# Jon Moulton's Diary

## The truth and nothing but...is a fine sounding maxim but can it apply to the grey areas of business?

*Veteran financier Jon Moulton has been involved in buyouts, turnarounds and venture capital since 1979 with firms such as CVC, Permira, Apax, Alchemy and, most recently, Better Capital, where he has been the chair since 2009*

The rewards available in private equity are very substantial so the temptation to be dishonest is all too obvious.

We live in times where codes of conduct, mostly driven by actions in equality, discrimination, harassment, bullying and the larger woke agenda have become commonplace.

Narrower ethical codes have received less attention and explicit codes that bear on simple dishonesty such as telling lies or helping to support falsehoods are not very numerous in the PE world.

In the UK, the BVCA have a pleasantly brief code of conduct that is a bit behind the times – you cannot accept funds from "unspecified sources". I think the last decade of statutory money laundering stuff has been introduced unnoticed!

### Ethical standards

The BVCA's first rule is "All members shall promote and maintain ethical standards of conduct and at all times deal fairly and honestly with each other and with companies seeking private equity". You may note that this does not cover the rest of the member's business activity.

There are numerous other codes and regulations that encompass PE businesses.

Probably the one that catches the largest number of individuals in the UK is the code of ethics of the accountancy bodies. Mostly this means the Institute of Chartered Accountants in England and Wales (ICAEW) members who are caught by its code. Although the code document is an unreadable 266 pages, its summary is commendably clear. Accountants should be "...straightforward and honest in all professional and business relationships" and should not "be knowingly associated with information that contains materially false or misleading statements, statements or information that have been provided recklessly, or those that omit or obscure required information".

### Grey areas

Now consider this standard against the many situations between disadvantageous truth and beneficial dishonesty in PE.

Sometimes truth is a black and white issue, but actually there is a lot of grey. Take fund valuations – high valuations encourage investors so the temptation is obvious. Noting that many secondary fund sales take place at a discount to stated values obviously suggests a real issue here.

The private equity auction process for buying and selling companies is pregnant with black,

> ***'Sometimes truth is a black and white issue, but actually there is a lot of grey'***

grey and white issues. Here are some...

- The seller will prepare forecasts for potential buyers — which might straddle the more optimistic to deeply unlikely territory.
- Interesting accounting approaches are not unknown in forecasts or in historic financials.
- The ICAEW code would have you disclose "requires information" that might be very disadvantageous to the seller – dodgy accounts or revenue recognition perhaps.
- Sellers can even invent other buyers to encourage a high price.
- The buyers can behave pretty dishonestly too.
- The pressure on sellers and on buyers can vary widely. It is a paying strategy if there is an anxious seller with, say, end of fund pressures, for the buyers to string out the process with petty due diligence or "committee meetings" with a view to a late price drop. Saying you will pay 100 when in fact you have an internal decision only to buy at 85 or less is clearly dishonest but can be rewarding.
- Other dishonest buyer games include saying they don't need to raise debt to consummate a transaction when they do, or saying they can complete in eight weeks but planning for 12 weeks and taking 16, which is common.
- A very bad one is where a PE buyer is intent on a buy and build strategy so tries to close two deals at the same time without disclosure. Very often that "two deals at once" fails and the seller would have been enticed into delay and cost, which they would not have risked had they been told the real high risk of non-completion.

There are lots more, less than honest, games.

The lawyers generally put in wordy disclaimers to try to provide a legal umbrella but bad news for the malefactors – the codes cannot be contracted away.

The good news for the untruthful is that enforcement of the ethical codes is rare.

**Codes of ethics are there to uphold 'fair and honest' dealings but can they counter sharp practices and subterfuges?**

Getty Images