Zachary Scott
INVESTMENT BANKERS

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Making a Market for Private Businesses

Designing and managing a process for selling a business.

by Jay Schembs

Investors in Amazon, Microsoft, or other publicly traded equities have the benefit of a robust market of buyers and sellers on a daily basis. Owners of privately held businesses, however, have no such luxury. In the private market, investment bankers design and manage a process to create competitive market conditions for sellers of privately held businesses.

"Running a process" in M&A vernacular means engaging in a systematic, disciplined sequence of events and activities designed to bring together interested and qualified buyers at the same time in a competitive process, enabling sellers to choose from comparable alternatives. Achieving this mission is easier said than done. Designing a process requires determining the company's value propositions and to whom they apply. The resulting target buyer composition, nature of information required, and length of time to absorb the information must be calibrated based on the characteristics of the chosen buyer group. The ultimate marketing strategy is often highly customized and can differ substantially from company to company.

WHAT IS THE VALUE PROPOSITION, AND TO WHOM?

A company's value, as opposed to price, could vary among potential buyers depending on how a buyer can use the target company's assets, capabilities, and market position. Strategic buyers may value improved access to distribution channels, entry to new customers, product features, geographic or market segments, or rationalization of excess capacity and cost structures. Likewise, a company's value can sometimes be increased by creating an environment for managers to take calculated risks and by providing them the capital to do so, a catalyst role that private equity groups (PEGs) often play.

The specific strategic value proposition(s) help dictate the buyer universe. Part of the advisor's job is to help identify different strategic value propositions and which parties can most likely realize the potential. For example, if industry consolidation is the winning strategy, direct competitors will be able to extract cost and asset efficiencies that others cannot. Sometimes, a fast growing company in a nascent industry can accelerate its growth in the hands of a PEG willing and able to provide the additional capital, experience, and know-how.

BUILDING THE BUYER GROUP

Analyzing the value propositions different buyers could employ helps to identify the universe of buyers that are likely to realize the most value as a result of the transaction. When there are buyers who can realize more value than the existing owners, a competitive process helps turn that "excess value" into a higher price. The following graphs illustrate buyer analyses for two different companies. Company A competes in a consolidating industry in which industry leaders are clamoring for market share. In this case, certain buyers can realize a better economic future once they own the company's assets and market position in comparison to what the company could accomplish on its own. As illustrated in the graph, five potential buyers could value this company much higher than others by assuming the existing company's market position. A process designed to include a wide number of other parties (such as PEGs with no relevant industry experience) would likely create incremental exposure risk and time demands on management for little benefit.

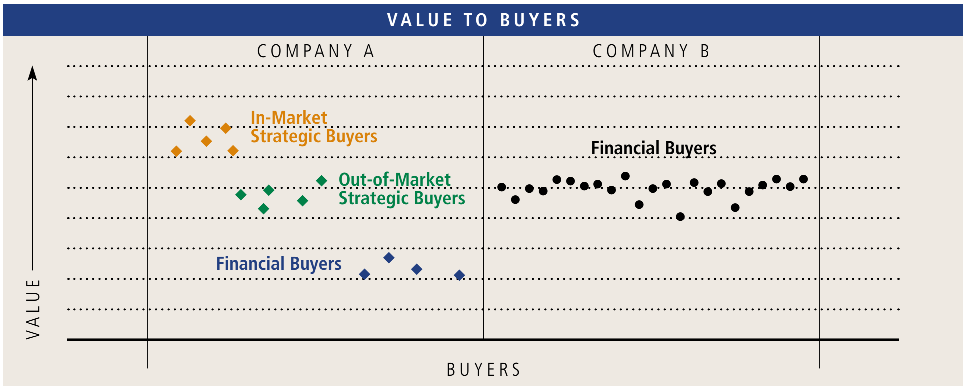
Company B, on the other hand, is a leader in its fast-growing segment with few competitors. In this case, there may be little variation in value among buyers other than as a result of their degree of optimism. The company's business plan largely is the strategic value proposition, and the class of buyers might likely be financial. The buyer universe will be selected based on size, geography, industry, and previous experience, and can potentially be a large group as there will be few distinctions among the buyer universe based on values to be realized.

DESIGNING THE SALE PROCESS

Prospective buyers need time to comprehend the critical information necessary to make and calibrate a purchase decision. Location, relevant knowledge, decision-making processes, and competitive dynamics are all considerations in defining when to contact potential buyers and how much time will be required by them to absorb the information. For example, sale processes involving foreign buyers tend to require more lead-time to overcome time zones, language differences, and cultural barriers. On the other hand, a limited market comprising direct competitors may warrant a shorter period, as buyers intimately understand the company's position and the opportunity. If PEGS are among the potential buyer universe, their requirements could be different from others. Each of these different groups might require different information to allow them to value the opportunity. Therefore, when multiple types of buyers are included in the buyer universe, customized presentations and a staged timing of contact and disclosure are appropriate.

While contacting every possible buyer ensures no stone is unturned, there are benefits and drawbacks of overly broad processes and long disclosure periods. Targeting large numbers of buyers increases the probability that confidentiality is breached. Even the most

VALUE TO BUYERS



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stringent non-disclosure agreement cannot prevent loose-lipped competitors, suppliers, or employees from trading industry scuttlebutt as well as sensitive competitive information. Fielding questions from a wide range of buyers places significant demands on the management team. Some buyers are just curious. Others require much hand holding to understand the company, its industry, and the company's value proposition. Finally, the disadvantage of casting a broad net is that potential buyers may resist spending the time and energy necessary to properly consider the opportunity. Faced with a "one-in-a-hundred" chance of success, buyers may be inclined to expend less effort on investigating the opportunity resulting in less reliability of buyers' stated interest and an elongated process.

CONCLUSION

Designing the appropriate sale process for a transaction is more art than science, requiring an understanding of the nuances of the company, its market position, industry dynamics, and the specific strategic options different buyers could pursue. The question is not whether a broad process ("shotgun") or narrow process ("rifle") is better; either could be appropriate in a specific situation. A thoughtfully developed buyer universe will flow from the strategic analysis and each prospective buyer should be included for a particular reason. Information developed for buyers must be customized for them to evaluate their specific strategic value propositions, and allowed adequate time to digest all relevant information. A well-designed process will be rewarded with a knowledgeable buyer universe that is prepared to compete for the business. **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, please go to ZacharyScott.com.

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