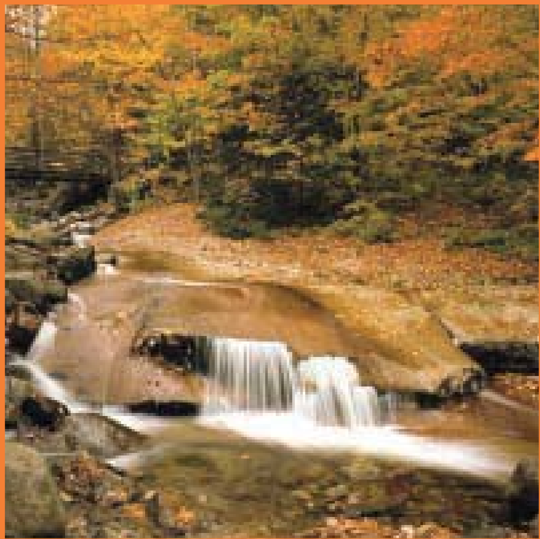
A Guide to Private Equity



BVCA *investing in enterprise*

21 years of investing in enterprise

PRICEWATERHOUSECOOPERS

BVCA mission statement

The BVCA represents private equity and venture capital in the UK and is devoted to promoting the private equity industry and improving the performance and professional standards of member firms and the individuals within those firms.

Private equity – investing in Britain's future

- Each year UK private equity firms provide several billions of pounds to form, develop and reshape around 1,600 ambitious UK companies with high growth prospects.
- Private equity makes managers into owners, giving them the freedom, focus and finance to enable them to revitalise their companies and take them onto their next phase of growth.
- Private equity is committed, long-term and risk sharing. It provides companies with personal experience and a stable financial base on which to make strategic decisions.
- UK private equity firms offer a wide range of sources, types and styles of private equity to meet many different needs.
- A great variety of businesses in different industry sectors benefit from private equity; from high to low technology and in different development stages, from start-up to large established companies.

Preface

The BVCA represents private equity in the UK. Its full members are private equity firms which provide equity funding to growing unquoted companies and account for over 95% of formal private equity investment in the UK. Associate members of the BVCA include firms that provide mezzanine finance, fund of fund managers, secondary purchasers, acquisition finance houses and direct investors into private equity funds, and also lawyers, accountants and other advisers experienced in the private equity field, as well as educational or research organisations closely associated with the private equity industry.

The BVCA is devoted to promoting the private equity industry. One of the ways the BVCA achieves this is by providing information to those seeking private equity. "A Guide to Private Equity" is a key component in the range of BVCA publications. For further details about other BVCA publications and research see the Appendix on pages 56-58 or the BVCA's website **www.bvca.co.uk**.

Keith Arundale, of PricewaterhouseCoopers LLP, when advising entrepreneurs on preparing business plans and finance raising, realised that they often viewed the process of how private equity firms appraise business proposals and arrive at their required equity stakes as a mystery. He therefore suggested that the BVCA should have a guide to private equity – so he was duly asked to write it! The first Guide was published in April 1992 and since then many tens of thousands of copies have been sent out or downloaded from the BVCA's website. This new edition has been updated by Keith and the section on the business plan further enlarged. I would like to thank Keith for initiating the Guide and for his continuing help over the years.

I would also like to thank the BVCA Executive and in particular Sarah Eaton for the production of another excellent Guide.

Anne Glover
BVCA Chairman
October 2004

Contents

Contents

An introduction to private equity

Definition

Private equity is medium to long-term finance provided in return for an equity stake in potentially high growth unquoted companies. Some commentators use the term "private equity" to refer only to the buy-out and buy-in investment sector. Others, in Europe but not the USA, use the term "venture capital" to cover all stages, i.e. synonymous with "private equity". In the USA "venture capital" refers only to investments in early stage and expanding companies. To avoid confusion, the term "private equity" is used throughout this Guide to describe the industry as a whole, encompassing both "venture capital" (the seed to expansion stages of investment) and management buy-outs and buy-ins.

How this Guide can help you

This Guide aims to encourage you to approach a source of private equity early in your search for finance. It explains how the private equity process works and what you need to do to improve your chances of raising it. It gives guidance on what should be included in your business plan, which is a vital tool in your search for funding. It also demonstrates the positive advantages that private equity will bring to your business.

The main sources of private equity in the UK are the private equity firms (who may invest at all stages – venture capital and buy-outs) and "business angels" (private individuals who provide smaller amounts of finance at an earlier stage than many private equity firms are able to invest). In this Guide we principally focus on private equity firms. The attributes that both private equity firms and business angels look for in potential investee companies are often very similar and so this Guide should help entrepreneurs and their advisers looking for private equity from both these sources. "Corporate venturers" which are industrial or service companies that provide funds and/or a partnering relationship to fledgling companies and may operate in the same industry sector as your business can also provide equity capital.

Throughout the 1990s the technology hype, internet boom and massive capital investment propelled the New Economy revolution, but internet mania in the late 1990s caused technology stocks to skyrocket until the bubble burst in March 2000. There was over-optimism, too much easy money, proven ways of doing business were replaced by irrational exuberance and private and public company market valuations were driven to unsustainable levels.

Post bubble, in the current economic environment, private equity firms are looking for investment opportunities where the business has proven potential for realistic growth in an expanding market, backed up by a well-researched and documented business plan and an experienced management team – ideally including individuals who have started and run a successful business before. There is currently no shortage of funds for investment in the UK. Excellent opportunities remain open to companies seeking private equity with convincing business proposals. This Guide will help you to understand what private equity firms are looking for in a potential business investment and how to approach them.

What is private equity?

Private equity provides long-term, committed share capital, to help unquoted companies grow and succeed. If you are looking to start up, expand, buy into a business, buy out a division of your parent company, turnaround or revitalise a company, private equity could help you to do this. Obtaining private equity is very different from raising debt or a loan from a lender, such as a bank. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of your success or failure. Private equity is invested in exchange for a stake in your company and, as shareholders, the investors' returns are dependent on the growth and profitability of your business.

Private equity in the UK originated in the late 18th century, when entrepreneurs found wealthy individuals to back their projects on an ad hoc basis. This informal method of financing became an industry in the late 1970s and early 1980s when a number of private equity firms were founded. Private equity is now a recognised asset class. There are over 170 active UK private equity firms, which provide several billion pounds each year to unquoted companies, around 80% of which are located in the UK.

Would my company be attractive to a private equity investor?

Many small companies are "life-style" businesses whose main purpose is to provide a good standard of living and job satisfaction for their owners. These businesses are not generally suitable for private equity investment, as they are unlikely to provide the potential financial returns to make them of interest to an external investor.

"Entrepreneurial" businesses can be distinguished from others by their aspirations and potential for growth, rather than by their current size. Such businesses are aiming to grow rapidly to a significant size. As a rule of thumb, unless a business can offer the prospect of significant turnover growth within five years, it is unlikely to be of interest to a private equity firm. Private equity investors are only interested in companies with high growth prospects, which are managed by experienced and ambitious teams who are capable of turning their business plan into reality. However, provided there is real growth potential the private equity industry is interested in all stages, from start-up to buy-out.

Some of the benefits of private equity

Private equity backed companies have been shown to grow faster than other types of companies. This is made possible by the provision of a combination of capital and experienced personal input from private equity executives, which sets it apart from other forms of finance. Private equity can help you achieve your ambitions for your company and provide a stable base for strategic decision making. The private equity firms will seek to increase a company's value to its owners, without taking day-to-day management control. Although you may have a smaller "slice of cake", within a few years your "slice" should be worth considerably more than the whole "cake" was to you before.

Private equity firms often work in conjunction with other providers of finance and may be able to help you to put a total funding package together for your business.

Questions to ask yourself before reading further...

- Does your company have high growth prospects and are you and your team ambitious to grow your company rapidly?
- Does your company have a product or service with a competitive edge or unique selling point (USP)?
- Do you and/or your management team have relevant industry sector experience? Do you have a clear team leader and a team with complementary areas of expertise, such as management, marketing, finance, etc?
- Are you willing to sell some of your company's shares to a private equity investor?

If your answers are "yes", private equity is worth considering. If "no", for other sources of capital and advice call your local Business Link (see Appendix).

Internal and external financial resources

Before looking at new external sources of finance, make sure you are making optimal use of your internal financial resources.

- Ensure that you have good cash flow forecasting systems in place
- Give customers incentives to encourage prompt payment
- Adhere to rigorous credit control procedures
- Plan payments to suppliers
- Maximise sales revenues
- Carefully control overheads
- Consider sub-contracting to reduce initial capital requirements (if appropriate)
- Assess inventory levels (if appropriate)
- Check quality control

Then think about the external options.

- Your own and your co-directors' funds

- Friends' or business associates' funds
- The clearing banks – overdrafts, short or medium-term loans
- Factoring and invoice discounting
- Leasing, hire purchase
- Merchant banks – medium to long-term larger loans
- Public sector grants, loans, regional assistance and advice
- Business angel finance
- Corporate venturing
- Private equity

But please don't get the impression that private equity is a last resort after you have exhausted your own, your friends', your business colleagues' and your bank's resources. There are many advantages to private equity over bank debt. Private equity firms can of course work in conjunction with the other external sources as part of an overall financing package.

Some of the alternative sources of external finance are elaborated on below for your information.

The **Small Firms Loan Guarantee Scheme** allows businesses without sufficient security for commercial bank lending to obtain loans from participating banks that are guaranteed by the Government. The Small Business Service (SBS) guarantees 75% of the loan. Borrowers pay a 2% premium on the outstanding balance. The maximum loan for businesses trading for more than two years is £250,000 or £100,000 for newer businesses.

The scheme is available to UK businesses with an annual turnover of up to £3 million – for manufacturers up to £5 million.

