

# DEALMAKER ESSENTIALS

Looking for VC backing for an MBO? Got debt providers breathing down your neck? Richard Young's been speaking to FDs and financiers about how best to handle the relationship with your backers – and what to do when things turn sour.

## WITH FRIENDS LIKE THESE...

**“THE FD IS A** key role for us – we'll speak to them second only to the CEO in investee companies,” says Kip Kapur, managing director of Barclays Ventures. Well it's nice to know you're wanted. And there's a good reason for that. As finance director, you have at your fingertips the only things that a financial backer is really interested in: the numbers.

If that seems a tad cynical coming from a journalist, let's hear what an FD has to say. We'll call him “Alan”. He's frank about the relationship with his VC backers. “I'm quite clear on what they're doing: they're running the rule over the financials,” he says. “I do sometimes wonder what they're adding to the business. But I suppose they're with you because you can't deliver all the money yourself – and to help facilitate an exit, I guess.”

Doesn't sound like the basis of a fond relationship, does it? But getting on well with your backers, at the very least on a business level, is essential once you've taken their money.

### Starting out

“It's essential for management and their funding providers to stay on good terms to ensure the continued growth of the business,” says Frank Atkinson, partner at accountancy firm, Alexander & Co. “Choose a VC or debt provider who understands the sector you operate in and has an enthusiasm for the size of your deal.”



Frank Atkinson: don't underestimate the value of presenting both plusses and minuses in your business plan.

One of the problems is that at the start of the relationship, you won't necessarily have a chance to pick and choose backers who you get on with. “We didn't actually have much to do with the choice of VC – our previous corporate parent made the decision,” says Alan. You might only have one backer interested in the business. Or your CEO or chairman might take the lead on finance selection, leaving you with a dodgy day-to-day relationship.

### Getting to know you

“When you've got their backing, you must give your financier a balanced and honest view on your business position,” says Atkinson. “Present both the plusses and minuses – any unflattering details that you keep back will undoubtedly resurface at some point to haunt you. That will break the trust you've worked hard to develop.”

But don't assume that putting in masses of effort to the business plan will be rewarded. “We spent a lot of time putting together our business plan,” says Alan. “But they only spent five minutes looking at it! Often they only want to know that you've got a strategy, rather than what it is. They're financial engineers. They leave you to do the strategy and the planning.”

Not surprisingly, private equity professionals put a different spin on this. “We tend not to look at investments in pure, clinical financial terms,” says Kapur. “We see the businesses we invest in as products of human endeavour. If you don't appreciate that fact, you're unlikely to be receptive to how the numbers have come about.”

Lesson? Have a detailed plan, get the strategy straight – but use it as a guide to generate the performance targets for consumption by your backers.

### Communication is the key

“We feel we've got a good relationship with an FD if they're happy to pick up the phone to us,” says Kapur. “We like to have confidence that they know the business and report on it accurately and in a timely fashion. But they also ought to have confidence that we're not going to shoot the messenger. It's got to be a case of working it out together and moving forward.”

It's not just VCs who appreciate being in the loop. “Keeping the bank as sweet as the VC is also really important,” says Alan. “So I don't wait for the bank to ask us questions – I call or email them on a regular basis with our monthly results, and also when there are unusual patterns in

**“IT'S ESSENTIAL TO STAY ON GOOD TERMS WITH YOUR FUNDERS TO ENSURE CONTINUED GROWTH”**

## VC RELATIONSHIP CHECKLIST

**Paul Hinder** worked his way up through the finance function at Cable & Wireless, then left to take up FD and non-exec roles at a number of companies, mostly in IT and telecoms. He's now a "company doctor" advising businesses on finance, strategy and fundraising. He's got plenty of first-hand experience of how the relationship between VC and FD works and offers the following tips to finance directors:

