THE MANAGER'S KEYS TO SUCCESS : HOW TO OPEN UP EQUITY TO FINANCIAL PARTNERS

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There are two types of situations where managers may be faced with the question of opening up their equity to financial partners: either as an entrepreneur, combining the functions of majority shareholder and manager of the business, or as a CEO, when the majority shareholder decides to sell a subsidiary or business unit.

The entrepreneur will certainly have greater control over the conditions and timing of such a project, but, in either case, ensuring the success of such a transaction for all stakeholders and the group rests on comparable underlying considerations and issues.

PREPARE WITH DEDICATED EXPERTS AS EARLY AS POSSIBLE

Such a project brings many changes with it. Managers often do not set aside enough time to prepare and are then caught up in the process. Taking the time to think through and to carefully prepare for such a project will help avoid mistakes.

It is also important to seek specialist advice from external advisors, who will help in taking a step back to be able to objectively examine the project. Furthermore, they provide valuable expertise and experience with respect to capital that, by definition, managers do not have. They can raise questions or identify technical issues that managers cannot anticipate. It is important to make sure that all advisors will be able to work on the project as a team, led by the manager.

In this respect, a thorough preparation must not only take into account the business and financial aspects of a project, but also the legal and tax aspects. Addressing one aspect without the others may trigger negative repercussions. For instance, structuring the equity without taking into account thin-capitalisation rules may lead to the non-deductibility of interest charges, or a governance agreement may prove difficult to implement given the legal provisions specific to the form of company, or the timing of a project might need to be postponed in the event of wealth restructuring (for example, in France in the case of a "Dutreil agreement" followed by an *inter vivos* transfer).

CLEARY DEFINE THE OBJECTIVES AND THE STRUCTURE OF THE PROJECT

When establishing the business plan, managers need to clearly define the objectives that such a capital investment transaction must achieve, in particular with respect to the group's business development strategy, the project's timeframe and the growth strategy.

It is also important to evaluate correctly the amount of equity needed, given the development objectives and the size of the market. Underestimating the capital needs can significantly restrict the group's development or growth, however overestimating the needs may result in the group making bad decisions with respect to external growth. Similarly, it is crucial to properly assess the breakdown between equity, bank financing, mezzanine financing or private unitranche financing; this is a custom-made assessment depending on the company and its market.

Equally, entrepreneurs should not open up their equity to a financial investor on spurious grounds. It would be a mistake to aim at securing equity for that sake alone, without having an actual business development strategy nor clearly established managerial transition objectives.

In addition to setting business objectives, managers must ensure that these are consistent with their personal situation. Engaging in a development strategy with a financial partner requires much time and energy. Such a project will have an impact on family life and should therefore be discussed with one's spouse.

With clearly established objectives, managers will be able to not only identify the partners best suited to support them and the group, but also to align everyone's interests and skills as closely as possible.

IDENTIFY THE RIGHT FINANCIAL PARTNER

As a general principle, it is essential to fully understand the way financial investors think and operate, as well as their characteristics and objectives. Some investors prefer to go for a long-term investment strategy, even if this means a lower IRR. Others, for instance, are specialised in certain market sectors or in turn-around situations, while other investors have developed a strong network in specific regions of the world. Furthermore, the financial investment market has become more diverse over the past years: next to plain vanilla private equity funds or family offices, a number of new players have emerged, such as private debt funds, funds combining financial investors and experienced entrepreneurs, or SRI funds that target performance with a specific focus on environmental and socially responsible matters.

It is also essential to ensure that there is a cultural compatibility and « fit » between all stakeholders. There is no ideal partner, however certain teams will work together better than others. It is therefore useful to gain insight into the DNA of a potential financial partner (some teams are comprised of former entrepreneurs with a strong "operational" approach, others will delegate all powers and responsibilities to management, or will involve many consultants) and it is highly recommended not only to contact any referral provided by the financial investor, but to also get other feedback.

Finally, entrepreneurs who are used to running their business independently need to be made aware that a partner coming on board will not only bring new assets for the development of the group, but possibly also have specific requirements, and that the group's governance will need to be adjusted accordingly.

Private equity is not a necessity per se, but it may represent a great opportunity to fuel a manager's ambition for his or her group. This requires thorough preparation to both achieve the targeted objectives and meet their new partner's expectations.