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What do Private Equity Funds expect from CFOs?

Finance Function Effectiveness Research Turkey, 2012

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Introduction

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Following recent developments in the world economy, Turkey has become a major centre of attraction for foreign investors and foreign capital.

Approximately 50 private equity funds of Turkish and overseas origin actively invest in the Turkish market, while up to 100 funds invest from time to time. These funds have recently invested in approximately 150 companies.

The retail industry, consumer goods industry, service sector, healthcare industry and media sector are the top recipients of investment from private equity funds, and investments in these industries are expected to grow in the coming periods thanks to Turkey's young, consumption-oriented population.

A number of private equity funds that have yet to invest in Turkey are seeking opportunities and closely tracking developments in the market. Specifically companies that have expanded to a certain extent are being followed by large private equity funds.

In light of these developments, we have prepared the 2012 edition of the **Finance Function Effectiveness Research** report to aid in understanding the reciprocal expectations of private equity fund managers as well as expectations of CFOs at companies these funds invest in. We will also outline the different perspectives adopted during this process.

We trust you will find this research useful.

About the research

The year's edition of **Finance Function Effectiveness Research - Turkey**, entitled "What do Private Equity Funds expect from CFOs?", has been prepared based on face-to-face interviews with both private equity fund managers and CFOs of private equity portfolio companies.

20 questions relating to the three main stages of the investment process – pre-investment, investment, and post-investment – were presented to both sides, and from the responses we have drawn a general picture of what private equity funds expect from finance functions and the extent to which these expectations are met.

Our research is grouped in three main categories:

1. Pre-investment process:
Criteria taken into account by a private equity fund and a target company during the selection process

2. Investment process:
Evaluations relating to the execution phase of a private equity fund's investment in a company

3. Post-investment process:
Expectations held by the private equity fund managers and the portfolio company management for each other's activities after the investment process is complete

Portfolio structure

Private equity funds generally prefer to invest in emerging Turkish companies with a turnover valued between TRY 50 million and TRY 200 million and to take a shareholding percentage of 30% to 50%.

The total headcount at the surveyed companies in which private equity funds are shareholders has increased by 54% on average since the investment. In terms of the Finance Function, the headcount has increased by 32% on average since the investment.

This result indicates that private equity funds are concerned with how the Finance Function operates and play a role in changing the ways of doing business if deemed necessary.

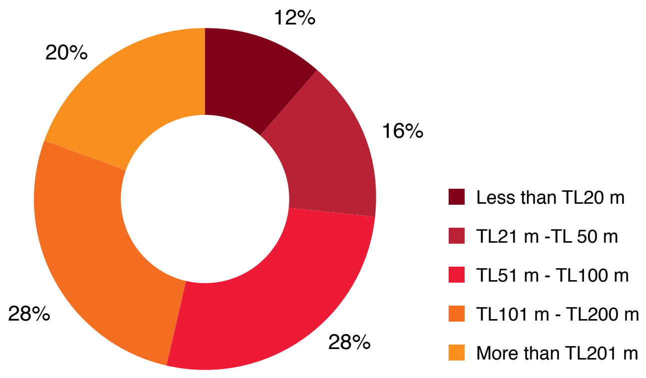
Growth in total headcount:

54%

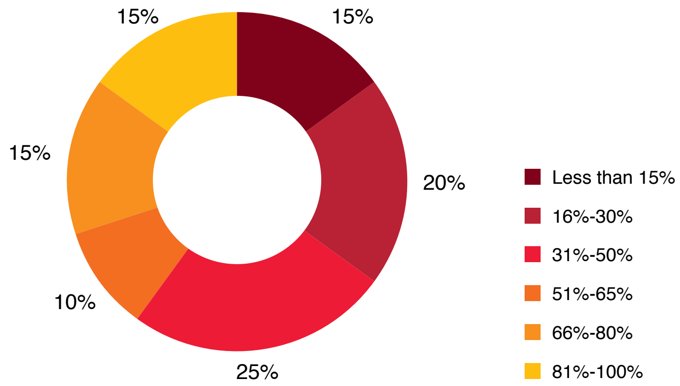
Growth in Finance Function headcount:

32%

Turnover size of companies in private equity fund portfolios



Private equity funds' shareholding percentage in their portfolio companies



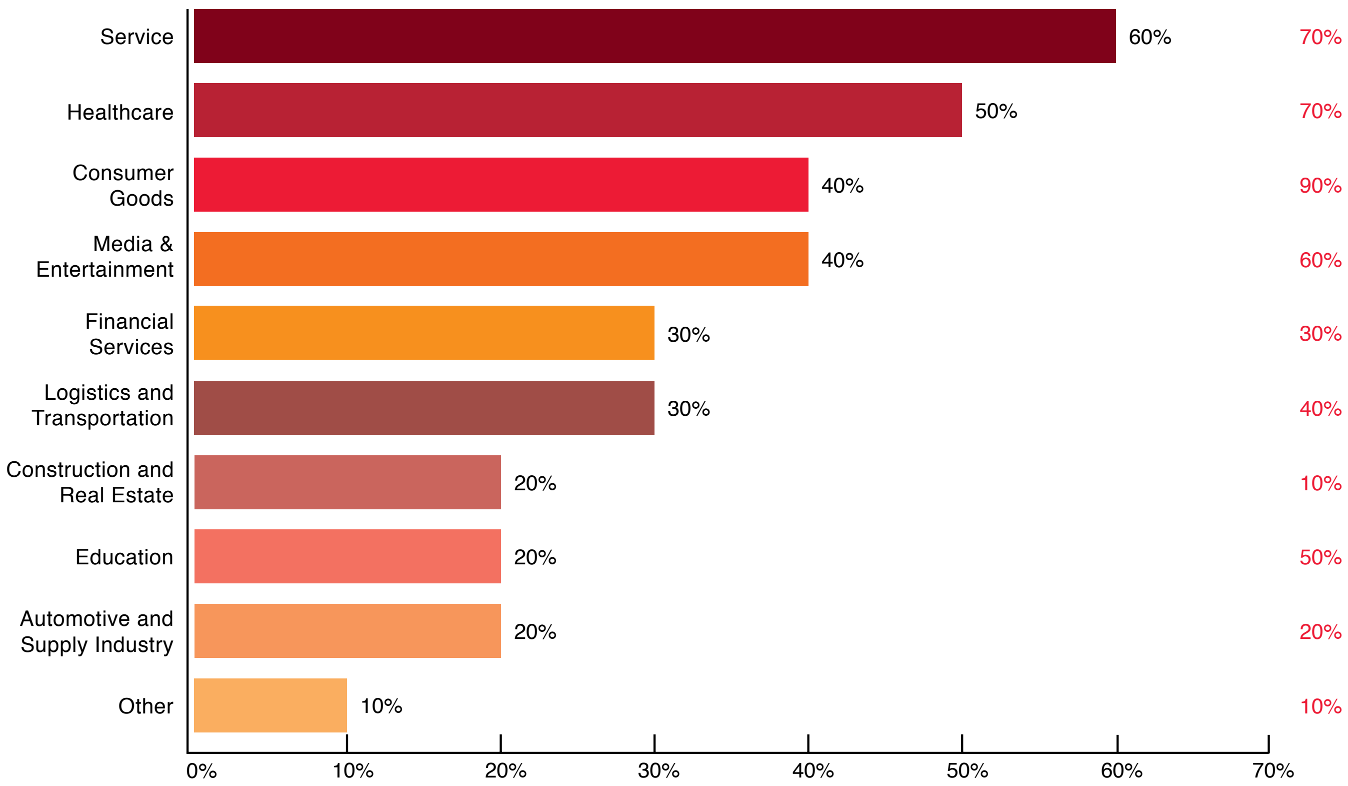
Attractive industries

The industries that have attracted the largest portion of investment in private equity funds' current portfolios are service and healthcare. These are followed by the consumer goods industry, which includes retail, and the media & entertainment sector.

