Mind the (Skills) Gap

A ThoughtSpark research note highlighting the key skills gaps in venture capital and private equity backed firms

June 2015

Management Summary

- Private Equity houses based in the UK with assets under management of over £2 billion\(^1\) were interviewed during April 2015 and asked to rate the average skill levels they usually encounter in the companies they acquire/fund and found that marketing and IT skills were rated lowest;

- All skills sets were rated on a scale of 1-100%, where 100% is the optimal skill level, and 0% a complete absence of that skill;

- The skills private equity houses were most satisfied with are: new product development (71%), sales (69%) and overall financial and business management (57%). All these skills are typical of successful entrepreneurial start-ups;

- Respondents also rated human resource management (56%) and product or service distribution skills (50%) on or above the critical half-way threshold;

- However, a number of competencies that are core to the good running of a successful organisation were rated below the 50% capability watershed, suggesting that these are the areas requiring particularly close scrutiny and attention for development and ‘tooling-up’ within funded or acquired firms;

- Unsatisfactory skills levels were reported for IT management (45%) and professional, accountable and measurable marketing (44%);

- Sub-par IT management is a particularly worrying lacuna as (a) high-functioning IT is nowadays critical to customer service, sales effectiveness and operational efficiency, and (b) most businesses hold critical information within their IT systems (customer profiles, purchase journeys, channel performance, etc) which is essential for accurate analysis and modelling;

- Similarly, a lack of marketing skills can significantly reduce a businesses’ ability to identify and reach out to high-potential markets and customers, and generate demand from those markets.

\(^1\) This community comprises some 40+ firms
Introduction

In a revealing piece of research issued earlier this year, the British Venture Capital Association (BVCA) has revealed that 2,200 companies in Britain are currently financed by private equity (PE) or venture capital (VC), representing in excess of £30bn invested. Even the government offers equity investment funds via Capital for Enterprise, administered by the British Business Bank. A number of studies report a recent upsurge in early stage funding, with market analysts such as CB Insights detailing surges of activity at the individual fund level. Other commentators\(^2\) have highlighted the convergence of government support and incentives, alternative investment appetite and rapidly changing customer buying habits, combining to create a perfect storm of encouragement and demand for VC investment.

The expected surge in private equity backed business growth has come after a considerable period of uncertainty and pressure for the private equity industry. Last year, a survey from Ernst and Young\(^3\) reported that the sector “... faced exceedingly high expectations from investment professionals, increasing demands from investors and an unprecedented level of regulatory burden.” In a telling change of mood, this year’s iteration of the same survey\(^4\) now says, “Many believe the overwhelming demand for private equity labels it as the asset class of choice. As the industry positions itself for further growth, private equity firms recognize that investors are focusing on operational excellence as a key differentiator.”

So venture capital and private equity appears to be playing an increasing role in developing British business, whether at the seed-stage or at second or later-stage. Most commentators agree that the PE or VC house is not only bringing development capital to the party, but also key skills that complement the strengths of the funded venture and its people. So what are the skills that are least developed, and therefore most needed, in private equity backed firms at the point of acquisition?

According to a survey by PriceWaterhouseCoopers\(^5\), better businesses have appropriate risk management in place and have financial and non-financial information at their fingertips. The information is timely, relevant and consistent with the objectives of the business. Although this PwC study is mainly directed towards financial management issues, it does clearly show that ‘broadening the service or product offering’, ‘working capital/cash-flow management’ and ‘reputation/brand management’ are seen as the skills or capabilities most in need of improvement in private-equity backed companies. In more commonly used business terms, those key areas for improvement translate into New Product Development, Financial Management and Marketing.

Most studies of the private equity industry focus on financial management issues – and those at the PE/VC firms rather than in the companies they acquire. This short research note aims to start looking at the other side of the coin – namely where skills tend to be sub-par in acquired firms, and therefore where the acquirer needs to pay priority attention to filling those skills gaps. Such a broad insight serves to highlight those areas of potential under-skilling and under-performance which require particular attention from private equity houses and venture capital companies when ‘tooling up’ acquired companies for reliable and sustainable growth.

\(^2\) Startups.co.uk, New study reveals UK’s most active tech VCs, August 89th 2014
\(^3\) EY, Navigating the Headwinds, 2014
\(^4\) EY, Positioning to Win, 2015
\(^5\) PwC, Flexibility in uncertain times, April 2013
The research

Accordingly, ThoughtSpark commissioned independent research to produce a short study on the issue. The study conducted interviews, by telephone, amongst PE houses based in the UK with assets under management of over £2 billion and who invest in European companies. These interviews were conducted during April 2015. Respondents were asked to rate the average skill levels - across a series of key areas – that these private equity firms tended to encounter in the companies they acquired/funded. Responses are expressed as a percentage, where 100% is considered optimum skill level in each function.

