A force for good

Over the past 20 years, the face of private equity has undergone a major transformation. At a recent roundtable hosted by Baird Capital, business leaders from across the sector debated the changing face of private equity, and how far it can go to helping SMEs expand today


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ANDREW FERGUSON: We see a lot of headlines of a negative nature about private equity, focussing on big buy-outs, fat cats and asset stripping, which is not a world I recognise in mid-market private equity today.

Twenty years ago we were stock picking, we put in a bit of corporate governance, and hoped we'd got the right business and management team. Debt was cheap and a lot of the models were based around deleveraging and maybe less so on strategic planning. Today, there's much more involvement in the businesses we invest in, a lot more thinking about the path to value, international growth, and operational improvement. For many SMEs, private equity can be a force for good.

TIM TROTTER: Now, there's a focus on how to support and develop the management team. Those who work in private equity have had a lot of experience in spotting strengths and weaknesses in management and know how to mentor and manage talent. When it comes to product development, innovation, and business development, private equity can offer contacts and experience, which can save a lot of time.

JON BERNSTEIN: *Many of these companies have been in the family for generations. It must be complicated telling someone that they need a stranger they've never met before telling them how to run their business.*

PAUL CARTER: It is hard and you do have to part company with the people who are holding things back. But you have to remember that the reason for involving private equity is to take the business forward for the benefit of everyone else involved. Not only does private equity bring good financial management, but having someone with industry experience in a chairman or non-exec role brings insight and consultancy that can deliver a better bottom line.

JOHN D'ARCY: That experience is reflected in the make-up of private equity houses these days. Whereas they used to be 100% accountants, we now see people with operational experience as well and that's important. While typically, 10 years ago, everyone seemed happy with the idea of leveraging up and floating upwards with the market, now there's a genuine belief that there is value to be created within the guts of the operation. So it's not just about mentoring at the top, it's also about getting the most out of the middle and bottom of an organisation.

ADRIAN YURKWICH: These days it is possible to do that. Before we've even made the investment we have a pretty clear strategy. It's about buying and building - investing in new products, technologies and geographies - over a three- to seven-year period. Private equity is often accused of being short-termist but we are more long term than the City which looks at things quarterly.

JON BERNSTEIN: *The perception is that you're building it for exit, and whether it's sustainable is of less interest.*

ADRIAN YURKWICH: It is being built for exit, but it is also sustainable. No sophisticated buyer will pay a good price for the business if they don't believe that in the next five years it will be even more successful.

ANDREW FERGUSON: The problem is that the press love bad stories. Debenhams is always used as a cautionary tale. [In 2003 various private equity houses invested £600m to acquire Debenhams. They trebled their investment in three years after cutting costs and selling off freehold property, leaving the company with £1bn of debt and plummeting shares.] That's one example of potentially bad practice held up as a reason for mistrusting private equity as a whole.

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DENNIS HALL: If I look at the vast majority of businesses that private equity get involved with, there's an increase in R&D, employment and investment. The problem is that it doesn't make a good story. The fact that we create jobs goes unnoticed.

JON BERNSTEIN: *Is it that the jobs that are being created are being created out East and actually you're losing jobs in domestic markets?*

ADRIAN YURKWICH: Not always. You have private equity firms that are interested in growing and building business, but you do also have distress funds and turnaround funds. They take over very distressed businesses and, to make them profitable, have to make difficult decisions. Sometimes doing the right thing for the business can mean job losses.

PAUL CARTER: There's very strong evidence to suggest that the drive to get offshore is fine if you have significant manufacturing regularly taking place, and it's got good volumes - they can set up and become good at it. But if you've got a lot of volatility, engineering change, and very short lead-times, those markets are not geared up for that.

ANDREW FERGUSON: That said, the ability to access the Far East from an SME perspective is a lot harder. As an SME making a couple of million pounds a year, it is much more difficult to find quality suppliers from the Far East.

DENNIS HALL: That's where private equity can help. A small business in the West Midlands may not have that expertise, but a private equity house might. The other part of the equation comes when these businesses are looking to grow and internationalise.

JON BERNSTEIN: *We've talked about SMEs as a single group but in the US in the private equity arena, there's talk of sectorisation...*

JAMES PITT: We routinely come across firms in the US that specialise only in retail, or software, or media, and there are plenty of them, but that's less likely to happen in the UK.

ANDREW FERGUSON: At Baird, we focus on three large areas: manufactured products, B2B services and healthcare. They're pretty broad, but we did that because we felt that, over decades, you build knowledge, experience and contacts. We feel if we know our sectors better, we can better invest our investors' money.

JON BERNSTEIN: *So what will mid-market private equity look like in 10 years' time?*

ADRIAN YURKWICH: I don't see it changing hugely. Over the last 20 years, the market has become more competitive, so private equity has had to up its game. Now, it has to work closer and harder with the company to deliver growth, it can't rely on a macro high level of growth to turbocharge the top line.

ANDREW FERGUSON: Evolution doesn't happen quickly. In 10 years, firms may be more international, perhaps more sector-focused, perhaps with more operational people. We will have to find increasingly sophisticated ways of building value in our portfolio companies in the years ahead.

JAMES PITT: Beyond that I think we're going to see changes to the industry structure. It's quite a mobile industry. And the logical outflow of these comments about increased competition, sophistication and necessity to add value means that for the vendor, selling prices could be higher.

DENNIS HALL: Ten years ago most people round a dinner table wouldn't have heard of private equity but now one in five people in the UK work or have worked for a private equity-backed business. It's a major driver of UK growth and I think that's going to continue.

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