If All You Have is a Hammer, Everything Looks Like a Nail

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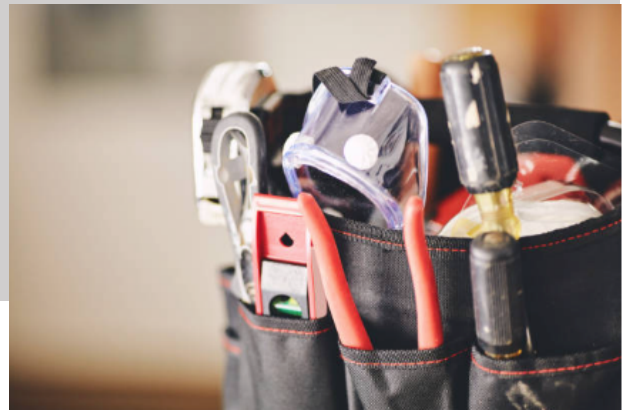
It is downright painful to admit that investment bankers aren't the most important parties in the financial value chain. After over thirty years of pitching that a competitive marketing process is the answer to almost any capital need, a reflective look back casts a shadow on that line of thinking.



Investment banks provide an essential service and that is to assess how the market will view a private business asset through collecting multiple viable options for a client, doing so either by demonstrating specialized knowledge or through the process of creating a competitive playing field. The investment banking industry has evolved to focus on the latter, and to our eyes, sacrificing the former.

"Running a process" looks like this: briefly analyze the company, prepare a confidential memorandum, develop a target market of potential capital providers, provide them information, answer questions, obtain indications of interest, invite the preliminary winners to a management presentation, open a data room with lots of detailed information, ask for final bids, select a winner and start the transaction documentation.

Need a loan – run a process; need to raise equity capital – run a process, need to sell your business – run a process. The auction process has become a commoditized service in that every investment bank claims to be able to develop a target list of capital providers and bring them to a head and "let the market speak." Don't read into this any diminution of the value of accomplishing and completing such a process. Doing it well is not that easy and good firms provide a valuable service that a company management team or a different type of professional firm will not be able to match.

"Nothing said herein suggests owners shouldn't avail themselves of advisers and alternatives, but they should not think that there is only one answer to all questions, and a little creativity can go a long way."

Going back to hammers and nails, what we have realized over a long time and a lot of processes is that there are situations where a formal auction process isn't necessarily the best approach to achieve the objective. One of the interesting and rewarding aspects of our role is having the opportunity to understand the complex reality of a situation and using creativity to design a customized approach to best accomplish the objective or solve the problem. There are a few situations we've repeatedly encountered where an alternative approach to an auction should be considered.

A Strategic Business Combination

To our amazement, companies that should know their competitive landscapes and understand the benefits of a potential business combination often don't. Each corporation has its own process of assessing a new opportunity and often many internal communities must be brought together to form a common mind around a proposal. Not all within the buyer's organization will have the same range of perspectives so there is a lot of education internally to build consensus toward a decision to act. There must be an internal sponsor or "champion" and that sponsor must be able to effectively articulate a value proposition that meets the disparate needs of all of the organization's stakeholders.

An auction process assumes that each buyer will know what the value of the target is to them and will bid up to the lower of what they believe they need to win the auction or the value to them. Except it's often not true. Each buyer has its own value proposition to add to the equation, and it is important to the seller that the buyer embraces that as a transaction is considered. If there is a lot of synergy value, it is worth the time to assure that it is understood between buyer and seller. If it is sizeable, there will be enough for the parties to share such that the seller can be assured that the value received is more than could be achieved from other non-strategic parties.

Exploring the nooks and crannies of how value is achieved takes time and might not fit a prescribed schedule – and as different parties are coaxed along, their own internal processes and the information they require at decision nodes may not have anything to do with each other or with a destructively rigid "process letter."

More Than Just Capital

More than just capital, a partner is needed. When the characteristics of the capital partner are critical to success, an auction is not the best way to make that choice. Choosing a long-term capital partner requires assessment of factors that can't be measured in an arm's length formal request for proposal process. If it did, choosing a spouse might be able to be done more efficiently. A resume and one long day of speed-dating should suffice.

> "Sometimes the first reasonable deal is the best deal."

Unconsciously, people give preferences to things and people with which they are familiar, therefore the adage, "The known devil is better than the unknown angel." The corollary to this is that people feel uncomfortable with a lack of familiarity. Familiarity embeds a greater degree of knowledge and that is important if the purpose is to choose a partner to achieve career and investment success – which itself is de-risking, and a value creator in the transaction process. It can't sufficiently happen overnight or in a few scheduled, chaperoned, and orchestrated meetings.

Time is Critical

Opportunities sometimes happen quickly and taking advantage of them requires the same fleet of foot response. To paint the picture clearly, let's assume raising capital within a specific time frame will allow the company to take advantage of an opportunity such that its value will double immediately. A capital source will want some of that value in exchange for its investment. Obviously, the capital source who will settle for a smaller share of the value would be better for the existing owners, but if the probability of winning drops with the time required to line up the alternatives, investment timing becomes a greater contributor to value creation than the differentiation of the source. Put simply, it makes more sense for the seller to accept an investor requiring 50% of the gain to hold out for another investor who might only require 35%, but where waiting puts the entire opportunity at risk. Sometimes, the first reasonable deal is the best deal.

There is no question that it would always be better to have all alternatives aligned side-by-side so they can be evaluated and the best one chosen. Some situations fit this model and the seller can feel comfortable they got the best deal that was available. Unfortunately, the world is dynamic, time is money, and nothing sits still. Nothing said herein suggests owners shouldn't avail themselves of advisers and alternatives, but they should not think that there is only one answer to all questions, and a little creativity can go a long way.

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