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TECHNOLOGY ACQUISITION UPDATE

18 Reasons a CEO Should Not Sell His Own Company

by Thomas V. Metz, Jr.

A CEO should never attempt to sell his or her own company. It is a big mistake and can cost the shareholders dearly.

At first glance, it is tempting for a CEO to try to sell his or her[1] own company. After all, he knows the company and the market very well. A CEO's mind set can often be characterized as: "I know the industry; I know how to negotiate; I'm a smart guy – I can handle this. In addition, we will save a fee."

Sure they can put a deal together. It happens all the time. But was it the best deal? Was it the right thing for the shareholders? Have the shareholders been well served?

CEOs are simply not objective about their own companies. They can't possibly be objective. They are intertwined in the center of the company, at least they should be. They are too close to the situation. They often delude themselves that they know their industry so well that they know who the good buyers are. Of course they know some of the good buyers. But they limit themselves with preconceived ideas about the companies and the market. Their knowledge constrains them about how they think about the situation and the transaction. They rarely go exploring and seldom contact companies outside of their core market.

Many technology CEOs, and technology people for that matter, like doing things themselves. Their upbringing reinforced this behavior, they likely did well in school, and have achieved success as a result of their own efforts. Business, however, is a different matter entirely. Business is not about doing things yourself. Business is about organizing people, building a team and utilizing the skills of others. Many technology CEOs need to learn how to be better businessmen and businesswomen by delegating more effectively, trusting others, and not doing everything themselves.

A CEO can make a number of mistakes when attempting to sell his or her own company. The M&A process involves many important subtleties that CEOs often overlook. A CEO should spend his time where he can create the most value – running the company, setting goals, monitoring progress, and executing the business plan.

Over the years I have observed many CEOs attempting to sell their own companies. What follows are 18 common mistakes that CEOs often make when trying to undertake this task themselves.

#1 "This Will be Easy"

Many CEOs think selling a company is easy.

[1] In the interest of readability, 'he' refers to 'he' or 'she')

The process seems very straightforward: find a buyer and agree on the price. Sometimes CEOs think they have a head start because the company currently has licensing deals with several firms that might be potential acquirers.

What they fail to take into consideration is the tremendous amount of time and effort to do the job right. Without significant experience in M&A, they miss the subtleties that can lead to a higher price, more favorable terms and a smoother process. Even if a CEO has M&A experience, he can't be fully objective and he still has to run the company – usually a full time job in itself.

The situation is analogous to taking on your own home remodeling project. On the surface, it looks fairly straightforward. However, halfway through the project you uncover some unforeseen problems that are beyond your expertise or you get busy at the office and can't devote the time to keep the project moving forward. In hindsight you would have been better off bringing in a professional, saving both time and money and with a better end result.

#2 Too Narrow a Search

CEOs tend to pick the low hanging fruit. Their search process is rarely thorough. CEOs typically contact six companies. Yes, six companies. Not ten, not 20, not three, but six companies. Don't ask me why; it has simply been my observation.

My guess is that they think that it is enough and that they know why other companies would not be good buyers. A CEO can avoid the search problems entirely by convincing himself that a particular buyer will pay the highest price. It may also be that they don't want to be turned down so they don't pursue certain buyers.

Once a CEO begins discussions, he stops looking for additional prospects. He is content to engage one or two potential buyers. In addition, CEOs rarely seek out the tangential and fringe companies that often can be excellent buyers.

Deals can fall apart. It is wise to get multiple offers; create some competitive bidding. However, creating competitive bidding involves too much work for the CEO.

Many CEOs tacitly assume that the incremental price will not be worth the incremental effort. This is simply not true. They delude themselves into thinking that the buyer in hand will pay the highest price.

#3 No Full-Time Commitment

Identifying and contacting candidates is a full time task that can last for a number of months. This process can be very tedious – something that an executive level person may not want to undertake. A CEO who is running a business cannot possibly give his full attention to a comprehensive search process.

