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The Easy Way Out—The Unsolicited Offer?

The unsolicited offer usually favors the buyer.

by Jay Schembs

Most owners receive a steady stream of overtures expressing interest in acquiring their business. While these inquiries are typically summarily rejected, at some point a business owner may begin to contemplate a sale to solve succession, age or health issues, achieve personal goals, or deal with external industry pressures. At that time, they might consider the most recent unsolicited approach as an easy solution to whichever problem is occupying their mind. However, the "easy way" out is rarely easy, and in our experience, quite often delivers a sub-optimal result.

A buyer that is considered fair and easy to negotiate with helps form a view that the unsolicited offer can be a quicker, easier, more private outcome. Only in the rarest of situations does this prove to be true.

Unsolicited offers that land on owners' desks and fill their voice mails can range from thoughtful dialogue with an interested competitor to blind mailings from third parties soliciting sellers on behalf of private equity firms. The rationale for an unsolicited offer is that buyers believe that they can pay less, obtain more favorable terms, and avoid the time pressures and uncertainties inherent in a competitive process. These benefits to direct buyers have proven to be successful, which is why the practice continues.

Many owners believe that dealing with one party is easier, faster, and/or less disruptive to the organization than a formal, expensive, far-reaching process. A buyer that is considered fair and easy to negotiate with helps form a view that the unsolicited offer can be a quicker, easier, more private outcome. Only in the rarest of situations does this prove to be true. Normally, the drawbacks outweigh the seeming expediency of the moment. We offer herein some thoughts on the drawbacks of pursuing the single-buyer unsolicited offer.

INITIAL ENTHUSIASM MAY WANE AS THE LAYERS ARE PEALED AWAY

Most unsolicited inquiries do not turn out to be actionable. Private equity groups often hire "finders" to send out thousands of letters to solicit potential sellers. These letters primarily serve to tease out interest among a sea of potential targets. As we discussed in a previous IN$IGHT article [See: *Private Equity Diversity*, Fall 2012], private equity buyers are much more selective than preliminary discussions might indicate. They are happy to learn more about a business, knowing they can quickly and easily back away for myriad reasons such as customer concentration, industry uncertainty, margin profile, or management depth, among others.

Strategic buyers typically have more logical reasons to acquire a specific company. Oftentimes, the target is a known competitor or supplier, or is in a tangential industry that provides opportunities to expand the buyer's product or service offering. However, the economics of a business combination to the buyer are difficult to assess, and their decision processes can be highly unpredictable. Unlike private equity groups, strategic buyers are not under time pressure to employ committed capital. Many corporations have "rules" about how they do things and are rigid rather than creative regarding deal terms. Sometimes this isn't found out until after a lot of time, energy, and money have been expended. Whether dealing with strategic or financial buyers, engaging in a one-off process requires realism regarding the likelihood of a deal getting done on the terms and in the time frame articulated during the initial discussions.

DEALING FROM A POSITION OF STRENGTH

Whether the prospective buyer is financial or strategic, the playing field is not level. These buyers are almost always more sophisticated evaluators of fair market value than business owners. Their first order of business is to request exclusivity, which once granted, swings the negotiating pendulum their way. Once negotiating from a position of strength and after the seller becomes invested in the diligence process and the outcome, buyers can then persuasively argue for meaningful alterations to initial deal terms, a tactic far more difficult to execute within a competitive process. At that point, as sellers have lost negotiating leverage, the only alternative is to walk away from a deal.

SELLERS CAN'T ESCAPE INTRUSIVE DUE DILIGENCE

Any transaction – whether through a competitive process or a through a single party unsolicited offer – results in demanding diligence requests. Sellers in general face a number of risks as they negotiate a potential sale, which are exacerbated for an unprepared seller. How and when information is disclosed is very important – for example, contacting top customers or suppliers, employees learning about a potential sale – before a deal has closed can have adverse consequences. Further, disclosing information without critical review can lead to negative conclusions by the buyer, require deeper dives into an area of analysis that has previously not been done, or both. Without thoughtful planning that will allow anticipation of these requests, valuable time can be burned up during the negotiating period in order to react to and formulate responses. This churning of data can seem endless and can leave management frustrated, as they are forced to work two jobs trying to respond to diligence requests while also running the business. Because time is rarely on the side of the seller, any unnecessary delays to close a transaction can be very painful and costly.

Control over when and with whom to sell a business is a vaulable option. Having actionable alternatives strengthens the value of that option.

THE BEST DEAL?

How does the seller know if the deal they negotiated is the best deal, or even a good deal? It's hard to say without perspective on what the market will bear. A competitive market gives an owner perspective on the best terms

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and provides alternatives from which to compare. The presence of alternatives forces the "winning" buyer to move faster and agree to competitive terms. In a competitive process, the seller can gain agreement to all critical deal terms and timing before granting exclusivity. When dealing exclusively with a single party, the seller will never know whether the result was the best (e.g., price and deal structure, timing to close a transaction, impact on the organization and local community, and employee outcomes) that could be achieved.

Control over when and with whom to sell a business is a valuable option. Having actionable alternatives strengthens the value of that option. Even if a suitor presents what appears to be a compelling offer, taking a "pause" to prepare for due diligence while simultaneously examining alternatives prior to granting exclusivity keeps the prospective buyer honest, helps minimize internal disruption and time, and helps in negotiating the best possible deal. ZS

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ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, go to **ZacharyScott.com.**

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