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As an established leader in the private equity community, TA Associates was invited to participate in Expert Insight, a nationwide educational series for managers of growing companies. For more information on these topics, contact TA Associates.

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## Only Companies That Need Money Need VCs, Right ?

With all the hype surrounding the “dot-com billionaires,” money-losing start-ups and their venture capitalists, it’s easy to see how entrepreneurs might think that venture capital is only for those who desperately need money. Actually, rapidly growing, highly profitable companies have long taken advantage of what venture capital investors have to offer. So, why take money when your company doesn’t need it?

**Diversify your net worth** - Selling some of your stock ownership to an investor provides the obvious benefit of diversifying your net worth so that you and your family don’t need to worry about daily fluctuations in the value of your business.

**Swing for triples and home runs instead of singles and**

**doubles** - Entrepreneurs are sometimes held back from making the “right” aggressive business decision because the majority of their net worth is tied up in their business and they risk too much personally. In today’s competitive environment, if you don’t seize a market opportunity, somebody else will. Having some liquidity set aside allows you to make more objective decisions.

**Obtain a sounding board for advice and contacts** - By tapping into the collective experience that an investor has gained from years of involvement with growth companies, you can access their Rolodex and learn from other people’s mistakes!

**Learn to walk before you run** - Entrepreneurs often learn the hard way about the pitfalls of missing expectations as a

public company. While private equity investors have high expectations too, they are generally much more forgiving than today’s public markets. A good investor will help you put the systems and reports in place to prepare you as a public company.

**Pay tax on capital gain instead of ordinary income** - With marginal tax rates on ordinary income approaching 50%

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\$5 billion of capital, TA’s investments are focused on growth companies in technology, financial services, and healthcare. TA is usually a minority investor but may also assume control positions in support of management buyouts, recapitalizations or industry consolidations. Since the founding in 1968, TA has supported and invested in over 330 companies.

*Insight by Michael A. R. Wilson, Principal*

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in some states, being able to “sell off” a piece of your income stream and pay long-term capital gains of 20-25% can be a smart tax planning move. Uncle Sam will be the only one complaining.

**Attract or retain talent by offering stock with credibility** - With the backing of a well-regarded investor, employees of private companies have good reason to believe that their stock/options has value that is likely to increase over time.

**Have your cake and eat it too** - Since some investors are willing to buy minority positions, you can achieve the above while retaining control of your company and participating in most of the appreciation through your retained stock interest.

## The Tweener Transaction

### An Alternative to Selling a Great Private Company

You're running a growing, private software company. Your product's average price has increased 20% in two years, and your sales are up three fold! You are highly profitable. Investment bankers say you may never be more attractive. Sell now, they say. For a lot.

The numbers are staggering, and the risks abound in continuing to go it alone. Your spouse, business partners, and employee option holders are seduced by the prospect of cash now. You also notice that your top managers are becoming more risk averse as they focus more on protecting the base than growing it. All this, yet you have a nagging feeling that you are leaving a lot on the table if you sell. Besides, you still have a lot of fun being CEO.

Based on information from Securities Data, from 1998 to 2000, between 6,000 and 9,000 private businesses were sold annually in the United States. The vast majority of these businesses were sold because of estate planning, succession issues, or simple risk aversion. Business owners often don't analyze their true interests when contemplating a sale, and many experience seller's remorse.

What if you could do something in between? Gain some liquidity, but keep control. Far fewer 'tweener' transactions are completed every year. There's a limited market for such a trans-

action, and most intermediaries don't focus on these structures. Selling 100% is easy to understand. Selling 33% is more subtle.

A number of later stage private equity firms focus on the 'tweener' transaction. Some call it a "private IPO," and others a "minority recapitalization."

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**"Business owners often don't analyze their true interests when contemplating a sale..."**

The key ingredients of such a transaction are significant liquidity for shareholders (including the CEO), continuity of control by management, minority ownership for the new investor, and added financial muscle for expansion.

The benefits of such a move are many. You maintain control and stay immersed in the business. You gain a financial partner who will shoulder future risks with you. You may find that you return to your risk-loving roots, for you have created a real nest egg. Perhaps most importantly, you haven't compromised your desire to stay involved in the source of your success.

## Smart Business circa 2001: Fully Funded Business Plans

Nearly all private technology-oriented companies considering the market for growth capital have faced it in the past few months: the triple witching hour. First, private equity guys are no longer easy money. They still have serious cash, but they parted with it at gargantuan valuations in 1999 and 2000, and aren't feeling particularly charitable. Second, debt guys are tightening their belts. Do you know what CLEC stands for? They wish they didn't. Third, much of the fair weather corporate, angel, leasing and hedge

fund capital has dried up in the face of today's dubious exit strategies and their own problems. Not a pretty picture.

But for the patient entrepreneurial team with a clear plan, all is not lost. Over the next couple of years, greater gains in market share will be made by companies that focus on customer needs and watch the bottom line.

The key is realism. Do you know your customers and their budget this year? Have you tailored your expense plans to that? How many strategic projects do you have going at once? How many months can you survive a downturn? Are you fully funded for that?

**Get fully funded** – conservatively, for at least 15 months of operations. Despite the triple witching hour phenomenon, there is still ample capital. That capital seeks realism, humility,

and a believable path to cash flow. Investors today will offer you reduced terms from what you expected. Take the deal, and don't take less capital than you need. Here's why.

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**IF YOU ARE FULLY FUNDED:** You own a little less of a company which you believe will be worth a mint. Don't fret. You have just increased your probability of getting there. The expected value of your ownership stake has just increased.

**IF YOU ARE NOT FULLY FUNDED:** You own more of a company that may need additional capital in 6-12 months. What will the market be like?

**"...greater gains in market share will be made by companies that focus on customer needs..."**

Generally, private market valuations lag public market valuations. By then, the massive re-trenchment in the NASDAQ will be fully priced into private deals.

It is still a great time to be a technology entrepreneur. The pace of change has not slowed; only purchasing rates have. Get your plan fully funded. Stick to the fundamentals. Don't spread your company too thin. Emerge with a significant gain in share. Go public in 2003.