Business Links are part of the SBS and can provide advice on the various grants available to small businesses as well as practical advice, help and entry to the various schemes run by the Department of Trade and Industry (DTI). Grant opportunities include grants for research and development, Local Regional Development Agency grants and the Phoenix Fund for disadvantaged communities and groups. New businesses (particularly those using new technology) can get help with premises and management from the various Business Incubation Centres in the UK or from one of the UK Science Parks. You may also be eligible for EU grants if you are in an innovative business sector or are planning to operate in a deprived area of the UK or a region zoned for regeneration. Apart from Business Links your local Chamber of Commerce and town hall should have lists of grants and available property.

A new product **Selective Finance for Investment in England** has replaced the former Regional Selective Assistance Scheme and is provided by the Regional Development Agencies. Funding of up to 10-15% of a project's total eligible capital expenditure may be obtained.

The Regional Venture Capital Funds (RVCFs) are one element of the £180 million Enterprise Fund that was created in 1998 through the SBS to stimulate more finance for small businesses and address market weakness in the provision of that finance. The RVCFs were set up to address small to medium enterprises (SMEs) seeking small-scale investment (i.e. £500,000 and below). The funds cover the North East, North West, London, Yorkshire and the Humber, South East and South West, East Midlands, West Midlands and East of England.

The concept of **Enterprise Capital Funds** (ECFs) is a proposed new UK Government initiative following a consultation process instigated at the 2003 Budget. This aims to improve access to growth capital for small and medium-sized enterprises by applying a modified US Small Business Investment Company (SBIC) model to the UK by:

- Bringing more entrepreneurial investors into the management of funds aimed at smaller, early stage deals.
- Offering incentives to investors to make these investments.
- Enhancing the impact of business angel networks in providing sources of risk capital and expertise to SMEs.

ECFs will be privately managed and invest up to £2 million of equity into an enterprise. A pathfinder round of ECFs is to be launched, subject to European state aids clearance. ECFs will use a limited partnership model with two variants.

- A professional FSA-authorised fund manager who acts on behalf of passive investors.
- An active investor model (e.g. business angels) who invest and manage own funds through ECFs (maybe without authorisation).

Business angels are private investors who invest directly in private companies in return for an equity stake and perhaps a seat on the company's board. Research has shown that business angels generally invest smaller amounts of private equity in earlier stage companies compared with private equity firms. They typically invest less than £100,000 at the seed, start-up and early stage of company development. Many companies find business angels through informal contacts, but for others, finding a business angel may be more difficult, as the details of individual business angels are not always available.

The **Enterprise Investment Scheme** was set up by the Government to replace the Business Expansion Scheme (BES) and to encourage business angels to invest in certain types of smaller unquoted UK companies. If a company meets the EIS criteria, it may be more attractive to business angels, as tax incentives are available on their investments.

The aim of the UK Government's **University Challenge Seed Fund Scheme** is to fill a funding gap in the UK in the provision of finance for bringing university research initiatives in science and engineering to the point where their commercial viability can be demonstrated. Certain charities and the Government have contributed around £50 million to the scheme. These funds are divided into 15 University Challenge Seed Funds that have been donated to individual universities or consortia and each one of these has to provide 25% of the total fund from its own resources. If you are looking into the commercialisation of research at a UK university which is in receipt of a fund, contact your university administration to enquire about the application process. Follow-on finance may be provided by business angels, corporate venturers and private equity firms.

Corporate venturing which had developed quite rapidly in recent years still represents only a small fraction when compared to private equity investment activity. Direct corporate venturing occurs where a corporation takes a direct minority stake in an unquoted company. Indirect corporate venturing is where a corporation invests in private equity funds managed by an independent private equity firm. Corporate venturers raise their funds from their parent organisations and/or from external sources.

Do speak to friends, business contacts and advisers as well as your local Business Link. Do remember there are many misconceptions about the various sources of finance, so obtain as much information as possible to ensure that you can realistically assess the most suitable finance for your needs and your company's success.

Well-known private equity backed companies

Antler

Benjys

Ben Sherman

Earls Court & Olympia

Early Learning Centre

Filofax

First Leisure

Focus Wickes

Gala Group

Halfords

Kwik Fit

Linguaphone

Ministry of Sound

New Look

Pinewood – Shepperton Studios

The AA

The advantages of private equity over senior debt

A provider of debt (generally a bank) is rewarded by interest and capital repayment of the loan and it is usually secured either on business assets or your own personal assets, such as your home. As a last resort, if the company defaults on its repayments, the lender can put your business into receivership, which may lead to the liquidation of any assets. A bank may in extreme circumstances even bankrupt you, if you have given personal guarantees. Debt which is secured in this way and which has a higher priority for repayment than that of general unsecured creditors is referred to as "senior debt".

By contrast, private equity is not secured on any assets although part of the non-equity funding package provided by the private equity firm may seek some security. The private equity firm, therefore, often faces the risk of failure just like the other shareholders. The private equity firm is an equity business partner and is rewarded by the company's success, generally achieving its principle return through realising a capital gain through an "exit" which may include:

- Selling their shares back to the management
- Selling the shares to another investor (such as another private equity firm)
- A trade sale (the sale of company shares to another)
- The company achieving a stock market listing

Although private equity is generally provided as part of a financing package, to simplify comparison we compare private equity with senior debt.

Private equity compared to senior debt

Private equity	Senior debt
Medium to long-term	Short to long-term
Committed until "exit"	Not likely to be committed if the safety of the loan is threatened. Overdrafts are payable on demand; loan facilities can be payable on demand if the covenants are not met.
Provides a solid, flexible, capital base to meet your future growth and development plans.	A useful source of finance if the debt to equity ratio is conservatively balanced and the company has good cash flow.
Good for cash flow, as capital repayment, dividend and interest costs (if relevant) are tailored to the company's needs and to what it can afford.	Requires regular good cash flow to service interest and capital repayments.
The returns to the private equity investor depend on the business' growth and success. The more successful the company is, the better the returns all investors will receive.	Depends on the company continuing to service its interest costs and to maintain the value of the assets on which the debt is secured.
If the business fails, private equity investors will rank alongside other shareholders, after the banks and other lenders, and stand to lose their investment.	If the business fails, the lender generally has first call on the company's assets.
If the business runs into difficulties, the private equity firm will work hard to ensure that the company is turned around.	If the business appears likely to fail, the lender could put your business into receivership in order to safeguard its loan, and could make you personally bankrupt if personal guarantees have been given.
A true business partner, sharing in your risks and rewards, with practical advice and expertise (as required) to assist your business success.	Assistance available varies considerably.

Sources of private equity

There is a wide range of types and styles of private equity available in the UK. The primary sources are private equity firms who may provide finance at all investment stages and business angels who focus on the start-up and early stages. In targeting prospective sources of finance and business partners, as in any field, it works best if you know something about how they operate, their structure, and their preferences.

Private equity firms

Private equity firms usually look to retain their investment for between three and seven years or more. They have a range of investment preferences and/or type of financing required. It is important that you only approach those private equity firms whose preferences match your requirements. See how to find the right private equity firm to approach on page 15.

Where do private equity firms obtain the money to invest in my business?

Just as you and your management team are competing for finance, so are private equity firms, as they raise their funds from a number of different sources. To obtain their funds, private equity firms have to demonstrate a good track record and the prospect of producing returns greater than can be achieved through fixed interest or quoted equity investments. Most UK private equity firms raise their funds for investment from external sources, mainly institutional investors, such as pension funds and insurance companies, and are known as **independents**. Private equity firms that obtain their funds mainly from their parent organisation are known as **captives**. Increasingly, former captives now raise funds from external sources as well and are known as **semi-captives**. These different terms for private equity firms now overlap considerably and so are increasingly rarely used.

How may the source of a private equity firm's money affect me?

Private equity firms' investment preferences may be affected by the source of their funds. Many funds raised from external sources are structured as **limited partnerships** and usually have a fixed life of 10 years. Within this period the funds invest the money committed to them and by the end of the 10 years they will have had to return the investors' original money, plus any additional returns made. This generally requires the investments to be sold, or to be in the form of quoted shares, before the end of the fund. Some funds are structured as quoted **Venture and Development Capital Investment Trusts** (VCITs) and some types of unquoted funds may be able to offer companies a longer investment horizon.

Venture Capital Trusts (VCTs) are quoted vehicles that aim to encourage investment in smaller unlisted (unquoted and AIM quoted) UK companies by offering private investors tax incentives in return for a three-year investment commitment. The first were launched in Autumn 1995 and are mainly managed by UK private equity firms. If funds are obtained from a VCT, there may be some restrictions regarding the company's future development within the first few years.

So How do I select the right private equity firm?

Some private equity firms manage a range of funds (as described above) including investment trusts, limited partnerships and venture capital trusts, and the firms' investment preferences are listed in the BVCA **Directory** of members. A fully searchable version of the Directory is available free of charge to those seeking private equity investment on **www.bvca.co.uk**. It lists private equity firms, their investment preferences and contact details. It also lists financial organisations, such as mezzanine firms, fund of funds managers and professional advisers, such as accountants and lawyers, who are experienced in the private equity field. Your advisers may be able to introduce you to their private equity contacts and assist you in selecting the right private equity firm. If they do not have suitable contacts or cannot assist you in seeking private equity, obtain a copy of the Directory and refer to the professional advisers listed in the "Associate Members" section.

As far as a company looking to raise private equity is concerned, only those whose investment preferences match your requirements should be approached. Private equity firms appreciate it when they are obviously targeted after careful consideration.

You may find it interesting to obtain a copy of the BVCA's **Report on Investment Activity** which analyses the aggregate annual investment activity of the UK private equity industry. It looks at the number of companies backed and the amounts they received by stage, industry sector and region.

You should be mindful of the requirements of the **Financial Services and Markets Act** (FSMA) before you communicate a business plan to potential investors. See pages 51-55.

The next chapter will take you through the selection process in more detail.

Selecting a private equity firm

Targeting

The most effective way of raising private equity is to select just a few private equity firms to target with your business proposition.

The key considerations should be to assess:

1. The **stage** of your company's development or the **type** of private equity investment required.
2. The **industry** sector in which your business operates.
3. The **amount** of finance your company needs.
4. The **geographical location** of your business operations.

You should select only those private equity firms whose investment preferences match these attributes. The BVCA Directory of members specifies their investment preferences and contact details. It also includes the names of some of the companies in which they have invested.

