

The Art and Science of Selling a Company

Jonathan (not his real name) came to me wanting to sell the business he founded in the early 1970s. I could tell he was nervous by the way he clenched his jaw. He had several people approach him over the years, but he wasn't ready to sell until his wife pointed out they were well past retirement age. Now that he had made the decision, he realized he didn't have any idea how to proceed. He told me he didn't even know how to accurately price his business, much less how to handle all the paperwork that would go along with the sale. "It's basically like selling a house, right?" he asked. I had to tell him that selling a business and selling a home were two very different things. But I assured him that I could help him with every step along the way.

CONGRATULATIONS

Before we get into the nitty-gritty of selling your business, let me first offer you congratulations: You've built a company that's worth selling. As an entrepreneur, you understand how rare a feat that is. Many ventures fail or fizzle out, the victims of intense competition, economic forces, or lack of access to capital. Of course, plenty of business owners manage to build profitable little businesses that support their families and a few employees. What you've accomplished is far more difficult: You've constructed a viable middle-market business with loyal customers and a stable workforce. Over the years, you've refined systems for keeping the books, collecting revenues, training employees, and servicing customers. Perhaps most impressively, you've developed a company that can survive without you – the business won't fall apart the moment you leave. That's how real wealth is created.

If you plan the exit properly, you'll be financially secure and set for whatever you want to do next, whether that's retirement or some other endeavor.

This book will help you understand and gain confidence in navigating the mergers and acquisitions (M&A) process. I'll walk you through both the art and science of selling a middle-market company. Granted, some complex technical skills, such as building financial projections and structuring the deal terms, are important, but success in selling a company is just as much about psychology, relationships, timing, and instincts. You need to market the company in a way that creates excitement without overpromising. You also have to keep your employees in the dark – but do so in a way that maintains their respect and loyalty once the transaction is announced. You need to manage your own roller coaster of emotions throughout the process. And you need to come out of the deal knowing you got the best deal possible. That's what this book is designed to do.

I'M HERE TO HELP

Doing it yourself is tempting, I know. After all, you know the company better than anyone. And you made it this far by relying on your own instincts, hard work, and an ability to figure things out. You're an expert at running your business. However, you're probably not an expert in selling it. The business world is a cutthroat place, and those who are unprepared or over-matched rarely come out on top.

So, why should you devote your scarce time to what I have to say? I began my career at a major Wall Street investment bank, and when I started doing middle-market deals, I quickly realized it's an entirely different world with different sets of deal types, processes, valuation methodologies, and tactics. Given the smaller deal teams and the unique attributes of founder-owned businesses, middle-market transactions have a variety of multidisciplinary challenges. As an M&A advisor (to minimize repetitiveness, I will use the phrases M&A advisor, investment banker, and banker interchangeably), I specialize in selling middle-market businesses. This book focuses on the specific needs and challenges of the founders/owners of these companies.

LET'S LEVEL THE PLAYING FIELD

Do-it-yourself sellers put themselves at a severe disadvantage when transacting with seasoned repeat buyers. You can bet your buyer and their advisors have negotiated many deals. Any number of sports analogies apply – and they're all variations on the theme of the enthusiastic amateur going up

against a seasoned professional. If you occasionally play a round of golf, you wouldn't expect to compete with a professional golfer and come out ahead. The pro will almost certainly win. He has top-shelf equipment. He practices his swing obsessively. The elite player employs a coach to analyze his mechanics and follows a strength-training program and flexibility regimen designed to maximize his innate talent. In addition, the professional plays in tournament after tournament, going up against elite competitors and performing well. He has learned to control his nerves at stressful moments and to master his emotions as the pressure mounts. Even if you shoot the round of your life, you're still likely to finish well behind the pro. The pro will dominate you throughout the competition while quietly noting all the gaffes in your strategy and cataloging the many holes in your swing. Your flaws aren't obvious to you, but they're abundantly clear to the expert. The same applies to all sports – an amateur has essentially no chance against a professional, well-coached player.

You can level the playing field by arming yourself with information and surrounding yourself with a team that will give you competent professional advice. In fact, I'll share the factors to prioritize when selecting the best advisors for your business.

So, exactly what will you learn by reading this book?

- Context regarding the *why* behind important elements of the process.
- Framework for selecting the optimal time to sell.
- Respective roles and expectations of the various deal team members, expected fees, and factors to prioritize when selecting them.
- Prioritized questions to ask yourself and your advisors to make informed decisions.
- Understanding your counterparty's (i.e. buyer's) perspective and typical strategies.
- Negotiation tactics and the underlying psychology behind many of them.
- What to expect from yourself psychologically/emotionally and how to best prepare.
- Things that can be done *today* to make your business more valuable/sellable.

Given the emotional excitement and pride that owners have in the businesses they built, many expect buyers to view their business as special and anticipate unrealistically high valuations. In his book *Walk Away Wealthy*, financial planner Mark Tepper aptly summed up the unrealistic hopes of middle-market sellers: "Many business owners stubbornly cling to fantasies about selling their businesses easily and for big money. They're certain that they will (a) find multiple high-quality suitors for their company as soon as

they put it on the market, (b) get several quick offers worth many times their company's [earnings], and (c) walk away rich and happy without having done any serious exit planning in advance" (Tepper 2014, p. 3).

If only it were that easy. The truth is that selling a company is exceedingly hard. Most business owners I meet are woefully ignorant of what it's going to take, how long it's going to take, and the likelihood of success. Here are the harsh facts:

- Just 20% of businesses of any size successfully sell to a third party. The success rate is probably more like 50% for middle-market businesses – but a 50% chance of victory doesn't sound very good when your life's work and net worth are on the line.
- Private equity (PE) firms close on approximately 1% of all businesses that they review. Statistically, there's a better chance of getting into any of the Ivy League universities.
- Depending on the reported source, only 25–50% of signed letters of intent (LOIs) result in a closed transaction, with many of those at terms materially lower than the initial agreement (Beshore 2018, p. 92). The absolute highest close rates I've encountered among professional buyers are around 80%.

