Forecasting practices and portfolio company performance in Private Equity (PE) – a practical rationality perspective

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This paper (in progress) is derived from a recent piece of research which looked at PE practice through a series of semi-structured elite interviews with experienced practitioners in 21 leading PE firms. The practical rationality approach was used to explore what PE investors actually do in practice at the different stages of the PE investment cycle. It is suggested that the routines and protocols of forecasting play an essential role, supporting judgement around key decisions at the deal and exit stages of the investment cycle. However, the same practices also pervade the post-deal, portfolio management, phase of the cycle, where they can lead to a suboptimal allocation, not only of financial capital but also other scarce leadership resources such as time energy and attention. Here value may be destroyed when forecasting practices undermine the capacity of portfolio management teams to identify emerging opportunities and threats. Such practices also expose general partners in the PE firms themselves the risk of attribution bias and leave them underequipped when it comes to engaging with the underlying complexity of their investee businesses and working effectively with portfolio management teams to create value and negotiate a successful exit. It is suggested that forecasting practices dominate because they allow PE practitioners to remain within an ontological and epistemological comfort zone, which reinforces a position of expertise and legitimacy and becomes a cornerstone of their professional identity, as presented to other stakeholders such as Limited Partners, potential investee management teams and their competitors in the PE market. On a deeper level, such practices can also be construed as a kind of systemic confirmation bias, providing a defence against the anxiety triggered by the inherent complexity, uncertainty and unpredictability of portfolio business performance.