

# MODERN DISTRIBUTION MANAGEMENT

The Newsletter for the  
Wholesale Distribution Channel

## What Sellers Should Expect

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### How to make the best deal work, part 1

*For any distributor considering the sale of the business, this two-part article provides a wealth of information and perspective on how to evaluate and manage the many variables to achieve the best outcome. It provides detailed tips based on extensive interviews and experience on types of buyers, key considerations for sellers, expectations vs. reality, confidentiality, curb appeal and closing the deal.*

Part 2 of this article is [here](#).

*This article is an edited excerpt from the book, The Acquisitive Distributor, published by NAW-DREF. For more information, go to <http://www.nawpubs.org/>.*

Some acquirers buy companies all the time. They have experienced people, an established process they use to handle transactions, and a seasoned group of advisors to assist them with the details. The buyer's acquisition team may be working on numerous deals, in various stages, at the same time. The chances of the buyer's acquisition staff getting emotionally involved in a transaction are pretty low.

Most prospective sellers are engaged in a once-in-a-lifetime event. They have not been involved in the sale of a large business before and will probably not do so again. The seller does not have an experienced staff, a process to follow or a team of advisors whom he knows well from prior deals. The prospective seller has no other deals in the works, and may not be in touch with any other prospective buyers for his company. The chance of the prospective seller's getting emotionally involved in the transaction is 100%.

The prospective seller may be a lone wolf. The seller may not be able/willing to confide in key staff due to fear of word leaking out. Even the seller's financial officer may be left out of early discussions.

### Buyer's Vantage Point

The prospective seller needs to understand the basics of the acquisition process from the buyer's viewpoint. To start with, the seller must recognize different types of buyers and their varying objectives.

### Different Buyer Types

Who are the buyers? They can be categorized as follows:

- Investment groups: It's just another investment in their portfolio.
- Manufacturers and retailers: don't understand the dynamics of distribution; buying an outlet for their products (manufacturers) or a low-cost supplier (retailers).
- Distributors from other lines of trade: may not recognize the differences from one type of distributor to another.
- Individuals: including cashed-out entrepreneurs and retired executives from big companies; both feel they are business experts who can run anything.
- Rollups and other industry consolidators: could be an investment firm or another distributor; they almost always know a great deal more about finance than about running a customer-focused business.
- Competing distributors: have the distinct advantage of understanding your business and being able to see both the existing value and the potential.

### **Typical Buyer Mistakes**

Most of these buyer types don't understand distribution and some don't even know what to look for. The distribution business is based more on intangibles than most other businesses. The value of customer relationships and the importance of key salespeople are not well understood. Much of the value of distributors is simply invisible, especially when compared to retail stores, manufacturing equipment, etc. The nature of business-to-business customer relationships is harder to understand and quantify than business-to-consumer or manufacturer-distributor relationships.

A distributor is a special kind of vendor. The barriers of entry and exit are low and it is very easy for customers to change suppliers. If the acquirer does not understand the added value of distributors, especially the fragile nature of relationships, the customer who has many alternatives can easily go elsewhere.

The distributor is also wedded to his information systems platform. Large acquirers, especially those with highly developed MIS expertise, expect to integrate their acquisitions onto a powerful, company-wide enterprise system. In some cases they never got around to it, leaving the smaller companies on their own systems due to the cost and disruption of making changes. Some distributors concentrate their acquisition searches on targets already using the same software package as the acquiring company. Other acquirers avoid targets with antiquated systems, or those who have switched to a new system within the most recent year or two.

### **Staying in the Game**

There are two types of distributors: the buyers and the bought. If you want to continue to occupy a seat at the giant poker table of distributor owners, don't sell your business. Working for someone else is not the same as playing with your own chips. Playing your own hand is not the same as having someone watching over your shoulder, or reaching into your cards. And watching someone else play isn't really that much fun, once you have done it all yourself.

Your PeopleNo one else will treat your people exactly the way you do. They won't think so and neither will you. Things will be different – better in some ways and not as good in others. Be honest with them – the way you would hope to be treated if the show were on the other foot.

An ownership change can be a very good thing for many of the people who used to work for you. The most talented, adaptable workers may find opportunities with the new organization that you could never have given them. A capable buyer with strong financing and a commitment to invest in the business may be the best thing that ever happened to some of the employees. Many may find the change of ownership to be a non-event, seeing little difference in their daily work lives after the acquisition.

Acquisitions can mean nothing but heartache for the employees of the acquired company, depending on the industry. This is generally not true in distribution. The enlightened buyer realizes the importance of the people to the customer relationships he is paying for. Some employees, such as sales and support people who are the keepers of those important relationships, are the very reason the buyer wants the company. There is a shortage of skilled workers at all levels in distribution. Finally, distribution companies are unlike factories, where jobs may be eliminated or relocated, especially when the buyer has a facility in the same market.

### **Your Birthright**

Esau sold his birthright to Jacob, his twin, for a bowl of soup. If you consider your business to be your birthright, and you are thinking about selling it, consider the price you are willing to accept.

If your family name is on the front door, and that is important to you, you are selling the right to change that name. If you want the business to keep that name, don't sell it unless the price is worth the unhappiness. The name will be changed. Thomas Edison never forgave J.P. Morgan for changing the name of Edison's company to General Electric.

