

## Trade Sale Exit Strategies – Finding a Buyer That Needs You

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### ABSTRACT

Most business owners grapple with the problem of selling their business. While they may be very good at running their business, they flounder when it comes to finding a buyer that will place a premium on the value of their firm. One technique for finding the right acquirer is to find a potential buyer that has a serious problem you can solve. The task of the owner is to be proactive in seeking out corporations where the firm can take away a serious problem or threat. This paper reviews a buyer identification process where the seller mitigates or resolves a threat or problem for the buyer.

### TRADE SALE EXIT STRATEGIES – FINDING A BUYER THAT NEEDS YOU

Most business owners grapple with the problem of selling their business. While they may be very good at running their business and creating value for customers, they flounder when it comes to finding a buyer that will place a premium on the value of their firm. For most it is simply that they haven't applied themselves to the problem, for others, they don't know where to start.

There has been very little research in the area of trade sale exit strategies (McKaskill et al., 2003). Hawkey (2002) discusses trade sale exits at length as one of a number of possible exit strategies for smaller firms. However he does not provide any insights into the selection of potential buyers. In the 2003 ICSB paper by McKaskill et al. the research question posed by the authors was; *What factors contribute to the seller achieving a premium on sale of their business?* The authors presented a tool for measuring the quality of an exit strategy; the Exit Ready Index. The Index was composed of a set of attributes of an Exit Readiness Strategy that had been validated with a number of venture capital firms. As part of the development of the Exit Ready Index, the authors identified *selecting potential buyers* as part of the sales strategy. This paper reviews one of the selection methods – finding a potential buyer that has a problem you can fix.

This paper reviews a number of examples of where the selling firm has identified a potential buyer through this process as well as situations where the buyer has acknowledged that 'solving a problem' was a key factor in the acquisition. Unfortunately few corporations are willing to admit publicly that an acquisition has been made for this reason, thus the number of cited examples is relatively low. The examples do however show that this approach to identifying a potential buyer should be considered as part of a process of buyer selection.

Many of the examples were derived from internet searches using Goggle. However it was difficult to find the appropriate screening words to isolate the type of acquisitions sought. For example, on 8 th May 2004, the word 'acquisitions' provided over 3.8 million references while 'acquisition' gave over 13 million references. Longer phrases such as "acquired all the shares of" gave a manageable list of 554 while "acquired all the outstanding shares of"

provided 766 references. The phrase “acquired the business of” provided 3,130 hits. The descriptor “trade sale” gave 49,600 hits but was not useful since it included products for trade or sale.

The examples cited in this paper have been accessed on several different dates mostly using the phrase “acquired the shares of” or ‘acquired the business of’. The search was not exhaustive but was conducted to find specific examples of ‘problem solving’ acquisitions. In the vast majority of cases either reasons for the acquisition were not provided or a very general ‘business development’ reason was given.

The ‘problem solving’ technique for finding the right acquirer involves seeking out potential buyers that have a serious problem the firm can solve. This may seem somewhat simplistic but there are clear examples where this has been the prime objective of the acquisition.

In seeking out a potential buyer, the seller may use a number of screening techniques to identify buyers. For example, this would include situations where the acquirer is looking to expand their business through acquisitions. A quick internet search lists numerous incidents of such acquisitions as well as corporate announcements where investment objectives include expansion through acquisitions. However, the seller’s screening criteria should also seek out situations where the seller can solve a strategic problem for the acquirer. A proactive trade sale strategy suggests that owners should take the initiative in seeking out possible acquirers based on the screening criteria. Further evaluation will determine which of targeted acquirers have the willingness and capacity to buy. Those targeted potential acquirers that have a serious problem which can be overcome by the selling firm should offer a significant chance for the selling firm to achieve a premium on the sale of their business.

Most acquisitions are undertaken to provide support for expansion, whether this be additional products or additional markets. The ‘problem solving’ acquisition is not generally mentioned. Pearson (1999) lists reasons why corporations might acquire unquoted companies. Included in that list is a reference to a one problem solving situation; ‘to protect a key source of supply which otherwise might be acquired by a competitor’. As will be shown from the examples in this paper, there are many areas in which the assets or capabilities of the acquisition might resolve threats to a business.

To better understand the circumstances that drive this type of acquisition, think of the ‘problem’ as a threat that might be solved, mitigated or reduced. This is a situation where the threat is seen by the corporation as a potential or actual reduction in current or forecast revenue if no counter action were undertaken. Normal business life is littered with such activities including price wars, introduction of new technology, new legislation, loss of a major distribution channel and so on. The ‘problem solving’ strategy for making a strategic sale of a business is to be able to identify situations in which the firm’s assets or capabilities can counter an existing or emerging threat for a corporation that has both the capacity and willingness to enter into an acquisition. Here are some examples that demonstrate the situation.

