday parks such as Park Dean and Forest Holidays were of particular interest.

In 2018 and 2019, by contrast, fewer deals took place in the HTL sector (just 33% of all consumer-facing transactions), but value continued to increase. Blackstone's £4.5bn (re-)acquisition of Merlin Entertainment was the highest-value deal that year.

Geography

Over the last five years, across all sectors, we have seen a concentration of European private equity investment and interest in the GSA (Germany, Switzerland and Austria) region. From our discussions with multiple funds, Germany looks set to continue being a region of specific interest over the coming years.

In the UK, the exit from the EU had an impact on UK's attractiveness to foreign markets. When asked in 2019, six out of ten financial investors said that Brexit has made the UK less attractive for private equity investments. On the other hand, almost a third said that Brexit had increased their interest in other European countries.

Private equity funds with consumer-facing assets across Europe

MBS

KSL CAPITAL PARTNERS
CATTERTON
Langholm CAPITAL
LDC
LEAPFROG
LGP
LGV
Lightspeed
LION CAPITAL
LIVINGBRIDGE
LONE STAR FUNDS
Lovedale Capital Partners
MACQUARIE
MARGAN
MAVEN
MAYFAIR
MCI
MIDOCEAN
MILESTONE
milestone investisseurs
MIMIR
MML
mobeus
Montagu
MOTION
NAVIS
NB AURORA
NEUBERGER BERMAN
nsr new silk route
nimbus
Nixen
NORDIAN
NORTH CAPITAL
NORDSTJERNA
NORTH COVE PARTNERS
NORTH EDGE
Northzone
NOVA
NOVATOR
nvm
OAK HILL CAPITAL
Oakley Capital
OAKTREE
octopus ventures
OMERS Private Equity
OMNES
ONEX
OpCapital
OPENGATE CAPITAL
PAI PARTNERS
PAINE SCHWARZ PARTNERS
Palamon Capital Partners
Palatine
PALLADIUM
panorami
parcom capital
Partners Group
PATRICIA INDUSTRIES
PATRON CAPITAL PARTNERS
penta
PERMIRA
PERSEUS
PERWYN
PHD Equity Partners
Phoenix
PIPER
PLATINUM
Platform Equity
POLLEN STREET
PRIMARY
PRIMEVENTURES
PROMETHEAN INVESTMENTS
PROVIDENCE EQUITY
PSP Investments
Qualium
QUILVEST
RBS
Rcapital
Redpoint
REV
RHÔNE
RISK CAPITAL PARTNERS
RIVER STONE
RJD partners
ROARK CAPITAL GROUP
ROCKPOOL
RUTLAND
SAPPHIRE PARTNERS
SCF PARTNERS
Scottish Equity Partners
SEARCHLIGHT
SEQUOIA
SILVERLAKE
silverfleet capital
SIRIS Capital Group, LLC
SOFINA
Soulet
SOVEREIGN CAPITAL PARTNERS
SPECTRUM EQUITY
Spring Capital
STAGE CAPITAL
STAR Capital
STARWOOD CAPITAL GROUP
stellex
STONEPEAK
STRACO
SUMMIT PARTNERS
SUN CAPITAL PARTNERS, INC.
SPC
SYCAMORE PARTNERS
SYNOVA CAPITAL
TA ASSOCIATES
TDR Capital
ONTARIO TEACHERS' PENSION PLAN
TCV
TEMASEK
Tengram Capital Partners
TENZING PRIVATE EQUITY
terra firma
THE CARLYLE GROUP
TCG
THE JORDAN COMPANY
The Tucapia Company
THCI
TO
TORREA
Total Capital Partners
TOWERBROOK
TPG
TRISPAN
True.
TRUSTBRIDGE
TSG CONSUMER
UBS
Vespa Capital
VISIO CAPITAL
VITRUVIA
Webster Equity Partners
WestBridge
WHITE PINE PARTNER
Yoo Capital
VFM Equity Partners

Appetite for future investments in the consumer-facing sector

This is a unique time for the consumer sector and the private equity funds which invest in our industries. With economic downturn, the acceleration of key consumer trends and the overhaul of entire sub-sectors, there is opportunity for funds to capitalise.

"We're about to see a real concentration of winners and losers"

Since the start of Covid-19, businesses across the consumer-facing sectors have needed to evolve dramatically and speedily to remain viable. Supported by government loans and subsidies, they have significantly reduced their cash-outgoings, overall cost infrastructure – and in some cases, been able to pivot propositions to ensure relevancy through the crisis. With some exceptions, nearly all businesses in our sector will emerge from the lockdown periods with more debt, less cash and reduced future cash flows – which of course makes them vulnerable to forced changes in equity or debt ownership.

However, a recent report from Deloitte suggests that private equity funds will have an integral part to play in the eventual rebuilding of the consumer-facing sector and our economy. Other than governments and central banks – both of which are already bailing out struggling businesses – very few entities have the funds needed to guide businesses through this period of economic difficulty. "In short," reads the Deloitte report, "private equity funds often invest when so many others are afraid to act."

In order to paint a true picture of the current appetite for investment, we spoke to more than 100 funds operating in the consumer-facing sector. We found that a significant – but not overwhelming – number of funds are open to making investments in the consumer-facing sector in the next 12 months.

We found that:

- 69% of funds said they were either 'very likely' or 'likely' to invest in the consumer-facing sector in the next 12 months
- Only 3% of respondents said that it was 'very unlikely' that they would make an investment

The following section explores the themes that emerged in our conversations with these 100+ private equity funds, and provides an analysis of interest in different areas of the consumer-facing sector, and the motivations and strategy of the funds.

Opportunity amid the disruption

Most of the private equity funds we spoke to confirmed that Covid-19 has not lessened their appetite for investment in the consumer-facing sector.

It appears we are witnessing multiple waves of investment activity. The first wave, which took place at the outset of the crisis, included businesses looking to raise cash after precipitous reductions in revenue. For example, one fund told us that it was in conversation with a business it highly regarded pre-Covid-19 as they simply needed a rapid injection of cash to pay salaries – and had already exhausted traditional lending channels.

The second wave, which will span a longer period, will take place as companies restructure, and private equity funds look to capitalise on new consumer trends – and businesses are forced to rebalance their capital table to bring new cash into the business. Many PE funds reported that now companies had restructured, and taken cost out, several assets were now materially more attractive. In particular, they highlighted businesses that were either asset backed, or had the possibility to disrupt themselves through digital channels or product innovation.

Through our conversations with private equity funds, a number of key themes emerged around the considerations and motivations of investors during this time. Funds are having to juggle competing priorities, investing significant energies keeping their existing portfolio businesses robust, while simultaneously watching the market for windows of opportunity. As one fund articulated: "*we are having to play offence as well as defence*."

In this section, we provide a snapshot of how Covid-19 has impacted the long-term investment plans of private equity houses in the consumer-facing sector.

Portfolio is priority

One theme that reoccurred throughout our conversations was that funds across the industry are prioritising their current portfolio before seeking new investment opportunities. We have seen funds increase their packages of support and escalate their engagement with portfolio companies, providing leadership support, financial aid and business advice. A full analysis of fund leadership during Covid-19 can be found on page 37.

Assessing the market through the lens of Covid-19

Taking a step back, many private equity houses have been watching the crisis unfold with interest, using the pandemic as an indicator of resilient brands, strong leadership teams and lasting consumer trends.

One specialist consumer fund commented: "*the economic shock has accelerated the various trends we've been tracking, and we're about to see a real concentration of winners and losers. With this in mind, we see lots of upcoming opportunity.*"

For private equity funds, companies that demonstrate agility, creativity and strength in responding to the crisis are well-equipped to thrive in a post-Covid-19 world. It is these businesses that are of interest.

