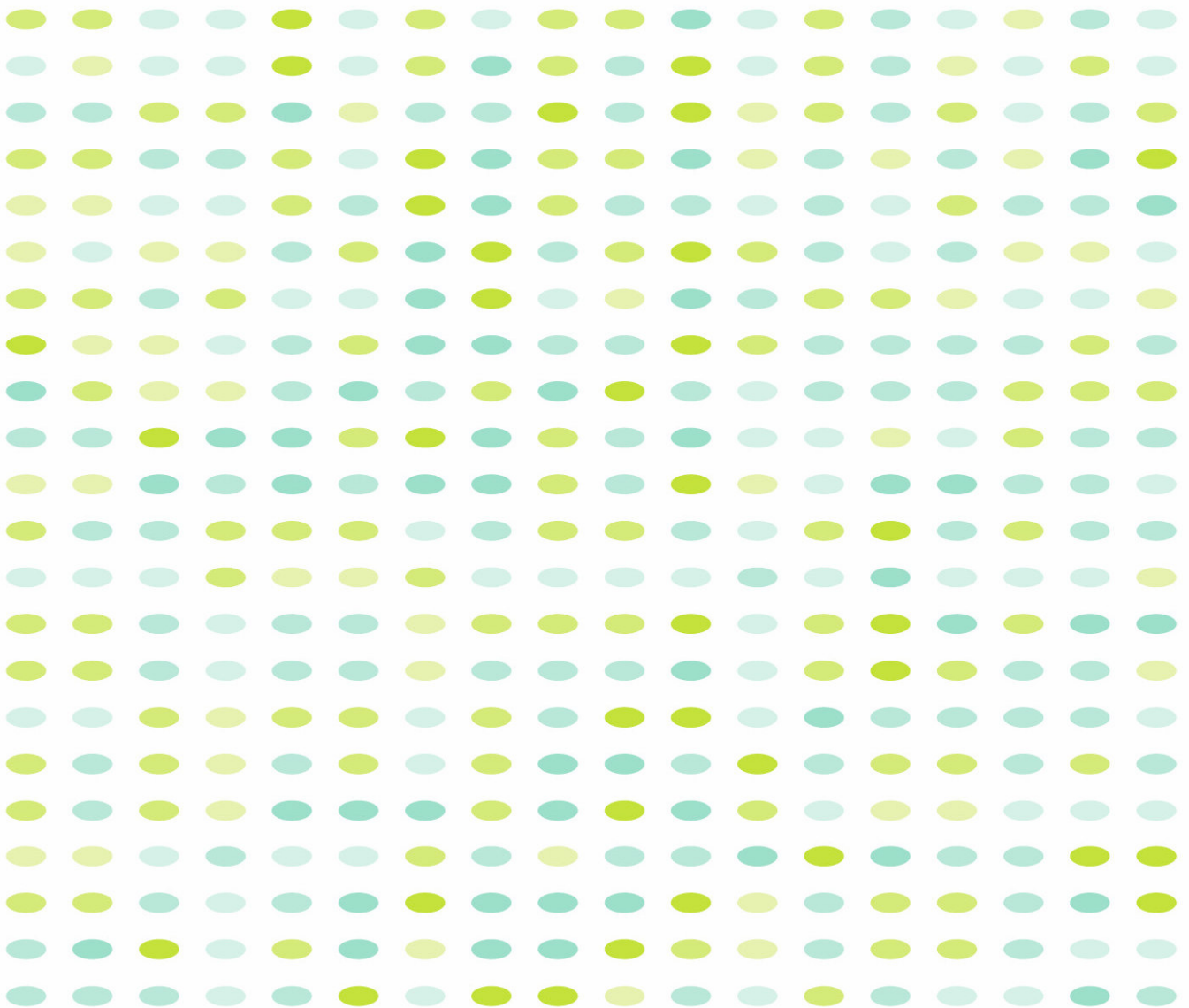


The SWAIN guide to the Art of Effective Negotiating



In conjunction with:



The SWAIN guide to the Art of Effective Negotiating

The South West Angel Investor Network (SWAIN) connects private investors or “Business Angels” with companies looking for investment.

