Use Proper Caution with Management Buyouts

By Gary Papay, CBI, M&AMI

For a business owner approaching retirement age, a buyout by the core management team in certainly an option. But with any business sale it's important to proceed with caution.

Selling the business that you've poured your heart and soul into for many years to managers you've work with side-by side can be very rewarding. If the sale is set up properly, it gives them a chance to own their own business. It also helps protect your legacy since these are people who believe in your vision and understand the company culture.

But if the sale is not structured properly, a management buyout can be extremely detrimental. A company's strong, positive culture can quickly turn negative with a rift between the owner and management team.

Consider a business owner looking ahead and planning to retire in about five years. The owner brings his key managers together and encourages them to start thinking about buying the company.

But when those five years have passed, some situations may have changed.

What if the business is doing so well and the owner is enjoying the success so much that he or she just can't leave as planned? What if the economy has turned and the value of the business will no longer support the owner's plans for retirement? What if the owner has gone through a divorce or another life change that will have an impact on his or her decision to sell the business?

What will be the reaction from the management team when the owner makes it known that he or she is no longer interested in selling? No doubt the reaction would be negative. You're likely to see some managers moving elsewhere, affecting operations and hurting business value.

Timing is not the only potential hurdle. Confidentiality is always an issue. A leak of the news that your business is up for sale can create issues with customers, vendors and other employees.

The sale price of the business can also be a difficult issue with a management buyout. An owner, most likely, will be looking to get fair market value. But the management team may actually expect a discount because they believe they've helped to build the company.

Then there's the financing of the deal. A business owner may find that the management team doesn't have the cash to fund the acquisition. Fortunately, lenders generally offer favorable terms for management buyouts. Lending institutions understand that the managers know their business and have already proven that they have what it takes to be successful.

The alternatives are seller financing (more opportunity for bad feelings) or partnering with a private equity group or an angel investment group.

No matter the approach, a business sale to employees can be a sensitive process that requires the assistance of the right business professionals (attorneys, business intermediaries and accountants) as well as careful timing and a reasoned approach.

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