Indeed, a conversation with one Chair revealed how aware businesses are of investors paying attention to their crisis management. He commented: "*the first question anyone will ask before investing is: show me your case study for Covid-19. They'll want to know what happened, how your company was impacted, what you did and how you stayed resilient. So I'm telling all of my businesses to capture their decisions and consequences and track learnings. For the next two or three years, investors will be asking: how did you cope during that crisis?*"

The crisis is also allowing private equity funds to reassess their pipeline of investments, and watch consumer trends. One fund told us that it is no longer interested in assets it had been looking into five months ago, saying: "*many of the interesting features of businesses are being put to the test during this time. It's very valuable to sit back and watch.*"

Another reoccurring theme in our conversations with investment funds was an awareness of not being opportunistic. *At the* height of the pandemic, it would have been fair to think that a surge in healthcare and pharmaceuticals would be on the cards. However, PE funds told us that they would not be swooping in on short-term trends without thinking about the organisation's suitability to their long-term goals and how it compliments their existing portfolio and expertise. One Chair noted this, commenting: "*I think we should be cautious of deals being contrived for the sake of it rather than for sustainable quality.*"

"We will definitely be taking some time to understand the current climate before we commit"

Playing the waiting game

Most funds are not set on immediate activity. Almost every private equity house told us that they will be waiting some months until they make any investments, holding off until the dust has settled and there is greater visibility around the long-term impact of Covid-19. After all, it is very difficult to value consumer assets at this point – value is a function of projected free cash flows, and there is no real way of quantifying what future revenues, at least over the next one to two years, might be.

Moreover, there is very little appetite among those with valuable assets to sell at this point. One fund articulated this, saying: "*anyone who owns a half-decent asset that isn't under pressure is going to sit on it for a while. If you have any flexibility – now is not the time to sell.*" Discounting distressed investments, therefore, we may not start to see new high-value transactions until towards the end of 2020 and early 2021.

Assets are adjusting in value very quickly as the picture forms of what our 'new normal' will look like. PE funds, both specialist consumer and generalist, are having to hold off and predict which businesses will be of value in the future.

One fund told us that it was delaying making investments until it could assess the impact of global macrotrends around unemployment and economic recession: "*there are an extra 2 million people unemployed in the UK, and extra 2.5 million in the US. These sorts of things have ripple effects so we will definitely be taking some time to understand what this will do to the economy before we commit. But we want to be in a scenario where we can accurately assess businesses on their EBITDA.*"

Valuations

Covid-19 is set to have a long-term impact on valuations of businesses in the consumer-facing sector. The economic fall-out of the pandemic will be felt for decades to come, as whole sectors are shut down, and there is scarcely a consumer business not predicting lower revenue, at least in the coming years. However, there are a number of associated complexities with accurately calculating valuations at this time.

Firstly, it is almost impossible to make a precise valuation in the current economic climate. For businesses with severely disrupted cash flow, forecasting revenue and EBITDA for this year (and indeed, the next two years) is almost impossible, making it exceedingly difficult to price-up assets.

While this process is easier in subscription-based businesses that have a reasonable share of their revenues in reoccurring subscriptions, private equity funds are, in the main, having to judge value on current consumer sentiment.

Furthermore, setting valuations at this time can challenge the relationship between businesses and their potential investors. One generalist private equity house told us that this was one of its predicted roadblocks in the coming months: "*there is a challenge in bridging the gap between founders and investors. It always takes a little bit of time for founders to get their head around the fact their company just is not as valuable as it was four months ago.*"

Moreover, businesses often receive pressure from their boards to not entertain lower offers. One fund explained this: "*if you're a Chair or on a board, you're not going to accept that just because your stock is down 3% it is time to entertain an offer of negative 30 or negative 20. In time, however, they will probably come to terms with the new reality and reset expectations.*"

Despite these complexities, there is no doubt that assets in the consumer-facing sector will be trading at lower multiples. We have already started to see this play out. At the beginning of May, for example, KKR bought a majority stake in the US multinational beauty company Coty for $3bn, a figure well below what Coty was valued at before Covid-19 forced their major channels, in particular nail and hair salons, to close.

Our conversations revealed that funds across the board are attempting to draw distinctions between businesses that are momentarily dipping in value and those that are experiencing a long-term downward shift.

Some funds reported that they did not anticipate buying assets at lower prices at all. One fund explained: "*if a business is going to continue to be a sought-after commodity in the future – even if it is disrupted now – there's no real reason why a valuation would shift.*" Another fund agreed: "*there is still an unprecedented amount of dry powder. I think quality assets will still trade at pretty heavy prices.*"

What funds are looking for: purpose and strong EBITDA

Almost all funds we spoke to indicated that to be a viable potential investment opportunity, businesses must have been fundamentally stable before the crisis. This notion even extends to the funds specialising in distressed investments. One fund, known for specialising in underperforming assets, said: "*our thinking is that we're not going to invest in a business that is – or was – struggling. Practically this means we're no longer looking at the retailers we've been looking at for the last five years – why bother when you can have really good businesses?*"

Specifically, most funds we spoke to are looking to support organisations feeling the impact of Covid-19 – not 'turnaround' businesses that were struggling pre-February 2020.

One private equity fund articulated this: "*the direction of policy – when lockdown restrictions are lifted business start to recover – will be to look at perfectly good businesses which were performing well pre-Covid and, provided our assessment of the macro is positive, we'll help them repair the balance sheet.*"

As such, almost all PE funds were looking to help repair the balance sheet of businesses that had a strong EBITDA before the crisis.

One global investment fund told us: "*we're following a particular investment strategy geared around buying good businesses which were beneficiaries of the trends out there, rather than buying distressed assets which have become casualties at bargain prices and trying to turn them around.*"

Almost exclusively, the funds which are looking to invest in the consumer sector are seeking companies with a proven business model, and a strong purpose. In our conversations with funds, we very often heard phrases such as: "*we will not compromise on quality,*" and "*purpose remains a high priority*".

Covid-19 has increased the visibility around an organisation's purpose, its CSR activity and how it responds to crises in terms of its people and its colleagues. Going forward, it will be interesting to see if 'purpose' does indeed play a role when a fund considers investment opportunity.

What funds aren't looking for: distressed investments

The consumer-facing sector already has a number of distressed businesses in need of immediate cash injections. However, our conversations have revealed that most PE funds are not interested in these distressed acquisitions unless the asset aligns with their long-term goal. One fund commented: "*the key is to overlay great opportunities in distressed investments with the potential longer-term trends that will come out of this. That's the tension that's informing our investing.*"

Most funds posited that if a business is distressed now, it is indicative of its overall position in the market. "*There are so many small businesses that are going to be distressed – and it just proves that no one needs them. I think there are going to be many more administrations like the retail collapses we've seen… and ultimately, I don't think that's a bad thing.*"

Another fund agreed, commenting that Covid-19 has simply accelerated the downward trend for previously struggling businesses. "*If you look on Debtwire, the number of businesses appearing as distressed is increasing day-by-day since Covid-19… but they're all very familiar names that were frankly distressed anyway.*"

Despite these views, we are seeing global funds raise capital for distressed investments. Bain Capital Credit closed a new distressed debt and special situations fund in June, with more than $3.2bn in commitment. Jeff Robinson, one of the fund's managing directors, commented on the opportunity at hand, saying: "*on the distressed side, in any 10-year period, there are maybe two great years to be a distressed investor, and we're in the midst of those two great years.*"

New interests: physical assets and debt

The types of investments that funds are looking to make are changing.

Firstly, of those funds looking to make strategic investments in businesses during and beyond Covid-19, there is a particular appetite for asset-heavy companies. Companies are no longer being assessed on a balance sheet and cashflow basis, but instead on the value of their assets, like infrastructure, inventory and freehold property.

For example, there is now increased interest in businesses that are property heavy, such as hotels, pubs and restaurants – where the opportunity exists to possibly repurpose assets if needed as a response to the 'new normal'. Multiple funds also expressed interest in commercial real estate, which can be repurposed and turned into 'dark kitchens' for food delivery businesses or mini-warehouses for e-commerce companies.