(a) Pioneer Computer Systems (PCS) acquired a supplier to gain control over a strategic component of their product development infrastructure.

In 1984 Pioneer Computer Systems utilised a 4th generation language from North County computer Services (NCCS) in Escondido, California. At that time the language, USER11, operated on the RESTS/E operating system on the Digital Equipment Corporation's PDP 11 computer product line. With the introduction of the VAX series of computers, the USER 11 product was ported over to the VAX to provide an identical programming and end-user environment. However this failed to use any of the new features inherent in the VAX and thus PCS faced a decline in its market acceptance. NCCS were determined to stay with a transparent interface thus threatening the survival of the PCS applications written in USER 11. *To solve the problem PCS raised \$1.5 million in venture capital, acquired NCCS and rewrote the USER 11 product to utilise the advanced features of the VAX.*

Source: Dr. Tom McKaskill, Former CEO, Pioneer Computer Systems

(b) Agere Systems acquired Massana rather than let their initial investment be lost.

"Agere Systems announced Monday the acquisition of an Irish semiconductor-maker that designs broadband network chips that are 10 times faster than current technology.

The start-up has only produced a prototype, which several companies are sampling, including possibly Cisco Systems and Apple. The privately held company has not turned a profit. It has received about \$30 million from U.S. and overseas venture capital firms. Agere will have to inject cash to cover research and employee salaries, without revenue coming in immediately. It will assume a small amount of debt. The Dublin company is a startup venture founded in 1996 that began as a provider of engineering services. It has collaborated with Agere for the last year on developing gigabit Ethernet chips used in high-speed broadband networks. Agere produces chips for slower speed Ethernet connections. Massana was on track to fulfill its contract, *but Agere decided it wanted more control over the project so it decided to buy the company*, said Sohail Khan, executive vice president of Agere's Infrastructure Systems." (Author's italics)

Source:

Accessed 7<sup>th</sup> September 2003

<http://www.mcall.com/business/>

c) Chinadotcom acquired Ross Systems Inc., a supplier of ERP systems. Ross Systems have a history of poor management that made them vulnerable to takeover. Chinadotcom may have decided to acquire rather than let them pass into a competitor's hands.

"ATLANTA (Dow Jones)—Chinadotcom Corp.'s CDC Software unit signed a definitive agreement to acquire Ross Systems Inc. (NasdaqNM: **ROSS – News**) for \$5 in cash and \$14 worth of chinadotcom common shares. In addition, *CDC Software has been a master distributor of Ross Systems' enterprise business solution, iRenaissance suite, in the Greater China region.*" (Author's italics)

Source:

Accessed 6<sup>th</sup> September 2003

<http://www.rosssystems.com>

d) Peoplesoft Acquired Distinction Software Inc. as a counter to the announcement by SAP of a suite of supply chain optimization products.

In early 1998 SAP announced a suite of supply chain optimization products replacing their alliances with a number of small software companies. Within a few months their major competitors including Peoplesoft, J D Edwards, Oracle and Baan all made similar announcements. However these were mostly development initiatives and not completed products. Peoplesoft took the opportunity in late 1999 to acquire a small software house, Distinction Software Inc. which had a complete suite of products in order to counter the move by SAP.

Source: Dr. Tom McKaskill, former CEO, Distinction Software Inc.

Solving a serious problem, negating a threat, overcoming an obstacle, or removing a constraint are ways of creating strategic value for the acquirer. Most acquisitions are made for Fair Market Value (FMV), a term used to describe a valuation based on industry standards, most often some multiple of net earnings. A seller wishing to secure a premium on the sale needs to find additional value over and above the FMV. The buyer needs to see value beyond that which is represented by the earnings on an investment. It is by creating this additional or 'strategic value' that the seller can achieve a premium on the sale of the business. Resolving a serious problem for the buyer is one technique for achieving the premium on sale.

Many firms take a conventional path to selling their business by working with a business broker. The broker works with them to package the business for sale by putting together a business report on the state of the business; a financial memorandum. This is then used to advertise the business or to approach likely buyers. The expected value of the business is normally determined by the return that an independent investor would achieve if they bought the business 'as is'. While this process will almost certainly find a buyer, it is unlikely to gain a premium for the seller over a 'fair market value'.

Business brokers typically do not have the time or industry knowledge to seek out corporations where a strategic value case may be made. Often a business broker is brought in to make the sale because the business is in trouble. This leaves little room for researching the market or developing an intimate knowledge of industry players that might uncover a potential acquirer that might be prepared to pay a premium.

