Achieving Liquidity Event could be as difficult as building a business: steps needed before selling your company

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Entrepreneurs start business in order to be their own boss and determine their destiny . Most entrepreneurs have few things in common, freedom to make decisions and implement their vision. Entrepreneurs start business to avoid working for someone. Their primary objective is not making money but do what they like most. Money becomes the reward for their hard work .

Although, thousands of individuals start businesses every year, the success rate is low. The major reasons for failures are due to not having adequate information about the business, not understanding the pikes and valley of business and competition prior to launching the business. Not having passion for the business may contribute for the failure.

Most business owners focus on one or two aspects of the business without realizing that they have to be knowledgeable of the legal aspect, market, logistics, product development, cash flows, human and financial management. Some business owners focuses on the one or two aspects of the above without realizing that all the ingredients are important in succeeding in business. Most businesses fail due to financial mismanagement. Businesses with owners with different disciplines that complement each others seems to succeed, although, there is no statistical or empirical data to support it.

Successful business owners recognize early on the need for attracting professionals once the company reaches to a level where it affords to attract seasoned management team. Proven, seasoned management team not only manage resources efficiently and add value to the business, they also anticipate in predicting the future of the business and manage risks. Professional managers are the additional brains of the organization, work along with the founder/founders as a team to accelerate growth. Smart/wise founders, focus on what they do best and delegate the rest to others, they give freedom to the professionals with the understanding that delegation of authority give the freedom for creativity, quick decision, and as a result assure success.

Professional managers always explore ways to develop the best business plan and ensure that the company achieves its objectives. In addition to day-to-day operational management, professional managers bring many years of experience that help them craft a long-term strategy in building a strong team and grow the business.

Small and mid-size companies should accelerate growth in order to be competitive in their market and must explore creative ways of maximizing value.

After a company grew to a certain level, founders, usually, explore their options and look into liquidity event. Liquidity event may be achieved by going public, which is becoming difficult for small and mid-size companies due to the complexity of the SEC requirements. The other option is to sell it to larger company. Either option requires adequate preparation to achieve the objective.

Some founders realize that accelerating growth organically may not be adequate to accomplish fast growth, by both organic and acquisition; some companies choose to increase growth by acquiring synergistic companies. It is proven that acquisition could deliver the best growth potential provided that it is executed judiciously; successful integration secure the economic of scale as desired provided a focused well thought out plan for integration is executed.

It is imperative that the acquirer investigates all aspects of the target business prior to signing Memorandum Of Understanding, or committing to a deal making process, it is critical that the target management team is professional, honest, have business acumen and ethical conduct. Otherwise, the success of the deal will be in question.

I remember a deal where we identified a company which we compete in the market and thought acquiring it will make sense for us, when we approached the company initially, they resisted our idea, overtime, they agreed to be acquired by us, we signed memorandum of understanding ("MOU") to start working on our due diligence, the company was a private company where the financial statements needed to be audited for prior two years, the audit took more than we anticipated and at the same time we were negotiating the details of the deal and an agreement was signed subject to closing conditions. During negotiation, we were able to know the Management philosophy, core value and how they operate the company. The audit and due diligence including speaking with the target customers took over six months. In the middle of our due diligence, the CFO resigned, which was a red flag for us, in addition, the management missed its sells target for the two quarters, which made us uncomfortable.

Although they missed the two quarters, we were hopeful that the acquisition was worth pursuing with some adjustment to price, however, we were a little uncomfortable and as a result we extended the closing time for another three months so that we can re-evaluate our $160 million valuation for the target, we called a meeting with the management of the target at the beginning of their fourth quarter, which was October, asked them if they can deliver the figures in their plan. Although, they missed their numbers for the last two quarters, they appeared comfortable to meet the numbers for the quarter.

We placed a call to the CEO of the Target in the beginning of December and asked him if he was on target for the quarter as we agreed at the beginning of the quarter, he

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told us with certainty that he would deliver the numbers. Our Executive Team discussed the status of the acquisition in December after receiving the assurance from the Target CEO and the Executive Team concluded that we should wait and see.

