When It's Not (Just) About the Money

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How to weigh intangible considerations when evaluating a potential sale.

The Pacific Crest Trail (or "PCT") is a 2,650-mile hike stretching from Mexico to Canada. The average trip takes about five months and will wind through distinct geographic regions, from the hot and arid deserts of California to the dense evergreen forests of the Cascades.

Imagine talking to a weary hiker in the later stages of their journey, crossing from Oregon into Washington as you walk with them over the Bridge of the Gods. You might ask, as you struggle to keep pace, "Why are you hiking the PCT? What do you want out of it?"

They pause, stop walking, and look wistfully over the Columbia River, lost in thought. Finally, they turn to you and say **"Well, let's just see what the IOIs come in at and go from there."**

Transactions are long, expensive, and exhausting journeys that can help to achieve important outcomes in a business owner's life. We have written on the crucial operational questions of transaction planning several times in the past (see: **Preparing for Sale parts I, II, III**, and **Before You Want to Sell**). That advice remains critical for owners who want to understand the discrete organizational changes they need to make to achieve their transaction objectives.

But it begs the question...

What Do I Want?

As a necessity, our industry often condenses the nuances of a transaction into a single EBITDA multiple or cash figure. These are used as shorthand for value which, unfortunately, has become the primary way in which a transaction's value is communicated and understood.

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But in the lower and middle market, non-monetary considerations can often play **significant** roles in transaction considerations. If your ownership group is a public company owned by a large set of stockholders with competing interests, the idiosyncratic needs of any specific shareholder are irrelevant. Instead, transactions need only to deliver tangible return to shareholders in the form of green paper rectangles.

But **value** to a private business owner is far more than the payout at close. For example, a common situation we've witnessed is an owner who is completely burnt out and is hoping to earn "beach money" from their sale. An offer contingent on a five-year employment contract is a fundamentally different offer than one which allows the owner to delete Outlook and buy a boogie board.

Business owners should carefully consider their full suite of relevant transaction objectives before they start their transaction, including:

- How important is the timing of payments? How much should future earn-outs or holdbacks be discounted?
- Are there any potential buyers who you would not want to own the business?
- Are there any legacy considerations? Is it important that the company retains its name, or certain operations?

- Is it important that certain roles within the business remain unchanged? Are there any jobs, either with related parties, or with current employees, which you would want to remain?
- How important is retaining or not retaining your own role?
- How important is speed of close?
- How important is it that the transaction feels like a win (we'll refer to this as a "feel-good outcome")?

Importantly, the answer to most of these questions isn't just yes or no. Instead, the relevant question to ask is...

What's It Worth?

These transaction objectives matter just as much to buyers as they do to sellers. All things being equal, a seller who's willing to wait on an earnout, for example, will get paid more than a seller who is not. Our would-be boogie boarder might say he needs to retire at the start of the process, but if the only strong offer he receives includes an employment contract, he might wait five years for the Amalfi Coast rather than heading to Myrtle Beach today.

We would advise business owners who are considering their range of transaction objectives to assign an actual cash value to each potential question. It's common for sellers to have a price floor in mind during the transaction, under which, they're unwilling to sell. We'd advise using that floor as a thought experiment where you can value other components of the transaction. If a seller is hoping for a sale of $10 dollars, for example, they may need $11 in total compensation to justify $3 of holdback. On the other hand, a feel-good outcome – where the buyer is a trusted party, employees keep their jobs, and the seller gets to retire – may only need to reach $8.

It's not that our suggestion is optional; in fact, every single one of our questions will have to be weighed and answered at some point in a transaction.

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Unfortunately, they're often answered in the 11th hour of a transaction—as IOIs or LOIs trickle in—during which investment bankers and general counsel are on the clock, and there's precious little time for careful consideration.

It is at this point where we feel obligated to offer...

A Cautionary Warning on Feel-Good Outcomes

Every business owner is going to have his or her own conception of a feel-good outcome. It might mean keeping the name of a family company alive, employees retaining their jobs, selling to a trusted party, or staying on the board in some capacity. **But once you sell your company, you sell your company.**

As we talk about wargaming optimal outcomes from a transaction, it's worthwhile to note that what we're mostly discussing is reducing the purchase price of the company, and in exchange, getting paid less. This poses a problem because, in the long run, assets in the free market tend to be allocated to their highest and best use just as gravity pulls a rock down a hill.

If a strategic buyer who would consolidate operations is truly the logical owner, then at some point, they (or someone like them) will probably own the company.

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Just as we advise business owners to evaluate the importance of feel-good outcomes, we advise accurately discounting their impact. In our earlier example, a feel-good outcome justified a $2 reduction in purchase price. That might seem like a justified discount, but, in three years when the company is sold again at full value to a chop shop, the seller may come to believe that they gave away 20% of their company's value to delay, not deny, a bad outcome.

We have written on the topic of keeping options open throughout the transaction process (see: **The Disadvantage of Constraining the Universe of Buyers in a Sale Process**). In a similar vein, we would suggest keeping an open mind as you consider the world of transaction objectives available to you. As transaction advisors, we've seen first-hand the common disconnect between "Stated Preferences" (or what owners say they value) and "Revealed Preferences" (or what owners actually choose) first-hand.

To be clear: we're **not** saying business owners should just discard any hope for a feel-good transaction. In some markets, there may be strong operators who can be relied upon to run the company in good faith and uphold the owner's optimistic transaction objectives in the long term. Even if there isn't such an operator, kicking the can down the road can be a legitimate goal. If a business owner is willing to take a 20% haircut so that they can look at their former employees in the eyes at the local grocery store, that's a perfectly rational strategy. It may truly be, that, after careful consideration, some items are simply nonnegotiable, and some buyers are no-gos.

In Conclusion

So, back to our hiker/business owner.

Before they pack their bags, or ship their dry food, or explain that they did not read the memoir "Wild", our hiker should think carefully about why they're going on the journey. When the IOIs come in, that shouldn't ignite a soul-searching process. Instead, there should be a flexible valuation framework already in place, where each offer can be weighed and balanced against pre-considered transaction objectives.

In this world, not only is the journey far smoother, but more likely to succeed.

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