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The Iron Triangle of investment success

There is a generally known project management principle called the project management triangle, or what is sometimes called the "Iron Triangle" which can be useful when analyzing the goals of any given project. In the private practice legal field it can sometimes be reduced to the options of fast, good or cheap ... pick any two.

The concept is that if a client wants something done quickly and to a high standard, it will not be cheap. If a client wants something quick and cheap, it's not going to be high quality. And if a client wants something high quality and cheap, it's going to take longer to accomplish. Overall, the Iron Triangle is a principle which generally holds true.

Although my practice focuses primarily on commercial real estate transactions, I am frequently tasked with advising clients on potential private investment opportunities of a real estate nature as well as a myriad of other investment opportunities, whether they be technology startups or other potentially exciting innovations.

In my experiences of advising and consulting clients on potential private equity investments — real estate and otherwise — I have found that there is truly an Iron Triangle which investors should adhere to when assessing such "opportunities."

However, the meaningful difference in the Iron Triangle referred to below versus the principle described above, is that all three requirements must be met — not just two.

When one is presented with an opportunity to take part in an investment of any nature, the following three requirements should be carefully analyzed and fulfilled: (1) trust the person(s) with whom you are investing; (2) truly understand the investment; and (3) have a well-defined exit strategy. While these may seem like obvious and basic standards; they are often easily overlooked or discounted without careful contemplation.

Trust the person with whom you are investing

During Ronald Reagan's frequent discussions with leaders of the former Soviet Union on nuclear arms reduction, Reagan adopted the popular Russian proverb of "trust, but verify." The proverb reflects the idea that while one might trust the source of information, verifying that such information is trustworthy and accurate is well-advised.

Many of us are presented with investment opportunities from various individuals within our professional circles, however, there is nothing wrong with verifying the information provided.

Whether it be reviewing a private placement memorandum or confirming the track record of the promoter, developer or investment adviser, one needs to truly have a comfort level with the person bringing the investment.

This can seem like an easy analysis — and perhaps sometimes is — however, as a cautionary tale, I'm sure the hundreds of investors with Bernie Madoff's funds in years past felt they trusted him as well. In the end, there is nothing wrong with obtaining references and performing due diligence on the person bringing you the investment.

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If they are offended by such investigation, then perhaps you need not read further.

THE REal DEAL

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Understand the investment

The best way to illustrate this requirement is to base it on my personal experience. My proficiency is commercial real estate investment — I understand real estate-related transactions investment and how real estate investments can produce a return for investors.

Whether it is a quick cash-on-cash return on a flip, a longer term internal rate of return goal on a buy and hold investment, or a value-add play which involves construction expenditures to reach a desired return, I understand a proposed real estate investment opportunity.

What I don't understand is how a medical device can obtain Federal Drug Administration approval in the United States, how a voice-over Internet protocol platform in Vietnam will be profitable within a target 24-month period or how a smartphone home inspection application can reach broader markets and make money.

I mention the above scenarios because they are real investment opportunities which I have seen with great enthusiasm from a promoter; however, I have no idea what road needs to be traveled to be profitable. The point is that just because something is presented as an extremely exciting or once-in-a-lifetime investment opportunity, doesn't mean you should dive in without performing much due diligence.

You may satisfy the trust requirement but if you don't understand the mechanics of the "opportunity" being presented to you before forking over your hard-earned money, you should proceed with caution.

A reasonable exit strategy

Perhaps you have done your homework and satisfied the above requirements. Good work. Now how are you going to get your initial investment and, hopefully, your profits back? Understanding your investment's exit strategy is not just a necessity, it's essential to your peace of mind as an investor.

Exit strategies are sometimes uncertain, depending on the type of investment. However, they should not be completely open-ended. It can be extremely frustrating to not understand why you are not receiving any returns on your investment at any given time. This is why you need to know what your exit strategy is.

As opposed to the project management Iron Triangle concept where two of the three elements are utilized to analyze a potential project, the Iron Triangle of Investment Success outlined above should seriously contemplate the satisfaction of all three requirements.

Confirmation of one or two of those requirements — without the third — will often lead to failure. By no means does this mean one will have 100 percent success in such private equity investments. However, if one adheres to the above three main guidelines, the likelihood for success increases substantially.