- **It's all about managing expectations.** The VC must have confidence in you as FD, and in the management team in general, to deliver on the numbers.
- **Always** do what you say you will do.
- **Never** say what you are going to do until you know how you are going to do it.
- **Know the hot buttons for the VC.** Hitting covenants – and accurately forecasting to hit them in the future – is one of them.
- **Be predictable.** Management information and board packs must be sent out like clockwork every month. Even a day late gets noticed and starts alarm bells ringing at the VC end.
- **Be accommodating.** Don't rearrange VC meetings but always oblige if the VC asks for them to be moved!
- **Agree what KPIs** the VC wants to see measured and make sure you are seen to use these, as well as your own metrics, in reporting performance.
- **Do a re-forecast every month.** But only change the forecast seen by the VC if there is a material movement. One way to keep the forecast stable but still communicate changing external factors is to have a "risks and opportunities against forecast" sheet in the information pack. Use this to explain all the possible movements, all in one place.
- **Don't give** more information than is needed; don't give less, either.
- **Minimise changes** to your reporting formats. The VC may want to see how things looked in the original format and to have the difference explained.
- **Explain variances.** And explain the impact on the full year, but also what business action is being taken in respect of the forecast variance.
- **NO SURPRISES.** Forecast material events before they actually happen, if possible. If something is introduced into the forecast first, it will be classed as less of an issue.

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our trading or cash flow. That proactivity gives them confidence and makes them feel involved in the business."

Lesson? Keep talking. Deliver the information you all agreed you'd deliver, on time. Otherwise the relationship may go sour even when the business is doing fine.

### Playing middleman

One of the dangers for you as FD is that you end up playing both sides off against each other. Since you're probably doing the day-to-day reporting of the numbers, you'll want to get clear, accurate information across to the VC. And as the most financially aware member of the management team, you're in a great position to communicate investor imperatives to them. But that can create tensions.

"We like to be clear with the management team as a whole what the role of the FD is and what information we need from them," says Kapur. "That's partly so we're all agreed on the right KPIs for the business. But we need to feel that the FD is 'authorised' to have conversations with us about them. We don't want to make FDs feel that the relationship with us is one of being a 'whistleblower' on performance."

It's a pain, but to some extent this is a question of playing politics. "We always ensure that whatever discussions we have as a board, we always put on a united face for the VCs," says Alan. "As an FD, you have to present the same messages to the VC as your CEO does, but in a finance context."

Former FD, now company doctor, Paul Hinder agrees that this role is crucial to smoothing the relationship. "Make sure you know your numbers *and* you know your business *and* its market inside out," he says. "You will then be one of the few

people that can translate a question about the business into numbers and vice versa."

What happens when you don't believe your CEO's outlook and/or they won't accept your view that you need to brief the backers? "I've been there," says Hinder. "As FD, you might have a feeling that events will prove you to be wrong and the CEO right. And in any case, by speaking up you are undermining the CEO. But if you're correct and didn't speak up – what then?" Hinder's options are fairly bleak.

You can shout from the roof-tops and have a public showdown. But who will the backers support? "If it's the CEO, you're history. If it's you, the normal scenario will be you get a new CEO and the new CEO will usually then want his own new FD."

You can shut up and the CEO is later proved wrong. "So the board and investors then say the FD should have said something sooner," says Hinder. "They lose confidence in you and want a new FD anyway."

Or you discreetly contact key influencers – directors, investors, advisers. "Try to inform them diplomatically of your concerns about the CEO's outlook – knowing you have just totally undermined the CEO.

"It's like an FD has a sign pinned on their back," Hinder concludes. "It reads, 'Messenger: willing to be shot.'" Kip Kapur, take note.

Lesson? Stay united as a management team. But as FD, you've got to translate both ways to keep the relationship sweet.

### When it goes wrong

No business plan survives the first set of interims. It might not just be poor forecasting – one of the big sins as far as VCs and banks are concerned. External factors can derail the best thought-out strategy, and that's going to test your relationship with the backers.

