



Punk Rock and The Sale of Your e-Business

January 2007

By Stanley P. Jaskiewicz

Should You Stay or Should You Go? It's Not Always An Easy Decision.

"Should I stay or should I go?"

That was the question that those classic '80s punk rockers The Clash asked in a song by the same title about a romance gone awry.

That's just a song, though.

But, interestingly enough, that hard-driving ditty is applicable to the world of e-business: The entrepreneur contemplating the future of his or her business — a love built of the same good times and bad, and with the same blood, sweat and tears as a real-life romance — confronts the same dilemma when it's time to make that decision: Should he stay or should he go?

How could a person not expect such perseveration? When an entrepreneur reads about the rapid rise of YouTube (www.YouTube.com) from startup to \$1.65 billion buyout, he or she can easily forget about the many new firms that fail, and instead imagine being the personification of — or fantasize about — having a company that becomes the next tech-economy icon. As Microsoft CFO Chris Liddell commented on how Google made YouTube's founders wealthy, and talking about YouTube and free Internet phone-calling software outfit Skype: "It's never been easier to create high-value companies at any time in history." (See, www.nbr.co.nz/home/column_article.asp?id=16869&cid=3&cname=Technologys.)

It Takes Guts To Succeed

But the assent to business bliss may not be so easy.

"One day is fine, next is black\ ... If I go there will be trouble\And if I stay it will be double."

More words of dilemma from The Clash. In business, you need fortitude to ride the crests and dips of a business cycle, and that's all the more true in the volatile technology sector. You've heard the story, maybe lived it: The initial excitement of getting a new firm online inevitably turns into the routine of doing all the little things that help a business succeed — or learning the lesson of failure if the otherwise enthusiastic entrepreneur does not do those “little things.”

Because employees are rarely as committed to the company as the founder, he or she frequently must “stay,” literally, for long hours, and may see that slavish devotion as the only way to avoid the “trouble” of turning operations over to those whose time horizon doesn't go past 5 p.m. — and then only on weekdays. Sometimes, in fact, a change of control is what's needed to move to the next step. Steve Jobs, for instance, has certainly revived Apple on his rebound by using skills gained in his other successful ventures while away from the computer-maker.

Yet, if as a result of these struggles even the firm's founder is not enthusiastic about her creation, that trouble may well double, as the song warns. A business without motivated leaders will surely drift and be easy prey for the next aggressive startup. Certainly, it would be much less valuable to a buyer. Eager managers who can grow the firm, for instance, won't want to cast their lot with a company whose leadership has already conceded defeat.

So, in a *prima facie* paradox, then, entrepreneurs building a tech company should be planning ahead for the nearly inevitable opportunity they'll face, and be thinking about selling the business — almost from its formation. Those who don't take this path might find a door of blockade instead of a window of opportunity. We're hardly in anything like the throes of the deflating Internet-investment bubble of 1999-2000, but still, when business and product cycles in technology are measured in months, no one should plan on building a company from which he or she can retire.

Time to Sell? Don't Get Personal

So, when that time comes, and a tech-firm founder is deciding whether to sell the “baby” he or she birthed or nurtured — or both — from concept to reality (or not to sell) he or she should consider business and personal concerns. Most important, though, the founder should remember that the firm is not really a baby, or a family — it is simply a business, nothing more. With that in mind, it's best to remember that a decision to sell should be reached based on economics and business reasons, and not driven by emotional attachment. Hanging onto a failing business because the enterprise was your idea (or an ancestor's) simply deprives the current family and heirs of what they could have invested in had the present-day operator sold the business when selling was possible.

Use Practical Judgment

Business calls for practical judgment — even if harsh at times — and not the affection one feels for a loved one. While we can all admire the well known firms that have stayed in the same family for generations, we don't recall the thousands of other failed firms that never made it past the first generation, or that died when their owners passed up opportunities to pass them on and let them live.

