THE EXIT ACADEMY

Why Businesses

Sell For Less Than They Should

Mark Carmichael

The Exit Academy

Lesson Download

Why Businesses Sell For Less Than They Should

I've yet to see any credible research on this question, but conventional wisdom among M&A advisors holds that 50+% of privately owned businesses sell below their full market value. Whatever the figure is, it is certainly true that many owner-managed businesses fail to achieve the optimum valuation when selling. How can this be?

One significant reason is that small- and medium-sized businesses are sold in an inefficient marketplace. A host of factors, when coupled together, begin to illustrate why this inefficiency persists. Consider the following:

• Information is not readily available on comparable sales of other firms in your sector, making it hard to quantify what your business is worth. By contrast, if you wanted to sell your 2-year old Toyota Prius, a wealth of information for determining its value is at your fingertips.

• The potential buyers for your firm are limited in number and may be located at home and abroad. Identifying them, contacting them and bringing them to the negotiation table takes time, which is always limited.

• Negotiations between buyer and seller can take months.

• Ineffective advisors working on behalf of either seller or the buyer (or both) can lead to inefficiencies within the transaction (i.e. they're not doing their job professionally). They may also create a poor transaction structure that does not optimize the deal (or causes the deal to fail altogether).

• Emotional conflict and contrasting personality types between buyer and seller principals, as well as their respective lawyers, can negatively affect deal terms.

Notwithstanding the above, there are a few commonly accepted principles when it comes to M&A valuations, all of which are intuitive:

• Large, public company buyouts have mixed records when it comes to creating "alpha" (financial returns that are higher on a risk-adjusted basis than the market would expect), and very often the sellers capture more value than the buyers. This is because:

  •Large, public companies typically have very strong valuation indicators for a buyer to assess (long track records of performance, robust financial reporting systems, liquidity of its shares, better financing/debt arrangements, etc.).

  • M&A transactions involving large companies face a great deal of public scrutiny.

  • These transactions typically involve a variety of bankers, consultants and executives with many years of transaction experience and expertise. In other words, the problems I identified above are less likely to materialize.

• In the sale of small and medium size enterprises (SMEs), on the other hand, the value created by M&A plays primarily to the buyers. This is because:

  • There is usually a significant difference in the M&A experience and capabilities of SME owners versus larger corporations (larger corps being the most typical buyers of SMEs, although this is not true in all sectors).

Disclaimer:
This document is produced for information only in general terms and its application in specific circumstances will depend on the particular facts. We always strongly recommend that you seek your own advice from a qualified M&A advisor and when appropriate, from your lawyer, accountant or other professional advisor as appropriate. The content and opinions expressed in this report do not constitute advice whatsoever and neither The Exit Academy, The Intelligent Exit nor any affiliated businesses, staff or other representatives shall be liable for any loss arising from your reliance on any of the information contained in it.

If you're considering the exit of your business, contact us at: **ExitSupport@markcarmichael.com**
We work with ambitious clients who want to make the most of their exits. Business owners from around the world come to us to determine their ideal exit strategies. Our market-leading approach to selling businesses drives the development, implementation and execution of the most effective sell-side strategies designed to achieve extraordinary results. We typically work with businesses with an enterprise value of $25 - $500 million.

©2021 Mark Carmichael – The Exit Academy

- Often these transactions do not feature any element of competition between buyers, leaving the seller in the dark as to how others would value the company and whether the seller is getting a reasonable deal.
- Affordable debt financing for M&A tends to be less available for smaller transactions, thus lowering prices offered.

What does this mean for the business owner of an SME looking for an exit? Forewarned is forearmed. Knowing the rules before you get in the game can translate to a life-changing sum of money and better all-around transaction structure for you, your staff, customers and suppliers. Here are a few specific things to keep in mind when it comes to valuation:

- Valuation can be calculated. There are many approaches to valuing businesses. But the price that a buyer is prepared to pay is negotiated. The value placed by buyers on different attributes of your business is subjective and is therefore, subject to variation to the extent beauty (or price) is in the eye of the beholder. This is an important concept for sellers to remember: Valuation can be calculated, but price is negotiated.
- Unless there is a specific time pressure regarding a sale, work with your advisor to set a "walk-away price" before you start negotiating with buyers. This figure is kept strictly between you and your advisor and is never shared with potential acquirers. If you and your advisor (who should have a current understanding about your industry's M&A dynamics, valuations, etc.) agree on a walk-away price and do not receive an offer at or above this price (despite running a robust sales process), consider taking the company off the market to address weaknesses highlighted by potential buyers.
- Well-designed sell-side strategies culminate in the highest prices, highest probability of success and best overall deal terms. A sale process that involves a higher number of qualified, researched buyers results in a competitive bidding scenario, which weighs heavily in favor of a higher price being realized.
- Ensure that your advisor and accountant work together to display accurate and correct financial information to buyers, including normalizations and projections.
- Ensure you and your company are prepared well before you commence the process of actually selling your company. This can make the difference between success and failure.

Preparation, discipline in sticking to a comprehensive process and experience of the team will often determine whether a business or sold for fair value or it becomes another example of a company that went for less than it should have.

Disclaimer:
This document is produced for information only in general terms and its application in specific circumstances will depend on the particular facts. We always strongly recommend that you seek your own advice from a qualified M&A advisor and when appropriate, from your lawyer, accountant or other professional advisor as appropriate. The content and opinions expressed in this report do not constitute advice whatsoever and neither The Exit Academy, The Intelligent Exit nor any affiliated businesses, staff or other representatives shall be liable for any loss arising from your reliance on any of the information contained in it.

If you're considering the exit of your business, contact us at: **ExitSupport@markcarmichael.com**
We work with ambitious clients who want to make the most of their exits. Business owners from around the world come to us to determine their ideal exit strategies. Our market-leading approach to selling businesses drives the development, implementation and execution of the most effective sell-side strategies designed to achieve extraordinary results. We typically work with businesses with an enterprise value of $25 - $500 million.

©2021 Mark Carmichael - The Exit Academy