PRIVATE EQUITY
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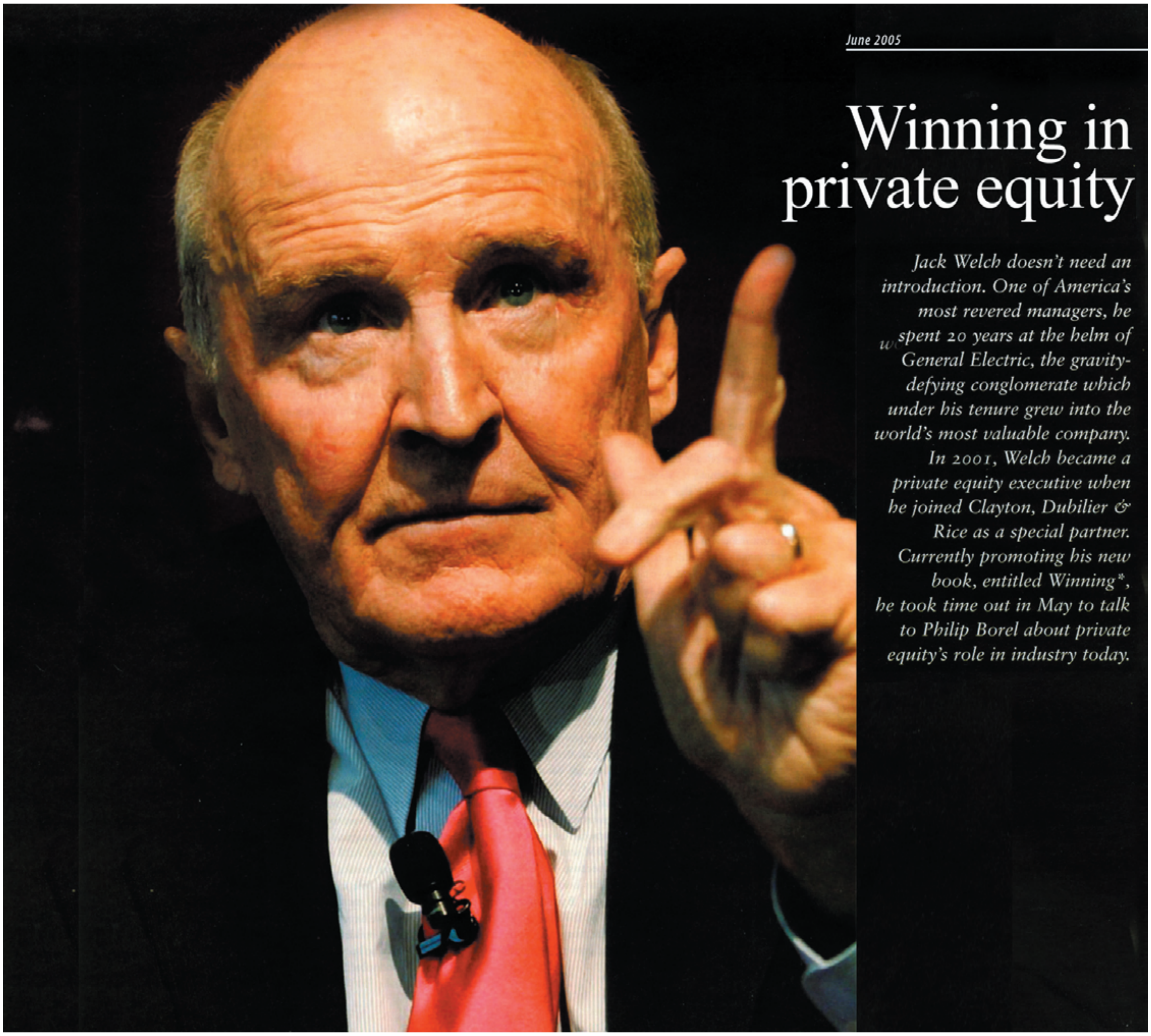
June 2005

