Forbes INSIGHTS

PRIVATE EQUITY: SEEKING VALUE FROM VOLATILITY

How PE Leaders Can Harness Uncertainty To Innovate Future Solutions

IN ASSOCIATION WITH

Crowe

Introduction

Forbes Insights in collaboration with audit, tax and consulting firm Crowe LLP conducted a survey of 500 leaders of companies with $500 million or more in yearly revenues.

Findings were summarized in recently published report "The Volatility Strategy: How Leaders Are Seizing Opportunities In Both Calm And Turbulent Times," which explores how executives that seek to innovate in the face of risk can make their organizations more responsive, capable and more likely to meet or exceed revenue growth targets—in both stable and uncertain times.

A closer examination of the responses from 63 executives in the private equity sector reveals a significant opportunity to increase value through adapting traditional approaches to navigating volatility, particularly that of economic change. These relevant findings, and their potential implications for the industry's future, are explored in more detail below.

A Pervasive Concern Around Uncertainty

More than half (52%) of respondents in private equity point to uncertainty about the future as impeding their organization's ability to benefit from volatility. This is the highest result among the eight industries surveyed, well above the all-respondent result of 41%, and by far the most commonly cited concern among PE respondents. Out of 10 potential impediments and given the option to choose as many as desired, no other issue was cited by even 30% of PE respondents.

Among 13 industry-specific causes of volatility, inflation was the one most frequently cited by private equity respondents as affecting their organization today. And when asked to name the single greatest contributor of volatility in their organization, inflation was again the top answer, named by nearly half (48%) of private equity respondents.

VISUAL I

Top Sources Impeding PE Organization's Ability To Benefit From Volatility:

52% Uncertainty about the future

29% Complexity (difficulty in prioritization; in choosing strategies/actions)

27% Time constraints

25% Pressure to perform in the short term

19% Insufficient capital for transforming people/processes/technology

VISUAL II

Top Sources Of Volatility Private Equity Leaders Are Facing Today:

Inflation 64%

Rising/elevated interest rates 54%

Recession fears and uncertainty 51%

Forecasting Vs. Embracing Volatility

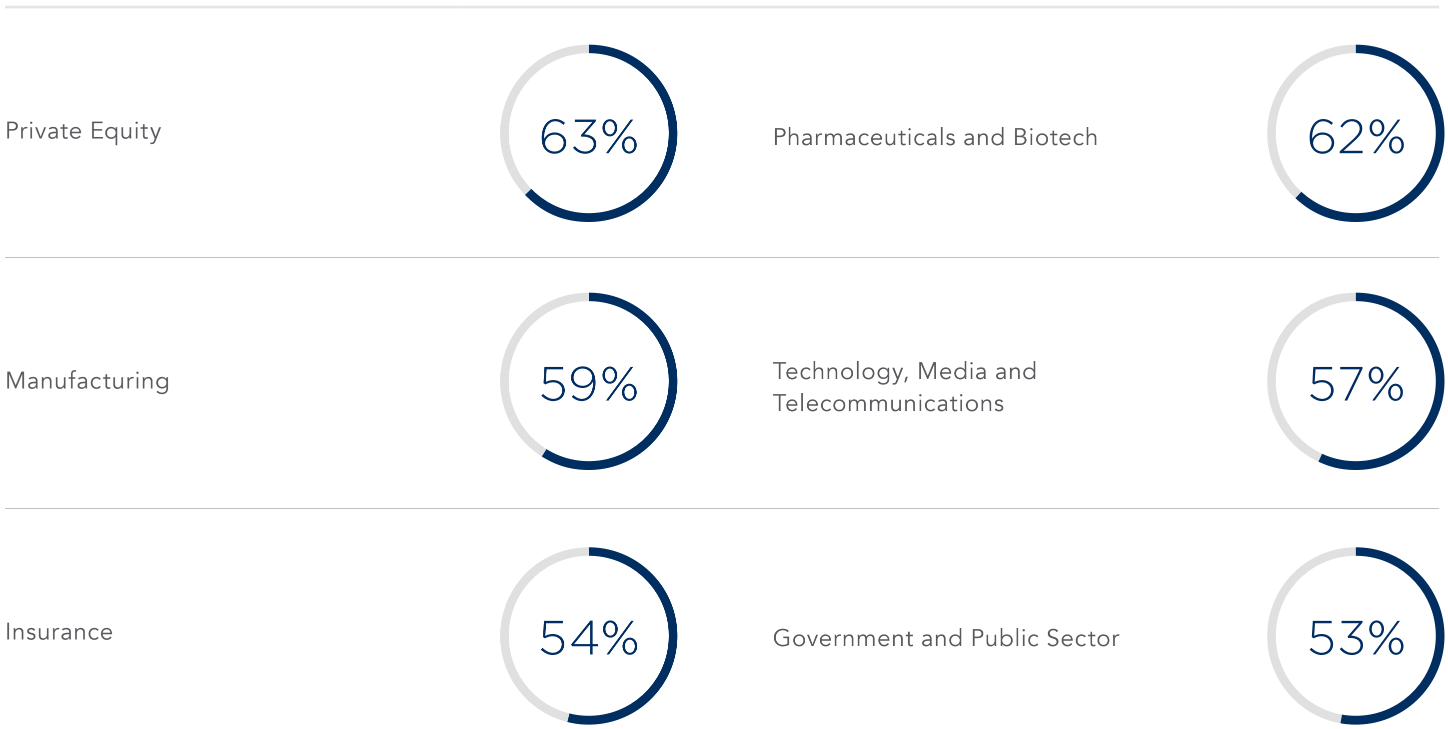
This concern around future uncertainty may help explain why private equity leaders are heavily spending on innovating how they anticipate and respond to volatility. More than a quarter (29%) of PE respondents are extensively investing in technology and processes that improve forecasting, detection, analysis and decision-making to better address volatility.

