



Original Research: A Brief Note on What Private Company Owners Care Most About in an M&A Transaction?

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Abstract

When private business owners purposefully seek a new majority owner for their businesses, do they care only about Enterprise Value (price)? What motivations, fears, and concerns do they have? Do all Owner-Managers care about the same factors? What conclusions can we draw from asking successful Owner-Managers their views?

In research surveying approximately 75 successful Entrepreneur Owner-Managers, we assessed their outcome preferences from an M&A transaction. Owner-Managers care most about Enterprise Value and personal freedom. They also indicate that they care about a wide spectrum of other characteristics.

Introduction & Purpose

Bigelow is widely known as the only independent M&A advisory firm that focuses exclusively on working with private company owners to build, and ultimately capture, the Enterprise Value of their businesses. We work with private company owners who, not only manage (or lead) the organization, but are also the principal owners of it. We call these friends Entrepreneur Owner-Managers (EOMs or Owner-Managers.) They are not simply employees or managers (agents), rather they have significant skin-in-the-game as owners, usually a large portion of their wealth is in the organization (principals). This is a critical distinction because they are much more heavily invested (dollars and emotions) in their businesses than a "corporate CEO" who is a highly compensated employee, but de minimis owner. EOMs care deeply about the success of the company for its employees, management team, customers, suppliers, and company culture, and for most, their legacy as Owner-Managers.

EOMs care about different things than employee management executives and often care about different factors than other Owner-Managers. Their individual situations, companies, industries, competitive dynamics, and pressures make for a wide range of views and experiences. About half of our sample are leaders of family businesses, often multigenerational, which adds another level of complexity. That is what makes our practice so fascinating.

We have studied the decision-making of EOMs for years through scholarly research studies including our [Entrepreneur Strengths Study](#) and [Entrepreneur Owner-Manager Risk Tolerance Study](#).

In preparation for one of our recent Bigelow Forums, we asked, “Is it time we ask our Owner-Managers what they really care about in an M&A transaction?” Could we do this in a quantitative, systematic way (scientific survey) to better appreciate Bigelow’s anecdotal evidence? Our Bigelow EOM Care Survey was conceived, and we hope you find the results and findings educational and interesting.

Survey & Respondents

Bigelow created an online survey with approximately 20 discrete questions. It was distributed to hundreds of Owner-Managers via email. We received 76 responses, but not every respondent completed every question. While some of the respondents were past clients of Bigelow, many had no experience with Bigelow. Survey sample summary:

- N = sample size of 76 respondents
- 100% active in the business
- ~50% had completed a transaction and ~50% had not yet
- ~50% considered their business to be a family business
- ~25% were under 50 years old; ~50% were age 51-65, and ~25% were over 65 years old
- ~11% were female

What Do EOMs Care About?

The main question we wanted to explore was: what is most important to EOMs in an M&A transaction? We wanted to find out what they care about, what matters most, and the degree of consistency. We chose a technique of providing 13 characteristics and we asked EOMs to rate their importance level.

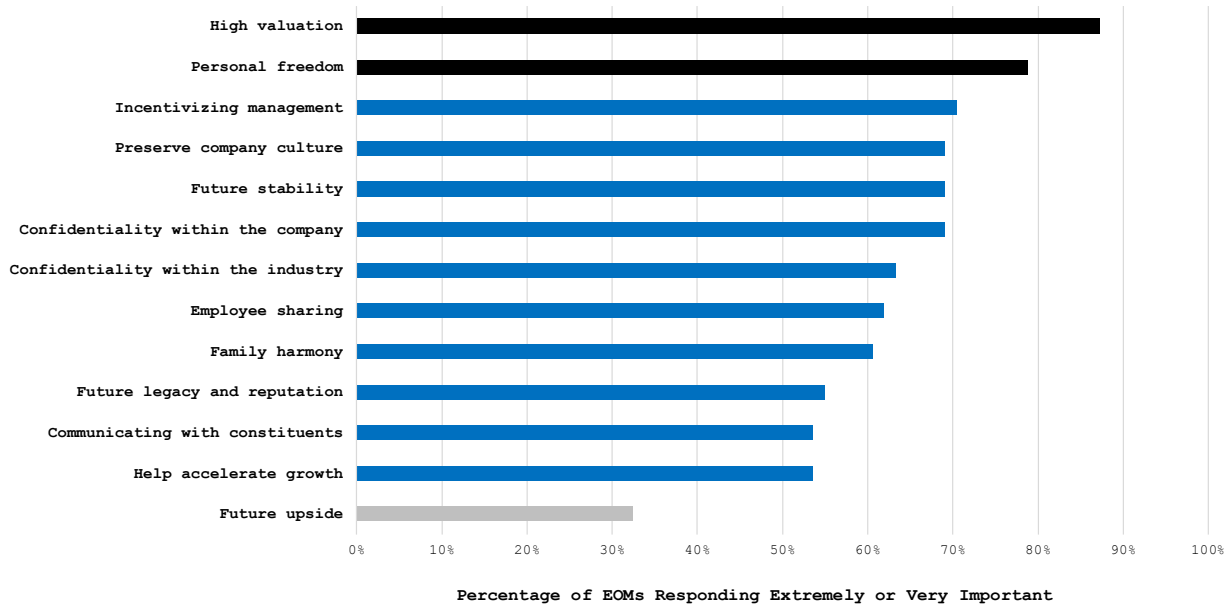
Table 1 How important to you were each of these motivations, fears, and perceptions before you decided to capture Enterprise Value through an M&A transaction?

