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When Family Businesses Should Think Like Private Equity Firms

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Adopting all or even some PE investor strategies can add value and enhance competitiveness, especially when a successor takes over or the company may be sold.

Family businesses must navigate a dynamic market environment while ensuring long-term competitiveness and sustainability. While institutional investors (i.e., large organizations that invest money on behalf of others, such as pension funds or insurance companies), have relied on structured strategies that increase their companies' financial values for decades, family businesses often are not aware of these strategies.

This article explores how family businesses can integrate such value-improving "investor strategies" without compromising their culture or long-term vision. We discuss practical measures—including efficiency improvements, growth initiatives, governance optimization, and capital efficiency enhancements—that can help family businesses in growing, reducing risk, and making more profit. These goals might be particularly important when preparing for internal succession or a potential sale.

The Evolution of PE Firms

While the roots of venture financing ideas can be traced back to the 1940s, private equity (PE) firms became popular in the 1970s, initially focusing on selecting the most appropriate targets and financially restructuring companies to generate returns. By the 1980s, these firms shifted toward actively increasing the value of their portfolio companies rather than merely reselling them without making any changes. Over time, they developed structured processes and specialized teams dedicated to value creation in the acquired firms (i.e. "investor strategies").

Large corporations now widely use these strategies to enhance their performance and strategic positioning. These strategies go well beyond what is commonly called the "DuPont formula," which consists of a key performance indicator system aiming to increase the return on investment. Indeed, PE "investor strategies" include several analyses and a "tool box" for various strategic and operational activities (described below) that allow for improving the firm's value in a holistic way.

However, family businesses have been generally slow to adopt these strategies, even as global competition increases and reduces their margins, forcing cost efficiencies. To remain competitive in the 21st century, adopting these investor strategies can help all family businesses to grow, reduce risk, and/or increase their profit. They can be especially useful when a new generation is taking over or when the family is thinking about selling the firm. Whether succession is internal or external, it makes sense to diligently prepare the firm for handover. This article first outlines how typical PE value-enhancement programs work and then highlights which aspects can benefit family businesses.

PE Strategies for Increasing Company Value

PE investors assess value growth through key financial metrics, such as the multiple on invested capital (MOIC), which compares proceeds from the PE's company sale plus additional income throughout the holding time to the capital invested. Achieving 200% to 300% returns over a four- to eight-year holding period is common. This level of value creation results from a mix of strategic, operational, structural, and financial measures. While not all PE strategies (e.g., using debt when buying the firm) suit family businesses, many elements, such as working capital optimization, can be adapted to drive sustainable growth.

While the effectiveness of the strategies depends on some firm and industry characteristics (e.g., market fragmentation, capital intensity, etc.), they generally work well for firms across industries, in particular those with stable cash flows that are not in need of urgent restructuring.

Identifying Value-Enhancement Opportunities

A typical PE-driven value-enhancement program includes 50 to 250 individual measures, ranging from large-scale projects generating millions in value to smaller initiatives worth far less, maybe thousands of euros or dollars.

Opportunities for such initiatives exist at all levels of the organization. While shareholders and management typically identify major initiatives, department heads often uncover smaller yet impactful efficiencies. For example, procurement teams may be tasked with reducing material costs by 10% across the board, or sales teams may be encouraged to offer discounts to customers for larger orders.

Each identified opportunity undergoes an initial value assessment that is completed jointly by representatives of the PE firm and the family firm. The goal of this assessment is to prioritize the most promising actions along a) their feasibility (How long does it take? How much does it cost? What are the risks involved?) and b) their value-enhancement potential (mostly measured in contribution to EBITDA). Since not all initiatives ultimately deliver the promised results, PE firms set ambitious targets, often aiming for a company valuation increase of two to five times its original value.

Key Value-Enhancement Strategies

Value-enhancing initiatives typically fall into five categories. They aim to increase firm profit through either increasing revenues (e.g., higher prices, new product mix, new markets) or decreasing costs (e.g., efficiency improvements).

