

How Extended Holding Periods Are Reshaping Private Equity Strategies

By Dan Hawkins

TODAY'S PRIVATE EQUITY INVESTMENT

HOLDING PERIODS have stretched to 7.1 years, the longest since 2000, according to S&P Global's "Private Equity Buyout Funds Show Longest Holding Periods in Two Decades." The first quarter of 2024 marked the slowest deal environment since the onset of the COVID-19 pandemic in 2020, with nearly one-third of private equity-backed inventory being held for more than five years and 12 percent for more than seven years, according to PitchBook's *Q2 US PE Breakdown* report. In the last decade, the median holding period has almost doubled, increasing from approximately three years to approximately six years. Furthermore, based on what we are seeing with clients, nearly 80 percent of deals fall through because of high valuations.

Despite limited partners demanding returns on their capital, sell-side investors are still unwilling to lower valuations and exit their high-performing portfolio companies. The current solution for many private equity firms is simply to extend the holding period and use this as an opportunity to bide their time to gain a higher return on capital, revisiting the investment thesis and value creation plan. The buy-and-build strategy is tougher to carry out in the higher interest rate environment.

In other words, financial engineering used to be the top choice for value creation among private equity investors; now, investors' top choice is to build a better company to ultimately sell.

With extended holding periods becoming more common, how are they impacting private equity firms, portfolio companies, and their boards?

Impacts

The deal environment has shifted the need for board support. Boards and investors have taken a more hands-on approach as discussions about cost, liquidity, and cash flow become more frequent. Cash management is the name of the game right now as management teams and boards navigate today's market accordingly. Cash is being directed more toward debt commitments than growth initiatives. While the key goal historically has been growth, it has now shifted to money management in an ongoing high-interest and slow-growth environment.

This impact on all stakeholders is changing both the day-to-day and the long-term approach. With firms experiencing different economic cycles, investors and boards are trying to end on a high note. This has forced them to rethink their strategies in terms of reshaping their organizations to prepare for a down market in certain industries (e.g., residential construction) rather than an active market. These shifts are all accompanied by an increased number of founders tapping out. People are getting antsy and bowing out as many founders and other management team members no longer want to stay through an extended holding period. Management team retention issues, combined with founder departures, are causing some slowdowns in momentum, giving investors an extra headache as, without a cohesive leadership team or an on-time exit, it can be more difficult to fundraise, and limited partners will not give capital as freely until they see returns on prior fundraising.

Strategy Shifts

These headwinds have driven the need to rethink strategy and the medium-term business focus. Below are some common investor and board trends today.

Open Doors for New Investment

Funds are setting up continuation vehicles for co-investment, for new capital to continue the investment through new partners, or for ways to fuel the organization and bolster it until an exit occurs. The underlying need to de-risk and recalibrate expertise within the organization and board shows some new operational initiatives portfolio companies and investors are taking on during extended holding periods.

Shift from Build-and-Buy Growth to Internal Improvements

From 2020 through 2023, value creation was all about growth for private equity firms. In 2024, with longer holding periods and a new economic cycle underway, private equity is more focused on cost efficiency, processes, working capital, and reducing unnecessary costs and expenses. This happens through reducing management layers, consolidating positions, and, in some cases, integrating previous acquisitions to reap efficiency benefits. Organizations are also looking to enhance supply chains and procurement strategies and to optimize internal processes through people and technology. Much of this stems from longer holding periods; these actions were all necessary before, but now management teams have the time to implement these tactics following the buy-and-build period.

Reevaluate Skills

Over the last decade, private equity investors have begun to appreciate how talent and organizational capabilities can impact value creation. However, most talent strategies focus on firing and replacing key management roles early in the holding period. Changes are looming in the CEO and chief financial officer (CFO) realm; with longer holding periods becoming inevitable, boards are looking for C-suite leaders who are less growth-oriented leaders and more hands-on operators. The CEO profile has shifted toward prioritizing more efficiency-focused leaders. Based on what we're seeing with clients, there has been a significant rise in portfolio company CEO replacements in 2024. However, with these clients, CFOs are still the most commonly replaced leader within the senior management team, and, more interestingly, the CFO profile at the beginning of a holding period is often different from the profile at the end, especially when the exit is extended a couple years. While these leaders may have been the right players on the team during the first year of investment, it may be time to reevaluate skills and capabilities more holistically.

Actively Address Board Gaps and Needs

The role of the board has evolved and with it, board assessments have become more rigorous as investors and management teams need additional and different types of support than boards have historically provided.

Investors are looking more progressively at board composition. In addition to industry expertise and experience, portfolio companies need more holistic boards with outside perspectives in areas such as cybersecurity, digital transformation, and human resources. Moreover, there's greater demand for independent experts who can bridge gaps in expertise and tactical know-how alongside the investors serving on the

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Take a Chance to Revisit Bold Moves

With market and strategy shifts occurring, now is the time to think about new investors, technologies and digitalization, and expertise on the management team and board. It's also an ideal time to pilot the use of generative artificial intelligence to drive efficiencies and internal improvements, trimming the expense of larger,

high-volume transactional work. Though add-on acquisitions as part of the build-and-buy era have slowed, organizations are further integrating these businesses to create one company to streamline operations. In addition, some larger companies are buying similarly sized organizations as an opportunity to drive earnings before interest, taxes, depreciation, and amortization, or EBITDA, from synergies and consolidation.

At the end of the day, the role of the private equity board is to represent the best interests of the investors and ensure that the CEO is set up for success. These are unique times, presenting additional opportunities for the board to support its CEO. The CEO should surround themselves with the right people in the C-suite, with board expertise bolstered for the advisory benefit of the CEO. With additional time on the horizon, ensuring the right partners are selected will provide the greatest value to both the CEO and the organization at large. Because private equity boards are not bound by the US Securities and Exchange Commission and governance rules in the same way that public organizations are, leaning into strategy and playing a truly advisory role will help the bottom line over time. **D**



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