

FINTECH COMPANIES -

Private Equity Guide



Introduction

'Eventful' is a good one-word summation of 2020. For Fintech companies, it has been no different. Overcoming short-term challenges has been on the top of the to-do list for many. Luckily, it is often followed by 'figure out how to grasp medium to long-term opportunities.' Some companies may have bypassed the main issues created by COVID-19 and are already busy examining how to grow their business.

BDO has developed the [RETHINK framework](#) to assist companies, including in the Fintech space, respond to the global pandemic. The framework helps businesses [react](#) to the immediate fallout of COVID, increase [resilience](#) and best position themselves to [realise](#) their full potential.

Outside funding may be necessary to reach that potential. One possible investment avenue is private equity firms (PEs). On the PE side, there has been a steadily increasing interest in Fintech. But how can you identify the best prospective investors? Which PEs are best suited to take you to the next level - or to a favourable exit? This guide seeks to answer such questions. Furthermore, the guide will cover the main steps along the way; from the first investment considerations to post-acquisition collaboration and reaching potential earn-out targets.

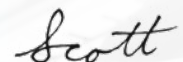
Receiving investment from - and being acquired outright by - PE investors can be great news for a Fintech company. PE firms are very focused on generating growth, as exemplified by analysis from BDO UK. A study of PE-backed companies showed that they on average increased revenue by 53% and staff by 43%.

However, PE can also be a risky path to additional capital. PE firms often have goals and focus points that differ from other investors - as well as potentially your own. One example is whether the PE fund plans to roll up your company and several other acquisitions into one entity.

Knowing how to prepare for a potential PE acquisition, what PE firms are looking for, negotiating the optimal deal and collaborating with the PE firm post-investment are all crucial aspects.



Tim Aman



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In this guide, BDO experts give their advice on how you can achieve the best results. They are:



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Preparing for a deal

What are you looking to achieve – and when?

COVID-19 has led to changes across all industries. Business models, runways, solutions, and market prospects have been – and are being – revised. Fintech is no exception. While the global pandemic creates new opportunities and possibilities, it also necessitates meeting new challenges.

COVID-related challenges, growth ambitions, building out resilience, and expanding market positions are just some of the areas Fintech companies may be considering. The same applies to potentially solidifying exit plans. In all cases, funders and management teams may be looking to secure external investment.

Private equity is a good source of both extra capital and collaboration that can help you reach your goals.

There can be many upsides to working with PE firms. A solid focus on growth, strong experience streamlining business processes and understanding how to expand your operations are reasons why PE is a good funding avenue to consider. However, it is not the only way to raise capital. Others include debt, loans, and public markets. Each option comes with specific advantages and drawbacks, making close consultation with your advisors pivotal to making the optimal choice matching your situation and goals.

Defining your goals and strategy for securing investment starts with looking inward. What you wish to achieve and by when form a good starting point for deciding if PE investment is the right choice. Your current situation, market, and solution, along with prospects, strengths, weaknesses, threats, and opportunities – as well as near, medium, and long-term goals – will all need to be objectively analysed.

Finding answers can start with asking questions like:

- 01 Are you looking for an exit or to take your company to the next level?
- 02 In either case, what is your timeline?
- 03 What are your company and solution's core strengths and weaknesses?
- 04 How will securing extra capital help you?
- 05 What are your plans for the raised capital?
- 06 Why is PE investment the right way to go?
- 07 How much control are you willing to cede?
- 08 What parts of a PE firm's expertise are most important to your situation and goals?
- 09 How do you see your position as founder or management team post-deal?

As a passion-driven founder or management team, objectively answering such questions may require outside assistance. Advisors capable of meeting you at eye level with an understanding for your situation, market and solutions provide a good sparring partner.

Thorough analysis of your company based on the questions above have knock-on benefits. For example, it can teach you valuable lessons about your business's current state and identify areas for improvement. Something that is true whether you reach a deal or not.



What PE investment enables

Private equity firms are becoming more frequent investors in the Fintech space. 2019 saw [\\$137.5 billion invested in Fintech, globally](#). Many investments and deals involve PE companies, including megadeals such as the \$3.4 billion acquisition of Verifone. Deciding whether PE investment is the right fit for your company involves knowing how PEs can help you reach your goals.

The list of potential benefits varies between PE firms, as does their size, focus, and expertise. General advantages from working with a PE tend to include:



Market expertise: PE firms have a track record of collaborating with portfolio companies on expanding market share and building out new markets. If your company is looking to expand the likes of sales, their expertise can be invaluable.



Access to contact and customer networks: PE firms often have vast networks of contacts that can help you connect with business experts as well as identifying and engaging with new potential customers.



Streamlining operations: Fintech companies are often defined by rapid growth. Internal business processes may end up lagging behind, hindering efficient operations. PE firms are often experts in the organisational and financial sides of running a business and can assist with optimising business operations and daily management.



