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Women's PE Summit: This Used to Be Such a Friendly Neighborhood

The thing about being out here in California is that it makes one think about earthquakes. And the thing about earthquakes is that they expose fault lines.

The credit crunch–an 8 on the Richter scale of finance–has exposed one in world of private equity. Alliances have shifted like tectonic plates, and gulfs have appeared where once the ground seemed solid.

The newly rediscovered tensions came into view at the second annual Women's Private Equity Summit here in Half Moon Bay, Calif. Panelists in Thursday afternoon's three sessions exposed the new suspicions that constrain once-simple relationships between private equity firms, known as general partners, and the investors that put money into PE funds, known as limited partners. Then there is what now seems like the permanent standoff between banks and private-equity firms. Deal Journal compiled this thematic organization of some insights gleaned from the panels. Because of the rules of the conference, we couldn't quote panelists by name:

General Partners vs. Limited Partners: The New Thrilla in Manilla In private equity parlance, general partners are the professionals who work at firms like Kohlberg Kravis Roberts & Co. or TPG and their brethren. Their job is to raise money, pool it into a fund, then make smart investments. Along the way, they not only plan to make a big profit, but also collect fees on the money they are holding until they invest it. Limited partners are the people who give the GPs that money: pension funds, endowments, and other so-called institutional investors.

In good times, the GP-LP relationship is uneventful. LPs hand over their money and, over the course of the next decade, the GPs invest the money and send back more. Then there are the bad times, which sometimes resemble the scene from "Reservoir Dogs" in which five angry men point guns at each other, shaking and ready to shoot.

LPs are watching their pennies–and the GPs who hold them. As one panelist put it, "the days of free money are over. LPs have the money and we are going to dole it out more carefully. The days are over of letting GPs invest in 40 companies and letting 39 of them fail." One LP panelist who manages money for a pension fund noted that her colleagues are "spending more time evaluating GP behavior, seeing how they own up to or cover up mistakes." LPs are also keeping a gimlet eye on GPs, making sure that they don't write extra fees into new LP agreements.

They also are worried over the debate raging in Washington over private-equity taxes. If lawmakers require GPs to record some of their profit, or carried interest, as ordinary income it would nearly double their current tax rate. LPs are worried that GPs will increase their fees or costs to offset any shortfall, and, according to one panelist, they are closely scrutinizing every new investing agreement to make sure they don't get squeezed for bigger fees. Another panelist noted her frustration with a GP that had raised five billion euros but hasn't invested a cent in more than a year–and yet is still collecting a 2% fee for a total of 80 million euros that goes into its coffers, which is split up among the firm's partners for a rich year-end payout. "I just can't wrap my head around it," the panelist complained. "I'm sure there are reasons they should be taking this much home on an annual basis, but I'm not sure what they are."

Venture Capital vs. Private Equity:
For decades, private equity and venture capital had a kind of sibling rivalry. But venture capital now wants to be an only child. According to one panelist, the National Venture Capital Association has started a Congressional lobbying effort–knocking door-to-door in an example of "trick or treating for adults," cracked one panelist–in an effort to distance itself from the widely criticized world of private equity. The NVCA's worry is that it will get lumped in with private equity when it comes time to vote on those carried-interest taxes. The NVCA is making two arguments. The first, that venture capital is a long-term business that helps small companies grow into giants like Google. The second, that venture capital has never used leverage and has not caused any trouble. When venture capitalists visit Congress, the basic message is this, according to one panelist: "We're not asking for TARP or bailout money. In fact, we're not asking for anything. Leave us alone."

To hold private equity at arm's length, the venture-capital industry is reminding Congress of companies such as Google and Hewlett-Packard that grew and thrived on venture capital in their early years.

In one panel, proponents of venture capital and those of private equity clashed. Congress's assault on private equity "targets a population of people that is unsympathetic to the larger audience," groused one private-equity investor, who noted that private equity helps save companies. A venture-capital supporter disagreed, noting that private-equity fees are much higher than those in venture capital. "You can get rich on fees working for a private-equity firm. You couldn't get rich working for a VC firm," one panelist said. VCs, she reasoned, don't use debt and don't collect 20% fees.

Private Equity vs Banks:
Banks are eager to take loans off their balance sheets. Private equity wants to use loans to buy companies. The credit crisis has created an impasse that won't soon be resolved. "If there's anything you think a bank won't do to get out of a deal, forget it," one panelist said.