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How leading PE sponsors leverage working capital to fund strategic initiatives

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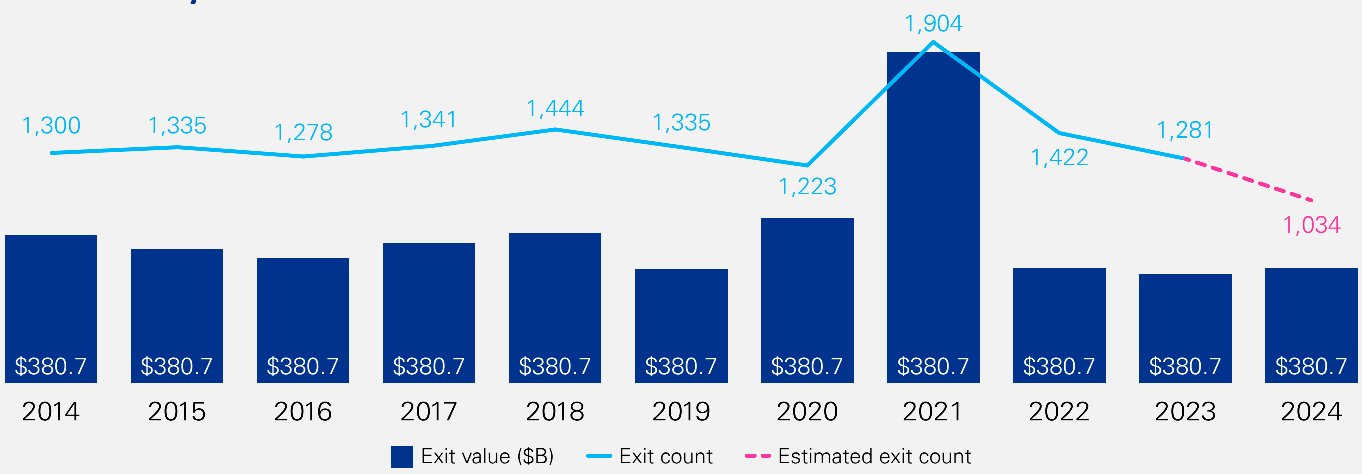
Turbocharging PE returns through cash flow and working capital optimization

Amid an increasingly volatile macroeconomic and geopolitical landscape, the private equity (PE) sector faces mounting challenges across the deal lifecycle—from fundraising to deal execution and exits. Although the Federal Reserve has begun reducing interest rates, financing costs for buyouts, platform operations, and capital investments continues to pressure PE returns.

Widening valuation chasms and high interest rates have triggered a reduction in total exit count, despite Q3 exit value increasing 50 percent through the first three quarters of 2024 due to larger exits.[1] Meanwhile, the median holding period for portfolio companies increased from an average of 3.8 years to over four years in the past five years, as PE firms await more favorable exit conditions.[2]

PE exits activity – 2014 to 2024



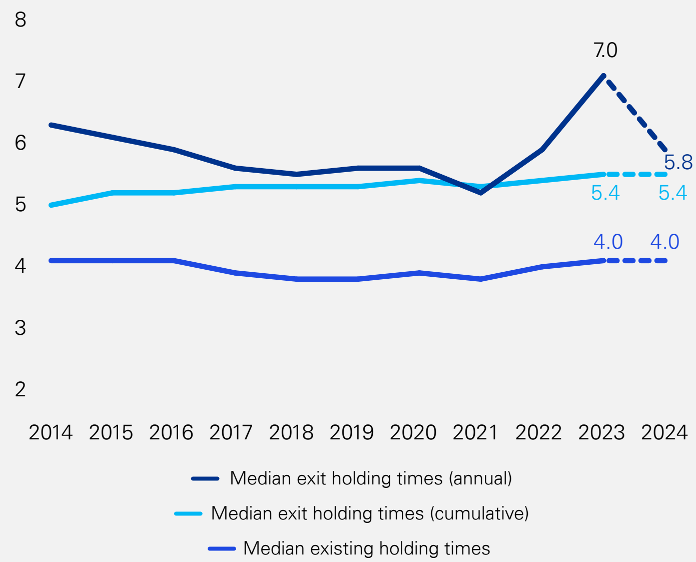
Source: Pitchbook, Geography: US, As of September 30, 2024

As deal volume declined and exit values climbed, the market has shifted focus to premium assets. With longer hold times for mature assets, PE sponsors are seeking strategies to extract increased value from portfolio companies beyond the traditional cost cutting exercises.