1. Stage/type of investment

The terms that most private equity firms use to define the stage of a company's development are determined by the purpose for which the financing is required.

Seed

To allow a business concept to be developed, perhaps involving the production of a business plan, prototypes and additional research, prior to bringing a product to market and commencing large-scale manufacturing.

Only a few seed financings are undertaken each year by private equity firms. Many seed financings are too small and require too much hands-on support from the private equity firm to make them economically viable as investments. There are, however, some specialist private equity firms which are worth approaching, subject to the company meeting their other investment preferences. Business angel capital should also be considered, as with a business angel on a company's board, it may be more attractive to private equity firms when later stage funds are required.

Start-up

To develop the company's products and fund their initial marketing. Companies may be in the process of being set up or may have been trading for a short time, but not have sold their product commercially.

Although many start-ups are typically smaller companies, there is an increasing number of multi-million pound start-ups. Around half of BVCA members will consider high quality and generally larger start-up propositions. However, there are those who specialise in this stage, subject to the company seeking investment meeting the firm's other investment preferences. Around 15% of companies receiving private equity each year are start-ups.

Other early stage

To initiate commercial manufacturing and sales in companies that have completed the product development stage, but may not yet be generating profits.

This is a stage that has been attracting an increasing amount of private equity over the past few years, accounting for around 20% of the number of financings each year by BVCA members.

Expansion

To grow and expand an established company. For example, to finance increased production capacity, product development, marketing and to provide additional working capital. Also known as "development" or "growth" capital.

More UK companies at this stage of development receive private equity than any other, generally accounting for around 50% of financings each year by BVCA members.

Management buy-out (MBO)

To enable the current operating management and investors to acquire or to purchase a significant shareholding in the product line or business they manage.

MBOs range from the acquisition of relatively small formerly family owned businesses to £100 million plus buy-outs. The amounts concerned tend to be larger than other types of financing, as they involve the acquisition of an entire business. They tend to account for around 15% of financings undertaken each year by BVCA member companies.

Management buy-in (MBI)

To enable a manager or group of managers from outside a company to buy into it.

Buy-in management buy-out (BIMBO)

To enable a company's management to acquire the business they manage with the assistance of some incoming management.

Institutional buy-out (IBO)

To enable a private equity firm to acquire a company, following which the incumbent and/or incoming management will be given or acquire a stake in the business.

This is a relatively new term and is an increasingly used method of buy-out. It is a method often preferred by vendors, as it reduces the number of parties with whom they have to negotiate.

Selecting a private equity firm continued

Secondary purchase
When a private equity firm acquires existing shares in a company from another private equity firm or from another shareholder or shareholders.

Replacement equity
To allow existing non-private equity investors to buy back or redeem part, or all, of another investor's shareholding.

Rescue/turnaround
To finance a company in difficulties or to rescue it from receivership.

Refinancing bank debt
To reduce a company's level of gearing.

Bridge financing
Short-term private equity funding provided to a company generally planning to float within a year.

2. Industry sector

Most private equity firms will consider investing in a range of industry sectors – if your requirements meet their other investment preferences. Some firms specialise in specific industry sectors, such as biotechnology, computer related and other technology areas. Others may actively avoid sectors such as property or film production.

3. Amount of investment

Around 80% of UK private equity firms' financings each year are for amounts of over £100,000 per company. There are, however, a number of private equity firms who will consider investing amounts of private equity under £100,000 and these tend to include specialist and regionally orientated firms. Companies initially seeking smaller amounts of private equity are more attractive to private equity firms if there is an opportunity for further rounds of private equity investment later on.

The process for investment is similar, whether the amount of capital required is £100,000 or £10 million, in terms of the amount of time and effort private equity firms have to spend in appraising the business proposal prior to investment. This makes the medium to larger-sized investments more attractive for private equity investment, as the total size of the return (rather than the percentage) is likely to be greater than for smaller investments, and should more easily cover the initial appraisal costs.

Business angels are perhaps the largest source of smaller amounts of equity finance, often investing amounts ranging between £10,000 and £100,000 in early stage and smaller expanding companies.

4. Geographical location

Several private equity firms have offices in the UK regions. Some regions are better served with more local private equity firms than others, but there are also many firms, particularly in London, who look to invest UK-wide. Over 20% of total investment is outside the UK and several private equity firms have offices located abroad.

The business plan

A business plan's main purpose when raising finance is to market your business proposal. It should show potential investors that if they invest in your business, you and your team will give them a unique opportunity to participate in making an excellent return.

A business plan should be considered an essential document for owners and management to formally assess market needs and the competition; review the business' strengths and weaknesses; and to identify its critical success factors and what must be done to achieve profitable growth. It can be used to consider and reorganise internal financing and to agree and set targets for you and your management team. It should be reviewed regularly.

The company's management should prepare the business plan. Its production frequently takes far longer than the management expects. The owner or the managing director of the business should be the one who takes responsibility for its production, but it should be "owned" and accepted by the management team as a whole and be seen to set challenging but achievable goals that they are committed to meeting. It should emphasise why you are convinced that the business will be successful and convey what is so unique about it. Private equity investors will want to learn what you and your management are planning to do, not see how well others can write for you.

Professional advisers can provide a vital role in critically reviewing the draft plan, acting as "devil's advocate" and helping to give the plan the appropriate focus. Several of the larger accounting firms publish their own detailed booklets on how to prepare business plans. However, it is you who must write the plan as private equity firms generally prefer management driven plans, such as are illustrated in this chapter.

Essential areas to cover in your business plan

Many businesses fail because their plans have not been properly thought out, written down and developed. A business plan should be prepared to a high standard and be verifiable. A business plan covering the following areas should be prepared before a private equity firm is approached.

Executive Summary

This is the most important section and is often best written last. It summarises your business plan and is placed at the front of the document. It is vital to give this summary significant thought and time, as it may well determine the amount of consideration the private equity investor will give to your detailed proposal. It should be clearly written and powerfully persuasive, yet balance "sales talk" with realism in order to be convincing.

It needs to be convincing in conveying your company's growth and profit potential and management's prior relevant experience. It needs to clearly encapsulate your company's USP (i.e. its unique selling point – why people should buy your product or service as distinct from your competitors).

The summary should be limited to no more than two to three pages (i.e. around 1,000 to 1,500 words) and include the key elements from all the points below:

1. The market
2. The product or service
3. The management team
4. Business operations
5. Financial projections
6. Amount and use of finance required and exit opportunities

Other aspects that should be included in the Executive Summary are your company's "mission statement" – a few sentences encapsulating what the business does for what type of clients, the management's aims for the company and what gives it its competitive edge. The mission statement should combine the current situation with your aspirations. For an example, see the BVCA's own mission statement on the inside front cover. You should also explain the current legal status of your business in this section. You should include an overall "SWOT" (strengths, weaknesses, opportunities and threats) analysis that summarises the key strengths of your proposition and its weaknesses and the opportunities for your business in the marketplace and its competitive threats.

1. The market

You need to convince the private equity firm that there is a real commercial opportunity for the business and its products and services. This requires a careful analysis of the market potential for your products or services and how you plan to develop and penetrate the market.

Market analysis

This section of the business plan will be scrutinised carefully; market analysis should therefore be as specific as possible, focusing on believable, verifiable data. Include under market research a thorough analysis of your company's industry and potential customers. Include data on the size of the market, growth rates, recent technical advances, Government regulations and trends – is the market as a whole developing, growing, mature, or declining? Include details on the number of potential customers, the purchase rate per customer, and a profile of the typical decision-maker who will decide whether to purchase your product or service. This information drives the sales forecast and pricing strategy in your plan. Finally, comment on the percentage of the target market your company plans to capture, with justification in the marketing section of the plan.

Marketing plan
The primary purpose of the marketing section of the business plan is for you to convince the private equity firm that the market can be developed and penetrated. The sales projections that you make will drive the rest of the business plan by estimating the rate of growth of operations and the financing required. Explain your plans for the development of the business and how you are going to achieve those goals. Avoid using generalised extrapolations from overall market statistics.

The plan should include an outline of plans for pricing, distribution channels and promotion.

- *Pricing*
  How you plan to price a product or service provides an investor with insight for evaluating your overall strategy. Explain the key components of the pricing decision – i.e. image, competitive issues, gross margins, and the discount structure for each distribution channel. Pricing strategy should also involve consideration of future product releases.

- *Distribution channels*
  If you are a manufacturer, your business plan should clearly identify the distribution channels that will get the product to the end-user. If you are a service provider, the distribution channels are not as important as are the means of promotion. Distribution options for a manufacturer may include:
  - Distributors
  - Wholesalers
  - Retailers (including on-line)
  - Direct sales – such as mail order and ordering over the web, direct contact through salespeople and telemarketing.
  - Original Equipment Manufacturers (OEM), integration of the product into other manufacturers' products.

  Each of these methods has its own advantages, disadvantages and financial impact, and these should be clarified in the business plan. For example, assume your company decides to use direct sales because of the expertise required in selling the product. A direct salesforce increases control, but it requires a significant investment. An investor will look to your expertise as a salesperson, or to the plans to hire, train and compensate an expert salesforce. If more than one distribution channel is used, they should all be compatible. For example, using both direct sales and wholesalers can create channel conflict if not managed well.

Fully explain the reasons for selecting these distribution approaches and the financial benefits they will provide. The explanation should include a schedule of projected prices, with appropriate discounts and commissions as part of the projected sales estimates. These estimates of profit margin and pricing policy will provide support for the investment decision.

- *Promotion*
  The marketing promotion section of the business plan should include plans for product sheets, potential advertising plans, internet strategy, trade show schedules, and any other promotional materials. The private equity firm must be convinced that the company has the expertise to move the product to market. A well-thought-out promotional approach will help to set your business plan apart from your competitors.

  It is important to explain the thought process behind the selected sources of promotion and the reasons for those not selected.