SWAIN specialises in helping small and medium sized companies to find equity finance, and assists private investors in the South West to search for investment opportunities in businesses with growth potential.

The following guide has been produced to help you understand the issues involved in negotiating the right deal for you. It is especially targeted toward the process of achieving investment and has a bias toward those seeking such investment rather those seeking to invest (although inevitably Business Angels will find the content of interest).

Introduction

The Concise Oxford Dictionary Definition of Negotiation is to *‘confer with others in order to reach a compromise or agreement’*.

Negotiating is something we use in everyday life across a range of issues. It plays a large part in the satisfaction you feel when you achieve what you have set out to. Some people are intuitively good at negotiating, others less so, but as with many skills there are a number of basics which you can learn (and use regularly) which will make you more successful.

Whilst understanding the principles of valuation, deal structure and who does what in the process are of great importance, to achieve an acceptable result is perhaps the most important factor in any type of transaction. If either party feel particularly aggrieved (a win-lose situation) it could be a recipe for disaster. Unless you are in a position to defend those issues which are important to you, achieving an outcome which you are satisfied with is unlikely to be achieved.

You can of course carry out your own investigations (via the internet for example) and you will no doubt come across a number of self proclaimed ‘experts’ who have written lengthy texts about this ethereal subject. What it is important to stress however is that, each will provide their own views on what has and has not worked for them, and they are not you. Whilst their opinions are therefore potentially pertinent and relevant, it is important

to factor yourself into this process and to find a style which is most relevant to your personal skills.

It is also important to draw your attention to the fact that this ‘brief’ guide does not encompass the subtle role that body language can play during negotiations. This is an extensive subject and guidance on this matter abounds should you wish to understand more.

What you must remember however is that others may have also read these guides so the underlying principles remain the same ie know what you wish to achieve - whether it be best or worst case - and the boundaries beyond which you are unwilling to move. The subtleties then become methods by which you may (or may not) influence people and may (or may not) improve your position.

Experience suggests that you have an intellectual and potentially emotional argument to win - although when dealing with a dispassionate investor (if you ever find such a person!) your priority must be the former.

The Basics

Preparation, Preparation, Preparation!

The need for preparation cannot be stressed enough. If you do nothing else before entering into any negotiation you should:-

- 1) Understand what you wish to achieve (objective setting); and
- 2) Aim to understand what the investor is seeking to achieve.

You are setting off on a process which will most likely result in the sale of a proportion of your equity. In disposing of the right to the future return derived from this equity, what are you seeking to achieve? Points to consider might include:-

- Are you seeking cash investment, knowledge, experience, contacts or a mix of different 'values'?
- What must you not lose/offer ('deal breakers')?
- What are you less concerned about ('pawns')? - some of these may actually be important to the investor so can be traded;
- What problems do you think you may encounter or have to negotiate over?;
- What is a realistic value for your business and what issues may effect that value?; and
- What are your weaknesses (assume they will be identified) and how will you rationalise them?

The above is about understanding the importance of various matters to you and hence can only be set by you. Think about what the ideal position would be, which are realistic and which you simply cannot move upon without walking away from an offer.

So, what are you willing to 'sell' to achieve your goals?

Investments come at a price - it may be in terms of equity but potentially, just as importantly, it may come in the form of control. They are often one and the same, but complex shareholder agreements can separate the two.

Please remember that this process is not only about achieving a cash investment. Like you, investors have different motivations. Some may have skills to bring to the process, but not be willing to invest cash. Some may wish to exert a high level of executive control to keep a tight reign on their investment.

So what do you know about these investors? There is often very little information about these individuals in the public domain, although a search at Companies House may identify where (if anywhere) they have made investments or are company office holders elsewhere. So how do you find out more? In simple terms, don't be afraid to ask! Remember that this is a two way process,

not only should you ask questions of the potential investors, but you may also be able to ask the SWAIN executives as they are there to help you (within the bounds of confidentiality).

The above is simply a prompt for you to give thought to what is important to you - which may mean something completely different to an investor. Being prepared for their stance will mean you are better able to consider the alternatives - if you are willing to compromise.