In response to the question, "In which industries do you intend to primarily invest in the next five years?", the private equity funds tend to prefer the service and health sectors most in line with their current portfolios. However, it is apparent that their interest in the consumer goods industry and the media & entertainment sector in particular has been increasing.

Industry breakdown of companies in current portfolios of private equity funds

Industries targeted by PE's for investment in next 5 years



1. Pre-investment process

Targeting quality over quantity

Private Equity Fund

A great majority of private equity fund managers first focus on the growth potential of a target company, then the effectiveness of the company's management.

Private equity funds do not prioritise measurable indicators such as EBITDA margin, market share, turnover and debt-capital structure as investment criteria because they believe that they can improve the business based on their experience and accumulated know-how.

Ranking of criteria:

1. Growth potential
2. Effectiveness of company management
3. EBITDA margin
4. Market share
5. Innovative power of the company
6. Turnover or size of the potential transaction
7. Company's debt and capital structure

CFO

Ranking of criteria:

1. Proposed shareholding percentage
2. Proposal terms
3. Speed and effectiveness of investment process
4. Fund size
5. Experience in the industry

A great majority of CFOs at target companies say the most important criteria for company owners are the proposed shareholding percentage and proposal terms. The size of the private equity fund and its experience in the industry are less important for company owners.

Are you ready to partner with a PE?

Most CFOs that we interviewed said they received consultancy services during preparations for the sale of shares to a private equity fund.

Other important preparations include carrying out an independent audit and tax audit as well as debt restructuring.

Changing a company's business or operating model and reducing costs are criteria that are rarely considered during the preparation process.

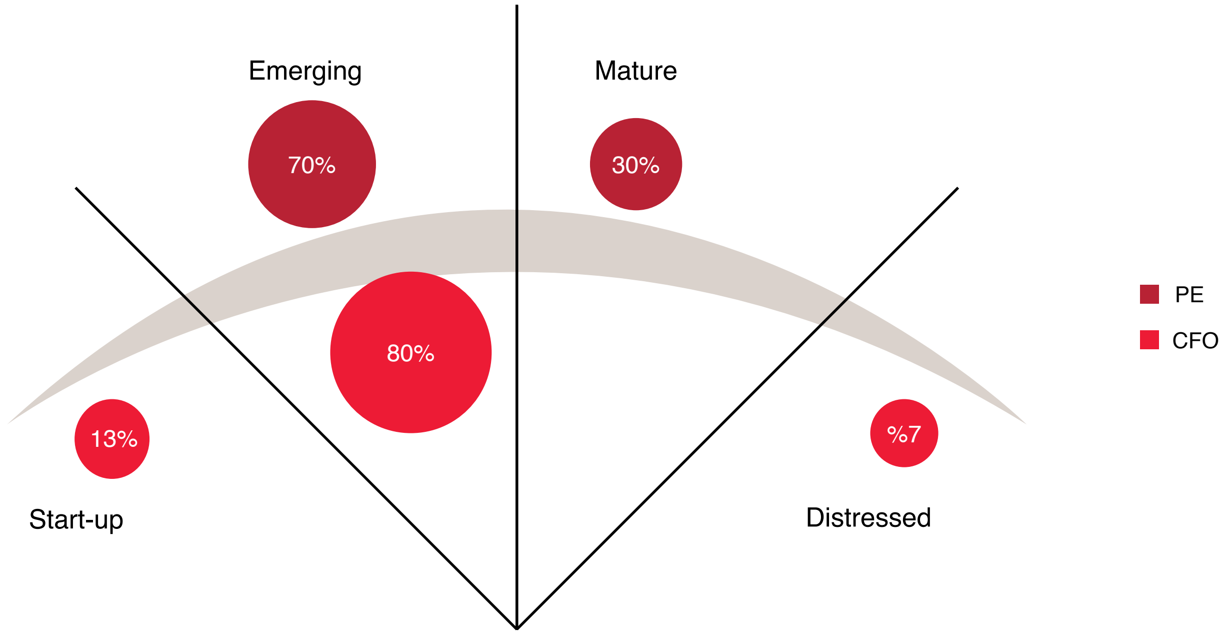
- *Companies who received consultancy services for the sale of shares: 41%*
- *Companies that carried out an independent audit and/or tax audit: 23%*
- *Those who resorted to debt restructuring: 18%*
- *Those who made organisational changes: 9%*
- *Those who changed the company's operating model: 5%*
- *Those who reduced costs: 5%*

Does life-cycle position affect decision to invest?

70% of private equity funds prefer to invest in emerging companies, and a great majority of PE's portfolio company CFOs agree.

The CFOs said a private equity fund might consider investing in a company at the start-up or distressed stage, but actual investments made in such companies are very rare.

Life-cycle position of companies preferred by private equity funds



2. Investment process

Ingredients for a successful investment process

Private Equity Fund

A great majority of private equity fund managers say one of the most important criteria for success of the investment process is direct access to company management. "Exclusivity" is another topic that is of importance. However, CFOs at PE's portfolio companies do not believe these topics are as important.

Both parties believe the actual presence of company shareholders in the management is the least important item.

