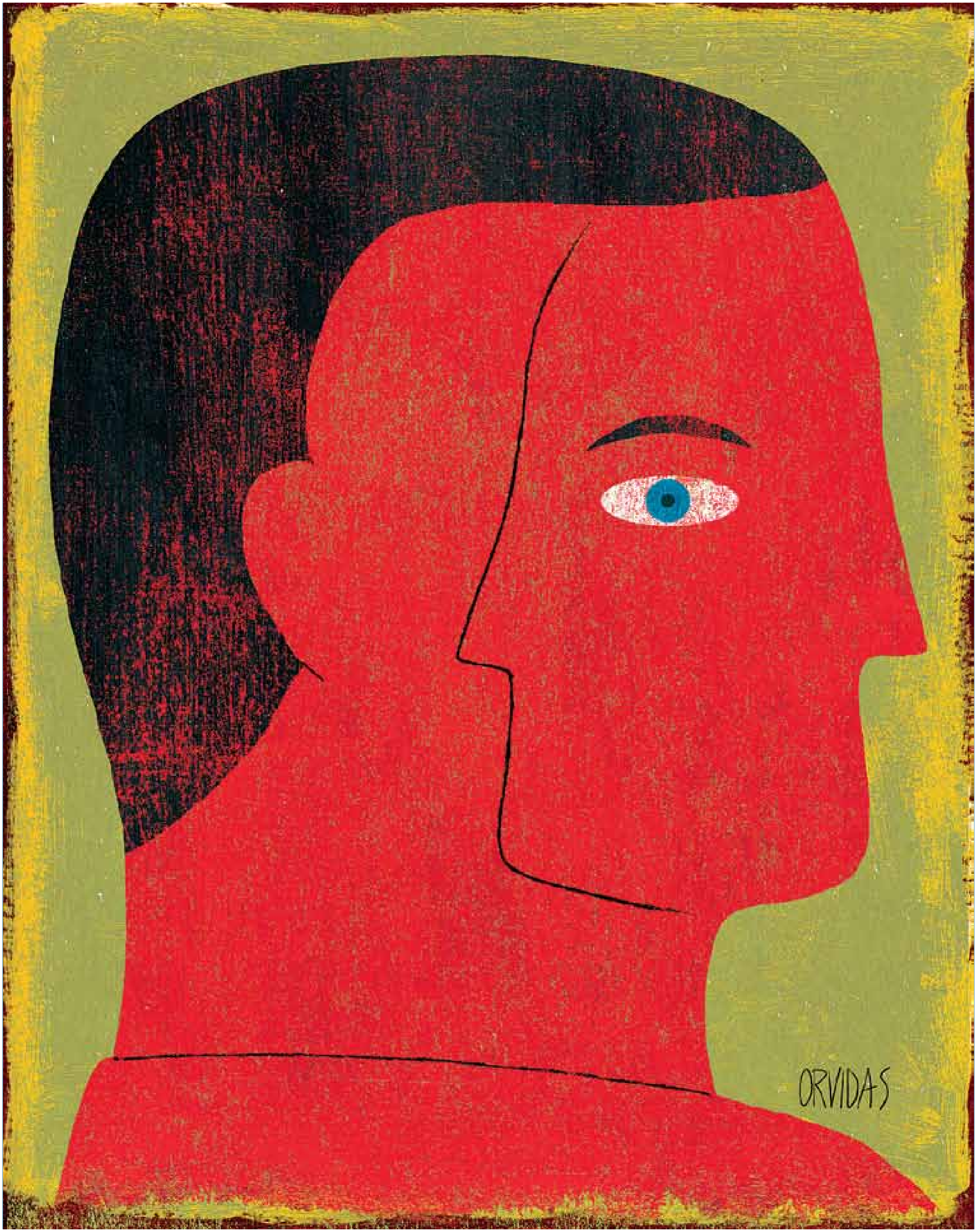
ORVIDAS

Summary

The private equity industry has not always excelled at explaining how its investments benefit companies, communities and the economy. Now firms and industry-wide groups are addressing reputational issues head-on.

BUILDING A BETTER PUBLIC IMAGE

As new regulations and competitive necessity draw private equity firms into the public arena, ignoring reputational issues may no longer be an option.

BY FERGUS WHEELER AND DOUG DONSKY

In a 2005 interview, Franz Müntefering, then leader of the German Social Democratic Party, described private equity firms as "locusts" stripping the country's industrial base. In Germany, at least, the name stuck, so much so that public discussion in that country today tends to be in terms of "good locusts" and "bad locusts" — drawing a distinction between firms that act responsibly and abet the long-term growth of companies in their portfolios and those that don't. While that is hardly the universal view of private equity around the world — in the Persian Gulf region, for example, private equity is generally lauded as a natural and valuable way to support local enterprise — it illustrates the kind of negative public perception that has often dogged private equity, particularly in Europe and the U.S.

Much of the flak comes from outside the industry, as politicians, unions and workers attack private equity out of concern for jobs that may be lost when companies are taken over and reorganized. There's also a postrecession notion, often fostered in the media, that private equity firms contributed to the financial crisis through overloading their portfolio companies with debt. Moreover, a number of recent private equity–backed deals have ended up in litigation. Whether this well-publicized acrimony eventually colors the view of boards contemplating a sale to a private equity sponsor — or forces more onerous terms and conditions than were once accepted — remains to be seen.

