THE SHERIDAN ROAD MAP

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LIBYA HAS $70 BILLION TO INVEST—AND NO TAKERS

Private equity firms such as California's Colony Capital once courted Libyan investments, but backed off before the war broke out

Several years ago, Libya was primed to dole out some of the billions the oil state held in cash during its time as an international pariah. When the country made its way back into the West's good graces, private equity managers shined their wingtips, straightened their ties, and headed for Tripoli, eager for a slice of the estimated $70 billion controlled by the Libyan Investment Authority.

"It was the spot that everyone was soliciting as both investor and investee, thinking this was the foothold for Northern Africa and the closest oil producer to Italy and France," says Thomas J. Barrack Jr., chairman of Santa Monica (CA) private equity firm Colony Capital. "They were rising from decades of isolation and economic sanctions and needed everything."

One of Libyan leader Muammar Qaddafi's sons, Saif Al-Islam, came to the U.S. in 2008, attending a lunch hosted by Blackstone Group (BX) Chairman Stephen A. Schwarzman at the billionaire's Park Avenue apartment. Donald Marron, who once ran Paine Webber and is now chairman of private equity firm Lightyear Capital, also had the younger Qaddafi for lunch. It was all aboveboard, complete with U.S. diplomatic security. Neither Blackstone nor Lightyear would comment.

Those managers and others who didn't land a Libyan account likely are breathing sighs of relief that nothing came of those meetings. Barrack tried to pull off a deal with the Libyan Investment Authority in 2007, when ownership of Libya's oil refiner, Tamoil, was transferred to the fund. Colony sought to buy Tamoil's refineries outside of Libya in Germany, Italy, Switzerland, and elsewhere, as well as more than 3,000 of its Tamoil filling stations across Europe. Colony dropped its $6.1 billion bid in March 2008, citing lack of information about the assets and other financial data. Colony has no Libyan ambitions now. "Libya is too confusing, and it's too dangerous," says Barrack. "There is no transparency, no leadership, no infrastructure, and no clear signal from the West as to what is the strategy or end game." Calls to the Libyan Investment Authority were not picked up.

Other financial industry veterans forged links with the Libyans before the recent fighting started. Former Bear Stearns executive Frederic Marino started an $800 million hedge fund with seed capital from Qaddafi's government. Three calls to Marino were unreturned.

London-based FM Capital Partners, founded in 2009 with financing from a smaller Libyan sovereign wealth fund, was preparing to raise money from other outside investors this year for the first time, according to two people briefed on the plans who declined to be identified because the firm is private. Those plans may have to be postponed because other governments have frozen Qaddafi's assets.

Libyan money is a "huge hindrance" to soliciting new investors, says Don Steinbrugge, managing partner of Agecroft Partners, a Virginia consultant to hedge funds and investors. "Once there is a transition to a more stable government, their asset base should be a positive in helping them build the business," he adds.

By Jason Kelly and Jesse Westbrook • Bloomberg Businessweek, March 28, 2011

AOL Tries for Some Silicon Valley Cred

The company has opened its sleek new Palo Alto offices to Valley startups, hoping some of the creativity will rub off

A conference room at AOL's West Coast HQ

"AOL is cool." The phrase appears in big blue letters on a long whiteboard lining a hallway of AOL's (AOL) newest outpost, in Palo Alto, CA. Since the Internet giant signed a seven-year lease on a 225,000-square-foot building last August, it has thrown the space open to a wide assortment of startups, which work in close proximity to 170 of its own engineers. The new digs are part corporate office, part startup incubator, and part college community center. The hope for AOL executives is that some of that entrepreneurial energy rubs off on their 28-year-old company.

Nothing is less cool than professing one's coolness, of course, especially if you're an Internet dinosaur evoking a bygone era of dial-up modems. AOL was a hot stock in the 1990s, only to become half of AOL Time Warner in one of the worst mergers in U.S. history. The company spun off in 2009 and has a market cap of $2 billion; that's a fraction of its value on the day the Time Warner merger was announced. Yet AOL's quest for cred may actually be working. There's a waiting list of startups that want to move in. "We really have tried to make our offices into centers of creativity where we can invite other people to come in and work with us," says Tim Armstrong, chief executive officer of the New York-based company. "The opportunity is to take some of the world's best entrepreneurs and technologists and have them work in a deeply engaging place."

AOL's building is less than a mile from Facebook and right around the corner from buzzy startups such as Cloudera and Box.net. More than 75 people from 25 companies—most with no formal AOL affiliation—work in the building. They range from a digital comic book maker, Graphic.ly, to a developer of anti-spam software called Impermium. Another tenant is SSE Labs, a business accelerator program that helps Stanford University students start companies. "Entrepreneurship is lonely and hard, so it's really nice to have people who are going through the same hardships as you," says Cameron Teitelman, a senior at Stanford who founded SSE Labs last summer.