Furthermore, several of the funds we spoke to indicated that – at least in the short term – where their fund allows, they would be making debt rather than equity investments in the coming months. One fund, which specialises in distressed investments, said: "*the buy in to the debt of some of the pubs operator / owners or hotel groups could be quite interesting. That's probably the space where I see capital being deployed over the next months.*"

Another agreed: "*as a fund, we have moved away from quality assets and are looking at more debt-like investments than equity-like. It's currently much safer to lend money to businesses thanks to the protection there versus equity investing, because you're the first to be repaid or you have some asset protection. We don't want to be in a position where we've taken over equity but then the business is looking into a black hole of losses.*"

Geography

Covid-19 has changed the way that private equity investors look at foreign markets.

In Europe, some funds are still viewing the continent as a single entity, while others reported that Covid-19 has sparked a new approach of handling each country on a specific case-by-case basis. It seems to be UK-centric or US-based funds who suggest the former, and pan-European organisations who are seeing discrepancies.

"Europe is reasonably co-ordinated," one fund told us, while another posited that Covid-19 had actually *"levelled the playing field,"* suggesting that *"now everywhere has the same degree of interest."*

Larger funds with more of a presence in Europe are taking a different view, however.

"American investors who see Europe as one country are going to be hugely disappointed," one fund told us, *"because there is such divergence between how governments have reacted and how economies have fared."*

This will inevitably impact valuations between markets. A European-focused private equity house confirmed this: *"if you've got two businesses with the same profitability, the same calibre of management team and same amount of government funding… but one was in Italy vs. Germany – you'd get a 20% discount on the Italian business just because of the state of the economy."*

Indeed, the German market is of particular interest to investors. Germany's economic downturn has so far been less severe that France and Italy, shrinking by 2.2% compared to the overall eurozone economy which shrank by 3.8%. However, while this puts the region in good stead for investment activity, more than one fund expressed that the small scale of the German leisure market (particularly the experiential-focused arena) would be a challenge going forward.

One fund told us that they were particularly interested in Asia, as the region is in the farthest-along stage of the pandemic. It will be interesting to see whether European-centric funds reorient themselves towards Asia in the coming months.

Post-Covid-19, we can expect to see more foreign investments taking place globally, as funds seek to scatter their line-up of brands geographically. One fund explained that this strategy had already paid off, suggesting that geographic diversity brings security because multiple assets are not impacted by regional events or local downturns at the same time. Moreover, this trend will likely be fast-tracked as funds realise that they can manage businesses remotely.

The 'view' on the UK is still evolving – with future government interventions, and indeed, the eventual impact of Brexit, likely to play a significant role in setting the valuation of UK-centric assets.

Sector analysis

Our conversations with funds have provided a snapshot of private equity appetite within the different areas of the consumer-facing sectors, and how different PE-backed businesses have performed across the industry during the crisis.

Firstly, it is worth noting that Covid-19 has served to accelerate existing underlying consumer trends – for instance, exacerbating pre-Covid-19 challenges in the casual dining sector, driving digital innovation and widening the gap between traditional and forward-thinking retailers. In the most part, therefore, PE funds that have been operating with these trends in mind have been less affected by Covid-19, as with funds who have a digital-heavy portfolio, for example.

However, in some instances, luck has had a role to play. We heard from one fund which has profited from a recent investment in the healthcare sector supplying a drug useful in Covid-19; and another that had acquired a sex toy company where demand grew exponentially during lockdown. Regardless of sector, funds with investments in 'essential products' such as food or maternity wear have fared well.

Most appetite for investment going forward appears to be in the following sub-sectors.

"We used to look at digital as a significant growth engine. Now, it's a vital part of survival"

Digital

Covid-19 has fast-tracked digital transformation at an extraordinary pace. Across the sector, we have seen businesses race to adopt online revenue streams and digital-natives enjoying significant commercial success.

This is especially true in speciality products, where consumers have continued to purchase at the same rate but moved online. One private equity fund told us that one if its portfolio businesses, a digitally-native skincare brand, was enjoying sales up 400% during lockdown.

It is therefore unsurprising that a key area of interest for PE funds is digital. PE funds across the board are looking for opportunity within the digital sector, or else citing a strong digital proposition as a requirement for any possible investments. One private equity fund commented that: "*we used to look at digital as a significant growth engine. Now, it's a vital part of survival.*" Another agreed, and told us that it was *"reframing its whole portfolio towards robust and digitally-led businesses."*

Perhaps most notably, the entire sector has experienced a boom in e-commerce , with entirely new demographics moving online to shop. In April, the Office for National Statistics reported that e-commerce sales had reached a record high, accounting for just over 30% of all retail sales, and Covid-19 is expected to have added £5.3bn to the UK's e-commerce sector by the end of the year.

E-commerce has been especially strong in specialist products and heritage brands. One fund, which is behind a heritage footwear brand, told us that demand had not decreased through lockdown – rather online sales rocketed as customers were just accessing the product via another channel to stores.

It is therefore no surprise that private equity houses are gearing future investments towards digital businesses, and e-commerce in particular. We have already seen evidence of private equity activity in this space. At the beginning of the crisis, Blackstone agreed a £120m deal to buy a portfolio of logistics sites, predicting a post-Covid-19 boom in online retail.

The move towards online shopping is not new. Like many areas of interest – such as sustainability and CSR – Covid-19 has served to accelerate existing trends. One private equity fund compounded this point: "*e-commerce, I think, will come out of this looking pretty good. I think it will just accelerate the structural shift that's been happening for a while.*"

More than one fund told us that, anecdotally, they had heard of private equity funds entering the e-commerce market for the first time in the wake of Covid-19, predicting a permanent online migration.

Others are looking to invest in traditional businesses and guide them through a digital transformation. One private equity house explained: "*it would be feasible to roll up a few of these traditional brands and make them digital. If you have the team and the playbook, you can buy the brand, the IP, the product and the inventory and create a digital front-end. That way, you don't have to build the brand or establish the products yourself.*"

Food delivery is another area where we can expect activity. Most predominantly, private equity funds expressed interest in acquiring property assets from businesses such as hotels, pubs or commercial real estate companies, and repurposing them to make 'dark kitchens' for restaurants to use to serve customers digitally.

Beauty and personal care

The global beauty industry has been historically resilient, and our conversations with private equity funds confirmed that there is still appetite for investment in this area of consumer goods.

Indeed, we can look to China for evidence that the beauty sector will fare well in the face of the crisis. According to a recent report from McKinsey, the Chinese beauty industry saw sales dip by up to 80% in February compared with the 2019 – but only 20% by March, a rapid rebound given the circumstances.

Our conversations with CEOs of beauty businesses and PE funds operating in the beauty space affirmed this view.

Funds with portfolio beauty businesses told us that they had been minimally affected by the crisis, thanks to the acceleration of the macrotrend towards wellness and selfcare during lockdown. In particular, those with businesses in they hygiene, skincare or bath-and-body categories had performed well.

As salons closed, the demand for DIY hair and nailcare products also increased. In the US, the consumer insights organisation Neilsen reported a 23% rise in hair dye and a 166% increase in hair clippers.

In the UK, online sales of prestige-brand nail polish have seen double-digit growth every week since lockdown began in March, sparking analysts to suggest that nail polish is Covid-19's iteration of the 'lipstick effect' (the principle that people see lipstick as an affordable luxury, and sales will stay strong, even in times of duress).

There has also been a move towards hygiene-related products, with many multinationals and independent businesses alike scrambling to meet the sudden demand for hand sanitiser. One fund, which owns a fragrance company, recalled the intensity of the first few weeks of the crisis, when the business was simultaneously preserving cash, managing its inventory but also creatively driving its top-line towards the development of an anti-bacterial product.

Overall, we can expect to see beauty remaining a key area of interest in private equity, but with a renewed focus on digital capabilities, wellness and brand.

One fund told us that: *"I think right now, for me it would be difficult to invest in a traditional beauty brand that doesn't have real strengths in digital."*

Travel, leisure and hospitality

Covid-19 has had perhaps the most severe impact on the travel, leisure and hospitality sectors. As lockdown took hold, businesses were forced to close their entire estates, bringing in zero customers and generating no revenue.