FORGET WHAT YOU KNOW ABOUT SELLING PROPERTY

Many business owners mistakenly assume selling a business is similar to selling real estate. You've probably sold a few houses in your day and perhaps a commercial property or two. Yes, those are complicated transactions – but they're child's play relative to selling a business. There are a number of key differences:

- While a property transaction can be completed in 30 days or less, the total timeline to sell a business is 5 months at a minimum, and frequently in excess of a year.
- Real-estate sales require little of your time, and the process is all about the property, not about you. In an M&A transaction, seller owners and their staff commit significant time and resources to the process – typically more than 1000 hours.

- Businesses are much more complex, involving processes, organizational structures, and human dynamics.
- When a buyer purchases a business, they are buying its people, with a particular sensitivity to dependencies on you as an individual.
- Given this complexity, the diligence process is more thorough and intense, involving multiple professional advisors reviewing thousands of pages of documents.
- Middle-market business valuation is infinitely more complicated. Determining the value is difficult given the lack of publicly available data, especially involving truly comparable companies.
- Confidentiality is critical in a business sale, given the associated risks. Real estate is intentionally listed as publicly as possible.
- Given these factors, the market for businesses is inefficient. This is reflected in the wider dispersion in outcomes between highly effective versus mediocre advisors. This range is 5–10% in real estate but can be over 100% in business sales.
- Unlike turning over the keys to a property and never returning, you probably won't be able to quickly walk away from a business sale. Most transactions require the seller's cooperation during a post-sale transition period of at least six months but likely for year(s).
- Most middle-market deals delay a material portion of the purchase price, with ongoing financial and legal strings attached. Consequently, offers are frequently incomparable. Each will have a different mix of cash up-front relative to other forms of payment, along with extensive differences in the fine print (important!).
- Transaction structures and documentation are customized and highly negotiated versus the standardized templates in real-estate deals.
- Operating real estate requires nominal involvement and can be easily and efficiently outsourced to competent third-party management companies. A business is a delicate organism that only a few insiders can seamlessly jump in and manage. If you were to die or become incapacitated, the impact on its value would be huge relative to that of your investment property.

THE OLD "DATING GAME"

As odd as it might seem, a useful way to think about the dynamics of selling a business lies in terms of the subtle push and pull of a romantic courtship. Sellers and buyers engage in a unique mating dance when transacting. Here are some of the ways these two seemingly dissimilar processes are actually alike:

- Playing hard to get has its advantages. You can't force a buyer to actively pursue you, and overeagerness can make you look desperate. Generally, the person who cares, but not T-H-A-T much, will have the best outcome. This is best accomplished when you have a strong plan B of continuing to run your business and choosing *not* to sell.
- Exuding confidence is critical. Your actions and nonverbal cues are constantly being analyzed to try and assess the strength of your position. In context, some actions may be perceived by the buyer to mean their offer is significantly higher than others, which causes them to worry about overpaying. Objectively assess your behavior and ensure your actions are consistent with a seller who has multiple strong(er) alternatives. Buyers respect assertive sellers.
- Talk is cheap. You roll out your A-Game when trying to impress a romantic partner. You're careful about what you say while taking pains to seem relaxed and spontaneous. Too much honesty – about your personal shortcomings, about your political beliefs – is risky, so you say what you think the other person wants to hear. The same is true for some buyers who say all the right things until the ink dries.
- Lust can cloud your emotions. Your enthusiasm to do a deal can often create wishful thinking that blinds you to things that are obvious to everyone else around you.
- Call me, maybe? Frequently, investors will not provide a clear no but instead keep things in an indefinite and vague *maybe*. It's frustrating for the seller but great for the buyer – after all, it costs nothing not to commit. The dating scene leads to similarly vague interactions – maybe he or she is scared to say no, or maybe they're interested but not ready to say yes. Who knows?
- Money isn't everything. In romance, money is an inevitable part of the equation, but it should never be the driving force behind a relationship. As Dr. Phil says, "People who marry for money earn every penny." Selling for a great headline number to a jerk who you don't trust to honor your post-deal earnout is likely not worth it. Life is too short, particularly when you're going to reach financial security anyway.

- Monogamy is expected. In most romantic relationships, both parties expect the other to be faithful to them. In the M&A process, that expectation is legally enforceable. Any LOI you sign will require exclusivity – and if you cheat on your suitor, you can expect to be slapped with a lawsuit.
- There are no perfect options. Just like no spouse is perfect, no buyer will be perfect. You need to weigh all of the different pros and cons and select the best fit. And you'll need to accept that imperfection is part of the game.
- You only need to find one spouse. Maybe none of the other possible suitors like you. As long as one buyer does, that's all you need. Of course, that's not ideal in a business sale – multiple interested parties will bid up the price and provide you with greater negotiating leverage. But in the end, all that really matters is that you find a single buyer willing to meet your terms.

BEFORE WE START

First, if any of the words you encounter are unfamiliar, you can find a glossary at the end of the book.

Second, I've disguised the names and details of my past clients; in some cases, several people have been condensed into one to make a clearer point. My goal is to recount their struggles so that you can avoid them, while also changing the details enough that my clients won't feel that I've violated their trust.

Finally, while I know it's tempting to skip ahead and read just the chapters on selling and negotiating, I'd urge you to at least scan the earlier chapters. They help set up the psychology and reasoning behind the practical steps.

