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Why PE Firms Can't Afford to Ignore Company Culture in Their PortCos

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MAR.13.25

Key Takeaways:

- **Culture Drives Value Creation.** Private equity firms aiming for rapid ROI often overlook company culture, which can derail even the best operational strategies. Without engaged employees and strong leadership, productivity and growth will suffer.
- **The Three-Legged Stool of Culture.** A successful company culture relies on customer focus, employee engagement, and accountability. Ignoring any of these factors leads to poor performance and missed targets.
- **Cultural Due Diligence is Essential.** Assessing company culture during due diligence helps PE firms identify challenges early, address resistance to change, and build a strong foundation for sustainable growth.

With interest rates still running high and a large chunk of equity funds nearing the maturity wall, private equity firms are under intense pressure to accelerate value creation.

While most plan to achieve ROI in 4-5 years, the sweet spot has moved closer to 18-24 months for maximizing EBITDA and building a runway for sustainable growth.

With this accelerated timeframe, most PE firms launch into an aggressive 100-day plan designed to shake up the operation and transform the company into a world-class organization.

Unfortunately, many get tripped up immediately because they ignore the most critical component in value creation: Company culture.

As many PE firms quickly discover, even the savviest, most promising productivity strategies fail miserably if the people tasked with implementing them aren't on board. That might sound obvious, but a surprising number of PE firms completely overlook this critical component and get blindsided by cultural issues that immediately derail time to value.

Here's why you can't afford to ignore company culture and how to make it a key factor in your roadmap for value creation.

Success Starts with People

Without the right people in the right roles with the right support, no amount of operational optimization will overcome the deficit. It's no different than if a piece of critical machinery is malfunctioning—a cultural malfunction will slow production and revenue generation to a crawl.

Leadership plays an essential role in creating a positive company culture. In many companies, there's a tendency to promote high-performing operators into leadership roles because "they've earned it" through performance or tenure. Except great operators don't always make great leaders, and that's especially true if they're not coached or taught how to be leaders. When they fail due to lackluster training or support, they don't take a demotion. They leave and take their institutional knowledge with them.

PE firms must acknowledge that the talent landscape has changed dramatically. Across the board, people don't stay with the same company for 30 years like the Baby Boomers did, and they're much less tolerant of a toxic workplace environment. While the manufacturing sector boasts one of the longest average tenures (around five years), getting people past the first 90 days is crucial.

Add to this the fact that many manufacturers fail to properly document their processes and Standard Work, and it's a recipe for disaster that even the savviest PE firm can hardly overcome.

Understand the Three-Legged Stool of Culture

A successful company culture has three critical elements, each requiring the other two in order to achieve optimal function. Ignoring any one of these means sacrificing performance:

Customer focus

Look beyond the sales team's relationship with customers and order pipeline. How does the organization treat its product? Do they prioritize superior quality and on-time delivery? If there's a high error rate or a backlog of orders, it's not focused on the customer.

Employee engagement

Do leaders ask for their team's input and feedback? How's their safety record? Do they offer training and development? What's the mood and sentiment at the frontline and mid-level? What's the turnover like? If there's a "we-them" mentality between the front line and leadership, that's a problem to address immediately.

Accountability

This includes both the KPIs they track currently but also how leadership and their teams communicate about meeting targets. Are they open to change and continuous improvement? Are people at all levels invested in optimizing the company's performance? If the staff isn't on the same page and working toward shared goals, changing processes won't yield the expected results.

Conduct Cultural Due Diligence

In order to derive maximum value in the shortest time possible, PE firms must include company culture in the due diligence process.

To get a true picture, it's vital to assess the culture of prospective and/or existing PortCos through an outside perspective. An organization can tell you what they believe to be true about their culture, but an objective, third-party assessment often reveals a much different reality.

Conducting cultural due diligence pre close or diagnostic post close can help you know exactly where the team stands in terms of culture, identify the obstacles and build a plan to overcome them. Even if your firm plans to bring in new leaders or a whole new management team, you must address cultural pitfalls for them to be well received. Focus on instilling teamwork and showing how the proposed changes will benefit the workforce and the organization, will ultimately improve the business results and improve team morale and job satisfaction.

Invest in the Team

After the assessment, show that you intend to fill gaps with coaching and resources to help the company and its team reach their fullest potential. Many organizations achieve this through offering a Supervisor Academy or develop internal core team capabilities through multiweek program for cross-training and continuous improvement. This allows new and established leaders to build skills, take on a project and see it through, then apply those lessons across the organization.

Investing in people builds a foundation for collaboration and problem-solving culture and sets the tone for long-term partnership and success. But it's also important to be honest and realistic. There may be individuals who actively resist change or perpetuate toxic behavior and the leaders will need to take actions to address them quickly so that the organization can move forward, unencumbered by lackluster leadership.

Consider the Environment

Remember that the culture of an organization also includes the physical environment. Manufacturing facilities don't have to be dark, dreary dungeons. Housekeeping, organization, cleanliness, and good visibility go a long way toward fostering morale, safety and success.

At one OEM parts manufacturer, a Quality inspector was tasked with evaluating every part at the end of the line using a light stand (1000 lux) and the defects are fixed in a rework offline. This created a tremendous amount of waste, not to mention the delay and repeating errors. To solve the problem, the plant leadership upgraded the lighting placement at each workstation to the same level (1000 lux) and used the Quality inspector to train the operators on how to spot repeat defects and address them immediately. The fact that the operator could actually see the components improved defect detection dramatically, and they were able to solve the problem at the source, drastically reducing wasted time and material.

Build a World-class Organization

Every company, whether PE-owned or not, should strive to be a world-class organization—a place where people are invested and proud to come to work. The secret to building a world-class manufacturing culture is a holistic focus on the customer, employees, and performance accountability that includes a shared vision and commitment to success. It's the only way to achieve the kind of rapid transformational value creation that delivers immediate results and long-term sustainability.

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