Competition
A discussion of the competition is an essential part of the business plan. Every product or service has competition; even if your company is first-to-market, you must explain how the market's need is currently being met and how the new product will compete against the existing solution. The investor will be looking to see how and why your company can beat the competition. The business plan should analyse the competition (who are they, how many are there, what proportion of the market do they account for?). Give their strengths and weaknesses relative to your product.

Attempt to anticipate likely competitive responses to your product. Include, if possible, a direct product comparison based on price, quality, warranties, product updates, features, distribution strategies, and other means of comparison. Document the sources used in this analysis.

All the aspects included in the market section of your business plan must be rigorously supported by as much verifiable evidence as possible. In addition to carrying out market research and discussions with your management team, customers and potential customers, you may need input from outside marketing consultants.

2. The product or service

Explain the company's product or service in plain English. If the product or service is technically orientated this is essential, as it has to be readily understood by non-specialists.

Emphasise the product or service's competitive edge or USP. For example, is it:

- A new product?
- Available at a lower price?
- Of higher quality?
- Of greater durability?
- Faster to operate?
- Smaller in size?
- Easier to maintain?
- Offering additional support products or services?

With technology companies where the product or service is new, there has to be a clear "world class" opportunity to balance the higher risks involved. Address whether it is vulnerable to technological advances made elsewhere.

- If relevant, explain what legal protection you have on the product, such as patents attained, pending or required. Assess the impact of legal protection on the marketability of the product.
- You also need to cover of course the price and cost of the product or service.
- If the product is still under development the plan should list all the major achievements to date as well as remaining milestones to demonstrate how you have tackled various hurdles and that you are aware of remaining hurdles and how to surmount them. Specific mention should be made of the results of alpha (internal) and beta (external) product testing.
- Single product companies can be a concern for investors. It is beneficial to include ideas and plans for a "second generation" product or even other viable products or services to demonstrate the opportunities for business growth.

3. The management team

Private equity firms invest in people – people who have run or who are likely to run successful operations. Potential investors will look closely at you and the members of your management team. This section of the plan should introduce the management team and what you all bring to the business. Include your experience, and success, in running businesses before and how you have learned from not so successful businesses. You need to demonstrate that the company has the quality of management to be able to turn the business plan into reality.

The senior management team ideally should be experienced in complementary areas, such as management strategy, finance and marketing and their roles should be specified. The special abilities each member brings to the venture should be explained. This is particularly the case with technology companies where it will be the combination of technological and business skills that will be important to the backers. If some members have particular flair and dynamism, this needs to be balanced by those who can ensure this occurs in a controlled environment.

A concise curriculum vitae should be included for each team member, highlighting their previous track records in running, or being involved with successful businesses.

- Identify the current and potential skills' gaps and explain how you aim to fill them. Private equity firms will sometimes assist in locating experienced managers where an important post is unfilled – provided they are convinced about the other aspects of your plan.
- Explain what controls and performance measures exist for management, employees and others.
- List your auditors and other advisers.
- The appointment of a non-executive director (NED) should be seriously considered. Many surveys have shown that good NEDs add significant value to the companies with which they are involved. Many private equity firms at the time of their investment will wish to appoint one of their own executives or an independent expert to your board as an NED. Most private equity executives have previously worked in industry or in finance and all will have a wide experience of companies going through a rapid period of growth and development.

The BVCA's annual survey of the Economic Impact of Private Equity reveals that generally over three-quarters of the private equity backed companies feel that the private equity firms make a major contribution other than the provision of money. Contributions cited by private equity backed companies include private equity firms being used to provide financial advice, guidance on strategic matters, for management recruitment purposes as well as for their contacts and market information.

4. Business operations

This section of the business plan should explain how your business operates, including how you make the products or provide the service. It should also outline your company's approach to research and development.

Include details on the location and size of your facilities. Factors such as the availability of labour, accessibility of materials, proximity to distribution channels, and the availability of Government grants and tax incentives should be mentioned. Describe the equipment used or planned. If more equipment is required in response to production demands, include plans for financing. If your company needs international distribution, mention whether the operations facility will provide adequate support. If work will be outsourced to subcontractors – eliminating the need to expand facilities – state that too. The investor will be looking to see if there are inconsistencies in your business plan.

If a prototype has not been developed or there is other uncertainty concerning production, include a budget and timetable for product development. The private equity firm will be looking to see how flexible and efficient the facility plans are.

The private equity firm will also ask such questions as:

- If sales projections predict a growth rate of 25% per year, for example, does the current site allow for expansion?
- Are there suppliers who can provide the materials required?
- Is there an educated work force in the area?

These and any other operational factors that might be important to the investor should be included.

5. Financial projections

Developing a detailed set of financial projections will help to demonstrate to the investor that you have properly thought out the financial implications of your company's growth plans. Private equity firms will use these projections to determine if:

- Your company offers enough growth potential to deliver the type of return on investment that the investor is seeking.
- The projections are realistic enough to give the company a reasonable chance of attaining them.

Investors will expect to see a full set of cohesive financial statements – including a balance sheet, income statement and cash-flow statement, for a period of three to five years. It is usual to show monthly income and cash flow statements until the breakeven point is reached followed by yearly data for the remaining time frame. Ensure that these are easy to update and adjust. Do include notes that explain the major assumptions used to develop the revenue and expense items and explain the research you have undertaken to support these assumptions.

Preparation of the projections

- Realistically assess sales, costs (both fixed and variable), cash flow and working capital. Assess your present and prospective future margins in detail, bearing in mind the potential impact of competition.
- Assess the value attributed to the company's net tangible assets.
- State the level of gearing (i.e. debt to shareholders' funds ratio). State how much debt is secured on what assets and the current value of those assets.
- Include all costs associated with the business. Remember to split sales costs (e.g. communications to potential and current customers) and marketing costs (e.g. research into potential sales areas). What are the sale prices or fee charging structures?
- Provide budgets for each area of your company's activities. What are you doing to ensure that you and your management keep within these or improve on these budgets?
- Present different scenarios for the financial projections of sales, costs and cash flow for both the short and long term. Ask "what if?" questions to ensure that key factors and their impact on the financings required are carefully and realistically assessed. For example, what if sales decline by 20%, or supplier costs increase by 30%, or both? How does this impact on the profit and cash flow projections?
- If it is envisioned that more than one round of financing will be required (often the case with technology-based businesses in particular), identify the likely timing and any associated progress "milestones" which need to be achieved.
- Keep the plan feasible. Avoid being over optimistic. Highlight challenges and show how they will be met.

You might wish to consider using an external accountant to review the financial projections and act as "devil's advocate" for this part of the plan.

6. Amount and use of finance required and exit opportunities

State how much finance is required by your business and from what sources (i.e. management, private equity firm, banks and others) and explain for what it will be used:

- Include an implementation schedule, including capital expenditure, orders and production timetables, for example.

- Consider how the private equity investors will make a return, i.e. realise their investment (see page 49). This may only need outlining if you are considering floating your company on a stock exchange within the next few years. However, it is important that the options are considered and discussed with your investors.

The presentation of your business plan

Bear the following points in mind when you are writing your business plan.

- *Readability*
  Make the plan readable. Avoid jargon and general position statements. Use plain English – especially if you are explaining technical details. Aim it at non-specialists, emphasising its financial viability. Avoid including unnecessary detail and prevent the plan from becoming too lengthy. Put detail into appendices. Ask someone outside the company to check it for clarity and "readability". Remember that the readers targeted will be potential investors. They will need to be convinced of the company's commercial viability and competitive edge and will be particularly looking to see the potential for making a good return.

- *Length*
  The length of your business plan depends on individual circumstances. It should be long enough to cover the subject adequately and short enough to maintain interest. For a multi-million pound technology company with sophisticated research and manufacturing elements, the business plan could be well over 50 pages including appendices. By contrast, a proposal for £200,000 to develop an existing product may be too long at 10 pages. It is probably best to err on the side of brevity – for if investors are interested they can always call you to ask for additional information. Unless your business requires several million pounds of private equity and is highly complex, we would recommend the business plan should be no longer than 15 pages.

- *Appearance*
  Use graphs and charts to illustrate and simplify complicated information. Use titles and sub-titles to divide different subject matters. Ensure it is neatly typed or printed without spelling, typing or grammar mistakes – these have a disproportionately negative impact. Yet avoid very expensive documentation, as this might suggest unnecessary waste and extravagance.

Things to avoid!

On a lighter note, the following signs of extravagance and non-productive company expenditure are likely to discourage a private equity firm from investing and so are best avoided.

Things to avoid
Flashy, expensive cars
Company yacht/plane
Personalised number plate
Carpets woven with the company logo
Company flag pole
Fountain in the forecourt
"International" in your name (unless you are!)
Fish tank in the board room
Founder's statue in reception

The investment process

The investment process, from reviewing the business plan to actually investing in a proposition, can take a private equity firm anything from one month to one year but typically it takes between three and six months. There are always exceptions to the rule and deals can be done in extremely short time frames. Much depends on the quality of information provided and made available to the private equity firm.

Reaching your audience

When you have fully prepared the business plan and received input from your professional adviser, the next step is to arrange for it to be reviewed by a few private equity firms. You should select only those private equity firms whose investment preferences match the investment stage, industry, location of, and amount of equity financing required by your business proposition. For the initial approach, it is worth considering sending only a copy of the Executive Summary to potential investors. This has the advantage of saving costs and increasing the chances of receiving attention. Before communicating your plan to potential investors, read pages 51-55 concerning the FSMA requirements.

Confidentiality

All private equity firms who are members of the BVCA are bound by the BVCA's "Code of Conduct" which states that they will respect confidential information supplied to them by companies looking for private equity capital (or indeed in which they have invested). There are safeguards you can take, however, if you are particularly concerned about confidentiality. These include:

- Seeking professional advice
- Checking whether the potential investor has any major conflicts of interest, such as a significant investment in a competitor
- Leaving out the more confidential data
- Sending only your Executive Summary
- Using the BVCA's standard **confidentiality letter**

If you wish to use a confidentiality letter, an example of one can be obtained from the BVCA's website. The general terms of this letter have been agreed by BVCA members and with your lawyer's advice you can adapt it to meet your own requirements. You can then ask the private equity investor to sign it, before being sent the full business plan. We would recommend, however, that you only ask for a confidentiality letter when the potential investor has received your Executive Summary and has shown an interest in giving your proposal detailed consideration.