The space is rent-free for now. Entrepreneurs will eventually pay AOL a discounted rent—and get free perks, such as access to a cafeteria with a pool table, foosball, and beer on tap, usually Samuel Adams or Anchor Steam. AOL hosts happy hours on Fridays and a biweekly lunch. A recent guest speaker: Arianna Huffington, who just sold her Huffington Post to AOL for $315 million.

The mix of occupants has already made life at AOL a little less stuffy. "We come in at 12 p.m. and stay until 6 a.m.," says Teitelman of the SSE Labs students. The coming and going has attracted local attention. In January a Palo Alto policeman came by and asked AOL staffers why kids were arriving at and leaving the office at such odd hours.

There's evidence that an exchange of ideas is starting to occur. The founders of MapMeIn, a startup trying to develop online floor plans of indoor spaces, have been trading technical pointers with Christian Dwyer, senior vice-president for AOL's MapQuest site. During an informal chat recently, Stanford's Teitelman explained to AOL's head of West Coast recruiting that the company should give up on mass e-mail blasts to potential recruits and instead target students in a vaunted Stanford computer science class called CS210. Trent Herren, AOL's head of initiatives, who's leading the effort to attract startups, is delighted with the influx of talent. "These are the people that are convinced they are going to change the world," he says.

AOL is well into an extensive remodeling of what it calls its West Coast HQ. During a recent visit, the offices smelled of fresh paint and workers wheeled furniture past an aquarium in the lobby. By May, the first floor will have a gym, a coffee shop, and a usability lab for observing product tests behind a one-way mirror. The new layout will roughly double the space available to startups, and AOL will begin reviewing applications for new occupants in April.

Other than a feeling of youthful vigor, what does AOL gain from all this? The company says it could get the inside track on investing in or acquiring one of these fledgling companies. AOL's bigger idea, though, is that being surrounded by startups will help create an alluring culture at AOL, attracting good people who, in turn, create products. In 2009, Armstrong hired a former Yahoo! (YHOO) executive, Brad Garlinghouse, to help revive AOL. Garlinghouse gained notoriety five years ago for writing the so-called Peanut Butter Manifesto, which accused Yahoo of spreading its focus too thinly over too many products, like peanut butter on bread. As AOL's president of applications and commerce—and the top executive in Palo Alto—he's spearheaded projects such as Editions, an e-reading app for tablets, and the forthcoming revision of AOL Mail (code name: Project Phoenix).

While the mother ship has been shedding employees—AOL recently laid off more than 900—Garlinghouse is looking to fill 80 tech positions in Palo Alto, New York, and Virginia. "AOL wasn't building great products, and the brand was reflecting that," he says. "We have to expunge the ghosts of AOL and start fresh."

By Douglas MacMillan • Bloomberg Businessweek, March 28, 2011

Does your company sponsor a 401(k) savings plan or a 401(k) retirement plan?

Illustration by Kyle T. Webster

As a starting point, most 401(k) plans are savings plans—OK for retirement, but not great. Some plans have taken steps to become retirement plans, such as automatic enrollment, automatic deferral increases, and investment portfolios designed for retirement investing, like age-based target-date funds or managed accounts. Those are some of the criteria for evaluating whether a 401(k) plan is a retirement plan, but they are not enough to convert a savings plan into a retirement plan.

What's the difference? Here is my list of the key characteristics of a 401(k) retirement plan:

Each participant knows how much retirement income a typical retiree of the employee's income level needs for a reasonable standard of living. Most experts say that people need an income replacement ratio of 75% to 85% of their final pay. Part of that will be from Social Security—on average, about 40%—and, for most people, the balance will come from their 401(k) plans. (That is because most participants have few, if any, other financial assets.) If you don't know what you need, how do you know if you will have enough?

In a retirement plan, participants also know how much retirement income their current 401(k) account will "buy" at retirement. (Alternatively, the estimated retirement income could be based on both the current account balance and projected future deferrals.) Each of your participants is on schedule, behind schedule, or ahead of schedule in their retirement savings. How can they calculate that? Most can't; as a result, participants need help from plan sponsors and providers. In a "real" retirement plan, each participant is told whether he is on course or not and, if not, what changes need to be made. The calculation of the shortfall between current behavior and the needed retirement amount is called "gap analysis" and is available from some providers.

The key is that the participants be given the information—for example, on their quarterly statements. Simply providing Web site calculators hasn't worked.