If your great-grandfather started the business, and your grandfather and your father ran it before you did, you are selling the right to have your son or daughter succeed you. If you want your family to continue to run the business, don't sell it unless the price is worth it. Your child will not be asked to run this company.

### **Selling Your Soul to the Devil**

Owner-managers are in some ways a tormented bunch. Many owners of multi-generational businesses start feeling their obligations to the next generation almost as soon as they complete paying their debts to the one that preceded them. Those owner-managers are trying to beat the third-generation jinx that predicts failure for most businesses under third-generation ownership.

Many owner-managers find themselves faced with a dilemma: What's better for the next generation – selling the business now, or keeping it with the hope that at least one member of the family will want to take it over some day? This question is called when a qualified buyer appears with a reasonably attractive offer.

Experienced buyers long for the opportunity to take a close look at the financial details of an attractive business. By placing a strong offer on the table, buyers know that the prospective seller and his advisors will engage in a sacred ritual: How much would be left after paying off liabilities, minority shareholders, taxes and deal expenses? What annual income could be expected from the proceeds? Will there be enough to maintain a certain lifestyle, to provide for the family, to make gifts to charity?

If the numbers look good, the prospective seller may start to fantasize about what life would be like, and about the advantages of being able to travel, play golf and go boating.

Once a prospective seller starts spending that money in his mind, his negotiating position may weaken dramatically. This is called selling your soul to the devil. Don't do it.

### **Lessons from *The Prince*: Expectations vs. Reality**

Poor Niccolo Machiavelli wasn't really such a bad guy; he is just misunderstood. Machiavelli was a long-time civil servant who took the trouble to write down his observations about what worked, and what didn't work, in the politics of Italy in the 16th century. He was not the person in charge, but in his role close to the boss he was able to learn the rules of the game. Some of the rules that Machiavelli authored pertain to the business of acquiring a company. One of those rules was this:

*When taking over a principality you only have to do two things: Kill the previous prince and his whole family and do not change current laws and taxes.*

Most successful acquirers may not be able to quote from *The Prince*, but many of Machiavelli's rules are second nature to them. Sellers take note.

Poor George Westinghouse. He ran his companies for progress, for his people, and for profits. Thinking the founder to be a poor manager, the moneymen finally gained control of Westinghouse Electric and ran it strictly for profit. Westinghouse lived until 1914 but never got over the changes made after he was pushed out.

If you sell your company with the expectation that you will continue to work there for a long time, in a role similar to the one you are accustomed to, you are not being realistic. No matter what was said during the negotiations, you are being unrealistic. You may beat the odds, but the chances of this happening are about the same as winning the lottery. If you're feeling that lucky, maybe you should buy a lottery ticket.

### **Advisors**

Ironically, the owner-manager may be supremely confident (overconfident) about his ability to negotiate the sale transaction without outside help. An executive who has piloted his business successfully for years – avoiding the shoals, dealing skillfully with customers, suppliers, employees, lenders, and politicians – feels supremely confident. Such a leader may not anticipate too much of a challenge when faced with financial types who don't really understand the business.

Tragically, the owner with a long history of having vanquished the competition may stumble when working on the biggest sale of his life. A distribution owner-manager in upstate New York was known for his skill in assembling his large business through shrewd acquisitions. Ironically, he was a victim of selling his company to one of the failed industry rollups described in an earlier chapter.

### **Stalking Horse**

Buyers like to work on acquisitions where the seller is not negotiating with anyone else. A primary reason is that buyers are usually able to pay a smaller premium when they aren't forced to compete with another suitor.

Just because the seller prefers not having another suitor does not automatically mean that you're better off playing one buyer off another. An auction may not be in your best interests, depending on the circumstances.

In general, I think sellers should have at least two qualified buyers lined up. Competition does tend to bring better offers.

Here are some of the possible negatives:

- The auction may scare some good buyers away. They don't want to invest the time and money on a transaction with a low likelihood of success.
- The auction process forces you to open your books to several prospective buyers, some of whom may just be fishing for information, which can be used against you in the marketplace.
- The process may make you feel forced to sell the business to someone, even if the offers are disappointing. The company may be seen as shopworn if you ultimately decide not to sell.

### **Confidentiality**

The larger the buyer's organization, the sooner word of the deal will leak out. It's almost impossible to keep secrets in big companies due to the anonymity factor: leaks can't be traced when so many people are in on the secret. The lethal grapevine of security leaks in distribution is through the network of suppliers. Many acquirers canvass supplier personnel as part of their deal planning and, later, due diligence. The acquirer wants background information about the pros and cons of buying various competing distributors. They want to know if the suppliers will support the change in ownership. Supplier employees, especially sales people, tend to confide in the salespeople and buyers at their distributors. Despite the usual pledges of confidentiality, and sincere efforts to comply, the "need to know" network in most acquirers is too large to prevent such leaks.

It's far better for the prospective seller's people to hear about what's going on from the seller himself. Most employees are sophisticated and alert enough to understand the owner's position and appreciate the respect shown to them by their leader. The owner-manager then has the opportunity to preempt the rumor mill and provide his side of the story. If the "secret" deal becomes widely known and then falls through, the prospective seller has breached the trust of his people and endangered morale.

Buyers well know the sensitivity of the confidentiality issue, and some try to use the seller's fear against him. Many buyers have renegotiated the pending deal with the owner, knowing that he worries about holding the company together should the deal fall through.

*Part 2 of this article is [here](#).*

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