WHEN THE MULTINATIONAL MEETS THE PRIVATE FAMILY BUSINESS:
10 KEY ISSUES FOR A SUCCESSFUL NEGOTIATION OF AN M&A TRANSACTION BETWEEN THE TWO

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The vast majority of business enterprises worldwide are "family run", or purely private entities, where operational management and ownership reside in or are controlled by the same individuals.

On the other hand, often competing alongside these private companies within the same industries, are a relatively small number of "multinationals" – meaning, for the purposes of this guide, large scale (i.e. generally cross-border) enterprises whose business operations are carried out by "professional managers". These professional managers do not themselves hold a controlling ownership stake in their business.

It is difficult to overstate the cultural differences between private, operator-owned enterprises and the multinationals whose management is accountable instead to faceless institutional shareholders, regulatory standards of good governance or vaguely defined community stakeholders.

These polar worlds - the private business and the multinational - come into stark contrast when they are forced together in the case of an attempt to combine the two by way of a corporate merger or an acquisition by the multinational.

Once the dust settles, the key to **any** successful post-merger integration is clearly a beneficial financial and operational fit between the enterprises. The end game for every successful integration, however, must first pass through the stage of the negotiation and closing of the transaction. How to ensure that the cultural divide between the multinational and its potential operator-owned partner does not cause such negotiations to abort in frustration before the deal can close?

An understanding of the key differences and issues that govern the world views of these two types of enterprises is a good start. Following is a description of 10 such key issues, which can act as a guide in "getting the parties over the hump".

1. PROCESS KNOWLEDGE

The most important difference between the private company and the multinational in their M&A engagement is their divergent level of process knowledge. Unless the private company has had a "false start" already, in another transaction with a multinational, the owners of the private business will normally have never gone through the process of selling their business.

On the other hand, the experienced business development manager within the multinational will be well aware of the **road map** of a transaction: from initial contact to the signing of a Confidentiality

Agreement, followed by a Letter of Intent, due diligence, the signing of a formal Purchase Agreement, the "Closing", post-closing adjustments and finally ending with indemnity claims.

The private business owner tends to focus on the initial contact and the trust-building phase associated with the first "handshake" understanding between the parties. Many a business development manager at a multinational has relished the spectre of the family business owner "starting to spend the money", long before the transaction has closed.

For the transaction-savvy multinational, the game only begins once the Letter of Intent has been signed. Suddenly the initial intensity wanes, as negative findings in the due diligence process are trumpeted as a means to whittle down the initial Letter of Intent purchase price. Long response times cause the entrepreneur to doubt whether the transaction will actually happen. Fees spent on lawyers ensure that the seller is more and more "pregnant" with the idea of getting the deal done, no matter the cost. Lengthy negotiations on the scope of indemnities wear down the private business operator, who becomes increasingly distracted from the day to day operations of his or her business.

For the private business owner, the peak of enthusiasm occurs on signature of the Letter of Intent. **Things never get more positive as the deal progresses beyond that point**. The actual Closing can even be a letdown.

The most important measure that the private business owner can take, in order to attempt to level this process knowledge mismatch, is to obtain appropriate professional advice. Much as the trusted family advisor may well know the ins and outs of the target business, he or she may not necessarily be skilled in mergers and acquisitions. Likewise for the private company's executives: operational process expertise does not equate to mergers and acquisitions expertise.

Both sides will be appreciative of this investment. Experienced M&A advice will undoubtedly allow the private business owner to obtain a better deal, in selling off his or her prized asset. The multinational will also benefit from a smoother, more efficient, and more realistic negotiation process. Ultimately, the deal will be more likely to close.

2. WHO'S THE BOSS?

Early on in the process, the parties need to determine who has the final say in their negotiations. In the private company, job titles may be misleading. The family patriarch (or matriarch) may have enormously more influence than the titular President.

The negotiators for the private business also need to identify the power structures within the multinational. Their initial contact may be with the "operations" representative – their common industry cohort with whom they did business commercially in the past. However, a separate team is usually in charge of the acquisition, led by the skilled business development strategist, with assistance by the general counsel. The private business representatives also will be wise to enquire as to whether the CEO of the multinational has the final say on their transaction, or whether the company's board has final authority. There could be surprises down the line, when the board imposes a new condition.

3. PERSPECTIVES ON BUSINESS VALUATION

Fundamentally, all operating businesses are valued as a multiple of revenues, EBITDA or other appropriate measure of annual return. However, subjective assessments of value are also important in

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negotiating the transaction. To the senior private company owner, the company may be his retirement fund. Therefore, payment terms may be as important to him as aggregate valuation.

To the multinational, the target of their acquisition may have accessory values, such as a significant competitive advantage, accumulated know-how, a "strategic brand", a pool of low-cost employees or simply new economies of scale. None of these values are directly reflected in a pure financial analysis. But they may well drive the purchase price.

4. DIVERGING AGENDAS

Similar to the varying perspectives on business valuation, the key decision-makers within the multinational and the private business may have different agendas and motivations for getting the deal done.

