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Negotiating the Business Acquisition

Once a prospective buyer has performed preliminary due diligence and has concluded he wants to acquire a business, negotiations will usually commence. This newsletter discusses a pro-active approach a buyer should take to reach an agreement while ensuring all of his key objectives are achieved.

1. Assess Buyer and Target Objectives

A buyer should assess what is motivating both parties to consummate a deal. What are the strengths and weaknesses of each side's position? Besides the shareholders, are there other relevant parties (employees, unions, customers, suppliers) whose objectives need to be considered? What is the reputation of the target's advisors? Are they deal makers or deal breakers? By performing this analysis, a buyer can strategize on what tactics he can use during negotiations to advance his objectives without generating ill will from the other side.

2. Set the Offer and Reservation Prices

As part of the valuation of the target, the buyer must establish its offer and reservation prices. The offer price is the first salvo and is normally included in a letter of intent that outlines all of the key terms and conditions of the proposed transaction. The reservation price is the maximum amount the buyer is willing to pay for the target. Part of what determines the reservation price is the buyer's best alternative to a negotiated agreement. If the buyer has a number of viable options other than an acquisition, the gap between the offer and reservation price should be small.

A buyer should avoid adjusting the reservation price during negotiations unless something of a material nature is uncovered during due diligence that would rationalize such a change.

3. Anticipate Trade-Offs and Disputes

Once each side's objectives have been identified, it is important to determine areas of compromise in order to make the overall deal compelling to the seller. The strategy is to concede on items that may be important to the seller but are not as important to the buyer. This should create good will and allow the buyer to gain acceptance of his key objectives during negotiations.

If there are areas of dispute that initially cannot be resolved, it is important to be creative in order to bridge the conflict. One of the most common areas of disagreement is with respect to the purchase price. Will the seller take a note back for a portion? Can an earnout bridge the gap?

Earnouts are valuable mechanisms to resolve purchase price disputes. The buyer may consider this incidental to the overall negotiations believing the chances of a payout under the agreed formula are low. The seller however, may apportion significant value to the earnout if he assigns a high probability of a payout.

Role playing is a useful exercise a buyer should employ throughout the negotiation process. Discussing various scenarios with members of his negotiating team allows the buyer to anticipate seller reaction to his tactics and to think several steps ahead like a chess player.

4. Determine Bargaining Costs

A buyer must consider bargaining costs when setting his reservation price. This includes out of pocket expenses for legal, due diligence and other advisory fees as well as the internal costs of employees involved in the negotiations. This latter cost, while not explicitly out of pocket, could be significant. A buyer should contemplate whether termination fees be paid by the seller in the event it decides not to consummate the deal. This would discourage a change of heart and compensate the buyer for some or all of his bargaining costs.

5. Know When to Walk Away

There will be instances when not completing an acquisition is the best option for the prospective buyer. This could be as a result of due diligence revelations or disagreements on key items that cannot be resolved to the buyer's complete satisfaction. The risk is to consider all costs incurred to date and impose a deal rather than ignoring sunk costs and focusing on the future and other viable alternatives. It is in these instances where discipline is crucial in order to avoid consummating a bad deal.

Aries Advisory Group is uniquely qualified to assist you in the acquisition of a business. We can provide a preliminary analysis and valuation of the target company, perform due diligence and assist you during negotiations. And we can provide the objective opinion you require to avoid executing a bad deal. If you require assistance in the acquisition of a business, please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.