"We did go 'off plan'," says Alan. "We had been sign-posting the issue that arose: we told the VC that we could see hard times coming. Then when the situation became a bit clearer, we got some num-

**"WE WARNED THE VC HARD TIMES WERE AHEAD. BUT WHEN WE GOT NUMBERS ACROSS, THEY WENT ANAL"**

## “AS FD I HAVE TO MAKE THE RELATIONSHIP WORK; BUT THE VC HAS A CHOICE: THEY COULD REMOVE ME”

bers across to them – and they went completely anal about the whole situation.

“They started quoting the 18 month-old management plans at us,” he continues, “even though in the intervening time, pretty much everything had changed. That was the point at which it was clear that they did take the original plan seriously. Suddenly it all became a number-crunching exercise. And at that point, as FD, you have to prove that whatever else is happening, costs are not going out of control.”

As a VC, Kip Kapur is eager to put a positive spin on this “adaptation” process. “We had an investment that was facing severe market disruption,” he says. “Now, it’s doing something quite different to what it set out to do three years ago. Working through that process required more than just a good relationship with the FD. But they were instrumental in getting the management team to communicate the new strategy.”

And if you’re getting a hard time from the backer for deviating from plan? It’s not personal. “I’ve learned that the relationship between your manager at the VC and his internal overseers and investors is as important as your relationship with him,” says Alan. “Bear in mind, he’s probably signed off personally on the deal, so he needs to find justifications for any alterations to the

performance for his own managers.”

Lesson? Open communication channels are never more important than when things aren’t going to plan.

### The exit

“It’s really useful for us if the FD appreciates the VC world,” says Kapur. “Finance directors who are mindful of our objectives and who help us to manage the exit process will get on well with their backers.”

But then, few FDs are in any doubt about the importance of the exit from day one. Apart from anything else, if you’ve got an equity stake yourself, it’s your chance to cash in, too. “Mind you, they talked about it to me a lot more when we went off plan!” says Alan. “At that point, they did come out with a few odd comments that didn’t seem to tally with what the management team thought were viable exits. But in general, they don’t seem to hold much back on their exit thoughts.”

Lesson? Everything else in this relationship is foreplay ahead of a successful exit. Make it clear you understand that and the backers will appreciate you a lot more.

### Final word

Alan may be cynical about the relationship with his private equity backers. But he’s also realistic about what to expect



Kip Kapur: VCs don’t always shoot the messenger (although Paul Hinder disagrees)

from the relationship. He has to deliver predictability. “Personal chemistry is less important,” he says. “Trust and confidence are the essential parts of the relationship. If they have confidence in you as FD to begin with, it’s simply a question of building up that trust over time. So you have to remain honest and straight-talking throughout the relationship.”

Hinder agrees, but adds: “You need to adapt to the style of the person at the VC who is dealing with you to do this well. The odd lunch and glass of wine goes down well with some – whereas with others you’ll be lucky to be offered a biscuit.”

What about the other way around? How hard do the VCs work to win over an FD? “Do I trust the VCs?” Alan says. “Well, I trust them to deliver the best financial result for the business.

“But then, do I have any choice but to trust them? That’s what you really have to remember about the relationship with a VC. As an FD, you don’t have a choice but to make the relationship work; they do have a choice: they could remove me!”

Richard Young is editor of Real Finance

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## Viewpoint on ... The FD’s relationship with their backers

“The way to any investor’s heart is by delivering on your business plan and not springing any unwelcome surprises in the meantime. Private equity and debt providers back management and their business plans. Your business plan will therefore set your backers’ expectations – and it is important that, having set them, you meet them. Although many managers have built highly successful companies without ever needing



to produce a 75 page magnum opus – the reality is that without a detailed plan, it will not be possible to raise equity or debt finance to support a buy-out or growth capital fund-raising. A good business plan is always authored by management, ‘finessed’ by their corporate finance adviser, and should provide a bottom-up analysis of the business’s growth potential for the next three years.”

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