| Characteristic | Number of Respondents Checking Choice | | | | | Weighted Average |
|---------------------------------------|---------------------------------------|----------------|--------------------|--------------------|----------------------|------------------|
| | Extremely Important | Very Important | Somewhat Important | Not Very Important | Not at All Important | |
| 1 High valuation | 29 | 33 | 8 | 0 | 1 | 4.25 |
| 2 Personal freedom | 37 | 19 | 8 | 7 | 0 | 4.21 |
| 3 Confidentiality within the company | 29 | 20 | 15 | 6 | 1 | 3.99 |
| 4 Incentivizing management | 18 | 32 | 20 | 0 | 1 | 3.93 |
| 5 Preserve company culture | 16 | 33 | 21 | 1 | 0 | 3.90 |
| 6 Confidentiality within the industry | 28 | 17 | 16 | 8 | 2 | 3.86 |
| 7 Future stability | 22 | 27 | 11 | 8 | 3 | 3.80 |
| 8 Future legacy and reputation | 17 | 22 | 27 | 5 | 0 | 3.72 |
| 9 Employee sharing | 13 | 31 | 20 | 7 | 0 | 3.70 |
| 10 Family harmony | 28 | 15 | 13 | 8 | 7 | 3.69 |
| 11 Communicating with constituents | 16 | 22 | 24 | 9 | 0 | 3.63 |
| 12 Help accelerate growth | 14 | 24 | 20 | 12 | 1 | 3.54 |
| 13 Future upside | 5 | 18 | 22 | 17 | 9 | 2.90 |

Note: See Appendix for full characteristic descriptions provided to survey respondents.

At the suggestion of our third-party statistician, we elected to summarize the importance of each characteristics by adding up the percentage of EOMs that rated each characteristic either extremely important or very important. Figure 1 below graphs these findings.

Figure 1: What do EOMs care about?



We believe that there are several interesting observations from the survey responses. First, over 75% of the EOMs cited high valuation and personal freedom as extremely important or very important. Their rankings were the only ones more than one standard deviation (.324) higher than the weighted average (3.78). We view this as significant. The emphasis on Enterprise Value is understandable, as a high valuation is often an important component of validation of the professional success of an Owner-Manager. However, gaining personal freedom, whether to retire from the business or change ones' role within the company, is often a primary driver of a transaction. Again, this was the only characteristic (in addition to Enterprise Value) which was more than one standard deviation higher than the mean response.

Another observation is the sheer number of other characteristics EOMs care deeply about. Twelve (12) of the thirteen (13) characteristics were scored by more than half (50%) of the EOMs as either extremely important or very important. The only characteristic that was low (less than 50%) was the desire for future upside. It was the only characteristic that

scored lower than one standard deviation below the mean response. So, while EOMs are overwhelmingly interested in valuation and personal freedom, they also care about 10 other characteristics.

