Hispanic Private Equity: A Cultural Approach to Achieving Superior Investment Returns

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INTRODUCTION

Hispanic-facing companies present a burgeoning and largely overlooked investment opportunity in the private equity arena.[1] As the private equity investment class has become increasingly saturated, it has experienced diminishing returns.[2] In order to maintain strong returns, investors need to identify and target new investment opportunities. This Article focuses on the potential of Hispanic-facing companies, which we have defined as (1) those that are Hispanic-owned, (2) those that provide traditionally Hispanic products or services, or (3) those that can benefit from targeting their products or services to the Hispanic community. These companies are particularly well positioned to prosper in coming years due to the healthy top-line revenue environment[3] emerging in the United States. Hispanics' high demographic growth, relatively youthful population, strategic location in urban and cultural centers, growing purchasing power, strong brand loyalty, and the increasing cultural chic of Hispanic goods

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[1] We are aware of different regional preferences and meanings of the terms "Latino" and "Hispanic." This Article uses "Hispanic" generally but defers to our interviewees' preferences as to the use of "Hispanic" or "Latino."

[2] Carol Loomis, *KKR: The Sequel*, FORTUNE, June 13, 2005, at 64, 64.

[3] In a healthy top-line environment profits can be expected to increase, driven by increased volumes sold, due to the companies' growing consumer base.

and services lead us to conclude that Hispanic-facing companies will experience strong revenue growth in the upcoming years and are thus prime investment targets. Additionally, Hispanic-facing businesses are strong candidates for profiting from the value-added benefits provided by the private equity tool-kit due to some common traits that we term "Hispanic business characteristics," such as a high rate of family ownership and low use of debt financing. Despite the fact that minorities comprise 28% of the U.S. population and 15% of domestic business owners,[4] they only receive 2% of all private equity monies.[5] Although Hispanic-facing companies are too small in number and size to sustain mega-fund involvement, there still remains ample room for smaller, specialized funds to exploit this opportunity.

This Article contributes a novel perspective on both the attractiveness and the challenge of Hispanic-facing companies in the private equity arena through qualitative field research. Through interviews with lawyers and financial experts as well as with Hispanic-facing business owners, we gleaned a great deal of insight into the industries in which Hispanic-facing companies are involved. We also learned about the specifics of these companies' business models and about managerial assessments concerning the direction and attractiveness of their particular sector. The views of the former group matter greatly because many of these individuals are responsible for deploying capital to a variety of investments and their perceptions directly affect whether potential projects are financed. As profit and price data for privately owned companies is largely unavailable, these statistics are absent from our discussion.

Part I of this Article provides an overview and brief history of private equity while setting forth some of the benefits this investment mechanism provides. Part II describes the Hispanic demographic. While acknowledging the difficulty of treating this diverse group as one consumer demographic, the second Section explores the systematic growth in population and purchasing power that this demographic is experiencing and describes some of that growth's most salient characteristics. Part II also considers characteristic practices and customs often found in Hispanic-owned companies. Part III will explain the methodology used for researching this Article and the limitations inherent to it. Part IV identifies specific industries and companies that are poised to benefit from the above discussed demographic trends. Part V analyzes the optimal strategy for investing in these companies including the cultural and psychological factors which are material to this analysis. Part VI looks into the social implications of infusing capital into Hispanic-owned and Hispanic-targeting businesses. Finally, Part VII summarizes the Article's findings.

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[4] Jodi Helmer, *The Future of Minority Owned Businesses in America*, J. EDM FIN., Fall 2005, at 38, 40.

[5] *Private Equity Heats Up*, HISP. TRENDS, May 2006, at 36, 38.

Hispanic-facing companies are well positioned to increase in relevancy in the private equity market due to their attractive fundamentals. However, the unique culture that Hispanic-facing companies are products of and in which they operate present special challenges for the mainstream private equity world. Thoughtful and targeted investment into this emerging market could ensure benefits for all and create a trend with positive societal implications.

I. Overview of Private Equity

A. *Definition of Private Equity*

Private equity is an umbrella term for private placements of money in any business venture. The term includes numerous subcategories, such as venture capital, leveraged buy-outs, mezzanine lending, and real-estate private equity.[6] Private equity has grown exponentially in the past decade.[7] In 2006 alone, nearly $372 billion of private equity capital was deployed globally to fund buy-outs.[8] Although vernacularly many people associate this term with the large leveraged buy-out firms like Kohlberg, Kravis, Roberts & Co. ("KKR"), the Blackstone Group, and the Apollo Investment Corporation, the majority of funds do not compete at this mega-fund level. In the 1980s, there were extraordinary returns in the private equity space at all size levels.[9] However, such profitability has become much less common due to the recent infusion of large amounts of money into these investment classes and the consequent higher multiples[10] that investment targets are commanding.[11] This development has even resulted in some funds experiencing negative returns.[12] Financial analysts predict a continuation of decreasing returns across the board as this market becomes increasingly efficient.[13] As a result, going forward, private equity investors will need to look towards niche, alternative investments that restore attractive returns and maintain an overall acceptable risk level.

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[6] Jack Levin, Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions 1–7 (2005).

[7] Nicholas Varchaver, *Private-Equity Forecast*, Fortune, Jan. 22, 2007, at 21, 21.

[8] *Id.*

[9] Loomis, *supra* note 2.

[10] Multiples refer to a number multiplied by EBIT, earnings before interest and tax, or EBITDA, earnings before interest, tax, depreciation, and amortization (a set accounting point), that dictate the sales price.

[11] Telephone interview with Hilary Candela, Managing Director, Aquarius Capital Partners, in Coral Gables, Fla. (Jan. 15, 2007).

[12] Ulrich Lossen, *The Performance of Private Equity Funds: Does Diversification Matter?*, Munich Business Research Working Paper Series No. 2006-14, June 2006, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=916702.

[13] Kathryn Tully, *Rising Debt Costs Put Squeeze on Leveraged Deals*, Fin. News Online, July 31, 2006, http://www.financialnews-us.com/?page=ushome&contentid=1045300952.

B. Private Equity Transactions

Private equity funds operate by pooling capital to invest in business ventures. Although other structures are possible, private equity funds are generally structured as limited partnerships with the fund itself acting as the general partner. Funds usually seek minimum capital commitments from qualified investors such as financial institutions, pension funds, and wealthy individuals. These investors become passive limited partners in the fund partnership, and when the general partner identifies an appropriate investment opportunity, the firm is entitled to "call" the required equity capital from the fund. The investment decisions are made by the general partner, which also holds the fund's portfolio investments. Over the lifetime of a fund, anywhere between five and twenty-five separate investments will typically be made with no single investment comprising the lion's share of the total commitments.

The private equity fund is typically compensated with a management fee, which is generally 1% to 4% of the fund's total committed equity capital. In addition, the general partner usually receives a performance fee of 20% of all gains. Despite the above fees, total equity returns tend to be very large due to the high leverage used in leveraged buy-outs and the high levels of risk associated with early to mid stage investments.

Although the specific industry and the company's maturity have a large influence on the method and timing for exiting an investment, most private equity firms improve the value of the companies in which they invest and realize correspondingly large returns within approximately three to seven years.[14] At this point, private equity firms generally exercise one of three options: (1) they take the company public via an Initial Public Offering ("IPO"), (2) they sell the company to a strategic buyer, or (3) they attempt to sell the company to another private equity entity.[15]

C. Traditional Arguments for Private Equity

Private equity has been criticized by many as reckless speculation that replaces companies' long-term strategic visions with nominal window dressings. Although there may be funds that engage in this short-term "flipping" process, in which companies are purchased when sectors are out of favor and then sold when markets correct, this is a simplistic characterization of the industry as a whole. Private equity firms do have the potential to add value to firms in which they investment in a variety of ways, such as (1) engaging in financial engineering; (2) enabling companies to bypass costly Sarbanes-Oxley ("SOX") requirements as well as

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[14] LEVIN, *supra* note 6, at 1–3.

[15] Rick Newman, *Private Equity: An Expert Tells How It's Done*, U.S. NEWS & WORLD REP., Nov. 22, 2006, *available at* http://www.usnews.com/usnews/biztech/articles/061122/22daniello.htm.

eliminating the need to keep an eye toward quarterly earning releases; (3) playing a more effective monitoring role that better aligns principal and agent interests; and (4) implementing improved management techniques and incentive packages.

First, from a management perspective, many private equity firms have expertise that enables them to improve the efficiency and productivity of their investments, instilling new energy that might have been missing before.[16] On a related note, financial engineering can be used to help companies achieve the optimal capital structure and effectively utilize financial instruments to maximize returns while minimizing risk.[17] Many small companies on their own either choose not to leverage up or do not have enough effective access to the capital markets to do so. As experts in financial structuring with numerous banking contacts, private equity firms can remedy this.[18] Although in theory these smaller companies could independently implement strategies to improve their performance, the reality is that significant, valuable changes are often implemented by the private equity firm after acquiring a company.

