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CCG PERSPECTIVES

Why Do Private M&A Transactions Fall Apart?

Our Top Five List …

By Deborah Smith

So, you are thinking about selling your company. Or maybe you are just thinking about the "what if" and whether it makes sense to explore it? Alright. Now what? We are forever reminding clients – whether we are engaged by the buyer or engaged by the seller – people part with their companies a whole lot slower than they part with their "as-is" assets. It will take longer than they think. It will also be more complicated than they think. Small things matter in corporate-level transactions because more often than not, the company was built by "someone" and that same "someone" may not be too far away from the negotiating table. Private corporate-level transactions are more often than not personal. It could be just about the proceeds. There is nothing wrong with that. But other times, the company may be part of a legacy and how that legacy carries into the future matters, sometimes more than the proceeds. Employees, brand, protecting what has been built, sustainability into the future – these are some of the many things that matter. Whether these circumstances ring true or you have your own unique set of facts, it may be surprising to hear many deals still fall apart for one of many common reasons that have absolutely nothing to do with economics. So again, are you thinking about selling your company? Now what?

Perhaps with a little bias, our best advice – consult an advisor. There are too many issues that come up during deal negotiations that are too important to try and figure out yourself. We have had the opportunity to work on many deals in our careers and no two of them have been alike. More importantly, there is limited utility in occupying the negotiating seat if your goal is stay active in the company post-transaction. Negotiations involve tough decisions, usually unpopular ones, and more often than not, a situation inevitably arises where you are trying to convince the other side to do something they don't want to do, and vice versa, so understandably it helps to have someone else in the middle. Furthermore, not having experience with a breadth of options or a brain trust to help you think creativity about seemingly no-win issues could kill the deal you had once thought was meant to be. Too many people often underestimate what is involved in private corporate level transactions or have their own M&A departments with their own home team, and often think they can go it alone. Avoid being penny wise and pound foolish.

With that backdrop, let's get down to the point of this article – what are some of the key issues that rear their ugly heads and have the weight to kill any transaction? This is our top five list that came immediately to mind. Of course, we have a much longer list but that longer list is a topic for another day.

1. **Cultural Fit:** Buyers/sellers may not always lead with cultural fit as their number one deal priority, but it usually ends up at the upper echelons of the list. It should not be surprising, but people tend to do deals with people they like - likeminded people with common philosophies, visions and/or teamwork mentalities. That's cultural fit. Without cultural fit, even if a deal is able to struggle through the finish line on the ultra-positive belief things will just work out, the halo usually doesn't have enough magical power to hide the lack of cultural fit post-close. Post-close, lack of cultural fit goes by the better-known term "integration issues". As many know, integration issues are the number one reason deals are unsuccessful post-close. It's what you don't know that necessitates taking the time to really develop an understanding of who the counterparty is. Not just one person, but the organization behind the person. Take the time to get to know the people you will be dealing with on the other side of the table on a day-to-day basis as an organization. Make sure you can live in the same house. We have encouraged clients to ask themselves if the people involved would pass the 6-hour flight test as your flight companion. Talk, communicate, meet. Do your people due diligence. We are not suggesting you should look for a sports buddy, but you do need to believe that the other side has the capacity to resolve and work through the issues that come up on a day-to-day basis.

2. **Employee Considerations:** It seems so obvious, yet buyers are somehow surprised when there is a mass exodus by management staff after the deal closes. Seems clear that a buyer will want to make sure employees are incentivized to still produce and that key employees are there to deliver on projections. Sellers typically want to ensure their employees remain intact post close, and even more so if there is a structured purchase price intertwined with target performance. The underlying complication is that neither the buyer nor the seller wants the uncertainty of adding key employees to the negotiations. Why? Because employee interests may not be aligned with either the buyer's or even the seller's interests. Nonetheless, companies are run by people and it is critical that both sides treat employee considerations with thoughtful and careful attention. This is where an advisor can be helpful, providing advice as to the

who, *when*, and *how* decision points with respect to key employees. Keep in mind that the more people who are involved in the potential transaction (or are aware of it) the greater the risk of confidentiality breaches as well as injection of more uncertainty into the due diligence and negotiation process. The strategy, tactics, message and outcome need to be well-controlled. It is not unusual for the buyer (and potentially the seller) to insist on employment agreements to ensure key talent stays (who may also not be the owners). From a buyer's perspective, it takes time to integrate companies and so the last thing a buyer needs is to deal with moving headcount unexpectedly. If you think you will be able to make decisions with certainty about key employees after close, then do so at your peril.