Financial insights: While Fintech companies may be experts at their financial offerings, they are not necessarily well versed in the regulatory and financial compliance issues of all the regions where they are active.



Objective insight: Passion and speed define the development of Fintech companies. Without those, the company would not have grown to its current size. However, getting an external, objective, data-centred evaluation of your company from a PE can help identify areas needing to be addressed if you want to reach the next level.



Higher profitability: [As illustrated by BDO UK data](#), the likely result of PE investment and assistance is that your business will grow revenue and become more profitable.



Exit options: PE investment is an opportune avenue for Fintech company founders and management teams looking to exit the company and reap the monetary reward of many years' hard work.

Considering PE investment also involves looking at where interest between you align – and where they may differ. Many potential challenges (described in detail later in the guide) arise due to a lack of focus on aligning interest and clearly stating goals early on during the negotiation process.



How to leverage financial and tax support

One of the areas where PE firms may be of great assistance to Fintech companies concerns financial issues. This sounds counter-intuitive, given that a Fintech's solutions almost invariably revolve around financial matters.

Fintech founders and management teams are often comprised of a combination of engineering, technical, and technological experts, as well as members with a background in finance. The latter category is often bankers with strong experience and track records within the industry. They may even be banking specialists who are used to working in sub-industries like challenger banks. One area where their financial background is almost invaluable relates to situations when Fintechs are viewed as regulated entities. In such cases, having a person approved by the financial authorities as part of your team will usually be a set requirement for doing business.

Issues arise due to the complex legal and regulatory landscape that Fintechs face – especially when expanding into new markets or offering new solutions. Due to the geographically differing and continually developing rules that govern Fintech companies, a strong sense of current and coming applicable rules' influence of business operations is crucial.

Apart from regulatory aspects, Fintech management teams will not necessarily be experts in financial areas like tax and VAT/GST. They do not have the expertise to deal the various international tax issues that can arise, such as corporate income tax exposure, VAT/GST operational taxes, transfer pricing, employment taxes, share incentive schemes, and the founders' own tax position.

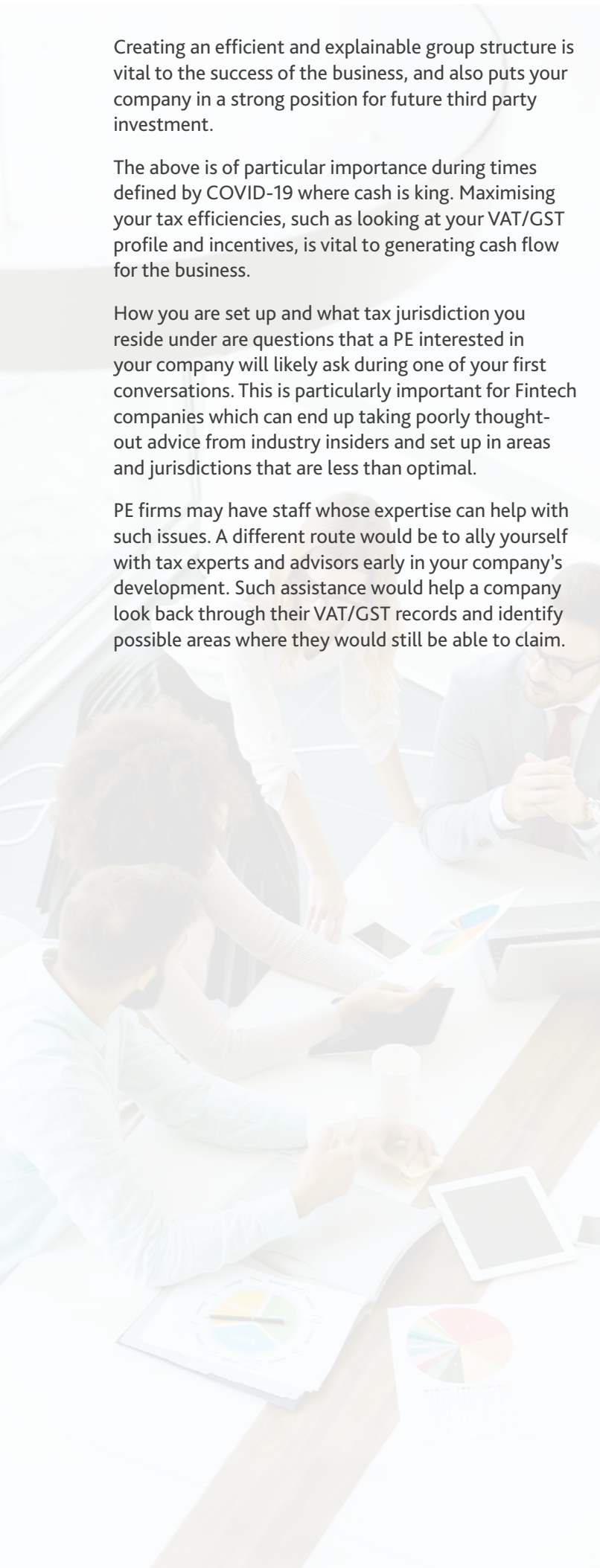
Working with Fintech companies, we often find that, especially in the start-up phase, the group structure has a number of tax inefficiencies i.e., not maximising tax incentives such as research and development tax credits / local country tax incentives. We also find companies generating significant tax issues by creating structures that are no longer applicable in the current global tax environment i.e., setting up entities with little substance in tax havens.

