

All in the Family

Family offices have natural appeal to many businesses looking for investment. They should use that appeal to get deals done.

This is **part two** of a four-part series on the powerful new role that family offices are playing in private equity.

So, your family office has decided to start investing directly in private companies. You've done the groundwork. You have your formalized strategy and you understand what you want to accomplish. You know the kind of returns you're looking for and you even know the size of the deals you want to target.

Next question: How will you go about sourcing investments and winning those deals? You need to have an answer and it needs to be a good one. To secure attractive deals, family offices must communicate advantages that enable them to go head to head with the many financial sponsors that are also competing for those deals. They need to elevate above the competition.

One advantage is industry expertise. Family offices are most successful when they stick to what they know and source deals that match their core competencies.

"When family offices first get into direct investing, they tend to do it on an opportunistic basis," says Francois de Visscher, founder of de Visscher and Co. LLC, an independent financial adviser to single-family offices. "Maybe a friend recommends a deal to them. But, quite often, those deals are not aligned with the family's long-term objectives and skill sets. As a result, these investments can sometimes fall short."

A better approach is to look for deals in an industry sector where family offices can put their native expertise to work. This expertise can give them an edge in deal origination because it shows they have knowledge, experience and networks in a given sector.

"This is where family offices can outsmart long time professional investors," de Visscher says. "Whether your family has done business in metals or medical devices, you need to search for deals in a particular space where your family can add real value."

Family offices are well-served to look for deals in a particular industry where they can put their expertise to work. "This expertise can also give them an edge in deal origination that other financial sponsors might not have, given their knowledge, experience, and networks in a given industry," says Jeremy Swan, Managing Principal—Financial Sponsors & Financial Services Industry Practice at CohnReznick.

Another advantage for family offices is their natural appeal to business owners. Often, there is chemistry between the family that's investing and the business owners who are seeking investment because these owners are also operating a family business. This is especially true in the middle market. Whereas investment firms are often viewed as looking to maximize profit via financial engineering, family offices are often seen as—and often are—real people who have the best interest of the target business at heart.

"Many companies come to me and say, 'We want a family office as an investor. We don't want anyone else,'" says de Visscher, who is also a director and shareholder of his own family's \$5 billion global enterprise, N.V. Bekaert S.A. Many of these are middle market companies that are concerned about their place in the community and want to continue providing jobs for local residents. They believe family offices share their values and are more respectful of their concerns. This concord can help seal the deal and contribute to the future success of the business

What's more, unlike other financial sponsors, family offices are not under pressure to sell the business within a predetermined time frame. In fact, family offices often choose to hold the businesses they invest in for a longer term, gradually building wealth via a dividend or income strategy. For example, a business that consistently generates a low double-digit return year after year could be a very good investment for a family office. On the other hand, the same business might be attractive to a PE firm only as a potential quick sale because the firm needs to generate greater returns in a shorter period of time.

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This advantage can also help family offices bypass the auction process and avoid competing against dozens of other investors for the same deal. “The last thing you want to do is overpay for one of these auction deals,” says de Visscher. “That’s why you need to be proactive and find proprietary deal flow that matches the core competencies of your family.”

Indeed, family offices are starting to band together to accomplish this. They’re forming networks, sharing deal flow among themselves, and identifying opportunities in the market where their capital will be well received.

For family offices testing the direct investment waters for the first time, so-called club deals are proving to be a good fit. A club deal provides deal access to investments through a lead family office that may look like, and market itself like, a traditional private equity fund. “Here, the lead family office shares investment opportunities with a small number of other families to provide the capital needs of the investment,” says John Bova, a business development and strategy leader for CohnReznick’s Private Equity and Venture Capital Industry Practice. “This ‘investment club’ offers a test for family offices to work with other co-investors and perhaps gain some experience with board sitting post-close.”

CohnReznick, for its part, has teamed with a family office advisory firm that currently operates a database of 27,000 family-run companies with revenue ranging from \$30 million to \$1 billion. The companies are categorized not only by industry but also by the age of the CEO, the age of the board members, and the number of generations the business has been held by the family. The advisory firm monitors these factors and approaches businesses at the moment they are most likely to be looking for a growth partner or considering a liquidity event.

Once a deal is sourced, family offices still need to conduct the proper due diligence including financial, IT, operational, and tax diligence. This is not a function that most family offices have in-house. However, there are reputable advisers in the marketplace that can help family offices look before they leap. By conducting thorough due diligence, a trusted adviser can ensure that family offices make the most lucrative investments at the best possible price.

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