#4 Ignoring Opportunity Cost

Where can the CEO add the most value? Trying to sell the company or continuing to build it? More value is created when the CEO continues to increase traction in the market, grow revenues, and keep customers happy. The value of these activities is always greater than the amount of the fee saved. The CEO should spend his time building and enhancing the business.

#5 Selling the Future

Most CEOs are accustomed to raising capital and they see the process of selling a company as very similar to raising capital. They think this experience is transferable to selling a company. When trying to sell the business, they paint the same picture. They sell their vision – large markets, rapidly growing revenues and substantial profits. They focus on where they are going, not where they are. In other words, they are selling the future.

A business plan is forward looking. It is about growth; it is about the future. A descriptive memorandum for selling the company, on the other hand, focuses on the present. It is a coherent snapshot of the current situation. This is where the company is today. This is the technology that is complete today. There is quite a difference between selling a future vision and selling the company as it exists today.

#6 Presenting the Wrong Information

CEOs don't take the time to develop the proper documentation to promote the sale. Most fail to draft a selling memorandum or

even a one-page summary of the acquisition opportunity.

Most CEOs just send out a business plan, not a selling memorandum, without realizing that there is a difference.

Since they are not well versed in the process, CEOs are not usually aware of what information should be communicated at different stages of the M&A process. They will often give the wrong depth of detail – too much information too soon or too little information too late.

#7 Poor Positioning

CEOs generally are not skilled at positioning the company to potential buyers. How should the company be presented? What technology should be emphasized? Which assets have the most value in the marketplace?

CEOs can be self-focused, company-focused and not outwardly looking. Technology assets may carry a different weight in the market than they do internally. Assets should be viewed from an external perspective, not from management's internal perspective.

Since value is extrinsic, not intrinsic, buyers will view value differently from each other and differently from the CEO. One buyer may want to add the seller's products to its product line; another may embed the seller's core technology inside the buyer's technology.

#8 Glossing over the Negatives

CEOs love to portray their company in a good light. "Everything is going great. We have great marketing, great technology, great people." CEOs are so close to the situation that it is difficult for them to view the transaction from the buyers' eyes.

When a serious buyer completes their due diligence, they will know almost everything about the company, warts and all. It does no good to start off by saying the company has no warts; it just wastes everyone's time.

CEOs rarely admit that they have done a poor job in marketing or sales. However, a company with excellent technology that has not had the time or capital to undertake a serious marketing effort can be positioned as a good opportunity for the buyer.

#9 Representation without Representation

Third-party representation signals that the seller is serious. Buyers have some assurance that they are not wasting their time with a tire-kicker.

If a potential buyer receives an inquiry from an investment banker, it means the company is being represented professionally. It means they are serious about selling the company. In addition, the deal has been screened; it has passed the muster of the investment banking firm. Buyers don't want to waste time with a company that is not serious about selling.

#10 Unable to Ramrod the Transaction

The CEO cannot push the transaction without appearing somewhat desperate. He cannot call the buyer every other day. An intermediary, however, can ramrod the transaction. He can call the buyer four times a week to keep the deal moving forward. This is the advantage of being a third party; he is just doing his job. Buyers expect him to be aggressive, to be persistent. A persistent CEO, on the other hand, is usually perceived as a desperate seller.

#11 Setting the Wrong Price

A CEO's own prejudices can cloud the value issue. Unrealistic value expectations can be deadly. What the market is willing to pay may be very different from what the CEO thinks his company is worth or ought to be worth.

CEOs may want to sell only if the price is greater than a certain threshold (where his stock options are in the money). This may put strains on pricing the deal and may not be in the best interests of the other shareholders.

#12 The Fallacy of a Narrow Value Range

This is a subtle mistake, but a common one. CEOs assume that value falls within a narrow range and that an interested buyer will pay them what their company is worth. This presupposes, of course, that they know what their company is worth.

