

## Managing the Business Sale Process

Business owners and executives who are looking to sell their company often focus on the quantitative elements of valuation. However, maximizing the value that is received upon the sale of a business rests to a large degree in how well the sale process is managed. This edition of *Value Strategies* examines some of the do's and don'ts in managing the business sale process.

## Maintaining Confidentiality

One of the first issues that arises when considering the sale of a company is how to maintain confidentiality. It can be very damaging if employees and customers become aware that a company is for sale. While the use of nondisclosure agreements can help to reduce the risks involved, they do not offer guaranteed confidentiality. Therefore, it is important that the information dissemination process be carefully managed in order to reduce the risk that the company's highly sensitive information will be used inappropriately. In addition, business owners and executives should have a contingency plan in the event that rumors begin to spread. For example, the owners could convey to their employees that the company is looking for capital from various sources in order to undertake an expansion plan.

In most cases, it is necessary to inform a handful of key employees that a sale of the company is being contemplated. It may be necessary to involve those employees in the sale process (e.g. information preparation) and, in any event,

the buyer will want to interview key employees prior to consummating a transaction.

In this regard, it may be prudent for the seller to provide key employees with a special bonus upon the successful consummation of a transaction, as well as "pay to stay" bonuses, which will help to ensure that key employees do not leave for a period of time following the transaction. Such agreements usually have "parachute clauses", which stipulates the severance entitlement in the event that an employee is terminated shortly after the transaction occurs. While agreements with key employees can erode the value received by the seller (due to the costs involved) the consequences of losing key employees just prior to a sale can be much more severe.

## Identifying Potential Buyers

Business owners and executives should think carefully about who might be a potential buyer for their company. Whether or not those potential buyers are approached is another matter. While competitors are an obvious choice, they are often not the ideal buyer. Furthermore, the seller faces the risk created by the disclosure of confidential information to a competitor.

In most cases, the best buyer is a "platform buyer". This is a buyer that views the seller's business

as offering something that the buyer does not currently have (e.g. certain customers or intellectual property), and where the buyer perceives that it can leverage those intangible assets to generate incremental revenues. A platform buyer may be one that offers complimentary products or services within the seller's industry. Alternatively, it can be a buyer

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**"...the information dissemination process must be carefully managed..."**

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that currently operates outside of the seller's industry or geographic region, and which views the acquisition as an opportunity to quickly access a new market. The other advantage with a platform buyer is that these buyers typically are looking to retain most, if not all, of the seller's employees and even to create opportunities for those employees that did not previously exist. This helps to facilitate ownership transition.

Finally, financial investors (such as private equity funds) can also be excellent buyers, particularly if they already have a portfolio investment in the seller's industry and are looking at a market consolidation opportunity.

## Creating the Auction

When selling a company – whether privately held or a public company – it is generally accepted that value is maximized by creating an auction. But the key question to address is how broad the auction should be.

Casting a wide net for prospective buyers may appear to be an appealing approach because the seller never knows whether a buyer might be interested until they are approached. Intuitively, many sellers believe that having as many possible buyers at the table will lead to an all-out bidding war. However, managing a broad auction can be problematic. In order to entice prospective buyers to submit a meaningful offer, it is necessary for the seller and key employees to meet with each buyer and to provide them with the information they require. This can be an onerous exercise, and detracts from the seller running the business. In this regard, business owners and executives should remember that it is critical to keep running their business while it is being sold. Furthermore, the greater the number of prospective buyers, the greater the risk of a breach of confidentiality.

A more selective auction can often be a preferable approach as it can be easier to manage and less risky (e.g. it reduces

the number of parties that receive sensitive information about the company). But a selective auction requires more research and analysis prior to the commencement of the sale process, in order to ensure that the right buyers are being approached.

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**“Platform buyers are ideal.”**

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The seller should recognize that an auction is really about creating alternatives – which is fundamental to developing a strong negotiating position (see

the Winter 2010 edition of *Value Strategies*). At Veracap, the rule of thumb that we like to use is to count the number of serious, qualified buyers on one hand, but not one finger. In our experience, this strikes a good balance between creating alternatives and avoiding distractions to running the business.

## Disseminating Information

An important part of managing the sale process lies in how the seller's confidential information is disseminated to prospective buyers. This should be done in stages. The first document that prospective buyers receive is a confidential information memorandum (“CIM”), which highlights key aspects of the seller's operations, employees and financial performance. The content of this document should allow buyers to establish whether they believe that the seller's

company represents a strategic fit, and to develop a preliminary sense of value. The CIM should not contain sensitive details such as gross profit by customer.

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**“The CIM should not contain sensitive details...”**

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The reason for this is twofold.

First, many prospective buyers who receive the CIM will conclude that the seller is not a good fit with their existing business. It is of no use to provide sensitive information to disinterested buyers. Second, for those buyers that do express a meaningful interest, the limited content in the CIM allows for the seller to create a two-way discussion. This affords the seller an opportunity to ask the buyer to provide some details about the reasons for their interest in the company, and how the two businesses would fit

together. This type of discussion provides the seller with important information about the buyer's strategy, which is key to successful negotiations.

## Soliciting Offers

A recurring question that arises in the business sale process is whether the seller should establish a firm deadline for the submission of offers. The advantage of establishing a deadline is that it can allow the seller to more readily compare offers at the same time. However, this strategy can often backfire. This is because it can be problematic for the seller to deal with a buyer that has missed the deadline. Allowing a buyer to submit their offer after the stated deadline has passed can compromise the seller's negotiating position, because it indicates to the buyer that the seller may not have already received an acceptable offer.

