Privcap/ Report

Born-Digital:

Helping Portfolio Companies Become Tech-Enabled Competitors

EXPERT DISCUSSION

AN EXPERT DISCUSSION FOR VALUE-CREATION PROFESSIONALS

Two value-creation experts discuss artificial intelligence applied to portfolio companies, "table-stakes" projects versus more advanced business functions, and where to begin. Also discussed – private equity's ability to shape the digital future of a portfolio company, instilling a culture of experimentation, and how digital capabilities can increase exit valuations.

Featured Experts:

Cory Eaves,
Operating Partner,
General Atlantic

Angela Zutavern,
Managing Director,
AlixPartners

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This report is based on a recent Privcap webinar. View the program here

"I love AI, but if a company is having a conversation about how to use AI, it's the wrong conversation. It should definitely be about the business problem."

–ANGELA ZUTAVERN, ALIXPARTNERS

Privcap: Cory, talk about the fact that private equity, because of its influence over its portfolio companies, is uniquely positioned to shape the digital future of a portfolio company.

Cory Eaves, General Atlantic: Private equity is in a great position to help our companies with this transformation. It starts with understanding what the market is doing and what their competitors are doing. We talk every year to dozens, sometimes hundreds of different companies in given sectors, and that gives us a great starting point to understand where they are. General Atlantic invests primarily in technology-driven companies. So, in some sense, this what we do all day, every day. We have a long track record of helping companies down the tech path. One of things we bring to the table is access to talent. We've built a network over many decades of technology leaders and business leaders.
We work hard to bring those leaders to our portfolio companies. We've got a real network—partners and suppliers like AlixPartners and others in the market who help us with these types of transformations. Then, finally, for many of our companies—when they're ultimately graduating from being part of GA, when they're going through an IPO or being sold—technology becomes an important part of the story.

Angela Zutavern, AlixPartners: I would totally agree with Cory. I see a couple of reasons why PE companies are uniquely positioned to help portfolio companies up their games. PE companies see technology and digital trends over and over across many portfolio companies. I've helped with these transformations hundreds of times. PE companies can really help the management team navigate those types of changes and decisions.
The second thing we see with a lot of portfolio companies, even technology-based portfolio companies, is that many of them are still in the early stages of using digital technologies and data. So, with some small investments, they can see a big uptick in performance—either on the revenue side or cost-savings side—and catch up quickly to where we see the technology leaders operating today.

Privcap: Broadly, how can a private equity firm help a company with a legacy business model, which perhaps has not fully adopted a lot of the digital advantages that are available today?:

Eaves: Sometimes the right starting point for companies is to take something they're doing already and try to figure out ways to bring automation and digital technology. We have a home care business that sees patients in their homes, many elderly patients. They have an electronic medical records system that requires a certain number of steps and approvals and workflow to generate the right documentation for those patients. This company had a

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handful of nurses at the home office who did nothing all day long but review medical records. They implemented some robotic process automation (RPA) to essentially automate that step, which freed the nurses up to do more of a quality-control check on the front end.
It's a minor example, something that is very simple. But it's a toe in the water. It's a way for the company to get started, to introduce digital technology and start to automate parts of the process.

Zutavern: One of my favorite examples, and where technology like AI can make a big difference, is when it comes to increasing revenue through better customer knowledge.
There was a portfolio company, a consumer services company, which had grown through acquisition, and which never before had brought all of their customer data together in one place. So they built a cloud-based data platform, bringing all of their customer data together from all the different brands, got rid of the duplicates, updated addresses. Then they were able to leverage third-party data to match up with their internal customer data and used AI to predict who would be interested in their services. They also used it to predict where the best cross-sell and up-sell opportunities were. Leveraging AI and technology with the customer data, if you're not already doing that, is a great place to start and often has a good return.
Some other examples: we see a lot of portfolio companies doing finance transformation, building this type of data platform to use for finance transformation. It can also be used for other applications like supply chains. Many companies are using web data like social media data or customer credit reviews. They're collecting publicly available data and they're using it to design new products or improve existing products. The more types of data, the better.

Eaves: To use another healthcare example, a relatively large company started their journey with an acquisition. They went out and found a small, innovative spin-out from MIT and Harvard that had just a handful of engineers, but had built some really impressive technology to review and process medical records. The technology was integrated into their core platform. The portfolio company was able to use that technology and automate the approval of a vast number of the cases flowing through their system. The nurses were able to focus on a much smaller set of cases and give them a deeper review. Then, this technology approved all the ones that just flow through automatically. If a company's in the right position is to find a small, interesting technology, sometimes an academic one, that can be used as a starting point to help grow this capability.

Privcap: How do you start the conversation with a management team about integrating AI and other technologies into business processes?