If participants are behind schedule, a 401(k) retirement plan would tell them how much they must increase their deferrals to get on schedule. Some providers already offer this service and others will develop it—if the demand is there. Without that information, how can participants accumulate the right amounts?

When this information is automatically provided to participants, it must be based on assumptions (which should be stated clearly) and on the needs of the average or typical participant. Of course, no participant is truly typical—or even average. However, without that general guidance, participants will have a hard time making decisions about their individual needs. It is better to have the "solution" for an average participant than no information at all.

Also, with that information, participants can better understand that the long-term objective is retirement income—and how to get to that income through saving and investing. Without the information, success is largely a function of luck.

Of course, for participants who want to customize their retirement planning—for example, a later retirement age, a higher savings rate, or a different investment strategy—the plan can offer retirement calculators. Many providers already have services to help participants with those calculations.

If your plan offers these services, you are sponsoring a 401(k) retirement plan. If not, talk to your providers and advisers about how to convert your savings plan into a retirement plan.

If you don't know what you need, how do you know if you will have enough?

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On the Inside, Looking Out

As CFOs gear up for growth, they are seeking targets that can help their companies innovate.

After a long hiatus, companies are once again focusing on growth. But in an environment in which organic growth will be challenging and big deals may look too risky, many are taking an alternative path, exploring the acquisition of young businesses that can supply them with new talent, new technologies, and new products or services. Above all, today's dealmakers are looking to buy innovation.

Because so many companies responded to the recession at least in part by downsizing research-and-development budgets and addressing short-term needs like liquidity, they are now "basically buying their R&D by buying companies they think have real potential to grow over the long term," says Mark Heesen, president of the National Venture Capital Association (NVCA).

In their renewed quest for the next big thing, many executive teams have realized that they may not have all the answers in-house. "For us to expect that we'll think up all the great ideas and develop them internally is a stretch," says Bruce Knooihuizen, CFO at computer-services firm Rackspace, which has acquired four start-ups in the past four years.

The idea of purchasing a market-ready new product or service has a particularly strong appeal, because it allows a company "to accelerate an R&D or product-diversification process that otherwise would take years on an organic basis," says Mat Wood, a partner in BDO USA's transaction advisory practice.

Some large companies have begun eyeing young businesses to meet their innovation needs after continually getting beaten to the punch on new products by their smaller rivals. For instance, two-thirds of the 25 drugs approved by the Food and Drug Administration in 2009 were developed by emerging companies, notes Christopher Wadsen, managing director of the strategy and innovation practice at PricewaterhouseCoopers. "Big Pharma spends all this money on R&D and isn't as successful as small start-up companies in coming up with novel innovations," he says.

An Eye on the Little Guy

While megadeals were few and far between in 2010, the number of transactions skyrocketed, with many deals so small that their details were not publicly disclosed. In sum, 427 venture-backed firms were acquired last year, the highest number since Thomson Reuters and NVCA began tracking such data more than 25 years ago.

There are several factors in buyers' favor in the market for early-stage businesses. One is that many development-stage companies have had time to gestate while waiting for M&A activity to pick up and are now ready for prime time. "From an acquirer's perspective, you've got well-trained people, developed technology, defensible patent positions, and companies becoming increasingly profitable or near-profitable," says Trevor Chaplick, a partner at law firm Proskauer Rose.

Small companies with hot technologies are also more open to being purchased rather than holding out for an initial public offering, given the challenging market for IPOs and the high bar for success as a new public company.

Another plus: finance chiefs who do pull out their pens are getting decent deals, despite the increasing interest in acquisitions. It's still a buyer's market, although the distressed-firm markdown bin is not as full as it was 18 to 24 months ago.

Despite those advantages, CFOs are nonetheless moving more methodically, even on smaller transactions. That's partly due to ongoing uncertainty about the economy, and partly a legacy of the recession. Those who relied heavily on leverage to do deals in the past are particularly cautious. "We don't see folks rushing to the market with a checkbook to do an irrational transaction," says Steve Joiner, managing partner for the southeast M&A group at Deloitte.

Smaller, but Not Easier

That caution is warranted. Despite their bite-sized nature, smaller deals come with challenges of their own. Less-sophisticated companies may have little-to-no revenue, unclear business agendas, and disorganized finances. They may have failed to protect their intellectual property. And they may have made concessions on agreements that will lead vendors or customers to expect new terms following a change in control.

A lack of historical data can throw finance departments off their due-diligence game. "The two things these companies get acquired for are things that CFOs tend to not be focused on," says Matthew Bartus, a partner at law firm Dorsey & Whitney who represents emerging growth companies. "These acquisitions are not about revenue or earnings; they're about the people and technologies." As a result, the long-term worth of venture-backed companies can be hard to determine.