PE	Ranking of criteria	CFO
1	Direct access to company management/private equity fund management	5
2	Company's management reporting effectiveness	4
3	Same management understanding as target company/private equity fund	1
4	Exclusivity in the investment process	8
5	Adequacy of human capital capacity	3
6	Target company undergoing independent audit and/or tax audit	2
7	Cooperation of target company's personnel throughout process	6
8	Presence of consultants on the sell side	7
9	Actual presence of company shareholders in management	9

CFO

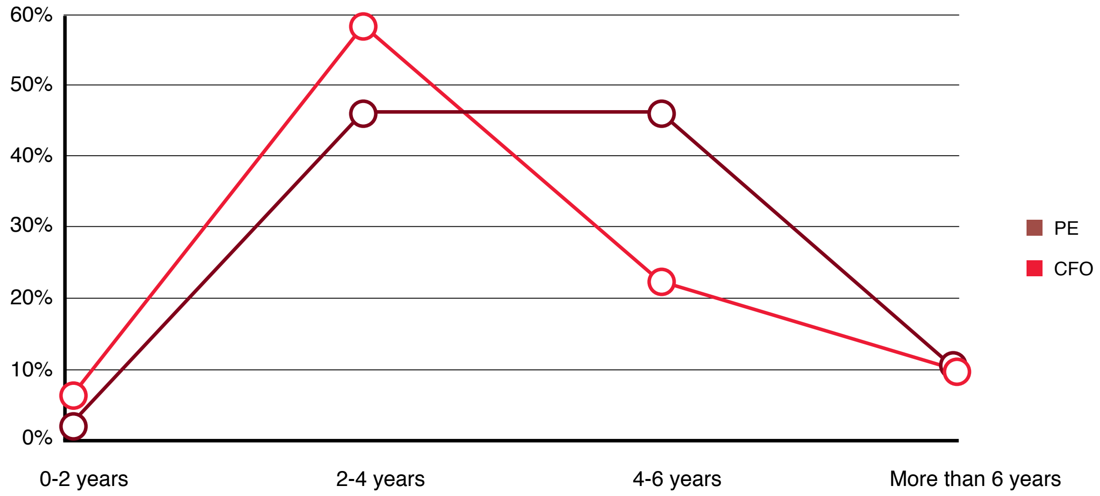
CFOs at PE's portfolio companies say that having the same understanding of management as the private equity fund is the most important element for the success of the investment process. Another aspect that matters for these CFOs is whether their company undergoes an independent audit and/or tax audit. Private equity funds, however, do not find this criterion as important since they require additional audit during a financial due dilligience study anyways.

How long will the partnership last?

Private Equity Fund

47% of private equity fund managers and 59% of PE's portfolio company CFOs foresee the partnership to be between 2-4 years, meaning their expectations are similar.

Private equity fund and CFO expectations for duration of partnership



CFO

47% of private equity fund managers foresee partnerships lasting 4-6 years, whereas only 25% of PE's portfolio company CFOs think the period will be so long. This indicates that private equity funds tend toward longer-term vision and that their strategic plans are likely spread over several years.

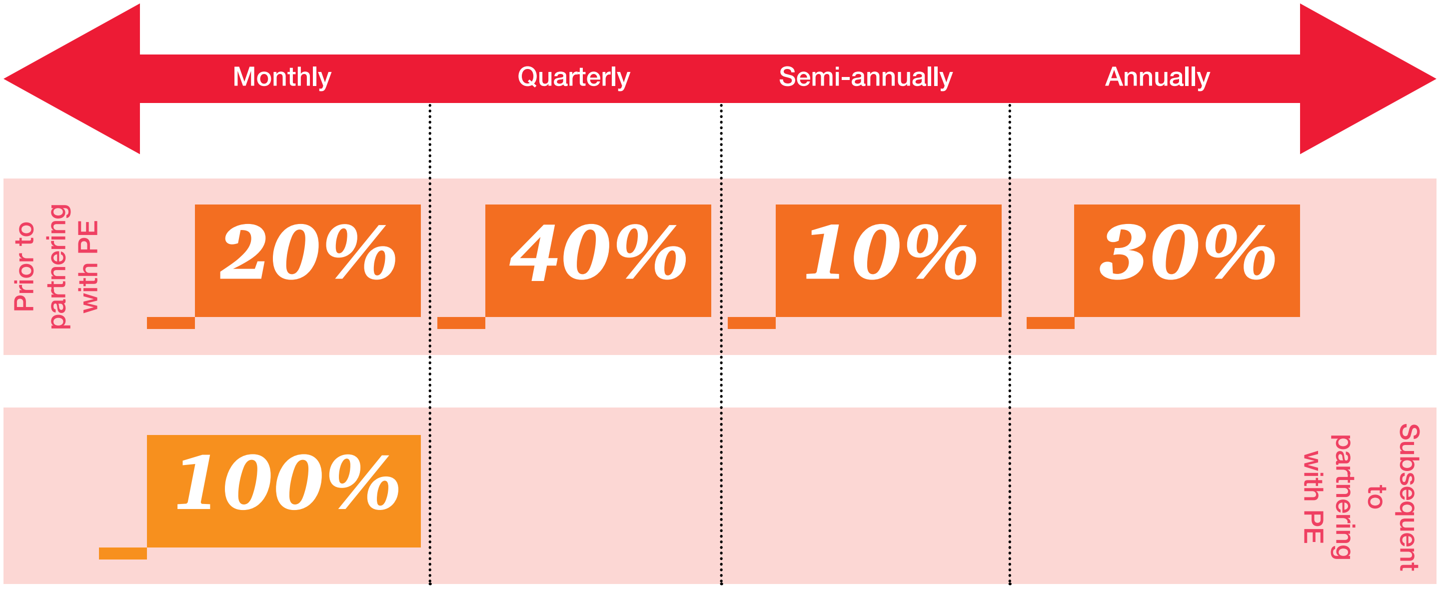
3. Post-investment process

Changes in frequency of measuring financial performance?

Private equity fund managers say they want to track the financial performance indicators of their portfolio companies on a monthly basis, however only 20% of portfolio companies do so prior to bringing in a private equity fund as a shareholder.

In order to meet the expectations of private equity funds, the portfolio companies that previously measured their financial performance quarterly, semi-annually and annually begin to measure their corporate performance on a monthly basis.

Change in frequency of measuring financial performance at PE's portfolio companies

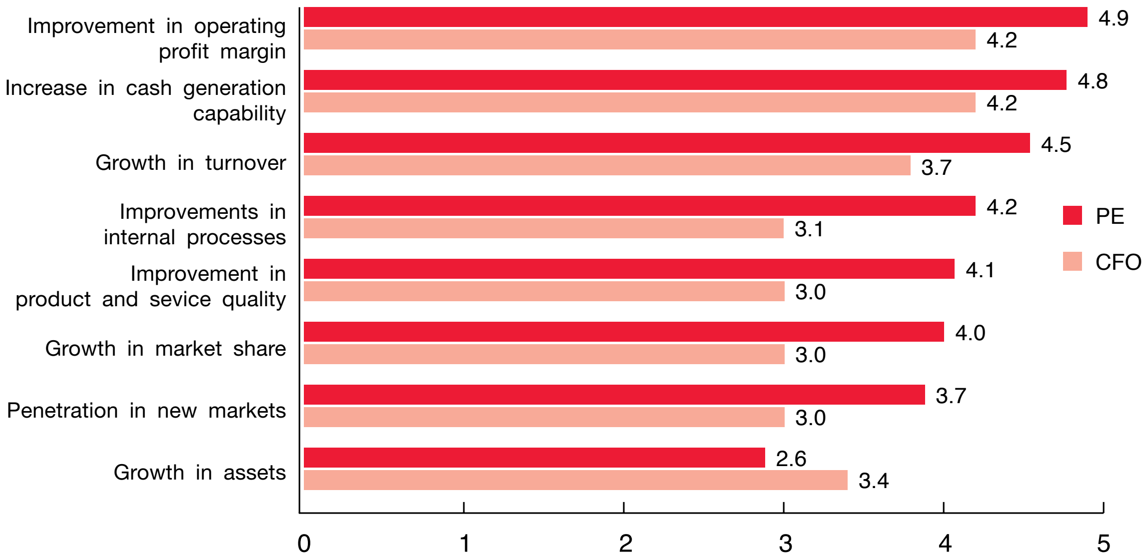


Top priorities for measuring financial performance

Private Equity Fund

A great majority of private equity fund managers state that improvement in their portfolio companys' profit margin, cash generation strength, and turnover growth are vital criteria for evaluating the company's success.

