Exit strategy

How to negotiate a put and call agreement when selling your business **Interviewed by Sue Ostrowski**

When selling your business, you may be thinking about scoring a quick payout and retiring.

But many buyers today want the person who built the business to continue to play a key role after the sale, and, as a result, leave you with a stake in the company. If the arrangement works, everyone benefits. But many times, sellers have difficulty adjusting to a new role where they no longer are in charge.

If you've negotiated the deal correctly, you can exit the deal with relatively little pain. But if you haven't, it may cost you, says Bill Finkelstein, an attorney in Dykema Gossett PLLC's Corporate Finance Practice Group.

"In today's market, the buyer, often financial as opposed to strategic, is frequently not looking to buy the entire company," Finkelstein says. "The buyer wants the investment, and control of the company, but it wants to keep the management team in place for its expertise, knowledge of the market, reputation and key relationships, and it wants to incentivize management to grow the business."

Smart Business spoke with Finkelstein about how a put and call agreement can offer options to a seller.

How are buyers approaching the market today?

Traditionally, the buyer buys 100 percent of the company and puts the former owner under a management contract. However, after 'cashing in' the former owner may exhibit less drive and interest in running the company.

Today, it's not unusual for smart investors — or strategic buyers who are in different markets — to want to retain and incentivize the management that got the company to where it is, and partner with them going forward. As a result, they buy a majority interest, but the former owner is still invested.

This is a smart play for the acquirer, but it makes the transaction more complicated. As the seller, you have concerns. Selling to a larger corporation gives you better access to capital markets, and funding sources should be better and less costly, allowing you to improve operations and grow your business. However, are you really going to be in control, or is corporate headquarters going to be pulling the strings?

It's a difficult situation because the buyer is coming to the table with a lot money. The buyer is in control and ultimately will have the final say on major matters such as expansion, capital improvements, etc.

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How can the seller plan for an appropriate exit strategy?

Oftentimes the solution is a buy/sell agreement, which might not be that attractive to the seller. Under a typical buy/sell, one party notifies the other that he or she will buy the other's shares for a set amount, or under a formula or valuation process. The other side may elect to sell or, if the price is too low, buy. Frequently, the price is payable in cash, and as a seller, you don't want to exercise the buy/sell agreement with the possibility you might be required to buy back your company.

The seller is often at an economic disadvantage. A buy/sell agreement is not going to scare a buyer that is a global company. It can say, 'Fine, I'll buy you out,' and trigger a discounted price, knowing the seller took the money from the sale and used it. You worked your whole life to build a company turn it into cash and now you must sell your shares at a lower price or buy the company back.

What is the alternative?

From the seller's perspective, you should try to negotiate an option, called a put and call, for the seller to require the other side to purchase your remaining shares, either all at once or staged out, or for the buyer to exercise the right to buy the remaining shares from the seller.

The put gives the seller an out if the situation becomes, 'I tried, but I don't like headquarters telling me what to do. We just don't see eye-to-eye, so let's part company.' Moreover, the buyer can buy the rest of the seller's shares if it wants total ownership later. An additional advantage is that a buyer who wants to retain management may think twice before vetoing management's plans knowing you may exercise the put if disagreements or differences reach a certain level.

This is a very good tool if you can negotiate it. In order to ensure some degree of management stability or to allow the buyer to plan for the capital needed to buy the remainder of the shares, you may not be able to trigger the option for a reasonable period. A period of three to five years, beginning on the third anniversary of the sale, is not uncommon.

How do you determine the price of the put?

If you sell a majority interest in your company at a multiple of earnings or cash flow, you can say you want a put and called priced at the original sales price formula.

But if, at the time of the put, the company is more profitable, you don't want to sell at today's price, so you can negotiate the put and call price at the greater of today's price or the same formula applied to the then trailing 12 months before the sale. Therefore, if the company is more profitable, the price of the buyout increases; this is fair because you could argue the additional value is due in large part to your efforts.

This formula also provides a guaranteed floor. You don't want the put price to be lower than the original sales price because of the financial risk of a downturn in the economy or industry, or bad decisions by your new owner.

Having that exit strategy is crucial to ensure the reason you sold in the first place — to get liquidity — doesn't vanish. <<

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