

Management Buyout and Leadership Succession at Easter

Management buyout (MBO) and leadership succession transactions are options for owners that seek to exit. Lets look at what this genre of transactions actually are. They have common characteristics of true shift in leadership of the business. Ownership also transitions. Leadership and ownership may transition at different speeds. A transition of leadership will occur immediately. Transition of ownership may occur in stages.

The terms MBO and leadership succession are actually interchangeable. A transition of business ownership and leadership is to either an internal party or group (MBO) or a person recruited from outside the business (leadership succession).

MBO and leadership succession transactions have become common. An owner wants to exit but has such deep connections in the business that outright sale for value is not possible, or perhaps not even desired. A skilled business manager / leader wishes to take a step into ownership, acquired in tranches by staged purchase or options. The structure possibilities are incredibly wide.

I want to point out four common aspects of these transactions:

First, do not rush.

They take time as they involve a transaction neither party will be familiar with. I have not been involved on one that has spanned less than three months, and between three and nine months is the bell curve. They are personal in a way that outright acquisitions are not. We humans, much as economic dogma would assert we act in a utilitarian manner, are driven primarily by engagement, making a difference and being involved in what is meaningful.

Second, do not get stuck on a valuation number.

Valuation is simply that, valuation. A single number that stands like a light seeking to be truth. It is very helpful to get a common focus on what drives a valuation. First is the forecast earnings before interest tax and depreciation (EBITDA), which is the measure of earnings quantum. Second there is the multiplier which is the measure of earnings quality (or measure of certainty that earnings will be repeated in the future, or risk that earnings will not be repeated). Vendors often get a valuation that assumes perfect transition, purchasers see transition risk in large letters. MBO / succession transactions are more collaborative than positional. A

valuation is essential yes. However it is the negotiation that occurs around each parties view of what drives each of earnings quantum and earnings quality that creates the transaction.

Third, understand that two transitions occur at settlement.

Where there is a staged acquisition of shares the Vendor will exit business leadership and step into governance, which will almost certainly be unfamiliar country. The Purchaser will step into ownership and leadership, the latter familiar, the former not.

Fourth, understand mutual commitment.

An MBO is not an owner taking the step to "appoint a General Manager" because they "want to step back" and in the employment arrangements "equity might be available in the future". Such an arrangement is not an MBO or leadership succession transaction. The owner is remaining the leader of the GM. The GM has no committed pathway to equity.

Now, two completely different subjects.

First why Easter?

It is not simply a four day weekend with Easter eggs and hot cross buns. Good Friday invited us into the great paradox of the Christian faith – death is the path that leads to life. The cross was originally a universal symbol of shame to dehumanise anyone hanging from its beams. Christ however takes that symbol, disregards its shame and restores humanity to its true glory. Hence walking the way of the cross is not for the faint of heart.

Second, a commonly used word is **unprecedented**.

A dramatic word. Housing, debt, education, law and order, environment, covid, the list of reported unprecedentedness goes on. Have you ever wondered what unprecedented means? Now is your chance. Well unprecedented is an adjective. That means it has no precedent. Scanning a few dictionary definitions. Has not happened before. Without previous instance. Never before known or experienced. Unexampled. Unparalleled. Is not previously known. For those who enjoy unpicking meaning now go check out known versus knowing and then reflect again on unprecedented.

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