T.V. METZ & CO., LLC

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TECHNOLOGY ACQUISITION UPDATE

The Seven Critical Deal Skills

Why Deal Skills Matter in Tech Transactions

As a boutique investment banker specializing in selling technology companies, I have long pondered what key deal skills lead to successful transactions. Over the years, actually 23 years, that I have been structuring deals, I have come up with a brief list of the consummate deal skills that can be applied across any industry or sector.

Good deal skills are manifested by the outcome of a transaction: First of all, the deal gets closed. The client gets the best price, typically by getting multiple offers. All the best buyers are contacted, especially the non-obvious ones. The transaction gets back on track after it breaks down. (Forty percent of all deals blow up at least once.) The deal gets completed smoothly, with fewer problems, fewer delays, fewer arguments, fewer hassles and in a reasonable time frame.

Two questions that I am often asked are: "What sectors have you worked in lately?" and "Have you ever done a deal in the XYZ industry?" This leads me to believe that tech CEOs and venture capitalists think that industry knowledge or contacts are all that matter. On the contrary, deal skills are far and away the most important component of closing the sale of a technology company.

Industry knowledge certainly is a good thing; however, it can be learned. With a week or two of diligent effort, you can get fairly up to speed in any industry sector. Study industry reports, talk with a handful of CEOs, read the trade press, view industry web sites, and you will know what is going on. And making the right contacts is a fairly straightforward process.

When it comes to getting a deal closed at the best price and with the least problems, these seven deal skills will beat industry knowledge every day of the week.

Seven Critical Deal Skills:

1. Listen Between the Lines.

Listening between the lines means not just hearing what the person is saying, but understanding what the person really means.

When principals meet, they rarely listen well. They are thinking about what they are going to say next, rather than really hearing the other person.

Listening is the ultimate deal skill. You can't get someone what they want if you are not sure what it is. You cannot overcome an objection if you don't understand it clearly. A skilled deal person understands exactly what each side wants to achieve.

2. Know How to Identify the Non-Obvious Buyers.

Drilling down on the core market is the easy part. The selling company can probably come up with a list of 10 to 20 buyers without too much trouble. These are the easy ones, the obvious candidates. An important deal skill is knowing where to find the less obvious buyers.

The best buyers may be in markets that are adjacent to the core market. Understanding the importance of adjacent markets is critical because they may be the most fruitful places to look for buyers. Buyers in adjacent markets will often pay the most because they will use acquisitions to enter a new market. The nuances of markets, especially at the edges, are where the real action is.

For example, last year I sold an email direct marketing firm. It creates and emails newsletters and weekly updates for its corporate clients. This business touches on a number of adjacent markets—advertising agencies, direct marketing firms, Internet advertising companies, marketing research firms, customer relationship management firms, and interactive marketing firms. Companies in each one of these market sectors were good potential buyers.

3. Read People.

Another great deal skill is reading and understanding human beings. What kind of person are you dealing with? What is their level of risk tolerance? What kind of communicator are they?

Consistent patterns emerge among people. Recognizing these patterns can be helpful in working with someone new. What is their communication style—is it direct or indirect? Do they have the courage to face tough issues or do they shy away from them? An experienced deal person is flexible in dealing with different personality types.

A good deal person will see through the stated objection to the real objection. People don't always tell you the real reasons for things. They even get their own objectives mixed up. They can be insecure. Sometimes they have to save face. Knowing how to read people is a consummate deal skill.

By the way, the best deal people are not generally technology people. The skills that make a good engineer, programmer, or inventor are not the same skills that make a good deal person. Tech people are usually smart, highly analytical, logical, and can focus acutely; but they are usually not good at putting themselves in the other person's place, understanding their motivations, and relating to the other's point of view.

4. Perfect Your Horse Trading.

Horse trading embodies a number of skills. It involves give and take, feeling out the other side. How to go back and forth with offers and counter offers is an important one, knowing whether to come back with a little or a lot. Even the tone of the reply is important.

What is negotiating expertise? Is it toughness? One who never budges? No, that is not necessarily good negotiating. Good negotiating skills involve having a sense for what you can achieve, knowing how to effectively work with the other party and reaching an agreement.

Communicating clearly is a key part of negotiating. Good communication skills help build trust on both sides and keep objectives clear.

Negotiating skills are particularly valuable when the value is intangible—when there is no concrete basis for value, which is usually the case in technology transactions. And remember, you don't just negotiate price. Terms can be every bit as important.

5. Apply Creative Problem Solving.

If there were no problems, deals would simply go together all by themselves. The best way to solve deal problems is to understand the issues clearly and to employ creativity in developing solutions.