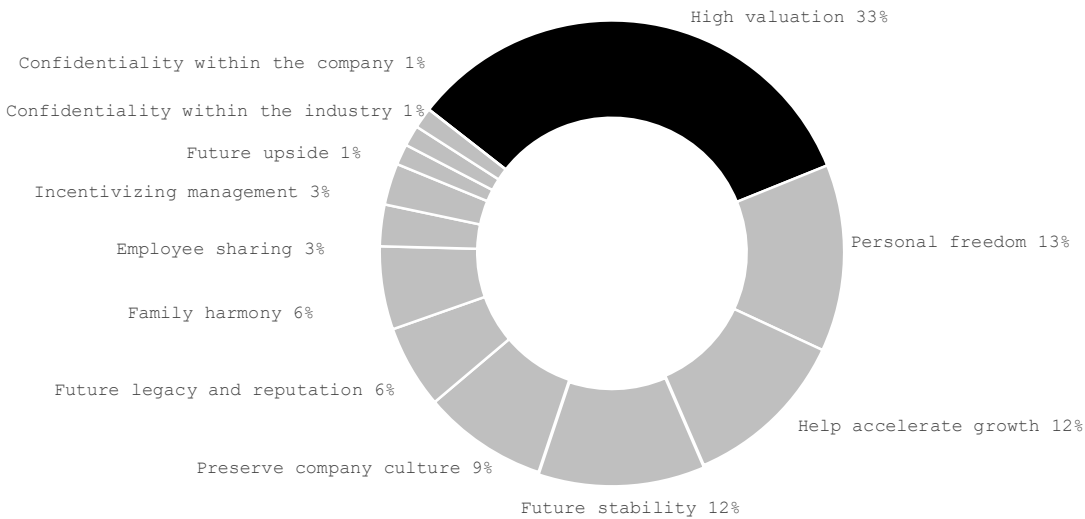
Single Most Important Characteristic

Another way we investigated what was important to EOMs is to force them to pick the single more important characteristic. Again, we provided the same 13 characteristics and Table 2 details the responses.

Table 2 What was the single most important characteristic?

| <u>Characteristic</u> | <u>Number of Respondents</u> | <u>Percentage</u> |
|--|------------------------------|-------------------|
| 1 High valuation | 23 | 33% |
| 2 Personal freedom | 9 | 13% |
| 3 Help accelerate growth | 8 | 12% |
| 4 Future stability | 8 | 12% |
| 5 Preserve company culture | 6 | 9% |
| 6 Future legacy and reputation | 4 | 6% |
| 7 Family harmony | 4 | 6% |
| 8 Employee sharing | 2 | 3% |
| 9 Incentivizing management | 2 | 3% |
| 10 Future upside | 1 | 1% |
| 11 Confidentiality within the industry | 1 | 1% |
| 12 Confidentiality within the company | 1 | 1% |
| 13 Communicating with constituents | 0 | 0% |
| | 69 | 100% |

Figure 2 The single most important characteristic on a percentage basis.



It is not surprising that high valuation garnered the greatest percentage of respondents at 33% as this is consistent with our earlier observations. What is more surprising, however, is that 66% of EOMs pick one other motivation, concern, or fear as their single most important choice. Owner-Managers care about a wide variety of outcome considerations and merely assuming that valuation is always their number one driver is wrong. Understanding the variability of individual Owner-Managers' concerns is critical because our data showed that 12 of the 13 choices were picked as the single most important characteristic by at least one EOM.

Does Hindsight Change the Importance of Characteristics?

One of the hypotheses we wanted to explore, was whether the importance of characteristics change with the benefit of hindsight. We asked those EOMs that had completed a transaction, we call Veterans (N = 40), to rate their characteristic responses after a transaction as well. Most of the characteristics did not exhibit a statistically significant change in the number of respondents from before a transaction to after. However, Table 3 below details the 5 characteristics where the response change was meaningful.

Table 3

| <u>Characteristic</u> | <u>Number of Respondents Checking Extremely or Very Important</u> | | <u>Change</u> | |
|---------------------------------------|---|--------------------------------|-------------------|-------------------|
| | <u>Before a Transaction</u> | <u>After a Transaction</u> | <u>Difference</u> | <u>Percentage</u> |
| | 1 Confidentiality within the company | 25 | 19 | -6 |
| 2 Confidentiality within the industry | 27 | 21 | -6 | -22% |
| 3 Future legacy and reputation | 18 | 14 | -4 | -22% |
| 4 Communicating with constituents | 21 | 18 | -3 | -14% |
| 5 Future upside | 12 | 14 | 2 | 17% |