Eaves: It can be a good leverage point to start with a very specific use case - something small - and work backwards a bit from there. There's no need to create a grand five-year strategy for AI deployment. In many cases, the right place to start is with the process and not the technology. Figure out a specific business problem. I can give you a great example: One of our companies provides services to autistic children. The main problem that they face is to match the clinicians with the patients and get the scheduling right. It turns out that some of the biggest impact we could have was reorganizing the way their scheduling team worked. Once they dove in and understood the best way to match patients by what the patient's needs were and their geography, then they came back as a second step and built and installed technology over the top of it.
Companies that go out and buy a technology, hire a bunch of engineers as a starting point without great clarity on what the problem is they're trying to solve, don't always get to the end game they hope for.

Zutavern: I couldn't agree more. I love AI, but if a company is having a conversation about how to use AI, it's the wrong conversation. It should definitely be about the business problem. A great way to start is by developing one or more business cases, making sure that people understand what problem we're trying to solve and where it's going to show up on the P&L. So, not 'How can we use AI technology in pricing,' but rather, 'How can we increase revenue through different pricing approaches? And what will dynamic pricing do for us?'
If that's a really strong business case, then yes, absolutely, AI can make that happen, but it should definitely start with the business case. Another great example on the operations side is manufacturing and supply chain, where there are a ton of operational efficiencies to be had. Lots of manufacturing equipment has all kinds of sensor data, but the conversation shouldn't be, how do we use all our sensor

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data? It should be, how do we optimize our labor or how do we reduce maintenance costs, then take it from there with technology that can solve those business problems.

Privcap: Talk about the importance of fostering a culture of experimentation. . .

Zutavern: With any type of technology, especially technologies like AI, there's no such thing as getting it right every time. In fact, AI benefits from experimentation and the more you use the models, the more accurate they get. So, if companies are too quick to dismiss something as a failure, they're never going to get to the successful model or the successful implementation. The trick is to create the culture of experimentation and allow the time for experimentation while still meeting schedules and deadlines and taking risks that aren't too big and that are socialized and syndicated with the rest of the company. It's definitely a balancing act, but you cannot do AI without experimentation.

Eaves: I completely agree. Companies that experiment ultimately deliver innovation faster. Companies obsessed about getting everything exactly perfect before they roll things out ultimately wind up taking longer to get there. If you're creating a culture of experimentation, it will deliver speed. Also, a lot of businesses naturally lend themselves to experimentation because many types of businesses provide services in many different geographies, where they might have different products. It's often easy to carve off a certain part of the business, a certain set of customers, a certain geography, a certain product, and try something: a price change or a new technology or user interface change in one of those parts of the business and see how it does. That's one of the things that we often encourage our companies to think about.

Zutavern: We also see companies using the approach of developing multiple miniumum viable products. You should expect some of those MVPs to fail. But the ones that succeed, you go on and expand them further and eventually implement them enterprise-wide. That's the way to do it without experiencing too much pain associated with failure.

Privcap: Have either of you experienced cases where an AI project that didn't go where you wanted it to go, forcing you to manage through the frustration that management may experience?

Eaves: Definitely. The earlier example I gave of the company that automated medical records review—we actually found some of the physician's offices sending medical records in were gaming the system. They started sending in things that they knew would automatically work around some of our technology. So as we refined the technology and installed it, we were trying to shoot for a moving target. It took a while to fix that problem—maybe more than a year for us to fix it. We ultimately wound up regrouping and coming up with a totally different approach.

Zutavern: I've worked with a few food manufacturing companies and they were interested in using AI to inspect the food product or to identify problems early on, to figure out if the food products were meeting specifications or not. They were using video data and computer vision technology with AI. Some of the early models weren't so accurate. It all depends on how good your training data is - many companies don't have tons of training data to train these AI models.
Another approach is to use humans in the loop, where you have the AI evaluate a video or pictures, and then you have a person review some of those results and say, "Yes, no, right or wrong." Then, the model can keep learning from there. When you're not sure if an AI model is going to work, run the AI model alongside the traditional process, and keep training it until you can convince yourself that it's just as accurate or better than the human process.

Privcap: What are some business processes that AI can address, that go beyond some of the mundane "table stakes" processes that people are most familiar with?

