

How to do a management buyout

A Guest Article by Jim Keeling
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Six key steps to a successful MBO

When a management team sets out on a management buy-out (MBO), they are first and foremost looking for money. They have worked out how much they need, realise they do not have enough themselves, and simply want to get their hands on the necessary funding as soon as possible. But what exactly is an MBO, and would an MBO be suitable for your business?

An MBO is when a management team buys the business it runs. If, as is typically the case, the team members don't have the necessary funds, they will need to raise some of the money from a third party. So the deal takes on an extra layer of complexity. It is no longer just the management team's deal: the team members have to share the risks and rewards with their backer. And that can raise some thorny issues.

Usually, however, an MBO is not possible, either because the business is not in fact for sale or because the price is simply too high. At other times, the target may be for sale, but only to outside parties – in other words, to anyone but the management team.

A delicate game

Even when the vendor of a business may be prepared to sell to an MBO team, the management often has to play a delicate game before declaring its hand. Sellers will naturally worry that they will not get the best price for the business if the management team is known to be a potential buyer and therefore conflicted.

So it's not unheard of for management teams who raise the idea of a buy-out to be shown the exit at once – not just from the meeting room, but from their jobs as well. Yet other vendors may welcome an MBO proposal as the best sale route. This uncertainty illustrates the need for care at all stages of the process.

Here are six steps, all of which are normally necessary to secure a successful management buy-out.

1. **Preparation** is key. The first step in an MBO is to evaluate the opportunity that is to be presented to investors. In this way, the management team and its advisors are able to assess whether funds can be raised – and so whether to take that first delicate step towards discussion with the vendor.
2. Once it is decided that the target is suitable, the investment proposition – including the **business plan** and all associated documentation – can be prepared and put to the chosen investors in the best possible light.

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3. The **management team** must be as strong as possible. The stronger and more complete the team, the more interesting the funding proposition will be to investors – and the better the deal management will achieve.
4. A crucial question in any MBO is how the ownership of the business will be split between the management team and its backers. Different backers will require different proportions of the business, depending on the return they are seeking and how attractive they find the proposition. It is vital to identify the **right type of investors**, whether providers of equity or debt. This is just one aspect of the deal on which management teams generally take specialist advice.
5. Once the case has been prepared, the MBO team must negotiate with one or more preferred backers. Yet the management team also has to agree terms with the vendor, and the **two sets of negotiations** are normally carried on in parallel.
6. Even after terms are agreed in principle, there is still **plenty more work to do**. This includes due diligence (that is, checking everything!), tax structuring and preparing legal documents. Deals can fall over at any moment – many a slip 'twixt cup and lip – so great care is needed throughout.

We sometimes compare doing an MBO to riding in the Grand National. Every time management gets over one hurdle (agreeing funding, say, or reaching a deal with the vendor), the team feels as if it is finally in the clear – only to find there is yet another fence to be jumped. But don't despair: the end does come eventually. And, fortunately, this particular race has many winners!

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