



Issues Facing Midmarket Business

A TWIST ON PRIVATE EQUITY – COMMUNITY EQUITY

By Devon Fleming

There exists a tremendous opportunity in the present US economy to revolutionize the way companies and investors work together that could dramatically alter the financial future of privately held businesses. Community Equity (CE) is a new way to look at adding value to these companies. CE creates value in midmarket businesses by providing a suite of technology and management services to consolidate costs allowing focus on growth and provides an executable exit strategy. In this article we will discuss the current state of the Private Equity (PE) environment and introduce CE; highlighting distinctions between the two business models and focusing on the benefits of CE.

In theory, CE is similar to the current PE model; invest in privately held companies in order to grow the platform and reap a significant ROI. There is one big difference; in the current PE model, the majority of the ROI goes to the PE groups and investors leaving a much smaller percentage going to those who built the company. Enviably this business transaction economy has negative ancillary effects on entire communities and ultimately our country at large.

Here is some history about why we find ourselves in this dilemma. Since the Great Recession many privately held businesses have been struggling to grow; a result of an economic slowdown, as well as other factors. Inorganic growth (growth by acquisition) has become the method of choice for many investors and some entrepreneurs, for the simple reason that with interest rates remaining historically low, money is cheap – if you can get the money you need to grow.

PE investors see (seize) an opportunity to offer solutions to companies facing stagnate growth. This can include many apparent admirable actions, such as making the business run more efficiently; and many not so endearing practices, such as borrowing as much money as possible to pay the private equity group a "dividend" simply for being the new owner. Here is some background on the magnitude of the numbers. In 2013, PE firms extracted a record \$66.2 billion in these types of payments, many times the traditional PE ratios. These practices are driven by the desire to increase returns rather than to improve the business model of a company that is the focus of the investment.

The result of these practices is that nearly \$70 billion that was paid to PE owners last year that could have gone to hiring more employees and buying equipment to improve the business. But it instead went to the PE groups that purchased these entities. Buying a company, then leveraging the balance sheet in order to make a dividend payment, simply because debt is so cheap, is not a growth strategy for midmarket companies or a viable exit option for their principals.

Even with the advantages that PE represents in capital availability, a large portion of the capital that has been raised and is ready to be invested in privately held companies hasn't been used in purchasing middle market companies for a number of reasons. This is part of the reason why there is \$1.4 trillion that has been raised by PE investors, but has yet to be put to work acquiring privately held companies.

Many companies are wary of these institutional investors for good reason; however, more importantly, many of these companies' founders have no succession plan that mitigates purchase risks that are viewed as detractors by PE and buyers in general. The question is; what is the alternative? let's take a little deeper dive to see what is really going on in this environment and why there is a need for a newer business model that is designed to minimize these purchase risks and that establishes a more equitable share in the upside growth once an exit event occurs.

A number of years ago the CenterPoint Group (CP) (cpi411.com) led by Dr. John James Lombardi, MBA, set out to bring together a new way of looking at business value and to effectively change the current business development landscape. The result was the concept of Community Equity. This concept seeks to add value to companies organically (from the inside out), by implementing strategic measures, mostly in the form of various types of technology and digital marketing, as well as

setting up the management of the company so that it is less owner-centric. The companies that are in the process of this transformation become part of a CP community. These companies are known as CP portfolio companies. What is important about this community is that many services and economies of scale are leveraged by CP's management team giving market advantages to the portfolio companies for outside investment, exit planning or continued operation.

Many of the portfolio companies' principals need exit strategies. These strategies are a specific part of CP's offering and a central element of community equity. In the end, this process has strategies that drive the value of the companies that makes them more viable for an exit event. It also helps many business principals with the struggle to see their company from the "buyer perspective", particularly after spending decades building their company. This knowledge helps CP and the portfolio companies' principals minimize operational and succession risks that in-turn builds value.

CP offers a fresh perspective to business principals, so they can see a greater amount of growth and value in their company, in advance of a sale. In essence, CP sets up companies to be better positioned when it comes time to transition to a new management team and literally puts more money in seller's pockets, allowing them to participate in more growth of the company that they built in the first place.

CP's Community Equity improves business planning and helps companies grow organically making it a more sustainable solution, allowing the business (as well as investors, if needed) to reap the financial rewards in partnership.

For additional information on Community Equity and CentrePoint, visit us at www.CPI411.com.



**2 ENTERPRISE DRIVE, SUITE 303
SHELTON, CT 06484
(203) 445-0011
WWW.CPI411.COM
INFO@CPI411.COM**