KEVIN GASKELL

HOW TO FUND YOUR DREAM

A BIT OF BACKGROUND

Having led Porsche from teetering on the edge of collapse to number one in the market and led BMW to four years of record growth, I was looking for a new challenge.

Out of the blue, George Soros, global investor, called and invited me to a meeting in the USA. He wanted to discuss the opportunity to launch the exciting online business called CarsDirect in Europe. I agreed to do it on the back of such an exciting opportunity and the easiest finance ever. He put $25 million into the bank and invited me to get on and build the company.

Too good to be true? Probably, because just a few months later a call came from the USA — “We’re pulling out of Europe, please send the $25 million back!”

It was a big shock, but by then I was convinced about the potential for the business and didn’t want to give up. So, together with the small team, we bought the company, the business plan and the laptops for £1 — but now we needed funds to build the technology and create the business.

We went to the City of London, confident that since both George Soros and CarsDirect USA were big names, had raised hundreds of millions, their reputation would help us raise finance.

I pitched our business to a major investment bank — at a really fancy breakfast – and, with my fingers crossed, asked for a £1 million investment. Everyone in the banking team suddenly had another meeting to go to. We had got our pitch wrong and we weren’t asking for enough money to even raise a smile!

In the end we raised £500K from family and friends, then built the company to be market leader. A few years later we sold it for £97 million!

The next chapter

Since then, I’ve focused on developing SMEs – they provide over 90% of the jobs in the UK and are a vital part of our economy. I have led teams which have built or revitalised 15 companies in data, telecommunications, manufacturing, landscape gardening, health and safety and cyber.

To do that, I've worked with eight different private equity houses as well as a number of banks and a host of angel investors. So, I've learned from my experiences along the way and now have a clear view on the process of funding a business.

Growing a business is never easy. There are many aspects to get right — leadership, strategy, finance, operations, products, sales and marketing. Understanding and supporting the financial structure of any business is a learning curve for anyone who hasn't done that before.

This document outlines some of the key aspects of what I've learned and I offer it to you so that you don't have to travel the same path, with the same potential pain and pitfalls, that I have. External funding can be an energiser and catalyst to the growth of a business as long as all parties understand the rules and share a common view of what success for the business will look like.

FIND THE RIGHT INVESTOR

There are two things to keep in mind when you're pursuing investment:

1. **Banking is a business — they expect to make a profit.**
2. **Balance sheets are not emotional — they should be factual.**

When you're financing your own business, you have an emotional investment — but most investors won't have the same level of passion. They're looking for something that will make them money, and **if they feel a kinship with the business, that's a bonus.** That means that, to find the right investor, you need to look at the market very carefully, present your proposition in the best possible way, but **always, always, stick to the facts.**

This where the challenge starts. There are many investors all seeking good businesses in which to invest. If your business is in good shape and you prepare properly, you will have a choice of investor — **choose carefully.** Look for an investor who will share your dream for the business.

Consider some key criteria:

- Seek an investor who is familiar with your sector.
- Find an investor prepared to understand your business.
- Match the investor to the required investment size:
    - Not too small that the investment is insignificant.
    - Nor too big to be suffocating with reporting demands.
    - Or an investor who will not panic if results dip one month.

CHOOSE THE CORRECT TYPE OF FUND

Different funds have different investment criteria — **make sure that you know what they are.** If you match the funding need to suitable investors, understand their investment criteria and present a good business plan you should be able to select a supportive and aligned investor. However, successful investment brings its own kind of problems. **Funding comes with expectations of performance and a need for reporting.**

Choose your funding with the future in mind:

- Is there room for growth capital to be raised if the rate of growth exceeds expectations?
- Does the fund expect consistent and even growth? What happens if they see uneven growth for any reason? Do they panic or take it in their stride?

HOW MUCH EQUITY AND CONTROL DO YOU RETAIN?

When you are considering raising capital remember — **the business is your baby until it isn't!**

If you are the founder, owner or majority shareholder, then make your decision.

- Invested capital will help you to grow, but it has a cost.
- The board may well decide something different to you.

Forget DUAL CLASS share structures and other such fancy schemes – the truth is that majority shareholder calls the shots.

UNDERSTAND THE MERITS OF DEBT VS EQUITY FINANCE

Each means of funding has different positives and negatives. Spend some time to make sure you are familiar with the terms and merits of senior and subordinated debt.

In particular, make sure you understand:

- The payback terms of any debt arrangement.
- Payment in Kind (PIK) notes and the consequences of using one.
- Mezzanine finance.
- How a leveraged finance deal actually works.

Get familiar with the terms and processes associated with each of these.

Make sure the bank covenants are appropriate and take the time to thoroughly understand them. **These are really important** and they can HURT you if you agree to something you haven't thought through properly.

APPOINT AN INDEPENDENT ADVISOR

Financing your business is, potentially, selling your business. Whether you think you are or you are not, you are actually relinquishing control, in part or whole. You can only sell the equity in your business once. **Make sure that you fully understand the implications of the decision you make.**

In order to be certain that you fully understand the deal, it's good sense to get the best advice that you can. Investment agreements are complex and, while you may only see one or two during your career, **advisors see one or two every month.**

Never be embarrassed to ask the dumb questions — you may live to regret it if you don't. That's why you've engaged an expert so ask them for their advice.

