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The new normal

It is sometimes said that chief financial officers are in charge of everything at the firm outside of deal-making. In today's market and regulatory environment the CFO role has evolved into one of the busiest at private equity real estate firms.

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In light of new regulatory requirements and an increase in LP data requests, the job of a CFO at a private equity real estate shop has become a lot more complicated. The decline in deal activity appears to be inversely proportional to the dramatic rise of painful things, other than deals, that CFOs must deal with.

With most of the nitty-gritty issues, the CFO plays a lead role.

Limited partners account for a considerable number of challenges that CFOs must, now more than ever before, meet and overcome. LPs now demand unheard-of levels of detail as they scramble to assess the health of their portfolios. This means that CFOs are responding to frequent inquiries about the performance of individual portfolio companies.

When it comes to fundraising, LPs are paying closer attention to marketing presentations and demanding more documents, making the process more time-consuming.

James Stevenson, CFO at Baltimore-based ABS Capital Partners, has been through two fundraising events during his seven years with the firm. "We're certainly being asked for more information," says Stevenson, adding that the greatest challenge is time management and making sure staff handles all inquiries in a timely and efficient manner.

As requests increase during a fundraise, the use of technology becomes critical. Having a web portal in place allows managers more time to spend on developing a more targeted message in their pitch book.

A good pitch book has to be crystal clear and has become the fundamental element in the fundraising process, says Jeremie Le Febvre, a Paris-based placement agent for Triago. "If the LP is not hooked by the fifth page, you're out," says Le Febvre, adding that the presentation has to provide detail and be attractive.

"LPs are essentially saying tell me what's compelling about you," adds CP Eaton Partners placement agent Peter Martinson, adding that highlighting your track record is one of the most effective slides in a pitch.

As firms dedicate more resources to meet increasing demands, CFOs are careful to contain soaring fees. Planning the firm budget is a lot more fun when you have a new, double-sized fund under your belt. But, under current market conditions, keeping costs down has become a high priority.

In fact, a number of private equity firms are taking additional steps to hold their service provides more accountable to the fees they charge, with some firms scheduling regular reviews others setting up specific "vendor management offices".

To better manage these costs, Ernst & Young has seen a number of private equity clients establish a relatively new function. "A vendor management office is set up to manage [service provider] relationships. This enables for better budgeting, better forecasting," says Samer Ojjeh, a principal at Ernst & Young.

Other firms are asking vendors to provide regular updates on charges through monthly calls. A CFO shared his firm's philosophy on vendor management: "You're managing your service providers in terms of budgeting, accountability, planning. And those simple things make a big difference and set a tone."

To better budget, the CFO said: "I had set up monthly calls for service providers. For the first time they have to stick to a budget. It is a half hour call. If they are going to exceed the budget, they have to call us. It's a recognition that 'guys, we're watching you'. It's changing the mindset more than anything else, that they don't have a blank check."

US regulations

CFOs are also concerned with complying with new regulations passed in the US this summer. Most firms will face a heavier burden on the compliance front.
In the US, firms will be required to register with the SEC. Being a registered investment advisor means hiring a chief compliance officer or, if you can't afford one, designating someone within the firm to play that role – often the CFO.

President Barack Obama signed off on legislation 21 July that will require private equity and real estate managers with more than $150 million in assets to register with the SEC by July 2011.

Under the new registration requirements, private equity firms will need to establish formal compliance policies to outline how they would deal with potential conflicts of interest. Registration also means firms need to designate or hire a compliance officer, as well as face regular inspections by the SEC.

Gearing up for compliance, costs can be significant and require careful planning. "With respect to direct costs, you need to evaluate the people that you need and the advisors that you need. We needed to hire staff; we had to beef up our compliance team," says a CFO. "Before we registered we had to plot all that out and we were prepared for the additional costs."

The so-called "Volcker rule" is also included in the law, which will limit banks' proprietary trading activities with regard to private equity funds. The rule forces banks to hold no more than 3 percent of a private equity fund's capital.

Former Federal Reserve chairman Paul Volcker developed the rule, which originally called for US banks to choose between running private equity and private equity real estate operations and taking deposits. Banks will have seven years to comply with the rule.

Another headache for CFOs to consider – required SEC registration will also add work to fundraising. Registration as an investment advisor will add more work to the fundraising function, as the PPMs and other marketing materials will have to conform to the new compliance rules. Many GPs will be surprised to find that things they used to publicly say and write about their firms are not allowed in a compliant marketing environment.

In today's tough fundraising environment, even existing investors will give re-ups the same rigour as if they were evaluating first-time funds, says Michael Thonis, managing director and chief operations officer at Charlesbank Capital Partners. Today, due diligence includes performance attribution on "every investment we'd done. Had we done well because of EBITDA growth, debt reduction, multiple expansion? We had all that information, but still, when you have to package it all up and make it look right", that takes a lot of work.

Going public

Once a firm is publicly listed, the job of the CFO changes significantly. A CFO who thrived at the private company may not be qualified for or interested in the same job at the public company.

“A large number of companies that go public look for a new CFO before they list, or they bring in a more experienced person for an interim period of time while the CFO learns how to be a public company CFO,” says Gregg Passin, a partner at human resources consultant Mercer.

Perhaps most importantly, once a firm goes public, the CFO has to spend a lot more time in the public eye. Whereas before, the CFO interacted with a carefully selected group of sophisticated limited partners, now the CFO has to report to a much larger universe of public investors which is constantly shifting – and which the private equity firm can no longer carefully select.

“You have to be able to deal with the public markets which is a completely different mindset,” says Tim Smith, CFO of Euronext-listed private equity fund of funds Conversus Capital. “It means dealing with public investors, sell side analysts, public side bankers and several different regulatory bodies – many of the relationships you don’t have to manage as a private company CFO.”

Public company CFOs also spend much more time talking with research analysts and with media, and fielding questions on quarterly, semi-annual and annual earnings calls.

“[As a public company] your CFO needs to have a public presence,” Passin says. “On an earnings call it's the CFO who goes over the numbers. You have a much more public persona both within the company and in the public.”

Not all CFOs enjoy having a public presence, of course, and an aversion to the spotlight might be what drew a CFO to a private equity firm in the first place. CFOs who prefer to stay behind the scenes and crunch numbers might not want to stay on board when the firm goes public.