



Think. Forward! (Part Four)

By [Dan Kowalski](#), [Arun Shukla](#), [Phil Lynch](#)

Use Deliberate Thinking to get back in business after the gut punch of COVID-19 in the Private Equity world.

Unless your portfolio is singularly built on business platforms whose models work even when people self-quarantine (think Netflix and hand sanitizer production), your portfolio company valuations have taken a hit due to the spread of coronavirus 2 (SARS-CoV-2). COVID-19 may have thrown you off course from the value creation roadmap, but a deliberate detour will get you back on the value creation highway. So now what?

Introduction

This is Part Four, and the last in this series on how to use Deliberate Thinking to navigate the impact and ultimately bounce back stronger from COVID-19. Parts [One](#), [Two](#), and [Three](#) of this series, leveraged our sapience to go beyond binary “yes and no” decisions situations to those requiring hybrid “maybe” choices. We discussed how to identify if and how to make “business” lemonade by recognizing assets for their potential within the current environment, and how to adapt to the longer-term impacts through “Stop, Start, Continue” calls for action which may arise from the new normal being established amidst the pandemic or future business disruptions.

Until now, we have assumed completion of the front-end thinking required to identify these issues and develop countermeasures to adapt both PE portfolios and their portfolio companies. In this concluding article, we will cover how to use Deliberate Thinking to increase our understanding and refine our thinking when there are no rules.

What is Deliberate Thinking?

Deliberate Thinking is built upon on the thought points of Nobel Laureate, Daniel Kahneman. He says that we have two systems for thinking. System 1 thinking is used when we have a lot of prior experience so our known solutions will work. System 1 uses if/then reasoning to provide solutions e.g., in the business context of PE, if a portfolio company’s cash position is weak, then we may hold back on rent payments or extend vendor payments. System 2 thinking is used when we have no prior experience for the situation or solution e.g., other than for critical emergencies, we are unable to see our patients for a prolonged period, or patients defer elective procedures thereby severely impacting confidence in revenue projections. Deliberate Thinking uses System 2, when the automatic if/then reasoning of System 1 isn’t available. We have less clarity on the issue and have no, or only vague, ideas about solutions. Before COVID-19 provided so many unclear issues, we might have applied System 2 thinking



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to critical scenarios such as targeting a new acquisition, divesting a business line, or when to begin preparing for an exit from an investment.

Why should we use Deliberate Thinking?

Deliberate Thinking allows us to move beyond knee-jerk responses and develop more complete solutions. Now more than ever we must understand that most, if not all, of our tried and tested approaches and playbooks will not work. Determining the path forward isn't something that is readily available in our existing toolset and therefore isn't part of System 1 thinking.

Why do we have to be deliberate?

Kahneman and a host of other behavioral economists have proven time and again that humans have biases, particularly when associated with decision making, and are therefore irrational. We default to thinking fast as much as possible. This ability to analyze problems and decide quickly is often a strength within Private Equity; however, this ability is hampered when there are not many parallels from which to draw insight. The situation gets exacerbated for the general partners (GPs) who on one hand have to stay true to the original thesis of the fund sold to the limited partners (LPs) while at the same time dealing with the “new” market dynamics of the portfolio investments.

Historically, we have always had an answer because we have LOTS OF RULES and experience. This leads to applying a rule to a situation (such as extending payment terms when revenues dip), even if it may not match the conditions perfectly (we may need to change our entire business model and restructure the business more systematically). When we misuse a solution, then we create more trouble. The basic premise of Deliberate Thinking means that we turn off System 1 thinking and turn on System 2 thinking. Turning on System 2 thinking requires a conscious effort; it requires us to be deliberate.

How do we think deliberately?

When we use Deliberate Thinking, we ask questions to gain better understanding. This means gathering and considering more information to help arrive at an answer. We must listen to the answers to the questions. In turn, our questions should focus on one of the following intentions:

- Gather new information
- Confirm existing information
- Gain clearer understanding
- Identify potential paths forward

After asking a question, listen and document the new information or insight to create shared understanding. Use the best information available to develop solutions. In the Private Equity space, Sponsors can use this approach to assist their Portfolio Companies in working through challenging decisions in this environment. We are recommending that System 2 thinking become the way that



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dialog happens between portfolio managers and company management. This is a deliberate departure from daily-weekly dialogs that are anchored to a 13-week cashflow model.

How does this really work?

We have the capacity and capability to be Deliberate Thinkers if we:

- Truly turn off System 1 thinking
- Remember that there are no answers from the past that work for this (or any) unique situation (however, we may be able to leverage some experience e.g., “don’t throw the baby out with the bathwater”)
- Ask questions to increase understanding
- Listen to the input and document the discussion
- Create a new solution (and be aware that you may need to iterate on it to make it work)

The first two are the most challenging for decision makers, both, at the portfolio manager level as well as the company management level. We are primed in our traditional ways as we want to act and use what may have worked before. When we stop acting and start thinking, then we can make real progress. The new dialog between the portfolio managers and company management needs to happen along the latter three. It may seem awkward and will require some facilitation. Many times, the result of Deliberate Thinking seems obvious when looking back on it – as it is said, “the wisdom of hindsight”. That would be the wisdom that comes from sapience.

What’s next?

A significant majority of players in the PE industry will look at the above list and comment, “that’s just common sense.” Many may even say that this is implicit in their current ways of communication. Perhaps for some it is. However, common sense tends not to be so common and is practiced in the rearview – a luxury not afforded upon Private Equity. Now, more than any other time, portfolio companies and their leadership teams need assistance in practicing Deliberate Thinking. We must move past being reactive and become proactive. Think. Forward!

Want to learn more?

We all have the ability to think deliberately but need help because of our bias for action. Conducting After Action Reviews (AAR) can help provide insights into where our thinking worked and where it did not. We can learn to think better. SLKone, with our bespoke solution DNA, is adept at helping organizations, Private Equity Sponsors, and Leadership teams work through these challenges and processes.