Allow your advisor to front up the negotiation — representing you as the owner/management. This depersonalises the situation and reduces the emotion in the transaction allowing the discussion to progress more smoothly.

UNDERSTAND THE EXIT PLAN OF THE INVESTOR

Be clear about how long they intend the investment to run. Some funds have a fixed timeline for their exit from an investment, while others are evergreen and will stay in place as long as you need them. Both have positives and negatives. You need to be aligned with your investor's strategy and timetable.

Get your advisor to go through these topics with you. **Make any decisions only when you feel that they can be made from a position of knowledge.**

KNOW YOUR OWN PLAN

Have a clear picture of what business success looks like to you. Without this you cannot determine what funding you need or the best form for the investment.

Do you need short-term finance or long-term finance?

Do you want your investor involved forever? Do you want to remain in the business? In the short-term, that may be a great idea, but many founders change their minds and extricating yourself down the line may be difficult and/or expensive.

Your investor is investing in more than just the business, they will expect your team to be part of the deal. That may mean new contracts with your key personnel for a lock in period.

What is your exit strategy?

I always say, **'start at the end and work back to here'.** You need to be clear about how you want the story to end. Are you intending to:

- Earn your way out following the investment?
- Buy the company back?
- Sell the business?
- Continue on a growth strategy with further funding rounds?
- How a leveraged finance deal actually works.

Be aware that smooth and happy earnouts are rare. Successful entrepreneurs are typically very determined individuals. Whatever is agreed in the deal, once the investor starts to make changes to the company, the founder will often find it difficult to continue to be enthusiastic and passionate in the business.

If you are intending, or even considering, leaving the business, you need to fully understand the leaver provisions which the investor will have included in the deal paperwork. These can be very punitive for an early exit.

EVEN IF YOU GET EVERYTHING RIGHT, THERE WILL STILL BE FRUSTRATIONS!

The value added through invested capital should be significant, but the approach to the negotiation will depend on which side of the fence you happen to be sitting. I have been on both sides and seen **deals compromised by a lack of understanding** by each party of the needs and ambitions of the other.

Fundamentally, all parties should be seeking to achieve the same objective — the development of a positive and successful business resulting in sustainable growth in shareholder value.

Some of the things that raise my blood pressure in negotiations are:

- Management by spreadsheet — **I call it heroic maths!** Just because the spreadsheet says it is so, does not mean that, in the real world, it is so. A reality check is required by both parties to ensure that the spreadsheet model, often built by an analyst not involved in the business operation, does not drive the business strategy.
- Reluctance to moving the discussion away from a **zero sum game.** One party should not have to lose for the other party to win. Investment should be approached as a partnership in the business. If both parties fully understand the business and what they can bring to it, then 2 + 2 can equal 7. The result being that both parties win.
- **The investment process takes too long** — 12 months is not so unusual and I have known exclusivity periods of 9 months or more. This is very distracting for the business management and becomes damaging to the business. To reduce the possibility of extended discussions, management must plan early, have a clean set of trustworthy numbers, be able to clearly explain their strategy and be careful about the investors they invite to negotiate.
- Investors install an **advisor, board member or chairperson who is not impartial.** The legal role of the board is to ensure the company's prosperity by collectively directing the company's affairs. This should be to the benefit of all shareholders and relevant stakeholders. Members of the board, and particularly the chairperson, should be selected by all parties during the funding negotiation.

To minimise risk

Unless the business has a **fabulous cash-generating commercial model,** the investment of external capital is a key element of developing a growing business. It should be a **positive step forward on the journey,** but like everything else, it needs to be understood and managed.

Some business leaders may wish to grow their business, but **prefer not to raise external capital** because it exposes their business to new investors and potentially new and different shareholders. In these cases, there are many alternative investment strategies which include:

- Stay small, grow on your own generated cash.
- Maintain control of the business, sell MINORITY stake.
- Find sympathetic investors – friends and family.

Even if you raise capital from 'supportive' investors, such as friends and family, make sure that all of the paperwork is completed as if the investor were an unknown party.

To protect the business and the investor, it is absolutely critical that the expectations of both parties are clearly understood and that the documentation reflects the legal standing of all signatories. Never risk disagreement about an investment compromising a friendship or damaging the business.

Final thoughts

Creating and building a business should be exciting and fun. Of course, it is hard work, but carefully planned investment will amplify your efforts and support the growth of a strong, sustainable and successful company.

If you are going to consider external investment, then make sure you **consider the following steps as a minimum:**

- Write down your vision of success for your business.
- Write down your reason for seeking external investment.
- Go to market early, avoid time pressure.
- Carefully consider what kind of investor you want to engage with.
- Take references on potential investors — speak to investee CEO/CFO's.
- Get good advice from independent specialist advisors.
- Never share advisors with the investor.
- Take time to understand the deal.
- MOST IMPORTANT: find the partner who shares your ambition.

There are fantastic investors out there and many bring more than money, giving advice, support, and introducing you to their network. You've just got to find them.