

Mergers & Acquisitions in Today's IT Services Market **- A View through the Looking Glass -**

Recently, I was sitting in a meeting with a client, his attorney and a prospective buyer for his IT service business. The meeting had gone well; the two parties seemed to have strong synergies from many points of view. Strategically speaking, my client's firm appeared to be a perfect fit with the buyer's desired acquisition profile.

The meeting had just adjourned and the door to the conference room had just closed when all of sudden, from the back of the room, I heard my client's attorney rise to his feet and exclaim, "well, we seem to have the upper hand here, so let's see what they come back with and I'll be sure to dot the "i's" and cross the "t's" should they send in a proposal or letter of intent."

"Furthermore", shouted my client's attorney, "while this prospective deal appears very viable, we need to see several more prospective buyers, we want a variety of offers to see just how much we can get for this business."

Looking over at my client, I noticed he was delighted that his attorney was "taking charge." It appeared to be just what he wanted: someone to take charge of perhaps the most important financial transaction in my client's life. However, this scenario caused me a degree of alarm.

Having been through a number of merger and acquisition meetings and negotiations in my career has allowed me to see many things, the most prominent and interesting aspect is the behavior of both buyers and sellers during the M&A process: from preparation, to negotiation and finally through deal closure. And while I could write a book on the behavior of buyers during this process, here I would like to focus on the behavior of sellers. For it is they who I believe could benefit most from the one ingredient, the one piece of knowledge I have come to respect through my cumulative years of experience that could make this time a more enjoyable, challenging and rewarding experience for them.

So what's this all-encompassing, all-powerful, enlightening piece of knowledge?
Let's call it *perspective*.

Mr. Webster defines perspective as "the mental view of the relative importance of things"; he further describes it as "viewpoint, standpoint, mindset, and a frame of reference". A versatile word, he goes on to use the phrase "attitude" in describing it.

I vividly recall the first experience my sister had purchasing a home during the early 80's. At the second open house she attended, she was ready to commit to a deposit. "Sorry", said the broker, "the house was just taken off the market". How could this be, she wondered in utter amazement? She had just walked in the door, and there wasn't another soul in sight? What's going on? What had she missed?

THE MARKET

My first rule on perspective: know the type of market you are in.

Buying and selling real estate can be very similar in many ways to buying and selling a business. There are external market forces and conditions that will influence and affect the value, process, and outcome of a purchase or sale. In my real estate example, my sister had no idea that she was attempting to purchase a home in a "sellers" market. That is, the demand for homes in her geographic area was at a record high, and was further exacerbated by a shortage of homes for sale within that market. Basic economics says short supply and high demand translate into higher prices and a very short cycle time for a home to sell. Buyers were lining up and even entering bidding wars to buy homes during this time. Homes were selling above the listed price. Very similar to the M&A market in the IT Services and Staffing industries back in the mid to late 90's.

Conversely, today's M&A market in the IT Services Industry, whether a consulting practice or an IT staffing business, is experiencing slower activity and growth than in years past. It is very much a "buyer's market". This means that there is a good supply of IT service businesses for sale on the market today, and that while there are active buyers in this market, there are fewer buyers than we have seen over the past several years. Buyers today have the luxury of waiting to find the ideal fit and the right deal. These buyers are very selective and have set demanding criteria for synergy and value.

THE ROLE OF ADVISORS

The reliance my client put on the ability and knowledge of his attorney and CPA leads me to my next rule on perspective: know the skills, strengths and limitations of your advisors and how, when and where to use them.

This rule requires that as a prospective seller, you must be prepared to take an active, not a passive role in the sale of your business. I recall some years back during the final phases of a deal closing, in a room full of attorneys and accountants, the seller of an IT service business was conferring with his attorney over some of the language contained in the Purchase and Sale agreement. The seller was advised not to agree to certain inconsequential parts of the P&S agreement. The result was disastrous. The buyer thought the likelihood of completing a transaction successfully was so low he canceled the deal.

As a seller, you must be ready, willing and able to make the final call on key elements of the deal. This means you must be willing to trust your judgment after conferring with your advisors, even if it means disagreeing with your key advisors at times. This relates

to my earlier point of a seller needing to take a pro-active role in the selling of their business. You probably want to use the advice of your attorneys for legal matters, your CPA for financial matters and your M&A advisor for the business and transaction matters. You will need to weigh the pros and cons of the deal and decide whether to assume some risks. Remember that your advisors, in particular attorneys and CPA's, are conservative and risk-adverse by nature, which means that by and large they will avoid risk like the plague. If a seller waits until the lawyers and accountants are comfortable with the risk level in any deal, very few deals would ever get done.

TAKING RISKS

This brings me to my next rule on perspective: be prepared to share some risk.

No business deal is ever totally free of risk. While the degree of risk will vary, the very nature of business dealings contains elements of risk. It is always surprising to me that after many years of taking risks in building and running a business, an entrepreneur is unwilling to take even slight risks when it comes to selling his business. I am referring to risks such as believing that the business you are selling will continue to prosper, or believing that the buyer will do everything in their power to ensure the continued prosperity of the acquired business. Why would any buyer want to hurt a business they just paid good money to acquire? Many sellers worry most about future earn out payments. Most prudent buyers want the seller to have some "skin in the game" - that is, to share some risk along with the buyer's risk of acquiring the business.

The more uncertain the economic outlook, the more the buyer will want to share the risk. What message does it send to the buyer about your confidence in the business's future growth potential if you're uncomfortable sharing the risk going forward? You know your business much better than the buyer does, would you feel comfortable if the tables were turned. A seller and a buyer must be willing to take a leap of faith when selling or buying a business. There will be risks in any deal you can only work to minimize and control the level of risk you cannot completely eliminate it.

WILLINGNESS TO PULL THE TRIGGER

My final rule on perspective: you must be ready, willing and able to move on a deal that meets your expectations.

Every seller should have a benchmark of what you will "accept financially" for your business. What is your bottom line? So if an acceptable prospective buyer comes along in this "buyers market" and presents a proposal that basically meets or exceeds your expectations for overall value and payment structure, why wait? It is here that the seller should very carefully weigh the opinions of any professional who is advising the seller to "wait for better offers". Waiting for other offers in today's M&A environment could spell disaster. This may be the best offer you will see for quite a while or ever. Sellers often tell us they wished they had taken an earlier offer, especially when the buyers are in control of the market.

M & A today in the IT Services Industry is one that requires you as a seller to:

1. Raise your level of awareness as to the type of market you are in along with the dynamics and implications contained therein
2. Take a pro-active role by participating in the entire M&A process and by knowing when and how to use the advice of your advisors
3. Be willing to take some risks, and
4. Be willing to act decisively when the right deal comes along.

By maintaining a clear informed perspective you should find selling your IT service business in today's M&A environment a more challenging and financially rewarding experience. Finally, one last piece of invaluable advice: get yourself an experienced M&A advisor. You'll find that by doing so that you will be well on your way to gaining a clear and experienced perspective.

We would like the opportunity to represent you if appropriate; however the important issue for you is to have an M & A advisor, someone you can trust that meets your needs.

Remember to hold on to your perspective it may be your best ally.