Ranking of financial performance measurement criteria of PE's portfolio companies



CFO

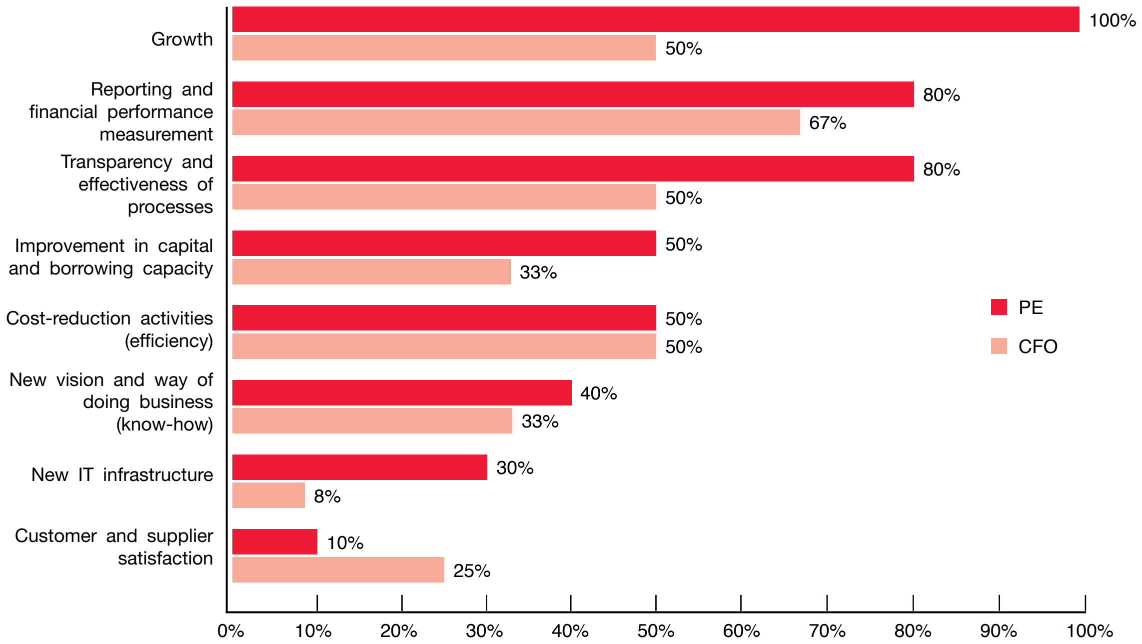
Although CFOs at PE's portfolio companies hold nearly the same opinion of these priorities, they say improving a company's internal processes, the quality of its goods and services and growing its market share are not as important for financial performance measurement criteria.

What will a PE bring our company?

Private Equity Fund

Private equity fund mangers primarily want to improve growth in their portfolio companies, however PE's portfolio company CFOs do not feel growth is as important. As revealed in the pre-investment section, growth potential was one of the most important decision-making points for private equity funds.

Post-investment improvement areas in PE's portfolio companies



CFO

PE's portfolio company CFOs also consider changes to management reporting and corporate performance measurement to be among the most important areas for improvement in the post-investment process.

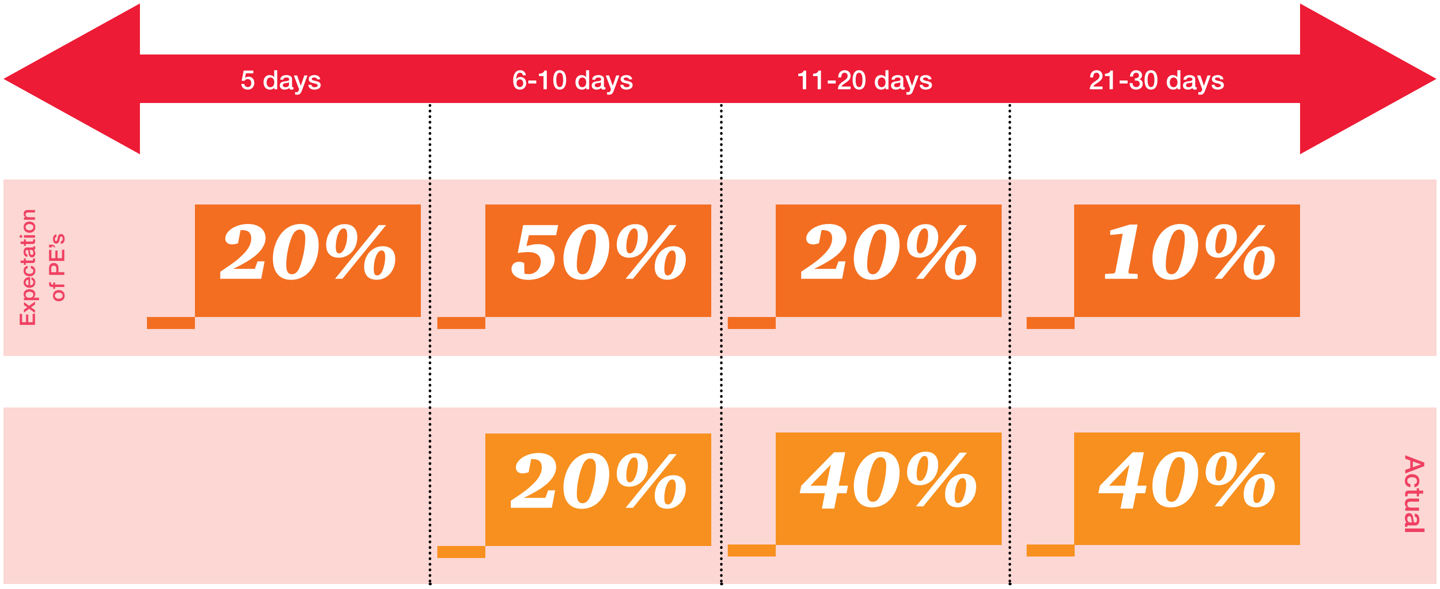
However, the most striking difference between the parties can be seen in the need for improvement regarding transparency and the effectiveness of processes.

When will management reports be ready?

Half of private equity funds request that management reports should be ready within 6-10 days, however only 20% of portfolio companies can meet this request.