3. Time Kills Deals: Every buyer and seller should always keep in mind that the longer a deal process drags out, the greater the risk it doesn't close. *Time kills all deals*. In addition to deal fatigue, financial and strategic situations change and outside factors (which very quickly lead to a walk back of the deal or re-trade) can unwind a deal. The process is a delicate balance between taking time to underwrite the opportunity and the organization properly and taking so much time that you end up with no deal. Our advice tends towards expediency once you get to the point of papering a transaction. Don't overcompensate on every point. Be strategic about it. For the most part, many seemingly important considerations you belabor during the transaction negotiation process won't really matter post-close. Why? Because if a deal is in trouble after it closes, the small stuff won't rescue it. An extension of this consideration is if the parties opt for a non-simultaneous sign and close. Delayed closings are sometimes necessary but keep in mind that each side has one foot in the door (or out) so it may be imperfect on many levels. Closing conditions may help to shift risk but are rarely strong enough to eliminate risk for either party entirely.

4. It's Those 'Other' Deal Terms That Can Terminate Deals: While buyers/sellers tend to focus on the economics of a deal, there are many other terms that must be negotiated in the definitive documentation. Negotiating the economics in some ways is the start of the negotiation. It is by no means the end. Transaction documentation attempts to balance reps & warranties, indemnification, covenants and economics. This topic is a lengthy one and the *do's* and *don'ts* of transaction documentation will be saved for another day. That said, we tend to have a guiding philosophy – do not allow the counterparty to negotiate these buckets in isolation from the others. They are all interrelated. If you do, the checks and balances the definitive documentation otherwise offers you are weakened and eventually you may end up with a contract that in the final read through just isn't acceptable. An added complication is that many transactions in the current market environment are structured, with a component focused on incentivizing management to perform post-close. The structured transaction alters the weights of the checks and balances in the definitive documentation. For example, a simple question follows with a complicated answer – if purchase price is contingent upon future performance, where is the line that determines what the management team, versus the buyer, can do and when, post-close? And importantly, what about the employees? Also keep in mind that unlike an asset "as is" transaction, the seller will be required to make certain representations about the business, assets, financial results, performance, etc where the ramifications of inaccuracies survive closing, as would post-closing obligations. At the end of the day, the ramifications of representations and obligations are substantial and serve many purposes, one of which is to act as a risk-allocation mechanism. If the right balance cannot be struck, the likelihood of the transaction closing significantly declines.

5. What About the Investors? Investors need to be on board. Their consent will either be implicitly or explicitly required. Lack of investor consent can unwind a deal. It is important to craft the strategy, transaction rationale and positive attributes of the transaction for the seller, the buyer, and ultimately, the investors. This seems obvious. Getting the message on point, effectively and efficiently will take thought and effort. The less obvious question is when to approach investors with news of a transaction. There are such things as “too early” and “too late” and both may have negative transaction ramifications. Ultimately, it will depend on who the investors are and the seller’s relationship with them. They are critical to the deal success so this group of constituents should never be far from your mind.

Let’s end with a quick comment on vision and strategy. It’s a topic that weaves its way throughout the transaction process. It is one thing to agree to a strategy pre-close, it is another to stay committed to it post-close (particularly if buyer funding for future growth strategies is important). Organizations change over time and ensuring that both parties are committed to shared goals and objectives is key. For the seller, without post-close effective decision-making processes in place, runs the risk of real exposure if the buyer simply decides to move in a different direction, orphaning the seller’s company without options. For the buyer, depth of bench and succession planning may be key to ensuring what was paid for survives into the future. Agreeing to a strategic plan up front can alleviate the brunt of some of these issues. We encourage it regardless of which side we represent.