Life after sale

How do you advise an entrepreneur on selling his business when he intends to stay on? **Jonathan Silverman** reports

Advising a client at the time that they decide to sell-out to a suitor who wishes them to stay on afterwards presents a number of challenges to the practitioner. As the Irishman said when asked for directions at the roadside: "It would be better not to have started from here."

This is especially the case where the client has a business which is likely to be acquired by a conglomerate or consolidator which may not even have previous experience of running a business in that sector but which has simply identified a potentially profitable area of activity or the opportunity to acquire a supplier.

It is often the case in the luxury goods market or in the specialist IP sector where a seller has developed a brand or novel technique which is identified by a prospective acquirer as being capable of achieving significantly increased sales if marketed as part of a bigger offering or where the right level of resources will enable the business to grow faster than can be achieved at present.

This is especially true at the present time where funds for expansion are difficult to come by and where market opportunities may be missed simply due to a lack of funds.

In some cases a prospective sale can arise where a key customer sees an opportunity to acquire a struggling supplier either as a cost saving exercise or as a protective move because that supplier is crucial to their business.

Preparing clients

Such was the case of the major mail order company which acquired their software supplier which was critical to their business, believing that once they had made the acquisition they would be able to ensure 24/7 service from that supplier. The outcome was very different because inevitably the other customers of this software supplier who had been hard fought by the management suffered, the sellers became disillusioned and soon parted company, leaving the buyers with a near useless and costly acquisition.

The key difference for which you have to prepare your client is that the large corporate will inevitably have an entirely different culture from the small flexible and friendly environment in which the client will have operated while building the business.

The skill is to manage the client's expectations well ahead of any negotiations. This is particularly important where entrepreneurs have initially cut their teeth working for large businesses.

Yet the story should perhaps start earlier-on in the life of the business since many start-ups and young companies find themselves with a real problem when they come to sell, simply because they do not have full control of their equity. Many will have issued shares to families, friends and benefactors at an early date without recognising the potential risks of losing control.

It is essential for lawyers to ensure that there are either "drag and tag" provisions in the articles or the shareholders' agreement, or that similar mechanisms exist to enable the client to offer 100 per cent of the business to a prospective buyer.

The challenge is that, by their very nature, entrepreneurs are used to having total control and are likely to want to continue to direct or influence their businesses after it has been acquired, whereas the buyer will expect to both hold the purse strings and effectively direct the business. The skill of the practitioners is to look at the matters at the time of the disposal in the round.

The provisions in not only the sale and purchase agreement but also the service agreements and management agreements must be carefully drafted and scrutinised by both parties to minimise the opportunity for future friction.

Agreeing business plan

While it may not appear to be integral to the discussions at the time of disposal there is considerable merit in ensuring the parties agree a business plan to which both sides sign up. That plan should be carefully woven into the service agreement provisions so that if there is any material variation to the business plan the seller can object and either walk away without restriction or perhaps trigger a compensation package appropriate in the circumstances.

The trick is to try and ensure that where the seller is staying on as, say, a divisional director with the remit to build the business further, that he is given clear lines of communication to the board, has an adequate degree of autonomy, and is working to a clearly defined plan.

Consequently the documentation needs to be properly drafted to ensure that there is a mechanism to protect the seller so that once the honeymoon period is over and the stresses and strains of running a business come into play there is a clear framework in place.

Facing realities

As legal adviser, you will need to encourage full and frank discussion between the parties to avoid any long-term problems, through discussions such as to how existing and new marketing opportunities are going to be addressed.

The bespoke shoe manufacturer considering a sale to one of the major luxury brands group was horrified to be told in a preliminary meeting that their products would be sold through the group's boutiques rather than through stand-alone shoe shops and wisely walked away from the deal rather than compromise their hard earned reputation.

Likewise the possibility that the conglomerate might take an existing brand and migrate it to an entirely different range of products may be something which would be diametrically opposed by the originator of the brand; especially if the sales documentation failed to address any possibility of additional financial rewards at a later date.

This is perhaps one of those classic situations where a practitioner has to ensure wherever possible that he is involved as early as possible in the dialogue between the parties to achieve a satisfactory result for his client.

"Know your client" could not be more important than when acting for a company where the level of consideration passing at completion may be modest but where the opportunity for future rewards will depend very much upon the parties being able to successfully work together.

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