MANAGEMENT BUY-OUTS

A Management Buy-Out (MBO) can be the first choice for many sellers seeking an exit as it is assumed to be not only quicker but also honourable and fair. After all the sellers have employed the senior management team for years and now it is their turn to take over the reins. On paper, the idea looks excellent. A highly leveraged (financed) buy-out from known parties, who understand the value of the business, creating an instant sale. The financiers offset the risk of high borrowings, by knowing that there is an experienced management team, which is familiar with the business. The sellers received the proceeds and the buyers get the chance to do better than their old boss. Thus the MBO in theory is a win-win for all, but there are many significant disadvantages.

Usually, the buy-out management team is less cash-rich than their trade buyer might be. They have historically been employees, rather than employers and are therefore unlikely to be risk-takers by nature. In addition, as soon as an MBO team believe they can buy the business, the dynamics of the employer-employee relationship changes, and the parties have very different agendas.

An MBO team will ideally obtain an exclusivity clause on agreeing terms, subject to contract. This gives the team a set time frame to complete, while keeping all negotiation away from any other potential interested parties. This move however means that the sellers are now restricted from exploring trade buyers, which is a major draw-back, as such buyers are normally willing to value and pay more for a business. This is because they can obtain economies of scale, remove a competitor, and be able to finance the deal more readily using their own venture as security.

An MBO funding is likely to come from a combination of external sources as well as a realistic contribution for the MBO team themselves. External funders like to see a contribution that reflects “meaningful pain” should the future business fail. But this commitment is often too much for MBO candidates. Frequently they do not have the necessary funds, or the collateral to raise them. The shock and risk of the sums involved can be too high.

A failed MBO attempt can result in a very disgruntled senior management team. But would another interested party want to inherit such a team? Or have the sellers now effectively rendered the business unsaleable? For these reasons, many sellers explore a trade-sale first and only if that fails, they try and generate a satisfactory deal by exploring an MBO.