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Proximity matters

Fire fighting is a business that requires dedication, team effort and a commitment to serving others. In addition, it also highlights an important business principle that is becoming more widely acknowledged: proximity matters. While financial service firms will rarely need to respond to a deal as quickly as a fire fighter responds to a fire, there has been a visible movement to establish satellite offices in financial hub cities and a shift away from the mindset that all important financial work can only be conducted from New York City.

In the past few years, the explosion of hedge funds based in Connecticut has only provided further proof that there is a viable alternative to Manhattan in the world of high finance. While Manhattan is likely to remain the finance capital of the world for the foreseeable future, there are many smaller but equally vital business centres that have appeared across the United States.

Investment banks have a history of showing that proximity matters in a client service business. Perhaps the first small step in that regard was the move of investment banking headquarters from Wall Street to Midtown in Manhattan. As Fortune 500 clients and private equity firms (traditionally Wall Street's biggest source of fees) starting concentrating in Midtown Manhattan, the bulge bracket investment banks reacted by moving their headquarters within walking distance of their clients. Today, of the world's most prominent investment banking houses, only Goldman Sachs (at 85 Broad Street) retains a headquarters near Wall Street and Broad Street.

The explosive growth of Silicon Valley in the 1990s provides even further proof that proximity matters. The boom of technology companies in and around Silicon Valley forced the world's leading investment banks to respond to this new business opportunity by placing teams of bankers in the San Francisco Bay Area, including some of the world's best known financiers, such as Frank Quattrone. Bankers simply followed the money. It was perfectly logical that client service focused firms would eventually follow their clients.

However it is interesting to note that the investment banks followed not only the high tech companies that were birthed in Silicon Valley, but also their backers, the venture capital firms that recognised the importance of being near their potential investments. The growth of Silicon Valley was greatly assisted by the influx of venture capital firms many years before the investment bankers began arriving. This fact takes the concept that proximity matters even further, as it is not only relevant for traditional sellside firms such as the investment banks, but for buy-side firms as well.

Similar to their cousins in venture capital, for many years private equity sponsors have believed in the concept that proximity matters. In the ultra-competitive deal environment that characterises the private equity world today, this belief has resulted in private equity firms establishing satellite offices and even headquarters outside of the traditional cradle of Manhattan. The most cherished transaction in private equity is the proprietary deal. As competition for deal targets has increased, the equity sponsors have come to realise that being near their targets may, on the margin, give them that critical edge to find and win the deal.

A perusal of *Fortune* magazine's Private Equity Power List reveals the usual suspects. The Blackstone Group, KKR, the Carlyle Group,

Texas Pacific Group, and Bain Capital occupy the top five spots. While these firms' reputations are well known across the world, market presence is more than a brand name (though being well known is certainly an advantage). This group of highly sophisticated and competitive investors have acknowledged that proximity matters in the most explicit manner possible. All these firms have established at least one if not several satellite offices and staffed them with significant headcount.

While New York City is still the most common headquarters for the titans of the buyout world, for private equity firms focused on the middle and lower middle market, other cities are similarly if not more important. For many years, the middle market and lower middle market buyout firms have been pioneers in establishing headquarters and satellite offices in other large US cities that have traditionally been home to middle and lower middle market, entrepreneur-owned firms. In a trend that has accelerated in recent years, Los Angeles, San Francisco, Chicago, Dallas and Atlanta have seen an increase in the size and number of buy-side firms that call those cities home and as a consequence an increase in the number of firms that support their activities, from mezzanine lenders to commercial banks to boutique investment banks.

For middle market and lower middle market firms, the proximity to their potential targets or clients may be the critical deciding factor in whether or not they win a deal. After all, it is easier and often preferable in a competitive process to distinguish oneself by being part of the local community than simply being the highest bidder or providing the least expensive financing package.

All else being equal, the hometown or local boy (or girl) is more likely to win than the guy who is thousands of miles away, flying into town for a dinner meeting and being hours late due to a flight delay. In particular, in buyouts where there will be an ongoing relationship between the buyer and the seller, proximity may even trump a higher bid for the business.

Being local to the entrepreneurs and small business owners that make up the vibrant middle and lower middle market is not only helpful at the time the winning bid is selected, but perhaps most importantly, is critical when attempting to identify good buyout candidates. Indeed, the probability of finding a proprietary deal is enhanced when the common meeting place may be a country club or some other social event in the community. Being close to potential investments is an accepted strategy, for private equity sponsors and for those firms that provide capital and services in support of their efforts: commercial banks, mezzanine funds and investment banks. The ability to respond quickly to a deal is considered mission critical.

While it may be true that no financial firm, whether equity sponsor, mezzanine lender or investment bank, is likely to establish a presence as local as the neighbourhood firehouse, all want to be able to respond quickly. In today's hypercompetitive financial environment, when the deal siren calls, firms are well advised to get to the fire as quickly as possible. ■

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