40% of PE's portfolio company CFOs say they complete the management reporting within 11-20 days. This indicates that although both parties attach importance to management reporting, the needs and expectations of private equity funds often cannot be met within the timeframe desired.

Expectancy vs. actual days (after period closing) to prepare management reports



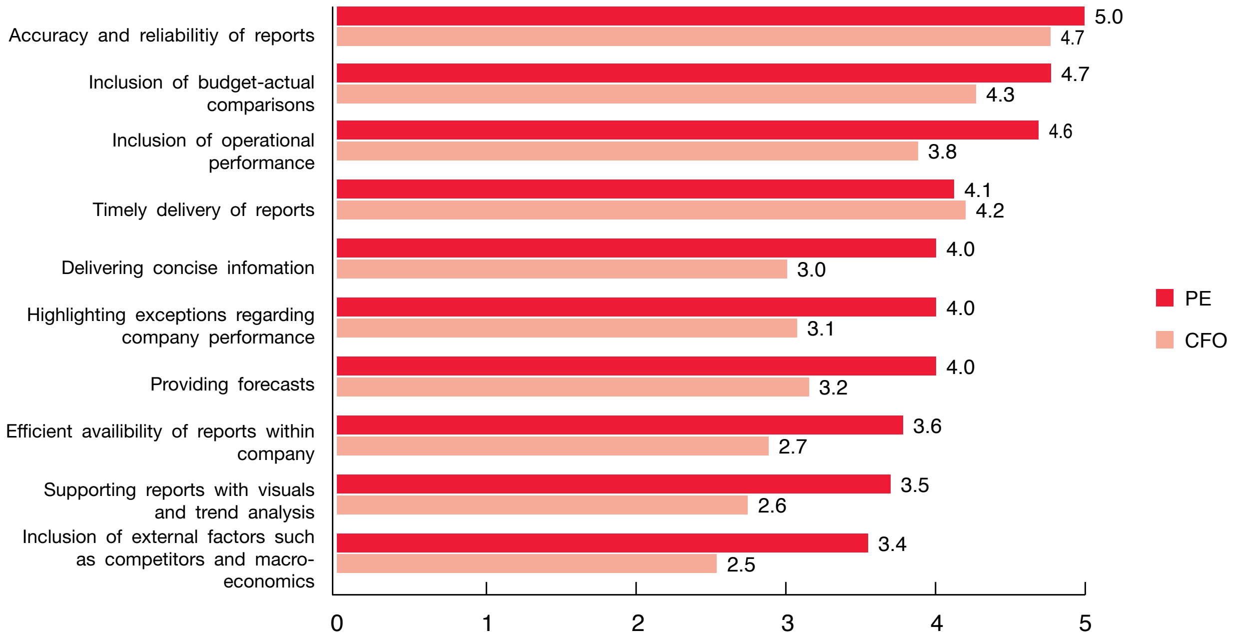
Priority in management reports: Accountability

Management reports which are accurate, reliable and include budget – actual comparisons are greatly valued by both private equity funds and PE's portfolio company CFOs. In other words, the accountability of the content of management reports is a common need for both parties.

While private equity funds want information on operational performance to be included in management reports, PE's portfolio company CFOs do not attach the same level of importance to this information.

Considering the increasing expectations from CFOs in recent years, it has become a necessity that CFOs work closely with the other operational functions at their company, which in turn has resulted in an expansion of authority and responsibility among CFOs. Today top executives want management reports to also include explanations of company operations that are supported with specific operational key performance indicators as well as numerical data.

Ranking of significant aspects of management reports



Why do management reports fail to fulfil expectations?

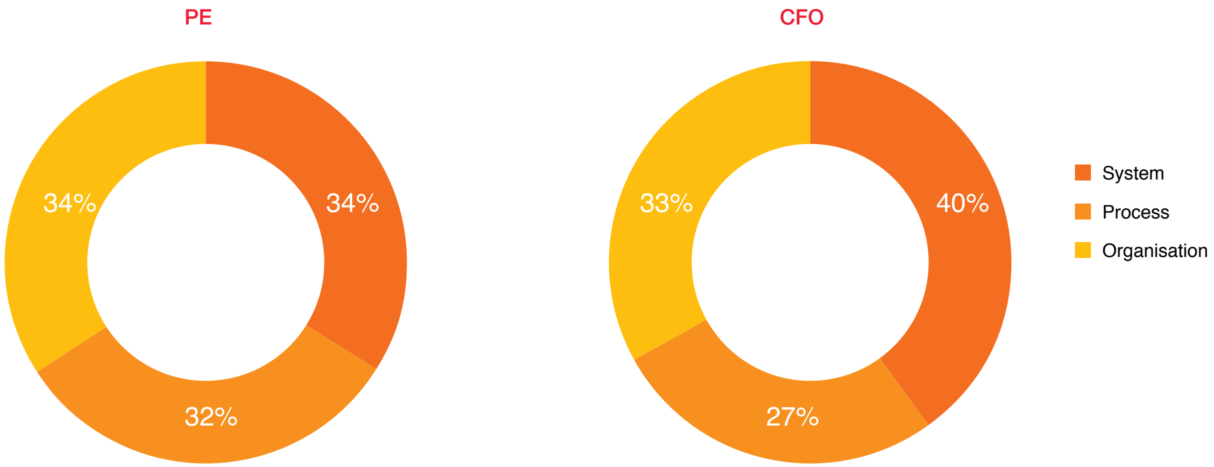
Private equity fund managers want management reports to include key performance indicators and present high-quality analysis, however most of these expectations are not currently fulfilled.

Most CFOs say the reports do not meet expectations because the quality of the data is low, there are data deficiencies and that it takes too much time to manually adjust errors caused by systemic mistakes, hence, there is insufficient time for delivering the expected high-quality analysis.

