Results

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Private Equity Challenges

THE MANAGEMENT COMMENTARY

It seems that Benelux private equity players have never had it easy. Now, they will have to contend with two major trends unfurling in parallel: greater but more complex deal flow, and fiercer competition for future capital.

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Greater but more complex

Paradoxically, a depressed stock market will bolster the potential for private equity deal flow. The reason is twofold. Firstly, the level of corporate restructuring will rise. The need to generate cash and "streamline" portfolios will cause corporations to spin-off non-core and slower growing assets. Witness KPN' s pink pages or Vendex's sale of retail formulas to CVC.

Secondly, opportunities for public-to-private transactions will blossom. With a sagging stock market, private equity players will increasingly initiate bids on publicly listed funds. Still, such transactions are -and will remain- highly complex, especially with Dutch corporate governance as it is.

Competition for future capital

Over the past five years, the number of investors willing to commit funds for Benelux players has surged, allowing established players to increase their commitments and new players to enter the market. However, today's lack of earnings growth, combined with more complicated exit trajectories, have hurt average investment performance and generated dissatisfaction among capital providers. For the upcoming rounds of fund raising, capital providers will have the upper hand. As a result, current compensation structures -particularly management fees- will undergo a mini shakedown and poorly performing funds will be unable to raise additional capital.

Consequences

The trends outlined have two implications. The first: Benelux private equity players seeking to satisfy their capital providers -and keep market share out of the hands of international players- will have to boost average deal size and be prepared to handle more complex deals.

Secondly, Benelux players will need to focus relentlessly on improving their investment performance. It's true, access to capital and deal flow once used to guarantee success. Today, these are just "plain hygiene factors." Somewhere down the line, success also required superior deal screening and structuring skills. In today's competitive market, only the combination of all these strengths, sprinkled with the ability to add operational and strategic value to even the most complex deals, can yield extraordinary results.

For most Benelux private equity players, "acknowledging" these consequences is not enough: they will have to realign their organisations substantially. Most have traditionally relied on professionals with corporate finance backgrounds. Now, screening and structuring complex deals, as well as initiating, supporting and monitoring performance improvement, will warrant profound operational and management expertise. This knowledge gap must be filled quickly. Also, adding value to larger and more complex deals, pre- and post-deal, requires that the activity portfolio of senior staff be slimmed down substantially.

These organisational imperatives sound easy on paper but implementing them is another challenge. Benelux players who succeed in doing this may well be among the long-term winners in private equity.

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