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Boutique Investment Banking

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TECHNOLOGY ACQUISITION UPDATE

Nine M&A Mistakes

Companies make a number of mistakes when arranging the sale of a company or when making an acquisition. This article illustrates the nine most common mistakes that we have observed over the years.

1. Selling at the Wrong Time

Timing is one of the primary drivers for getting the best price when selling a company. The best time to sell is when the market is heating up when larger companies have the greatest need for your technology, and they have decided to move into your market. They need to acquire technology and expertise in order to make a speedy market entry.

Many companies wait too long before selling. There is always a reason to delay the sale just get revenues up a little more, just get the latest product version finished, etc. Venture capital firms are also guilty of waiting too long. VCs are in the business of hitting home runs, not singles or doubles. So they typically wait too long to sell, hoping for that home run. The market may be on a different time schedule than your company's growth curve. If you wait for revenues to peak, there may be little growth left. One of the cardinal rules of M&A is that a company should always sell before it needs to sell.

2. Confusing Price with Value

To close any transaction, the parties simply need to agree on price. They do not need to agree on value. Price is necessary; value is not. Different buyers will have various ideas about the value of a company. In fact, values can vary dramatically depending on the strategic importance to a particular buyer. If you trade me your bike for my skateboard and we are both happy, there is no reason to establish a value.

Value in the technology sector is strategic. It is not based on the company's financial statements. Do not get locked into valuation formulas. For the most part they are irrelevant when selling a company with strategic value. And multiples of revenue are entirely irrelevant. Value is in the eye of the beholder. A company is worth whatever a buyer is willing to pay.

3. Overlooking the Edges of the Market

Many companies presume that they know who the best buyers are because they know their market space intimately. This mindset can be limiting and insiders can be blind to the edges of the market. Markets are always gray around the edges where change occurs more rapidly. These peripheries are where the emerging buyers exist.

Emerging buyers are newer companies that are growing rapidly, often in a new market sector. They are relatively unknown. Emerging buyers can be excellent acquirers for acquisitions under $25 million. They regard acquisitions as an attractive means to spur their growth. Emerging buyers can be difficult to identify because they exist in fluid, less defined sectors. These companies often have access to capital and an acquisition may have more strategic importance to them than to other buyers.

4. Not Generating Competitive Offers

The highest price is achieved when there are multiple buyers and a competitive bidding process. Even the presence of one additional buyer can often make a dramatic difference on price. Many selling companies make the mistake of not reaching out to enough potential buyers and not generating competitive offers.

Casting a wide net ensures that all potential buyers will be contacted. The smaller the acquisition, the more potential buyers there are. A company selling for less than $25 million will have more potential buyers than larger firms. How many companies should be contacted? We usually contact between 75 and 125 companies in most searches. Then we can be confident that all potential buyers have been contacted. In many transactions that we have completed, the buyers were in adjacent markets, using the acquisition for market entry. The more buyers, the more competitive offers we obtain.

5. Not Getting Buyers to the Table at the Same Time

It is a common occurrence for tech companies to receive inquiries about being acquired. Some acquirers may have a very serious interest. I am frequently asked to assist with the sale of a company after the firm has received interest from a particular buyer. Now the seller must respond to that buyer and at the same time reach out to other potential buyers. Thus, timing becomes a vital issue.

How can we respond to the current buyer in a timely manner and still reach out to other buyers? We don't want the original buyer to go away; they may be the best acquirer. The mistake that companies often make is to take the first deal without reaching out aggressively to other potential buyers. It is all too easy for a seller to convince themselves that this buyer is the best one and will pay the highest price. The only way to be sure is to reach out to other buyers and get the parties to the bargaining table at the same time.

6. Not Being Creative

Many people assume that there are only a couple of ways to solve a problem. Most problems, however, have multiple solutions. Step outside the box; don't be too linear. First of all, do not assume that the stated problem really is the problem. How a problem is expressed can frame the potential solution possibilities. Perhaps there is a different problem hiding within the putative problem. It is often beneficial to restate a problem in a variety of ways, thus opening up alternative possibilities to view the problem and new potential solutions.

Second, be aware of clinging to your assumptions. Many people rarely question their assumptions; they view their assumptions as truths. People make assumptions about the market, about the opposing party, about their motives, etc. These assumptions may be unrealistic. Check your assumptions.

Third, always look at the issues from your opponent's viewpoint. People in the technology sectors can be a little too self-focused. They may not fully understand the other side's position. Try to address the problem from the other side's point of view.

7. Bad Negotiating

Bad negotiating includes an assortment of issues, but let's touch on the most egregious ones. Not accurately understanding the other party's positions is probably the biggest negotiating mistake. One must understand the reasons behind their positions and also how they perceive value. A good negotiator must understand the strategic importance of the seller's technology, or other key assets, to a buyer. Unseasoned negotiators often have unrealistic expectations for price and terms. Such expectations can lead the negotiator down the wrong paths and make the person unwilling to compromise when he is actually negotiating from a position of weakness. Understanding the relative positions of strength and weakness for each party is critical to achieving the best outcome.

Never ever use e-mail to negotiate. There is absolutely no immediate feedback. You cannot hear their reaction, the tone of their voice. You cannot tell how they feel about the issue. The telephone is a much richer communication medium, offering immediate feedback about the tone and color of conversation.

8. Failing to Seek Professional Advice

This point may be a little self-serving, but it is a mistake that occurs all the time. A CEO who negotiates the sale of his own company puts himself at a distinct disadvantage. He or she cannot possibly view the company objectively; nor can he spend the amount of time that selling a company requires. There is no way a CEO can run the company and competently manage the sale process at the same time. The transaction will always be shortchanged and mistakes can be very costly.

An objective third party can be more effective in negotiations. He can establish a constructive atmosphere, help defuse unreasonable claims and minimize extreme posturing. A knowledgeable deal maker can overcome problems, head off issues before they become serious, and keep the parties on track. An experienced adviser increases the odds that the transaction will be concluded at the best price and with the fewest problems.

9. Perfect Acquisition Syndrome

Perfect Acquisition Syndrome applies to acquirers who have developed their acquisition criteria such that no company will ever live up to their expectations. Perhaps they made an acquisition in recent years that worked out great. Now this acquisition becomes the standard against which all future acquisitions are judged. It is difficult for any company to measure up to such a high standard.

The criteria were developed by the management team or acquisition committee. They suggest criteria that sound smart. The tighter they define it, the smarter it sounds. They end up developing perfect criteria for the perfect acquisition. There is just one problem perfect acquisitions are extremely rare. A better course of action is to develop reasonable criteria, do your homework and have a plan to deal with the components that are not perfect.

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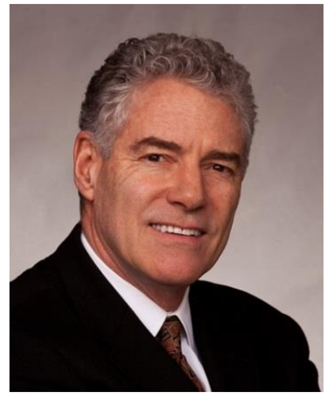

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Boutique Investment Banking

We specialize in selling technology and service companies from $7 million to $75 million in transaction size.

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