Optimizing a portfolio company's cash flows is an underutilized strategy to enhance overall business performance, create operational value, and unlock substantial returns.

By prioritizing cash flow optimization, management teams and PE sponsors can unlock valuable cash reserves for strategic reinvestment, elevating an asset's quality and value. This strategic reinvestment can fuel technology upgrades, reduce capital costs, and fund acquisitions—enhancing an asset's operational performance, capabilities, and competitive position.

Median PE Company Holding Times Years



Source: Pitchbook, Geography: US, As of September 30, 2024

[1] "Q3 2024 US PE Breakdown," PitchBook, October 8, 2024

[2] Ibid.

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Unlocking cash flow optimization

With the current high borrowing costs and valuation uncertainty, effective cash flow management can help boost returns. As a rule of thumb, comprehensive cash flow and working capital optimization can unlock as much as ~5–10 percent of portfolio company revenue for strategic reinvestment.

These results depend on portfolio company's evaluation of opportunities, its related decisions and trade-offs, and capabilities within people, process, policy, and technology. Importantly, operational discipline remains crucial to sustaining cash flow improvement.

Key areas of focus include the following:

Accelerating receivables via order-to-cash improvement: Improving receivables accelerates cash inflows, while reducing liquidity risk and bad debt exposure. In some cases, this amounts to accounts receivable reduction of 10–30 percent (or around 2–4 percent of revenue). By revamping collection efforts through reprioritizing collector outreach, accelerating and standardizing capture of non-payment reasons, and implementing effective dispute management protocols, companies can systematically pull forward customer collections. Simultaneously, they can map critical upstream issues affecting billing and front-end processes. Data-driven insights gathered from dispute data help propel decision-making on non-payment root cause elimination and corresponding upstream process enhancements, thereby enhancing billing accuracy and timeliness to improve cash flow.

Decelerating payables via procure-to-pay improvement: Strategic payables management can optimize cash flow without sacrificing vendor relationships. This can improve accounts payable balances by 5–20 percent and 1–2 percent of revenue. By determining risk and leverage across the supply base to discern vendor-specific risks/opportunities, and deploying tailored programs, portfolio companies can optimize AP process and polices to sustainably unlock cash while communicating changes and managing supplier noise quickly and effectively. Contrary to common belief, structured payables optimization can strengthen supplier partnerships by providing predictability to suppliers. This predictability assuages the anxiety of accounts receivable teams who are pressed to allocate limited time and resources toward unpredictable customers that represent the largest risk to collections performance.

Mastering inventory management: Effective inventory management is a cornerstone of enhancing liquidity and can reduce inventory by 10–30 percent while improving cash flow by (~1–3 percent of revenue), while maintaining healthy margins and growth. By leveraging data-driven demand forecasting accounting for the nuances of today's dynamic environment, refining procurement processes, and streamlining inventory control (through planning and replenishment, supply chain, and better SIOP), portfolio companies can optimize inventory held without compromising customer demand. Rebalancing frees up cash that would have otherwise been tied up in inventory, reduces carrying costs, and lowers risk. By identifying patterns in inventory turnover and fine-tuning order quantities, management can prevent stockouts and overstock, optimizing working capital and maintaining crucial service levels and customer satisfaction.

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Case history

Order-to-cash and procure-to-pay optimization helps a portfolio company achieve more than $30 million in savings from AR and AP

A recently acquired, PE-backed technology company with billions in revenue required help reducing its debt load to minimize interest expense and free up a greater share of each dollar of growth for reinvestment in the business to realize the investment thesis. With KPMG support, the company diagnosed the opportunity levers in weeks and unlocked more than $30 million in cash flow benefit in ~9 months across key segments. Operational and commercial changes within order-to-cash and procure-to-pay processes underpinned this cash flow benefit.

