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NOTEBOOK OF IDEAS FOR

DIVESTITURES *of* SECURITY GUARD COMPANIES

A periodic informational letter published by Robert H. Perry & Associates, Incorporated
Dedicated to Buyers and Sellers of Security Guard Companies

Reaching The Wall Of Resistance

Going For The Last Dollar

OVER-NEGOTIATING

For most owners of privately-held security guard companies, the business represents the majority of their net worth. Therefore, the quality of life during retirement, the next investment venture, or the relief from some financial burden depends on the price they receive when they sell their business.

They started it and nurtured it. It's almost part of the family. There can be no mistakes that will keep them from getting top dollar. Their future depends on it.

However, consummating a transaction becomes less likely if the sellers begin the sale process with the mind-set that in order to get maximum value they *always* have to be one-up on the buyer on every negotiating point. If the buyer offers five, the seller counters with eight, and pushes the negotiations to the limit – variously called "over-negotiating", "reaching the wall of resistance" or "going for the last dollar."

Throughout the negotiations there are many points upon which an agreement must be made. In a typical transaction there may be over 100 negotiating points. Some have large consequences to one or both sides. Others have little effect, but nonetheless must be resolved.

Sellers who act on their own, without benefit of advice from thier negotiating team (which we will discuss below) are more than likely to over-negotiate since they are proceeding from emotions attached to their business.

A likely scenario would go something like this: the seller at the outset of the negotiations asks the buyer to increase the offering price by 2%. To the buyer, this is probably not a large concession because the increased price still meets its financial model parameters – so the buyer agrees to it.

Then later in the deal, the seller asks the buyer to increase the down payment by 10%. The seller is inclined to make this request because the buyer already moved without much resistance on the price, and sends the seller a signal that there are still concessions left on the table. Again, to the buyer this is not by itself a large concession, it's agreed to because it still fits within the parameters of the financial model.

After the buyer makes two concessions, the seller asks for another, seemingly small concession. But this time, the buyer does not agree with the seller's request. This confuses the seller because the request seems insignificant. However, what the seller does not realize is that the last request, when taken with the bundle of concessions to which the buyer has already agreed, makes the buyer re-examine its financial model. All the concessions, when considered as a bundle, result in a serious deterioration of the return on investment. This forces the buyer to reconsider the reason for wanting to buy the company in the first place.

If the seller is lucky, the buyer will stay with the negotiations and eventually renew interest in the company. This usually comes at the expense of the seller having to give back some of the previous concessions. Or worse, the buyer may lose interest and no longer want to buy the company. The buyer sees the seller's pattern of always trying to better its (the seller's) side of the deal as the seller not being motivated to sell, or unwilling to negotiate in good faith, in which further negotiations would be a waste of the buyer's time. Thus the seller actually loses some of the financial advantages previously negotiated, or loses the deal altogether - all because of the narrow focus of having the last dollar.

Prudent sellers, those who need to sell or recognize that the deal at hand is unprecedented, will learn which points are really important to its interests and which are not. They will recognize the items that are necessary in getting these points, while at the same time not over-negotiating and throwing the deal off track. In other words, they'll "pick their battles" to stay focused on their ultimate objective.

Sellers need to know why the buyer is interested in the seller's company. Knowing this will give sellers insight as to just how far they, or the members of their team, can push on some of the negotiating points. For instance, if the buyer has a national account that represents a large percentage of the buyer's total business that has requested service in an area not presently served by the buyer, but serviced by the seller, then the buyer would have a strong interest in the seller's company. It needs the seller's infrastructure in the area to provide service to the important customer's sites. Within certain price constraints, it's more economical to purchase a company than to try to build business in a new area.

Also, if the buyer is contemplating an initial public offering, the additional volume may enhance its offering value. Or the buyer may need the seller's expertise in certain areas of security, which may make the buyer's marketing efforts more attractive.

Sellers need to understand the importance of the buyer's financial model . This model serves as a measure for the buyer's return on investment. It is the reference point for the buyer's decisions, and is usually prepared before the parties enter into serious negotiations.

Its starting point is the information furnished by the seller. The information is then adjusted to reflect the way the buyer intends to operate the company, the end result being the buyer's profit model. The buyer usually does not share the model with the seller; to do so would obviously give the seller undue negotiating leverage. From this model, the buyer formulates its maximum offer, again based on the buyer's return on the price it expects to pay the seller. It's important to note that the model is often imposed by the company's board of directors or investors, and thereby limits the authority of the *buyer's* negotiating team on certain issues. As the seller's demands push the terms past the limits justified by the model, and/or increases the buyer's risk in the transaction, the buyer becomes less interested in going forward with the deal.

Sellers need to understand the buyer's negotiating style. Proactive buyers develop a negotiating pattern. There are buyers who say "this is my final offer" and mean it. Then there are those who use this comment as a starting point for negotiating. Some start low on every issue, then through protracted discussions allow the seller to negotiate upwards, and thus give the seller a sense of winning or reaching a limit.