In restaurants, for example, some funds see Covid-19 as the beginning of the end for the sector, showing no interest in investing in this area. Especially as social distancing measures look set to stay in place for quite some time, restaurants will be operating at 50-80% occupancy while fixed costs remain the same, meaning a much slower recovery curve than other sectors.

"I think some of these restaurants will never open up again," one fund told us. *"The numbers just don't make sense: their growth has been predicated on getting more and more people to spend discretionary cash with them. The occupancy of tables needs to be high for them to turn a profit. Even operating at 70-80% capacity won't be enough for a lot of restaurants."*

A few funds reported that they felt the UK government had not offered sufficient support, with one suggesting that "*the government hasn't really grasped what seasonality means for businesses in the sector.*"

Others, however, are more positive – suggesting that Covid-19 has just accelerated existing trends: "*this is the start of a much longer shift,*" one fund said, "*away from casual dining and towards more creative concepts.*"

Indeed, the restaurant sector is likely to go through a significant overhaul in the coming months, with the adoption of digital tools to serve customers on- and off-site more easily. Moreover, as greater numbers of people work from home and city centres become less populated on a day-to-day basis, we can expect to see businesses choosing more residential locations for their sites. Amid all this change, some funds see opportunity. One fund said: "*demand is sure to return in the restaurant sector – and brave investors will seize that opportunity.*"

Another fund told us that it was looking closely at fine dining restaurants, and weighing up whether it would be a quick area of the industry to bounce back.

The leisure sector has also experienced a drastic hit from Covid-19. After years of rapid growth, and the emergence of new, experience-led concepts, it will be interesting to see the long-term impact Covid-19 has on the space. One fund told us that they were no longer interested in investing in leisure, despite spending years looking into businesses such as festivals, crazy golf and escape rooms. "*Despite taking a very evident share of wallet in the last few years,*" the fund said, "*it is just too difficult to predict the speed of recovery for businesses like this.*" One fund took the opposite view, expressing interest in the sector and positing that "*people will still want to be spending money on small ticket leisure. I'm pretty sure of that.*"

Moreover, many funds indicated that travel was also no longer an area of interest, citing a sharp decrease in international business travel which will hurt the sector. Anecdotally, many of the funds we spoke to told us that their businesses were revaluating their own travel policies, and realising that productivity can be achieved without extensive travel.

One fund said: "*there are going to be lasting changes in travel and hospitality. Selfishly speaking, I usually travel to New York once a month – but I'm realising I can have the same meetings just as efficiently through Zoom. That way, I save the company money, and when I do go to New York I can spend quality social time with the teams over there without having to rush back.*"

However, other funds took opposing views of the travel and leisure sector, suggesting that the disruption will breed innovation. One fund told us it was currently examining the travel and leisure sector, seeing opportunity in businesses which are pivoting creatively and new concepts emerging from the crisis.

Retail

The retail sector has been one of the most visible sectors throughout Covid-19, with essential retailers rallying together to keep the nation fed and non-essential retailers ramping up their online proposition in an effort to keep trading.

But the sector is under more pressure than ever before. In May, the UK's lockdown brought retail footfall down by 80% year-on-year, and even as non-essential retailers reopen their doors, the BRC predicts that the sector will not see sufficient uptick for quite some time. In terms of subsectors, fashion and general merchandise are likely to be struggling the most. In fashion specifically, businesses are currently having to cope with billions of pounds worth of out-of-season, unsold stock.

Throughout our conversations with private equity funds, we found that PE-backed retail businesses performing well during Covid-19 all had one thing in common: strong digital capabilities and an omni-channel approach. This will most certainly inform future investments, with one fund telling us that they would only invest in a retailer with an "*innovative and established digital presence.*"

Most private equity funds told us that they had little interest in activity in the retail space. One fund, which has a number of portfolio retailers, told us that the current climate is too difficult for future investments in the space, and that it will be looking to other sectors instead.

Many funds expressed that their disinterest has more to do with the wider retail backdrop than Covid-19, suggesting that the pandemic has served to accelerate the decline of traditional retailers and widen the gap between new and old ways of shopping. "*This might be step-change for retail,*" one fund said. "*Hopefully this will drive innovation away from boring shop fronts and force businesses to rethink their retail concepts.*"

Another fund confirmed this, telling us that it would consider investing in retail, but only if the businesses had a unique proposition: "*I would stay away from middle of the road retailers. Either you're good at convenience price and service volumes – or you stand for something specific, you live by your values and you build a relationship with customers based on service and support. Anywhere in between those two ideas and you are lost.*"

Healthcare

The threat to health posed by Covid-19 has accelerated the conversation around consumer healthcare. While some funds indicated that they felt engaging in this space would be short term and opportunistic, others identified the consumer healthcare sector as a future key strategic area.

One fund told us: "*we are very interested in the healthcare space. Looking ahead, I think there's going to be a much greater focus on anti-obesity and I think the group that were previously not engaged or interested at all in healthcare are going to suddenly be looking up after this.*"

Specifically, digital businesses in the healthcare sector have performed well throughout Covid-19. Peloton sales, for example, have jumped 66% during lockdown as people find alternative ways to keep fit at home. We have already seen some private equity activity in this area: in June, L Catterton invested in the Swedish online rowing business Hydrow.

Similarly, businesses operating around mental health and wellness have also seen a boost. Apps such as Headspace and Calm have experienced a significant uptick in downloads.

PE funds indicated that these sorts of digital businesses, as well as online pharmacies and telemedicine companies, are particular areas of interest since Covid-19.

"The food sector is now a very interesting place"

Food and drink

The food sector has been one of the most visible areas of the consumer-facing industry throughout Covid-19. As pressure mounted on supply lines, manufacturers, suppliers and retailers rallied together to keep the nation fed, which garnered significant recognition and acted as an excellent category-builder for the food sector.

At the same time, other developments in the sector took place, such as the boom of meal kit subscription services and wholesale, food service or restaurant businesses pivoting their propositions towards DTC. One fund told us that it had seen "*massive, massive growth*" in its food delivery infrastructure business, while one Chair we spoke to, who is on the Board of a food packing business, said that they had grown by 176% over lockdown supplying meat and fish for a major UK grocer.

Some parts of the drinks sector have also performed well over lockdown. One fund told us that its mixer business was booming through grocery channels, as more people spend on drinks to have at home.

For investors, this sort of growth has increased interest in the food and drink sector. "*We have a food business,*" one fund told us, "*that has gone from being in an unloved sector to a very interesting place.*"

From our conversations with funds, we identified two main sub-sectors that investors are looking on favourably. Firstly, health and wellness – a number of funds said that they are looking to the supplements, vitamins and health foods categories. Secondly, funds told us that they were looking into ingredients and flavours.

However, more than one fund expressed concern about investing in the food industry, owing to the difficulty in predicting its future. In order to invest successfully, funds must gauge which trends will be short-term and which will continue. One fund, for example, told us that it had noted consumers gravitating away from incubated craft brands and towards large well-known names during lockdown. While this development is probably only short-term, and opposes macrotrends of the last five years, it affects investor activity as many small artisan brands do not have the liquidity to survive a sudden dip in sales.

One fund in particular articulated: "*it is very hard to judge the value of this sector at the moment. For example, should food companies be more at a premium? For private equity investment we need to feed confident of what a company will look like in three – five years' time and that is very difficult to predict.*"

Homeware

Throughout our conversations, we also detected an interest in the homeware category.

Through lockdown, as people stayed indoors and were forced to re-evaluate and re-purpose their surroundings, the consumer sector saw a spike in demand for DIY home improvements products and homewares.

As such, private equity funds told us that their homeware brands had been performing well, and that there is appetite for investment in homewares going forward.

Further considerations

Due diligence considerations

Going forward, we can expect the Covid-19 crisis to have a lasting impact on the considerations private equity funds take into account before investing. From our conversations, we identified a number of specific areas of increased importance to funds:

Firstly, supply chain robustness. Covid-19 revealed the weaknesses in many companies' supply chains, not only the vulnerability to a sudden spike in demand but also a reliance on an international supply network. Going forward, PE funds are likely to integrate a review of a company's supply chain operations, and its potential risks, into a due diligence framework.