How quickly should I receive a response?

Generally you should receive an initial indication from the private equity firms that receive your business plan within a week or so. This will either be a prompt "no", a request for further information, or a request for a meeting. If you receive a "no", try to find out the reasons as you may have to consider incorporating revisions into your business plan, changing/strengthening the management team or carrying out further market research before approaching other potential investors.

How do private equity firms evaluate a business plan?

They will consider several principal aspects:

- Is the product or service commercially viable?
- Does the company have potential for sustained growth?
- Does management have the ability to exploit this potential and control the company through the growth phases?
- Does the possible reward justify the risk?
- Does the potential financial return on the investment meet their investment criteria?

Presenting your business plan and negotiations

If a private equity firm is interested in proceeding further, you will need to ensure that the key members of the management team are able to present the business plan convincingly and demonstrate a thorough knowledge and understanding of all aspects of the business, its market, operation and prospects.

Assuming a satisfactory outcome of the meeting and further enquiries, the private equity firm will commence discussions regarding the terms of the deal with you. The first step will be to establish the value of your business.

Valuing the business

There is no right or wrong way of valuing a business. There are several ways in which it can be done.

Calculate the value of the company in comparison with the values of similar companies quoted on the stock market.

The key to this calculation is to establish an appropriate price/earnings (P/E) ratio for your company. The P/E ratio is the multiple of profits after tax attributed to a company to establish its capital value. P/E ratios for quoted companies are listed in the back pages of the Financial Times, and are calculated by dividing the current share price by historic post-tax earnings per share. Quoted companies' P/E ratios will vary according to industry sector (its popularity and prospects), company size, investors' sentiments towards it, its management and its prospects, and can also be affected by the timing of year-end results announcements.

The investment process continued

The private equity investment process

STAGE	ENTREPRENEUR	ENTREPRENEUR AND PRIVATE EQUITY FIRM	PRIVATE EQUITY FIRM	REPORTS
Approaching the private equity firm/ evaluating the business plan	• Appoint advisers • Prepare business plan • Contact private equity firms		• Review business plan	BUSINESS PLAN
Initial enquiries and negotiation	• Provide additional information	• Meet to discuss business plan • Build relationship • Negotiate outline terms	• Conduct initial enquiries • Value the business • Consider financing structure	OFFER LETTER
Due diligence		• Liaise with accountants • Liaise with other external consultants	• Initiate external due diligence	CONSULTANTS' REPORTS ACCOUNTANTS' REPORTS
Final negotiation and completion	• Disclose all relevant business information	• Negotiate final terms • Document constitution and voting rights	• Draw up completion documentation	DISCLOSURE LETTER WARRANTIES AND INDEMNITIES MEMORANDUM AND ARTICLES OF ASSOCIATION SHAREHOLDERS AGREEMENT
Monitoring EXIT	• Provide periodic management accounts • Communicate regularly with investor/s		• Seat on Board? • Monitor investment • Constructive input • Involvement in major decisions	MANAGEMENT ACCOUNTS MINUTES OF BOARD AND OTHER KEY MEETINGS

An unquoted company's P/E ratio will tend to be lower than a quoted company's due to the following reasons.

- Its shares are less marketable and shares cannot be bought and sold at will.
- It often has a higher risk profile, as there may be less diversification of products and services and a narrower geographical spread.
- It generally has a shorter track record and a less experienced management team.
- The cost of making and monitoring a private equity investment is much higher.

The following are factors that may raise an unquoted company's P/E ratio compared with a quoted company.

- Substantially higher than normal projected turnover and profits growth.
- Inclusion in a fashionable sector, or ownership of unique intellectual property rights (IPR).
- Competition among private equity firms.

Calculate a value for your company that will give the private equity firms their required rate of return over the period they anticipate being shareholders.

Private equity firms usually think in terms of a target overall return from their investments. Generally "return" refers to the annual internal rate of return (IRR), and is calculated over the life of the investment. The overall return takes into account capital redemptions, possible capital gains (through a total "exit" or sale of shares), and income through fees and dividends. The returns required will depend on the perceived risk of the investment – the higher the risk, the higher the return that will be sought – and it will vary considerably according to the sector and stage of the business. As a rough guide, the average return required will exceed 20% per annum.

The required IRR will depend on the following factors.

- The risk associated with the business proposal.
- The length of time the private equity firm's money will be tied up in the investment.
- How easily the private equity firm expects to realise its investment – i.e. through a trade sale, public flotation, etc.
- How many other private equity firms are interested in the deal (i.e. the competition involved).

Other methods
Private equity firms also use other ways of valuing businesses, such as those based on existing net assets or their realisable value.

Personal financial commitment

You and your team must have already invested, or be prepared to invest, some of your own capital in your company to demonstrate a personal financial commitment to the venture. After all, why should a private equity firm risk its money, and its investors', if you are not prepared to risk your own! The proportion of money you and your team should invest depends on what is seen to be "material" to you, which is very subjective. This could mean re-mortgaging your house, for example.

Types of financing structure

If you use advisers experienced in the private equity field, they will help you to negotiate the terms of the equity deal. You must be prepared to give up a realistic portion of the equity in your business if you want to secure the financing. Whatever percentage of the shares you sell, the day-to-day operations will remain the responsibility of you and your management team. The level of a private equity firm's involvement with your company depends on the general style of the firm and on what you have agreed with them.

There are various ways in which the deal can be financed and these are open to negotiation. The private equity firm will put forward a proposed structure for consideration by you and your advisers that will be tailored to meet the company's needs. The private equity firm may also offer to provide more finance than just pure equity capital, such as debt or mezzanine finance. In any case, should additional capital be required, with private equity on board other forms of finance are often easier to raise. The structure proposed may include a package of some or all of the following elements.

Classes of capital used by private equity firms

The main classes of share and loan capital used to finance UK limited liability companies are shown below.

Share capital
The structure of share capital that will be developed involves the establishment of certain rights. The private equity firm through these rights will try to balance the risks they are taking with the rewards they are seeking. They will also be aiming to put together a package that best suits your company for future growth. These structures require the assistance of an experienced qualified legal adviser.

Ordinary shares

These are equity shares that are entitled to all income and capital after the rights of all other classes of capital and creditors have been satisfied. Ordinary shares have votes. In a private equity deal these are the shares typically held by the management and family shareholders rather than the private equity firm.

Preferred ordinary shares

These may also be known as "A" ordinary shares, cumulative convertible participating preferred ordinary shares or cumulative preferred ordinary shares. These are equity shares with preferred rights. Typically they will rank ahead of the ordinary shares for both income and capital. Once the preferred ordinary share capital has been repaid and then the ordinary share capital has been repaid, the two classes would then rank pari passu in sharing any surplus capital. Their income rights may be defined; they may be entitled to a fixed dividend (a percentage linked to the subscription price, e.g. 8% fixed) and/or they may have a right to a defined share of the company's profits – known as a participating dividend (e.g. 5% of profits before tax). Preferred ordinary shares have votes.

Preference shares

These are non-equity shares. They rank ahead of all classes of ordinary shares for both income and capital. Their income rights are defined and they are usually entitled to a fixed dividend (e.g. 10% fixed). The shares may be redeemable on fixed dates or they may be irredeemable. Sometimes they may be redeemable at a fixed premium (e.g. at 120% of cost). They may be convertible into a class of ordinary shares.

Loan capital

Loan capital ranks ahead of share capital for both income and capital. Loans typically are entitled to interest and are usually, though not necessarily, repayable. Loans may be secured on the company's assets or may be unsecured. A secured loan will rank ahead of unsecured loans and certain other creditors of the company. A loan may be convertible into equity shares. Alternatively, it may have a warrant attached that gives the loan holder the option to subscribe for new equity shares on terms fixed in the warrant. They typically carry a higher rate of interest than bank term loans and rank behind the bank for payment of interest and repayment of capital.

Other forms of finance provided in addition to equity

Clearing banks – principally provide overdrafts and short to medium-term loans at fixed or, more usually, variable rates of interest.

Investment banks – organise the provision of medium to longer-term loans, usually for larger amounts than clearing banks. Later they can play an important role in the process of "going public" by advising on the terms and price of public issues and by arranging underwriting when necessary.

Finance houses – provide various forms of instalment credit, ranging from hire purchase to leasing, often asset based and usually for a fixed term and at fixed interest rates.

Factoring companies – provide finance by buying trade debts at a discount, either on a recourse basis (you retain the credit risk on the debts) or on a non-recourse basis (the factoring company takes over the credit risk).

Government and European Commission sources – provide financial aid to UK companies, ranging from project grants (related to jobs created and safeguarded) to enterprise loans in selective areas. See pages 9-11.

Mezzanine firms – provide loan finance that is halfway between equity and secured debt. These facilities require either a second charge on the company's assets or are unsecured. Because the risk is consequently higher than senior debt, the interest charged by the mezzanine debt provider will be higher than that from the principal lenders and sometimes a modest equity "up-side" will be required through options or warrants. It is generally most appropriate for larger transactions.

Additional points to be considered

By discussing a mixture of the above forms of finance, a deal acceptable to both management and the private equity firm can usually be negotiated. Other negotiating points are often:

- Whether the private equity firm requires a seat on the company's board of directors or wishes to appoint an independent director.
- What happens if agreed targets are not met and payments are not made by your company?
- How many votes are to be ascribed to the private equity firm's shares?
- The level of warranties and indemnities provided by the directors.

- Whether there is to be a one-off fee for completing the deal and how much this will be?
- Who will bear the costs of the external due diligence process?

The Offer Letter

At this point, the private equity firm will send you an Offer Letter, which sets out the general terms of the proposal, subject to the outcome of the due diligence process and other enquiries and the conclusion of the negotiations. The Offer Letter, without being legally binding on either party, demonstrates the investor's commitment to management's business plan and shows that serious consideration is being given to making an investment.

The due diligence process

To support an initial positive assessment of your business proposition, the private equity firm will want to assess the technical and financial feasibility in detail.