In most areas of our lives where we sell big ticket items, such as a house, value falls within a fairly narrow range. For example, depending on market conditions, a house may range in value between $725,000 and $875,000. The high price is 20% higher than the low price. The value does not swing widely.

A technology company, however, can range quite widely in value. The same company could be worth $2 million, $5 million, or $10 million depending on the strategic fit with the buyer. This is a range in which the high price is five times the low price – a huge range of value!

How does this affect the process of selling of a company? Don't assume that buyers will pay similar prices. Offers may vary dramatically, so it makes the most sense to obtain as many offers as possible.

#13 Failure to Manage the Process

The sale of a company involves many detailed activities. Time lines must be met and one of the tasks an investment banker performs is to manage this process. You don't just locate a buyer and then have a few meetings. Many tasks need to be accomplished along the way.

A professional intermediary can make sure that the deal moves along in a timely manner, that activities are coordinated among the parties, and that the inevitable obstacles that occur in every transaction are overcome.

#14 Not Listening

Buyers will communicate to a third party many things they would never tell the CEO directly. A third party can pick up clues along the way about how strategic the technology is to the buyer, how the buyer regards the management team, about how the buyer perceives value and how much they might be willing to pay.

A CEO usually focuses on what points he wants to make and what he wants to say. This is not very productive. One must listen with big ears. What is the buyer saying between the lines? What are they really after? What is the feeling you get from them? A good negotiator is really a professional listener.

The negotiator's job is to figure out the other side's motivations and how to get to the next step. There are many ways to solve the problems that inevitably pop up. The biggest danger is not being aware of a problem before it becomes full blown. You can't head it off if you don't know it's there.

#15 Uncreative Structuring

There are so many ways to structure a deal, so many ways to be paid; it is not just stock or cash. Since they are not professional deal makers, CEOs are generally not very imaginative in coming up with creative structuring ideas where both parties might be better off. The key to good structuring is to fully understand the objectives of each party and have an open, creative mind set.

The CEO may actually believe what his venture capital investors tell him about their price expectations. An experienced deal person, who has dealt with many venture capitalists, will have a better idea of what the VCs will find acceptable. I have seen CEOs ask wildly unrealistic prices, sending buyers running. This approach is not at all productive.

#16 Adversarial Beginnings

Sometimes things can get a little heated, with friction developing between the buyer and seller. To avoid an adversarial relationship between the parties going forward, it is best to have an intermediary handle the negotiations. An experienced third party will be more adept at knowing what paths not to take and what conversations not to have.

A case in point is negotiating the president's salary and option package. Who can best negotiate these items – the CEO himself or an independent third party? Let the third party be the bad guy.

#17 Incorrectly Valuing the Buyer's Stock

If the seller receives stock from the buyer, what is the value of that stock? A private firm's last VC valuation may be totally arbitrary and a public company's stock price may not represent its true value. Most investment bankers are experienced at valuing companies and can be very helpful in negotiating a value that is real.

#18 The Fallacy of Saving a Fee

Everyone loves to save a fee. Is trying to save a fee really worth it?

CEOs must ask two questions regarding saving a fee. First, is the amount of the fee saved greater than the incremental value that the CEO could add by focusing on building the business? Second, is the amount of the fee saved greater than the incremental price paid as a result of having several bidders?

A CEO can create the most value by keeping the customers satisfied and by bringing in new sales. Providing leadership, solving problems and building a strong team are also key skills that the CEO brings to the company.

Rarely is the amount of a fee saved greater than the opportunity cost of the president's time, nor is it greater than the value derived from competitive bidding. The amount of any fee saved is negligible in the context of the deal.

Summary

Most CEOs vastly underestimate the time and effort to do a thorough job selling a company. There are a lot of moving parts surrounding the sale of a company. The right thing for the shareholders is to have a professional intermediary sell the company, not the CEO or his team.

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