Entrepreneurial Exit Management -
Key Success Factors of the Private Equity Buyout Option

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The proposed research examines the entrepreneurial exit as a buyout with the involvement of private equity investors (exit buyout). An explorative approach was employed to develop and refine a framework to define the constituents of success and the key factors leading to a successful outcome of the exit buyout process. The results are based on predominantly qualitative research techniques conducted within five case studies of entrepreneurs having recently exited their small- and medium-sized firms. Quantitative methods are limited to the collection of a long list of case candidates and the analysis of selected variables from an investor perspective with a survey of 23 exit buyout investors across France and Germany.

The following findings are suggested:

The satisfaction of entrepreneurs is driven by maximisation of firm valuation and the ensuring of the firm's sustainability. Entrepreneurs appear to be satisfied with the results achieved and a closed transaction shortly after their exit, but also in the longer term, as they witness the positive evolution of their firms post-exit and the potential financial upside linked to an earn-out agreement.

The satisfaction of investors with the exit buyout concept was found to be positive overall and driven by a smooth transition of the firm's management to a successor as well as by limiting information asymmetries throughout the process through due diligence and contractual guarantees. However, the increase in valuation levels from 2002 to 2008 and intense competition between investors started to hamper investors' economics and represents a concern for them.

The fit between entrepreneurs and investors appears to be an important criterion in the screening stages of the process. Investors actively try to mitigate cultural differences through personal contact and team composition. External advisors appear to contribute to successful exits through match-making and price optimisation when intermediaries are involved and can help to mitigate information asymmetries when accounting and legal experts are engaged. However, a balance of means needs to be ensured to avoid entrepreneurs' frustration with overly complex and formal due diligence processes.

While the sector of activity and size of the firm seem to play a smaller role, firm performance and a well-prepared organisation were identified as important contributors to a successful exit.

Market conditions were identified as a moderating variable that can have an impact on the valuation within overall cyclical financial markets. This suggests the importance of appropriate timing as an important success factor.

Exit strategy and process variables were identified as potential levers, with, for example, MBOs and OBOs representing a more attractive and less risky exit buyout option to investors compared to MBIs. Negotiation-based processes helped to optimise fit, whereas structured processes, including auction components, where perceived as maximising the valuation.

An integrative framework of success factors was developed, implications for entrepreneurs and investors were derived and a set of measures was proposed to further promote the exit buyout concept, which shows potential to become a more widely applied alternative to trade sales, IPOs, and MBOs with no involvement of private equity investors in the future waves of business transfers across Europe.

Unternehmerisches Exit Management -
Erfolgsfaktoren im Falle eines Private Equity Buyouts

Der Autor untersucht den unternehmerischen Ausstieg in Form eines Buyouts unter Beteiligung von Private Equity Investoren (Exit Buyout). Die Bestandteile des Erfolgs und die Schlüsselfaktoren für einen erfolgreichen Exit Buyout Prozess werden mit Hilfe einer explorativen Vorgehensweise entwickelt. Die Ergebnisse basieren auf überwiegend qualitativen Forschungsmethoden. Fünf Fallstudien untersuchen Unternehmer, die vor kurzem ihre mittelständischen Betriebe veräußert haben. Quantitative Methoden beschränken sich auf die Sammlung von Fall-Kandidaten und die Analyse ausgewählter Variablen aus Sicht der Investoren im Rahmen einer Befragung von 23 Buyout Fonds in Frankreich und Deutschland.

Die folgenden Ergebnisse werden dargestellt:

Die Zufriedenheit der Unternehmer wird durch eine hohe Unternehmensbewertung und den gesicherten Fortbestand des Unternehmens getrieben. Unternehmer erscheinen zufrieden sowohl direkt nach einer abgeschlossenen Transaktion, als auch auf längere Sicht, wenn sie die positive Entwicklung ihres Unternehmens mit verfolgen und durch Earn Out-Vereinbarungen davon finanziell profitieren.

Die Zufriedenheit der Investoren mit dem Exit Buyout-Konzept ist getrieben durch eine reibungslose Übergabe der Unternehmensführung, sowie durch die Begrenzung von Informationsasymmetrien mit Hilfen von Due Diligence und vertraglichen Garantien.