Additionally, key man risk is likely to have increased importance going forward. From now on, businesses looking to be acquired or to receive private equity capital will have to have a clear set of procedures in place to alleviate the risk of every key decision-maker being simultaneously unable to work.

Later in this report we discuss the critical role of founders in driving agility and rapidly reinventing business models in their organisations. With this in mind, PE funds may opt to invest in founder-led businesses in the future, which have been seen to adapt well in a crisis.

Covid-19 has also brought the seasonality of businesses to the fore, and thrown the downfalls of relying on summer trade into sharp relief. This is especially true for holiday companies operating in the travel sector, where the summer season is responsible for funding the rest of the year.

Private equity funds are also looking for businesses that have solid digital capabilities. Regardless of sector, some funds confirmed that they would only be looking at businesses that have invested in digital transformation and can reach their customers – in some way – online.

Transacting remotely

PE funds told us that – like almost all other elements of business – investing and deal-making will look very different in a post-Covid-19 world.

On the one hand, funds told us that Covid-19 has revealed the ease at which businesses can be managed remotely. Most specifically, international deals are now potentially more attractive, as funds have realised they can effectively manage a business remotely.

As a counter point, however, funds noted that securing deals over Teams or Zoom is much more difficult than making deals in person. Throughout our conversations we found

funds to be surprisingly 'sociable' in how they make investments – wanting to have spent considerable time with companies and their leaders in person before making investments. When it comes to making new deals, many told us that they are only considering companies with whom they had begun negotiations – or at least had had conversations – before Covid-19 began. Many funds said that they have been consciously maintaining relationships with the founders and management teams of possible investees throughout Covid-19, even if they had paused official proceedings.

Indeed, one Chair told us that the deals currently taking place look very different from any in a pre-Covid world. She explained: "*there is activity taking place, but it's not happening with the usual fanfare. They are fast, quick deals between two parties who have a high level of trust.*"

Venture capital and digital

In making investments in digital businesses, a number of funds voiced the opinion that private equity investing has been more challenged by Covid-19 than venture capital in investing in digital / technology assets, due to the holding times and long-term nature of private equity investing. Covid -19 will inevitably breed innovation – especially in the digital space – and we can expect to see lots of early-stage venture capitalists entering the consumer-facing market.

Lenders

A further detail that came through in our conversations was that funds did not anticipate difficulties in securing finance from banks. Despite the uncertainty around cashflow, funds told us that banks are still open to lending money with an understanding that a business' current cashflow may not reflect its quality as an organisation.

Leadership needs of consumer-facing businesses through and beyond Covid-19

Covid-19 has disrupted the talent landscape, and brought an entirely new set of leadership priorities to the fore. More than any MBA ever could, the last four months have shaped and defined leaders in our sector.

"My experience is that a crisis creates and defines leadership"

Covid-19 has already transformed the landscape of the consumer-facing sector. Alongside accelerating consumer trends and changing the face of our consumer businesses, Covid-19 will also have a lasting impact on management, their priorities and the make-up of senior leadership teams going forward. In the same way that the last financial crisis defined a previous generation of business leaders, so too will Covid-19 – to an even greater extent – define the next generation of forward-thinking leaders: resilient, agile, purposeful and determined.

In our conversations with private equity funds, we explored in depth their leadership priorities during Covid-19 – and also discussed emerging skills that they believe will be required to address the needs of their business in the 'new normal'.

Additionally, to understand how private equity funds view the performance of their leadership today, we asked the funds whether they thought the leadership teams in their portfolio businesses were well-equipped to handle the coronavirus crisis, both in the 'survival' stage, and in navigating the new normal. Of the funds we spoke to, 77% told us that they were either 'very confident' or 'confident' that the senior executives leading their portfolio businesses were up to the task of leading their businesses into a 'new normal' and beyond.

In this section, we outline some of the key themes that emerged in our conversations with the funds around leadership.

Lessons from Covid-19: leadership needs in a crisis

The finance function

Throughout Covid-19, CFOs have been central to the survival of businesses. CFOs have had to juggle competing considerations to keep their businesses operating, extending far beyond the day-to-day CFO role – including grappling with multiple government subsidy schemes (often across different territories), managing cash, partnering with ever-more-involved funds, renegotiating costs, refinancing and renegotiating covenants – as well as the emotional toll of furloughing or laying off employees. As one fund put it: *"the workload of the CFO doubled over night."* Almost all the PE funds we spoke with noted the amount of pressure CFOs have been under during Covid-19 – and how admirably many CFOs have transitioned from leading a finance role in a successful, stable and growing business to leading a company that suddenly has a liquidity crunch, and whose prospects look very different from January 2020.

One fund posited that CFOs who focused on short-term tasks at hand, as opposed to long-term thinking about the future of the business, were more suited to the crisis management stage of Covid-19. They commented: "*our CFOs have handled the number of new tasks very well – we've found they thrived in that structured mentality. I think we've valued when CFOs have been less strategic and have been able to focus on the task at hand.*"

Some funds suggested that possibly the finance function in some of their portfolio businesses had been too streamlined going into Covid-19 – without the horsepower or capacity to step into increasing operational roles. In these cases, they have often kept the CFO focused on the more strategic questions arising from the current situation – and deployed resources from elsewhere to address finance operational challenges: "*When the crisis hit, we decided to say: 'look, what's happening right now requires you to focus on the core finance functions and skills.' And we took some of these operational elements and gave them to someone who had proven experience in operational crisis management.*"

Overall, however, most PE funds reported that their CFOs have performed well – particularly more seasoned individuals who experienced the 2008 financial crisis. As one fund partner observed: "*over many years, we have invested in hiring seasoned and experience CFOs – and probably overhired in many cases. This has definitely paid dividends in the last few months*"

On the other hand, some funds told us that they have witnessed finance executives struggle to move beyond the basics of business-as-usual and take on issues like long-term cross-business cashflow and crisis management. As one aptly put it: "most *CFOs are not born to battle.*" Indeed, we were given a handful of examples where funds havereplaced CFOs in the midst of Covid-19.

"Most CFOs aren't born to battle"

In many cases, funds have had to step in to assists CFOs in the renegotiation of covenants, and have leveraged their banking relationship to approach the bank on behalf of their portfolio businesses. This increased package of support has strengthened the relationship between funds and portfolio CFOs. Many funds confirmed this view, suggesting that similar backgrounds in finance put private equity teams and portfolio CFOs in a good position to work together.

Human resources

Across the board, PE funds reported that Covid-19 has revealed how critical the HR function is to an organisation. Throughout the crisis, HR Directors – sometimes called Chief People Officers – have been tasked with keeping colleagues healthy and mentally well, overseeing vast remote working networks and acting as a reminder to CEOs to remain focused on their people. Alongside all of these immensely important tasks to maintain positivity, HRDs are also having to balance redundancies, retrenching, furloughing, delivering the bad news of no pay increases or bonuses and determining new working patterns / salary levels (which is obviously particularly complicated and sensitive in a unionised setting).

Specifically, funds told us that the best HRDs are those who are simultaneously operational experts, able to handle delicate matters of employee wellbeing, and who can also work alongside the CEO and CFO to put in place short and long-term cost-cutting measures.

One fund articulated: "*HRDs are pretty well equipped for this. They understand payroll, compensation, tax and have been able to understand government furlough schemes – and roll them out – at pace. What you want in a crisis is someone drilled for a situation, and our HRDs have proved just that.*"

Some funds reported that they had under-invested in the HR function, and their portfolio businesses were struggling in this area as a result. One fund noted that one of its portfolio HRDs was far too junior, and not able to manage the technicalities of workforce planning and restructuring.

Interestingly, one private equity fund noted the increasing importance of an HRD – but told us that more that one of its businesses does not currently have an individual leading its human resources.

Much has been written about how to elevate the HR position, and why 'people people' are so consistently under-represented in the boardroom. Indeed, historically, the HR function has been undervalued and even underpaid when compared to other positions. Post-Covid-19, however, we may well see an increase in HR representation at board level – with several PE-backed businesses looking likely to upweight the function in the years ahead.

