TECHNOLOGY ACQUISITION UPDATE

Negotiating when Value is not Tangible

Negotiations in the technology and software industries can be challenging because the company's value is uncertain. Companies are acquired before they have established a record of earnings and value typically depends on earnings. Game theory gives us some insights on how to negotiate when the value is intangible.

How do you negotiate price when your value is strategic, not financial? Negotiating intangibles requires understanding your opponent, market knowledge and knowing the impact of your strategic assets. At the end of the day, all prices are negotiated.

Asking the value of a technology company is like asking the value of Elvis' guitar. The answer is whatever someone will pay you for it.

Rules of Thumb

Looking for a simple answer? Sorry, there really aren't any rules of thumb that are of any merit. Ratios calculated after the fact are rarely applicable to other transactions. Only in industries where companies have similar cost structures and operating characteristics (such as garbage collection) do revenue multiples make sense. Everyone likes rules of thumb because they make life easier. But by making life easy, they make life inaccurate.

Examine Your Strategic Assets

An in-depth understanding of your company's strengths is imperative. What are the drivers of value in your company? Is it technology? Market share? Customer base? Brand recognition? Development capability? Can you quantify these strengths?

What additional revenues will you bring to the buyer? Are there cross-selling opportunities? What about recurring maintenance revenues?

Common Negotiating Mistakes

Inexperienced negotiators make a number of typical mistakes. Unseasoned negotiators can have unrealistic expectations. In addition, they can let a large problem engulf and mire the discussions. Deal structures may be devised that are inefficient; a different structure may have been preferred by both parties.

A Few Strategy Tips

What strategy is best for negotiating when value is intangible? Generally, the most useful negotiating strategy is one with high realistic expectations and with small decreasing concessions. The savvy negotiator should have a realistic sense of what can be accomplished.

Negotiations are dynamic situations — the tone and balance can change dramatically throughout the discussions. The perception of value can change as well. It is difficult to prescribe a set strategy before negotiations begin; however, a few fundamental points are worth mentioning.

Anticipate concessions and plan a few in advance. A no-concessions strategy is dangerous, since concessions are usually expected. Don't compromise too early, but have a few in your bag.

A few additional strategy tips:

- Keep the focus on areas of mutual interests. Emphasize the common ground. Asking for too much could sour the atmosphere.

- Don't be afraid to introduce a few trial proposals. The other party's response can be very illuminating about their preferences and assumptions.

- With creativity and an open mind, a large problem can often be broken down into smaller issues that can be solved more easily.

- Be aware of emotion as well as logic in both your and the other party's arguments. Never underestimate the power of emotion in negotiations.

Every transaction contains uncertainties. Each party will have a different perception of those uncertainties and have a different attitude toward risk. A skilled negotiator will recognize these differences and exploit them in order to achieve a joint solution.

Know Your Opponent

The first step is to examine your company and understand your strong points. Learn as much as you can about the other party's strengths, weaknesses, market and customers. Understand why your technology and intangible assets are important to them.

Probe to learn why the buyer is interested in your company. What is your key strategic value to the buyer? Can they find this technology elsewhere? How can the buyer transform your intellectual assets into earnings? Why do their customers buy from them?

What is the buyer's framework for evaluation? How do they see your company complementing their strengths? Try to understand how they view value. It is much easier to sway someone using their reasoning and assumptions than it is to convince them that your reasoning is correct.

Companies pay large premiums to have immediate access to important technologies and to avoid the time and cost to develop it. What would it cost for the buyer to develop your technology on its own? Determine what their alternatives are to doing a deal with you. Don't forget the competitive aspect—by acquiring your company, the buyer keeps you out of the hands of a competitor.

Game Theory

Game theory is the study of competitive interaction and how people try to outsmart one another. By thinking in terms of game theory, you learn to think several moves ahead and to anticipate the actions and reactions of your competitor.

Game theory views problems from two perspectives—yours and the other party's. It is human nature to focus primarily on your own position. The best negotiators analyze the opponent, not just from a business perspective, but from a psychological standpoint as well.

Use a Third Party

Entertain the idea of using a third party to help you negotiate. An experienced third party can more objectively gauge reactions, overcome problems, devise compromises and draft structures that meet the needs of both parties. He or she can keep the negotiations moving forward without the seller appearing overly anxious to sell.

In summary, negotiating the sale of a company with intangible value is a challenge. The final determination of price will depend on the bargaining skills of the two contenders.

Remember—the value you get is the value you negotiate.

By the way, Elvis' guitar sold for $334,000.