The Veteran EOMs' responses provide a few insights. There were meaningful reductions, ranging from 14%-24%, in the characteristics of confidentiality, legacy, and communication before a transaction compared to after. We read these results to suggest that Veteran EOMs, with the

benefit of hindsight, were overly worried about confidentiality, legacy and communication as compared to their actual experience. The only response that had meaningful increase was future upside. If you recall from Table 1, future upside was the lowest rated characteristic, on average, of the respondent group. With the benefit of hindsight, some Veteran EOMs responded that they should have been more considerate of that characteristic before starting a transaction. We suggest that some business owners may discount the value of future upside (typically in the form of minority rollover equity) until they gain confidence in what the future may hold with a specific new partner. Often, EOMs come to realize that future upside is potentially quite valuable and attractive to them.

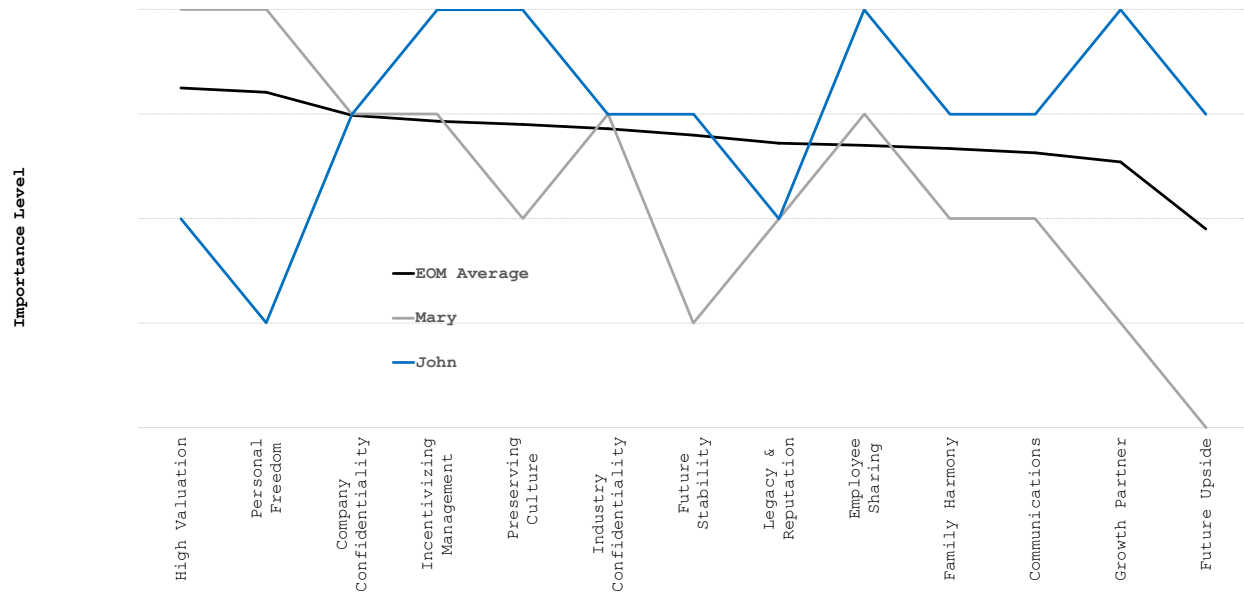
Variability Among EOMs

Do averages obscure? Is generalizing about a group of unique individuals even helpful? We suggest yes, but with a healthy dose of professional skepticism. Understanding the averages is directionally beneficial, but as we looked closer at the individual responses, we were struck by how varied the EOMs' views were on the same characteristics. In essence, they do not individually have the same motivations or concerns. Using the same data set as question 1, we simply view it through a different lens.

Figure 3 How important to you were each of these motivations, fears, and perceptions before you decided to capture Enterprise Value through an M&A transaction?

Figure 3 below shows three different response patterns. The black line represents the EOM group average responses (note the order of characteristics is sorted by average level of importance from highest to lowest, left to right). The gray line represents the responses from an actual individual EOM, we called her Mary. The blue line is another EOM respondent, we called him John.