Growth Strategies

Increasing sales is a primary goal. Targets can be aggressive, such as a 50% revenue increase within two years. Key growth drivers include product portfolio optimization, the addition of services offered, pricing adjustments, expanded marketing efforts, entry into new market segments, and international expansion. One key risk associated with this strategy is that quick price increases might deter customers. Moreover, long-term approaches such as new market entry carry the risk of failure, which may only become apparent after significant time and financial investment. Lastly, one key success factor is to educate and train the staff: For instance, salespeople often experience trouble when tasked with selling services instead of hardware.

Efficiency Improvements

Cost reduction and operational efficiency are central to value creation. Measures may include renegotiating supplier contracts and—often through top-down directives—reducing the workforce and lowering other operating expenses. Practically all processes in the company are reviewed for potential efficiency gains. Typical measures include streamlining workflows, automation, or outsourcing non-core functions. However, this strategy presents several challenges. First, management must find ways to maintain high levels of morale and motivation, while also ensuring that key personnel are not lost unintentionally. Second, efforts to streamline processes may result in the loss of critical capabilities—an outcome that must be carefully avoided.

Capital Efficiency

This group of measures focuses on optimizing working capital and capital tied up in fixed assets. Working capital initiatives aim to permanently reduce required inventory levels, accelerate or bridge incoming customer payments, and extend payment terms with suppliers. Moreover, firms can increase their liquidity by engaging in factoring, in particular in industries where customers have long payment periods. In the area of fixed assets, the primary goal is to professionalize the review and approval of investment and financing decisions while utilizing suitable financial instruments. The liquidity released through these measures is often withdrawn from the company to prevent a relapse into a state of inadequate capital efficiency. However, capital efficiency-related measures bear the risk of extensive bureaucracy and never-ending release processes. This means that firms need to find a way to maintain their agility and entrepreneurial approach. Moreover, working capital measures often involve horse trading: The customers and suppliers typically demand margin

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changes for agreeing on revised payment terms. This often leads to nitty-gritty discussions that ultimately strain the partnerships.

Governance Optimization

Governance measures were initially developed to prepare the company for the capital market. These changes strengthen the business, whether or not it eventually goes public. For instance, they might help reduce borrowing costs. Typically, companies establish an advisory board and appoint experienced executives to both top management and the second leadership level. These leaders bring the necessary expertise for the upcoming transformation and potential sale. To reduce reliance on key individuals, businesses invest in employee training and implement incentive systems for management. They also define organizational structures, reporting lines, and job descriptions more clearly. To enhance transparency, companies expand controlling functions and optimize reporting and risk management processes. They also professionalize planning, steering, and decision-making processes, as well as compliance and quality management. Additionally, they refine financial strategies, including financing and taxation, to ensure long-term stability and growth. When applying this measure, it is important to find the right balance. Controlling and compliance processes are important, but they must not suppress entrepreneurship and agility. Also the newly appointed management needs to deftly balance the investors' expectations and the company's perspective.

Strategic Realignment

A standalone measure is the development of a strategy aimed at sustainably strengthening the company's market position. This strategy leads to comprehensive action plans, such as changes in the value chain or business model, as well as the expansion or divestment of business units. Often, the goal is to streamline the company around a core competency where it possesses sustainable, unique selling points. For key areas, companies formulate sub-strategies and support them with specific measures, typically in fields such as human resources, innovation, digitalization, and sustainability. Strategic realignment is challenged by the differing time frames of short-term oriented PE and long-term oriented family firms, which require intense discussions. Moreover, strategic realignment often gets complicated when PE overestimates the firm's resources available for transformation.

Implementing Value-Enhancement Measures in a Family Business

Increasing company value is a comprehensive and complex endeavor that affects virtually all business areas and involves multiple interdependencies. Private equity (PE) investors have developed targeted methods to improve the likelihood of successful implementation in their acquired firms, including family firms. The following section outlines key aspects of these approaches.

Organizational Structure

Each initiative has an assigned responsible person. Initiatives are organized into clusters, with sub-project managers designated for each group. Typically, there are eight to 15 sub-projects with names such as "Product Portfolio," "Procurement Optimization," or "Manufacturing Processes." These sub-projects effectively bundle the 50 to 250 individual measures mentioned earlier. The managers responsible receive primarily quantitative targets and oversee implementation planning.

