

Surprises CEOs Face When Selling Their Company

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*Editor's Comment: Some people say there is no such thing as an original idea... that most ideas are refinements, extensions or improvements of someone else's idea. This article is a result of reading **Seven Surprises for New CEOs** by Michael Porter, Jay Lorsch and Nitin Nohria in the October issue of the Harvard Business Review although their article has no reference to M&A.*

Introduction

Most middle market company CEOs are aware of the process of selling a company, but some CEOs are woefully naïve in dealing with the sale of their company. For example, my experience is that the decision to sell is mostly event driven. An event such as sudden burn-out, partner dispute, family death, severe competitive pressures, lack of capital, etc. Seldom do CEO owners plan three to five years in advance when they reach a personal milestone such as 65 years of age or seldom do they sell at the top of the market when business is booming. So often, the situation arises when one or several negative events take place and in a response these CEO/owners will often enter into serious discussions with the most recent potential buyer and/or intermediary who just happened to be at "the right place at the right time." To enter into negotiations with just one buyer seldom produces the highest bid. There is an expression in the M&A trade that "one buyer is no buyer."

In this article, we are making the assumption that the CEO is savvy enough to hire an intermediary to orchestrate the sale of the company. Additionally, we assume that the intermediary has not told his client everything to be aware of in the M&A process... hence the title of this article, Surprises CEOs Face When Selling Their Company.

Surprise #1: Substantial Time Commitment

In the real estate business, once the owner engages the broker there is very little for the owner to do until the broker presents the various offers from the potential buyers. In the M&A business, there is a substantial time commitment required of the CEO in order to complete the sale properly, professionally and thoroughly. The following examples are worth noting:

- **Offering Memorandum:** This 30+ page document is the cornerstone of the selling process because most intermediaries expect the potential buyers to submit their initial price range based on the information presented in this memorandum. The intermediary will heavily depend on the CEO to supply him with all the necessary facts.
- **Suggestions of Potential Buyers:** Chances are that no-one other than the sales manager knows the best companies to contact and those not to contact (competitors) than the CEO. Arguably, this information should be mostly supplied by the intermediary, but as a thorough team effort, the CEO should play a major role in this endeavor.

- **Management Presentations:** Assuming the intermediary conducts the normal process of boiling down the bidders to 4 or 5 potential buyers, and then it is customary to have management presentations before the final bids are submitted. IN order to help extract the best offers, it is advisable that the CEO show the benefits of combining the buyer and seller and/or the future upside of the selling company.

Surprise #2: Enjoin Other Employees in the Process

A number of CEOs selling their company are paranoid about a confidentiality leak regarding the sale of their company. In fact, some CEOs prefer that no-one else in the organization is aware of the pending sale of the company. At a bare minimum, the CFO and Sales Manager should be informed. The CFO will be asked to pull all the financials together, to supply projections, to articulate reconstructed earnings (add-backs) and to supply monthly statement... all of which is a tip-off that the company is being sold. The Sales Manager will be asked to supply the names of synergistic companies in or around the particular industry. And, perhaps the CEO's secretary will be asked to set up a "war room" where all legal and contractual information is assembled for the buyer's due diligence team. In order to protect the company from confidentiality leaks and retention of key employees, the CEO should implement "stay agreements" for them.

Surprise #3: Accelerate Sales

The tendency for some CEOs is to become so distracted with the M&A process that he takes his "eye off the ball" in running the business on a daily basis. Potential buyers will be watching the monthly sales reports like a hawk to see if there is a turn-down in business. Buyers become very apprehensive when they see a recent downward turn in the company they are about to acquire and may, as a result, want to negotiate a lower price. A few years ago when I was in the process of selling Data Industrial Corporation, post 9/11 sales and the backlog were off from our projections. While the slowdown in business was understandable, the CEO would not make any price adjustments. As their intermediary, I advised the CEO to immediately send his internal sales department out on the road to build up the backlog.

Surprise #4: A Confidentiality Leak

Naturally, most CEOs expect the M&A process to go smoothly and usually it does. However, there should be a contingency plan in place for such occurrences as confidentiality leaks. The degree of damage determines what action should be implemented. On one occasion the draft of the Offering Memorandum was e-mailed to the CEO for his corrections; however, the sender from the intermediary used an incorrect letter in the CEO's e-mail address. As a result of this misstep, the e-mail was rejected by the CEO's computer and ended up in the company's general mailbox which was administered by the employee in charge of IT. The employee was told by the quick-thinking CEO that the Offering Memorandum was being used to raise growth capital. Luckily, the incident went no further. Much more serious confidentiality leaks can occur, and it is wise to discuss ahead of time how the matter is going to be handled with those concerned.

Surprise #5: Unexpected Low Bids

Ultimately, the M&A market sets the price of the company, particularly if the intermediary has done his job properly in searching the universe of potential buyers. However, rarely does a seller go to market without having certain expectations of price. Let's use a hypothetical case in which a company growing at 15% annually. The CEO believes that it is worth \$6 million selling price.

Either he can take the company off the market and return several years later when either the company's earnings have improved or when the M&A market has heated-up. Alternatively, the CEO can negotiate further with the top bidder by selling 80% of the company now and the remaining 20% in three years on a pre-arranged formula on the expectation that business will improve. Or, the CEO can sell the company now for \$5 million with an earnout formula that might give him the additional \$1 million.

Surprise #6: The P&S Agreement is Not What the CEO Expected

Numerous CEOs along with their intermediary drive the M&A process to the letter of intent and then turn over the deal to their attorney to iron out the details of the purchase and sale agreement. While the CEO should not micromanage his designated professional advisors in the transaction, he should be involved throughout the process or otherwise the CEO will inevitably object to the final wording of the document at the signing stage. The area most likely to be overlooked by the CEO is the critical section of reps and warranties.

Surprises #7: Agreement of Other Stakeholders

While the CEO can negotiate the entire transaction, the sale is not authorized unless certain stakeholders agree in writing, namely the Board of Directors, majority of the shareholders, financial institutions which have a lien on certain assets, etc. About twenty years ago I was retained to sell the largest Italian bakery in New England. It was owned by five different members of the same family. After receiving a letter of intent, both the CEO and we were surprised to realize that two of the families dissented from the proposed sale causing a huge family rift. The dissenting shareholders were fearful that their two sons would ultimately lose their jobs post sale. The deal did not close.

Conclusion

For many CEOs, selling their company is a once in a lifetime experience. They may be very experienced, very talented executives, but they can also be blindsided by surprises when selling their company.