Figure 3 Plotting Mary, John, and the EOM Average

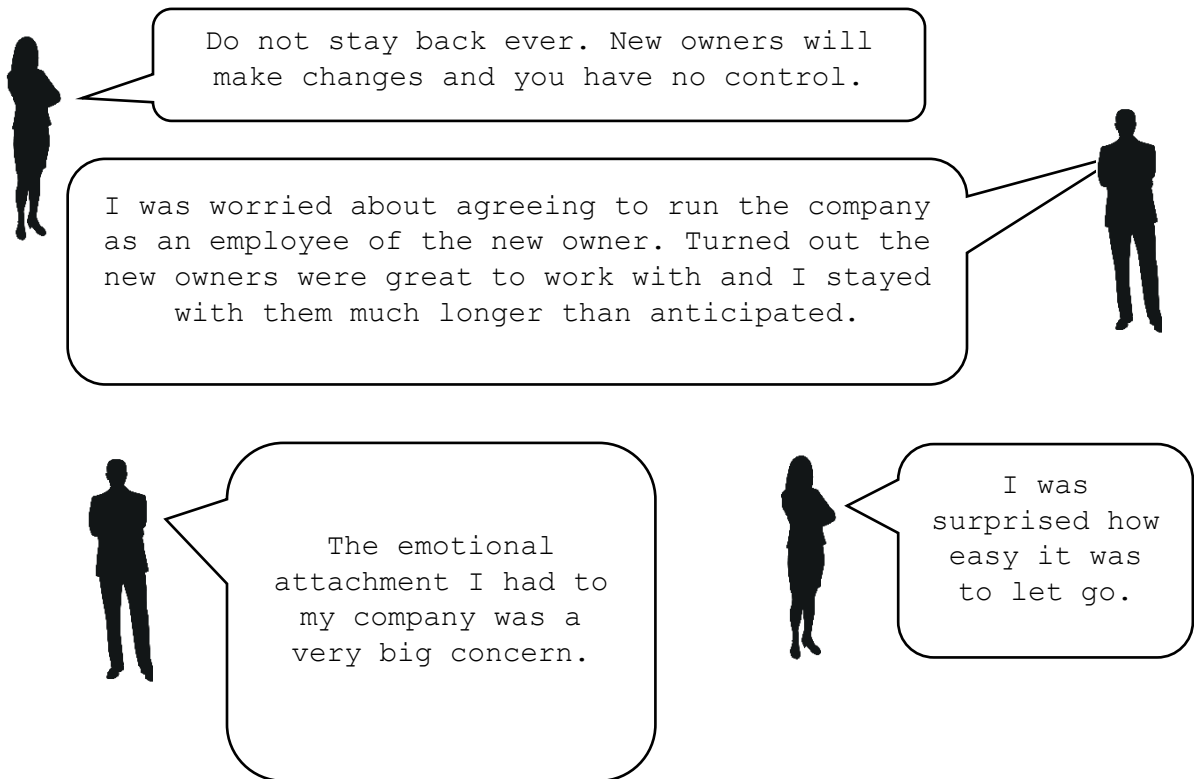


John and Marys' views are strikingly different. Just look at the first two characteristics. Mary rated high valuation and personal freedom as extremely important. Whereas John rated high valuation as somewhat important and personal freedom not very much at all. Neither John nor Mary are close to the average line for those characteristics. Opening the aperture a bit wider, and looking at the rest of the characteristics, John and Mary often appear as opposites to each other, bouncing above and below the EOM average line. So, if one only looked at the averages, you would likely miss a headline, which is the degree of variability among successful EOMs. This is the healthy dose of professional skepticism that we need to have etched into our minds if we think all Owner-Managers care about the same things in the same way. It is simply, not true. Having advised hundreds of Owner-Managers over the past 30 years, Bigelow can attest to how different individuals can, and should be.

Law of Small Numbers: Beware of a Sample Size of N = 1

Our hypothesis was that a wide range of views from EOMs is the norm, and our survey results support that conjecture. Not just in their individual

weighting of individual characteristics described by the survey data, but also on their views after a transaction. We asked Veteran EOMs who had completed transactions to provide a few insights into what they learned, and a selection of their quotes are below.