Whenever possible, companies staff sub-projects with internal executives. However, external consultants are brought in where independence or specialized expertise is required. This is particularly relevant when dealing with sub-projects such as "Organization," which may involve leadership selection and personnel cost reduction.

The sub-project managers report to a Program Management Office (PMO). The PMO is responsible for organizing and training all participants, supporting them in preparing decisions and resolving conflicts, monitoring project progress, coordinating timelines, and managing information and risks. It also ensures that dependencies between different projects, daily operations, and key resources are properly considered. Due to the need for specific methodological expertise and independence, the PMO is often staffed externally.

Above the PMO is a Steering Board, typically composed of a small group of senior management members and investor representatives. In the initial phase of a profit enhancement initiative, the Steering Board meets every two to four weeks, with meetings occurring less frequently as the initiative progresses. The PMO regularly updates the Steering Board on the progress of sub-projects. When critical sub-projects, key decisions, or issues arise, the respective sub-project managers are

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invited to participate in the meetings.

Implementation Stages

Initiatives typically go through four standardized implementation stages (sometimes broken down into five or even six), which reflect the maturity level of each initiative. Once an initiative has progressed through one stage, a decision is made whether it can move on to the next one. These implementation stages are typically as follows.

- Identification: Teams briefly describe the idea and assess its potential value contribution and its feasibility.
- Decision: The Steering Board reviews the implementation plan and business case before approving execution.
- Implementation: Teams execute all sub-measures. This phase typically takes the longest and may include multiple milestones or sub-projects, depending on the scope.
- Effectiveness: The initiative delivers measurable financial benefits and becomes a sustainable part of business processes.
- The PMO ensures full transparency on implementation progress and effectiveness. The Steering Board reviews each initiative's readiness to advance to the next stage and makes key decisions as needed.

Time Scheduling

Before acquiring a (family) firm, PE investors develop hypotheses on how to increase its value. As soon as they complete the acquisition, they initiate implementation immediately. Often, they launch a 100-day program, which typically follows this structure:

- First phase: Teams conduct a thorough company analysis, validate initial hypotheses, and identify key value drivers.
- Second phase: They define the strategy, make critical organizational decisions, and develop a detailed action plan.
- Final phase: The PMO begins implementing the action plan and focuses on achieving initial quick-win successes.

Afterward, teams align all action plans with the Steering Board's meeting schedule. Throughout the process, they maintain strong time pressure to ensure rapid execution.

Keeping Up Pressure

The program creates a significant additional workload alongside daily business operations. Participants must deliver quick results, learn new methods, and provide weekly progress reports. If delays or missed targets occur, the PMO immediately escalates the issue to the Steering Board. The related organizational changes often cause uncertainty among employees and management.

Teams prioritize highly sensitive measures, such as workforce reductions or site relocations, to minimize voluntary resignations and productivity losses caused by prolonged uncertainty. The overall strategy focuses on unlocking as much value potential as quickly as possible, allowing the organization to stabilize after two to three years.

Applying Investor Strategies to Family Businesses

In private equity (PE) investments, value enhancement goals focus on cash flows during the holding period and at the time of sale. Family businesses, however, often pursue different objectives. Some of these objectives, such as long-term control intentions, positive family reputation, and socioemotional wealth associated with the family firm, might clash with the PE's goals. Other family firm goals, such as improved market positioning or risk minimization, are well aligned with the PE's objectives.

Many family business owners believe that PE-driven measures prioritize short-term gains at the expense of long-term success and fear the potentially disruptive impact on firm culture. However, a closer look at the previously mentioned value-enhancement strategies reveals that this criticism is only partially justified. Many measures—such as those related to strategy or governance—are designed for long-term impact. Others, like capital efficiency optimization, generate both short-term (e.g., enhanced liquidity) and long-term (e.g., better strategic positioning) benefits, offering family businesses new opportunities for growth and stability.

