

## Let's Resolve to Make PE Better

The private equity industry could use a healthy dose of introspection, a greater willingness to adapt and a dedication to process improvement. The new year is a good time to start.

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**N**ew Year's resolutions tend to last about as long as a hangover. By now, you're probably tired of hearing about promises to lose weight, exercise, or quit smoking. So we promise – no talk of resolutions as we discuss the future of the private equity industry.

As practitioners of private equity since 1988, we've seen a lot of change and a lot of challenges, but nothing really compares to the wild ride of the past three years. Turmoil in the markets, increasing regulatory and tax scrutiny, and heavy competition have combined to make things more difficult than ever. Even so, many of us in private equity are getting better at what we do every day. We're making better investments, adding lasting value to those investments, and generating superior returns.

Resolutions or not, the beginning of a new year is a great time to assess where we are as an industry and where we'd like to go. In the spirit of our optimism about the future, we offer four prescriptions to make the private equity industry stronger in 2012 and beyond.

### Stop Being So Private

The private equity industry has a serious public image problem, and it started long before journalists began cherry-picking unflattering details from Mitt Romney's past deals (though that doesn't help). Let's face it – our industry has not won many fans among the general public, media, policymakers, and even the business owners we hope to woo, and a lot of that is our own fault.

We all need to interact more and be more open. That means building relationships with

journalists, penning guest articles like this one, meeting with politicians, being engaged with industry organizations, or simply telling anyone who will listen about what we do. Everybody we know in private equity believes in its ability to contribute significant good to the economy. We need to share our success



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stories and be more open about our mistakes to demystify what we do, because what we do is a great story, not only for our investors, but also for the towns and regions in which our businesses operate.

For us, success means providing the capital to businesses in good times and bad that enables them to create new products, expand to new geographies, complete add-on acquisitions and transfer ownership. And yes, success includes creating jobs! Private equity firms invest in more than 14,000 U.S.-based businesses that collectively employ more than eight million people, and our combination of financial capital and intellectual capital promotes growth in a way that no other form of ownership does.

### Live to Fight Another Day

The private equity industry will be strengthened by the process of natural selection and ultimately the emergence of the best and brightest. The PEGs that barely survived the Global Financial Crisis are zombies; they are unlikely to raise another fund. This ultimately will be a good thing for the survivors. While we believe today's fundraising environment is far more difficult than it should be given the returns of strong PEGs, it was way too easy in 2005 to 2008, helping give rise to some of the current walking dead. In this new era of caution and extreme competition, capital – debt and equity – will gravitate to survivors. Prequin's top-performing PEGs, the top 25%, account for 76% of all assets raised in the past 10 years.

Survivor firms successfully demonstrate two key points—what and how. "What" is a successful track record, including through the downturns. "How" means providing a coherent, logical, believable, supportable (with facts) and credible explanation to investors of your strategy and tactic for creating value, and evidence that it is replicable. Luck, important as it is, just won't cut it anymore. We focus on demonstrating rigor in the investment selection process, sticking with our knitting and beautiful realizations. But increasingly, you need to demonstrate your operating chops by creating EBITDA – this is ultimately the top guarantee of eternal youth.

### Practice, Practice, Practice

We've acquired more than 270 companies in our 24-year history. Along the way, we be-



came experts in the smaller end of the middle market, but we also developed key knowledge of certain industries. We are certain that by growing and enhancing these specializations through added talent, experience and knowledge, we've become better investors.

Industry expertise allows you to excel in select areas rather than be average in many. It's also a force of the market, as LPs are becoming more sophisticated and have high expectations – they want proof that a GP can create value and drive results. Virtually all firms today have talented investment professionals and extremely knowledgeable advisors making their PE allocations and manager selections. To invest more thoughtfully and strategically requires extensive knowledge of and experience with industries and ge-

ographies. With 5,000 PEGs worldwide, distinguishing yourself is more important than ever.

### **Adapt and Be Open-Minded**

It may sound like advice from your dad, but it's not a platitude. It really applies in the private equity industry, which could use a healthy dose of introspection, a greater willingness to adapt and a dedication to process improvement. We don't think there will be 5,000 PEGs in this world for very long. The survivors will learn from their mistakes.

We post all of our money-losing deals on the wall of every bathroom in our offices, along with lessons learned from them. Every day we're forced to remember these lessons, which is a great reminder that we can always improve.

LPs won't tolerate mediocrity in today's world, and history shows some mediocrity in our industry. For example, if you look at eras with the highest volume of deals, they correspond to the periods of lowest returns and vice versa. This should concern all GPs – over cycles, more investors will invest at the wrong times and LPs will ultimately be disappointed.

We hope you "resolve" to take some of these prescriptions to heart. Private equity is an excellent form of ownership. When done right, it is fundamentally better because it aligns interests, attracts and motivates the right talent, drives results at portfolio companies, delivers maximum value, and ultimately outperforms other asset classes. Here's to a happy and healthy 2012.