Making Sense

Creating Equity Value through Tech-Enablement

Moving Beyond Simple IT Due Diligence

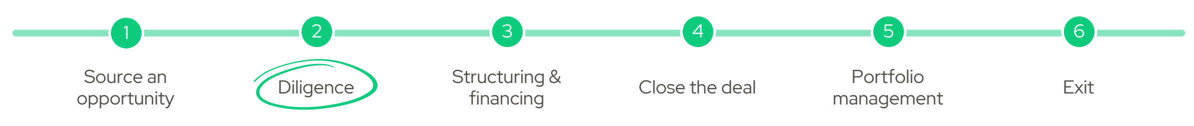
This article is co-authored by Gerson R. Guzman, Co-Founder of Ceiba Capital Partners, an investment firm that focuses on the tech-enablement and digital adaptation of lower middle-market companies; and Fernando Florez, Head of Strategic Partnerships at Making Sense, a tech-development company that helps private equity firms unlock value and generate higher investment returns through enabling technologies.

When you say the word technology, most people think of coding or the next big app, an amorphous concept that reflects revolutionary high-tech innovation. However, the reality of technology adoption is that it can occur in ways big and small. From incremental improvements to dramatic changes, the question remains the same: how, and more specifically, when to harness technology innovation across the Investment Lifecycle to drive portfolio companies' growth and create new business models.

When making an investment, private equity investors often overlook early technology assessment during the due diligence period. Instead, they tend to consider it once the transaction is done and the holding period starts.

The following diagram summarizes the Investment Lifecycle. In practice, the process is more involved with many intervening steps and workstreams, but the diagram provides a good high-level overview of how a traditional private equity firm manages the Investment Lifecycle. For our purposes, this simple diagram suffices to determine the best time for evaluating and implementing technology to rapidly scale and accelerate the growth of a business. Based on our experience, the value creation identification begins at the Diligence stage and is carried out throughout the Portfolio Management stages.

The Investment Lifecycle



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The Importance of Diligence – and the Trusted Advisor

Private equity due diligence is focused on identifying the risks and opportunities of an investment. It is no different than the way an executive determines resource allocation for internal projects, except that the PE professional has only 60-90 days to learn a fraction of what the founder or executive has mastered over decades.

In order to bridge that knowledge disparity, a prudent investor hires experienced advisors early on in the due diligence process to dive in and evaluate the various aspects of a company's operations. The basic due diligence playbook involves accounting experts, background investigations, environmental assessments, industry experts, etc... More often than not, the "technology" assessment, or rather due diligence, is conducted by a firm to assess the scope of a company's IT potential. Frequently, this is focused on hardware infrastructure, vulnerabilities, and capabilities.

In certain instances, due diligence will evaluate the capabilities of a company's systems. This is especially true for businesses that provide tech-enabled services or have critical software in place (such as a CRM, or ERP package). This siloed approach to due diligence is not holistic in ascertaining the opportunities at the operational level in order to marry existing technology or to drive innovation that improves a company's operations, products, or services. Evaluating the totality of the due diligence findings and determining the risks and opportunities is left to the private equity practitioner, who will identify them through extensive management consultations and plan for post-closing initiatives. Unless the practitioner is a savant, he or she needs to see the whole picture and determine which opportunities identified during this process have merit.

The key to unlocking potential is in figuring out how to bring together all aspects of the various due diligence streams to get a holistic view of the opportunities available to improve or transform the business model.

More often than not, this happens in earnest at the post-closing stage of ownership – Portfolio Management. At the same time, the budgetary and financial analysis, as well as the monthly and quarterly review process, drives the selection of projects identified during due diligence, or new projects that are identified in the normal course of the business.

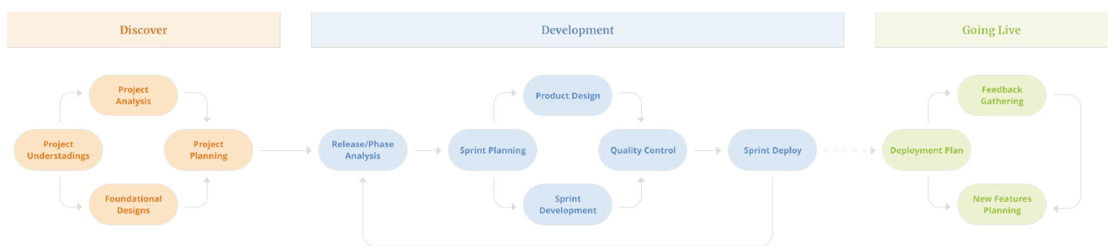
Moving from Portfolio Management to Portfolio Improvement

Most private equity firms have a 3- to 7-year investment horizon and it is imperative to quickly implement projects with the potential to generate outsized returns. To do so, management must have the right support and resources to execute. For the private equity professional, this begins during due diligence, but the information asymmetry and outsider status as a prospective investor or buyer makes it an imperfect process. As noted, investment firms have only a short window to conduct their due diligence and make a go/no go decision on a transaction. There is also a natural tendency from management and the workforce to be guarded during the due diligence process as they feel out their future potential partners. This means the investor may not have full access to all employees to conduct a full development assessment.

