Raising Capital, Maintaining Control *(IW Growing Companies, February 1999 issue, page 24)*

For smaller manufacturing firms, some of the most intriguing aspects of securing new growth capital involve two separate facets of the negotiations for a deal. The first relates to the company's initial offer to capital providers for a stake in the enterprise. The second addresses the level of involvement that outside investors seek in exchange for funds.

The resultant package of debt or equity is an interesting configuration of inquiries, concessions, and requirements that is supposed to result in all parties feeling comfortable that the deal is mutually beneficial. But that is not always easy to accomplish.

Business owners need to know prior to negotiations exactly what they are willing to concede in order to secure outside funds to support growth. A few of the primary questions include:

- What percentage of the company's voting stock will have to be given up?
- Will new debt holders demand specific controls on use of funds?
- Is outside funding aimed at long-term growth or a short-term exit strategy?
- Will capital providers expect a position in senior management in order to keep watch over daily operations?

There are all kinds of traps waiting for entrepreneurs who enter into negotiations without a firm grasp of the predefined limits to which they will go in order to close a funding deal. The following guidelines should be seriously considered prior to opening discussions with a potential provider of growth capital.

Keep Control — The first guideline (depending on the amount of capital being sought) is that outside investors should not receive more than 30% or 40% of the equity in the firm. The owner-entrepreneur must try to always maintain a controlling interest (at least a 51% stake) in the company. Otherwise, changes in policy and the direction of business decisions put in place will most likely reduce the original owner's influence on key operations and long-term strategy.

Document The Deal — Get every proposal (at each and every stage) in writing. If capital providers want something in return for their funds, make sure all parties are perfectly clear with specific descriptions of how the deal will unfold. Avoid the quick handshake based upon some loosely defined general concepts. These people are going to become stakeholders in the firm; sort out all the details up front before any money changes hands.

Help Wanted? — Investors may want to introduce operations or marketing talent into the present management scheme. Capital providers may want someone they handpick to work alongside the current owners, somewhat like an insurance policy to hedge the risk exposure of their investment. And they most assuredly will want detailed periodic financial reports. Decide upfront whether they should be active owner/managers, or passive investors.

Analyze Agendas — Spell out the perceived agenda that each party brings to the company's operations. If the focus is on long-term sales growth and expansion of manufacturing capability, don't get caught trying to devise some sort of near-term buyout, profit sharing, or other exit strategy. The last thing the company needs is an immediate deadline for quick results.

These guidelines should be role-played well in advance of the first face-to-face meeting in order to simulate the kind of "give and take" that might come to bear on negotiations. At each juncture, you and senior managers will need to think about all possible requests you'll encounter — and your counter proposals to such requests. Granted, there is no way to know exactly what an outside party is looking for in a capital deal, but a few hours invested with key managers to review multiple scenarios is time well spent.

Loggerheads over these issues might never surface — great! But it makes sense to sort them out and conceptualize ramifications before the outside money is sitting on the table.

Securing new growth capital is an exciting time in the life of a firm. Setting parameters early on for how it all comes together — and preparing a game plan for the development of the deal — can help the entrepreneur avoid a letdown after the funds are invested.