External consultants are often used to assess market prospects and the technical feasibility of the proposition, unless the private equity firm has the appropriately qualified people in-house.

Chartered accountants are often called on to do much of the due diligence, such as to report on the financial projections and other financial aspects of the plan. These reports often follow a detailed study, or a one or two day overview may be all that is required by the private equity firm. They will assess and review the following points concerning the company and its management:

- Management information systems
- Forecasting techniques and accuracy of past forecasting
- Assumptions on which financial assumptions are based
- The latest available management accounts, including the company's cash/debtor positions
- Bank facilities and leasing agreements
- Pensions funding
- Employee contracts, etc

This review aims to support or contradict the private equity firm's own initial impressions of the business plan formed during the initial stage. References may also be taken up on the company (e.g. with suppliers, customers, and bankers) and on the individual members of the management team (e.g. previous employers). The chartered accountancy firm may also be able to provide advice on the key commercial and structural risks facing the business and to carry out assessments on the company's technology base and intellectual property.

If the private equity firm commissions external advisers, it usually means that they are seriously considering investing in your business. The due diligence process is used to sift out any skeletons or fundamental problems that may exist. Make the process easier (and therefore less costly) for you and the private equity firm by not keeping back any information of which you think they should be aware in arriving at a decision. In any event, you will have to warrant this in due course.

Syndication

When the amount of funding required is particularly large, or when the investment is considered to be relatively high risk, the private equity firm may consider syndicating the deal.

Syndication is where several private equity firms participate in the deal, each putting in part of the total equity package for proportionate amounts of equity, usually with one private equity firm acting as lead investor. Whilst syndication is of benefit to the private equity firm in limiting risk in the venture, it can also have advantages for the entrepreneur as syndication:

- Avoids any one investor having a major equity share and significant unilateral control over the business.
- Makes available the combined business experience of all the private equity partners to the benefit of the company.
- Permits a relatively greater amount of financing than with a single investor.
- Can offer more sources of additional future financing.

And finally, completion

Once the due diligence is complete, the terms of the deal can be finally negotiated and, once agreed by all parties, the lawyers will draw up Heads of Agreement or Agreement in Principle and then the legally binding completion documents. Management should ensure that they both take legal advice and have a firm grasp themselves of all the legalities within the documents. The legal documentation is described in the next chapter.

Additional private equity definitions

Burn rate
The rate at which a company requires additional cash to keep going.

Chinese walls

Arrangements that prevent sensitive information being passed between different parts of the same organisation, to prevent a conflict of interest or breach of confidentiality.

Dividend cover

Calculated by dividing earnings after tax by the net dividend and expressed as a multiple. It shows how many times a company's dividends are covered by post-tax earnings.

Earn-out

Part of the price of a transaction, which is conditional on the performance of the company following the deal.

Gearing, debt/equity ratio or leverage

The total borrowings of a company expressed as a percentage of shareholders' funds.

IPO

Initial Public Offering, "flotation", "float", "going public", "listing" are just some of the terms used when a company obtains a quotation on a stock market. Stock markets include the Official List of the London Stock Exchange (where around 40% of trading company flotations are venture backed), the Alternative Investment Market (AIM), NASDAQ Europe, NASDAQ (USA) and other overseas exchanges.

Ratchets

A structure whereby the eventual equity allocations between the groups of shareholders depend on either the future performance of the company or the rate of return achieved by the private equity firm. This allows management shareholders to increase their stake if the company performs particularly well.

Yield

Calculated by dividing the gross dividend by the share price and expressed as percentage. It shows the annual return on an investment from interest and dividends, excluding any capital gain element.

The role of professional advisers

The financial adviser, accountant and lawyer have important roles to play in the private equity process, both for the management team seeking finance and the private equity firm. It is often the case that the financial advisory role and the role of the accountant performing investigatory due diligence are performed by different teams within the same organisation. Your accountant may therefore be able to act as your financial adviser.

The financial adviser's role

The primary role of the financial adviser in an MBO transaction is to provide corporate finance advice to either the management team or the private equity firm sponsoring the transaction. Your financial adviser will provide you with impartial financial advice, independent of the private equity firm and its own advisers. The precise nature of the role varies from situation to situation but typically includes:

- Undertaking an initial appraisal of management's financing proposition.
- Advice on your business plan – critically reviewing and appraising your plan to ensure that it includes all the areas referred to in the business plan section of this Guide and that the business plan is framed and presented in accordance with the requirements of the private equity firms.
- Advice on valuation of the business and planning for the ultimate sale of the business and realisation of management and the private equity firm's investment.
- Undertaking financial modelling – carrying out sensitivity analysis on the financial projections to establish that the forecasts make accounting and commercial sense. Checking that they have been prepared in accordance with reasonable accounting policies and with due regard to publicly available information.
- Advice on the most appropriate capital structure to be used to fund your proposal.
- Making introductions to appropriate sources of private equity with investment criteria that match your business proposition and a business style that should be right for you. If your business is a highly attractive investment opportunity for private equity firms, this may include organising an "auction" or a "beauty parade" of private equity firms to compete for the right to finance your company. The financial adviser will need to ensure that the terms of the FSMA – see pages 51-55 – are properly complied with in providing this service.
- Making introductions to appropriate sources of debt and other finance to help to fund the proposal.

- Reviewing offers of finance – reviewing the terms of the deal offered by the private equity firms and other finance providers and assisting in negotiating the most advantageous terms from those on offer.

- Assisting in negotiating the terms of the deal with the private equity firms and banks and with the vendor.

- Project managing the transaction to minimise calls on management time and disruption to the business.

- Providing other advice, at a later stage if required, on the flotation of your shares on a stock exchange, or their sale to another organisation, or other such transactions.

The accountant's role

The primary role of the accountant acting on behalf of the private equity firm, in an MBO transaction for example, is to undertake investigatory due diligence, such as described on pages 37-38. The precise scope of the accountant's role varies from situation to situation but typically includes:

- Reporting formally on projections.

- Undertaking financial and commercial due diligence – often a prerequisite to private equity investment. The accountant will also be able to make informal judgmental opinions on aspects of the plan to the benefit of both management and the private equity firm.

- Undertaking pensions, IT or environmental investigatory work and due diligence.

- Providing audit, accounting and other advisory services.

- Planning your tax efficiently – help management obtain the maximum benefit from the tax system, whether the aim is for a public flotation or to remain independent, and to minimise tax liability on any ultimate sale of equity.

- Valuing your company's shares – for tax planning and Inland Revenue negotiation.

Tax advice

The tax adviser will also help to ensure that, where possible:

- Tax relief is available for interest paid on personal borrowings to finance management's equity investment.

- Potential gains on the sale of equity are taxed as a capital gain and not treated as earned income.

- Capital gains tax (CGT) is deferred on the sale of equity.

- Exposure to Inheritance Tax is minimised.
- Tax indemnities provided by the company directors and shareholders to the private equity firm are reviewed.
- Tax relief on professional costs in connection with an MBO, flotation or other exit is maximised.
- Corporate funding is structured to maximise tax relief.
- Tax due diligence procedures are properly carried out.

Your tax adviser can also explain the qualifying criteria under which personal investments can be made through the Enterprise Investment Scheme and in Venture Capital Trusts.

Under the EIS, individuals not previously connected with a qualifying unlisted trading company (including shares traded on AIM) can make investments of up to £200,000 in any tax year and receive tax relief at 20% on new subscriptions for ordinary shares in the company, and relief from CGT on disposal, provided the investment is held for three years.

For VCTs, which are quoted companies similar in concept to investment trusts, income tax relief is available at 40% on new subscriptions by individuals for ordinary shares in the VCTs. The maximum amount qualifying for relief is £200,000 each tax year. In addition, no tax is payable on gains realised on the disposal of shares in a VCT. As with the EIS, the minimum holding period is three years. Some of the tax benefits of VCTs have been eroded by the removal of tax credits on dividends and the introduction of taper relief on CGT.

If you require a chartered accountant or financial adviser with experience in the private equity field, see the "Associate Members – Professional Advisers" section within the BVCA's Directory of members.

The lawyer's role

Usually there are at least two sets of lawyers involved in the private equity process; one representing the management team and one representing the private equity firm. Other parties, such as bankers and other private equity firms, if acting as a syndicate, will each want their own lawyer involved.

The private equity firm's lawyer

The lawyer is mainly concerned with ensuring that the private equity firm's investment is adequately protected from a legal standpoint. The lawyer will draw up the various investment agreements, usually including the following:

- *Shareholders' or subscription agreements*
  Documents detailing the terms of the investment, including any continuing obligations of management required by the private equity firm, the warranties and

indemnities given by the existing shareholders, penalty clauses and the definition of shareholder rights.

- *Warranties and indemnities*
  Documents that confirm specific information provided by the directors and/or shareholders to the private equity firm. If this information turns out later to be inaccurate, the private equity firm can claim against the providers of the information for any resulting loss incurred.

- *Loan stock or debenture agreements*
  A statement of the terms under which these forms of finance are provided.

- *Service contracts*
  Documents that formalise the conditions of employment of key members of the management team.

- *Disclosure letter*
  Contains all the key information disclosed to the private equity firm on which the investment decision has been based. It is essential that the directors do not omit anything that could have an impact on that decision. The disclosure letter serves to limit the warranties and indemnities.

The management team's lawyer

The management team's lawyer will review the Offer Letter (Heads of Agreement) from the private equity firm and, together with your financial adviser, will help you to negotiate acceptable terms. The team's lawyer will also, in due course, negotiate the investment agreements with the private equity firm's lawyer and produce the disclosure letter, as well as negotiating any loan documents with the banker's lawyer.

In the case of a new company, your lawyer can incorporate the company and draw up the Memorandum and Articles of Association, which govern the constitution of the company, its permitted activities and the powers of its shareholders and directors. Even in the case of an existing company, a new Memorandum may be required and new Articles almost certainly will be needed to document the dividend and other rights attaching to the company's shares following the private equity investment. If you need to find a lawyer experienced in these areas, refer to the "Associate Members – Professional Advisers" section of the BVCA's Directory.

