LEAP 100

MISHCON THE LEAP

City A.M. has teamed up with Mishcon de Reya and other expert partners to identify 100 of the most exciting, fast-growing firms in the UK. They operate at a range of scales and across many sectors, but all are in the process of making the leap to the next level in terms of revenue. We will track the challenges and hopes of this brave and economically vital group, sharing the collective portrait that emerges on this monthly page and at cityam.com/leap-100

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ZappiStore's Stephen Phillips on getting through his first VC raise

STEPHEN Phillips may have worked in market research for most of his career, but now he's swimming against the tide. "Market research is full of smart people who care about understanding human behaviour, but profit margins are slim and processes are very intensive."

At a recent Leap 100 roundtable, Phillips explained how his firm ZappiStore is trying to disrupt the industry, as well as sharing his experience of raising VC funding. "We go to big market research firms and say 'we'll take your thinking, your great ideas, and we'll automate the processes end-to-end, so we can deliver that much, much quicker and much, much cheaper.'"

Merging with a technology company and getting funding from WPP strengthened ZappiStore's ambition to cement itself as a real tech player – albeit one operating within the market research industry. "Our ambition as a tech company does not only translate in a particular mind-set or culture, but also in financial valuation and multiples, which seem alien to the market research industry."

Although they were growing organically and were profitable, he wanted to expand rapidly, so about a year and a half ago he tried to find a corporate finance house to help. "We hadn't really put a business plan together but we knew what the vision was," says Phillips. "Our corporate financiers constructed a very ambitious business plan that showed the kind of rapid growth that we were hitting. It made sense at the time, but it turned out to be the wrong business plan and a bit of a shackle."

The plan for the raise was to send out the idea to 50 VCs with an expectation of getting meetings with 10. However, 45 of the 50 wanted a meeting. "You go into these fancy offices to meet with two people and both have three MBAs and are only 25," says Phillips. "The whole thing was absolutely fascinating. I even did one trip to Silicon Valley. I wanted to raise US money – partly because around 65 per cent of our revenue is US based, and partly because we are a tech company and I wanted to feel like we are in that space." However, the eventual VC, Prime Ventures, is from Holland, explains Phillips. "The investor we ended up with had just sold a company in our space and just knew it really well, which made the conversations about the business model very easy."

But the deal took longer than planned. Phillips offloaded a lot of the raise to his chief operating officer, who is ex-BearingPoint, but it still distracted him. "All my headspace – like those moments in the shower when you have great ideas – were about the raise for six months. So the business did lose focus."

It was supposed to be wrapped up by March, but it ended up taking until July. The business plan projected annual growth from £6m to £15m, but this was starting to slip in the second quarter, as besides the distraction from the raise they were rebuilding a lot of the code. "We were not as open with the investor as we should have been. That's my biggest regret," admits Phillips.

"I had a meeting with the investors before they signed and they said they were getting nervous. I put everything on the table. They were very supportive and didn't try to reduce the money. They weren't investing in us for 2016 revenue; they were investing in us for 2020 growth."

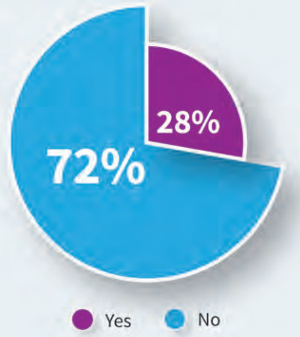
Phillips went on to speak with humility about the positive influence of the VC on improving processes, systems and management. But it would be a mistake to confuse humility with a lack of ambition. By the end of this year ZappiStore will have doubled and next year he expects to do the same. "They are going to make a lot of money from us," he says of his VC firm, "I hope."

GREG SIGSTON/ CITY AM

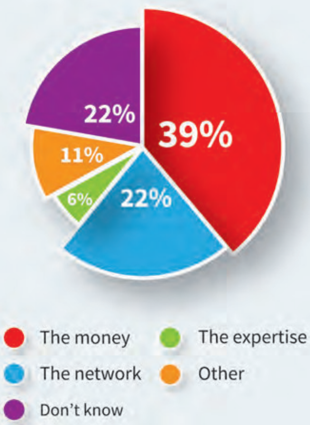
Stephen Phillips: The VC experience was absolutely fascinating

TOP RESPONSES

Have you received VC funding for your current business?



What is most attractive about VC funding?



Navigating the challenges of a management buyout

A MANAGEMENT buyout (MBO) can be a fantastic opportunity, but it's not for the fainthearted. The process can be gruelling, as the MBO team will need to juggle their job and home life while dealing with investors, lawyers, accountants, corporate finance advisers and, of course, the owners of the business.

No two MBOs are the same, but there are a few common ways they tend to come about. It may be decided that a business owned by a large corporate is no longer core. If there's a strong management team, the corporate might decide to sell the business to them. Or existing shareholders, who have built up the business, may want to exit. In fact, they may have consciously built up a strong management team to effectively make themselves redundant and, as a result, made it easier to sell the business without them.

MISHCON COMMENT

Nadim Meer

Alternatively, the management team might propose the buyout to the owner. This is often the result of managers seeing an opportunity to kick-start a business that they think isn't being run at its full potential. Occasionally we come across situations where the owner is running it for cash, taking out dividends rather than investing in its growth. The management might be frustrated and think they could do a better job of scaling the business.

However, a buyout is quite a dangerous thing for the management to initiate. They have obligations and duties as employees and sometimes as directors. Raising the prospect to unprepared owners is a signal that they're not focused on creating value for shareholders, but instead thinking about personal gain. A management team considering this should be diplomatic, ideally trying to make the current owner believe it's their idea to hand over power to the management team as well as showing the value to the owner of the capital payout an MBO may deliver to them.

The business owner must also tread carefully. If you've planted the seed in the heads of management that they're going to be the owners of the business, they will start planning what it will be like once you're no longer around. If the process doesn't work, it will feel like a demotion for the management team and they may be inclined to leave. Full commitment and a contingency plan will be needed in case it doesn't work out as expected.

Lawyers often get involved early in the process, giving strategic advice on how best to approach it. But once the process begins, the management team will need to be given license to speak with potential investors. There will need to be a management release letter setting out exactly what they can do and what information can be shared. Then lawyers will be involved in dealing with offer letters from investors, negotiating the heads of terms and the sale purchase agreement, as well as a suite of equity documents governing the relationship post-acquisition. It's a complicated process – even when everyone is well organised and prepared it can take longer than expected.

Despite the challenges, an MBO is a phenomenal opportunity for the incoming team. It can also be immensely satisfying for an owner to see a business being passed on to a management team they have hand-picked and nurtured – as well as providing an opportunity for the owner to secure a valuable exit.

Nadim Meer is partner in the corporate department at Mishcon de Reya.