

insight • strategy • impact

– gk strategy insights

How private equity can unlock the commercial value of PDD

gk strategy



– **gk** strategy insights

Over the last decade, political, policy, and regulatory due diligence (PDD) has emerged as a specialist discipline, oriented around assessing existential risks for assets with high exposure to government or regulator policy, as well as to public sector revenue streams.

This has traditionally taken the form of binary risk questions, such as, 'Will the government or regulator ban this service or render it otherwise unviable over the lifetime of our investment?'

While this 'red-flag' approach is certainly useful, it can encourage investors to view PDD conclusions as self-contained and independent from the asset opportunity or growth strategy. As a result much of the potential value of PDD in the deal – and post-deal – phases can remain untapped.

How private equity can unlock the commercial value of PDD

This has started to change. For many of our clients PDD has now shifted in emphasis towards how political, regulatory or funding considerations could affect current revenue or growth opportunities, in terms of the size and nature of addressable markets and the impact on margins (due to policy-derived increases in labour or compliance costs, or the level of competition in a sector).

This shift is based on two key insights:

1. PDD factors ('political dynamics') are a distinct set of market dynamics that affect the prices and the behaviours of producers and consumers, as well as the competitive position of particular assets.
2. Political dynamics don't just generate risk; they can also open up opportunities or promote innovation (as happened with the open banking reforms). This means that PDD can also be used to assess where potential policy changes could expand or create new markets (for example, through allowing easier change of use for buildings).

The competitive advantage angle is ultimately what separates asset-specific and commercially-focused PDD – and the high value add it can bring – from PDD that is more extrinsic and sector-level.

For example, more demanding regulatory requirements can impose unviable compliance costs (which can be modelled) on many sector participants while creating competitive advantage for those companies with the margins or operational capability to absorb such costs more easily. This can also drive sector consolidation and lower asset prices as small participants sell up (true of lettings agents, property managers, nurseries and independent financial advisors, to name but a few).

PDD commissioned with this in mind is no longer a self-contained exercise, but one that is complementary to and can inform commercial due diligence (CDD) work.

The question for PE firms then, is how deal teams can best work with PDD and CDD providers to integrate political dynamics into market assessments, business plans and performance projections?

There are several simple steps that we have found facilitate this:

1. Firstly, PE firms should ask a PDD provider to review the IM and/or VCDD as these generally contain implicit or explicit assumptions about political and regulatory factors, often based largely on the extrapolation of existing trends, rather than a horizon scan of policy drivers. Such reviews can bring a more commercial angle to PDD and help create common analytical ground between CDD and PDD teams.
2. Secondly, PE firms should facilitate coordination between CDD and PDD workstreams through joint kick-off calls and regular check-ins, as well as joint calls with management teams. The latter is especially important as it creates an opportunity to get management to speak to how their understanding of regulatory trends affects their business strategy, competitive position and growth plans.

Finally, it is worth noting that the benefits of integrating the PDD process into business strategies do not end at the point of acquisition. A post-deal exercise for assets in the first 100-days, or other portfolio companies can still be incredibly valuable for identifying emerging risks (and strategies to mitigate them), as well as opportunities for competitive advantage in terms of alignment with the developing policy and regulatory landscape.

GK Strategy has extensive experience delivering buy-side and sell-side PDD, and working with portfolio companies to maximise policy-driven opportunities.

To find out more, please contact martin@gkstrategy.com

gk

ground floor,
32-34 great peter st,
westminster,
london sw1p 2db

020 7340 1150