Looking ahead, one Chair noted the increased pressure on HR directors: "*because of the implications of health, safety and employee relationships, I can see companies renewing their focus on their HRDs and investing in upskilling them.*"

Chief executives

For those at the helm of their organisation, the last few months have presented never-before-seen challenges. Leaders have needed to make business-critical decisions at pace, on a day-to-day basis, often working around the clock. Many CEOs have had to make mass redundancies, which are in and of themselves hugely stressful and emotionally involved. Where businesses are still operating, or about to reopen, leaders are having to make what may turn out to be life and death decisions regarding their operations – with very little decision support or a clear road map to guide them.

In our conversations with private equity funds, almost all reported that the Covid-19 crisis has been a true test of the leadership capabilities of their portfolio CEOs. Not only has the pandemic revealed the need for a personally resilient CEO, but so too for a leader who can balance short-term matters of survival with long-term considerations about the future.

One of the newly-emerging leadership priorities for CEOs has been communication. During Covid-19, with increased uncertainty around job security, company liquidity and the overall future of the organisation, it has proven vital that CEOs establish consistent lines of communication with their whole company. One fund told us that their CMO writes a script for their CEO every week, outlining company updates, commercial performance and any internal news. This process has become a key feature of the business' Covid-19 strategy.

One Chair suggested that the best communication strategy for CEOs is honesty: not pretending to have all the answers, but instead levelling with colleagues when things are uncertain and always maintaining emotional stability. *"I've seen cases where being authentic, managing your own emotions and communicating candidly has really paid off,"* they said.

Effective CEOs have also been able to strike a balance between empowering individual teams while simultaneously centralising and controlling key decisions. Here, consistent communication with the wider teams has proven key.

Communication between CEOs and partners has also been vital in Covid-19. Chairs and funds told us that their best CEOs were consistently speaking with their commercial partners (such as retailers) and suppliers, to maintain transparency and foster an environment of knowledge sharing, especially in the early days.

Furthermore, the funds and Chairs we spoke to indicated that an ability to prioritise was a key early need for CEOs. The leaders who were able to draw a close team around them, delegate tasks to appropriate colleagues, and make quick decisions were the ones who came out on top.

Chairs and funds also mentioned that founder CEOs had performed particularly well during the crisis. They told us that founders were generally more tuned-in to specific costs and small details, and – thanks to a deep understanding of the market and their customers – were also able to rapidly innovate and reinvent their business model.

Looking ahead, it will be interesting to see if this crisis has a long-term impact on how private equity houses hire CEOs. On the one hand, private equity funds have traditionally sought to hire experienced CEOs. It remains to be seen whether this generation of CEOs, often individuals who led through the 2008 financial crash, will have the resilience and desire to lead distressed businesses over the next one to two years, and then a likely further three to five years during a rebuild and growth phase. Alternatively, as one fund suggested to us, will Covid-19 wave in a new era of CEOs who are younger, more nimble and tech-focused?

The role of the Chair

In our discussions, PE funds told us that many Chairs have played critical roles in guiding portfolio businesses through Covid-19.

We spoke to several Chairs of PE-backed businesses, who explained how their role has developed during the course of Covid-19.

Almost all Chairs told us that engagement – between both their executive teams and their funds – had increased, especially during the initial stages of survival. Chairs also reported an increase in their informal engagement, especially with the executives.

One Chair reported: "*obviously there is increased structural participation – with more board meetings focused on finance, capital, and liquidity – but there is also far more informal engagement as we support our executives through this period. Our executives are all at home, unable to directly communicate with or lead their teams, and they need our support. This has been a focus since the crisis.*"

Another Chair spoke on the importance of working at pace during this time: "*you need to be able to hit the ground every time you have a call, every time you speak. You have to be engaged right there and be able to deal with the difficult things within the hour. Covid-19 has made us all find new ways of being efficient.*"

While the majority of respondents spoke positively on the relationship between funds, CEOs and Chairs, some funds reported that it felt the Chairs of its portfolio businesses had not been sufficiently engaged throughout Covid-19 – and actually acted as a barrier between the fund and management in decision making.

"*What I've been surprised about is out Chairs not really directing,*" the fund commented. "*They don't seem to have played a part – the CEOs are driving things.*" This may be due to the increasingly plural nature of Chairs' directorships, meaning that some don't have the time to commit to each of their portfolio businesses, and in the current situation didn't have sufficient understanding of the detailed mechanics of each individual business to enable successful interventions.

Handling a crisis: who is best equipped?

Throughout our conversations with private equity funds, we identified a number of different viewpoints about what sorts of people – and which types of businesses – were best-equipped to manage Covid-19.

For example, many funds reported that founder CEOs had fared particularly well during the crisis. Funds told us that founders generally had a deep understanding of the mechanics of their business, their customer and the market, and had a true appreciation of treating every element of the business as their own.

One mid-market PE fund commented: "*we found that our founder CEOs have performed exceptionally well. They really understand the nuances of their business, are much more detail-oriented and were able to pivot their business very quickly. When all the odds are stacked against you and you're under great cost constraints, being able to revert to a start-up mindset is an invaluable tool.*"

Additionally, as companies pivot their business model in response to changed consumer demands, we predict that founders – often entrepreneurs themselves – are particularly well placed to pivot and reinvent businesses.

Other funds explained that senior leaders who have spent time in smaller, or even previously distressed assets were more personally equipped to deal with the crisis. Specifically, we learnt that leaders of struggling assets, in addition to having skills around managing cost and cash, are more accustomed to having difficult conversations with key stakeholders, such as fund partners or others in the business.

One fund articulated this: "*in quality assets which have never had to go through difficult conversations, the management teams have come across as very 'deer in headlights' during this crisis. Leaders of lower quality assets who are used to operating in difficult times were actually better equipped to have the conversations and make the decisions required, at pace*".

Another affirmed this view, discussing CFO performance explicitly: "*if you're a CFO who stands behind an expansion story with double-digit, like-for-like growth year on year and thinking about dividends, it's a very different story to suddenly be in a situation where tough conversations are needed to be had and bond, debt or equity holders need to be reassured.*"

By contrast, other funds told us that CEOs who had worked in large multinational businesses, especially those who had held a key role during the 2008 financial crash, stood out to them as particularly capable leaders. As one respondent told us: "*grey hair helps.*"

Burnout and fractions

Most of the funds and Chairs told us that they had not seen any tensions between members of the leadership team, or, indeed, individuals burning out beyond the expected stresses of the situation at hand.

Where fractions did occur between teams, funds and Chairs reported that it was usually to do with geography and a lack of co-location. "*I've only seen divisions in de-centralised businesses,*" one fund said, "*where there's a central team there's much more camaraderie.*"

Another fund reported that it had seen strains between core businesses and secondary divisions, but noted that these sorts of human tensions are probably pre-existing, and just exacerbated by Covid-19.

In terms of individual burnout, funds and Chairs told us that they had yet to see any severe cases – but anticipated it in the future.

For now, leaders are still energised, deploying creative problem solving to pivot their businesses. Moreover, the rapid pace of change during this time – from survival, to trading during lockdown, to rebuilding with social distancing measures in place – has required a consistent focus and meant that fatigue has not yet set in.

Looking ahead, we can potentially expect to see more burnout among senior leaders in the weeks and months ahead, when the pace of change slows.

"This crisis has brought us closer to our management teams"

Fund leadership

Over the last three months, we have seen private equity houses funnelling their funds, time and energy into guiding their existing companies through the crisis, often adopting a more 'hands on' approach to management. Many funds are rolling out increased packages of support to their assets – from both a financial and advisory perspective.

Almost all our respondents indicated that Covid-19 has served to strengthen relationships between the funds and their businesses. "*The all-hands-on-deck mentality, combined with the necessary daily meetings, has brought us closer to our management teams,*" one fund told us. Another went as far to say that it had previously been considering the suitability of certain senior leaders for the long-term, but their performance during Covid-19 had reaffirmed its confidence in those individuals.

