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Simon is a founding partner of Gresham Private Equity, a leading private equity investor in companies valued up to £150m. He is responsible for all new investments made out of Gresham's three offices in London, Birmingham and Manchester.

# THE BALANCE OF POWER – PRIVATE EQUITY AND NEGOTIATIONS

By Craig Hopwood & Simon Inchley

Simon Inchley of Gresham Private Equity and Craig Hopwood of Spirit Capital Partners offer their views on how the current financial climate is affecting the private equity market, and outline their experience of negotiations in this context. The 'win/win' sentiment expressed in this article is wholeheartedly shared by Huthwaite, which places the achievement of win/win outcomes at the centre of its approach to negotiation. Careful preparation and strategy planning are integral to negotiation in any circumstances, as is the ability to recognise a bad deal and having the courage to walk away from it.

**When buying or selling a company, where does the balance of power lie?**

**CH:** "A tricky question and possibly no right answer! It is probably a mixture of various factors, for example, the quality, strategic

desirability and scarcity of the target for the buyer whilst the vendor will be influenced by the urgency of their need to sell, how much time they have to complete the sale, their ability to create a competitive auction and the financial quality of the buyer."

**SI:** "It has been a seller's market for a long time; prices have been rising in a benign economic environment and the whole financial world has become very risk tolerant, which is why there are so many problems now! As a result, the balance of power has now partially corrected to the buyer, but in fact a successful deal needs to be win/win in any climate. We're buying or investing in businesses with a turnover of £10m – £100m, not massive global corporations, so management teams need to be happy with the deal that they get; it's naive to think that private vendors don't have any further involvement, given that their personality percolates throughout the whole business. If they're unhappy, it

jeopardises the success of the business going forward."

**What effect does the current turbulent financial climate have on this balance?**

**CH:** "With regards to the turmoil in the debt markets, the effect will vary for both buyers and sellers. It places any potential buyer who has either cash reserves or well-negotiated debt facilities available to it in a much stronger position. This may favour larger trade buyers but it is not always going to be the case and

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private equity houses have also remained pretty active. In particular we have seen continued activity in the oil and gas, healthcare and pharmaceutical sectors."

**It would seem a good time for private equity companies to snap up some bargains. But it has been reported that acquisition activity has dried up to a trickle. What is the reality?**

**SI:** "The big deals that make the headlines have almost stopped. However, deals are still happening in the sub £150m market, and these businesses will continue to have good reason to sell; they might need to resolve financial difficulties quickly, or manage a retirement succession issue, as more people tend to retire in tough times. On top of this, VCs' own investors want to see them invest given the fees that they are paying them to manage their funds, so a combination of all these drivers will keep the deals happening. The perception is that PE is closed – but that's simply not true."

**What characteristics make a company particularly attractive for PE investment?**



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Craig has been an Associate Director with Spirit Capital Partners since joining in 2006 and is based in Leeds where he primarily covers the North West, North East and Yorkshire regions. Spirit Capital is an independent private equity fund manager, which operates in the UK lower mid-market. Spirit's focus is to support proven management teams to acquire UK-headquartered businesses valued between £10m and £50m.

**CH:** "We tend to look for a number of attributes but it is rare in the smaller sized business that we typically invest in to find them all in any one company. Areas that we would look for would include: quality and track record of the management team, involvement and reliance on any vendors, financial history and ability to generate cashflows, future growth prospects, competitors, levels of profit and margins within the sector and the likely exit prospects."

**In your experience, which are the main areas for negotiation when trying to close a deal?**

**SI:** "There are marked differences for plcs and private vendors, but both should ultimately be focused on deliverability. It's all about working together collaboratively to devise an effective way of running the company going forward. Many vendors have their name over the door, are staying locally and have genuine friends amongst the employees, so it's not just about negotiating a fair price – continuing security of employment for certain people, and often an ongoing role for the vendor are key areas for negotiation. As a vendor, if you're prepared to engage positively with us then you put yourself in a very strong negotiating position. It's those that favour relationships with lawyers and accountants and start a ferocious bidding war based solely on price that may lose out."

**What, do you believe, are the traits of an effective negotiator?**

**CH:** "In my experience most people are not as good at negotiating as they would like to think that they are (including probably myself). I try to stick to the obvious bits that it is easy to rush, such as planning out what concessions I can easily make, what the other side will want and any concessions they may have to offer, trying to establish a good rapport, giving myself time to go away and think about things if necessary and of course bearing in mind that you may well need to deal with that person again in another corporate life later on. For private equity houses in particular, our reputation in negotiations and the overall ethics of our behaviour are often our most important attributes. We need to make sure that people want to work with us and view us as credible, trustworthy and able to deliver on a deal. Saying that, it is also important to know when to say no and not get caught up in 'deal fever!'"

**How does a company that wants to sell for the right reasons (not because they are in dire straits) negotiate with the private equity company to get the best deal?**

**SI:** "Have the confidence to work together collaboratively, that's how to get the best deal. If the vendor is prepared to engage with us on an open basis and tell it like it is, then we can build a solid relationship and create a strategy that works for both of us."

**What actions can hinder the negotiations process and actually jeopardise the deal?**

**CH:** "There are all sorts of things that can crop up and cause problems on a deal. Time invested in upfront planning is often well spent and maintaining good communications, particularly between principals rather than just the lawyers is vital. Negotiations on a deal can easily stall or even fail for a multitude of reasons. However, transactions may be more likely to be derailed by an event or development during the process itself."

**What does the future hold?**

**CH:** "In more challenging economic conditions, good businesses tend to stand out and become more visible. We remain very positive in our view that we can hopefully continue to identify and develop good relationships with some of these companies, maintain our investment stream and continue to support quality businesses. However, external factors such as the health and confidence of the debt markets, property prices, retail sales, strength of sterling etc. are likely to keep us all on our toes in the coming year."

**SI:** "The companies within our portfolio have looked at their cost base to make sure that it matches their anticipated revenue, and are looking at creating cash head room so that they can weather any storm, including irrational behaviour by their banks. I think that deals wise, reduced but reasonable volumes will continue, largely driven by cash out deals for plcs and retirement issues for the privates. It's a very mature market and consistency of volumes over time has largely been maintained. The same can't be said for deals at the top end of the market, but where we operate (SMEs up to £150m), it's not just about numbers and negotiation, you're dealing with people's lives. So there will always be drivers for exit and the need for a sensitively structured solution."