



## Private Equity

### Tapping Funding for Your Growing Business

By MILTON REEDER

*It feels like a catch 22: you need funds to grow your business, but banks won't lend the amount you need. For the business owner, and the banker whose hands are tied by strict debt:equity limits, the frustration is obvious. Yet the solution may be just around the corner: private equity.*

For successful companies facing financing challenges, private equity is a little understood, but highly effective, source of funds. Many who have heard of it wrongly assume it is only available for already-large firms. This misconception arises from the industry's history: private equity (PE) grew out of the leverage buyout firms that purchased and disemboweled major conglomerates in high profile deals during the 1980s. The assumption was that the individual businesses were worth more than the sum of them. Other people only know the venture capital part of the industry, which funds start up companies and received a lot of attention during the high tech boom. The reality is that neither picture is complete.

Today, Gordon Gecko and his "greed is good" mantra is long gone and the dot com boom has busted, yet the PE industry is alive and well. The complex industry gathers private and institutional money in funds with a range of objectives. They include buyout funds, hedge funds, venture funds, growth capital funds, and dedicated capital from wealthy individuals. Each private equity firm places its money in one or more funds to make investments in what are referred to as "portfolio companies." The part of the PE industry that this series will discuss, and my firm focuses on, is growth capital: funds that help companies grow to the next level.

Private equity firms provide equity funding in return for an ownership stake. They usually invest cash in exchange for convertible preferred shares in the portfolio company. While many firms focus on larger businesses seeking \$50 million or more in funding, there are a number of PE firms that work with growing businesses valued at \$5 to \$50 million and seeking as little as \$2 million in funding. The funding can take many forms ranging from common stock to convertible debt, but unlike traditional funding sources, the PE firm becomes actively involved in the companies it funds through board representation and active mentoring. Details of how to choose a PE firm and how deals are structured are discussed in other articles in this series.

#### About Accent Capital Partners

Accent Capital Partners specializes in growth equity for established small-cap and mid-cap companies (\$5 to \$50 million in value) involved in business services, light manufacturing, and real estate and finance.

We aim for long term relationships with our portfolio companies, so we invest in companies with top quality management that have a drive to succeed coupled with a vision of how to do so.

We are based in the Bay Area and can be reached to discuss your clients' private equity needs at 415.981.7200 or at [www.accentcapitalpartners.com](http://www.accentcapitalpartners.com).

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## Tapping Funding for Your Growing Business (con't)

The most critical question for a business owner or chief financial officer is: When should PE be considered? Many companies seek PE after hitting a brick wall with traditional debt financing and exhausting personal avenues. Waiting until this critical moment hurts the enterprise value and reduces your chance of raising the needed equity. Yet because PE firms offer more than funding—for example, they provide strategic input on your business plan and growth strategies, can help build the strength of your management team, and provide board expertise—they are best approached at times when you are considering substantial expansion plans or facing a critical juncture in the growth of your firm.

Many companies with the potential to be excellent fail due to a lack of capital. While CEOs may embrace the business school mantra that “Cash is King,” often they overlook their capital needs in the longer term. Some business owners fail to plan far enough ahead and raise the needed equity early enough to ensure a successful and smooth growth plan. It’s much more difficult and usually more expensive to wait until they really need the money to raise equity. Others struggle by “boot strapping” their growth: only reinvesting the cash flow generated from existing business. While they can feel better off since they don’t have to sell a piece of their company, in many cases, they limit or may even preclude the company from growing into important markets simply because they don’t have enough resources. You can avoid both of these traps by using private equity to handle your capital needs—without taxing your cash flow.

Private equity firms seek good companies that have the potential to be excellent, that is, companies with a strong management team and a successful product or service that is operating in a market that offers significant growth potential. More than anything, they look for a company that needs funding to leap to the next level. Assuming a company has significant growth opportunities, PE will fund a variety of transactions including: buying a competitor; buying out a partner and expanding management; expanding into new markets; or, taking a regional company national. The bottom line for the investor is that they seek risk-adjusted returns and are willing to invest the money and know-how to make it happen. The bottom line for a business owner is that PE allows you to implement well thought out growth plans.

A company that has not worked with a PE firm before will find the process very different than applying for a loan. Companies seeking PE need to refine their business plan to outline the planned growth and ensure all legal “i”s are dotted and financial “t”s are crossed *before* beginning the process. More importantly, the CEO needs to be prepared to cede some control—PE firms usually take a 40-65% stake—yet understand that he or she will retain day to day control and will likely end up wealthier than if the company grows using only its own resources and debt. Even Bill Gates ceded ownership control in return for growth potential.

The PE firm will propose a funding structure based on its valuation of the company. But more important than the numbers, the two parties need to ensure that the chemistry is right because the relationship is likely to last for years, if not the lifetime of the company. Both parties need to be sure that they can work together well, that they respect each other’s business vision, and that they can build the right team for the company’s next period of growth.

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## Tapping Funding for Your Growing Business (con't)

Private equity does not replace a company's banking relationship, it works with it. After an injection of equity capital, companies have even more avenues for growth as the extra equity lowers the debt:equity ratio and opens the doors for additional borrowing.

If you are the owner of a growing company, demystifying PE is well worth it: private equity can hold the key to taking your firm to the level that you can only dream of alone.