Creating an efficient and explainable group structure is vital to the success of the business, and also puts your company in a strong position for future third party investment.

The above is of particular importance during times defined by COVID-19 where cash is king. Maximising your tax efficiencies, such as looking at your VAT/GST profile and incentives, is vital to generating cash flow for the business.

How you are set up and what tax jurisdiction you reside under are questions that a PE interested in your company will likely ask during one of your first conversations. This is particularly important for Fintech companies which can end up taking poorly thought-out advice from industry insiders and set up in areas and jurisdictions that are less than optimal.

PE firms may have staff whose expertise can help with such issues. A different route would be to ally yourself with tax experts and advisors early in your company's development. Such assistance would help a company look back through their VAT/GST records and identify possible areas where they would still be able to claim.



Know what a PE firm expects

Going back about 25 years, it used to be that PE firms would not be particularly interested in companies valued at less than \$100 million. Since then, much has changed.

Today, Fintech companies all the way down to the scale-up (and in some cases perhaps even start-up) phase may be in PEs' investment sights. A rule of thumb is that companies who are past Series A funding might find interest among some PE firms.

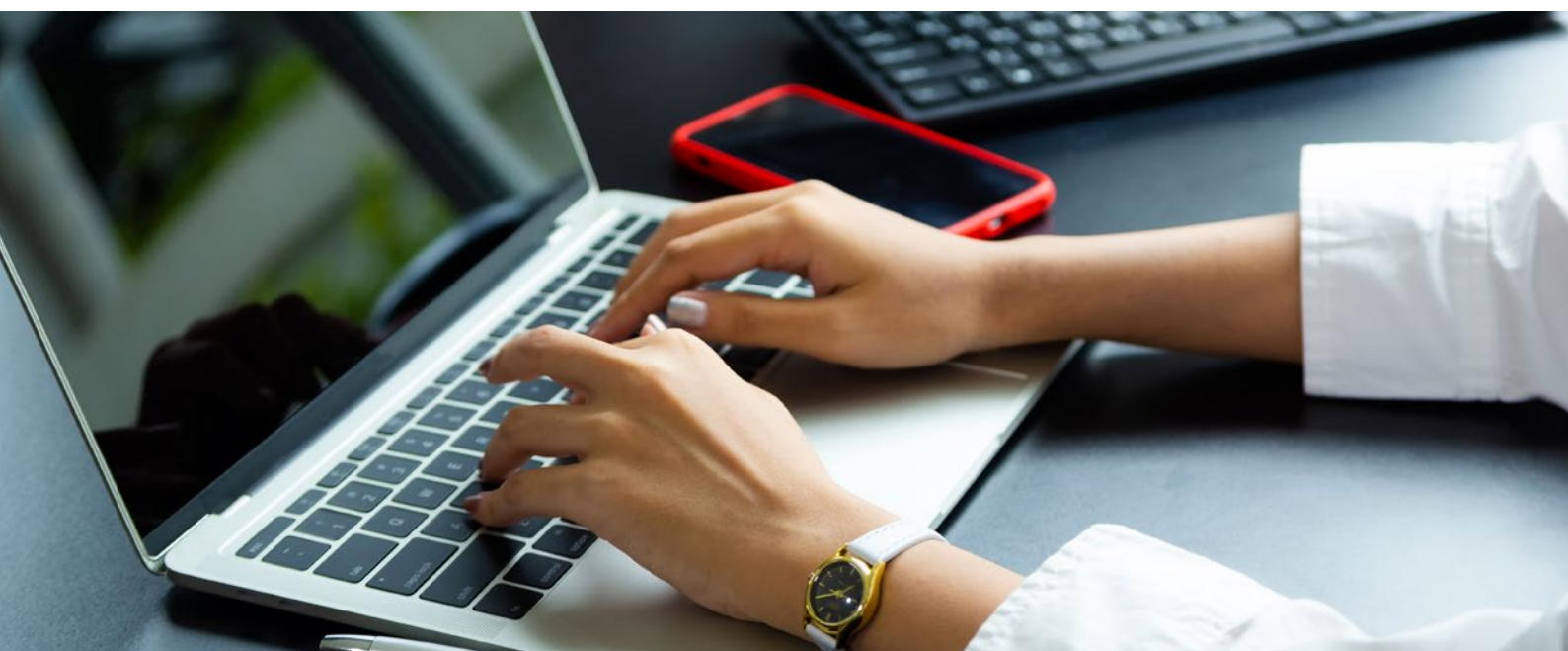
PE firms differ from other investors by having a very strong focus on creating growth within a set period. Usually, they will be looking at either doubling the value of their investment in three years or tripling it within five years. While some holding periods have been extended, in part due to COVID, you will want to keep that front of mind when looking at securing PE investment.