Most business owners know their industry and understand their own competitive position. By developing informal and formal relationships within the industry, they are often privy to information about problems being faced by other industry firms. Within their own business they will have assets or capabilities that provide them with a competitive advantage. This is often described as 'things we own' and 'things we do'. The process of seeking out strategic buyers based on solving a problem is to think of how other firms would use the competitive assets or capabilities of the selling firm. Those that could use these to overcome a problem or threat are target acquirers.

For example:

In 1990 the owners of Pioneer Computer Group (PCG) decided to sell their software firm. They had 160 staff over three locations; Northampton and London, England, and San Diego, California. They developed 4<sup>th</sup> generation languages for the PDP/11 and VAX computers and then used these languages to develop ERP system for discrete and process manufactures. After investigating the UK for potential buyers, they were disappointed in the low valuations and turned their attention to the USA. There they found Ross Systems Inc. that was utilising the VAX computer using a 3<sup>rd</sup> generation language and only selling corporate financial systems. Ross recognized that their future looked bleak unless they could compete with new software technology and gain access to a larger market. Pioneer's successful approach to Ross was to provide them with a new development capability and to provide them with a growth market in the manufacturing sector. The sale price achieved was 20% higher than what PCS would have been able to secure in the UK.

Source: Dr. Tom McKaskill, former CEO, Pioneer Computer Group

Finding the strategic buyer can take some time. The buyer must have both the need and the capability to buy. Often external circumstances provide the impetus for such a need. In the 'problem solving' scenario, it requires a search for corporations that need what the firm has that could overcome a problem or threat. Few corporations publicise their threats. A well networked industry executive may be able to spot opportunities but generally it requires some systematic approach to cultivating relationships where such situations are discussed. Sometimes it just requires boldness to initiate discussions with industry firms to discover where a strategic fit might occur. Generally it is only by participating in industry and professional networks that a firm will find out about a corporation that has a problem that they can eliminate or reduce.

Each industry has its own culture, associations and ways of networking. Thus no one process for seeking out a buyer will work in all circumstances. However a 'problem solving' approach will almost certainly be based on leveraging competitive assets or competencies. One method for identify potential acquirers under this criteria might be as follows; Look internally at the business and list out those things that the firm has or does that has strategic impact. Examples of acquisitions are included where appropriate. This list might include the following;

#### **Access rights, licenses, patents or brand names**

Corporations can sometimes be frustrated in expansion plans within a sector through the lack of intellectual property. This might be a license to operate, a recognized brand or access to technology which is protected by patents. A lack of such rights when competitors have rights or acceptable alternatives can be a threat to future revenues.

#### **Technical expertise or specialist knowledge**

In areas of emerging knowledge, the number of experts or specialists is often limited. Where competitors have such expertise and are leveraging it to gain market share, a corporation is threatened unless they can also acquire such expertise. Sometimes the only

way for a critical mass to be acquired quickly is to buy a firm which already employs such people or has developed such capability.

“Eastman Kodak Co. Monday announced plans to buy two companies that make digital printing systems and said the acquisitions would reduce its 2004 earnings. For Kodak, whose shares were down 3.6 percent in early trading, the deals are part of a drive to invest more in digital imaging. The company has been hurt by the waning film market”

Source: <http://www.forbes.com/newswire/2004/03/08/rtr1290006.html>  
Accessed 7<sup>th</sup> April 2004

### **Gateway capacity or technology**

Often in a specific sector, the ability to compete may depend on owning a share of a channel or access path. If, for example, capacity with a channel is only able to grow at a limited rate, the corporation that has control over part or all of that capacity has considerable influence over market share. The same logic would apply to a market where existing suppliers have effective control over the market due to high switching costs to their customers for moving to a new entrant.

“As part of its expansion plans and strategy to enter the Internet business, Kuoni Travel Group India has acquired Resnet from Traveljini.com, which is an investee company of ICICI Venture for an undisclosed sum. The acquisition of Resnet from Traveljini.com is the first and primary initiative in the overall Internet strategy of Kuoni India, the company said in a release. Resnet is an on-line booking engine and a comprehensive reservations solutions provider to the hospitality industry and represents various hoteliers on the GDS and Web platforms.”

Source: [http://www.financialexpress.com/fe\\_full\\_story.php?content\\_id=56473](http://www.financialexpress.com/fe_full_story.php?content_id=56473)  
Accessed 7<sup>th</sup> April 2004

“U.S. RealTel, Inc. (OTCBB: USRT), a national broadband services holding company operating primarily through its wholly owned subsidiary, Cypress Communications, Inc., today reported its consolidated operating and financial results for its fourth quarter and fiscal year ended December 31, 2003. The acquisitions of Cypress Communications and WorldCom's Intermedia Advanced Building Networks (ABN) unit in 2002 provided a platform from which to launch a strategy ultimately designed to increase shareholder value.”