Communication

Listen, clarify and understand!

Before identifying if there is a route to proceed, ensure you fully understand the other parties requirements and rationale for seeking satisfaction on a matter. It is fair to say that good negotiators are also good listeners. Aim to identify **ALL** concerns/issues, as by trying to settle each as they arise you may find that you offer a solution or compromise which could have been 'traded' for more than one point.

It is amazing how often people will jump to conclusions based upon what can be a simple statement. **DO NOT** make an assumption as to why a request/demand has been made without clarifying whether your understanding is correct. Remember that you are dealing with people - exploring the rationale behind a position should identify if it is simply emotionally driven (and potentially therefore irrational!) or has reasonable and justifiable intellectual grounding.

Remember that this is also about creating a long term relationship, hence act in a collaborative manner and be gracious in accepting concessions from the other party. An element of the process is about building trust and respect between you otherwise it is likely to fail now or at a later stage (which may at worst be dangerous to the asset which both parties are keen to protect).

Have genuine alternatives

We all work in an environment where competition dictates. If there is a single product/service available to you, you have to pay the price advertised. If you have alternatives you will consider each for its relative benefits. This may mean that you do not choose the cheapest as other offers may provide you with benefits which you will pay a premium for.

Inevitably therefore the preference is to have potential investors competing as this gives you the opportunity to achieve the best deal.

Bear in mind however the fact that if none of the terms on offer meet your requirements you must have genuine alternatives. This may mean organic growth, it may

mean an investment from a supplier, it may even mean selling the idea or your company to a competitor immediately - consider what options may, in different circumstances, be palatable and whether you would be happier to do one of these rather than accept an offer which means (for example) selling a larger proportion of your equity than you wish.

Remember, be willing to compromise or to walk away (neither is a failure if you have alternatives) - if the deal is too important to you, your ability to negotiate will be compromised.

Setting the bar

If you have yet to recognise the benefits of introducing a professional adviser with their experience of this process and the potential to (among other things):-

- bringing deal creativity;
- buy you thinking time; and
- stay rational through the process

this is the area where an adviser can potentially add most value.

If you are expecting to 'sell' a very small proportion of your equity for a large value, it is your professional financial advisor who should be in a position to check your methodology for identifying a reasonable valuation (or range of), bench mark it against others and bring your expectations in line with an accepted norm.

Recognise that not all investors will be impressed by what you think is a 'no brainer' opportunity. Individuals need to be brought into the process and convinced of both the potential and ancillary benefits. Deals can happen simply because an individual buys into a concept or has a particular wish to be associated with your brand/ethos (and this is often an element in the decision making process) but inevitably most are driven by the potential for large financial reward in the future. A justifiable company valuation is therefore a key foundation stone key to your negotiating stance.

At the point of writing, SWAIN Angel investments have ranged from £50,000 to £300,000 averaging at £125,000, equity percentages ranging from 5% to 45% averaging 19%. Whilst this is useful information, what it does not mean is that you will achieve an investment of £125,000 for 20% of your business. You may, you may not, but your adviser should be able to guide you as to a realistic value for your business today and the % of equity you should aim to sell for the value you are seeking.

Once this is set, your opening bid should generally be set at the highest level you can realistically justify as making too outrageous a demand is likely to lose you credibility.

Who to 'deal' with

Assuming you have reached an investor panel, it is likely you will already have been through an expert panel and also been provided with the views of the SWAIN executives, hence you should have a proposal which is credible and hopefully investment worthy.

To assist in achieving a successful investment, it is important to focus upon those who show positive signs of interest - the term used being 'keep the commercial fires burning'. Those who want to do a deal will find a way to work around the problems/complications and will possibly offer a solution after having asked a question. Look for those signs of interest - this is where understanding body language can actually be of benefit.

On the downside, one negative individual in a group of positives will create a pervading negative attitude. Consider carefully before presenting to or negotiating with a group or syndicate unless it is led by a suitably competent and positive party.