In addition to management benefits, the current regulatory environment has increased the desirability for many companies to either go private or postpone going public.[19] Many business owners cite the costly, inflexible, and invasive disclosure requirements introduced by the SOX legislation as reasons for forsaking publicly traded status.[20] In fact, there is a strong correlation between the new requirements and an increased number of companies going private.[21] The driving impetus for these trends is that SOX requires a higher than optimal allocation of resources towards monitoring and internal controls in order to prevent major fraud or malfeasance.[22] The private equity investment structure permits the fund to internalize the costs of this fraud and malfeasance, and thus permits it to choose the optimal level of diligence and monitoring, rather than blindly following the imposition of the federal regulatory system.

Further, the quintessential value private equity provides is a legalistic one. Private equity better addresses the principal-agency dilemma and permits optimal decisions to be made.[23] Under U.S. laws, particularly Dela-

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[16] *Id.*

[17] *Better Pay for All*, ECONOMIST, Jan. 20, 2007, at 18.

[18] Interview with William Gonzalez, Investment Professional, Goldman Sachs, in New York, N.Y. (Jan. 23, 2007).

[19] Joshua M. Koenig, *A Brief Roadmap to Going Private*, 2004 COLUM. BUS. L. REV. 505, 506 (2004).

[20] *Id.* at 512.

[21] *See* Heather Malec, *Post Sarbanes-Oxley: Public Companies 'Going Private' in Greater Numbers*, AMERICANVENTUREMAGAZINE.COM, http://www.americanventuremagazine.com/articles/39 (noting a 30% increase of going "private transactions" during the 16 months immediately post-SOX compared to the 16 months immediately preceding its enactment).

[22] *See* Koenig, *supra* note 19, at 513.

[23] Stephen Prowse, *The Economics of the Private Equity Market*, FED. RES. BANK OF DALLAS ECON. REV., 3d Quarter 1998, at 50–51, *available at* http://www.econ.upenn.edu/

ware corporate laws, shareholders are only entitled to elect the Board of Directors and are not permitted to meddle with the day-to-day decisions of the corporation.[24] Because the proportional ownership of most boards is relatively low, they may often face insufficient economic incentives to achieve the maximum returns, especially when those returns come at the expense of their social interests.[25] A director who owns 1% of a company only gets one cent for every dollar of improvement that he provides for the company.[26] Cordial relations and friendships with management make it unlikely that directors will push for every bit of potential value, especially since there is only a nominal financial gain associated with those actions.

Private equity solves this problem by eliminating a layer in this hierarchy.[27] Since private equity firms either own all or a large portion of a firm, they have an incentive to optimally monitor and consequently manage as owners.[28] The majority of management is appointed by the private equity fund, and decisions can be made with a true eye towards the maximization of shareholder returns rather than other value-destructing motives, such as management shirking, empire building, or other sub-optimal management-benefiting behavior, which are often present in public companies.[29]

Another advantage closely related to improvement in principal-agent relations is private equity firms' tendency to be very effective at aligning workers' interests with corporate goals by setting strong incentives.[30] Numerous studies have pointed to the performance advantages that occur when companies are run by "owners" or by employees that have effectively calibrated pay-for-performance metrics.[31] Traditionally laid out as a "renter's dilemma," ownership provides a financial and psychological incentive to become effective custodians of the corporate entity and thus permits better decision-making.[32] Not only is employee morale boosted,

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~rafaels/doc/foundation.pdf.

[24] *See* Del. Code Ann. Tit. 8, § 141(a) (2006).

[25] *See* Michael Jensen & William Meckling, *A Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, *in* A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS AND ORGANIZATIONAL FORMS 83 (2000).

[26] *Id.* at 11.

[27] *Draw a Veil*, ECONOMIST, Nov. 27, 2004, at 18.

[28] *Id.*

[29] *Id.*

[30] HAROLD BIERMAN, JR., PRIVATE EQUITY: TRANSFORMING PUBLIC STOCK TO CREATE VALUE 3 (2003).

[31] BRIAN J. HALL, HARVARD BUS. SCH., INCENTIVE STRATEGY WITHIN ORGANIZATIONS 2 (2002).

[32] Jensen & Meckling, *supra* note 25 (citing Adam Smith, THE WEALTH OF NATIONS, "The directors of such [joint-stock] companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.").

but companies are more likely to remain at the cusp of competitiveness if employees, and especially higher-level management, have enough "skin in the game."[33] Relative to their public company counterparts, private equity investment companies tend to grant management teams more effective levels and methods of incentives.[34] Furthermore, management teams oftentimes provide some of their own capital up-front.[35] Although many people tend to view this ownership issue as a zero sum game, the general view is that effectively calibrated incentives can increase the total size of the pie by boosting profits and making all parties better off, and, in many situations, quite wealthy.[36] The improved incentive structure permits both the management team and the private equity firm to share in the additional wealth created by the company's enhanced performance.[37]

In practice, not all private equity investments are structured as complete buy-outs or even majority share purchases. Some investments are simply a capital infusion in exchange for a minority stake. Oftentimes referred to as growth capital, these investments help provide the necessary capital to get companies "to the next level" without having to turn to the public markets.[38] All of these investments generally result in the private equity firm obtaining a seat or seats on the company's board of directors.[39] Functionally, this not only serves an important monitoring role but also generally provides a higher level or added expertise to the board.[40] Private equity firms either place their own principals on the board or assign highly qualified business colleagues who provide valuable advice and perspectives. Additionally, since many of these appointees sit or have sat on multiple boards, they can provide the traditional advantages of cross-pollination of ideas between companies.[41]

II. The Hispanic Demographic

A. *Who Is Hispanic?*

The term "Hispanic," as understood in the United States, is just over three decades old. It was first used in the 1970 U.S. Census to encompass all individuals "of Spanish-speaking background [who] trace their origin or descent from Mexico, Puerto Rico, Cuba, Central and South America,

[33] *Better Pay for All*, *supra* note 17.
[34] Bierman, *supra* note 30, at 3.
[35] Hall, *supra* note 31, at 33.
[36] *Better Pay for All*, *supra* note 17.
[37] *Id.*
[38] Levin, *supra* note 6, at 1–8.
[39] Prowse, *supra* note 23, at 30.
[40] Levin, *supra* note 6, at 1–7.
[41] *See* Adam C. Pritchard et al., *Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments*, 58 J. Fin. 1087 (2003).

and other Spanish-speaking countries."[42] The glue that binds Hispanics together is a shared background of beliefs, values, perceptions, and orientations derived from a common experience harkening back to the Spanish colonization of most of Latin America.[43]

Needless to say, the term includes an extremely diverse and open group, and this diversity somewhat weakens its value. Today, the term Hispanic includes individuals differing in race, national origin, socioeconomic class, and legal status. Hispanics are "blacks, they are Asian [descended] from almost all Asian countries, they are Semites, they are Caucasian, they are Native Americans, they are mestizos, mulatos, and many other races."[44] In fact, the group's fragile bonds are evinced by Latin American migrants' shunning of the term "Hispanic" and strong preference for identification based on their country of origin.[45]

Yet, despite the great variety of backgrounds encompassed by the term, a number of unifying characteristics give credence to the idea that there is something distinctive about "Hispanicity." The most important unifying characteristics are a shared ancestral language and religion. The Spanish language aids a perception of homogeneity among Hispanics by facilitating communication between a Mexican and an Argentine or a Peruvian and a Cuban, for example.[46] In addition, the Catholic religion represents a dramatic influence on Hispanics' way of thinking and feeling, with ideas of guilt, hierarchy, and stoicism permeating the culture.[47] Furthermore, although Hispanics are not defined by the following characteristics, the Hispanic population has a youthful age structure, low-average education levels, and a disproportionate concentration in unskilled jobs.[48] Thus, all the above characteristics distinguish Hispanics from other ethnic or racial groups in the United States and create a sense of common identity.

Nevertheless, it would be an overstatement to describe Hispanics as a well-defined, monolithic group. As stated above, there is cultural identification with the term, but it is tepid. In fact, cultural assimilation and socioeconomic progress render cultural expressions of a Hispanic ethnicity largely symbolic by the third generation.[49] Still, the sheer increase in numbers and the fact that 76% of Hispanics are either foreign-born or first-generation give some substance to the constructed ethnicity.[50] Thus, based

[42] Ruben G. Rumbaut, *The Demographic Foundations of the Latino Population*, *in* HISPANICS AND THE FUTURE OF AMERICA 16, 21 (Marta Tienda & Faith Mitchell eds., 2006).