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Many people within the industry argue that none of that matters — that it's all just so much noise from disaffected, ill-informed outsiders with axes to grind. Yet in several important ways, the public image of private equity makes a difference. Institutional investors, including public pension plans and university endowments, have joined the calls for more transparency, frequently asking fund managers to respond to lengthy questionnaires that ask for detailed information about their funds' capital structures, portfolio companies and operations. New rules, in legislation already passed in the U.S. and pending in Europe, codify such requests and institute other requirements. If more private equity firms go public, they will be forced to disclose additional information about their operations and will have to embrace a more traditional dialogue with institutional and individual investors and the media. Private equity, it seems, can no longer afford to be very private.

When a backlash against the industry first emerged during the most recent boom, many private equity leaders were unprepared for a public relations battle. But private equity has now engaged its detractors, fighting back with steps toward better public communication and adopting voluntary transparency measures for investors and other stakeholders.

Established organizations such as the British Private Equity and Venture Capital Association and the European Private Equity and Venture Capital Association, along with the newer Emerging Markets Private Equity Association and the Private Equity Growth Capital Council (PEGCC) in the U.S., have been pushing to tell the industry's side of the story and take control of its public image.

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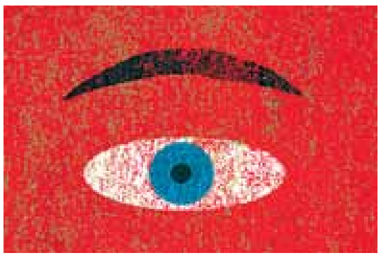
A major focus has been to publicize tangible evidence that illustrates the beneficial effects of private equity for local communities and the global economy and to refute claims that the industry looms as a threat to economic stability. In fact, a study funded by the PEGCC (formerly the Private Equity Council) that analyzed more than 3,200 companies acquired by private equity firms in buyouts or similar transactions between 2000 and 2009 and held through 2008 and 2009 found that only 2.84% of the businesses defaulted during the recent recession — compared with 6.17% of other companies. Those findings also challenged previous studies by Moody's Investors Service and Standard and Poor's, which the PEGCC contended had "inflated" private equity default rates by developing new, expansive definitions of what constitutes a default or by artificially broadening the universe of companies deemed to qualify as private equity–owned.

2.84%

of businesses acquired by PE firms in buyouts or similar transactions defaulted during the recession, compared with 6.17% of other companies — a statistic being publicized to emphasize the beneficial effects of private equity

Other broad initiatives have attempted to increase transparency in advance of new legislation. In November 2007 a working group formed by the British Private Equity and Venture Capital Association and led by Sir David Walker issued *Guidelines for Disclosure and Transparency in Private Equity*. The group made specific recommendations for improving the level of public disclosure by private equity firms operating in the U.K., and most of the leading firms now have adopted those practices. (The guidelines, which had to be adopted by firms that received more than half of their revenue from the U.K., have also led to other private equity firms publicly disclosing information about their managers and structures, along with other details.)

Those moves, as well as effective industry lobbying, have helped moderate the rules in the proposed Alternative Investment Fund Managers directive that the European Union is likely to adopt this year. One controversial proposal, which would have barred private equity funds based outside the European Union from being marketed to Europeans unless their host countries adopted similar regulations, is now expected to be dropped or watered down significantly. That proposal would have created a restrictive barrier few non-European firms could meet.



Firms are taking a more strategic approach in their communications with investors, the media and other stakeholders.

INDIVIDUAL PRIVATE EQUITY firms also are taking a more strategic approach in their communications — not only with their investors and the media but also with other stakeholders, including portfolio companies' employees, managers, customers, suppliers and labor unions, as well as with government officials and the communities and countries in which the companies operate. And unlike five years ago, when markets were booming and most firms could keep a low profile, revealing little about their operations or management, increasing numbers of private equity firms now are attempting to build recognized brands in the marketplace. Investor relations, marketing and media relations all have become important parts of the way they operate, and they're creating infrastructures that let them communicate both positive and negative news to employees, lenders, investors and other stakeholders as well as respond to their questions and concerns. Taking a page from public companies, many private equity firms have adopted best investor relations practices into their private limited-partner communications, including hosting investor days and organizing investor calls around significant news announcements.

These efforts aren't merely a matter of preparing to deal with looming regulatory requirements. They are also a response to the recent financial crisis, which has created more competition for capital, talent and deals. The current private equity marketplace is crowded with middle-market funds, many of them spun off by large banks or very large private equity firms, looking for ways to differentiate themselves to investors and the management teams of potential acquisition targets. Those brand-building efforts are particularly important as firms push into emerging markets and find themselves competing with local firms that may otherwise have an edge.

Yet, as important as it has become to improve public perceptions of private equity, there's another, even more compelling reason for private equity firms to be more open about how they operate and the value they provide. For example, a recent survey by a prominent private equity firm found that poor reporting and transparency were among the top four factors deterring investors from reinvesting with firms they had worked with previously. In fact, according to the report, two in five North American private equity investors intend to reduce the number of their GP relationships over the next two years. In today's risk-averse, competitive environment, a well-developed communications strategy can be a prerequisite for locking in future investment.

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