What can we make of these wildly different experiences? At Bigelow, we like to say beware of the law of small numbers, from drawing inferences from small sample sizes, in this case an N of 1. What one Owner-Manager experiences is not necessarily what others will experience. In fact, many times EOM experiences are actually the opposite. One of the ramifications of this is, while it is great to learn from other private business owners who have been through a transaction, their experiences are not entirely transferable. We often describe this as the unlearning that needs to take place with many of our clients. What they have been told by a friend or heard at a cocktail party is by no means a universal truth. What worked well for one Owner-Manager is not likely the solution

for others. More importantly, perhaps what failed for one Owner-Manager does not mean that it will not work for you.

Maybe this should not be a surprise. This survey shed light on the fact that Owner-Managers care differently about a variety of characteristics they face in an M&A transaction. Adding to this is that all EOMs' businesses are unique. They operate in different industries with different competitors with varying degrees of opportunity and risk. When combined with the wide range of investor types and personalities, the situation is just simply too complex to overly generalize. What then are the implications for private company owners looking to find the right next owner for the right reasons? Our opinion is that they require a custom solution, not a one-size-fits-all mentality.

Advice from Veteran EOMs that Have Been Through a Transaction

We also asked the Veteran EOMs to provide any other insights to share with EOMs who had not yet been through a transaction. Their response could either be a lesson to share, what surprised them, or what the EOM overlooked. Below are selected responses that may provide some insights.

1. "Managing the process was extremely time consuming and I was not equipped for this. I felt like I was outgunned by the buyers during the process and would have fared better with a banker helping to manage the process."
2. "During the years it took to build my company I avoided 'betting the company' on any single idea, product or transaction. By doing so we would live to fight another day, even if we made mistakes. However, when you sell your company it's unlikely that you'll get a do-over. So, make sure you like and understand the people you are entrusting your life's work to. This is one case where you are 'betting the company' on a single transaction."
3. "Take the time to develop a great strategic plan and begin implementation before starting the sale process."

4. "As early as possible, when the thought of capturing Enterprise Value becomes a viable concept, engage a team that can assess the best way to increase value from an investors' perspective."
5. "I should have been much more transparent with the employees at the outset about the project of finding a new owner."
6. "One could probably say about any life experience that nothing is as obvious at the beginning as it is at the end."

Conclusions

What conclusions can we draw from our survey results of what Owner-Managers care about in an M&A transaction? We think that there are several.

1. In the aggregate and on average, Owner-Managers care most about Enterprise Value and personal freedom. However, they care about a wide range of other characteristics as well.
2. When forced to pick a single most important characteristic, most of them choose Enterprise Value and personal freedom; the other choices are widely dispersed among 10 other considerations.
3. Averages obscure. The variability of individual EOMs is immense and believing that all EOMs care about the same characteristics to the same degree is wrong.
4. Hindsight. EOMs put a little too much concern on confidentiality, legacy, and communication before the transaction as compared to after. EOMs did not put enough weight on future upside.
5. Beware of an N of 1. What EOMs hear from a single Owner-Managers' experience cannot be taken as universal truth. There is significant

unlearning required as the breadth of experiences is much wider than most believe.

6. Custom solutions are required. Private company owner motivations and situations are very complex so there are no regular or simple solutions. Rather, we believe a deep understanding of the EOMs' motivations is the best way to craft a custom solution.

More research is needed for continued learning on the motivations, fears, and concerns EOMs have within the context of an M&A transaction. New questions have arisen in our minds as we have distilled this analysis. Is the way an EOM enters into a business a potential driver to what EOMs care about? Is there potential segmentation between EOMs that:

1. acquired their business;
2. raised capital from investors;
3. founded their business; or
4. led a business that had been handed down within the family.

We may address these questions and further preferences and outcomes of EOMs in future research. We hope that you found these survey findings helpful as you think through the motivation, fears, and concerns you may have as you contemplate finding a new owner for your privately held business.

Appendix

Full description of characteristics provided to respondents for the question in Table 1 (page 3 of 13) and Table 2 (page 5 of 13):

How important to you were each of these motivations, fears, and perceptions before you decided to capture Enterprise Value through an M&A transaction?

1. Personal freedom
2. Achieving a high economic valuation
3. Potential future upside/ownership
4. Future legacy and reputation
5. Confidentiality within the company
6. Confidentiality within the industry
7. Finding an owner to help accelerate your company's growth
8. Finding an owner to bring future stability
9. Preserving company culture
10. Family harmony/relieving family stress
11. Incentivizing your senior management team
12. Sharing with employees
13. Communicating with other constituents (e.g. stakeholders, employees, family, the public)