Professional costs

In many cases, the costs of all the professional advisers will be borne by the company receiving the investment. The private equity firm will usually increase the funding provided to allow for these costs, so you and your team should not be "out of pocket" as a result, although you may be left with a slightly smaller equity stake. However, there are circumstances where this is not possible, due to contravention of Company Law, or where it is agreed that each party bears its own costs.

Ensure that you agree the basis of costs before any work commences. In particular, ensure that you have firm agreement as to who is to bear the costs in the event of the negotiations being aborted. Usually in this case the private equity firm will bear the cost of work commissioned by them and you will pay the costs of your own professional advisers.

Professional costs incurred by the financial advisors, accountants and lawyers employed by the management team and the private equity firm, like any service, need to be carefully controlled. There is a range of costs that will depend on the complexity of the transaction, but will typically be around 5% of the money being raised.

Your relationship with your investor

Private equity for growth and success

Private equity investment has been demonstrated to contribute significantly to companies' growth. Private equity backed companies outperform leading UK businesses.

The annual "Economic Impact of Private Equity in the UK" shows that the vast majority of companies receiving private equity believe that without private equity they would not exist at all or would have developed less rapidly. Furthermore the report consistently demonstrates that private equity-backed companies increase their sales, exports, investments and people employed at a considerably higher rate that the national average.

While the growth and success of these companies owes much to private equity investment, enabling them to achieve their full potential, the non-financial input by the private equity firm is also a very important contributor. The private equity firm's involvement generally does not end following the initial investment. Of the private equity backed companies analysed in this survey, annually over three-quarters say that their private equity firms make a major contribution other than the provision of money. Contributions cited by private equity-backed companies often include private equity firms being used to provide financial advice, guidance on strategic matters, for management recruitment purposes as well as with their contacts and market information.

Most private equity firms' executives have a wide range of experience. Many have worked in industry and others have a financial background, but what is more important, all have the specialist experience of funding and assisting companies at a time of rapid development and growth. Levels of support vary, however, ranging from "hands-on" to "hands-off".

Hands-on

A "hands-on" or active approach aims to add value to your company. In addition to advising on strategy and development, the private equity firm will have many useful business connections to share with you. The private equity firm aims to be your business partner, someone you can approach for helpful ideas and discussion. A hands-on investor is particularly suited to a company embarking on a period of rapid expansion. However, day-to-day operational control is rarely sought. In order to provide this support, some private equity firms will expect to participate through a seat on your board. The director may be an executive from the private equity firm or an external consultant and fees will need to be paid for the director's services. The private equity firm will expect to:

- Receive copies of your management accounts, promptly after each month end.
- Receive copies of the minutes of the board of directors' meetings.
- Be consulted and involved in, and sometimes have the right to veto, any important decisions affecting the company's business. This will include major capital purchases, changes in strategic direction, business acquisitions and disposals, appointment of directors and auditors, obtaining additional borrowings, etc.

Hands-off

Some investors will have a less active role in the business, a "hands-off" or passive approach, essentially leaving management to run the business without involvement from the private equity firm, until it is time to exit. They will still expect to receive regular financial information. If your company defaults on payments, does not meet agreed targets or runs into other types of difficulties, a typically hands-off investor is likely to become more closely involved with the management of the company to ensure its prospects are turned around.

In reality

Most private equity firms in reality tend to operate somewhere between these two extremes.

Help to avoid the pitfalls

One of the private equity firm's positive contributions to your business might be to help you avoid receivership or liquidation. They can help you spot the danger signs of troubled times ahead and avoid business pitfalls.

Examples of danger signs

- Lack of response to changing environments
- Fixed price contracts
- Increasing level of fixed costs
- Cash flow problems
- Breaches in bank covenants
- Failing to meet capital interest or dividend payments
- Increasing overseas competition
- Over-trading
- Deteriorating credit control
- Uncontrolled capital expansion
- Inaccurate and/or untimely management information

- Autocratic management
- Financial impropriety
- Early success, but no staying power
- Over expansion and loss of control
- High turnover of key employees
- Extravagant executive lifestyle
- Dependence on too few customers/suppliers

Directors' responsibilities

As a company director you have onerous responsibilities to your shareholders and your creditors. Many of the duties and obligations of a director are mandated by the Companies Act 1985. Others are governed by the Insolvency Act 1986 (you should be particularly aware of the "wrongful trading" provisions contained therein) and the Company Directors' Disqualification Act 1986. Under the wrongful trading provisions a director may, by court order, be made personally liable for a company's debts if it is allowed to continue trading at a time when it was known, or should have been concluded, to be insolvent. Discuss any concerns with your private equity firm and other professional advisers before they become real problems and help to ensure success for you, your management team and your investors.

You should also have recourse to the new Combined Code on Corporate Governance which is aimed at enhancing board effectiveness and improving investor confidence by raising standards of corporate governance.

Guidelines for success

The following guidelines apply to most successful business situations:

- Stick to what you know – avoid industries in which you are not experienced.
- Encourage a common philosophy of shared business goals and quality standards so that you meet and even exceed the expectations of your customers. Communicate the objectives and results throughout your organisation.
- Avoid information overload – concentrate your management information systems on what is critical to success.
- Build your team – as your business grows, recognise the need to direct the company and to not be personally involved in each day-to-day decision, which should be delegated to senior managers.
- Cash flow – remember "cash is king", take care to manage your cash resources with the utmost care.

Your relationship with your investor continued

- Anticipate problems – know what is going to be critical as your company moves through its various growth stages.
- Keep your investors, bankers and advisers informed – they are there to help and do not like surprises.
- Watch your costs – ensure that the market price of your products gives a profit contribution in excess of the costs you incur. This may sound facile, but it is amazing how often this is not assessed regularly, resulting in unexpected losses.
- Do not anticipate sales – the costs can grow by themselves, but the sales will not.
- Use the network – a well-developed set of business contacts is one of the keys to business success. These could include customers, suppliers, trade associations, Government agencies and professional advisers.
- Look for opportunities – the business plan is the agreed route forward for the business, but other opportunities will arise. Assess them, discuss them with your investors and pursue them if it makes sense for the business. Adapt your business plan as your company develops and new opportunities are considered.

Realising the investment

Many business owners and shareholder management teams are looking at some point to sell their investment or seek a stock market listing in order to realise a capital gain. Private equity firms usually also require an exit route in order to realise a return on their investments. The time frame from investment to exit can be as little as two years or as much as ten or more years. At the time of exit, the private equity firm may not sell all the shares it holds. In the case of a flotation, private equity firms are likely to continue to hold the newly quoted shares for a year or more.

The options

The five main exit options are listed below. If you are considering any of these, you will need the specialist advice of experienced professional advisers.

Trade sale
The sale of your company's shares to another company, perhaps in the same industry sector.

The majority of exits are achieved through a trade sale. This often brings a higher valuation to the company being sold than a full stock market quotation, because the acquirer actually needs the company to supplement its own business area, unlike a public shareholder.

Repurchase
The repurchase of the private equity investors' shares by the company and/or its management.

To repurchase shares you and your advisers will need to consult the Companies Act, which governs the conditions of this exit option. Advance clearance from the Inland Revenue and professional accounting and tax advice is essential before choosing this route.

Refinancing
The purchase of the private equity investors' or others' shareholdings by another investment institution.

This type of exit may be most suitable for a company that is not yet willing or ready for flotation or trade sale, but whose private equity investors may need an exit.

Flotation
To obtain a quotation or IPO on a stock exchange, such as the Official List of the London Stock Exchange, AIM or NASDAQ (USA).

A stock market quotation has various advantages and disadvantages for the entrepreneur (see box over).

Involuntary exit
Where the company goes into receivership or liquidation.

Realising the investment continued

Going public

Advantages

- Realisation of some or all of the owner's capital
- Finance available for expansion
- Marketable shares available for acquisitions
- Enhanced status and public awareness
- Increased employee motivation via share incentive schemes

Disadvantages

- Possible loss of control
- Requirement to reveal all price sensitive information which may also be of interest to your competitors
- Unwelcome bids
- Continuing obligations – costs and management time incurred
- Increased scrutiny from shareholders and media
- Perceived emphasis on short-term profits and dividend performance
- The cost

Valuing the investment on exit

For partial disposals and certain exits it is often necessary to arrive at a mutually acceptable valuation of the company. The BVCA has produced guidelines that address the bases and methodologies to be used for valuing private equity investments although these are aimed principally at private equity fund managers, to provide consistency and commonality of valuation standards amongst funds, largely for fund performance measurement purposes. For guidance on valuing your company prior to initial private equity investment, see page 31.

Before you do anything – read this!

Legal and regulatory issues you must comply with in raising finance

Raising finance is a complex legal and regulatory area and you should be aware of the need to take legal advice during the process. In particular, sending a business plan to, or discussing it with, potential investors, is a financial promotion and this may require you or other persons involved in the process to be authorised or regulated here in the UK. In some cases, if you are not authorised by the Financial Services Authority, you may be committing a criminal offence or agreements entered into may not be enforceable against the other parties. Whilst financial promotions sent by those seeking funds to private equity houses will, in most cases, be exempt from restrictions in the Financial Services and Markets Act (FSMA), you should read the notes below for a summary of the various exemptions to the FSMA and the cautions on the inclusion of misleading statements in your financial promotion. We recommend that you seek professional/legal advice before communicating your plans to anyone.
This section of the Guide is not intended to give legal advice nor substitute for you taking your own professional and/or legal advice in these areas.

The Financial Services and Markets Act ("FSMA")

The FSMA came into force on 1 December 2001 and provides that "a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity". This does not apply if the person is an authorised person under the FSMA or the contents of the communication are approved by an authorised person. As you are likely to be raising finance to start-up or to expand your business it is unlikely that you will be authorised. However, the FSMA (Financial Promotion) Order 2001 (Financial Promotion Order) sets out various other main exemptions to the FSMA and these need to be carefully considered in each case.