Outside of growth focus, there is a lot of variation among PEs. Some are generalists, others may have dedicated focus on Fintech. Investment preferences may differ, ranging from minority stakes in pre-profit, growth-stage companies to billion-dollar acquisitions of mature multinationals. Similar differences influence the way you will collaborate after investment. For example, some PE firms specialise in rolling up several companies into one. If you are looking to keep running your company independently, you may want to avoid such experts.

Having defined your strategic investment goals will help you identify the optimal, potential investors. Before starting negotiations, it is advisable to identify at least three or four parties whose profiles and plans for your company, post-deal, match yours. Your consultants' wide network of contacts and industry expertise will be a good partner in identifying the optimal firms.

With a strong focus on achieving growth, PE firms will, when looking at investing in Fintech, be very focused on your scalability. In other words, they will expect your company to be able to expand rapidly. This can be tied industries (vertically or horizontally), geographically, through building out solutions, bundling through bolt-on acquisitions, through rollups, and more. Being prepared for the post-acquisition changes that will help deliver growth – and making sure that your solutions can handle it smoothly – will be a core focus point during technical due diligence. Similarly, a PE may be focused on your company's debt capacity. While this may not necessarily be a negative on its own, you may want to ensure that the company is not going to be saddled with insurmountable debts that it endangers its long-term prospects.

Smooth operations are pivotal to achieving growth. PE firms typically try to ensure that existing management and key employees stay with the company, post-investment. If your goal is to take your company to the next level, then this will also suit you. If you are pursuing an exit, defining, and negotiating earn-out targets will require a keen understanding of buyer's business objectives and expectations. In this case, achieving set growth targets for revenues, sales, and profit are likely going to be focal points for PE firms during target negotiations. Among COVID-19's effect on deals is that PEs may look to secure longer-term seller participation through higher earn-out targets and deferred consideration to manage cash flow.



Know your worth

The value proposition of many Fintech companies is on the rise in a time where contactless payments, alternative banking and lending are becoming more widespread. Counterbalancing the development are the likes of COVID-19's impact on projections of future earnings and growth. Together with financial and business advisors, your company should still be capable of producing good, realistic value estimations.

Staying within the parameters of ambitious but achievable projections for growth will be important during negotiations and subsequent collaboration.

If your own valuation is perceived as unrealistic, it may lower trust in your management team and lead to more difficult negotiations.

Material and immaterial assets, your code, R&D, patents, customer base, sales, and future potential will all be part of calculating your value. The same applies to past deals within your subindustry space. Generally, revenue or EBITDA (earnings before interest, taxes, depreciation, and amortization) multiples are used as yardsticks. Note that historical average multiples may not apply, in some part because of the influence of COVID.

Many factors can affect your valuation, both positively and negatively. Below is an inexhaustive list:



Technology: Including your products, services, intellectual property, and R&D. Also, how old and future-proof your technology stack is.



Industry trends: Both on the macro- and micro-level. Also includes how your solutions match where the industry and customer preferences are headed.



Competition: Who your biggest competitors are and why are you better positioned than them via technological or financial moats is central for investment.



Revenue: Includes current revenue, historical growth, retention rates, annual recurring revenue, and customer acquisition cost.



Revenue to cash flow: Turning revenue into positive cash flow and growth in liquid assets.



Growth potential: Opportunities for increasing revenue and profitability.



Sales: Upsells, retention rates, and historical sales performance.



Runway: How long you can keep operations going without injection of new capital.



Potential future sell-on: Interested future parties or your potential to IPO within a set timeframe.



Software stack: Unique competitive advantages of your software and solutions, related IP, and futureproof level.

Each area mentioned is an introductory overview and not meant as a full exploration. Furthermore, investors' analysis will cover current and past performance of key metrics, as well as future worth of material and immaterial assets (especially IP) over time. Fintech companies should be prepared to meet demands for granular data that quantifies and documents the areas mentioned above.

Issues may arise regarding differences between yourself and a potential investor in your valuation. If you and your advisors feel that there is no way of bridging that gap, it may be worth considering extending runways and revisit potential investment in the near future. COVID's impact on deals includes an excess of distressed companies currently looking for funding more than an objective analysis of your actual potential and worth.



Negotiating with a PE firm

What PE firms are looking at

As a rule of thumb PE firms are looking for a substantial return on investments in three (double) to five (triple) years. After the end of that period, they will be looking to either sell their part of a company on to others or otherwise create a return (for example by selling shares after an IPO). Even before COVID, [PE firms were preparing](#) for longer holding periods, but likely not beyond a maximum of seven years.