Eaves: At the getting-started level, we have a number of companies that are connected to a number of industry data sources in the healthcare sector. There are dozens, maybe hundreds, of different data sources. They're ingesting the data and they're able to produce some basic reports. If you're able to gather data, get it into your organization and run some basic reports off of it, that's table stakes. Beyond that is being able to use that data and actually start to generate insights and recognize patterns in the data. Those are very simple things like automating faxes, optical characterization technology (OCR) to recognize texts in a healthcare context. It might be looking at patterns in the data to recognize patients that have a certain disease. Certain patients

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are taking these medications, therefore we believe they have diabetes.
At the final stage are companies that have created their own models, their own data sets. They've done their own labels and they're no longer just applying off-the-shelf technology. These are in areas like fraud detection. We have a couple of companies in the financial sector that do some really amazing work in a very proprietary way around fraud detection and analysis in the financial sector. We have an insurance company that has built a model for customers who are likely to leave the company. They perform special outreach to those customers and try to essentially save them from leaving. That model around leave-prediction for their customers is entirely unique, entirely proprietary, and it's built entirely in-house.

Zutavern: Table stakes may be just knowing your customer, customer preferences, making recommendations. But if you're getting into customer lifetime value and true marketing effectiveness, that's a little more advanced.
Beyond table stakes - every company forecasts and traditional methods would take the past several years' worth of data and forecast predictions based on that. Well, with COVID and other situations, companies have experienced major fluctuations in demand, some much higher demands of lower demand disruption in supply chains. So, a more advanced approach would be using AI methods to do the forecasting, where AI can actually operate on a smaller dataset. Maybe you just look at the past month or the past week, or even the past day, depending on the volume you're dealing with. It can adjust to changes in the market in a much more rapid way.
If we're talking about basic pricing, that's table stakes. Beyond that is dynamic pricing and the ability to adjust prices based on all kinds of external factors. It could be competitors' actions, it could be weather or other events happening in the world. That type of dynamic pricing is more advanced.
What's really advanced are the companies creating a digital twin of their supply chain. They have an entire digital model representation of their supply chain and they're able to perform "what-if" scenarios. That's pretty advanced.
Then, in manufacturing, using basic sensor data is table stakes. Labor optimization can be table stakes. More advanced would be using video data to predict all kinds of issues with your manufacturing process

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before they happen, getting more insight into your manufacturing process than you could get from human observation or sensors alone.

Privcap: If you're talking about using AI as a predictive tool in a manufacturing setting, would that be like a sensor keeping track of a cog and if the cog starts to wobble that would indicate that perhaps it needs to be fixed or replaced, to put it in layman's terms?

Zutavern: Yes. Sometimes a plant manager doesn't know what went wrong until it's very obvious or until the end of the line. AI can go back and look at all of the data and determine what actually caused the problem. It can problem-solve for you. With AI, when you implement video data, you can get a lot more observations than you can get from sensor data alone. It just arms the plant managers with more observations. It's like as if they had eyes on the manufacturing lines 24/7.

Privcap: Cory, it sounds like the healthcare industry in particular is fertile ground for some of these AI solutions. . .

Eaves: Yes, that is right. The industry is playing catch up a bit and you're seeing a flood of investment and new innovation in healthcare. The whole sector is going through a multi-decade transition to value-based care, which means instead of paying a fee for service, paying for individual procedures that your doctor or hospital does, the industry is moving toward paying for outcomes and making healthier patients. That transition, fundamentally, over the long-term is about data. It's about being able to identify patients who are at risk and intervene early to prevent them from getting sick or to keep them healthy. There's been an explosion of companies in that space who were working to bring that future to reality.

Privcap: Can the adoption of AI help to increase an exit valuation?

Zutavern: Absolutely. I've been involved with many initiatives that have directly resulted in an increased valuation of the company when it exited. If there's data that shows non-digitally enabled and digitally enabled companies that are comparable, that's a no-brainer. Even if that data isn't readily available, I would still talk with the valuation experts and get a feel for how much you could increase the multiple and what it would take to get there.
You can't increase the valuation multiple by doing one digital product. But you could certainly increase it by creating a digital platform that enables the entire company and changes how they do everything from customer interactions to sales to marketing to operations. So technology enablement should be a really strong consideration in any exit strategy from day one.

Eaves: I completely agree. There's no question that these technologies absolutely change exit values, 100 percent. The caveat is they have to be linked to the business outcome. Back to this theme that Angela mentioned - investors are not going to give you credit just for having a great technology. They're going to want to understand that this technology translates into more customer retention or into winning business that you might not have won otherwise, or more efficient, scalable operations at lower costs.
As long as you're able to tell that story and make that connection, "We deployed this technology and therefore we're able to reduce hospital admissions," investors can very easily and clearly see the link to that technology. General Atlantic has had multiple IPOs this year and I can tell you that, in every single case, the technology really is part of the story. It's part of what people want to understand and it's part of what our companies absolutely think about as part of that process.

Zutavern: I would add that the flip side is true. Investors are expecting really advanced use of technology and, if a company doesn't have it, they're going to get hit even harder on the valuation than they would otherwise, because it's almost becoming something that everybody's expected to do now.

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