We were anxiously waiting to hear the final number from the Target CEO by the latest January second, nevertheless, we never heard from the CEO and called him on January fifth and we were told that they missed the numbers, we were speechless and composed and kept quite for about 30 seconds and say, how bad? He said "pretty bad"; we immediately, informed our board and the deal was terminated based on violation of closing conditions in the Agreement. Unfortunately, such incidents are common even in the large transactions. Nevertheless, the management and staff time spent, legal cost incurred during the due diligence process was significant and would not be recovered, although there were provisions that addressed recovering of such costs in the agreement, but difficult to enforce without going through a long drown legal battle.

Business owner/seller need to understand that most buyers are sophisticated, do their homework about the company such as its product, market share, management, employees, customers views about the target product and services, study the financial very thoroughly and the strategy at least for the next five years.

Business Owners/Sellers should dress the company properly prior to talking to potential buyers; need to understand that he/she is selling a package, i.e. management, product, assets, intellectual property, customers list, vendor lists and Goodwill. Seller should bring in a strong CEO and CFO if they do not have, and other management Team Members at least a year or two years prior to talking to potential buyer, the books must be audited, all intellectual properties must be verified and cataloged, board minutes must be compiled and current, all taxes and government fillings must have been filed on time.

Seller must anticipate receiving a checklist that the buyer may provide during the process. Hire a consultant/consultants to help organizing the company for sell; valuation of the company must be done to ensure that the seller has an idea of the value of the company. Ensure that the Seller's financials are audited by reputable accounting firm and identify competent attorney who has done many deals in the past. Such prior preparation will ensure that the seller would receive higher valuation and the sell goes smoothly.

Buyer may not be able to discover all inappropriate unorthodox charges during its due diligence process, however, seller needs to understand that fudging numbers is not only unethical, illegal or immoral, it is certain that it will be discovered during due diligence, if not during due diligence, within few months of closing the deal, if discovered, it will be embarrassing and will have financial consequences to the seller, buyer will deduct it from the retained amount, in addition, the buyer could sue the seller and the Management Team. The creditability of the seller's management team will be tarnished.

I remember an acquisition that we made over 20 years ago; the deal was equitable for both the seller and buyer. It was our company policy to keep the acquired company as a division and give the management autonomy to run the company, provided that the management delivers the agreed upon/plan numbers. The acquired company was decided to operate independently and one of the founders became the President of the new division. Three months after the acquisition of the company, our internal audit team discovered that the company was making payment for the President's wife 500S Mercedes. Further investigation revealed that the company has been making the payment for many years prior to the acquisition. The company stopped payment and the President was asked to refund for the three months payments made after the acquisition and the executives lost confidence in the President and the president's three years contract was reduced to one year. The controller, who was a controller prior to the acquisition confessed that she knew about it and offered to resign with regrets.

Such action is being penny wise and pound-foolish, the president was being greedy, although, he made millions of dollars out of the deal and had a three years contract with generous compensations package.

Seller must be aware that buyers are getting very selective, sophisticated and expect the best from the target company. Ethical conduct, transparency, good governance and implementation of Generally Accounting Principles, and retaining competent people in the organization have become the demand of buyers.

Sellers need to realize that being direct in the negotiation process will be an asset not a liability. Being direct will not hamper the deal but not telling the truth to potential acquirer will certainly kill the deal. People deal with people and expect the truth; giving blurred truth will not help the deal. All items must be brought to the table. Sellers should not appear to exaggerate; no need to do more selling once the buyer is at the table.

I remember a deal where we worked on for about a year where we organized a meeting between our Chairman and the Target's Chairman. All along in the process, for the last one year, both Chairmen were apprised of the deal by respective executives, board was knowledgeable of the deal. Our Chairman was delegated by our board to consummate the deal. The meeting took place but the deal did not go through because of our Chairman. Our Chairman felt that he was not comfortable doing business with the Target's Chairman because the Target Chairman does not appear to be trustworthy. Such incidents happen no matter how convincing the deal structure is. Chemistry is important. Early meeting with all the respective executives must be done to avoid cost and time spent during the negotiation process.

It is imperative that the seller must clean its house prior to talking to potential acquirer/acquirers, assemble good management team, implement good governance, hire trusted professionals to negotiate the deal, seller should not be greedy (be realistic about the value of your company), must have books audited by reputable audit firm for at

least three years. The above may not assure success in a deal, but it sure gives high probability of getting a serious offer provided that all the criteria that the acquirer is looking are fulfilled.

Starting and growing a business requires lots of personal and family sacrifices, preparing company for liquidity event also requires as much sacrifices and energy required to have a successful liquidity event.

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