Winning in private equity

Jack Welch doesn't need an introduction. One of America's most revered managers, he spent 20 years at the helm of General Electric, the gravity-defying conglomerate which under his tenure grew into the world's most valuable company. In 2001, Welch became a private equity executive when he joined Clayton, Dubilier & Rice as a special partner. Currently promoting his new book, entitled Winning, he took time out in May to talk to Philip Borel about private equity's role in industry today.*

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Winning delivers your accumulated insight into leadership in management. Private equity firms typically spend between three and seven years trying to improve businesses before exiting. Is that long enough for the kind of leadership you describe to have an impact?
Oh sure. Building a great team is one of the things you have to do, and it's one of the things I preach so hard in the book: build the best team and create a candid atmosphere for it to operate in. And there's no question that that can be done very quickly, certainly within a couple of years of a transformation of a business.

Have you personally found it difficult to get used to private equity's more short term mind-set?
Not at all. Don't forget my role is not about building the culture of the company, that's up to the CEOs that we hire. I'm reviewing their businesses on a quarterly basis, so I'm not dealing with the day-to-day combat they face. What was difficult for me in the beginning was looking at businesses not in order to turn them into an institution, but to make a contribution by fixing the business and then getting it ready for either a strategic buyer or an IPO. That's certainly a different mind-set compared to what we were doing at GE, where we were always looking for the next strategic bolt-on acquisition that would fill out a portfolio for the next 100 years. Getting used to that took some time, but now I'm over that.

"Diversification into new areas always brings with it greater risk, and that's the greatest challenge facing private equity today"

What do you see as the major differences between managing a private and a public company?
A private company gives you a lot less quarterly pressure, which gives you a better chance to always make the right decisions, make the right investments. Of course, in a public company you want to do the same, but sometimes the pressure to perform from quarter to quarter holds you back. Also, compensation schemes can be vastly different between private and public businesses. As a private equity investor, once you've bought a company, you can go and buy the best imaginable talent to run it. In most public companies, you have to try and build that talent, but you can't buy it.

Do you think private equity firms today can always attract the best talent, or are there executives who might be more comfortable without having to report to a private equity investor as majority shareholder?
You're talking about a one by one situation, there is no rule here. There is no question that the opportunity for personal gain can be vastly greater in private equity. So if a guy wants a bigger hit, making bigger dollars in the short term versus building a long career, his chances are obviously better in a private equity-backed business.

As an industry, private equity appears to be winning at the moment: capital is rushing into the market, and the large LEO firms are raising bigger and bigger funds - a healthy development in your view?
The more money there is coming in, the more pressure there will be to put it into play, so you'll have more pressure on prices, more auctions and a greater likelihood that people are going to diversify into areas that they know less about. As more capital flows into the industry, the more competitive it becomes, and the more risk needs to be taken on as a result.

Are there other major dangers that the industry ought to be thinking about today?
No. Diversification into new areas always brings with it greater risk, and that's the greatest challenge facing private equity today.

One way in which the large LEO firms are responding is by forming syndicates to buy bigger companies such as SunGard. If you were an investor in large buyout funds, how would you feel about this development?
I'm not an expert, but I'd hate to think that I was putting that much money into the same deal. To me it defeats the purpose of what an LP wants, but again, I'm no expert, and perhaps I'm wrong. The other crucial point is, what happens to the control element and who will be in charge when a club deal goes bad? CD&R has an aversion to club deals, to a lack of control, which I applaud.

In today's environment, can private equity still deliver the performance that investors expect?
It can. It may not deliver the same level of returns as it did in the 1990s, but then what's going to? I believe private equity will still outperform most other asset classes.

In the 1980s, private equity wasn't a particularly credible partner for corporations to do business with. At GE, did you pay much attention to focus on their core strengths, and they can assist other companies in enhancing their portfolios by buying cleaned-up businesses from them.

Welch, CD&R CEO Don Gogel: "I'm enjoying the heck out of this firm."

A perfect example of this was General Motors flushing out Allison, its aircraft engine business, in the early 1990s because they couldn't manage it with their union restraints and many other problems, CD&R buying it and fixing it and then Rolls Royce becoming a stronger global player when they bought it in 1995. It's a great case study of global corporations using private equity on both sides - as an exit mechanism to clean up a portfolio, and on the buy side to strengthen a portfolio.