With a time-constrained, returns-focused approach, PE firms will be locked in on growth scenarios and the growth potential of your company and solutions. Expanding to new markets or industries or growing through bolt-on acquisitions are areas that PEs will be focused on to boost your short to medium-term profitability. Another avenue is a roll-up of several companies into one to create economy of scale, bigger market share and cross-selling opportunities.

Fintech company founders and management teams seeking PE investment must be very aware of the growth focus. During the initial stages of deal preparation, the company should work to create detailed plans and strategies for achieving short to medium-term growth - on the scale a PE is looking for - without risking the long-term prospects of the company.



During negotiations, PE firms will often focus on a lot of the same areas that determine your value, such as:



Technology: Products, services, IP, and R&D. IP rights and resistance to technological developments are key areas for PE firms.



Management/employees: Your ability to deliver on business goals, overcome challenges, and create and update solutions.



Succession planning: Should management or key employees seek to leave, do you have a strategy for replacing them?



Contingency plans: Resiliency to industry and macroeconomic developments, including COVID.



Market trends: Changes to customer demands and similar that can influence your market position and service portfolio.



Customer relations: Your connection with your customer base can go a long way to increase your value; as can provably brand awareness among specific, relevant customer demographics.



Revenues: Recurring cash flow, expanding sales and growing profitability can go a long way towards securing a PE deal.



Investments: How is the raised capital going to be deployed?



Exit strategy: What are viable exit options for the PE firm (future sale or IPO). This also covers if you are looking to exit the company, post-deal.

Ahead of sitting down at the negotiation table, both you and the PE firm will have mapped out how various aspects of your company perform. This view will be used to form an outline of deal terms. Carrying out a similar process and preparing your arguments – based on detailed data and documents to support them - will give you a strong starting position for negotiations and help speed up the process.



Prepare for due diligence questions

Knowing what the other party is likely to be looking at is a critical factor in a deal negotiations process. This insight will help you discern what negotiation tactics will be effective, while also enabling you to prepare ahead of time.

Due diligence involves potential investors closely examining and evaluating many different parts of your business. Some of the areas include your software, code, architecture, and products – as well as financial and managerial aspects of your business.

To add more detail, some of the questions that a PE firm will ask include:



Sales and forecasts: What are your sales channels? Do you rely on a few large customers or many smaller ones? What are your churn rates? Do you have economic or product moats which give you advantages? How is your user experience and related user rating?



Products, product strategy and portfolio: What solutions do you currently offer? What are their competitive advantages? What are your plans to upgrade or evolve them? What other products are you developing? How will they help you achieve the PE firm's growth benchmarks?



Market situation: What is your current market? How is it developing? Are there other areas or verticals where you can increase sales? What other geographic regions are well-suited for your solutions?



Management team and key employees: Do you and the management team have the right skill set to guarantee growth? What is your track record with growth? Do you or your team have skill gaps? Who are the critical employees? How can you ensure that they remain with the company, post-acquisition?



Technology: What kinds of software do you use? How are your solutions deployed and upgraded? How do your solutions scale? Are there third-party dependencies? What is the cybersecurity situation?



Taxes and legal: What are your non-income-based taxes? What is your potential exposure? What is your sales tax situation? How is your company incorporated? What shareholder agreements are already in place?

For most companies, it can be advisable to undertake a [vendor due diligence process or similar sell-side due diligence activities](#). This is a due diligence carried out by a financial advisor ahead of negotiations to identify and mitigate any potential issues. Such a process can, among other things, identify areas where your reporting may be lacking and areas where attention and work ahead of negotiations may help improve your result.

Vendor due diligence (VDD), in some areas also referred to as sell-side due diligence, is particularly advisable for software companies, as their systems and solutions are often put through extra, in-depth technical due diligence by a PE firm.

Know PE firms' software and Fintech concerns

Fintech companies are attractive investment targets for private equity firms, as well as some corporate venture capital funds and many traditional venture capital firms. The extended interest might, in some cases, be tempered by the challenges and risk factors that investors see in the space.

Respondents in [BDO's 2019 private equity study](#) pointed to growth opportunities (42%) and finding and retaining management teams (33%) as some of the biggest challenges when acquiring target companies. This is something that may also apply to the Fintech industry. Other areas of concern include resilience to competitors, as well as regulatory and technological developments. 5G networks, bio-informetric recognition, VR, and data protection legislation are just a few examples of areas where Fintech companies may face increased challenges and opportunities. This is particularly true in relation to regulatory risks, as moving into new markets may mean having to comply with different sets of laws and regulations governing areas such as data, financial reporting, and capital reserves.

The speed of change in the Fintech space is another area that PE firms may see as an opportunity – or look at with concern. Fintech has become an increasingly active space with several major tech companies, as well as traditional financial juggernauts, looking to build out their position. Combined with the speed of technological development, this could lead to shorter product life cycles and narrower windows of opportunity. On the other hand, it may also create a broader pool of potential buyers for PEs when they look to divest of their investment in your company. Your company should have clear, well-documented strategies and policies in place for addressing current risks and should seek to protect against future issues through laying the foundation for future initiatives.

