Exit Strategy Missteps and How to Avoid Them

Far too many business owners underestimate the complexities involved in selling a company.

By Michael J. Walker

In my more than 30 years of experience in M&A transactions, I've heard the refrain from business owners time and time again: "Why would I need help? I know everything I need to know about selling my business."

It's true that owners know their businesses better than anyone else. Typically they have built the company from the ground up and are often banking on the success of its sale to fund their retirement, their family's future or other business opportunities. Yet far too many owners underestimate the complexity of the sale process.

A recent article in Canada's *Financial Post* summarized the results of a survey of more than 100 Canadian business owners who had recently sold their businesses. The vast majority acknowledged they had made some key mistakes and would do things differently if they had a chance to sell their company again. A similar U.S. study of 300 former business owners found that 75% felt the sale did not accomplish their personal or financial objectives (Richard E. Jackim and Perry Phillips, *The $10 Trillion Opportunity*, Palatine, Ill., Dog Ear Publishing, 2005, p. 12).

In my view, there are five common mistakes that business owners typically make when trying to sell their business:

1. Failing to plan in advance

A recent survey conducted by Price-Waterhouse-Coopers found that a mere 25% of business owners had done any formal planning for selling or transitioning their business. By preparing an exit strategy in advance, you have the opportunity to sell on your terms—when you want to, not when you have to. Taking a proactive approach to the sale of your business, in most cases, will allow you to:

• *Pay less tax on the proceeds.* A number of tax-planning opportunities are available to maximize the amount of cash that you and your family members can retain on a transaction, but most of these strategies must be implemented years in advance in order to be effective. The structure of the transaction will also likely have a significant impact on your after-tax proceeds. It is important to be aware of these implications in advance of negotiations with potential purchasers.

• *Enhance the value of the business.* It is critical that you understand the motives and objectives of the potential purchasers. Value-enhancement strategies can then be implemented to make the business more attractive to them—but again, these strategies take time to implement. These can include upgrading information technology, removing assets that are more valuable if sold separately (a non-core operating division, real estate investments, etc.) and locking in key employees via non-compete agreements.

• *Advantageously position and pre-sent your business.* Anticipating the purchaser's information requirements, and compiling the data in advance, will allow you to present the business in the best possible light. It also helps maintain control of the information flow, address potential issues in advance and avoid costly delays. Ultimately this will maximize the purchase price as well as the likelihood of closing the deal.

2. Failing to present the business to multiple purchasers

Because of time or resource constraints, confidentiality concerns or other factors, business owners often find themselves negotiating with one purchaser at a time and do not typically solicit and manage competing bids. In any typical day-to-day operation, a knowledgeable businessperson is likely to compare quotes when making a major purchase or contracting for services. Yet when it comes to the most important transaction of all, very few take the same approach.

Competition provides negotiating leverage for the seller and is the key to achieving premium pricing and favorable terms on a transaction. It also gives the seller additional options for a timely and cost-effective completion of a sale in the event that negotiations deteriorate with the initial purchaser. The best approach is to offer the business to a limited number of pre-qualified buyers in a controlled process.

3. Not understanding what the business is worth

Sale transactions often fail because of the inability of buyer and seller to come to an agreement on price. Most business owners have invested much of themselves in their business. Emotions can easily get in the way during negotiations, particularly if the purchaser has identified problems or is critical of operating methods developed or implemented by the owner. Nevertheless, it is my experience that many business owners actually underestimate the value of their business by relying too heavily on conventional valuation methodologies and failing to take into consideration the motivations of potential purchasers and potential synergies that could be achieved through a business combination.

For example, a purchaser may be willing to pay a premium price for the business if the company can achieve a key strategic objective, such as expanding into a certain market or obtaining access to a key technology or customer base. Similarly, if economies of scale (such as manufacturing synergies or increased purchasing power for raw materials) can be achieved by combining buyer's and seller's operations, the business may attract a price that is higher than its stand-alone value.

4. Losing control over the process

In order to achieve a positive result, it is critical that the seller maintain control of the process, specifically as it relates to:

• *Confidentiality:* Choosing your deal team wisely, managing the transaction externally and pre-qualifying potential purchasers will limit the risk of confidentiality breaches during the sale process. However, the biggest risk to the success of the deal is often the most overlooked. It is critical that you have an action plan that includes the appropriate timing and content of communications to employees, suppliers and customers. Confidentiality is critical, as misinformation and rumors can have a disastrous effect on business operations and can result in termination of the transaction.

• *Release of information:* It is important not to release too much information too soon in the process, particularly if competitors are among the bidding group. Certain proprietary information—such as customer lists, supplier terms and product formulations—should be released only when you're certain you have a deal.

• *Exclusivity rights:* Most business owners grant exclusivity far too early in the sale process. This weakens their negotiating leverage and increases the risk of falling victim to potential bidding tactics (e.g., a high initial bid that is subject to due diligence, followed by a low final offer after due diligence is completed).

• *Negotiations:* In many cases involving the sale of a midsized private or family-run business, the balance of power lies with the purchaser, usually a much larger company with greater resources and experience in negotiating transactions. Having an experienced negotiator at the table can increase your chance of receiving favorable terms. It is also critical to maintain deal momentum. Many transactions fail in the final stages owing to prolonged negotiations and delayed closing.

5. Failing to focus on the business

Managing an effective sale process is a full-time job that involves not only coordination of the marketing process, bidding process and information flow, but also coordination of all the other advisers who must work together to close the transaction (accountants, legal advisers, wealth managers etc.).

A business owner seldom has the time or resources to effectively manage a transaction process; as a result, operating results tend to suffer as focus shifts from managing the business to managing the sale process. This can decrease the value of the business, not to mention the added strain it puts on family and personal relationships. A professional M&A adviser can guide an owner through this lengthy and complex process.

A growing concern

The anticipated surge of aging Baby Boomers means succession strategy and exit planning are, and will continue to be, hot topics. I hope business owners take steps to prepare themselves for the transition.

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