The family patriarch is concerned about his legacy, an equitable distribution of family wealth amongst his children and proper treatment of long-standing loyal employees.

Legacy concerns may lead the owner-entrepreneur to make a less than fulsome disclosure during the due diligence process, solely for reasons of pride. The family may also be distracted throughout by the sense of emotional loss associated with the sale, together with a preoccupation with "what dad will do afterwards".

These concerns are worlds away from typical multinational agendas: year-end bonuses paid for deal completion, the fight for internal capital, or good old-fashioned empire-building. The private business owner will also often be bewildered by the incredible attention paid to tax structures. Tax treatment among sophisticated players can become an end unto itself.

5. RELATIONSHIPS WITH STAKEHOLDERS

A transaction with a multinational will provide an education to the family business owners on the value of "transactionalizing" its business assets. Handshake deals and personal relationships need to be replaced with formal commercial supply agreements. Customer goodwill becomes "warranty claim management". Intellectual property needs to be categorized and protected, with appropriate international filings. The family name suddenly becomes a tradable commodity. Longstanding "immaterial" title defects need to be identified and rectified, through seemingly arcane agreements with neighbouring property owners.

Good fences make good neighbors. Clarity and hard-headedness in the rules and in relationships also makes for a business enterprise which is easier to transfer. The private business owner needs to understand that with its deep pockets, a multinational seldom is given the "benefit of the doubt". The caring, solutions-oriented employees from the private, small scale business may find that when they are working for a multinational, their same actions and gestures towards the company's stakeholders are set in a different context. Suddenly, the fact of these employees' simply "taking care" of a long-standing supplier may make the multinational the subject of a negligent misrepresentation lawsuit, after the supplier went out of business, in part through having unwisely relied on these expressions of support and commitment.

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6. Employee Relations

One set of key stakeholders of the private business - its employees – quickly come to be viewed in a new light as part of a transaction with a multinational. Whereas previously remuneration may have been a function of family favour or long term loyalty, suddenly rigorous compensation systems and scientifically determined severance packages are the order of the day.

In order to close the transaction, the private business owner will normally be required to obtain specific professional advice in respect of previously never-contemplated concepts such as the transfer of underfunded pension plans, or the integration of benefits regimes.

7. Where's Waldo?

An important part of the multinational's due diligence will be tracking down key individuals among the informal structures of the private business. Who in fact has the business know-how? Is there a member of the family who owns important assets, knowledge or relationships, as distinct from the business the multinational is buying? How does one impose a non-compete on a family member who is not receiving any part of the purchase price?

8. Budgeting for Transaction Costs

As mentioned above, experienced professional advice in a mergers and acquisitions transaction has a high positive financial impact on the purchase price and on the results of the transaction for the seller. It can also be very expensive. The pricing of the advice of these advisors is largely based on the "one-off" nature of the relationship.

To the extent that regulatory filings are part of the transaction, additional, significant governmental fees may be required to be paid or shared by the seller. All of these expenses are normally incurred **prior** to the cashing of the purchase price cheque**.** They also remain due even if the transaction does not close, leading sometimes to perverse incentives to finalize the transaction quickly.

9. What's Driving the Timing of the Closing Date?

It is essential for any negotiator to understand who has time on their side. The variables driving the urgency of ultimately closing a transaction vary greatly, and are often counter-intuitive. The multinational representatives may wish to delay announcement of the transaction artificially for a few weeks, solely to have it fall within an appropriate quarterly reporting period. Or a multinational business development management representative may want to accelerate the completion of a deal, before she changes jobs within the company or before the CEO retires.

On the other hand, the private business owner may be more concerned about completing the sale before an important family wedding. The seasonality of working capital fluctuations may come into play. Finally, upcoming trade shows may force the timing of the Closing, where the private business owners worry about having to face their industry peers without spilling the beans.

10. Post-Closing Leverage

The experienced transactional negotiator will know that the solemn promises made in Purchase Agreements are often difficult to enforce in practical terms after the deal has been done and the purchase price funds have been transferred. Multinationals are loath to sue individuals personally.

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The same may be said for covenants given by individuals representing the multinational. How is one to enforce the handshake promise given by the senior executive of the multinational to “take care of” a trusted family employee, when that executive has since moved on to another posting?

A skillful use of holdbacks, escrow funds and occasionally letters of credit will lead to more meaningful and effective post-payment recourses, or at least a leveling of the playing field in this regard. The experienced advisor will ensure that the parties understand, **on the front end**, the impact of every last indemnity clause, as well as the limits to the scope of every representation and warranty. These conditional liabilities tend to be skipped over during the heat of the negotiations on financial terms. Both sides however need to fully understand their repercussions and adapt their behaviour and disclosure accordingly, before the Closing.

The private business owner will want to treasure in peace the sale proceeds received in exchange for giving up the prized family business. Dealing with an unexpected post-Closing indemnity claim, whether justifiable or not, can very quickly ruin the pleasure and satisfaction associated with “cashing out” on a lifetime investment of effort and dedication to a family business.

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