

# GP, heed thyself

*As general partners scramble to improve their firms' deal throughput, they'd do well to practice what they preach to the management teams at their portfolio companies*

by Rafi Musher

As the leveraged buyout industry evolves, general partners are thinking more actively about how they manage their firms and deploy their operating capital, people and expenses in addition to their investment capital. They are looking for better ways to match resources and deal review and to improve their yield on deal throughput. They have to if they want to prosper. And they may have a fine model in the lessons they preach to their portfolio company management teams. Cheap, available debt combined with older portfolios in need of inventory turn has made it the time to sell "everything that isn't nailed down," and the deal market has been busy. Although deals are out there and getting done, the competition is hot. "We thought this was an exclusive," one investor sighed not long ago. "Then they told us there were a couple of bidders. Then it was half a dozen bidders, and we all had to show renewed interest and proven effort, just to get to the next round."

Chasing deals can be expensive and time-consuming. How many people do you know who have spent months chasing a deal almost full-time, only to strike some killer glitch in the end or get beaten after thinking they had the high bid? If you're a firm with \$1 billion in your current fund and 25 professionals, one deal may absorb the equivalent of 2.5 full-time people for months, with no time to spare for portfolio work. And it is hard time—late nights, time on airplanes, time across the Atlantic, time away from families.

It's easy for an investor to become overly comfortable relying on big brand firms to hold his or her hand through the process. In the past, a fund working on a deal for three months would traditionally enlist massive

support. It might not make sense to launch the Seventh Fleet of outside advisory resources on every deal, but look back over the last few years and you'll find many firms kept what seemed to be at least a flotilla in the harbor. With steadily increased competition, however, opportunities for winning deals have diminished, and there is a good chance those squadrons are coming out just for a cruise rather than a quick sweep to victory.

For the last two decades, management fees were primarily for operating expenses and base salaries; the real money to be made was in the upside. But from 2001 through mid-2003, those 2% fees were looking more and more important. They still are. With the growth in many firms' new funds, forward-looking management fees are real numbers, to be managed with intention.

If more effort is needed to win a deal, and the chances of winning are more constricted, the internal time and outside funds that are spent must be managed aggressively to improve efficiency. Firms should be improving their yield for the effort and dollars they spend. From a competitive position, a sharp GP wants to spend intelligently while his competitors waste precious resources, leaving them little dry powder for the real battle.

The private equity business is about intelligently deploying assets to increase actionable deal throughput, or yield. You should quickly ditch bad deals and keep your teams focused on the good deals—those with high probability of success—or you'll find your firm at the end of the year with a lot of time spent and not much to show for it.

In the past year we've seen some firms working smarter—both in going to auctions

and in proprietary situations—as they consciously make efforts to better manage their deal focus, people, fees and yield. In the past, firms were looking for a large, full due diligence out of the gate; it was "Let's set up a team and get going." Nowadays, they must think out their needs more carefully, and work is staged, with more decision points.

Think of Japanese manufacturing lessons to American companies of the 1980s and 1990s: Do a little; test; do a little more; test; and when you get it right, turn it on. And just-in-time flexibility from suppliers has generated massive advantages in manufacturing, both in materials handling and better use of working capital.

Why would you look at your firm's operation differently from the way you look at your portfolio companies' operations? Why not analyze your own supply chain and purchasing processes with the same critical eye you use to review those at one of your portfolio companies? A little sophistication can go a long way toward improving overall performance and yield of quality output.

The LBO industry is maturing, and its operating practices need to follow suit. We're individually quick to put pointed questions to our portfolio companies' managers: "What are you doing this year to meet market conditions, improve operating performance and better position yourself for the future?"

Are we asking ourselves the same questions about our own businesses? ■

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