CONSIDER THESE FIVE ISSUES WHEN EVALUATING THE BENEFITS OF OUTSIDE EQUITY

Have you considered selling your business — or a portion of it — to an outside equity partner? Before spending a lot of time and money traveling down that road, you should ask yourself these five key questions.

Competitive Position

How will bringing on an equity partner help my company improve or sustain the competitive advantage we've gained in our industry or segment?

- Often, the opportunities in your industry are so tremendous that a combination of internal and external (acquisitions) revenue enhancements far exceed the cost of existing equity and debt capital.
- These opportunities may bring the talent, scale and synergies you need to elevate your business plan and strategic positioning. If the opportunities exist and all other lower-cost financial options have been exhausted, an equity partnership is worth considering.
- Long-term shareholder value based on your ability to gain and sustain a competitive advantage may ultimately result in above-average profits relative to your industry segment.

Cost of Capital

What is the cost of equity capital in my situation?

- Most equity investors will seek returns far greater than the cost of debt capital. Thus, to the extent you can finance your business strategy with lower costs of capital, outside equity is not needed. However, if outside equity is needed to buy out an existing equity owner, or you are seeking to "take some chips off the table," then perhaps it is the right option to pursue.
- As long as your company continues to build shareholder value that exceeds the cost of capital, then equity capital is worthwhile. This is especially true when lower cost options are not available. Often, windows of opportunity for strategic positioning can close quickly; therefore, in addition to the cost of capital, you must consider the cost of a lost opportunity.

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Control

How much control can I give up and still be comfortable?

- Even with a minority equity partner, you need to carefully analyze the agreement based on direct and indirect control within varying business outcomes. Often, outside equity partners like your industry, your business plan and your management team but do not want to run the company. They seek a sound return on their investment and need to protect their financial interest. Often, they bring experience, vision and connections you would not have otherwise, so control could be a moot issue if the business plan proceeds according to your expectations.
- It is important to do your due diligence with the equity partners to ensure they provide integrity as partners consistently with how they advertise themselves. Talk to other business owners and learn from their experiences with these investors.

Culture

The culture of my company has taken years to develop and it could evaporate in minutes. Will I be able to maintain this valuable culture when taking on private equity partners?

- Any change in ownership creates a new dynamic that can have implications for the corporate culture you have developed. Change creates fear and anxiety for the employees. On the other hand, not all cultures are great and some need to be improved. Thus, the infusion of outside equity can bring a refreshing and objective view about how to run the business more effectively. This could create career development opportunities for your key talent.

Consider the Process

- Often, outside equity is the first step in a two-step ownership transition process. Usually, the outside equity investor wants to get their return within 3 to 7 years. Thus, they want to cash out. This is often accomplished by selling to another company, perhaps a strategic/industry buyer. You need to be comfortable with the timing for the second step and ensure that it aligns with your personal and career objectives.

READY TO HELP

Aligning your strategic vision with the right financial options for your company is critical. By knowing your options, you will be able to execute them with better conviction and confidence. Contact your PNC Relationship Manager to help you think through your options. You may also want to visit **pnc.com/ideas** for more content around this topic.

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