Buyers Aren't Always Ready

Also, don't presume that there will be a buyer when you're ready to sell. If you're lucky enough to get an offer, or even an expression of interest, then *carpe diem* — at least explore that interest. You may be pleasantly surprised to find that the offered price is high enough to help you decide that it's time "to go." And the owners — the founder, even — may quickly learn how much the firm needs to improve, to have any value beyond their own salary. And keep this in mind: Even if the founder feels that the time isn't right to sell, the experience of negotiating a deal can be invaluable to doing it right — and avoiding mistakes — when it really is time to go.

Look Carefully: At Price, And Offers

The sale price you won't consider today may never be available again. Business founders and owners often feel that a proposed price is too low, but the valuation method they apply to their own firm might be too rose-colored concerning the undertaking's prospects. This can be especially true if they altruistically take out less in compensation than a comparable executive in a stronger firm would so that earnings are greatly understated from the perspective of an investor that must plan for management expenses.

Market Conditions Are Critical, but Fickle

Also, market conditions could change for any business, uncontrollably — a risk that can be worse for technology firms, and companies doing their trade primarily, or to a great extent, electronically — because of the volatility and rapid changes characteristic of the entire technology sector. Consider, for example: Natural disasters can drive up interest rates, dry up credit lines and depress sales. Technological innovation, speeding by like some competitive runner out of nowhere, could turn a company's lead product into the next dial-up Internet-access service, or phone modem — has-beens. Consider how quickly many icons of the late '90s tech boom have simply faded away, even those with superior technology. Who in 1997 would have thought that today, Alta Vista, to use one example, would simply be an afterthought in search technology, or that Microsoft would face challenges on many fronts, whether from technological innovator Google, or one-time laggard Apple? Often, in e-commerce, a good idea and high-speed connection are virtually all one requires to enter a market, so no firm's market share is secure, and the shoulders of the Information Superhighway are littered with the wrecks of slow-moving corporations that stand as silent reminders of the speed at which tech-development moves.

e-Entrepreneurs might even find that what they thought was valuable about their company isn't irreplaceable. A business model that can be implemented more cheaply when bought elsewhere won't interest anyone else at a price higher than the nuisance value of creating the same business from scratch. An existing firm with industry contacts and resources may be able to steal another business' goodwill, and just might do so without paying the stakeholders of that business for that goodwill, particularly if the marauding firm re-creates what the "victim" firm has already accomplished with "off-the-rack" knowledge or resources. This will be particularly true for technology businesses that rely more on traditional business assets, such as better marketing, than on the shield of a cutting-edge patent or other irreplaceable advantage. A competitor that faces low startup costs may simply be able to begin operations in competition, unless your firm can create legal or practical barriers to the competitor's entry (such as by locking up key contracts or employees, or building hard-to-beat market

share).

Selling, and Buying: Strategies to Consider

Once you accept the concept that you should consider selling your business, you should decide what type of buyer will be most likely to pay the highest price. That's what you want, after all. Initially, a firm in your own industry may seem like a good candidate, to expand its own business, eliminate your firm as a rival or acquire technological advantages that your company might have. But that type of buyer might be willing to pay only for the value of the increase in business that you can provide, plus a bit more. And if both firms are big enough, then you might also have to consider anti-trust concerns.

Going for 'Multiples'

But investment bankers — who get paid by commissions based on sale price — like to think bigger than that. Instead, they usually prefer to find a buyer willing to pay a “multiple,” or several times, your earnings. These so-called financial, or strategic, buyers might need your firm because your revenue pattern complements their own, or provides diversification. A true strategic buyer might want to use your firm as a step toward a much bigger deal, if it can bundle several firms to take public, or may want to acquire your company simply to better prepare itself for a sale. Although you may not be able to find this type of a buyer yourself, and probably will need professional advice to structure a deal with such a firm, the rewards can far exceed the cost.