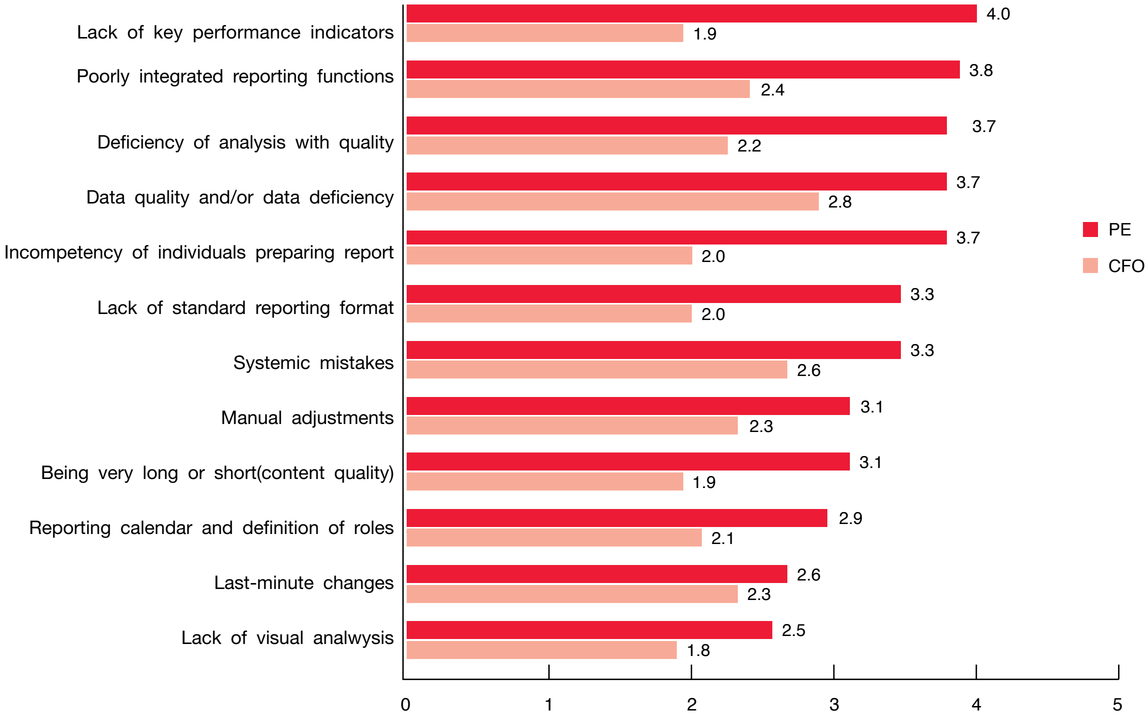
At this point, the need for automated reporting that will change the whole reporting infrastructure comes to the fore, which indicates that companies need to invest in this area. Today most private equity funds take such needs into account when determining the value of a potential target company.

On the other hand, private equity fund managers say their expectations are often not fulfilled because their portfolio company's reporting function is not effectively integrated with its other operational functions. As mentioned earlier, private equity fund managers feel it is highly important that management reports include operational key performance indicators.

Source of failure in fulfilling expectations from management reporting



Reasons management reporting is unable to fulfil expectatitons



PwC: "Companies are abandoning spreadsheet-based solutions and instead tracking their financial performance through reports prepared with integrated systems supported by operational key performance indicators."

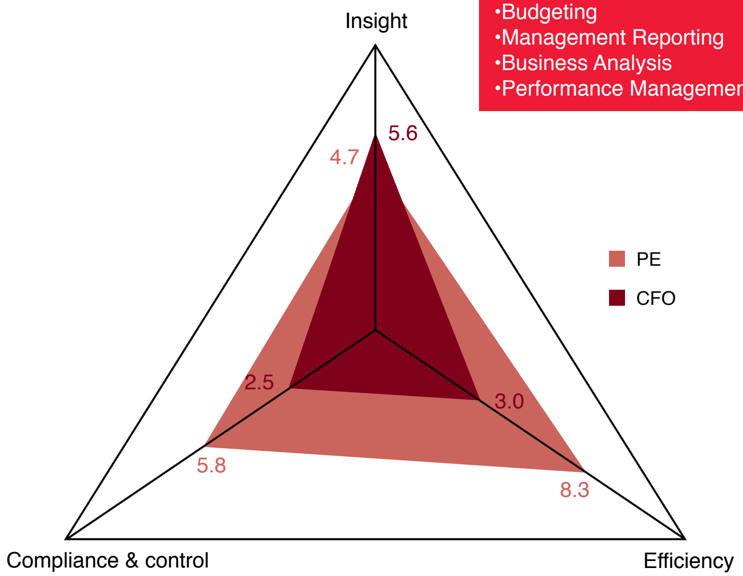
Responsibilities of the Finance Function

Private Equity Fund

Private equity fund managers say the responsibilities of their portfolio companies' finance function are "efficiency" oriented, covering issues such as general accounting, trade receivables and trade payables.

Our 2010 survey of CEOs yielded the same answer to this question, indicating that PE managers and CEOs share the same point of view of a finance function's responsibilities.

- Strategic Planning
- Budgeting
- Management Reporting
- Business Analysis
- Performance Management



- Treasury: Risk Management
- Treasury: Cash Management
- Internal Audit
- Internal Controls
- Tax Management

- Corporate Reporting
- Trade Payables
- Trade Receivables
- General Accounting

CFO

PE's portfolio company CFOs, on the other hand, believe that their responsibilities should be focused more on covering issues such as strategic planning, budgeting and management reporting in order to provide top management with "insight".

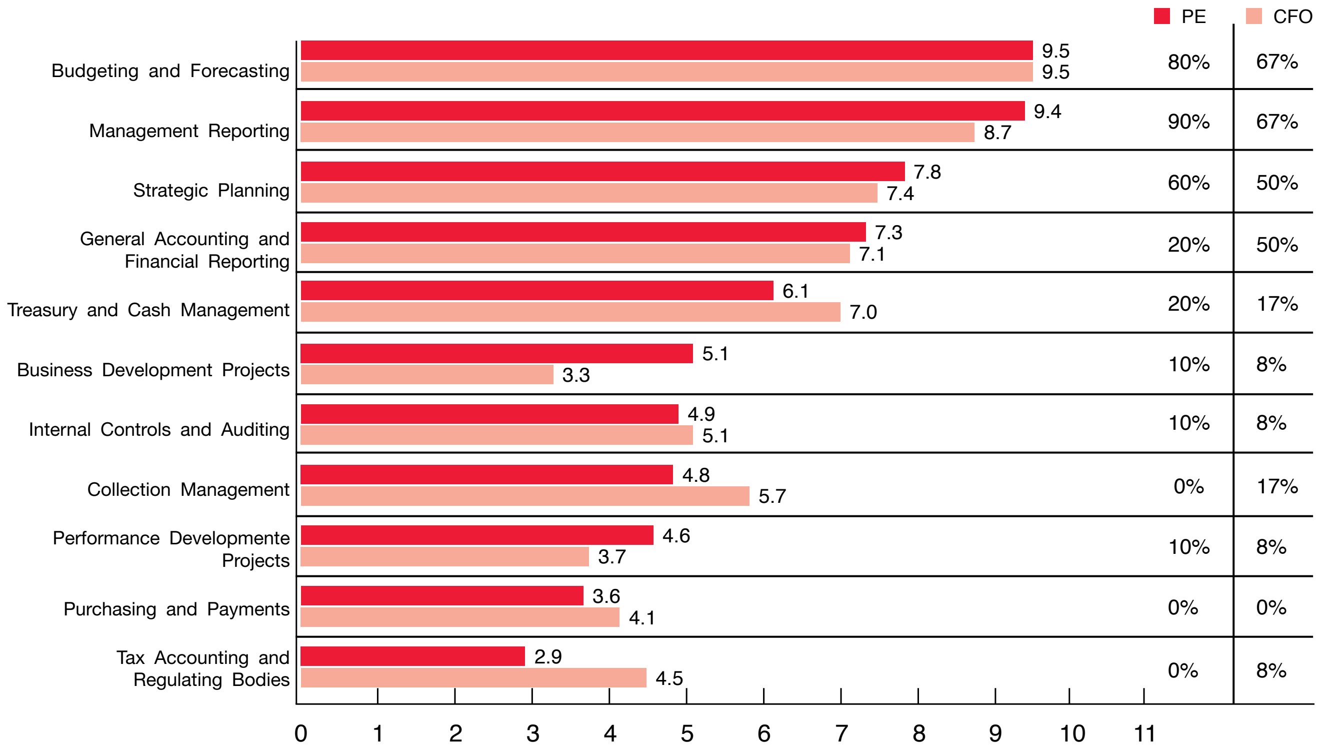
Management reporting, budgeting, forecasting and strategic planning are considered as the most significant responsibilities of a Finance Function according to both private equity fund managers and CFOs.