PE firms will also be looking at your portfolio and related IP with a goal of ensuring that it can scale and attract new customers. If your solutions need to be re-architected to enable the required scaling, this should be included in the deal specifications. Entering new markets or engaging new customer segments are two of the preferred ways of generating growth and ensuring that your solutions and back-end systems can handle said growth will be a central concern. The same applies to intellectual property (IP) rights, patents and where your technology is protected. For example, if your IP is reliant on third-party systems and solutions, or if you only have partial ownership of the IP in question.

PE firms often hire technical and IP experts to help them during due diligence and deal negotiations. Your company should be prepared to document every part of your software and IP during a negotiation process.



Knowing your potential IP issues

Do you own all the rights to your software, the underlying code, your solutions, patents, and other IP? While you would likely say yes, the answer may not be that straightforward.

Your code, products, and services are one of the main reasons why a PE firm is looking to invest in your company. The underlying innovation and work are what makes up a large chunk of your valuation. So, ensuring that they are indeed getting what they are investing in is one of the main IP concerns for PEs. IP, code, and solutions should be analysed ahead of M&A negotiations – and the same goes for the creation process.

Apart from the code itself, a lot of areas go into calculating its worth ahead of an M&A process. Scalability, costs, server and network requirements, future potential, revenue, royalty earnings, and license fees (payable or receivable) are all areas that a PE will consider. The same applies to other areas, including the likes of IP-related patents, patent applications, globally or regionally protection, trademarks, and certification marks.

A core area during this will be the IP rights. A PE firm – or any other investor – is looking to ensure that IP, associated rights, and Fintech solutions are free of future extra charges or litigation risks. To ensure this, a PE firm may look to hire external technical and judiciary experts to review your IP, code, and solutions early on during negotiations. As is the case for legal matters pertaining to IP, you and the PE firm may want such experts to be independent third parties to ensure insight without risk of perceived bias.

During a negotiation process, a PE firm will likely request copies of all material license agreements, patents, and all other IP-related agreements. Be aware that such documents may include the likes of R&D agreements, strategic partnerships, and joint venture agreements.

Preparing for IP-related negotiation and valuation can start with asking yourself questions such as:

- Was all development handled in-house? Often, there will be sub-contractors or consultants who have been involved. Depending on the contracts, they may have rights pertaining to your IP.
- Do you rely on third-party or open-source solutions? Many times, your solutions are built on existing libraries of code. Such dependencies may lead to IP issues.
- Who assisted in developing the IP? Past employees, external experts, and independent programmers may have contributed to your IP. Their contracts may include rights pertaining to the use of or sale of the IP.
- Is my software platform dependent? Examples would include mobile vs laptop and Android vs iOS. Your solutions may not work on all platforms or operating systems. Possible IP dependency should be explored, and risk exposure mitigated.
- What data sources do you have – and need? Data, data sources, and data processing are likely core to your solutions. Data-related regulatory risks, such as compliance with the EU's GDPR regulations, should be charted. The same applies to your solutions dependency on specific types of data.

When addressing the potential IP issues, company founders should also be aware of the potential risks to IP, should your company fail or be sold on. Setting up a holding company for your IP that is a separate entity may help secure your IP. However, this can also create new issues during deal negotiations.



How COVID-19 has changed the deal process

2020's global pandemic has changed parts of M&A negotiations and specific contract terms. Whether things develop toward a 'new normal' or returns to the way things used to be is yet to be determined.

For Fintech companies, it means needing to be extra aware of the acronym MAE. Material Adverse Effects, as the letters stand for (often referred to as MAC in the US), is a contract clause which removes a buyer's obligation to close a deal if new, substantial threats to the overall earnings potential of an acquisition target appear. Many countries have extremely high thresholds for invoking MAE conditions, but at the same time COVID-19 and the economic fallout continues to increase the risks of rapidly changing market situations.

Part of the reason is that regulatory approval times have been extended, with some places including a back-log of requests. Reduced face-to-face interaction, limited travel and remote working have all increased the average deal negotiation times. As market and business conditions remain volatile, risks of unforeseen changes to your potential earnings remain. Said risks can cover operations, liquidity, markets, capital, and technology, to mention just a few areas. Working closely with legal and financial advisors when negotiating MAE terms help guard against such issues.

In some cases, deal and payment structures may also have changed. Changes are appearing faster, and there is a bigger risk of deals proposed capital structures and earnout targets changing during – and after – negotiations due to changing market demands.

Other areas of deals and negotiations with a PE that can have been affected by COVID-19 include:



Due diligence: Projections, business plans, continuity plans, actual and potential liability exposure, and your financial forecasts will likely see increased scrutiny. The same goes for the pandemic's current and potential impacts on customers and markets.



