

The Advisor – Spring 2013

The Controlled Auction

There are a number of methods owners can use to sell their business. One of the most popular and attractive methods is the controlled auction.

Advantages of the controlled auction include:

1. **Price Discovery:** it provides the seller knowledge of what potential buyers will pay for the business.
2. **Competition:** multiple offers from prospective buyers should in theory, maximize the final sales price.
3. **Transparency and Fairness:** prospective buyers are given access to identical information to avoid claims of an unfair advantage.
4. **Control:** the seller controls the process and establishes the rules and timing of when offers are submitted and when a transaction should close.
5. **Speed:** inherent with control of the process, a properly executed auction can expedite the closing of a transaction when compared to a drawn out negotiation with a single buyer.

A controlled auction however, is not ideal in every circumstance. Some of the drawbacks to using this method include:

1. **Reduced Discretion in the Selection Process:** if the seller commits to an auction, price is assumed by all parties to be the key determinant in selecting a buyer. The seller may have other criteria (such as the continuation of the company on a stand-alone basis, maintenance of jobs, non-movement of headquarters etc.) that are equally as important but not disclosed. By committing to this process, the seller may be forced to cancel the auction if the other criteria are not met by the highest bidder.
2. **Reputational Risk if the Auction is Cancelled:** if the auction does not result in a sale or is cancelled, the negative perception from the marketplace could be significant i.e.:
 - a. The seller had undisclosed (i.e. self-serving) objectives other than price that were not met;
 - b. The seller had an inflated opinion of what the business was worth; or
 - c. The business is in much worse shape than originally thought.
3. **Prospective Buyers Will Not Participate:** certain buyers may have a policy whereby they won't enter into an auction in order to avoid a bidding war. They may also want to avoid the publicity that is inherent in the process. This could have the unexpected effect of reducing competition and the final sales price.

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Keeping employees of the target motivated during the auction process is a key component of success due to their inherent knowledge of the business.

Although an auction can be a relatively fast method to execute a sale, it can be a disruptive and drawn out process from an employee's perspective. This is especially true if the risk of termination after the sale is great. If certain employees believe that their future with the company is limited, they may not be as co-operative or forthcoming with prospective buyers as the owners would like.

It is important to identify an internal point person or leader to manage the process. This employee should have the authority to make decisions without delay in order to keep deal momentum at a high level. Retention bonuses and severance packages may need to be negotiated with key employees so that they remain engaged until a sale is consummated.

To conclude, it is best to use an auction to sell a business in the following situations:

1. If maximizing price is the main objective for the owner. If other objectives are more important, then it is probably better to negotiate a deal with a single buyer who is sensitive to these issues.
2. If the seller is confident that more than one or two parties would be interested in buying the business.
3. If the seller has commenced preparing for a sale in recent years so that:
 - a. All books and records are in order and have been audited or reviewed by an outside accounting firm with no report reservations;
 - b. A data room with all of the required information can be organized with minimal effort for buyer due diligence; and
 - c. All litigation and contingent liabilities have been resolved or mitigated.

Aries Advisory Group is uniquely qualified to assist you in the sale of your business. We will review your goals and determine the best method to use to ensure your objectives are met. We will then walk you through the process and assist you with the sale of the business through the chosen method. If you require assistance in the sale of your business, please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.