Post-closing it is the role of the investment firm, via the board of directors, to provide oversight and exercise its fiduciary obligations, and to constructively challenge management to improve the business. Often, advisors are required to evaluate the opportunity, supplement management, and provide project management while bringing an idea from concept to realization.

Discovering Technology Opportunities

This brings us to the Technology Discovery Process. Now that the investor has full access to the business, he or she can and must quickly go about determining where the opportunities truly lie for adopting, developing, and deploying technology to accelerate a company's performance.



This is a critical role that the right trusted technology advisor plays in working with management and the board to determine how best to proceed. While the investment firm may have identified the opportunity post-closing through its own due diligence process, it is imperative to move quickly to realize the potential value. Sometimes, extenuating circumstances necessitate a pivot or a project's acceleration.

This following case study describes the Technology Discovery Process.

As the Covid-19 pandemic raged, a Private Equity sponsor developed an investment thesis that opportunity existed in helping companies transition from analog, in-person business models to digital entities able to operate remotely.

A leading provider of court reporting services in the Northeast (The Company) was identified as having the potential to disrupt the litigation industry, which hadn't changed in generations. With courts shut down and judges, lawyers, defendants, witnesses, prosecutors, and legions of support staff in quarantine, how could an industry based on human interaction for depositions, trial preparation, and adversarial exchanges operate?

The Private Equity sponsor saw the opportunity to rethink how legal court reporting services were delivered. The investment firm acquired The Company with the intent of generating significantly higher returns by helping the business become tech-enabled. While it originally believed it could transition in-person depositions to a secure remote video platform, it very quickly recognized much greater potential to transform the business.

Though the PE sponsor saw the opportunity, it didn't know precisely how to get there. It engaged Making Sense post-closing to conduct a Discovery Process. During this phase, Making Sense collaborated with the firm to identify where technology could enable new opportunities and competitive differentiation. By leading investors and company stakeholders through a series of workshops, the team agreed on business, product, and investment goals and priorities. Workshops included: discovering a new value proposition, defining success and KPIs, and developing a product roadmap, among others.

The initial goal was to maintain The Company's market-leading position in court reporting while building a digital deposition platform that would bring together all parties including lawyers, court reporters, and witnesses within a remote deposition setting that recreated the courtroom experience. With these goals and new business opportunities in mind, Making Sense set out to create a cloud-based MVP (Minimum Viable Product) in record time to demonstrate the new ways of doing business and gain the first-mover advantage.

As a result, what once required physical proximity can now be achieved regardless of the location of those involved. While this significantly expands The Company's market, the firm was even more excited by new opportunities for tech innovation based on modernizing the business into a SaaS (Software as a Service) platform. The PE sponsor has transformed a traditional court reporting platform into a tech-enabled legal services business, with the potential for creating very valuable investment returns.

As this case study illustrates, technology can be daunting, but it is often one of the strongest levers of value creation. When used effectively, it can help drive efficiencies, improve productivity, and create new market opportunities. By undergoing an expert-driven Technology Discovery Process, the company was able to alter the value proposition through digital transformation that expanded beyond its core geography.

The Technology Discovery Process is key to envisioning how to deliver improved products and services in an ever-changing and dynamic marketplace. To get it right, you don't need to be a techno-wizard, but you do need to understand the process to discover and develop opportunities to improve your business, and ultimately work with the right capital partner and advisors to achieve your business goals.

About the Authors

Fernando Florez is a goal-oriented executive, with extensive experience driving business-growth strategies in the technology industry. Currently, he is in charge of overseeing Making Sense's business development strategy and building strategic partnerships to help partners increase their business valuation by embracing Digital Transformation processes. He's also focused on providing significant advice to private equity firms on pre- and post-investment in technology-enabled companies.

Gerson R. Guzman is Co-Founder of Ceiba Capital Partners, LLC, an investment firm focused on the tech-enablement and digital adaptation of the lower middle-market companies. With nearly 25 years of experience in principal investing, operations, and consulting, he has developed a strategic understanding of how technology and innovation can drive equity value creation. He has served on numerous private company boards and has worked with management teams to build their companies by leveraging technology and innovation to great success.

About Making Sense

Making Sense is a technology development company that designs, develops and builds software experiences people love. From concept to completion, we create new value and transform our clients' businesses through technology solutions that build new assets and address new opportunities. Headquartered in Palo Alto, CA, we have offices in Mexico, Colombia, and Argentina.

About Ceiba Capital Partners

Ceiba is an investment firm focused on buy-and-build opportunities in the lower middle-market where it can create value through tech-enablement and digital adaptation, in addition to established private equity value creation methodologies. The Ceiba team has the knowledge and experience to partner with founders and executives to identify and implement technology and digital solutions to accelerate a company's growth and scale. Ceiba invests at the intersection of proven performance and potential - in specific sectors of interest, including healthcare services and business services, among others.