THE LEAD
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Why Sponsors Matter (Second of a Series)

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Last week we kicked off our special series examining the differences between lending to middle market companies and those backed by private equity sponsors [link]. We discussed how these companies often are founded by visionaries with great creativity, but lack the management skills to execute the business plan to its full potential.

Let's turn to how private equity sponsors can help accomplish these goals. The first thing these firms look for is a partner. "There's a common myth that we buy companies to take them over and manage them," one managing partner of a New England middle market firm told us. "We buy them so that the management team can manage them."

He went on. "What we do is give the team the tools to grow. For example, many of these businesses don't have the access to capital they need to finance their growth. In many cases, they don't even have the experience or sophistication at the financial management level to know what's available out there. We can help with that."

Our own experience as a lender reinforces this point. CFOs of smaller companies tend to be more in the mold of treasurers or controllers. But given the increased demands of a PE-owned company taking on leverage, the skill sets required for the position are more akin to public companies. Knowing this, debt providers make credit decisions based on the strength of financial management. A weak presentation by a CFO at a lender meeting can do more damage to credibility than one by the CEO.

Another theme is distribution. How do you get your product to market?

A portfolio company we know had a fast growth skin-care line with excellent penetration in health food stores, but couldn't get into the bigger retailers. "I had been trying for years to break into CVS," the founder told us, "but it wasn't until the buyout when our [sponsor] partners helped crack the code." She continued. "They had been successful with several other launches, so brought the experience with the retailers we didn't have."

This is particularly true for middle market companies who look to expand overseas. By their nature, smaller companies lack the resources and capabilities to leverage partnerships with international vendors. But PE firms with global reach can tap their connections to pave the way to build these relationships. Or buy them.

We'll cover add-ons in future issues, but helping companies execute an effective M&A strategy is one of the hallmarks of a good sponsor. Being able to successfully identify, finance, and integrate acquisitions can make or break your returns and growth plan.

Corporate development help comes naturally to sponsors employing operating partner models. These former Fortune 100-quality executives, whether as on-the-ground consultants or replacing management, give less seasoned teams access to decades of experience in working through complex growth or cost streamlining projects.

Next week we look closer at what motivates a family run company to sell to a private equity firm.