Risk exposure: Increased privacy, HR, and cybersecurity risks may arise as work-from-home has become more widely adopted. This can also include altered supply chains, customer bases, and key facilities which may be affected by COVID-19.



Negotiations: Creating your data rooms may be slowed due to limited access to all information and documents. Face-to-face meetings and negotiations will be limited, which can lead to slower deal negotiations.



Changed Interim Operating Covenants (IOCs): IOCs are put in place to ensure that your company maintains smooth operations between the time a deal is signed and closed. Reacting to COVID-19-related developments may necessitate deal terms allowing for extended responses to rapid changes.



Earn-outs: For company founders and management teams looking to exit the company, earn-out targets may be changed and earn-out times prolonged to maintain stable operations.



Define your earn-out goals and targets

A deal with a PE investor can be an opportune way for funders and management teams to exit a company while ensuring its continued, successful development. In such cases, you will more than likely be negotiating earn-out clauses and targets.

Earn-outs are usually divided into fixed and variable components. Some (fixed parts) are often paid out when completing the deal. Variable components are paid out over time and may be tied to certain milestones, such as earnings or growth targets or certain other conditions.

For the PE firm, earn-out targets help ensure that a takeover is smooth, and that existing leadership is secured to support continuous company growth. Furthermore, it incentivises management to continue working toward creating growth and as a buffer if unexpected situations should arise. If, for example, the company fails to hit expected and agreed upon growth targets, the earn-outs may be lowered or nullified, depending on an agreement between the parties.

COVID-19 has led to wider adoption of earn-out clauses and generally also to larger portions of a deal being part of an earn-out (up to two-thirds of deal value as earn-out is not unusual). Uncertainty surrounding future market developments, changing consumer behaviour and uncertain revenue predictions all affect the situation.

During negotiations, earn-outs can be a tool that helps reconcile different stances on the value and future potential of your company. You can, in other words, want to push aggressive earn-out targets with high rewards if you believe in your company's performance and potential. Fintech companies should be aware that COVID-19 has led to a trend of longer earn-out periods (traditionally, earn-out targets have been set at between one and three years from deal completion) and larger shares of purchase prices assigned to earn-out targets.

While earn-outs can help both parties in a deal reach an agreement, several risk factors need to be addressed to avoid the risk of post-closing disputes. One revolves around calculation methods. Financial performance indicators such as consolidated net income or EBITDA are often used as a yardstick to define earn-out targets. However, if your company is rolled up with several others, post-acquisition, earnings can be exceedingly difficult to measure and involve navigating complicated legal structures.





Different forms of non-revenue/EBITDA-centric metrics can be used as alternative on a stand-alone basis or in together with revenue-based metrics. Examples include, but are by no means limited to, sales, growth, or customer acquisition. Defining such milestones requires developing specific, clearly described goals and targets and timelines ahead of negotiations.

Earn-outs may have material tax consequences to both seller and buyer. Said consequences are dependent on deal terms, earn-out payment methods and applicable legislation. As seller, the most important area is often income tax and how earn-out payments are treated. Earn-outs defined as compensation for services rendered may be viewed as taxable income and could lead to extra tax liabilities. Consulting with financial advisors will help you establish the optimal earn-out structures.



Start preparing early

PE firms' requests for data and information throughout the deal process may come as a surprise to Fintech companies. Once due diligence and negotiations begin in earnest, request for granular data can come thick and fast. This is often particularly true for financial matters, such as sales, customer growth, and revenue metrics and historical financial data.

Creating the best possible foundation for a successful, smooth deal negotiation should start well in advance. If possible, a year of internal preparations is recommended. This gives you time to identify potential issues, prepare documentation and optimise your company for the sales process.

Preparations include a wide variety of tasks and areas. Analysing employee contracts, legal and tax risks, structuring data and ensuring that documentation is in place for business processes, future earning perspectives, and risk factors are among the parts to address.

Using a maxim that preparing for tomorrow should start today definitely applies to preparations and getting documentation ready. Often, a good starting point is looking through what historical and current data is available and how it is structured. The next step would be how to structure and present data, information, and documents to a PE firm during negotiations. It is a task that should be based on what area you know that the PE firm will be looking at during due diligence and negotiations. Completing a deal negotiation without any issues or requests for additional data is almost unheard of. Needing to take time out from negotiations to prepare additional data is not necessarily something that can lead to a loss of confidence among PEs. Having it happen repeatedly throughout the process probably will.

PE investors will also want to know how you plan to deploy raised capital. How can the capital help grow revenue and how do you see it leading to increased growth and profitability? Detailed plans covering such areas should also be laid and presented – but also take into consideration that a PE firm will likely want influence over this process. Working with plans covering multiple growth scenarios will help show that you are prepared to tackle challenging situations.

PE firms may in some cases look to cover non-traditional areas of your company. For example, there may be requests for information and value analyses of non-financial activities such as corporate responsibility, social inclusion, and sustainability programmes. Debt capacity is often an area that PEs pay close attention to, and an area where you may want to negotiate max levels, as the company may otherwise risk being saddled with debts that hinder long-term growth (post-holding period).