In the US, private equity has been doing this for a long time. Do you believe the model will be as successful in Europe and Asia?
I think Europe provides enormous opportunities. Enormous. Europe is experiencing slow growth, with lots of traditional companies holding on to their assets. For private equity there are perfect opportunities to help these companies unload some of their legacy costs, some of the barnacles of bureaucracy if you will, and clean up their businesses. In many ways Europe's corporate sector in its current lethargic state and private equity are a perfect match.
Asia is harder right now. Japan on the face of it would seem made for private equity activity, but culturally it's still a struggle. Private equity flourishes mainly in developed countries when industry cycles change, businesses go out of fashion, have been built up with too many costs or are stuck in structures that can't deal with the need to change. In that sense taking the model from the US to Europe to Japan is a logical expansion, but the question is, how rapidly can the Japanese culture adapt? So far it has been slower than I thought it would be, although there have of course been some great successes, particularly if you consider Ripplewood's acquisition of Shinsei an LBO of sorts.

to financial buyers at the time?
Absolutely. I thought in the early days that CD&R and other firms like KKR did wonders to help America get more competitive, and I was a big supporter in the 1980s when it wasn't fashionable to be a supporter of private equity. I was outspoken in the fact that they were helping fat companies get thinner, and we always talked to private equity firms about selling to them versus selling to a strategic buyer. We usually found strategic partners for most of our things, but private equity firms certainly played a role in some of our divestitures, and we were constantly talking to them about buying assets from them. At GE, I'm sure this continues on today

Do you believe private equity today can play an expanding role in changing the global corporate landscape? Do corporations need private equity?
I think private equity firms can help companies flush out their portfolios

How can you make an impact at CD&R or its portfolio companies on a part-time basis?
In a number of ways. Let me give you a thumbnail sketch. For a start, I'm on the screening committee, so when deals come through, I don't have a veto, but I am a voice in the crowd, and I look at every deal several times before it goes to the next step, be it at an early stage of the screening process or for the final approval. We also run quarterly meetings where we bring in two portfolio companies for a half day review of their operational plans. We look at their human resources,

Welch vision: "I like operations, I like evaluating people, I like looking at the front end of deals."

their key initiatives, their acquisition plans and their operating results for the quarter. In addition, I have close guard of the companies' strategic planning reviews, two-day meetings where we focus on 'what we're going to be when we grow up' if you like. So I play an operational role and a review role, but not on a day-to-day basis.

I'm not by any means the boss in this firm, and I don't want to be the yes or no person, I'm enjoying the heck out of the firm. I like the people, I like what we're doing. I like operations, I like evaluating people, I like looking at the front end of deals, but I don't want to be negotiating deals, I don't want to be in rooms fighting over nickels. I've done that.

Has there been much change at CD&R since your arrival?

I think we've put more rigour into operations, and I've seen an increasing clarity around what we want to be. I don't mean to say that there has been a great breakthrough on this recently, but I think we have a pretty clear view now of what we will and won't do in the acquisition game. I have been very happy to see the firm's partners develop good companies like Kinko's and Jafra that were sold to strategic buyers for very high returns. And I think we have made some terrific investments in the past few years in Brakes, VWR, Culligan and Rexel - all market leaders in great spaces

"Europe's corporate sector in its current lethargic state and private equity are a perfect match"

Before you retired from GE, you closed down GE Equity, the corporate venture division of GE Capital. We're told you refered to it as a "popsicle stand"...

... I think I called it a popcorn stand. GE Equity had way too much venture capital, and I wanted to get out of it. I let GE Capital spend some money on it early on, but in my view private equity is a very difficult business for corporations to be in. They don't get any credit from the market when the private equity earnings go up, because their quality isn't perceived to be continual. But when they go down, the corporation does get punished. It's a lose-lose situation. Consistency of the earnings was one of our main selling points at GE, and so having the volatility of private equity with its quarter-to-quarter variations through GE Equity made no sense.

What's your next big project at CD&R - anything out of the ordinary?

No. We're busy looking at a bunch of deals. Just like everybody else in this market.■

*Winning *is published by HarperCollins. For details, visit www.Jack Welch Winning.com.*