Not establishing a firm deadline can also be challenging because the seller actually does want to receive offers at around the same time. Inevitably, some buyers will be well advanced in the process, while others will be far behind. Trying to slow down some buyers and speed up others can be like herding cats. However, if managed effectively, it can provide the seller with considerable flexibility, and hence a better negotiating position.

Soliciting offers should be viewed like climbing a ladder. Each successive offer should represent another rung of the ladder and should get the seller another step higher towards their goal. Attempting to jump to the highest rung of the ladder at the outset by deploying aggressive negotiating tactics can lead to failure, since a strong ladder requires many rungs in order to be effective. The seller should ask themselves, if the top rung breaks, how far will they fall? Therefore, the seller should try to solicit written offers from all interested buyers. A lousy offer is better than no offer at all, because it helps to

build the ladder. Once a prospective buyer has submitted a written offer, they are more likely to improve it at a later date rather than if they did not submit a written offer at all.

Prospective buyers are asked to submit a letter of intent ("LOI"). While an LOI is non-binding (except for certain provisions such as confidentiality), it becomes a pivotal document in the sale process, because it establishes the parameters of a deal. The seller will sign back the LOI that represents the best value for the company, thereby granting the chosen buyer a period of exclusivity in order to conduct its due diligence and to close the deal.

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**“All key elements of the deal should be addressed in the LOI”**

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It is important for the seller to ensure that all key elements of the deal are adequately addressed in the LOI (e.g. price, terms of payments, performance conditions, etc.). Anything that is not addressed or which is ambiguous becomes subject to negotiation after the LOI is signed. At that point, the buyer has the negotiating advantage because it is difficult for the seller to try to reignite discussions with a prospective buyer that was previously turned down.

While buyers will resist developing a detailed offer (citing the need for further due diligence material), the seller should recognize that if they cannot negotiate a comprehensive LOI when they have the negotiating advantage prior to signing, they are unlikely to successfully negotiate better value in the purchase and sale agreement.

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**“Due diligence takes a lot of time and effort for the seller”**

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## Closing the Deal

After the LOI is counter-signed by the seller, the buyer will commence its detailed due diligence and begin drafting the purchase and sale agreement. The seller should not underestimate the amount of time and effort that will be required by its management team during the due diligence phase. Again, it is important for the seller to continue running the business during this time, as any hiccups (e.g. lost customers) may result in an erosion of value.

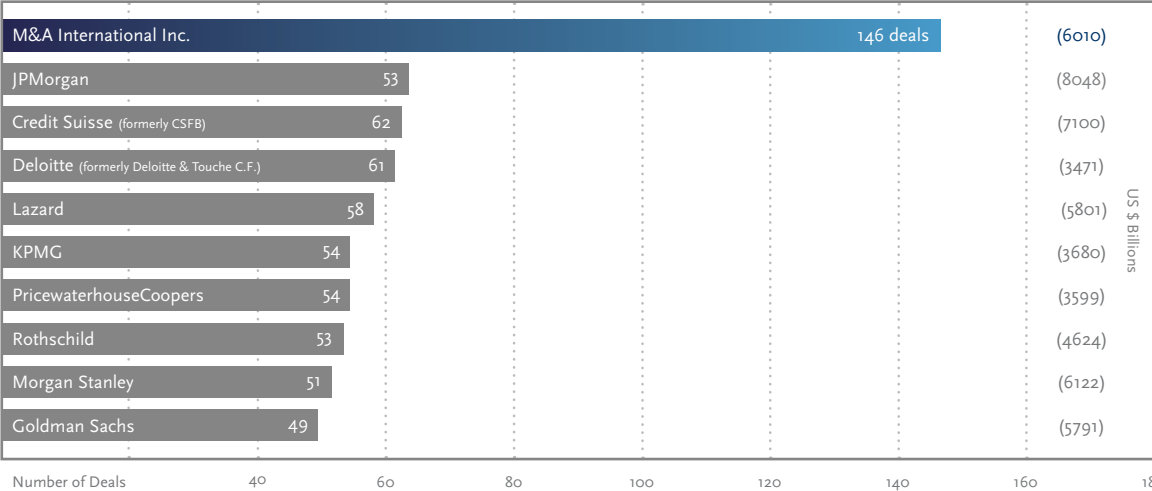
During the due diligence phase, the buyer will have access to all of the seller’s proprietary information and employees. It is important for the seller to ensure that there are no surprises during the due diligence phase, lest the seller be subject to the buyer’s attempts to grind down the price. Alternatively, the buyer may walk away from the deal, leaving the seller exposed to having to negotiate with alternative buyers from a weakened position. Therefore, any negative information regarding the seller’s business should be disclosed prior to counter-signing the LOI. Given that the buyer will have access to the seller’s most sensitive information, it is also important for the seller to ensure that they “bet on the right horse” – i.e. a buyer that is highly likely to close the deal.

**Final Words**

Effectively managing the business sale process is critical in order for business owners and executives to maximize shareholder value. Maintaining confidentiality and securing the allegiance of key employees is the first step. Thereafter, the seller should focus on identifying the right buyers, creating the right type of auction, and managing the information dissemination process. The LOI is a pivotal document in the sale process that, while non-binding, establishes the parameters for the deal. The seller must keep their focus on diligently running their business during the sale process and ensure that there are no surprises during the closing period that could result in value erosion, or worse, a failed deal.

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