The results were:

<table>
<thead>
<tr>
<th>Skill Area</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>New product development</td>
<td>71%</td>
</tr>
<tr>
<td>Sales</td>
<td>69%</td>
</tr>
<tr>
<td>Overall business/financial management (creating profitability)</td>
<td>57%</td>
</tr>
<tr>
<td>People management (employee productivity &amp; motivation)</td>
<td>56%</td>
</tr>
<tr>
<td>Effective market distribution (of product/service)</td>
<td>50%</td>
</tr>
<tr>
<td>IT management</td>
<td>45%</td>
</tr>
<tr>
<td>Professional, accountable and measurable marketing</td>
<td>44%</td>
</tr>
</tbody>
</table>

A large proportion of early stage businesses still closely managed by their founders whose success is based on their ability to identify a gap in the market and develop relevant new products as well as their skill in evangelising and selling. It is therefore, no surprise that new product development and sales skills are not lacking in the firms private equity and venture capital businesses choose to invest in. Similarly, best practice business management and acute financial management are also key qualities that make a business appealing to investors as low growth outfits rarely attract additional phases of capital. Efficient management of resources and effective distribution of products or services also score just above or on the 50% level of satisfaction.

At the very bottom of the scale though, we find another set of critical skills that are regarded as not up to scratch, as they do not reach the 50% capability watershed. These are: IT management; and accountable, measurable Marketing.

Marketing is a critical building block of business growth. Skills falling under the heading of Marketing include: market research, market analysis, customer profiling, campaign management and communications/PR. All of these activities combine to ensure that the right prospective customers are reached, through the right channel, with the right propositions and messages, in order to generate a strong flow of qualified sales leads. Sales then pick up these leads in order to close deals. General market awareness and company perceptions are critical to sales development. Yet effective PR and communications are a hard task to achieve if no overarching marketing strategy has been defined, with mixed messaging and misdirected targeting having a negative impact on sales potential.

In addition to this, research by the Cambridge Centre for Business Research (CBR) shows that specifically the shortage of marketing skills is one of the main factors limiting growth in small

---

6 This community comprises some 40+ firms
companies. Over 25% of small and medium sized firms said a lack of marketing and sales skills is a constraint to growth. Another report, specifically analysing manufacturing firms, found that in 2014, fully 70% felt that a marketing skills shortage was holding them back from growth.

Equally worrying is the fact that respondents identified a lack of IT skills in the firms they back. While confirming that the firms in question may still be very entrepreneurially minded and perhaps still capital-constrained, not being able to access and analyse business data means not having access to a full picture of the history and processes of the firm. It is thanks to efficient and functioning IT that firms are able to identify their best customers, to profile them and to target similar prospects. Moreover, robust, high-functioning and scalable IT is widely recognised as critical to delivering high levels of customer service, effective marketing and operational efficiency.

This lack of IT skills may also be part of a broader picture reflected in a study carried out on behalf of O2 which found that Britain will need 750,000 skilled digital workers by 2017 in order to support business and economic growth. Failing to produce this number of skilled workers could cost the UK economy as much as £2bn each year. This is a worrying statistic when aligned with recent numbers for computer science graduates across the UK which have dropped by 23.3% over the past 10 years.

Conclusions

In an encouraging climate for private equity and venture capital investment, businesses cannot afford to overlook the issue of the skills sets that need to be developed in funded or acquired firms. While this research confirms that core entrepreneurial skills are strong among private equity and venture capital backed firms, some important lacunae are also highlighted.

Specifically, these firms are very strong in new product development and sales effectiveness and also have a good track record for profitability, no doubt responsible for attracting initial interest in investment. But it seems that on the marketing/communications, and the core IT skills front, many are far too weak.

As businesses develop from boot-strapped entrepreneurial outfits to more complex structures, they will be unable to ensure continued profitability and the success of their sales teams without proper marketing strategy, structure, execution and messaging. In addition to this, the IT skills shortage represents an important hurdle to sustainable development of acquired businesses.

---

7 Centre for Business Research (CBR), 2003
8 MAS Manufacturing Barometer Survey Report Q1 April- June 2014
9 The Guardian, A UK digital skills gap looms, 18th August 2014