TECHNOLOGY ACQUISITION UPDATE

How to Select an Investment Banker

This article is intended to help CEOs, entrepreneurs and boards of directors make better decisions when hiring an investment banker for an M&A engagement. The article discusses the three most important criteria–experience, commitment and character.

Every transaction will have obstacles that must be overcome. The seller wants the highest price and the buyer wants the lowest price. These are diametrically opposed positions. It is no wonder that issues crop up. Experience is far and away the most important capability that an investment banker can provide for the client. The broader one's base of experience, the more effective the banker will be at solving the problems that inevitably occur.

First of all, what does the company want to accomplish by hiring an investment banker? There are usually three primary objectives:

1. Get a transaction closed.

2. Close it with the best buyer, at the best price and best terms.

3. Close the transaction in a timely manner, with the fewest problems, and a minimum of disruption to the company.

The Classic Dilemma

Sellers often face a dilemma when choosing an investment banker to sell a company for less than $30 million. Should they choose a small boutique firm? Or, should they choose a larger investment bank?

The larger firm may have more people and resources; however, there is always the possibility that the transaction will be turned over to a junior staff person. Generally transactions under $30 million do not receive full attention from larger investment banks. They simply cannot earn a large enough fee to make it worth their while.

A boutique firm often provides greater attention and more personal service on smaller deals. Remember—you hire the person, not the firm.

The Rolodex Myth

There is a pervasive myth that contacts or "knowing a space" is the primary driver for selecting an investment banker. I am frequently asked: "Do you have any contacts in the XYZ industry?" or "What space have you worked in lately?" I am rarely questioned about my skills or experience. Many CEOs and boards mistakenly believe that successfully closing transactions is all about contacts or industry knowledge.

Deals under $30 million are a different situation. The technology market space is like the Wild West. The landscape is vast and things are changing all the time. Access is not a problem. CEOs of tech companies are interested in knowing which companies are for sale. Making the contact is simply not an issue.

The key competency that an investment banker brings to a transaction is overcoming problems and negotiating the price. Making contacts is the easy part.

Selecting an Investment Banker

The best investment bankers have three qualities that enable them to close transactions successfully and get the best price for their clients—experience, commitment and character.

Experience

The person with the broadest experience will have the greatest depth of skills for resolving problems. Experience enables him to effectively manage the process and close the transaction at the best price.

Experience embodies six key aspects:

- Experience with strategic value
- Experience in technology markets
- Experience with similar size transactions
- Negotiating experience
- Creativity
- Deal savvy

Experience with Intangible Value

Value is almost always strategic, not financial, in technology M&A transactions. Value is not a function of a company's earnings, but rather a function of the company's technology, intellectual property, engineering team, etc. Strategic value is almost always greater than financial value.

The right M&A advisor will have a depth of experience negotiating transactions in which the value is strategic.

Dynamics of Technology Markets

Understanding the dynamics of technology markets is critical. These markets are fast-moving and fluid. An investment banker with experience in the technology markets will have a better understanding of how to close transactions in this rapidly changing arena.

A market sector in the early stages of growth has different dynamics than a consolidating sector. The motives for acquisition differ. In addition, adjacent markets are more important in strategic transaction.

The best buyer may reside in an in an adjacent market, not the core market.

Experience with Similar Size Transactions

Another pervading myth is that deals under $30 million should be run by the same process as large M&A transactions. A $300 million deal is a totally different transaction than a $5 million or $10 million deal. Large transactions utilize the two-step auction process which is not appropriate for smaller technology deals. Plus, there are many more buyers for an $8 million company than for a $300 million company.

Investment bankers who try to run an auction process on small deals are trying to put a round peg into a square hole. The best price and the best terms are not achieved for the client. A negotiated transaction, on the other hand, takes more time and effort but produces superior results. Do not assume that the process that works for large deals is appropriate for smaller deals.

Negotiating Experience

Effective negotiators have three key skills: people skills, communication skills and problem-solving skills.

Closing a deal means working with people. The more experience an investment banker has dealing with many types of buyers, the better job that banker can do for his client.

The experienced deal maker anticipates issues before they come up. He heads off minor problems before they become bigger problems. About 40% of all transactions blow up at least once. It takes experience to get these deals back on track and concluded successfully.

Imagination and Creativity

Imagination and creativity are the qualities that separate the great deal doers from the good deal doers. Tough problems demand that the investment banker take an out-of-the-box approach. Can the banker approach the problem with an imaginative mind set?

Deal Savvy

Deal savvy is presented last because it is the most elusive. It is difficult to define, but you know it when you see it. Deal savvy means simply knowing how to make deals happen.

Deal savvy enables the banker to deal effectively with bluffs, false objections and other impediments. An investment banker with deal savvy can work effectively with uncertainties and moving targets. He will find a way to get the deal closed.

Commitment

Will the investment banker give fully committed attention to the client? Is the deal large enough to get the banker’s interest? What priority will be given to the assignment?

Commitment is important because transactions can reach an impasse. When the going gets tough will the banker stick with it, scratching and clawing his way to close the deal?

Senior level attention is something you should demand. Who will be the individual working on your assignment? Is it a senior partner or will the assignment be handed off to a junior associate?

Character

Character embodies trust, integrity and chemistry. Integrity takes two forms in the context of a transaction. The first is integrity with respect to the client. The investment banker should have the integrity to inform the client about all aspects surrounding the transaction, even the bad news.

The second aspect of integrity relates to negotiating. Negotiations are more fruitful when each side trusts the other side. A banker who is constantly shifting his requests or positions does not generate trust.

The sale of a company is one of the most significant transactions in many peoples' business lives. You should enjoy and respect the people with whom you are working. The principals of a company will be spending a good six months with this advisor so choose wisely.

Summary

The broader an investment banker's experience, the more skilled he or she will be at overcoming the problems that inevitably occur. It is only through experience that a banker develops the rich talents that aid in closing transactions.