Selling A Business - The Eleventh Hour Contract Change

By Dave Kauppi, President MidMarket Capital

The next line could be, "Will it Derail Your Sale?" We have seen it go both ways, unfortunately. If a deal does blow up, everybody looses. The seller has spent six months of divided focus and many of the normal business development activities have been put on the back burner. His or her business will simply not be as strong if the business sale process is not completed.

Normally a buyer that has made it to this point is the one that recognizes the most strategic value and has indicated their willingness to pay for that value. The second, third, and fourth place buyers, if they even have been uncovered, are generally far short of the winning bidder. We have had some very specialized companies that were great fits for only one buyer and the next best bid was less than 50% of the leader's offer. That is not a very attractive backup plan, should the best buyer go away.

The buyer is also damaged by an eleventh hour deal blow up. They have devoted senior level people to analyzing, negotiating, preparing for the integration of the two companies, etc. It often involves several hundred thousand dollars of opportunity costs. If the target company was the answer to a gap in the buyer's product set, they will no longer be able to recognize the anticipated benefits unless they now build it themselves or go acquire the next best target company. Both of these approaches are expensive and time consuming.

Let's get back to the root of the problem. What would cause a buyer to make an eleventh hour change? Our experience has shown that in 80% or more of the cases, it has been the buyer's corporate counsel or outside counsel. They have discovered a deal component that when memorialized in a definitive purchase agreement is either not legal or violates the corporate "risk versus reward covenant."

This is where it gets emotional. It is done "after we had a deal.' We coach our sellers up front and warn them that this can happen. The way we position it is that as a simple matter of logistics, the buyer's legal team has very limited detailed involvement prior to crafting the definitive purchase agreement. In the heat of negotiations, however, the M&A guys have often agreed to something that will not pass the protectors of the mother ship (corporate counsel). When the particular deal term moves the Risk/Reward needle into the red zone, the corporate counsel over rules the M&A guys. An example of this would be an earn out that was open ended and not capped - simply unacceptable on Wall Street.

Another manifestation of the eleventh hour change is the buyer's business development team is tasked with bring the deal along to a point with final approval reserved for the president or the board. Sometimes the M&A team simply commits to something that gets rejected in the final approval process. Unfortunately, sometimes this is real and sometimes it is a popular negotiating ploy called deferring to the higher authority. It can be very tricky determining which is real and which is negotiating.

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O.K. So we have established that more often than not, the seller will encounter the dreaded eleventh hour deal change. How should he or she respond?

First Rule - be prepared and know that it is part of the normal process. Do not put it into the category of this is the evil empire looking to beat up the little guy.

Second Rule - Do not destroy your personal good will with the buyer. Often times, the owner has huge value to the buyer in terms of post acquisition product integration and education on their market. If this last minute deal change turns you into Mr. Hyde at the negotiating table, the buyer's Risk/Reward needle could be moved into the red zone. If they view you as someone that could damage company morale or who will be high maintenance or worse, will be litigious, they will walk away from the deal at this point.

Rule Three - If you feel you are about to explode in front of the buyers, ask for a 15 minute break, go into another room and unload on your advisors. Get it out of your system, calm down, and go back into problem solving mode.

Rule Four - Let your advisors do your bidding. Recognize that this is an emotionally charged area for you and it is essential for you to preserve your relationship with your future employer. Let your M&A advisor or your attorney be the bull dog, not you.

Rule Five - Respond in kind at the appropriate economic level. Do not look for a pound of flesh to compensate you for your sense of moral indignation. In corporate America it's not going to happen. Work with your advisors to identify the extent of the economic value you have lost due to the change. Ask for concessions in return that match the economics of the buyer's change.

Rule Six - Keep your eye on the prize. In this very emotional time, you must prepare yourself to be an economic being. If your next best buyer is $2 million below your current buyer's offer, do not put the deal in jeopardy by violating Rules One through Five for a change with maximum impact of $20,000. Put your ego on the shelf, step back, keep your moral indignation in check and preserve your good will. Remain fluid and creative while allowing your advisors to take on the role of the bad guy. Get your deal signed, enjoy your new substantial bank balance, and prosper as a prized member of your new company.

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