As such, "investor strategies" can appeal to many family firms. As noted above, the global market environment forces all firms to work on their productivity and efficiency, and family businesses are no exception. As such, applying "investor strategies" to one's family

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business can be very beneficial. In the following, we list four scenarios in which family businesses should particularly consider value-enhancement strategies.

Planned Sale to a Strategic or Financial Investor

When preparing for a sale, family businesses should consider accelerating parts of the value-enhancement strategies described above to make the company more attractive to potential buyers. This approach increases the likelihood of securing a higher sale price and better deal terms.

Crisis Situations

A family business facing a crisis—such as declining revenues, low or fluctuating profits, or emerging market risks—must act swiftly to restore profitability and mitigate risks. In such cases, PE investors' value-enhancement strategies can serve as a "playbook," helping businesses save valuable time when implementing necessary improvements.

Planned Internal Succession

Ensuring financial stability and business attractiveness for successors is crucial in an internal succession plan. Over the past decades, succession processes have become more structured and professionalized, leading to the emergence of a dedicated succession advisory industry. Yet these advisors often focus on legal, tax-related, leadership and (family) relationship-related topics. Surprisingly, many senior-generation business owners still invest little time and effort in preparing the company for transition before the official handover.

Performance Improvement Demands

Shareholders sometimes demand significant performance improvements beyond organic growth. This is often the case when family ownership expands through generational transitions. Shareholders who live far from the business, especially those residing abroad, tend to focus more on financial returns and expect higher and more frequent dividend payouts rather than pursuing non-financial objectives. Additionally, performance enhancement may become necessary if new individuals or organizations join the shareholder structure to increase available capital.

The intended benefits of value-enhancement potential are typically divided into financial and real value drivers. Financial effects are those reflected in financial reporting, such as cash flow. Real effects are tied to qualitative goals, such as the company's attractiveness to third parties, sustainability, or resilience. For family businesses, value encompasses both types and refers to the increase in value based on the difference between the company's value before and after implementing the measures.

Should You Go 'All In?'

The following section explores two options that family businesses seeking to enhance their value can choose from: the "full program" and the "selective adoption," which only comprises specific aspects of investor strategies.

Comprehensive Value-Enhancement Program ("Full Program")

Implementing a rapid and comprehensive value-enhancement program carries certain risks, particularly for family businesses. The company may lose the trust of its employees, customers, and suppliers, and an intense internal focus may cause it to overlook market developments and daily operations. Additionally, the high speed of change comes with consulting costs and the risk of poor decision-making.

However, the PE approach demonstrates that organizations are often more resilient and adaptable than management initially assumes. In scenarios a) and b) discussed above, such a full program can be a viable strategy. The alternatives, not preparing the company for sale or not actively driving profitability in a crisis, often result in even greater risks and costs in the medium and long term.

Partial Aspects ("Selective Adoption")

For a financially strong and sustainably well-positioned family business, a comprehensive and rapidly implemented value-enhancement program may not be the best fit. However, selectively adopting certain aspects of the methodology can help address specific weaknesses within the company. These include:

- Systematically identifying, evaluating, and consistently implementing potential improvements,
- Enhancing financial discipline, with a strong focus on liquidity,
- Setting ambitious goals and strict timelines,
- Improving transparency through enhanced controlling, and

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- Establishing clear decision-making rules and accelerating decision-making processes.

Hence, such partial adoption might be a good approach for companies facing internal succession or increased shareholder pressure as well as any family business aiming to increase its competitiveness. ***The attachment, downloadable above, outlines a road map of the necessary steps that family firm owner-managers need to engage in to run their own "investor strategies" program.***

Conclusion

While family businesses differ from other firms, including PE firms, they can benefit significantly from structured value-enhancement approaches. By selectively adopting proven investor strategies, they can strengthen their competitive position while preserving their unique culture and long-term vision.

AUTHORS' NOTE: This article is based on the decade-long experience of both authors working with family firms and PE firms. The article first appeared in German language in "Familienunternehmen und Strategie." Artificial intelligence tools, specifically DeepL, ChatGPT, and Grammarly, were used for initial translations and polishing the language.

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