Negotiating styles

As a final point, it is important to cover the range of different negotiating styles. Much as there are alternatives to those below, these are often referred to:-

- **Competitor** - assertive, unyielding, uncooperative
- **Collaborator** - seeks common ground
- **Compromiser** - both competitor and collaborator - ready to meet half way
- **Pleaser** - gives way too easily
- **Avoider** - ignores problems in the hope they will go away

The above are inevitably intertwined with various personality types - hence if you are deemed to have an aggressive/assertive character type you may well fall into the competitor style. The problem with this assumption is two fold. Firstly, your character type does not dictate your negotiating style. You are a person and therefore your style could differ from day to day depending on your mood! Secondly, a particular style is not always likely to yield the preferred outcome and any text which indicates that you are more likely to achieve a well negotiated deal based upon being solely one of the above is probably inaccurate. This is because negotiations are never the same twice - even if they are with the same person - because circumstances change.

I will provide an obvious example. It is often the case that entrepreneurs have a strong character - you are most likely one yourself. If both you and the potential investor (who is also likely to be an entrepreneur) stick to an uncompromising 'competitor' style, a failed outcome is almost inevitable.

So how, if at all, does the above help? In simple terms, the answer is that it probably does not. General consensus is that a mix of competitor and collaborator styles (with an element of compromise) is most likely to yield the best result and experience suggests that this is correct. Having made this statement, there are scenarios when seeking to 'please' a potential investor or 'avoid' a particular issue may actually work to your advantage under the right circumstances. If you do choose a particular approach/style however, it is preferable to avoid the extremes of this style as this is often a route to failure.

Recognise that it is important to remain dispassionate (although controlled anger has its place). To avoid being hijacked by 'dirty tricks' (which may involve the investor feigning the import of an issue or becoming particularly animated) it is often advisable to take notes - which also means you can hide an immediate reaction - whilst you give thought to a response.

In simple terms therefore, the style you decide upon will be the one which is suited to your character, your circumstances or, more importantly, you decide to adopt depending upon the stance taken by the other party.

The priority remains to understand what you are, or are not willing to compromise on and fit the negotiation to your style.

Conclusion

From the above you will understand that this guide is not exhaustive - it is however designed to help you through a process of potential conflict and is based upon hard experience rather than just theory. It is said that clever people learn from their experiences, really clever people learn from other peoples experiences!

So, in summary, the following 'top ten tips' should serve you well:-

1. Preparation, preparation, preparation! Be clear on your objectives as well as researching your potential investors. Seek to understand their viewpoint and requirements - eg do you know what else they have invested in and the equity investment achieved?;
2. Listen, clarify and understand - make sure you have the full picture before considering whether there is a route to proceed/negotiate;
3. Be realistic in your expectations - valuations are not an exact science but you need to be sensible;

4. Keep the 'commercial fires burning'. Focus upon those who want to do a deal not those who don't. One negative person in a room will make everyone else negative;
5. Use 'competitive tension' to achieve the best result. Although the e-bay analogy would be frowned upon by some, inevitably competing parties will improve your negotiating position;
6. Be confident in your proposal and clear on your strengths (with suitable responses in respect of your weaknesses). You know your business/products/concept etc well - if a number of investors have expressed an interest, it is likely that you have an investable proposal;
7. Know what you are willing to trade to achieve your end game and more importantly what you are not;
8. Have genuine alternatives - know when you need to walk away as accepting a bad deal could be worse than no deal;
9. Be patient - deals are not always struck immediately so it is best to not go into a meeting thinking everything can be resolved there and then;

And where would we be without a final plug.....

10. Be calm and dispassionate. Negotiating can be emotive as you are dealing with something which is very important and personal to you. If you can't be, use a professional who will do it for you!

Summary

Negotiation is a critical part of any business transaction. Skills can be learnt and developed, but having an experienced professional from a recognised firm by your side will inevitably make you more effective.

Details of such firms, who are associate members of SWAIN can be found at:

www.swain.org.uk

Or if you would like to discuss any of the topics or issues raised in this guidance note, please contact the following at Milsted Langdon, who prepared this guide.

Richard Plunkett
Corporate Finance Partner
Email: rplunkett@milsted-langdon.co.uk

Bristol office: 0117 9452500
Taunton office: 01823 445566
Yeovil office: 01935 383500

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