Big Decision, Big Risk

Consider, too, that although selling to a firm already in your line of business might seem the easiest and safest route, it poses the greatest risks. Here's why: While everyone should routinely sign confidentiality agreements at the start of any negotiation, some firms might craftily use such talks as competitive due diligence, with no valid intention of completing a deal. When the key assets are “soft,” as is often the case in technology firms — customer lists, marketing strategies and key employee relationships, for example — it might be very difficult for the wronged firm to prove that knowledge was stolen by a possible buyer through due diligence. Even if a firm doesn't try to evade its confidentiality obligations, people talk, face-to-face and online, and your sale talks could quickly be reported on someone's blog. So, if you talk to a competitor, consider taking extraordinary efforts to conceal the process. A client once changed his voice-mail recording three times a day to report plausible-sounding but entirely false meetings, to throw off anyone who might have suspected that he was in daily negotiations, particularly his own employees.

Play It Close to the Vest

Once those “in the business” know that you are in play, your customers and competitors will soon know it, too. No competent sales rep would ever fail to exploit a customer's uncertainty about whether its vendor will be in existence tomorrow. Your own employees shouldn't be the ones who (innocently or intentionally) “sink your ship” with loose talk about plans they might have overheard in the office, or seen in a misdirected e-mail (the modern equivalent of the sheet of paper left on the copier). Instead,

consult with your advisers about practical ways to secure your key knowledge as a precaution, even though you might have strong, legally binding confidentiality-protection agreements with the buyer. For example, consider withholding key commission rates or patent information until all cards, and documents, are dealt and spread out on the closing table. Many sellers identify clients and customers in due-diligence material only by coded numbers, rather than by name. Don't expose key employees to the potential buyer without you present, because loyalty can be very fickle (and easily swayed by promises of more money) in an industry that goes through upheavals regularly.

What Will You Do?

Another factor affecting the choice to sell or not is your personal career plans, a factor that might be overlooked in the heat of the deal. You need to ask yourself, among other things, whether you intend to stay in the industry, or whether you want to pursue something else. Would you like broader management experience in a different setting? If so, what type of setting, and what type of experience and responsibilities would you like?

A buyer who can acquire your business without bearing the cost of keeping you on the payroll beyond a brief transition might find the deal very attractive, as long as you aren't truly needed every day. From your perspective, knowing where you will land also simplifies negotiation of the standard noncompetition agreement with a buyer (which will always insist on one). It's far easier to protect your ability to go into a specific noncompetitive business that you have chosen than it is to keep many options open. A buyer might also become skittish if the seller balks over a noncompetition covenant.

Weigh, too, the details that will arise when you must negotiate your own employment agreement with the buyer — that is, if you plan to stay (and the buyer can afford you). Can your entrepreneurial spirit, for instance, tolerate a full mental and psychological commitment to operate a business that you no longer own, and to do that as a salaried employee? A buyer that knows it will have to incur the salary and benefit costs of hiring you for several years might not be prepared to spend as much on the company in the first place. In fact, if the buyer perceives more value in the company than you have been able to produce, it might prefer to replace you, to get the maximum value for its investment, and to bring in managers it trusts.

(For another perspective on this subject, see, [Should You Turn Your e-Commerce Business Over To The Head Geek? Not Necessarily — Communicate, and Educate, Instead](#), in the March 2006 edition of *e-Commerce Law & Strategy*.)

Working Out Price, Risks and Approaches

Negotiating the purchase price of a tech firm has its own special structuring concerns. While a buyer might be willing to pay substantial sums for hard assets or a long-established customer base in other sectors, tech and e-commerce firms rarely have such assets to sell. e-Commerce firms in particular usually haven't been around long enough to show a customer following — a concept that might be irrelevant when online shopping and prompt, accurate fulfillment houses let online customers switch their favorite seller over minor price differences. Instead, such firms usually can offer only prospects for growth and profit — and the purchase price will inevitably reflect such uncertainty.

(For more insight on selling, see, [The Deal Before The Deal: MOUs \[memorandums of understanding\] Can Keep You From Being Cowed](#), in the April 2005 edition of *e-Commerce Law & Strategy*.)