One CEO of a PE-backed retailer told us: "*my experience with our fund has been very, very positive. I believe that when times get tough it's the perfect time to test any business relationship – and the fund has certainly supported us through these troubling times.*"

One Chair of a PE-backed restaurant business compounded this view: "*I have not come across one fund in the consumer sector that hasn't tried to help where they can. Especially with businesses that are having to refinance, I've seen funds leveraging their banking relationship and speaking to the banks on behalf of the businesses. They've also been supportive in terms of sharing best practice.*"

Indeed, our interviews confirmed that, across the board, private equity funds are committed to stabilising their current businesses before turning their attention to further investment or acquisition.

One fund laid out its 'three stage' approach to leading its portfolio: firstly, cash and liquidity management; secondly, reinventing the business in order to trade during lockdown; and thirdly, benefiting from the crisis and emerging stronger.

Another fund also outlined the way it was supporting – but also critically challenging – its portfolio business. "*Some of the things, like cashflow forecasting, we covered thoroughly with our teams and supported them the whole way. But other elements of the response we've purposefully been a bit looser with – we've pushed them, challenged them and our teams have run with it. I'd say without exception every one of our businesses has stepped up to the plate and told us this approach has been really helpful.*"

Another fund held a similar view: "*I'm not going to claim that our input has materially changed any of the decisions our teams probably would have made. On balance, maybe they had the confidence to take those decisions a bit quicker with our encouragement.*"

Most funds suggested that they had been adopting a collaborative – as opposed to controlling – approach to leadership. Others, however, reported that authoritative leadership had been needed at times.

One fund told us that one of its management teams had taken a highly bullish stance, wanting to continue its aggressive acquisition strategy at pre-crisis multiples. In this case, the

fund refused to support this strategy. "*We had to say: the world has changed, the risk appetite has changed. Your area of the sector might not have seen a direct impact but risk factors have changed and the availability and pricing of debt has changed.*"

On the other hand, we also heard examples of management teams that were overly and unnecessarily cautious in the view of the fund. In these cases, funds have had to encourage leaders to step up, or else risk being out-run by the competition. One fund explained: "*the business was in a good financial position compared to others and so we had to impress on our teams the importance of being more aggressive, more customer-focused. This is a moment to be on the front-foot.*"

Striking a balance between caution and aggression emerged as a recurring theme among funds, especially around managing expectations of safety and security. One fund told us that it had to have very frank conversations with a leadership team, laying out the measures it was using to keep them safe from the virus, but encouraging people to walk out of the business if they felt unsafe. "*We had to say: we're trading. We're open for business. If you don't want to be a part of that then you don't have to be, but this is how we're moving forward.*"

Another repeated theme in our conversations was that of private equity funds utilising resources from their entire portfolio to support their businesses. Larger funds in particular have been able to provide significant support to mid-sized companies and share experiences and lessons learned from across their portfolios. One fund told us that, at the height of the crisis, it was bringing all its CEOs together for a group call once a week. During these calls, the CEOs were able to share trading patterns, consumer trends they had noticed and also swap ideas for rebuilding.

One fund told us that it had seen increased demand for transparency and information from its portfolio businesses: "*we've seen greater demand for data access, so we've had our team create reports which allow management reams to make decisions more quickly and accurately.*"

Another element of fund leadership during Covid-19 has been navigating salary cuts and utilising government schemes. The vast majority of funds told us that their senior leadership teams had taken significant pay cuts of between 20% and 100%, and that they felt this was a necessary, and morally right, measure to take while the business struggled and people were laid off. "*The management teams have come to accept this,*" one fund told us, "*there's a bit of a sense of: we're all in this together.*" The issue of remuneration and incentivisation is discussed in more detail on page 43.

Additionally, funds have had to consider whether to accept the state aid and tax advantages offered in some regions. One fund reported that it had been looking to multinationals such as Unilever and BP, both of which have not accepted any government support. "*I think there's a fair argument to say – our shareholders should fund this*" the fund told us.

Looking ahead: leadership in our 'new normal'

The next phase of Covid-19 will require senior executives to carefully balance competing leadership priorities, in order to guide their business through the crisis and succeed in a post-Covid world. As part of this process, private equity funds may look to restructure their businesses to best-equip their assets with skillsets to ensure commercial success. This is likely to look different depending on the business. One fund explained: "*I think there is fair argument to say that we will look at a different skillset depending on the business and its recovery strategy. Some of the seats around that board table may need to be different to deliver the new strategy. So yes, we are anticipating change – how deep and broad that will be, I'm not sure yet.*"

Similarly, this crisis has fast-tracked changes in some businesses, which have seen personnel changes as a result of performance or circumstance during Covid-19. For example, one fund told us that the CEO of one of its businesses had cut his term short, choosing to step up as Chairman early due to living with his elderly parents.

On the other hand, some funds are still averse to change, suggesting that the focus must be on immediate survival and not restructure.

Trading in a post-Covid-19 world

Emerging out of lockdown brings with it a new raft of significant considerations, as senior executives make changes to keep operating with social distancing, or else pivot their business to respond to sudden shifts in consumer behaviour. One fund articulated this: "*it's a two-step recovery: legally when you're allowed to open and then working out what type of opening you can do.*"

An added complication is that much of the data we usually rely on to drive usual commercial decision-making is unlikely to be useful.

As a result, we are already seeing business leaders adopting more agile approaches, returning to more intuitive modes of commercial decision making and prioritising 'walking the floor' to engage directly with customers.

Additionally, as short-term commercial performance becomes key, senior executives are going to need to become more entrepreneurial. One positive trend to emerge during Covid-19 has been the volume of new ideas, channels and products, proving that innovation can take days, not years. Going forward, we can expect to see the consumer sector adopt innovation processes which the tech and digital sectors have followed for decades – failing fast, but constantly learning and innovating.

"Very few businesses are doing the forward-thinking aspect yet"

Envisioning the future

Businesses in the consumer-facing sector must apply a new critical lens to their leadership strategies: thinking holistically about the future of their organisation.

Many companies, for example, will be forced to reconsider their entire proposition, and reposition themselves in a new market or for a new demographic. It is plausible to expect, for example, a long-term lull in international travel, dining out and experiential-led buying. Businesses in these sectors will need to employ long-term conceptual thinking to determine the opportunities amid the uncertainty.

Leaders will need to conduct rapid research in order to predict what that 'new normal' will look like – as there is currently very little data available which can be used to predict future consumer behaviour.

In order to fulfil this business priority, larger PE funds told us that they were predicting the rise of the chief strategy officer, the chief new horizons officer, or the chief concept officer, whose task it is to focus on the future across their portfolio companies.

Organisations disagree on how operational this role will be. Some suggest that chief strategy officers should only be concerned with big-picture thinking, constantly looking for ways to disrupt the wider market. Others want a chief strategy officer to adopt an operational approach and lead the implementation of each new strategy in the business. One fund which took this view said that: "*we're looking for people who can form a strategy, then take that strategy and operationalise it through a business.*" Mid-sized and smaller funds envision themselves playing a larger strategic, future-oriented role, in the coming years.

We can expect to see businesses working closely with their funds to better understand what the 'new normal' may look like. Funds can utilise their past experience – especially of previous crises – to guide their portfolio companies beyond Covid-19.

One theme that came through in our conversations was that businesses have not yet reached this phase of recovery. One fund said: "*everyone is still in the response to crisis cost-out, immediate restructure and initial trading. Very few businesses are doing the forward-thinking aspect yet.*"

Changing relationships

Looking forward, we can expect to see collaboration become a lasting feature of leadership in a post-Covid world.

Inside businesses, the crisis has redefined the relationship between the CEO and CFO. Never before has the finance function been so directly and closely involved in an organisation's short-term operations, and as such, the relationship between the chief executive and the CFO has become a key indicator of business success. Going forward, we may see culture fit and personality tests between the CEO and their possible CFO become a crucial part of the hiring process. Additionally, a collaborative relationship between the CEO, CFO and the HRD will also be vital.

