MIDDLE MARKET Growth
THE OFFICIAL PUBLICATION OF ACG Association for Corporate Growth

Staying on Track

ELISE CHOWDHRY | DECEMBER 3RD, 2015

What keeps you up at night?

When asked this question, private equity leaders most often mention limited availability of quality deal flow and current high valuations. Indeed, with valuations in the first half of 2015 at historical highs and dry powder at $1.34 trillion, market conditions may not be causing insomnia but are clearly on everyone's mind. Putting dollars to work with a reasonable risk/return profile is increasingly challenging and, without question, the No. 1 priority.

This market understandably has you deep in the trenches and may be diverting your attention away from a range of issues you know exist but just haven't had the time or resources to address. In today's environment, here are the issues with the potential to significantly disrupt your business and at worst, derail your firm's success:

SEC regulation: Most of the industry has had to adapt to the "new normal" of being regulated by the SEC, yet many PE firms remain unvisited and still don't know exactly what to expect. The SEC's "Private Equity: A Look Back and a Glimpse Ahead" report issued in May, along with more recent announcements and issued fines, gives strong indications of the agency's hot buttons as it moves to conduct normal examinations with broader scope.

You may or may not be on the list anytime soon, but it will pay to be prepared when the SEC does show up. The fines issued to date have been substantial but not debilitating. However, one could imagine fines getting steeper over time if SEC enforcement concludes that its guidance has been disregarded and warnings not heeded. Economics aside, an enforcement action can tarnish your reputation with LPs and others with immeasurable cost.

Cybersecurity: Cybersecurity breaches are affecting everyone—the U.S. government, Fortune 500 companies, small and middle-market businesses, individuals and large financial service firms alike. Middle-market investment firms are not likely to be immune. If you missed it, check out a great primer on this topic: "Your Risk of Cyber Attack? Greater Than You Think."

A recent report by External IT revealed that cybersecurity is weakest in three areas at financial services firms: security policy, accountability when moving company data, and disaster recovery. A recent survey found that while 88 percent of GPs agreed that breaches of data security are an increasing threat to the private equity industry, one in four admitted to having knowingly breached their firm's data security policies. The SEC has identified cybersecurity as a key risk and recently issued its 2015 Cybersecurity Examination Initiative outlining areas of focus for upcoming OCIE cybersecurity examinations. The potential financial and reputational damage from a breach makes this an issue to stay in front of, not behind.

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Reputation: Your reputation and that of your firm are fundamental to your success, yet fragile. To quote Warren Buffett: “It takes 20 years to build a reputation and five minutes to ruin it.” This is painfully true if you, any of your employees or your firm experiences a cyber breach; dated or misinformation gets posted and goes viral; or disgruntled former employees anonymously trash you on Glassdoor or another social media outlet.

Your firm can no longer guard its reputation merely through day-to-day actions. “Your reputation now lives digitally and is subject to scrutiny by potential business partners, clients, investors and recruits, as well as peers,” Rob Beltran, senior partner at digital reputation firm Lumentus, told me in an email. “Google and platforms like LinkedIn and Glassdoor are front doors to your company and your reputation. Owning your namespace in this digital environment is essential. It is a must to proactively monitor, manage and maintain what is discoverable about you online to protect and solidify your digital reputation on your terms,” he wrote.

Organizational dynamics: Internal issues can be hard to diagnose until there is a crisis if there are no evident signs or the signals are challenging to read. It is difficult to discover what could be quietly holding your firm back from even greater success without investigating and soliciting feedback. No question, giving and receiving feedback is uncomfortable for many. However, research suggests significant upside in biting the bullet to get organizational feedback. In an HBR study of more than 50,000 leaders, those who ranked in the top 10 percent in asking for feedback were rated, on average, in the 86th percentile for overall leadership effectiveness.

Feedback and assessment provide valuable insight on how to make your firm stronger, but they may also reveal issues that, if left unaddressed, can stymie firm performance and create cracks in your firm’s organizational foundation:

- **Low employee engagement:** More obvious signs include chronic or unexplained absenteeism and heavy use of social media during work hours. Perhaps less noticeable are colleagues who appear to be “checking the box” in terms of deal analysis and/or other responsibilities and somewhat disassociated from other co-workers. Gallup research consistently finds U.S. employee engagement hovering around a disheartening 30 percent and has estimated the productivity price tag in the range of $450 billion to $550 billion annually. Disengagement is costly whether you have only one employee who is not “sustainably engaged” or many.
- **Weak control environment:** Auditors, regulators and LPs look to a firm’s internal control structure and procedures to gauge not just the reliability of financial reporting, but also management’s attitude toward the importance of internal controls. At a minimum, inadequate policies, procedures, testing and/or documentation can result in a lack of confidence and more intense scrutiny; at worst, they can result in qualified opinions, lost LPs, fines or other financial consequences.
- **Inefficient processes:** While difficult to quantify, inefficiency can be expensive. An underutilized CRM system can result in miscommunication, duplicative calling efforts or missed deal opportunities; a loosely defined investment process can lead to poor investment decisions; an informal portfolio management process can fail to yield information and metrics that might prevent losses.
- **Lack of communication:** Employee disengagement, inefficient processes and a lack of employee collaboration can often be traced to this root cause. Without a culture of communication, productivity losses can be substantial.

Most of us know from experience that issues left unchecked rarely go away on their own; more often than not, they get worse over time. If you and your leadership team do not have time to focus on these priorities or conclude they go beyond internal core competencies, tap outside professionals who can address and solve these concerns. That will allow you to concentrate on your primary objective and stay focused on your path to success. //

Elise Chowdhry *is the managing principal of* Optimum Advisors LLC*, a management consulting firm that leverages industry experience and stakeholder feedback to help leaders of middle-market private equity and finance firms optimize firm success.*