Although general accounting transactions and financial reporting are considered important primary responsibilities by CFOs, private equity fund managers do not attach the same importance to these issues but agree that these are among the priority responsibilities of a finance function.

The most important difference regarding the perception of priority between these two parties is seen in the support provided to the business development projects by CFOs. Private equity fund managers want CFOs to broaden their vision, step outside their comfort zone within the company, grasp recent external developments and support business development activities. CFOs , however, do not perceive this as a priority.

Priorities of Finance Function's responsibilities

Level of importance



Technical competencies expected from Finance Function executives

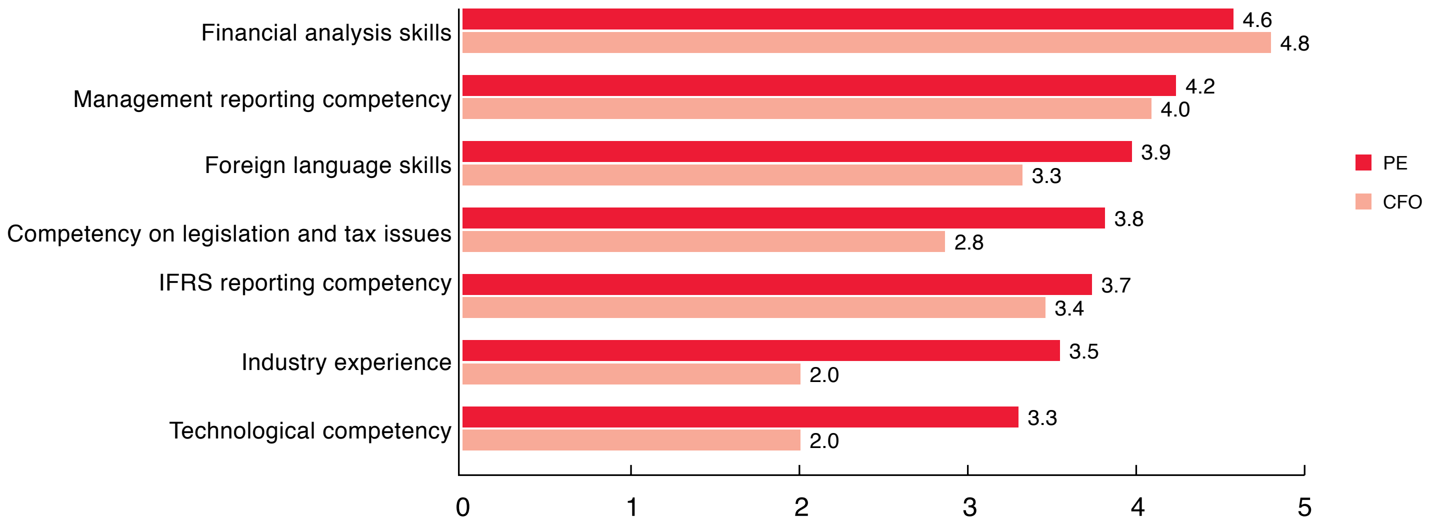
Private equity fund managers express their wish to work with finance function executives who;

- Have financial analysis skills, and
- Have competency in management reporting.

IFRS reporting competency has also become an important issue for CFOs.

Even if industrial experience and technological competencies are not considered as priorities by CFOs and private equity fund managers, a significant difference is observed in terms of ranking of these issues between the two parties.

Priorities of technical competencies expected from Finance Function executives



Social competencies expected from Finance Function executives

Private equity fund managers express their wish to work with CFOs who;

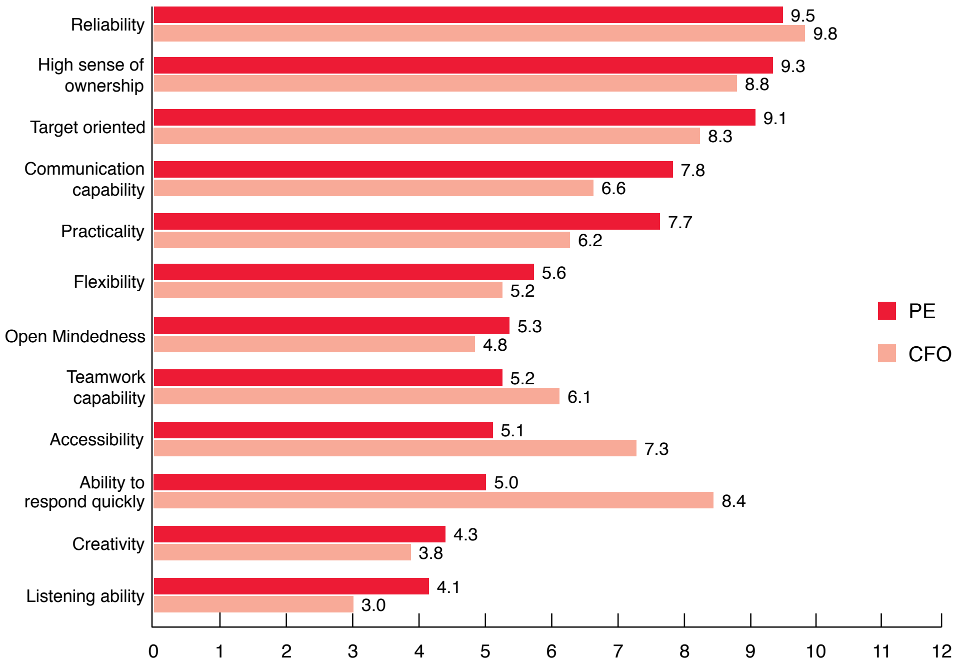
- are reliable,
- have a strong sense of ownership, and
- are target oriented.

CFOs have the same perception that these qualities are expected from them.

On the other hand, private equity fund managers also consider being practical and having strong communication skills as priorities whereas CFOs do not attach the same level of priority to these issues.

Our 2010 survey of CEOs yielded the same answer to this question as well. In parallel with the opinions of private equity fund managers, CEOs also wish to work with reliable CFOs who have a strong sense of ownership, are team players and respond quickly when called upon.