Private equity is among the top three industries extensively evaluating and investing in AI. Thirty-two percent of respondents say they are extensively investing in AI. They are also spending to upskill employees and expand their capabilities: 43% are extensively investing in expanding employees' skills and use of emerging technology, compared to 26% among all respondents.

But the private equity sector's relative concern about the impact of AI on its future appears to be low compared to other industries: 63% of private equity leaders expect their organizations to face moderate to very low levels of volatility from AI in the next three years. This could indicate that a majority of industry respondents may anticipate that rapid developments in AI could either positively impact the way they conduct business in the future, or help them to detect volatility from other sources.

VISUAL III

Respondents Expecting Moderate To Very Low Volatility From AI Over The Next Three Years:



A Volatility Dissonance

The responses of private equity leaders indicate that there may be a dissonance of sorts in the industry's ability to detect and perceive volatility from overall economic change.

More than a quarter (27%) of PE respondents say overall economic change **is currently having the greatest impact** on their organizations, the highest of any industry surveyed and more than ten percentage points higher than respondents overall (16% overall). Yet, PE respondents were one of the lowest of any industry to believe their organization **is currently experiencing** high levels of volatility from that same source; only respondents in the pharmaceuticals and biotech industry say they are facing less volatility from overall economic change today.

In other words: Compared to respondents in all other industries, private equity leaders are less likely to say they are experiencing high volatility from overall economic change—but are more likely to say that it is having the most impact on their organizations. This may indicate that PE firms more closely associate volatility with specific and measurable economic factors like inflation—or that they are less sensitive to the immediate implications of generalized economic change and moreso to its long-term impacts.

That explanation appears plausible particularly when considering the ramifications of significant market swings in 2023. The share of PE respondents saying their organization has primarily benefited from disruptions and volatility in the market fell from 65% in 2022 to just 38% in 2023. In the first wave, PE respondents were among the highest proportions answering that question, but were the lowest in 2023. It is worth noting, however, that fewer PE respondents said their organizations had been weakened by volatility in 2023 than they did the year before, which could indicate that they feel more confident in their ability to navigate volatility with less negative impact to their organizations.

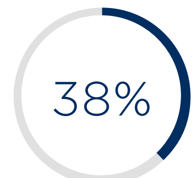
VISUAL IV

A Shifting Experience Of Volatility?

Proportion of PE leaders who say their organizations have primarily benefited from volatility:

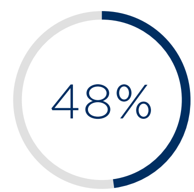
2022

2023

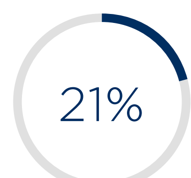


Proportion of PE leaders who say their organizations have been weakened by volatility:

2022



2023



A New Volatility Future

After a tumultuous year in which private equity's confidence in turning volatility into advantage may have been shaken, trends show that organizations may have located a path to capture more value in uncertain times.

The investments appear to be highly targeted: unlike other industries, private equity shows comparatively little interest, with only 13% of respondents (the lowest of all industries) saying their organization plans to extensively develop or expand shared performance metrics to address volatility. Additionally, a low proportion of PE respondents say they are leaning on M&A activity to access new sources of talent, with only 8% saying they extensively use M&A investments to access new talent and/or innovation, lowest among industries surveyed.

However, private equity is one of the leading industries in extensively increasing investments in workforce training (35% versus 23% overall), expanding employees' skills and use of emerging technology (far and away the most aggressive industry in this regard, as noted above), and increasing employee benefits (27% versus 19% overall). This suggests that PE firms are comfortable going forward with their teams in place, but seek to both elevate their training programs and their compensation plans.

Conclusion

Private equity organizations may well be developing their next generation of leaders to be highly skilled, diverse and well trained.

This could bode well for an industry that appears to be primarily concerned with forecasting volatility, particularly for financial indicators like inflation, but may benefit from embracing uncertainty through adaptive innovation that could minimize the negative impacts of those factors.

Together, investments in advancing technologies like AI along with an apparent dedication to evolving and training the workforce could translate to an industry with improved predictive capabilities, less concern about volatility and more adaptive and innovative workforces.

JASON COMPTON
Report Author

Methodology

In collaboration with Crowe LLP, Forbes surveyed 500 US-based executives from organizations with at least $500 million or more in annual revenues in August and September, 2023.

Of the 63 respondents in the private equity industry, a majority, 79%, are C-suite executives, board members or partners. Seventy-five percent of private equity respondents are primary decision makers of evaluating and purchasing accounting or consulting/advisory services.