The Financial Promotion Order differentiates between real-time and non real-time communications. A real-time communication is one that is a communication made in the course of a personal visit, telephone conversation or other interactive dialogue. A non real-time communication is one that does not fall within the definition of a real-time communication and includes letters, emails and publications (including TV and teletext). The Financial Promotion Order also sets out indicators to look for when determining if a communication is a non real-time communication. The indicators include if the communication is directed to more than one recipient in identical terms or if the communication is made in a way that the recipient cannot or is not required to reply immediately or can refer to it at a later time.

The Financial Promotion Order also distinguishes between solicited and unsolicited real-time calls, solicited calls being ones which are initiated by the recipient or take place following an express request (which is more than mere acquiescence) from the recipient.

Relevant exemptions to individuals or companies communicating business plans to potential investors include the following. Please note that, at the time of writing, the exemptions relating to the sale of body corporates and takeovers are under review. You are recommended to take legal advice before applying any of the exemptions outlined below.

Investment professionals

This exemption applies to financial promotions made only to or directed only at the following types of person who are sophisticated enough to understand the risks involved. These are:

- Authorised persons
- Governments and local authorities
- Professional firms who are exempt under the Act
- Exempt persons (where the financial promotion relates to a controlled activity which is a regulated activity for which a person is exempt).
- Persons whose ordinary business involves carrying on a controlled activity of the kind to which the financial promotion relates (i.e. private equity and venture capital firms, investment trust companies, large companies which have a corporate treasury function, other persons who carry on activities but are excluded by the Regulated Activities Order).

Also exempted are persons acting in their capacity as directors, officers or employees of such entities such as directors, officers or employees of authorised private equity and venture capital firms.

One-off communications

There are exemptions for one-off non real-time communications and solicited real-time communications in relation to certain categories of investments such as buying, selling or subscribing for securities and advising on investments. Subject to certain exceptions for solicited real-time communications, to benefit from this exemption, the communication must be made only to one recipient (or group who are expected to act jointly), it must identify the product or service and not be part of an organised marketing campaign.

High net worth individuals

High net worth individuals can sign a certificate exempting them from the general financial promotion restrictions of the FSMA in relation to certain categories of investments such as buying, selling or subscribing for securities or receiving advice on investments and in relation to non real-time communications or solicited real-time communications. To benefit from this exemption they must, inter alia, have an annual income of not less than £100,000 or net assets to the value of not less than £250,000, both as certified by their employer or an accountant. To fall within the exemption, the communication must be made to that individual and must relate to certain categories of investments that can include unquoted securities. It should be noted that, to be used, a certificate must have been provided before the relevant communication is made.

High net worth companies

Subject to certain conditions, the financial promotion restriction does not apply to communications in relation to certain categories of investments such as buying, selling or subscribing for securities and advising on investments which are made only to a body corporate which has net assets or called up share capital of £500,000 (if the company has more than 20 members) or £5,000,000 for other companies, a partnership or unincorporated association which has net assets of not less than £5,000,000, the trustees of a high value trust (assets of £10,000,000 or more) or to any director or officer of the high net worth company whose responsibilities include engaging in investment activity. The conditions are that the communication must describe the person to whom it is directed and state that it relates to controlled investments or activities, the communication must carry a health warning advising others not to act on it and provide that suitable procedures are in place to prevent others acting upon it. The distinction between real-time and non real-time communications is not made for this exemption, nor is there a requirement for a certificate as in the case of the exemption for high net worth individuals. Instead, the person making the communication must have a reasonable belief that the recipients are high net worth companies, etc.

Sophisticated investors

"Sophisticated investors" can sign a certificate exempting them from the general restrictions on financial promotion in relation to certain categories of investments such as buying, selling or subscribing for securities and receiving advice on investments, if they can produce a statement from an authorised person stating, inter alia, that that person is sophisticated enough to understand the risks involved in that type of investment. It should again be noted that, to be used, a certificate must have been provided before the communication is made. Any communication to a sophisticated investor must also be accompanied by certain "health warnings" to qualify for this exemption. This exemption is not limited to non real-time or solicited real-time communications. As there is no financial qualification (in contrast to the high net worth individuals exemption) it is likely to be more useful in marketing securities to private clients.

Associations of high net worth or sophisticated investors

There is also an exemption in relation to certain categories of investments such as buying, selling or subscribing for securities and advising on investments for non real-time communications or solicited real-time communications, which are made to associations of high net worth or sophisticated investors. This exemption is limited to situations where the investment is of a type which means that the person does not incur a liability to contribute more than he commits by way of investment, for example, a regular contribution to a business angel network.

Common interest groups of a company

A non real-time communication or solicited real-time communication in relation to investments in a company, such as shares and debentures, which is made to a group of persons with an existing common interest with each other and that company may be exempt. Again to be exempt the communication must be accompanied by certain "health warnings".

Sale of a body corporate

A communication made in relation to an acquisition or disposal of shares in a body corporate which satisfies certain conditions, such as that it relates to or will result in the sale of 50 per cent or more of the voting rights in a company to another body corporate, partnership, single individual or group of connected individuals, or which relates to the acquisition of day to day control of a body corporate, is exempt from the financial promotion restriction. There is also an exemption for takeovers, although this is subject to further conditions and requires further information to be provided.

There are also other exemptions available which may not be relevant in the case of private equity financing.

Misleading statements

The FSMA generally prohibits the inclusion of misleading statements in documents that are designed to induce or persuade people to enter into investment agreements or to buy or sell shares in companies. This would therefore apply to your business plan. Any person who makes a statement, promise or forecast or dishonestly conceals any material facts, or who recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive, is guilty of an offence if he makes the statement, etc. for the purpose of inducing (or is reckless as to whether it will induce) another person to enter or offer to enter into an investment agreement. Sanctions for a contravention of these provisions includes imprisonment up to seven years or a fine or both.

It is therefore essential that, irrespective of whether or not any of the exemptions in relation to financial promotions apply, any statement, promise or forecast contained in any communication, document, including a business plan, private placement memorandum, information memorandum, etc., made available to potential investors is verified in order to ascertain whether by itself, or taken in the context in which it appears, it could possibly be misleading or false or deceptive. This verification could be carried out by an authorised person such as an investment bank, corporate finance boutique or authorised professional services firm. If however you are sending your plan to a UK private equity house which is itself authorised then you do not have to have this verification process undertaken. You should nevertheless ensure that the plan does not contain misleading statements.

In case of any doubt, if you are seeking equity or debt finance, other than ordinary banking facilities, you are recommended to obtain legal advice before making any communications (whether written or oral) with potential investors, including the circulation of your business plan.

Appendix – further information

BVCA

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The BVCA represents private equity and venture capital in the UK and is devoted to promoting the private equity industry and improving the performance and professional standards of member firms and the individuals within those firms. Its members include private equity firms, professional advisers, corporate financiers, mezzanine firms and other companies whose executives are experienced in the private equity field. The BVCA's primary objective is to increase awareness and general perception of private equity by:

- Providing information about members to those seeking private equity.
- Representing members' views and interests in discussions with Government and other organisations.
- Providing a forum for the exchange of views among members.
- Acting as a source of education and training for employees of member companies.
- Developing and encouraging the highest standards of professional practice.
- Liaising with fund providers and political, regulatory and media contacts.

BVCA publications and research

Directory of Members
Lists private equity firms and their contact details, identifies their investment preferences (i.e. the minimum and maximum amounts, financing stage, industry sector and location). Also provides details of associate members including professional and other advisers, who are active in the private equity field. Published annually.

Directory of Members CD-ROM
The CD-ROM contains a PDF version of the Directory of Members. Published annually.

Entrepreneurs
A file containing case studies of private equity backed entrepreneurs.

Report on Investment Activity

Analysis of private equity industry investment, by financing stage, industry sector, region and type of private equity company, with details on independent funds raised. Collated by PricewaterhouseCoopers. Published annually in May/June.

The Economic Impact of Private Equity in the UK

The major survey of private equity and venture backed companies analysing their growth and contribution to the national economy, measured in terms of job creation, sales revenues and exports against FTSE 100 and FTSE Mid-250 companies and national growth rates. Published annually in November.

Performance Measurement Survey

An annual report analysing the aggregate net returns to investors from independent private equity funds by year and type of fund. Produced by PricewaterhouseCoopers for the BVCA. Published annually in May/June.

Reporting and Valuation Guidelines

Reporting Guidelines, addressing the content, frequency and timing of reports to private equity investors, and Valuation Guidelines, addressing the basis and methodologies to be used for valuing private equity investments. Published in July 2003.

Limited Partnership Agreement

The Limited Partnership Agreement is the key legal document used for private equity funds formed as limited partnerships. These explanatory notes are designed to explain the provisions commonly found in this documentation. Published in November 2002.

A Guide to Investing in Europe

Produced jointly by the BVCA and Ashurst Morris Crisp, this publication assists private equity practitioners when investing in Europe. Topics covered include capital structure, board and employee matters as well as issues of common concern. Published April 2002.

A Guide to Term Sheets

A guide aimed to provide those not familiar with the venture capital investment process with an outline of how investments can be structured. Produced May 2004.

For a complete list of BVCA publications and details on ordering, please visit the BVCA website **www.bvca.co.uk**.

Other useful contacts

Business Link

0845-600 9006 or **www.businesslink.org**

The equivalent bodies to Business Link are Business Connect in Wales, Small Business Gateways in lowland Scotland, Business Information Sources in the Highlands, and EDnet in Northern Ireland.

Enterprise Investment Scheme (EIS) Association

01732-465828 or **www.eisa.org.uk**

Also see the BVCA Directory under "Professional Advisers" for details on chartered accountants and lawyers with experience in the private equity field, who are associate members of the BVCA.

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Founded in 1983, the BVCA represents private equity and venture capital in the UK. We are devoted to promoting the private equity industry and improving the performance and professional standards of member firms and the individual within those firms.

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This Guide has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this document without obtaining specific professional advice. Accordingly, to the extent permitted by law, the BVCA, PricewaterhouseCoopers, their members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this document or for any decision based on it.

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This Guide was written for the BVCA by Keith Arundale, Director at PricewaterhouseCoopers LLP.

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