Source: <http://www.tmcnet.com/submit/2004/Mar/1027229.htm>  
Accessed 7<sup>th</sup> April 2004

### **High profile customers or hard to acquire customers**

Entry into a market or expansion beyond a certain point may require the corporation to secure the business of certain key accounts. If these are already being serviced by another firm, the only way forward may be to acquire the existing supplier.

### **Key locations or launching pad for expansion**

The costs of entering a new market from scratch may be prohibitively high in terms of time and/or investment. Exiting businesses may however already have built sufficient critical

mass and infrastructure that they can provide a launching pad for further expansion into the market.

“Axon Group plc, the business transformation consultancy, announced that it has agreed to acquire the entire issued share capital of MyDruid Services SDN. BHD, an offshore services partner based in Kuala Lumpur. Axon says the acquisition supports its strategy in two key areas. Firstly, it provides a beachhead into Asia, from which Axon intends to grow the local client base, focused initially in Malaysia, Singapore, China and Korea. Secondly, the Applications Management centre in Malaysia will become Axon's off-shore and on-shore capability centre for the region, providing resource to support both local and global clients. The acquisition will not have a material effect on the Group in 2004.”

Source:

[http://www.consultant-news.com/Article\\_Display.asp?ID=1420](http://www.consultant-news.com/Article_Display.asp?ID=1420)

Accessed 7<sup>th</sup> April 2004

### **Products which can fill out a portfolio**

In markets where the number of products is large, channel members try to limit their administration load by working with partners that can offer a wide range of complimentary products. A firm may be faced with erosion in its market if competitors can offer wider ranges of products. Thus acquiring a firm that can compliment a product line and counter competitor pressure may be a successful method of retaining existing business.

A similar argument can be applied to integrated solutions in engineering and software. The success of the large ERP vendors such as SAP, Oracle and Peoplesoft has come from their wide portfolio of products. Such firms often make acquisitions to provide a more comprehensive solution to customer's needs. Thus they may be also forced to seek an acquisition to counter a development or acquisition at a competitor.

### **Highly networked or well known industry leaders**

A corporation threatened with a loss of contracts may seek to acquire a firm with highly networked management or high profile individuals that can secure them a place on tender processes.

### **Experienced management team**

A corporation with a poor performing business unit or a situation which requires unusual expertise might seek to acquire a smaller firm just to be able to acquire a fully operational management team.

### **Reduce risk**

“Malaysian conglomerate Sime Darby has agreed to buy a controlling stake in three companies involved in auto distribution and parts manufacturing as part of moves to expand its motor vehicle business. It said the proposed acquisitions were expected to give its motor vehicle business a boost as Hyundai was one of the best-selling and fastest growing brands in Malaysia. Sime Darby chief executive Nik Mohamed Yakcop said the proposed acquisitions would provide a more balanced portfolio of marques and reduce its exposure to the euro.”

Source: [http://www.channelnewsasia.com/stories/afp\\_asiapacific\\_business/view/78679/1/.html](http://www.channelnewsasia.com/stories/afp_asiapacific_business/view/78679/1/.html)

Accessed 7<sup>th</sup> April 2004

In 1987, Userware International, a distributor of the COMMAND ERP solution, was the preferred supplier to a nationwide mattress manufacturer that sought to replace its existing systems across 26 plants. Finally, however, the manufacture acquired a competing software firm. They argued that the risks of such a large project justified the cost of buying the software firm and dedicating their staff to the implementation that was expected to take 3 years.

Source: Dr. Tom McKaskill, President, Userware International

As part of a longer term strategy for achieving an exit, the firm should develop a presence in the sector through PR, trade articles, conference attendance, market analysts and seeking out influential industry executives. They might also look for overseas companies interested in expansion into the firm's territory and also look for firms with lagging technologies.

In order to refine the list of potential acquirers, the firm needs to investigate industry corporations that have the size and capacity to fund a strategic acquisition. For each of these corporations, the seller needs to think through how each of them would benefit from the firm's assets or capabilities. What problems, challenges, limitations, constraints or threats are they facing? How can the selling firm provide a solution?

The firm needs to develop an approach to each potential acquirer where the firm can be provided with the chance to test out their logic and see if an acquisition might be of interest. Some firms might wish to use an independent third party such as a reputable accounting or legal firm to provide an introduction. Once they have established a short list of possible interested parties, the process of setting up a sale can move to the negotiation stage. In this stage it is critical to have more than one potential buyer in order to develop competitive tension in the buyer's eyes.

The examples shown above show that acquisitions are often done to resolve a difficulty. The selling firm's task is to take control of that process by being proactive – by seeking out corporations where they can add strategic value. By doing so, they can secure a premium for the business, sometimes many times greater than its fair market value.

## REFERENCES

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