Some buyers waste no time in getting their best deal on the table. They are usually on the fast track for acquisitions. They know the importance of keeping the momentum and not letting sellers have time to get interested in other buyers. This type of negotiating confuses sellers the most. The buyer gives in to all the seller's counterproposals in order to get to the bottom line quickly, which makes the seller believe that the buyer's interest in the company is stronger than it really is. This usually leads the seller to test the limits by searching for the buyer's point of resistance, an action often perceived by the buyer as a seller's lack of motivation, which will cause a serious buyer to walk away.

Obviously knowing the buyer's style would help the seller in deciding just how far to go before reaching the wall of resistance. But buyers don't come to the negotiating table wearing identifying labels. The seller who acts alone or with inexperienced advisors is not going to be able to read the subtle (and sometimes not so subtle) signs that reveal the buyer's negotiating style.

But how do the sellers know a buyer's motivation for wanting the company, the pricing model, and negotiating strategy? How do they know what's reasonable and fair, and whether they are getting a good or even an unprecedented deal? After all, the seller is a security guard company owner, whose skills are in running and building a company, not in selling it.

First of all, sellers should look within themselves. They should try to think like the buyer, putting themselves in the buyer's shoes. Would they consider their own demands as reasonable? Since the seller is emotionally involved in the process, this type of thinking becomes very difficult if not impossible to accomplish.

Therefore, a prudent seller will rely on the expertise and skills of their negotiating team – accountants, attorneys and deal manager (intermediary) to get through the often emotional, and always complicated maze of factors toward consummating a transaction. Before serious negotiations start, the owner will counsel each team member to make sure the professional understands why the seller wants or needs to sell, and the consequences of not selling – a very important consideration when making sure the deal does not jump off track by someone over-negotiating.

The attorneys and accountants

Often sellers talk to their accountants and attorneys first when they are thinking about selling. They are the ones who have looked after the legal and financial affairs during the *operating* years of the company. They are usually more than just advisors, they are trusted friends.

However, the legal and tax ramifications of *selling* a company are very complex and require specialized knowledge. If these professionals, with whom the seller has built a relationship, do not have this expertise, they will not be the most appropriate advisors for the sale. When this is the case, they should recommend someone within their firm who specializes in these matters to take the lead in providing counsel for their client. If there are no specialists within the firm, the accountant or attorney should seek a specialist from another firm to help them.

These professionals will be knowledgeable in contract law as it relates to selling businesses. *They should proceed in the negotiations always with their client's best interests in mind, which means they must constantly weigh the consequences of over-negotiating against looking after the client's legal position. They should not make large issues out of positions of less important legal consequences to their client.*

They will seek advice from the deal manager on how far they should push on issues. They will explain the consequences of the legal positions to the client/seller, then let them make the decision. After all, it's ultimately the seller who has to suffer the consequences of a failed deal.

The Deal Manager [Intermediary]

The seller will usually have spent less time with the deal manager than the accountant or attorney. By definition, the deal manager is usually not needed until the owner gets ready to sell, although the prudent owner will have established a working relationship with one long before the anticipated day arrives.

The experienced deal manager will have managed many deals in the security guard industry. He's in contact with people in the industry daily; it's his business to know the current market conditions and valuations for companies. He knows when a security guard company has been sold, and usually the price and terms - even if it's a deal he didn't manage. He will know whether or not the seller's price is good or bad and whether the terms are fair when compared to these industry transactions. His advice on the standard for selling security guard companies will be the benchmark the attorneys and accountants use to keep from over-negotiating. The deal manager also knows how to read the buyer's negotiating signals. He then alerts the parties on the seller's team when they are reaching the buyer's wall of resistance. Chances are he has already consummated one or several transactions with the buyer, so he knows what to expect and just how far to push on certain issues.

If he's really looking after his client's best interest, he will advise the client against going after minor concessions. Often this advice is not well received by the client, who perceives this as the deal manager wanting a quick deal and not looking after the company's best interest.

In giving this advice, the deal manager knows that the buyer considers the entire bundle of concessions when evaluating a transaction. Unless the concession is very important to the seller, he should leave it alone. It may be just the culprit that tilts the scale, and causes a good deal for the buyer to turn into a marginal one at best, which may turn into a "no deal" for the seller. RHPA

Written by: Robert Perry

This periodic informational letter is published by:

ROBERT H. PERRY
& Associates, Incorporated

We initiate and manage transactions for sellers of security guard companies. Established in 1977, we have successfully represented over 100 sellers located in the United States, Canada, Western Europe, the Caribbean and South America.

P.O. Box 67 (27402)
400 West Market Street, Suite 301
Greensboro, NC 27401 (U.S.A.)

Tel: 336.272.2266 ◆ Fax: 336.272.1142
E-mail: rhpa@mindspring.com ◆ www.roberthperry.com