Such deals can also easily fall apart. Witness Google's very public failed $6 billion bid to buy Groupon, the much-hyped shopping/social-networking site that offers consumers a daily chance to obtain deep discounts on local products and services. It's a simple model, and lucrative: Groupon keeps half the revenue and passes the other half to participating merchants.

Even as it fended off Google, Groupon has been on a buying binge of its own, looking to buy copycat companies outside the United States so that it can simultaneously stifle competition and expand its geographic reach. In 2010, it bought six such businesses, including Citydeal, a site that was founded in Germany in late 2009.

Jason Child, Groupon's CFO, says the company considers many things when deciding whether it should buy sites in certain regions or build new ones from scratch. "It depends on a combination of factors," he says. "How long would it take [to do the acquisition]? How closely aligned are they with our approach and our style?"

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EXIT SIGNS

The number of venture-backed companies acquired last year rebounded sharply from 2009.

Year	Total number of M&A deals	Total disclosed M&A value* (in millions)	Average M&A deal size (in millions)
2006	378	$19,142	$115
2007	380	$29,555	$175
2008	348	$13,878	$117
2009	273	$13,553	$147
2010	427	$18,451	$150

Note: Venture-backed deal activity only
*Accounts only for deals with disclosed values.
Sources: Thomson Reuters and National Venture Capital Association

Child says one of the main issues that arises when a big company targets a smaller one is the delicate business of approaching and winning over entrepreneurs who are used to working independently. "Entrepreneurs are excited about building stuff," he says. "They are not excited about larger companies' reputation for having more processes, more constraints, and more bottlenecks."

For that reason, the human element of small-company transactions is a crucial consideration. "When you're buying a company that's run by an entrepreneur, that person may be used to calling the shots and won't want to collaborate," says Jim Cohen, executive vice president of mergers and acquisitions at Consolidated Graphics, a commercial-printing company that frequently buys family-owned businesses.

The acquired business's principals and employees — and their willingness to continue working at the same pace and at the same level of performance — could be a deal's greatest risk, more so than financial issues. Inexperienced buyers often underestimate the difficulties of integrating smaller teams into their infrastructure, notes Bartus. "You can manage liabilities with escrow, but you can't address a situation where you acquire a team that won't work in the [new] organization," he says.

To keep a newly acquired staff interested, buyers might consider adding retention bonuses to earnout targets. M&A experts also suggest that buyers ensure a degree of autonomy for valued legacy employees, and recognize that those employees may expect more from the deal than a payout, however large. They will likely want their business — even when it becomes a small part of a larger company — to continue to grow. "The business objectives and the personal objectives of the ownership and key managers are often intertwined," says Will Frame, managing director of Deloitte Corporate Finance.

Grab a Partner

To get a handle on the true worth of a start-up and minimize the risk of a mismatch, many corporate buyers rely on the practice of establishing partnerships with potential targets. By developing a relationship — either by becoming a customer, an investor, an adviser, or a joint-venture partner — acquirers can learn about intriguing smaller companies and discover any potential problems.

Partnering is a long-standing practice at Intuit, the software company that makes QuickBooks. In its constant search for possible alliances, Intuit invites some 40 entrepreneurial companies to its headquarters about once a year. "The goal is not to sign up 50% right away," says R. Neil Williams, Intuit's finance chief. "The goal is to develop relationships longer term and to let [the smaller company] know who to contact if [that company has] a good idea."

These relationships should benefit both parties, executives say. This means that would-be acquirers should be frank with entrepreneurial partners should a potential acquisition lose its appeal or simply not make sense. "If people want to talk to us about washing machines, that's not part of our strategic plan," says Williams. "They appreciate when we tell them up front that it's not something we're interested in and they can move on and not waste time talking to us."

Williams acknowledges that even at a nimble software company such as Intuit, "innovation and creativity can be a scarce resource." The company continues to encourage its employees and engineers to come up with great ideas, and invests in the internal resources needed to turn ideas into products, but Williams says that many of the most promising ideas will come from the outside.

Will 2011 see early-stage deal-making continue at the same pace? With caution continuing to dominate CFOs' outlook, a sudden return to giant deals seems unlikely. Yet according to the latest Duke University/CFO Magazine Global Business Outlook Survey, fully a third of the CFOs who responded plan to spend cash on acquisitions in 2011 — twice as many as plan to use cash for research and development.

So, while a strengthening economy and growing confidence may usher in some larger transactions, for now, small deals — especially if they lead to innovation and growth — are indeed beautiful.

By Sarah Johnson • CFO Magazine, March 1, 2011

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