Within order-to-cash, the company improved the efficiency of its accounts receivable collection efforts by reprioritizing outreach via optimized customer segmentation and tailored collections strategies focused on value. Additionally, by implementing leading practices around identifying the reasons for non-payment and resolving customer disputes in a timely manner, the portfolio company significantly reduced delays in payment.

To optimize procure-to-pay, the company first had to undertake a holistic determination of risk and leverage across the supply base. This required a holistic determination of risk and leverage across the supply base. A variety of objective and subjective criteria and category-level benchmarking using proprietary data helped the company understand actionability and best practice targets at the supplier level. The insights from this exercise enabled the company to define and execute a tailored approach to commercial terms extension featuring both negotiation for medium-risk vendors and unilateral extension for lower-risk vendors.

Importantly, the firm also improved its AP processes by adjusting frequency of payments and the conditions that triggered the "payment clock." Critically, the company leveraged a newly established supplier escalation process, leading practice dashboards/KPIs, and refreshed policies to improve sustainability of cash benefit achieved.

Case history

How a portfolio company gained value by optimizing inventory

A portfolio company in the electronics, avionics, and systems manufacturing sector sought to free up cash by optimizing its considerable inventory, which it hypothesized was in excess of optimal levels. Following a rapid assessment with KPMG support in four weeks to diagnose and validate opportunities across the forecast-to-fulfill process, the company chartered an execution program that improved inventory levels by 15 percent in six months, and a 22 percent decrease in 12 months. Days inventory outstanding improved by 40 percent.

To achieve this result, the company began by optimizing the product master data, refining order parameters, lead times, and routings to enhance overall inventory performance and efficiency. Management conducted analyses of individual plant performance and identified specific opportunities for inventory optimization at each location. The company further optimized inventory stocking and replenishment strategies by performing transactional analysis and scenario modeling to quantify the trade-off between cost, service, and inventory implementation These insights and tools enabled management to fix its broken SIOP process and help fortify cash flow benefit sustainability moving forward.

The client also established performance metrics and implemented ongoing target measurement processes to ensure continuous improvement, adherence to strategy, and increased accountability to results in the organization.

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Assessing non-trade cash levers: PE portfolio companies can strategically manage non-trade cash levers—opportunities outside of normal sales and operational processes—such as real estate, capital expenditures, employee benefits, tax optimization, asset-backed financing, and other levers that impact the statement of cash flows. While typically overlooked, effective non-trade management typically yields at least 1–2 percent of revenue in cash flow benefit. Portfolio companies that comprehensively evaluate these opportunities can find corresponding actions that range from "no regret" moves to those that entail tradeoffs between cash flow and other business imperatives.