Consider an Earnout

In such cases, an earnout, or purchase price that is contingent on future targets (typically profitability), protects the buyer against getting a worthless business, and gives the seller an incentive. But earnouts can be complex to negotiate for bricks-and-mortar firms, and even more so for tech firms that operate primarily online. Questions to answer include whether the business (in the hands of the buyer) will have the financial and other resources to generate the profits to provide the buyer revenue. And who should bear the risk of transforming technology changes — the seller that sold to avoid those risks, or the buyer that paid real money for a business that might have declined in value rapidly? Also, the seller might not be able to affect results sufficiently to help the company make the earnout. Online firms' futures are so volatile that a seller forced to accept a purchase price composed largely of an earnout might find so little reduction in risk that he or she prefers not to sell.

Even more basically, the seller must coldly ask whether the buyer will be able to pay the earnout. A seller can at least try to control the risk of running his own business. Once his success depends on the fortunes of another, he has lost one of the perceived benefits of selling: reducing risk. At least investigate the buyer's credit history, and its assets, to avoid trading your ownership status for that of creditor. Consider what security you can obtain, too. The typical lien on the assets sold doesn't work well with the intangible assets of an e-commerce firm, so try for third-party collateral, such as a guarantee from the buyer's owner.

But remember that the greater your demands for certainty of payment, the fewer buyers that might be interested in a deal, or able to meet your criteria. Evaluating the likelihood that you will actually be paid for your tech firm can be as stressful as the decision to sell or not. Telling the buyer that you don't trust that it will pay what it has promised doesn't promote a friendly negotiation, or a long-term working relationship.

(For more information on an earnout as a tactic for selling an online business, see, [What's a Virtual Business Worth? Earnout Can Be a Way to Figure That Out](#), in the December 2004 edition of *e-Commerce Law & Strategy*.)

Be Careful of Equity Purchases

Tech-sector buyers often avoid paying cash for potential business by providing equity instead of cash. The seller weighing such an offer must decide whether the risks of her own business are less than those of the buyer's firm (unless a substantial cash down payment accompanies the equity). Still, a new risk exists as well — each new round of financing may add more investors ahead of your position. A seller's equity position may be heavily diluted, if not eliminated, by the time the buyer goes public, or is sold.

(For a related perspective, see, [Learning e-Commerce Contracts From Sherlock Holmes: How To Read The Unwritten Tech Contract](#), in the January 2006 edition of *e-Commerce Law & Strategy*.)

Decide, or Be Told

Finally, sellers must remember the words of the oft-heard quote: “It ain’t over ‘til it’s over.” Just because you believe the deal will occur, don’t begin to act as if it were certain. Once a seller shows the buyer that he’s committed to the deal by taking permanent steps such as changing leases or suppliers, the buyer can extract concessions that the seller might not have given earlier in the negotiations — because the seller now has no alternative but to give in and close.

So what is an owner supposed to do? For the few YouTube.com’s of the e-commerce world, there will be many more for whom simply contemplating the decision to sell or not to sell becomes devastating. However much a founder knows his own business, few are also experts in buying and selling businesses. But (with good advisers) the entrepreneur must weigh these competing concerns, shake off that “indecision” and decide whether to “stay or go.” If he does not, he could find that the aphorism, “Those who fail to plan, plan to fail” applies as much to e-commerce as to the most basic bricks-and-mortar firm. And if that happens, the decision about whether to stay or go will have been made — for you, instead of by you.

Stanley P. Jaskiewicz, a business lawyer, helps clients solve e-commerce, corporate, contract and technology-law problems, and is a member of *e-Commerce Law & Strategy*’s Board of Editors. He can be reached at the Philadelphia law firm of Spector Gadon & Rosen P.C., at sjaskiewicz@lawsgr.com or 215-241-8866.

© Copyright 2006, Law Journal Newsletters