[43] FELIPE KORZENNY & BETTY ANN KORZENNY, HISPANIC MARKETING: A CULTURAL PERSPECTIVE 20 (2005).

[44] *Id.*

[45] *See* PEW HISPANIC CTR./KAISER FAMILY FOUNDATION, NATIONAL SURVEY OF LATINOS (2002), *available at* http://pewhispanic.org/files/reports/15.pdf.

[46] KORZENNY & KORZENNY, *supra* note 43, at 23.

[47] *Id.* at 20–21.

[48] Marta Tienda & Faith Mitchell, *Introduction* to HISPANICS AND THE FUTURE OF AMERICA, *supra* note 42, at 1, 6.

[49] *Id.* at 3.

[50] Rumbaut, *supra* note 42, at 18.

on recent birth rates and immigration trends, the latter of which consistently replenishes the ranks of Hispanic culture, the term is sure to retain its relevancy in the years to come.

B. *Trends and Characteristics*

The Hispanic population is growing and changing quickly, and this dynamism has given Hispanics unique characteristics in their age distribution, income and purchasing power growth rates, and educational levels that differentiate them from other ethnicities and races in this country. Population-wise, high rates of immigration and fertility have set the foundation for a tremendously rapid growth, currently four times that of the general population.[51] The Hispanic population—estimated at 4 million in 1950—had reached 40 million in 2003.[52] Going forward, the Hispanic population is projected to surpass 100 million by 2050, accounting for 25% of the U.S. population.[53]

The combination of relatively high fertility rates and the immigration of young workers has also created a very young Hispanic demographic—with smaller middle-aged and senior groups. In fact, almost 40% of the Hispanic population is under age twenty and 65% is under age thirty-five.[54] By contrast, the non-Hispanic white and black populations are concentrated in the middle-aged to late middle-aged range.[55] Thus, beyond raw numbers, the impact the Hispanic population growth is having and will have in years to come will be further magnified by the aging non-Hispanic population. As the Pew Hispanic Center points out, "[A]s the huge baby boom generation moves toward retirement, young Latinos are filling in behind them,"[56] and these young Hispanics will be disproportionately represented in the labor force and schools, accounting for about half of the growth of the former between now and 2020.[57]

Unfortunately, high immigration of young uneducated workers and rapid population growth in less affluent areas of the United States have also contributed to a poor Hispanic educational profile. In fact, Hispanics have the lowest rates of high school and college degree attainment amongst all ethnic and racial groups.[58] Hispanic children tend to come from lower socioeconomic backgrounds, have parents with lower educational levels

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[51] *Id.* at 16.

[52] *Id.*

[53] *Id.*

[54] Jorge Durand et al., *The Demographic Foundations of the Latino Population*, *in* HISPANICS AND THE FUTURE OF AMERICA, *supra* note 42, at 66, 80.

[55] *Id.* at 82.

[56] PEW HISPANIC CTR., HISPANICS: A PEOPLE IN MOTION 2 (2005), *available at* http://pewhispanic.org/files/reports/40.pdf.

[57] *Id.*

[58] *See* Barbara Schneider et al., *Barriers to Educational Opportunity for Hispanics in the United States*, *in* HISPANICS AND THE FUTURE OF AMERICA, *supra* note 42, at 179, 179.

who lack knowledge of the U.S. educational system, and attend poorly funded schools.[59] This is a cause for great concern, for life-time earnings are closely tied to educational achievement and low educational achievement is likely to adversely affect Hispanics' income level in the long-run.

Nevertheless, there are some signs of improvement in the educational profile of Hispanics. For example, the National Center for Educational Statistics reported that, from 1990 to 2000, the number of Hispanic students at four-year colleges and universities grew by 69%, while the number of non-Hispanic whites actually declined by 4%.[60] Additionally, the educational profile of the adult population of foreign-born Hispanics has improved significantly during the past three decades.[61] The above two trends point to an improvement in Hispanics' educational levels and, quite possibly, a narrowing of the educational gap between Hispanics and the rest of society. Based on the size of the Hispanic demographic and its purchasing power, as will be discussed below, even if Hispanics continue to face limited educational opportunities, businesses will still have profitable Hispanic ventures, but it is important to note that "the future of the Hispanic market will . . . be brighter if higher levels of education are attained."[62]

Hispanics' average income is also considerably lower than the U.S. average,[63] but unlike their educational levels, it has been and is increasing rapidly. Between 1980 and 2000 for example, the Hispanic community's spending power grew from $106 billion to $323 billion, at a compound annual growth rate of 11.8%.[64] This growth is not surprising because Mexicans' income per person increases by two-thirds between the immigrant generation and the second generation.[65] A similar dramatic increase in income occurs across generations for all other Hispanic nationalities as well.[66] Moreover, the rapid increase in income is not limited to those Hispanics in the middle and lower classes—the wealth of affluent Hispanics is growing faster than that of the general population as well. Between 1991 and 2000, the number of Hispanic households earning more than $100,000 a year grew 126% when the number in the general population grew only 77%.[67] The above-mentioned startling rate of growth put the purchasing

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[59] *Id.*

[60] Gregory Fairchild, *EDM Overview—What is the Emerging Domestic Market?*, J. EDM FIN., Summer 2005, at 12.

[61] B. LINDSAY LOWELL & ROBERTO SURO, THE PEW CHARITABLE TRUSTS & USC ANNENBERG SCHOOL FOR COMMUNICATION, THE IMPROVING EDUCATIONAL PROFILE OF LATINO IMMIGRANTS (2002).

[62] KORZENNY & KORZENNY, *supra* note 43, at 49.

[63] Foreign-born Hispanic households median total household income was $31,470, compared to $54,752 for third (or higher)-generation white non-Hispanics in 2002. Cordelia Reimers, *Economic Well-Being*, *in* HISPANICS AND THE FUTURE OF AMERICA, *supra* note 41, at 291, 295 tbl.8-1.

[64] Fairchild, *supra* note 60.

[65] Reimers, *supra* note 63, at 296.

[66] *Id.* at 295 tbl.8-1.

[67] Press Release, Merrill Lynch, Merrill Lynch Expands Hispanic Focus: Hispanic Wealth

power of Hispanics in the United States at approximately $700 billion in 2004—exceeding the size of Mexico's economy.[68] Growth in Hispanic spending power in the next few years is predicted to be as impressive, as it is expected to surpass one trillion dollars by 2008.[69] Nevertheless, it is important to remember that this almost-mechanical increase in income is not magical and is generally driven by educational levels, as mentioned above.

C. The Hispanic Consumer

As may be inferred from the facts set-out above, the Hispanic consumer possesses distinctive preferences and habits, many of which originated in his or her country of descent. Two such characteristics are a strong brand loyalty and an affinity towards familiar Hispanic products and packaging.[70] Many companies are aware of the above, and by recognizing that upon their arrival to the United States Hispanic immigrants already have established brand preferences, those companies have seized the opportunity to capitalize on trans-border brand recognition.[71] Thus, companies such as Colgate, Kellogg's, McCormick, and Knorr have been able to retain their prominence amongst U.S. Hispanics in large part due to their brand prevalence in Mexico and other Latin American countries.[72] Knorr, for example, "learned to address the U.S. Hispanic market in the same way they address the Mexican market"—they use its Mexican name, *Knorr Suiza,* and offer the product in the same packaging in which it is sold in Mexico.[73]

McCormick & Company also took advantage of the emotional association Mexicans in the United States had to their Mexican food product and used the product recognition of McCormick Mayonesa from Mexico to introduce the Mexican brand into the United States.[74] For example, McCormick maintained the tagline, *Póngale lo sabroso*, from its Mexican packaging because research showed it had high recognition rates with Mexicans in the United States.[75]

Beyond trans-border brand recognition, Hispanic consumers often bring many distinctive habits and traditions to the United States from their countries of origin, such as listening to the radio. Radio is a very pow-

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Growing Above U.S. Average (May 29, 2003), *available at* http://www.ml.com/index.asp?id=7695_7696_8149_8688_8579_8785.

[68] KORZENNY & KORZENNY, *supra* note 43, at 19.

[69] *Id.*

[70] Transcript of The Seventh Annual Harvard Latino Law, Business, and Policy Conference, 8 HARV. LATINO L. REV. 93, 105 (2005).

[71] KORZENNY & KORZENNY, *supra* note 43, at 310.

[72] *Id.*

[73] *Id.*

[74] *Id.* at 132.

