Part 1: Transforming Branch-Based Business Operations in the Face of Recession and Beyond

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WHILE EVERY INDUSTRY WILL FEEL THE EFFECTS OF THE CURRENT BUMPY, RECESSION-LIKE MARKET, BRANCH-BASED BUSINESSES WILL BE DISPROPORTIONATELY NEGATIVELY IMPACTED.

Disseminated labor-intensive service businesses, or branch-based businesses, are businesses with many (many times hundreds) locations all conducting the same service locally. Examples include a $600M revenue home services business with 300 company-owned and 250 franchisee nationwide locations providing HVAC, plumbing, electrical, and lawn care or a $3B building products and industrial supplies company with 500 locations across 40 states. These businesses are excellent investments for private equity funds as they are most often for EBITDA improvement regardless of market conditions. They are typically a great investment strategy for an industry roll up of smaller businesses or to make a transformational change to professionalize the business with investments in people, process, systems and tools to drive scale and sophistication in both the commercial and operational components of the business. However, an extended economic slowdown will exacerbate their operational weaknesses of having inherently high fixed cost and having a low level of process excellence and standardization. Technology and AI will change the industry leader landscape with first movers in applications using it for AI-powered customer service inquiry responses, predicting inventory demand patterns, predictive maintenance, more robust customer segmentation to aid in dynamic pricing, and automating operational and financial repetitive tasks for less reliance on labor force.

Leaders should act now to transform their operations to: be more resilient, minimize the impact of a downturn and position the business for growth.

This series will cover the three steps private equity (PE) funds need to take to transform the operations of the branch-based businesses in their portfolios. This first article will detail how to identify and build an ideal operational and pricing model. The second article will outline how best to migrate to the new model, while the third article will detail how to make the changes sustainable through market swings.

This first article outlines both key questions that PE deal teams should ask during diligence, and the ideal operating design that PE operating teams should use as a guide to transform portfolio companies post-acquisition.

Why Are Branch-Based Businesses Especially at Risk?

Disseminated labor-intensive service businesses often operate with each branch acting as a separate business, do not take advantage of scale and so are inherently high fixed cost. Each high fixed cost branch becomes a significant cost issue during economic slowdowns as volume declines.

Limited standardization of their organizational structures, functions and processes also hinders their ability to adjust cost structures to deal with economic volatility.

As a result, many of these businesses have locked cost structures as well as utilization and overhead inefficiencies that cause them to run at much higher costs than needed. Lack of standardization makes company-wide changes risky and hard to implement in a short time period, limiting the ability to adjust operations as markets change.

Addressing these operating model restrictions can enable businesses to become more agile and, hence, lessen the market downturn impact.

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