

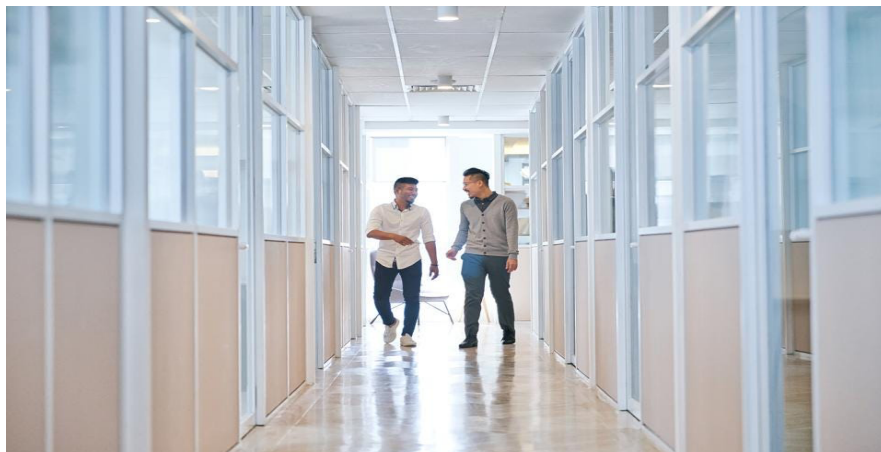
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Selling Your Company Effectively: Buyer ‘Bait And Switch’ Strategies And Seller Strategies



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Selling a company is often one of life’s most memorable moments. Unfortunately, the myriad challenges leading up to the moment is often not discussed. Through a series of common mistakes, sellers are usually placed at a distinct disadvantage in the mergers and acquisitions (M&A) process.

The process of selling a company involves nuances that are equally balanced in “science and art.” In many cases, buyers are well-intentioned and operate within industry norms. However, where money is involved, “bad actors” will be lurking nearby. If you are on the sell-side of the transaction, you must be prepared to engage in the “M&A tango” of weeding out fact from fiction and the buyers from the scammers.

Five Buyer ‘Bait and Switch’ Strategies

A “bait and switch” occurs when a potential buyer creates an appealing but ingenuine offer to acquire a company (the target company). This initial offer, “the bait,” is used to entice a seller into a contractual agreement. “The switch” occurs when the letter of intent (LOI) is superseded by a definitive purchase agreement that is fundamentally less

favorable to the seller. So why would buyers tactically engage in this type of activity? A few reasons and strategies are behind the desire to use this.

- **Ascertain intellectual property:** In this case, the goal is to uncover and “workaround” trade secrets, design rights, and other proprietary matters.
- **Uncover the target company’s solubility:** The primary intention is to extrapolate a company’s financial data for its benefit. Confidentiality agreements are imperative but do not adequately protect against “information leakage” and correlating reputational risk to the target company.
- **Broker a transaction:** Many proposed seek only to “tie down” a deal. Once the M&A transaction is contractually secure, they seek potential buyers to retrade the deal to. Absent disclosure, the engagement falls into the “bait and switch” column since the buyer can rarely solidify its capital partners’ or end buyers’ terms and conditions.
- **Achieve a post-close discount through earnouts:** Some buyers acquire target companies at a discount by structuring contingent additional post-closing payments to sellers, known as earnouts, that are fraught with potential traps for novice sellers.
- **Acquire at a discount:** This may be one of the most ruthless drivers of pursuit. In this scenario, buyers engage sellers under acceptable terms, only to apply multiple discount methods to devalue the target company.

Five Seller Strategies To Defend Against ‘Bait and Switch’

Imagine a seller having several viable LOIs to purchase their company in hand, only to choose the one that leads to a reduced purchase price, a dead end or litigation. It takes a culmination of years of tireless work to bring a company to market. Sellers must exercise power and discretion to avoid common M&A pitfalls. Here are five general strategies that sellers should consider.

- **Establish the basis for the company’s valuation:** One of the sellers’ most uncomfortable yet essential actions is establishing a firm corporate valuation. Quantifying the sum value of their efforts is difficult for most owners. Feelings aside, selling prices must be based on market comparables, future values, asset valuations and other material conditions. Potential suitors will almost always contest a target company’s go-to-market valuation. However, solidifying a pre-offering professional valuation gives sellers a baseline for future negotiations.
- **Initial self-diligence of the target company:** Most M&A transactions fall apart because of the buyer’s due diligence. Before going to market, sellers should consider hiring a well-established firm to perform a Quality of Earnings report on their company. Legitimate buyers will appreciate the credibility associated with the report. Buyers with ill intent will experience a diluted argument in devaluing the company. Additionally, the report creates an opportunity for the seller to make operational improvements and determine the appropriate time to bring the target company to market.

- **Establish your possible exit options:** Business fatigue, a need to recapitalize or a desire to pursue other opportunities are just a few factors sellers consider exiting their business. When sellers understand their “why,” they are best positioned to assess potential go-to-market offerings and acceptable alternatives. Structured business exit strategies address matters such as how long seller exit will take, what happens when they leave and if they will recognize earnings post-close. Frequently, this area becomes an afterthought. As such, buyers tend to prevail in establishing post-closing contingencies.

- **Conduct buyer due diligence:** Before accepting the LOI, sellers must have an understanding of their buyer’s profile. The LOI is only as good as the parties entering into the agreement. Therefore, sellers should leverage their network to learn about their buyers. Sellers are often uncomfortable with the perceived intrusive nature of conducting buyer due diligence. However, they must keep in mind that the buyer will be conducting due diligence on them and their company for the coming months. A few areas of consideration include determining the buyer’s source of capital, M&A transaction history, the reason for purchasing, references, etc.

- **Stage the due diligence process:** Sellers hold the power before the execution of the LOI. Their power quickly declines once the LOI is signed. Therefore, before signing an LOI, sellers should safely reveal as much information to the buyer as possible. Sell-side advisors often provide buyers with redacted material information to avoid disclosing the target company. This allows for the least number of variances post-LOI execution. In addition, the LOI should limit the due diligence window, address the seller’s desired exit options and require buyer warranties regarding their intentions and ability to close.

The M&A Tango

The psychological warfare associated with standard M&A activity is almost certain to zap the optimism out of the most ambitious sellers. The impacts are compounded when sellers operate from the deficit of self-defending the intrinsic value of their company. There are no “tamper-proof” M&A transactions. But there are “tamper-resistant” M&A transactions. It’s been said that “teamwork makes the dream work.” Sellers must build a team of trusted CPAs, transactions advisors, industry experts and other financial professionals to overcome M&A traps and achieve maximum success.

As the world deeper into the fourth economic revolution, business success will largely hinge on a company's ability to produce ground-breaking innovation that caps rising competition. Companies must include a strategic financial partner who understands the IP financing landscape. Properly structured IP financing can fuel a company's long-term strategic growth and guard its competitive advantage.

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