[75] *Id.* at 151.

erful medium in Latin America "where over 4,000 stations entertain, help locate people and services, and even disseminate agricultural prices in some cases,"[76] and this custom has been carried to the United States through migration. Like the other products mentioned above, Hispanic radio offers music and programming that allows the listener to feel culturally connected and reminds them of home.[77] As a response to this originally unheeded demand, many very successful Hispanic radio talk shows have sprung up in several parts of the country delivering content "that touches these consumers in ways that English radio cannot."[78]

As the above examples illustrate, many companies successfully target Hispanic consumers by gaining an understanding of the specific characteristics and preferences they bring from their home countries. Today Hispanics in the United States are increasingly unlikely to completely assimilate and lose their culture of origin.[79] They value their culture, and thus, it can be expected that their longing and attachment to the consumer preferences and habits developed in that culture, even to the level of a particular brand-preference, as noted above, will continue to affect their behavior.

D. Mainstream Embracing of Traditionally Hispanic Products and Services

The embracing of traditionally Hispanic products and services by U.S. society at large came about from corporations and politicians noticing Hispanics' great actual and potential growth in the 1970s and 1980s. This realization set the stage for an ever-increasing mainstream exposure of Hispanic products, services, and culture, to the point where the 2000 decade has been referred to as the "Latin Boom."[80] This is a time when Jennifer Lopez, Salma Hayek, and Ricky Martin are known across the spectrum of the U.S. population and "when Hispanics, Anglos, and other ethnic groups are dancing salsa; when being Hispanic is something to be proud of; and when speaking Spanish is considered an asset."[81] Korzenny and Korzenny note: "The Hispanic market is gaining tremendous stature from its influence on the general market. Latin influence is everywhere: in music, dance, movies, food, fashion, and movie and TV programming . . . . Eating salsa instead of ketchup is the norm."[82] Furthermore, this "Latin Boom" has gone beyond an increasing consumption of things "Hispanic" by society at large and has led to a process of retroacculturation.[83] Hispanics

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[76] KORZENNY & KORZENNY, *supra* note 43, at 263.
[77] *Id.* at 262–63.
[78] *Id.* at 262.
[79] *Id.* at 132–35.
[80] *Id.* at 295.
[81] KORZENNY & KORZENNY, *supra* note 43, at 295.
[82] *Id.* at 297.
[83] *Id.* at 296.

that had previously lost the ability to speak Spanish, or other Hispanic cultural markers, either attempt to re-learn Spanish and regain a connection to their ancestors' culture, or encourage their children to do so, as part of the more open and accepting environment in the United States toward the Hispanic culture. This further increases the demand for traditionally Hispanic products and services.

E. Hispanic Business Characteristics and Practices

Hispanics comprise a variety of nationalities, races, and cultural heritages. Consequently, it is very difficult to speak of "Hispanic business practices" or even about a traditional "Hispanic business" in general terms. Nevertheless, there are some characteristics common to many Hispanic businesses. Hispanic private companies do tend to be disproportionately family-owned,[84] a characteristic that greatly complicates their long-term operations and causes an over-reliance on equity for financing growth and operations.

Family-owned companies, regardless of the owner's ethnicity, are characterized by certain strengths and weaknesses from both operational and governance standpoints. On the positive side, a family-owned firm usually has a long-term view of their business, for example. Family members tend to be conscious of their standing in the community, and this prompts them to guard their reputation jealously.[85] These firms also tend to have greater independence of action, as they are subject to diminished pressure from the stock market, face little or no takeover risk, and also benefit from the greater stability, commitment, and motivation offered by family culture.[86]

Nonetheless, the above strengths have a flip side, and family businesses are also characterized by a set of operational and governance weaknesses. Family firms tend to have limited access to capital markets and experience the resulting inhibited growth.[87] They also tend to have confusing organizational structures, where authority and responsibility are not clearly defined, and this structural confusion often negatively affects business operations.[88] Still, the biggest weaknesses come from a vulnerable management style that is often affected by the overflow of family conflicts into the business.[89] These weaknesses often reveal themselves during succession,

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[84] Mario Paredes, the director of Hispanic Business for Merrill Lynch's Multicultural and Diversified Business Development Group, commented on the complications stemming from the fact that the majority of Hispanic businesses are family-owned. Press Release, *supra* note 67.

[85] MANFRED F. R. KETS DE VRIES, FAMILY BUSINESS: HUMAN DILEMMAS IN THE FAMILY FIRM 16 (1996).

[86] *Id.* at 23.

[87] *Id.* at 19.

[88] *Id.*

[89] *Id.*

with few family owned firms surviving a change of leadership[90]—"in the family business all stages of the process are likely to be influenced by family values, goals and relations."[91]

William Gonzalez,[92] an investment professional at Goldman Sachs's Urban Investment Group, has interacted with a number of family-owned businesses and understands the issues that outside investors face when dealing with these businesses. He noted that many small companies are structured as pass through entities, such as S-Corps, and many times this results in comingling of assets and liabilities. Studies have found that family-owned businesses and corporations tend to have a great amount of intertwining between business and personal debt and assets.[93] Consequently, the diligence process is often made very difficult because it is hard to differentiate the company's assets and liabilities from the owner's personal finances.

Additionally, as alluded to above, many family-firm owners tend to have stronger community ties and a greater social conscience about how a prospective buy-out will impact their employees or neighborhoods. Family-firm owners care about their standing in the community, even if it is for self-interested reputational reasons. This diminishes the likelihood of a deal occurring solely based on the right price.[94] Some of the interviewed investment professionals cited examples where the selling owner had very specific demands associated with the culture or ethnic make-up of the continuing firm (i.e., keeping a Hispanic identity). Owners may feel that the community will cease to benefit from the business if the firm changes its makeup and is run by an outside manager, with the owner no longer being integrated into the community.

Furthermore, family-owned businesses may also show some hesitation to sell-out and receive an attractive market-based price because of familial interests. A number of families owning a long-term positive cash flow firm may want to keep a business as an insurance policy for their family. For this group of family business owners, business means family, and running a business solely based on the latest marketing, management, and strategic trends is not the top priority.[95] Such a company may thus be

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[90] KETS DE VRIES, *supra* note 85, at 19.

[91] Annika Hall, *Towards an Understanding of Strategy Processes in Small Family Businesses: A Multi-rational Perspective*, *in* UNDERSTANDING THE SMALL FAMILY BUSINESS 32, 32 (Denise E. Fletcher ed., 2002).

[92] William Gonzalez is an investment professional at Goldman Sachs's Urban Investment Group, a private equity initiative committed to investing in ethnic-facing middle-market buy-outs and growth capital investments with capital commitments generally ranging from $5 million to $50 million. He graduated with a J.D./M.B.A. from Harvard Law School and Harvard Business School.

[93] George W. Haynes et al., *The Intermingling of Business and Family Finances in Family Owned Businesses*, 12 FAM. BUS. REV. 225, 225 (1999).

[94] *See* Sharon Nelton, *Valuing a Family Firm's Uniqueness—Characteristics of a Family Owned Business*, NATION'S BUS., Dec. 1992, at 57.

[95] NEIL N. KOENIG, YOU CAN'T FIRE ME, I'M YOUR FATHER: WHAT EVERY FAMILY

passed down from generation to generation, providing both a generous stream of income and an obvious career opportunity for future generations.[96] One private equity fund described these companies as "lifestyle businesses," providing the clichéd cushy salary for the founder's son-in-law with little eye towards running it at its maximum efficiency. Oftentimes there is also a strong identification with and a strong emotional attachment to these family-owned companies.[97] Owners, especially those in the first generation of ownership, vividly remember the strong personal investment they made to get the business to its present state, and may place a seemingly irrational value on the enterprise.[98] Furthermore, the vast majority of companies in Latin America are family-owned businesses.[99] Consequently, Hispanics may have a cultural-specific preference toward holding smaller family businesses privately both because they may not be familiar with alternative structures and because the social benefits that flow to a family owning a company may go beyond the bottom line.

Compared to larger corporations, smaller companies also tend to have less sophisticated legal and financial advisors as a function of their size. Thus, these companies and their agents are often less experienced and less effective negotiators, leading to a diminished ability to demand the multiples that other larger private equity targets are able to obtain. This creates an opportunity for a Hispanic-focused private equity fund, armed with knowledge of Hispanic business characteristics, to purchase investments at attractive multiples.

So far, most of our analysis has focused on characteristics and practices that are found in small and family-owned businesses. Yet, there are business practices particular to privately held Hispanic companies beyond those described above. According to Hilary Candela,[100] managing director at Aquarius Capital Partners, a small-cap private equity fund, approaching Hispanic businesses requires a much more relationship-based, grassroots oriented marketing effort because their owners tend to distrust outsiders.[101] Thus, it generally takes time to forge a working relationship with them as a potential suitor, with a lot of "handshaking go[ing] on." [102] Additionally, because of their smaller size and their preference for hiring close acquaintances or referrals, rather than top-level, sophisticated outside repre-

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BUSINESS NEEDS TO KNOW FOR SUCCESS 8 (2000).