A good deal person distinguishes between real problems and phantom objections that are designed to push the price down. He knows how to make some problems go away entirely and minimize the other problems.

Just because the seller says he wants cash, doesn't mean you shouldn't consider stock. What if the deal came down to a choice of $5 million in cash or $11 million in stock? Now would you consider stock? It depends, of course, on who the company is, but do not dismiss it out of hand.

Creativity can solve a lot of problems, in unique ways. There are rarely just one or two ways to solve a problem. A clever deal doer will come up with a range of acceptable alternatives. Most of the time when deal problems create an impasse, it is because the parties are not thinking creatively enough.

In one instance, I closed a deal that was technically a marketing agreement. The customer base was the primary asset, so rather than go through the problems associated with transferring stock or assets, the transaction structure simply involved paying for the customers as they migrated to the acquiring company. This was an unusual structure, but it was very simple and very effective.

6. Pace the Transaction.

Selling a company is like a slow dance. Managing the pace of a transaction is an art. You can control the timing to your advantage. Know when to push, when to back off, move it quickly or slow it down. There is —a rhythm to every deal, a cadence.

You can always slow the process down but you can rarely speed it up. A lot of CEOs want to go, go, go, push, push, push. Being proactive is one thing, but being impatient is another. This is not a good way to pace a transaction. Patience is a powerful deal skill.

A key to achieving the best price is getting multiple offers. However, receiving multiple offers doesn't do much good unless the parties show up at the table at the same time. You can't say— "Just a minute" and get back to them two months later. An experienced deal doer will manage the pace of a transaction to the client's advantage, using subtle deal skills to get the parties the table at the same time.

7. Structure the Deal

Structuring a transaction appropriately can make the whole process productive and successful. The key to good structuring is knowing what kinds of things are workable and what are not. A good deal person can be inventive and create structures that meet the needs of both parties.

A wide variety of issues crop up during the deal process. For example, should the Letter of Intent be binding or not? What about certain paragraphs? What length of a no-shop clause is reasonable? Experience and judgment can pay huge dividends handling the many minor issues that can cause stumbling blocks along the way.

Many deals have been structured as earnouts that should never have been structured that way. Sometimes earnouts are great, but they can also be awkward and messy. An earnout should be used when it is the appropriate structure, not because the parties simply can't agree on price. Smart structuring solves the needs of both parties in the simplest possible way.

For example, one selling company wanted to use an earnout as a way to boost the purchase price. The company had been in business for 20 years. Its business model was well-proven; it was hardly an unknown. So an earnout was totally inappropriate. It would have made the deal unduly complicated.

Many deals get completed. However, in my experience, many of these transactions are not structured optimally. With a little creativity and a better understanding of the parties' objectives, a good percentage of these deals could have been structured more intelligently, so that both parties would be better off.

Eight Additional Tips:

A few additional tools that are good to have in your bag of tricks:

1. Sniff Out Tire Kickers.

Figure out if the other party is serious. You can waste a lot of time and energy dealing with buyers that are not serious.

2. Keep Plan B Alive.

You should always have a backup plan. Keep your alternatives warm. Sometimes Plan C is a good idea too.

3. Know How to Approach Buyers.

It is important to approach buyers effectively so they will commit the time and effort to explore an acquisition. Who should you contact at the buying company? What about confidentiality? Should you provide a lot of information up front or only a little?

4. Communicate Effectively.

Clearly communicating a company's strengths and opportunities is a very good skill. Why do customers pay good money for the firm's products or services? Exaggerating is not a good idea; it will come back to bite you.

5. See Value Through the Buyer's Eyes.

Determine how valuable the company is to the buyer. Try to view value through their mind set. What would it cost them to duplicate what the seller has?

6. Manage Expectations.

Manage the emotions and expectations of the parties—the CEO, founders, VCs, shareholders and employees. And, to a degree, you can also manage the expectations of the opposing party.

7. Foresee Problems.

Know where problems might crop up and which roads not to go down. The wise deal person heads off issues before they become real problems. The easiest objections to overcome are the ones that never come up.

8. Persist.

Closing a deal can be an uphill battle. The tenacity to keep on pushing, persisting until you succeed, can make all the difference in getting a deal closed.

In Summary

Deal skills are about interacting with those pesky creatures called human beings, with all their quirks, biases, egos and emotions. Deal skills result from experience. You discover what works and what doesn't work by trying things out, by interacting with different types of people and situations. Effective deal skills are truly an art that can make all the difference in completing transactions at the best price and with the fewest problems along the way.

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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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