Priorities of social competencies expected from Finance Function executives



What has the PE brought to the company?

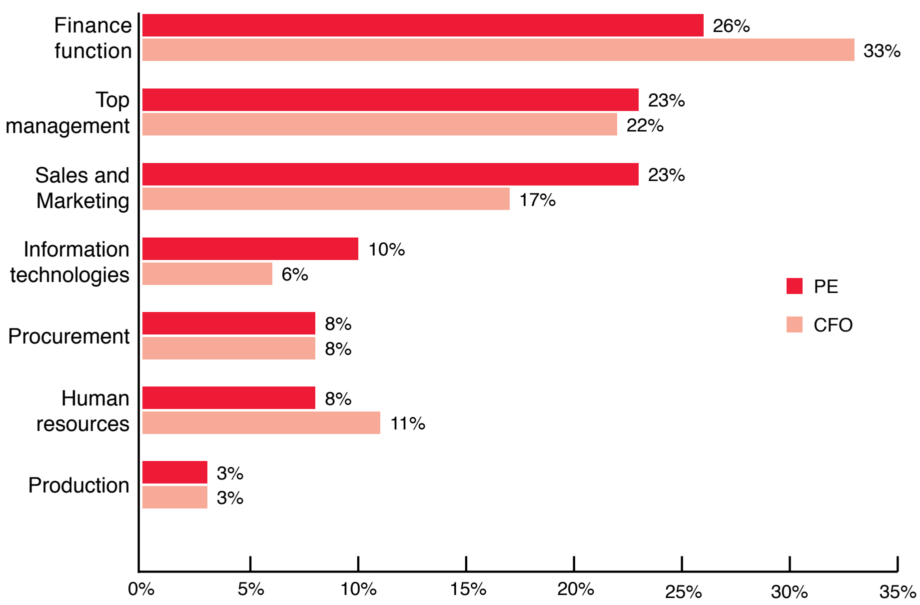
Private equity fund managers and PE's portfolio company CFOs share the opinion that the following functions often under go the most change subsequent to an investment.

- Finance Function
- Top management
- Sales and marketing

However, relatively less change is observed in how the information technologies, procurement, human resources and production functions do business. It was also determined that the areas that undergo the most change are the company's strategic planning, budgeting and management reporting system.

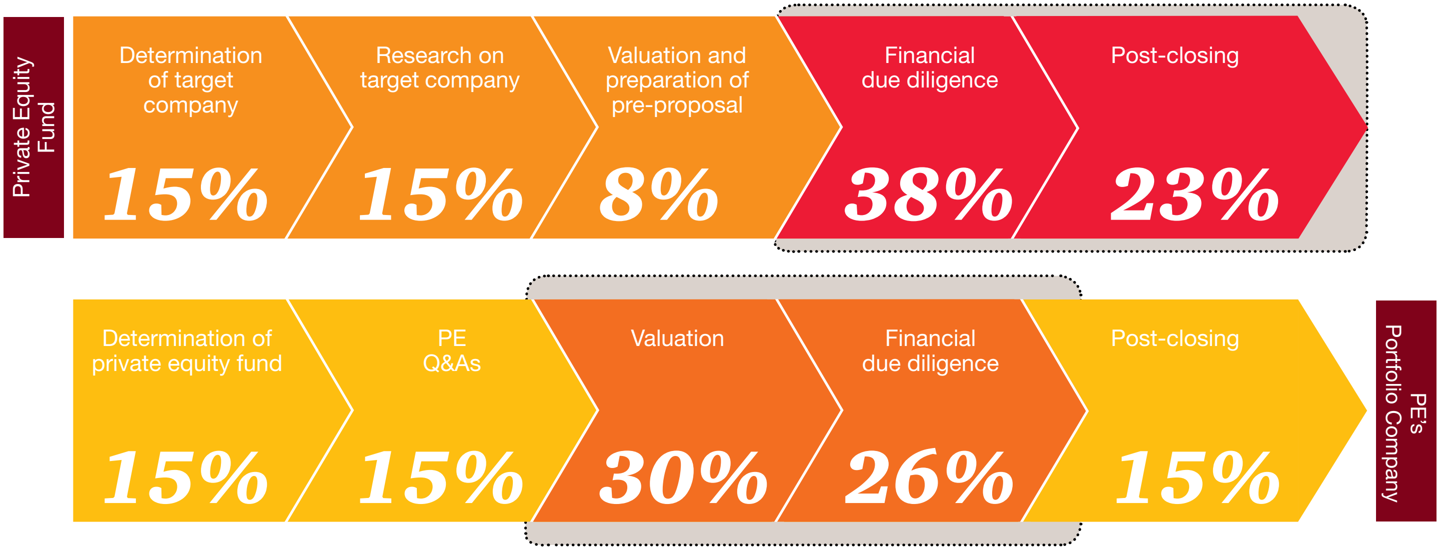
PE	Areas of greatest change	CFO
1	Company strategic plan and budget	2
2	Management reporting system	1
3	Company organisation structure and HR	3
4	Information systems and infrastructure	4
5	Business/operational model of the company	5

Way of change in doing business observed in functions



Tendency to use advisory services

Most of the respondent private equity fund managers stated that they mostly receive advisory services during financial due diligence and post-closing. In parallel with this, PE's portfolio company CFOs state that they receive advisory services during company due diligence but that they mostly need advisory services during share value assessment, which is one of their priorities.



Conclusion

Enhancing professional management thanks to an efficient and transparent Finance Function

Private equity fund managers consider accurate, reliable and efficient management reports as a significant tool for the success of the investment process.

Although it is thought that the one and only final target of private equity funds is to enable the growth of the companies in which they invest; it is observed that they also add value to their portfolio companies in terms of improvements in processes, management reporting frequency and discipline, together with improving the quality of technical and social competencies within the finance function.

Private equity funds need their portfolio companies to have a more efficient management reporting process that is integrated with systems in order to be able to effectively measure the financial performance of their investments.

PwC Management Consulting team provides consulting services to companies to help them improve their finance function effectiveness, enabling them to provide their shareholding PEs with accurate, transparent, reliable and timely management reporting.

We would like to thank all private equity fund managers and PE's portfolio company CFOs for their time and the support they have provided.

Management Consulting

PwC, one of the biggest assurance, tax and advisory firms, helps clients create the value they're looking for by working in close collaboration with the clients and stakeholders it is serving. We are sharing practice oriented thoughts, experience and solutions with the clients through the strong relationships established in 158 countries by over 180,000 people. PwC operating in Turkey since 1981, consists of 5 offices; in İstanbul (2), in Ankara, in Bursa and in İzmir, with close to 1,350 professional staff to provide the Turkish business world with the value it is looking for.

PwC is providing advisory services to Finance Functions with the aim of fulfilling their needs with its strong international business network and expertise in Turkey. We are providing our clients with the most appropriate solutions within the framework of "Global Best Practices" with our finance function effectiveness professionals and our knowledge and expertise accumulated over the years.

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