[96] Paul Westhead et al., *The Scale and Nature of Family Businesses*, *in* UNDERSTANDING THE SMALL FAMILY BUSINESS, *supra* note 90, at 19, 19.

[97] KETS DE VRIES, *supra* note 85, at 16.

[98] KOENIG, *supra* note 95, at 5.

[99] *En Efectivo* (CNN en Español television broadcast Oct. 22, 2006).

[100] Hilary Candela is a managing director at Aquarius Capital Partners, a small-cap private equity firm located in Coral Gables, Florida. Prior to this he was both an investment banker with Deutsche Bank and an executive at MasTec, one of the nation's largest publicly traded Hispanic-owned corporations.

[101] Candela, *supra* note 11.

[102] *Id.*

sentation, Mr. Candela says that these companies are less likely to successfully obtain the best possible multiples in a deal.[103]

Mr. Candela also notes that many smaller Hispanic businesses are great operationally but have unsophisticated accounting and reporting practices—these owners often run their companies from the "backs of their hands" and simply have a great intuition for business.[104] This presents a problem for the majority of private equity firms who are used to well laid-out, audited financial statements when conducting diligence on prospective target companies. Once again, this informal practice presents the opportunity to purchase the business at a discount, since few other funds are willing to buy a company with opaque practices. Nevertheless, these deals are inherently riskier since fraud and malfeasance is harder to spot given faulty or incomplete records. This highlights the importance of an informed cultural and relationship-based approach, which facilitates the use of character when conducting the investment calculus.

F. Hispanic-Facing Firm's Use of Credit

Hispanic companies are also distinguished by their inefficient capital structures due to an over-reliance on equity. This over-reliance on equity may be due both to credit supply and demand issues—banks undersupplying credit to Hispanic businesses and Hispanic business owners having a cultural aversion to debt. Both recent and historical reasons are probably responsible for Hispanics' cultural aversion to debt. First, more recent events, such as the relative unavailability of credit to private enterprises in Latin America,[105] may be behind this credit aversion. Korzenny and Korzenny note that this credit aversion may also have its roots in the many Islamic influences on Hispanic culture stemming from the eight centuries of Moorish domination of the Iberian peninsula, such as the prohibition of *riba*—the collection of interest on debt.[106] This prohibition is broad, and it is still debated whether it extends to other financial instruments.[107] Thus, if the concept of interest has been problematic since the laying of cultural foundations and recent history has reinforced this trait, it is understandable that "selling on credit . . . to Hispanics would be more difficult than selling the same to non-Hispanics."[108]

The inefficient capital structures found in many Hispanic-owned businesses may also be due to a shortage in credit supply. As one of our in-

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[103] *Id.*
[104] *Id.*
[105] ADOLFO BARAJAS & ROBERTO STEINER, INT'L MONETARY FUND INST., CREDIT STAGNATION IN LATIN AMERICA 9 (2002), *available at* http://www.imf.org/External/Pubs/FT/staffp/2001/00-00/pdf/abrs.pdf.
[106] KORZENNY & KORZENNY, *supra* note 43, at 21.
[107] *Id.*
[108] *Id.*

terviewees pointed out, lack of awareness or experience in Hispanic markets may cause investment banks to overlook this sector.[109] This market inefficiency may result in small Hispanic-owned businesses being less able to raise capital. Furthermore, these family owners typically must resort to commercial as opposed to business banks, where often personal guarantees from small business owners may also make these businesses' capital structures deviate from the ideal.[110] Regardless of the precise reasons for suboptimal capital structures in Hispanic-owned business, this situation presents an opportunity for a private equity fund to add value by leveraging acquired businesses up to the optimal level.

III. METHODOLOGY

Because profit and price data for privately owned companies are largely unavailable, this Article relies on qualitative field research. First, we interviewed legal and financial experts in the field regarding the Hispanic market and optimal investment strategies. We obtained greater insight into specific industries by interviewing Hispanic-facing business owners. We inquired as to their business models and practices and asked their opinions concerning the direction and attractiveness of their particular sector. Although some of these interviews were conducted over the telephone, most were conducted on location both out of convenience for our interviewees and in order to observe as much of our target companies' business as possible.

We interviewed all existing private equity funds dedicated to Hispanic-facing companies in the United States. We interviewed funds that have a strong presence in, but are not exclusively dedicated to, this space because of their geographical focus and large funds, in order to get their opinion on this investment space. We analyzed a number of sample deals these funds had conducted and inquired how these funds developed their comparative advantage vis-à-vis other firms.

For business owners, we surveyed the Hispanic 500 list and pursued our proprietary contacts of owners of Hispanic-facing companies with general enterprise values between $25 million to $250 million. We utilized a more formulaic interview process, asking questions regarding the industry, their business model, their general understanding and receptiveness to private equity transactions, and their outlook on the Hispanic market.

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[109] Interview with Ramon Rasco, Chairman of the Board of Directors, U.S. Century Bank, in Coral Gables, Fla. (Dec. 29, 2006).

[110] Haynes et al., *supra* note 93, at 1.

IV. Well-positioned Businesses

Hispanic businesses currently comprise a significant portion of the U.S. economy producing almost $300 billion of gross annual receipts.[111] They are expected to produce $465 billion by 2010.[112] Although many of these businesses are too small for private equity funds to currently have a significant rule, these statistics do reveal the growing capitalization in this market and the increasing relevancy of these companies. Amongst the top 500 Hispanic-owned businesses in the United States, the average top-line revenue growth is over 15% per year.[113] While Hispanic-owned companies are not necessarily Hispanic-facing and the latter are not necessarily owned by Hispanics,[114] in general, the majority of Hispanic-facing companies are Hispanic-owned. As discussed in the following section, Hispanic-facing and Hispanic-owned companies have particular idiosyncratic business practices that make a catered, relationship-based private equity approach superior to the standard impersonal traditional method.

A. *Industry Selection*

While it is hard to pinpoint which industries are particularly well-positioned to benefit from the above-identified trends, Hispanic-facing companies can generally be lumped into (1) companies owned by Hispanics; (2) companies that directly produce traditionally Hispanic goods and services or help bring products to the Hispanic market; and (3) companies that produce products that stand to be disproportionately consumed by Hispanics, given the ethnicity's unique demographics and preferences. The first group is self-defined. The second group is comprised of companies that provide traditionally Hispanic goods and services, such as food products like tortillas and sofrito, financial institutions specializing in remittances to Lain America, and entertainment and media companies that Hispanics tend to patronize. This group also includes firms that help mainstream companies place their products in the Hispanic market by advertising, marketing, and dealing with public relations. The third group includes companies which provide products targeted to society at-large but can benefit from general Hispanic trends with a niche strategy. These companies include those involved in financial, retail, and food. For example, private equity fund may target a diaper company and change its marketing strategy vis-à-vis Hispanics, due to the latter's extremely young demograph-

[111] Sandra Abrams, *Niche Firms Target Hispanic Population*, Investment Dealer's Dig., Nov. 13, 2006, at 14, 14.

[112] *Id.*

[113] Palladium Equity Partners, Opportunities in the U.S. Hispanic Markets, Puerto Rico Venture Forum 9 (2006).

[114] Of course a visionary entrepreneur, regardless of ethnicity, could very well own a business that targets the Hispanic market and seeks to benefit from the above-mentioned trends.

ics, potentially increasing overall sales. Along these lines, Palladium Equity states that it has made an investment in Wise, a potato chip manufacturer with a geographical distribution area that coincides with urban centers that have large Hispanic populations. Palladium Equity expects that, to the extent that these Hispanic populations grow in its distribution regions, Wise should experience strong top-line growth.

B. Hispanic-Facing Firms Within These Industries

We traveled across the country interviewing Hispanic business owners. We asked them about their business models and practices and about their outlook on the Hispanic market. Although these companies are not a perfect representation of all Hispanic-facing companies, they make up a good cross-section of the types of companies in this market sector. They are well-positioned to capitalize off the beneficial general trends and provide a good example of the characteristics of these businesses. These are two factors that a private equity firm specializing in this sector would find attractive.

1. Financial Services: U.S. Century Bank

U.S. Century Bank is a privately owned commercial bank, with over one billion dollars in assets and branches throughout southern Florida. Although it is not a Hispanic-centered bank, the majority of its customers are Hispanic, and, like Wise potato chips, the firm has been able to grow rapidly through effective targeting of this segment. In fact, the bank reached profitability in only three months of operation and has since experienced rising profits every quarter. Results like these are not typical in the financial industry.