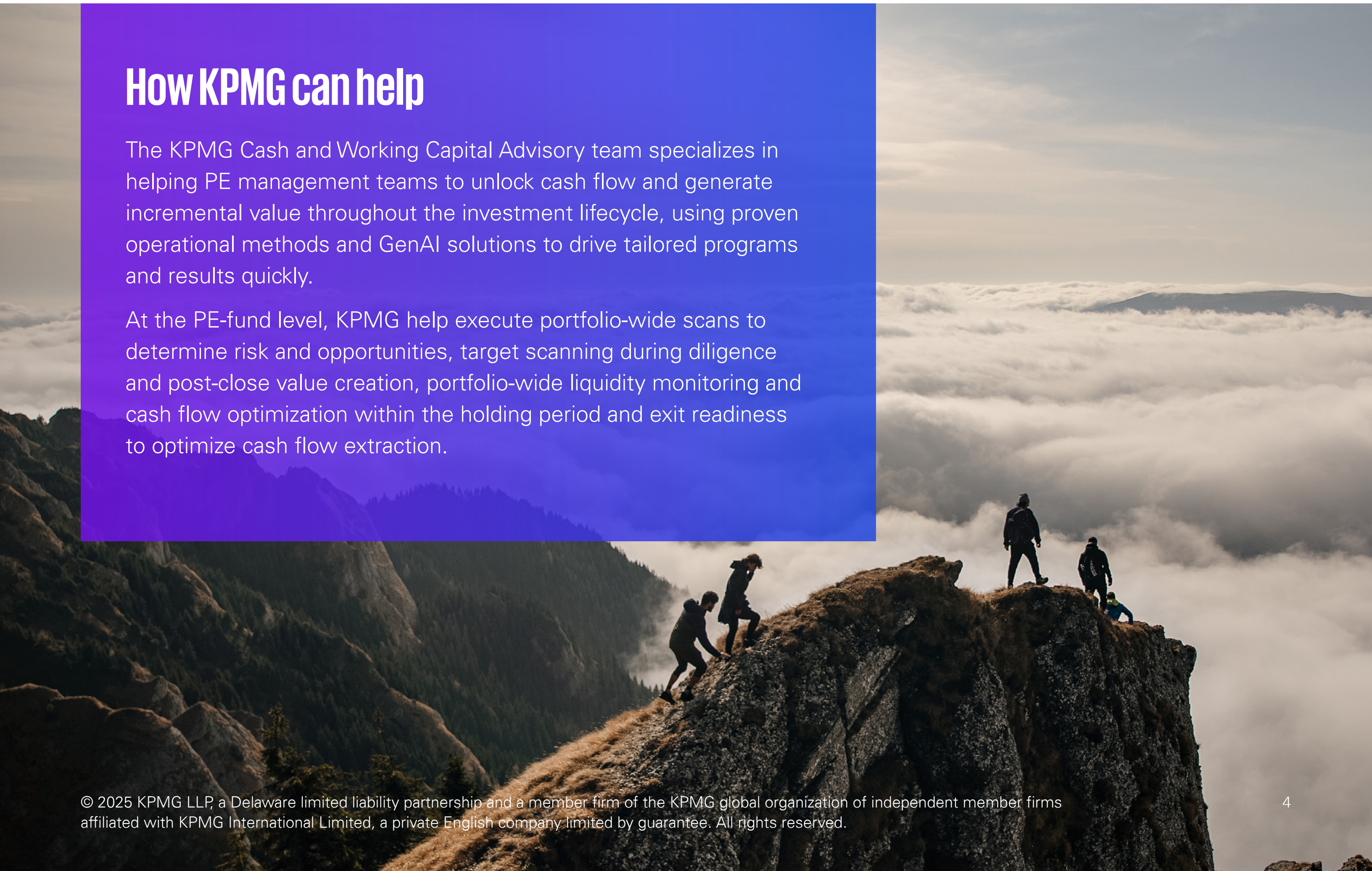
Leveraging technology and AI to drive better forecasting and cash performance: Data-driven tools around forecasting and performance improvement remain a critical enabler for disciplined cash flow management. Intelligent analytics and focused, outcomes-driven KPIs enable portfolio companies to quickly pinpoint improvement opportunities, automate manual processes, and link forecasts with operational improvement initiatives. This approach enables more informed cash-related decision-making, reduces labor costs, streamlines workflows, and uncovers actionable insights that unlock liquidity and amplify overall financial performance. As AI continues to develop rapidly, identifying and deploying AI nimbly within working capital processes will be critical for PE assets to optimize capital and service while decreasing costs.

By focusing on the core drivers of cash flow, PE firms and management teams can enhance operational efficiency and financial stability—positioning themselves for sustained success in an increasingly volatile market.

How KPMG can help

The KPMG Cash and Working Capital Advisory team specializes in helping PE management teams to unlock cash flow and generate incremental value throughout the investment lifecycle, using proven operational methods and GenAI solutions to drive tailored programs and results quickly.

At the PE-fund level, KPMG help execute portfolio-wide scans to determine risk and opportunities, target scanning during diligence and post-close value creation, portfolio-wide liquidity monitoring and cash flow optimization within the holding period and exit readiness to optimize cash flow extraction.



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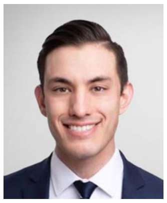

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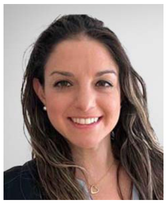

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