Preparing documentation and carrying out negotiations is a challenge when considering that it should take place without disturbing day-to-day operations. Splitting areas of responsibility to free up specific management team members for negotiations can help. The same applies to giving certain staff members more responsibility for daily operations while top management focuses on negotiations.



Collaborating post-deal

Plan for your collaboration

Once you and the PE sign on the dotted line, work, in many ways, starts in earnest. Signatures are the start of working with the PE firm and its employees. Establishing the fundamentals of that post-deal collaboration can begin already at the negotiation table.

Defining your goals for the short, mid, and long-term and being open about what you expect to get out of the partnership is a good starting point. The same goes for working with the PE on defining how collaboration should look in practical terms. Post-deal collaboration can be heavily influenced by many factors. Growing the company to the next level, rolling it up with several others or working toward earn-out targets and an exit create three very distinctly different starting points for collaboration.

It is sometimes remarked that PE firms will spend 50% of their time growing a company and the other half on figuring out how to divest. PEs may work towards various kinds of exits, including a management repurchase, secondary sale, trade sale, or IPO. Having a clear idea of what the end goal is and working together to achieve it will be a core aspect of your collaboration.

You may see varying levels of involvement in day-to-day operations and strategic decisions. A general rule of thumb is that PE firms will be much more involved than the likes of VCs. Some might want you to consider hiring specific people, often to develop business and administrative aspects of your company. Others will leave that part entirely up to you. Funds raised may be partially tied to specific areas, such as bolt-on acquisitions, or may be pooled more freely. How collaboration in such areas should work, and the PE's level of influence, should be outlined during negotiations. However, you and the PE should strive to continually ensure that actual involvement aligns with planned and agreed-upon involvement.

PE firms tend to be active board members and want to stay informed about your business decisions. Considering their broad experience from creating growth, it will often be a good idea to listen closely to their suggestions and recommendations – although perhaps not always. Keeping investors informed should happen regularly to ensure smooth collaboration. Selecting the right chairperson to your board is also an important, and often-overlooked, part of creating the best foundation for collaboration.

Finally, it is important to ensure that your unique culture and freedom to pursue innovation is not lost. If this is the case, it will damage both your own and the PE firm's ability to reach your desired end goals and targets.



Set clear targets

If there are issues with your communication and collaboration, they are often tied to misaligned expectations and goals.

Agreeing on realistic targets and goals for both yourself and the company, post-deal, is important for all the time you will be working alongside a PE. Perceived unrealistic plans and views on various areas of your business, such as growth potential or upsell opportunities, will often be a red flag for PE firms. During negotiations, it can prolong or even sour a deal before completion. Post-agreement it may lead to doubt on whether you and your management team are the right people to continue leading the business.

Shaping the conversation around targets and how to measure them happens throughout the negotiation process. However, it is a continuous effort where parts should formalise in the contract while others should remain more fluid and informal. In a rapidly changing industry, solidifying open communication channels between members of each party should be a core focus in the days and weeks after a deal is reached. As the market situation continues to evolve in the wake of COVID-19, updating and re-evaluating targets and goals should be a recurring point on the agenda for both parties.

The exact communication form and frequency will vary, the below are rules of thumb that apply to most situations:



Be proactive: Communicate clearly ahead of making bigger business decisions even if a PE is not going to have direct influence over said decision. If business problems arise, be clear about what the problem is and how you are planning to remedy it.



Define decision-making: Establish clear guidelines for how major decisions are made, including what decisions remain the exclusive remit of your company and which must be discussed with the PE firm.



Ask for help: PE firms are often experts in business operations and can offer valuable insight and assistance. Inform them of business issues, challenges, and opportunities. Ask for a second opinion when needed.



Set communication schedules: Agree with the PE and other potential parties on a schedule and format for communication. Also agree on templates for keeping PEs updated on specific metrics for your company.



Avoid surprises: PE firms will prefer hearing information in a timely manner. Otherwise they may feel like you are 'springing' new information on them. One way to avoid such issues is to arrange a call with PE representatives a couple of days ahead of board meetings to lay out what you hope to discuss during the meeting.



End note

Get the right advice – and advisers

This guide is only an overview of some of the aspects that a Fintech company should look to cover during deal preparation and negotiations. The key takeaway is that preparation is vital. The same goes for setting clear goals. Once you have decided to sell, you need to spell out what your role and responsibilities will be post-sale – or how you wish to exit the company. Otherwise, you will end up in a process that is unnecessarily frustrating and challenging for both sides.

Even during less tumultuous times, an acquisition process is a long-lasting undertaking and involves many novel tasks for Fintech company leadership teams. The good news is that there is little reason to undertake all of it on your own. By working with a good advisory team during the entire process, you will likely achieve a better result – and have a better acquisition process – than if undertaking it on your own.

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