Ramon Rasco,[115] chairman of U.S. Century Bank, elaborated on some of the unique market and business characteristics that make his bank so successful.[116] He stated that most large banks do not have an adequate knowledge of Hispanic culture and "don't know how to react when confronted with small business owners and community members who don't speak perfect English or wear business suits to work."[117] According to Rasco, U.S. Century Bank attempts to fill this void by becoming a "relationship bank" that provides local businesspeople and entrepreneurs with their first loans thus developing ties and loyalty. The bank often uses an

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[115] Ramon Rasco is the founder and chairman of the board of directors of U.S. Century Bank. He is a corporate attorney by trade, specializing in banking and real estate law and is a partner at Rasco, Reininger, Perez & Esquenazi, P.L., located in Coral Gables, Florida. He received both a B.B.A in business administration and a J.D. from the University of Miami.

[116] Rasco, *supra* note 109.

[117] *Id.*

unorthodox loan process to issue loans based on intangible factors, such as an owner's "character."

An understanding of the culture and business practices in this sector is crucial when making loans based on such intangible factors, according to Rasco. Smaller decentralized, service-oriented banks have been successful against the Wachovia's and Bank of America's amongst all demographics. Nevertheless, Rasco mentioned that because of cultural factors, Hispanic consumers in particular do not want to be seen as just a number and expect a holistic approach to customer service.

In terms of making a private equity investment in this sector, financial institutions differ from other areas in that banks are seldom purchased by funds—they are almost always acquired by other financial institutions in a strategic acquisition or undergo an IPO. Consequently, private equity investments in this sector generally consist of providing early stage capital, rather than purchasing the mature company. U.S. Century Bank's experience confirms this. Its launch was financed via a number of rounds of fundraising from family, friends and acquaintances; rather than with institutional money. Rasco mentioned that the close relationships the board held with other investors allowed it to raise sufficient capital. Nevertheless, it is unlikely that all financial institutions targeting this sector will be fortunate enough to have sufficient friends and family with deep enough pockets, thus presenting another opportunity for private equity funds.

2. *Hispanic Marketing Firms: Hispanic USA, Inc.*

Over the past decade, blue-chip companies have begun to absorb some of the implications of the 2000 census data regarding the huge growth of the Hispanic population. The majority of these firms do not have the cultural knowledge to effectively position themselves within this burgeoning market. Thus, Hispanic marketing firms and related advertising firms are in great demand. As large Fortune 500 companies spend more and more money on media advertisements intended to reach Hispanics, they employ agencies with cultural know-how to ensure that they are generating advertising messages that resonate with the Hispanic demographic.

José Cancela[118] is principal of Hispanic USA, Inc., a marketing firm focusing on Hispanics. While the current fad in the marketing business is to segment the Hispanic demographic, Mr. Cancela has found this to step be unnecessary. He argues that Hispanics' shared experience in the United States and common language are stronger than the differences of their na-

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[118] José Cancela is the founder of and a principal at Hispanic USA, Inc., a full-service Hispanic market consulting firm with offices in San Antonio and Miami. It serves a number of Fortune 500 companies in attempting to understand and connect with Latino markets. He previously managed station groups for both Univision and Telemundo along with several Latino radio stations. He is the author of the book *The Power of Business en Español*. He has appeared on CNN, CNBC, and the Today Show.

tionalities.[119] "Spanish is here to stay" within this demographic, says Mr. Cancela, even as some Hispanics undergo assimilation and integration. Furthermore, Mr. Cancela's research has found no correlation between Hispanics' wealth or English proficiency and their Spanish or English media preferences. This directly contradicts the common wisdom that wealthier Hispanics, who tend to speak English fluently, prefer English media and therefore can be reached effectively using English media avenues exclusively. Thus, Spanish media usage is fundamental to successfully reaching even the most assimilated, English-speaking Hispanic consumers. According to Cancela, marketing firms with knowledge of the Hispanic market can help harmonize differing English and Spanish marketing strategies currently used by blue-chip companies. This is particularly important for Hispanics, as the majority of this demographic is exposed to both Spanish and English media outlets.

3. *Hispanic Media: Entravision Communications Corporation*

Aaron Scoby[120] is the general manager of Entravision Communications Corporation's two television and three radio stations serving Monterey, California. Entravision's television station group is the largest Univision network affiliate, broadcasting both the Univision and TeleFutura network programs in the Monterey area. In our interview, Mr. Scoby noted that Entravision's Spanish-language television station leads the local market in ratings, beating out NBC, ABC, FOX, and CBS's affiliates in the key demographic of 18–34 and 18–49-year-olds, according to Nielsen Media Research.[121] More importantly, he pointed out that the success experienced by Entravision's local station runs deeper than the Hispanic demographic's strong growth but is also due to an increasing convergence between Hispanic and non-Hispanic preferences and bilingual Hispanics tuning to Spanish-language television.

First, Mr. Scoby stated that in the early 1990s, when he worked for a major English-language network, English-language television was considered "general market," while Spanish-language stations were considered separately from a competition and advertising standpoint. Over time, he has seen Spanish-language television grow to be considered part of the general market by advertisers and English-language competitors. This devel-

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[119] Interview with José Cancela, Principal, Hispanic USA, Inc., in Coral Gables, Fla. (Dec. 27, 2006).

[120] Aaron Scoby is general mangager of Entravision Communications Corporation's Monterey, California, broadcast properties, which include KSMS-TV Univision Channel 67, KDJT-CA Telefutura Channel 33, KLOK 99.5 FM Radio Tricolor, KSES 107.1 FM Super Estrella, and KMBX 700 AM Super Estrella. He is a graduate of Kansas State University and successfully completed the television executive program at Northwestern University's Kellogg School of Management in Chicago, Illinois.

[121] Interview with Aaron Scoby, General Manager, Entravision, Inc., in Monterey, Cal. (Feb. 16, 2007).

opment has resulted in a cost per point[122] for advertising spots quickly approaching that commaded by English media companies. While there remains a gap between English-language and Spanish-language advertising rates, he noted that this increasing lack of segmentation was not limited to television but could be seen in the music industry as well, as many Hispanic pop artists, such as Shakira, Jennifer Lopez, and Ricky Martin, who might have been considered niche fifteen years ago, are now helping to set general music trends. In the television context, Mr. Scoby pointed out that last year, even though both ESPN and Univision broadcasted the World Cup, a number of English speakers and non-Hispanics tuned to the Univision broadcast because they preferred its delivery style, fueling stronger ratings.

Second, Entravision's success also results from many English-speaking Hispanics tuning in. As Mr. Cancela noted, Mr. Scoby does not find strong language stratification across generations and income levels, and he stated that many affluent and second- and third-generation Hispanics prefer Spanish-language television despite being fluent in English. This point relates to the general cultural convergence mentioned above, but it is important in its own right because many predicted that Hispanics would give up Spanish-language media as they became English speakers and their incomes rose. To the extent Entravision and other Hispanic-facing media companies maintain a strong presence with English-speaking Hispanics, they have robust prospects, as any company that wants to successfully reach Hispanic will have to advertise in Hispanic media.

4. *Hispanic-facing Carrier and Remittance Services: Aeroexpress*

Carlos Moncada[123] is the owner of both El Charrito, a supermarket chain, and Aeroexpress, a remittance and mail carrier company that targets the Mexican community. Mr. Moncada started operating El Charitto, a supermarket in Salinas, California, in 1980, and built the chain to three stores by 1983.[124] Mr. Moncada explained he laid the foundation for this growth not by competing with the larger supermarket chains head on but by using his understanding of Mexican culture to offer products the larger chains did not carry. This strategy fueled strong initial growth, but the larger chains eventually caught on, and he had to adapt his business strategy.

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[122] Cost per point refers to the marginal cost associated with reaching one viewer or listener as determined by ratings services such as Neilson.

[123] Carlos Moncada was born in Santa Fe, Michoacan, Mexico, and immigrated to the United States in 1965. He owns and operates a number of Hispanic-facing business operations including El Charrito and Aeroexpress out of his Salinas, California, headquarters.

[124] Telephone interview with Carlos Moncada, Owner, Aeroexpress, in Salinas, Cal. (Feb. 14, 2007).

Mr. Moncada switched roads in the early 1990s, and while he continued to operate four supermarkets, he began exploring the remittance and mail carrier business to Mexico. Through Aeroexpress Mr. Moncada sought to serve part of the Mexican demographic that larger mail carriers and banks were neglecting. Aeroexpress has offices in Los Angeles and Chicago in the United States and in Guadalajara and Tulancingo in Mexico, and it services remittances for approximately 300 agencies in the United States. The company delivers letters, packages, and remittances to isolated communities in central Mexico, reaching locations not served by other major carriers, including homes that lack an official street address. Beyond its ability to tap into local knowledge of Mexico and reach geographically remote areas, Aeroexpress has the additional advantage of not requiring a bank account on the receiving end of remittances. This aspect of the business structure is key to reaching a previously underserved demographic, for many recipients do not have easy access to a bank in their communities and thus cannot be reached by many traditional remittance programs offered by the large financial institutions.

