Whether you are a corporation looking to sell off a non-core business holding, or an owner looking to sell the company you've built, you want the same thing:

First, to intelligently consider, compare and evaluate all your options.

Then, if it is a sale you desire:

To sell at an optimal value.

To ensure your employees are fairly treated.

To achieve the sale without endangering the business, its competitive position, or its intellectual property.

To canvas all the possibilities with utmost discretion.

To do it all in a time- and resource-efficient way.

To get back to your core business. . .

. . . or to your new life.

Then there are the many tactical questions and considerations.

The following are only some of the questions and concerns we have gleaned from our clients and personal experiences over the years, as advisors, principals and private company executives:

What is my company worth?

If need be, how do I increase the value of my company?

When is the right time to market and sell the company?

How do I do it, exactly?

What is the optimal process for me?

Where do I start?

What are the key steps?

How do I protect myself and my company?

How disruptive will this process be?

Can I do it with my team, or do I need an advisor?

What are the costs of this process and the terms of engagement?

What are the timelines of this process?

Which of my employees do I bring into the loop?

Are the market conditions right for a deal?

What are the current deal terms?

How should I structure the transaction, cash vs. shares for example?

What can I be doing now to get prepared?

Where do I go from here?

Over the next ten instalments, we will attempt to provide insights on many of these and other important questions.

We can't cover all the bases here, but hope we can illuminate the topic of selling your private, mid-sized company and planning for the exit, and providing insights on areas for further examination.

Watch for upcoming instalments, and happy reading!

Part 9 – How the *“Prisoner’s Dilemma”* applies to selling your business to your key employee

The Prisoner’s Dilemma is where both parties choose to protect themselves at the expense of the other participant, rather than co-operating to achieve a better combined solution.

Source: Fotolia

We were recently presented with a rather common private company scenario to consider:

A family member of his (I’ll call her Jane) was a key employee at a small private company, whose owner (Tom) was considering retirement.

Jane was a key contributor to the product offering of the company, and had an important and expanding relationship with key customers.

She was a natural option for Tom to approach to buy the business.

The transition discussions rolled along nicely until the keystone issue of valuation — how should Jane value the company?

Status quo – with her in her current role?

Pro forma – as if she was not there and not replaced?

Or, pro forma without her, but presuming she has been replaced by a comparable employee at market compensation rates?

Here is where Game Theory — the study of strategic decision-making pioneered by the brilliant American mathematician, John von Neumann — comes in.

Game theory is best known for the 'Prisoner's Dilemma', where both parties choose to protect themselves at the expense of the other participant, rather than co-operating to achieve a better combined solution.

The math behind this particular Prisoner's Dilemma

For simplification, we'll assume the company status quo is worth $15 million based on a fundamental valuation; without Jane, assume a value of $10 million, which isn't unreasonable for a senior employee and lieutenant to the owner of a small company.

However, in the scenario where Jane is replaced by a new senior employee the value is an unknown, because we cannot be certain either of the cost to replace her, or of the performance of the new employee.

This often leads to a potentially uncomfortable situation.

In this example, splitting the difference and selling the company to Jane for $12.5 million would result in a loss of $2.5 million in the eyes of both parties.

Tom could conceivably sell his company for $15 million.

Jane could keep working under the status quo and hope Tom changes his mind, rather than buying at $12.5 million or $2.5 million more than she feels the company is worth without her.

Jane may be willing to crystallize her loss if she fears being replaced, thereby losing all her $5 million sweat equity.

Tom may be willing to absorb the $2.5 million if he believes replacing Jane will be difficult, time-consuming, expensive and a risky distraction.

The problem is there will almost inevitably be bad blood, as both parties will consider themselves to be forced by the other into whatever compromise results.

Can this 'Dilemma' be avoided?

This problem arises when an individual cannot value a company as a closed system, independent of the effect or impact of being a member of the team.

The reason management buyouts work, is that the individual members of the team tend to not feel they have individual power, and do not want to risk holding fast to optimize their perceived personal value in the equation.

As a result, the company in a manager buyout tends to be valued objectively on its historical operating performance and outlook.

There generally is some interaction with the employees and the price, but it tends to be minor relative to the overall fundamental value of the business.

If you have a single employee with as much impact on its value as Jane has, you are not in position to value your company objectively.

So it is incumbent on you to build a team and a business that is sustainable no matter who owns it, or who gets hit by a bus, so to speak.

Otherwise, the situation will generally come down to a stare-down, which has more downside for Tom and Jane than it does upside.

The downside tends to be more fundamental for Tom than Jane, who could conceivably find another job and carry on after licking her wounds at her opportunity loss ($5 million of sweat equity).

Tom, on the other hand, imperils his entire $15 million value by rolling the dice.

So what should Tom, and Jane, do?

Initially, Jane holds all the cards.

But is she prepared to play hardball and threaten to walk away if the business isn't sold to her for closer to the $10 million value?

If not, the power shifts to Tom, who must decide how replaceable Jane is.

Generalizations can be dangerous, so your specific situation may have unique elements that push things toward a more constructive outcome—but the point is you need to pay attention to the game!

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This article is excerpted from and was originally published in the FINANCIAL POST.