We can also expect to see renewed engagement between private equity funds and executive teams. The pandemic and its associated issues have resulted in more engagement between funds and their assets, and a more hands-on approach. With only a few exceptions, there has been little tension between funds, CEOs and CFOs, who have worked together to ensure immediate survival and make strategic decisions about the future. From our discussions with funds, we found that many funds expect this to carry on, especially considering the long road that lies ahead.

Rebuilding businesses

Covid-19 has resulted in mass restructuring across the consumer-facing sector, and a never-before-seen displacement of talent. After the crisis, businesses in our sector are set to look very different, and there is opportunity amid the disruption to rebuild with diversity and productivity at front of mind.

One Chair articulated the change: "*there will be a reshaping, and businesses will not come out of this in the same size and shape as they were. This isn't a bounce-back situation: companies are committing to years of recovery.*"

Organisations – particularly ones funded and guided by private equity funds – will be forced to reconsider their leadership priorities, review their current teams and make decisions about whether the teams in place are the right ones to bring the business forward in a 'new normal'.

One Chair in particular confirmed this view, saying: "*there will be reshuffling, and hiring to fit completely new business needs. We can expect private equity funds – and other key stakeholders – to shake out some of the weaker teams*".

Just as Covid-19 will have a permanent impact on the considerations that funds undertake before they invest, so too has the crisis affected hiring decisions. Gone are the days when following a pre-defined plan constituted a good leader. Instead, funds will be looking to find people who are flexible, creative and agile in style to lead their assets.

The diversity agenda

The case for gender diversity is well proven, and there is a raft of evidence confirming that leadership teams which feature gender, ethnic and socio-economic diversity are more productive, more creative and more commercially successful. At this crucial juncture, it is imperative that businesses keep diversity front of mind, both when making decisions that will impact customers and rebuilding their businesses after mass restructuring.

In a recent report, the Boston Consulting Group suggested that PE funds have a unique position to play in fostering workplace diversity in society. Given the success that private equity funds have in scaling their businesses, BCG posits that the PE sector's actions can have a long-lasting ripple effect. It suggests that PE funds must install diverse boards and C-suites in their portfolio companies. Funds should look closely at their supplier diversity, set metrics, and pressure their advisors (including legal, accounting, financial, and commercial vendors) to bring diverse teams to the table. Beyond holding themselves accountable on these measures, they should compete with other funds to lead the way—and since PE professionals are among the world's most competitive, rising to this challenge should come naturally.

As funds re-evaluate their portfolio leadership teams and undergo restructures, there is opportunity to rebuild with diversity in mind and pointedly hire diverse candidates. Indeed, a blocker to progress in creating diverse leadership teams in our sector is the slow rate at which senior leadership roles have historically churned – and this crisis could present an opportunity to reverse this trend.

However, conversations with funds revealed that diversity is not high on the private equity agenda at the moment. Out of all the funds we interviewed, only a handful proactively mentioned diversity as a leadership priority.

Especially when it comes to rebuilding businesses, funds told us that they will be looking for a proven background of crisis management and will be adopting a risk-averse approach to hiring. For those funds looking for candidates who have been through the 2008 crash, by default the pool of leaders is older and overwhelmingly male and white.

By contrast, however, diversity is a far bigger priority for Chairs and CEOs. One Chair of a PE-backed business confirmed that diversity and inclusion remained high on his agenda: "*during times like this, diversity becomes increasingly more important. For me, it has gone beyond just gender and ethnicity. I'm particularly interested in age, in looking around the board table and seeing youthful faces.*"

The Chair in question touched on the importance of having a broad range of skills and experiences on the board: "*in this crisis, the young people are the ones who are brave enough and digital enough to transform the company in a heartbeat. I've got a very young MD who is fabulous: brave and fearless and digital and energetic; but then on the other hand I want some old heads round the table who have been through a crisis before and actually have the experience to say 'do you know what – don't worry about it. This is risky, but we've looked at the risk and we think it's OK, so just get on with it.' And it's that diversity of thinking that I think will be very helpful.*"

PE funds need to take the lead and renew their focus on diversity if they wish to be able to attract the top talent to their businesses and achieve commercial success. Additionally, as evidenced by the Black Lives Matter movement in recent weeks, diverse leadership teams will become an integral part of a business' 'social licence' to operate – and those businesses which fail to attract and retain diverse leaders could well find themselves out of favour with the consumer.

Remuneration and incentivisation

One item that must be higher on the agenda for PE funds is executive remuneration in a post-Covid-19 world. Many executives have taken pay cuts, forgone entire salaries and are faced with equity that is now entirely under water. Whilst it is clear – and right – that they need to make these sacrifices in the short term, many executives privately told us they expect their 'reward' to be readjusted in the medium term.

Indeed, several executives – particularly those that have had successful previous PE exits – and who have their own personal wealth, commented to us very privately: *"is it worth it?"*

Of course, especially for businesses making mass furloughs and receiving financial support from the state, the issue of remuneration can be a delicate and often politically-charged matter. Overall, there appears to be a mid-term appetite to address issues of executive compensation. However, as one fund explained, wealth creation opportunities will be fewer all round – including for executives: "*we expect – if there are any businesses where the balance sheets need restructuring, their shareholding and the incentivisation needs to be reset, then we would just expect to have to do that. Now, is the management going to be able to make the same amount of money they previously expected? Maybe not. But nobody is… and we're not either.*"

While most businesses in the sector are rolling out cost-cutting measures and freezing or reducing pay, it is unlikely that long-term executive incentivisation or remuneration will be front of mind. In a conversation with a Chair

of a PE-backed business, we discussed this point: "*as things recover,*" the Chair told us, "*incentivisation will definitely will come back on the agenda. Executives are happy to put in the work in the short term – to help the business survive – but there will come a point where they'll start to look to the stakeholders and say: 'I've helped this business get back on its feet – now am I correctly incentivised to keep guiding the business in the longer-term?'*"

One private equity fund affirmed this view, suggesting that: "*there will probably be an availability of talent soon because there are a lot of struggling businesses, and probably a lot of people sitting there thinking: 'all this management equity I thought was worth a healthy amount is now worth much less'.*"

From our conversations with private equity funds, CEOs and Chairs, however, we found that very few funds or businesses have had substantive conversations to date around long-term remuneration plans. Partly, this is of course understandable – we are still mid-crisis, and there are possibly too many unknown factors to reset management incentives at this stage. With that being said, funds could be advised to signal to their portfolio companies that MTIPs will be reset if needed – and in a realistic timeframe.

One portfolio Chair agreed: "*we're all thinking about how we can support a very different remuneration structure. Long-term incentive plans which stretch four or five years will have to go – so we have to think of different ways of managing and motivating people. I'm seeing some good conversations about this, but lots of mediocre ones, too. Remuneration is going to have to be vastly transformed… but at the moment there's not enough people biting the bullet.*"

Indeed, of the funds we spoke to, a few were actively surprised that the issue of remuneration was being discussed, suggesting that it was far too soon to reset incentive programmes.

One CEO of a PE-backed businesses told us that they had worked alongside their CFO and the fund to put a "*fair*" structure in place. But out of all the conversations we had, only a very small proportion reported to have a revised remuneration structure in place.

About Us

About The MBS Group

For more than 30 years, The MBS Group has been a leading sector-specialist executive search firm advising all consumer-facing industries.

Clients consider us to be the partner of choice when searching for critical leadership roles that make a difference. We work at board level and on executive positions across all functions of strategic importance. For more information, visit www.thembsgroup.co.uk

MBS has a strong track record of working with private equity companies of all sizes, and their portfolio companies. We have decades of experience focusing on the needs of institutional investors, and are proud to combine our deep knowledge of consumer markets, with an intimate understanding of the 'type' of candidate who would flourish in a private environment, be able to drive change and add significant value.

We handle a large number of appointments across the consumer space, many in anticipation of a private equity transaction or IPO – and focus on candidates with a high performance and value creation track record, and have demonstrated an ability to be operational, rounded and can act in a 'standalone' capacity.

We work at all stages of the deal cycle and are able to leverage expertise across all consumer-facing industries to be able to support private equity investors and their portfolio companies to build exceptional leadership teams.

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