Mr. Moncada continuously soul-searches to recognize Mexican immigrant community needs that are not being provided for by the traditional market. Oftentimes, despite specific products or services not succeeding in the strictly financial sense, he has continued to operate them for the bene-fit of his customers out of a deep sense of concern for what his community needs. Just last year, aware of the cross-border familiar separation faced by many Mexican immigrants, Mr. Moncada experimented with providing a flower home delivery service on Mother's Day. The flower venture was not a financial success but based on the recipients' responses, Mr. Moncada said the trial reinforced his commitment to helping the Mexican immigrant community. Furthermore, his whole family is involved in the operation of his businesses, and, therefore, he sees private equity opportunities as incompatible with his desire to run a business with strong ties to the Mexican community and a primarily family orientation.

5. Hispanic-facing Supermarkets: Mi Pueblo

Juvenal Chavez[125] is the owner of Mi Pueblo San Jose, Inc., a supermarket chain in California's Greater Bay Area. Mr. Chavez started his first business, a *taqueria*, as a partnership, and it was in this initial venture that he experienced first-hand the Mexican demographic's enormous underserved demand.[126] Within a year of his first business venture, he established his first grocery store in Redwood City, California, but Mi Pueblo's

[125] Juvenal Chavez was born in Aguililla, Michoacan, Mexico, and immigrated to the United States in 1984. He owns and operates Mi Pueblo, a Mexican supermarket chain based in central California that has annual sales of over $100 million.

[126] Interview with Juvenal Chavez, Owner, Mi Pueblo San Jose, Inc., in San Jose, Cal. (Feb. 16, 2006).

true breakthrough came in the early 1990s with his San Jose market. There Mr. Chavez achieved extraordinary growth with a 4000 square foot space despite having two established, large-footprint supermarkets on the same block. Mi Pueblo's success enabled Mr. Chavez to use the profits to finance the chain's expansion, placing stores in areas with a high Hispanic population density.[127]

Mr. Chavez explained that he has built his success based on his understanding of the Mexican community's wants and needs. When he first entered the supermarket business, he saw that other supermarkets did not appreciate or attempt to cater to the Mexican customer. Traditional supermarkets discounted Mexicans as simply transitory workers whose unique needs were not important or profitable enough to warrant changes in merchandising. Their thinking was that Mexicans had the same general needs as the Anglo shopper and therefore would, to some degree, assimilate to the consumption patterns already in existence in the United States.

Mr. Chavez knew that Mexican customers liked to be catered to like everyone else. Mi Pueblo's flagship store is set up to make the Mexican consumer feel at home. The store is decorated in vibrant pastels, Mexican music sets the shopping mood, and the Spanish-speaking employees wear nametags displaying their hometowns in Mexico. Additionally, Mi Pueblo emphasizes individuality by having personnel greet shoppers throughout the store, stocking delicacies from various Mexican states rather than treating the Mexican palate as homogeneous, and not having customers take numbers at the meat counter, for example.

Mr. Chavez's understanding and targeting of this niche demographic has paid off—his customers are loyal, and this allows Mi Pueblo to compete against bigger and cheaper chains successfully. Mi Pueblo's current eight stores gross over $100 million in sales per year and have produced 24% same-store sales growth.[128]

Despite his tremendous success and ambitions to grow even further with three to four new stores per year, Mr. Chavez attempts to stay under the radar and prefers not to have others know about his success. He stated that the intuition and expertise that he has developed through years of experience enables him to carry out uniquely the optimal strategy for the firm's future. Furthermore, Mr. Chavez prefers to stick to the family structure formula that made Mi Pueblo what it is today and has chosen to self-finance the chain's growth from its internal operations rather than turn to outside capital sources. He stated that resorting to private equity could lead to a change in the store's values, and he is unwilling to compromise in that area.

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[127] The business seeks regions with 30% or more Hispanic population concentration.

[128] Raksha Varma, *Mi Pueblo Owner Has More in Store*, SILICON VALLEY/SAN JOSE BUS. J., June 14, 2005, *available at* http://sanjose.bizjournals.com/sanjose/entrepreneur/2006/06/14/.

C. General Lessons

During our interviews we uncovered a few cultural factors and preferences that lead Hispanic consumers to choose a Hispanic-facing company's product or service over the oftentimes more economically attractive mainstream alternatives. In essence, many of these companies face the question: why would a Hispanic consumer choose my store over the Wal-Mart of that industry? The common theme that emerged when speaking to all of these companies and experts in the field was that a Hispanic-facing company's success depended on their ability to differentiate their good or service in the niche market. Of course this is not a novel strategy—any smaller company who wants to thrive within the shadows of an "800 pound gorilla" must differentiate itself by providing superior service to a subset of the market. What is novel is that this requires getting to know a new and emerging market with important idiosyncrasies. Currently, the majority of Hispanic-facing companies are organic to heavily Hispanic communities, and they have thus developed an intangible adeptness at catering to Hispanics' unique preferences. As discussed above, this cultural know-how is an intangible asset that often times is not easily recognized by the traditional private equity players. Nevertheless, many of the owners we spoke to felt that they were experts in understanding and effectively serving markets in general, rather than simply experts on Hispanics. Thus, many of these companies have ambitions of growing and serving broader clienteles in the future.

V. Optimal Private Equity Investment Strategies

We sat down with principals and partners from a wide variety of private equity firms across the country, ranging from some of the nation's largest private equity funds, managing over $10 billion, to smaller regional funds managing under $100 million. Some of these funds exclusively and successfully invest their capital in Hispanic-facing companies and are dedicated to exploiting the aforementioned opportunities in this market.

The message from niche funds was that Hispanics are a group with unique characteristics and preferences and it is possible to gain a comparative advantage in investing in Hispanic-facing companies by gaining cultural knowledge of this demographic. Understanding how Hispanics select brands and its relationship to the acculturation process is vital to making good investment decisions.[129] Aside from analyzing cash flows, you must understand both the language and the cultural context the business operates in, in order to effectively understand the good or service offered by

[129] Interview with Pilar Avila, Vice President, Palladium Equity Partners, in New York, N.Y. (Dec. 23, 2007).

the company.[130] Moreover, because the average private equity fund comes across hundreds of potential deals every year, the short amount of time it can dedicate to analyzing each deal, especially at the early proposal stage, means that unfamiliar sectors, such as the Hispanic market, are likely to be passed over based simply for expediency.[131] Thus, Hispanic-facing companies may not get the attention they merit during these initial screenings because of the extra time commitment ordinary funds would need to understand idiosyncratic aspects of this market.[132] Thus, a Hispanic-targeted fund would likely be able to sort through these deals with greater ease because of a stronger baseline understanding of the business culture and the market sector.

Many Hispanic-market niche funds mention cultural factors as being central to successfully approaching and courting potential targets. Even though each business owner has specific deal style preferences, from a cultural perspective, taking an approach tailored to Hispanic-owned companies can lead to superior results at the margin.

When discussing this issue with many of these funds a common theme that emerged was price. Price is the primary factor when sellers are considering parting with their company. Therefore a strong relationship will be insufficient to overcome an inadequate bid. Nevertheless, relationships are definitely instrumental in getting the company to the table in the first place.[133] Many of these prospective targets are small unregistered businesses, who tend to be untrusting of others and not well advertised to the outside investing community; this further bolsters the need to develop relationships to get ones foot in the door and to get plentiful financial and operational data necessary for making an informed bid for a company.[134] On a similar note, many times a deep relationship will permit a private equity suitor to directly bypass auctions in favor of privately negotiated sales, which have been shown to result in lower, more favorable multiples.[135] Finally, Andro Nodarse-Leon,[136] a principal at Leon & Mayer stated that from a legal perspective, a strong relationship with the man-

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[130] *Id.*

[131] Telephone interview with Victor Maruri, Founding Partner, Hispania Capital Partners, in Chicago, Ill. (Jan. 31, 2007).

[132] *Id.*

[133] Telephone interview with Andro Nodarse-Leon, Principal, Leon, Mayer & Co., in Miami, Fla. (Jan. 12, 2007).

[134] Candela, *supra* note 11.

[135] Gonzalez, *supra* note 18.

[136] Andro Nodarse-Leon is a principal at Leon, Mayer & Co., a growing private equity fund with a corporate arm focusing on small-cap companies and with offices in New York and Miami. Prior to launching this fund, he was an investment professional with Kohlberg, Kravis, and Roberts ("KKR"), one of the nation's largest private equity funds that pioneered the leveraged buy-out movement. Prior to that he was an investment banker with Goldman Sachs. Mr. Nodarse-Leon graduated with Honors from the Wharton School of Business and the School of Engineering and Applied Sciences at the University of Pennsylvania. Mr. Nodarse-Leon is an influential member in the Cuban American exile community and migrated to the United States from Cuba at the age of twelve.

agement team and past owners will enable a transaction to occur with a superior structure that has more value for all parties.[137]

The common theme that quickly emerged in all of the interviews with private equity funds was the difficulty in initiating a dialogue with many of these owners. This problem is not unique to Hispanics, because these funds exhibit a selection bias towards seeking only strong, profitable entities, which are less desperate to receive a capital infusion at the expense of dilution. Nevertheless, it seems that Hispanics tend to be harder to access than their Anglo counter-parts even controlling for all of these variables. There are two main reasons why this is the case: (1) a general lack of awareness by Hispanic entrepreneurs of private equity and the advantages and resources which it bestows, and on a related note, (2) the entrepreneurs tend to be too busy to educate themselves on this opportunity or to give outside firms a shot to introduce the advantages of these structures.[138] An awareness by Hispanic business owners of the term venture capital or private equity was virtually unheard of just five years ago.[139] Although there has been a steady increase in understanding, Pilar Avila,[140] a vice-president at Palladium Equity Partners, approximated that 90% of current Hispanic entrepreneurs still have very little comprehension of these available options.[141] Part of the solution to this problem is simply educating these professionals about the characteristics and advantages of private equity via conferences, articles, and eventually word of mouth. The current roadblock has simply been that Hispanic business leaders are too involved in the day-to-day operations of their businesses to worry about the longer term options and strategies or to educate themselves about these possibilities.[142]

Over 90% of private equity money resides within funds of $500 million or greater.[143] Because of the nature of optimal diversification, most of these funds will make equity contributions of at least $50–$75 million in companies worth many times this amount. Consequently, they are simply too large to be looking at the deal sizes that would be associated with most Hispanic private companies.[144] According to Victor Maruri,[145] a co-founder

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[137] Nodarse-Leon, *supra* note 133.

[138] Avila, *supra* note 129.

[139] *Id.*

[140] Pilar Avila is a vice president at Palladium Equity Partners, which with $750 million of assets under management is the largest private equity fund in the country focused on Hispanic companies. Located in midtown Manhattan, the fund generally makes capital infusions of between $15 million and $50 million and is willing to make larger commitments with co-investors. Ms. Avila previously was the executive director of the New America Alliance and prior to that was a vice-president at the United States Hispanic Chamber of Commerce. She also sits on the board of the Marathon Club.

[141] Avila, *supra* note 129.

[142] *Id.*

[143] Maruri, *supra* note 131.

[144] *Id.*

[145] Victor Maruri is a founding partner of Hispania Capital Partners, a Chicago-based

of Hispania Capital Partners, the optimal size for a fund that targets Hispanics is between $200 million and $300 million.[146] However, many of the interviewees noted that there is currently a dearth of funds occupying this space, which permits them to evade the widespread thinning of margins seen in the rest of private equity world. For example, while larger investments will be purchased for around x8 EBITDA, the relative lack of competition is permitting companies to be purchased for x4 to x6 EBITDA in these spaces.[147]

A major criticism levied against creating a Hispanic targeted fund is that the market is simply not deep enough to sustain it. Although comprising a total enterprise value of around $360 billion, most of these companies tend to be too small for traditional leveraged buy-outs, as insinuated above. Nevertheless, flexibility in size and stage can allow private equity funds to capture a large portion of this market.[148] Ms. Avila stated that although there is plenty of deal flow and they are deploying their capital with ease, it has required Palladium to be flexible with its types of deals.[149] When they originally launched the fund, they anticipated making most of their investments in buying out "middle-market" Latino companies.[150] However, they soon discovered that this strategy was difficult due to the small number of companies in this space that were available for sale.[151] Consequently, Palladium has turned to growth capital and earlier stage investments with great success.[152] One example is their recent funding of Promerica Bank, a commercial bank in Los Angeles targeting Hispanics businesses.[153] Seeing that Los Angeles Hispanics represent a large and growing, yet underserved market, Palladium backed a number of leading local business executives to launch this bank. Where most non-venture capital private equity firms would simply refuse to fund this deal, Palladium was willing to look toward the proven business model and strong growth prospects in assessing the viability and attractiveness of this project. Some of the other funds have indicated their willingness to do mezzanine lending and other untraditional structures, in addition to their willingness to consider smaller deals. Another factor that encourages these untraditional structures is that some lucrative government contracts and grants can only be obtained if the company has over 50% of its ownership by mi-

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private equity firm positioned to make investments in Hispanic-oriented companies. Its portfolio investments have ranged from women's hair care products to a Spanish language newspaper publisher. Mr. Maruri has over twenty-five years experience as an investment banker spanning positions at Banque Paribas, Credit Suisee First Boston, and JP Morgan.

[146] Maruri, *supra* note 131.

[147] *Id.*

[148] Avila, *supra* note 129.

[149] *Id.*

[150] *Id.*

[151] *Id.*

[152] *Id.*

[153] Avila, *supra* note 129.

norities—thus requiring a willingness to invest in a minority stake of a business to prevent crossing the 50% threshold.[154]

The little quantitative data that exists indicates that investing in these areas is highly profitable. Although no reliable information can be obtained regarding risk levels, venture capital investments in minority startups have achieved internal rates of return ("IRR") of approximately 20%.[155] Because these investments are generally in industries with few tangible assets, it is highly probable that they have lower amounts of risk associated with them, and therefore exhibit great risk/return profiles.[156]

VI. Social Implications

The injection of capital into Hispanic-facing companies, many of which are located in underprivileged immigrant communities, may also aid in the economic development of these areas. This is not a minor point. As mentioned above, the Hispanic population is projected to grow rapidly and will be overrepresented in labor and education in the future. Thus, the U.S. Department of Commerce has recognized that "empowering minority entrepreneurs and accelerating their level of productivity is critical to strengthening U.S. competitiveness nationally and worldwide."[157] If the United States is to continue being at the world's economic forefront, attention to this large segment is essential.[158] Recent studies suggest that empowering of individuals in underprivileged communities may be achieved via a business-oriented approach.[159] In fact, entrepreneurship has been cited as key to integrating the city poor into the urban economy.[160] As alluded to by the Department of Commerce, the innovation, creativity, flexibility, and adaptability provided by entrepreneurial businesses will in turn "be essential to keeping U.S. cities economically vital and internationally competitive in the future"[161] In addition, successful business owners who are nestled in these communities may serve as mentors for younger business leaders, thus further aiding the development of these areas.[162]

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[154] Boston Consulting Group, The New Agenda For Minority Business Development 11 (2005). Recent court cases have put this program into question. *See* Adarand Construction v. Pena, 515 U.S. 200 (1995).

[155] Timothy Bates & William Bradford, Kauffman Foundation, Minorities and Venture Capital: A New Wave in American Business 6 (2003).

[156] *Id.* at 14.

[157] Minority Business Development Agency, U.S. Dep't of Commerce, The State of Minority Business Enterprises: An Overview of the 2002 Survey of Business Owners 1 (2006).

[158] Korzenny & Korzenny, *supra* note 43, at 302.

[159] Dennis A. Rondinelli et al., *The Changing Forces of Urban Economic Development: Globalization and City Competitiveness in the 21st Century*, 3 Cityscape 99 (1998), *available at* http://ssrn.com/abstract=156912.

[160] *Id.* at 97.

[161] *Id.* at 89.

[162] *Id.* at 99.

VII. Conclusion

Hispanic-facing companies represent a growing and largely untapped investment opportunity for private equity firms. Hispanic-facing companies tend to be family-owned, and those run by Hispanic owners often have business practices that differ from mainstream companies. These firms often posses an intangible cultural knowledge that allow them to successfully capture the vigorous Hispanic segment, even when faced with competition from formidable mainstream companies. Although the private equity took-kit is well suited to add value to these companies by providing capital, improving capital structures, and implementing cutting-edge management techniques, many established firms often shy away from these targets due to these businesses' perceived opaque, or simply unconventional, practices. Additionally, despite that the fundamentals of this investment strategy are strong, this is an extremely challenging space to navigate due to the business owners' inherent distrust of outside investment and their consequent unwillingness to engage. A private equity fund specializing in this market can capitalize on this opportunity through its better understanding of these companies and the context in which they operate and a more grassroots relationship-based approach. The influx of capital into underprivileged communities, in which many Hispanic-facing companies are located, is also likely to have beneficial developmental effects in these communities.