Die Passung (der Fit) zwischen Unternehmern und Investoren erscheint als ein wichtiger Faktor während der Anbahnungsphase. Investoren versuchen kulturelle Unterschiede durch persönliche Kontakte und die Zusammensetzung ihres Teams zu überwinden. Externe Berater tragen ebenfalls zu einem erfolgreichen Exit bei. Unternehmensmakler helfen bei der Identifikation der Transaktionspartner und bei der Preisfindung. Bilanzierungspezialisten und Juristen können dazu beitragen Informationsasymmetrien zu begrenzen. Allerdings sollte ein Gleichgewicht der Mittel gewahrt werden, um Frustrationen der Unternehmer mit übermäßig komplexen Due Diligence Prozessen zu vermeiden.

Während die Branche und Größe der Unternehmen eine geringere Rolle spielen, erweisen sich Wettbewerbsfähigkeit und eine gut vorbereitete Unternehmensorganisation als wichtige Voraussetzungen für einen erfolgreichen Ausstieg.

Die Marktbedingungen werden als moderierende Variable identifiziert, die einen Einfluss auf die Bewertung haben können. Dies unterstreicht die Wichtigkeit der Wahl eines angemessenen Zeitpunkts für den unternehmerischen Ausstieg.

Exit Strategie- und Prozess-Variablen werden als mögliche Hebel identifiziert. MBOs und OBOs stellen im Vergleich zu MBIs attraktivere und weniger riskante Exit Buyout Optionen für Investoren dar. Verhandlungsbasierte Prozesse helfen den Fit zu optimieren während strukturierte Prozesse, insbesondere Auktionen, eine höhere Bewertung sicherstellen.

Ein konzeptioneller Rahmen integriert und priorisiert die einzelnen Erfolgsfaktoren. Implikationen für Unternehmer und Investoren werden abgeleitet. Die vorgeschlagenen Maßnahmen sollen das Exit Buyout-Konzept fördern und seine weitere Verbreitung in der nächsten Welle von Unternehmensübergaben unterstützen.

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List of Abbreviations

AFIC – Association Française des Investisseurs en Capital
BIMBO – buy in management buyout
BVK – Bundesverband Deutscher Kapitalbeteiligungsgesellschaften
CEO – chief executive officer
CMBOR – Centre for Management Buy-out Research
EBIT – earnings before interest and tax
EBITDA – earnings before interest, tax, depreciation and amortisation
EBO – employee buyout
ERP – enterprise resource planning
ESOP – employee stock owner plans
EVCA – European Venture Capital Association
EV – enterprise value
FTE – full time equivalent
IfM – Institut für Mittelstandsforschung
IPO – initial public offering
LBO – leveraged buyout
MBI – management buy in
MBO – management buyout
MEBO – management and employee buyout
M&A – mergers and acquisitions
OBO – owner buyout
PE – private equity
P/E ratio – price-earnings ratio
SECA - Swiss Private Equity & Corporate Finance Association
SME – small and medium-sized enterprises
VC – venture capital

1 Introduction

Europe's economies, especially France and Germany, are renowned for their dynamic, medium-sized entrepreneurial businesses, representing the vast majority of total employment and generating most of their growth through innovation and productivity improvement. This entrepreneurial activity is unfolding within a distinct process from firm creation to harvest. Personal aspirations, the desire to harvest the value created, corporate imperatives and succession issues drive entrepreneurs toward an exit decision. In Germany alone, an estimated number of up to 300,000 entrepreneurial "Mittelstand" businesses will change ownership in the coming years.[1]

In this critical harvest process, "the availability and effectiveness of the exit ultimately determines the value to be realised from the venture."[2] Entrepreneurs therefore have a large incentive to understand and act upon the relevant success factors.

Since the early 1990s, buyouts have gained importance as an alternative exit option to family transfers and trade sales to strategic investors, the most frequently applied exit options. Within a maturing continental European private equity market, the "mid-market" buyout of cash-generating and growing entrepreneurial firms has become a promising investment segment. Recent examples of successful transactions demonstrate their attractiveness to both entrepreneurs and investors, but hopes for a rich deal flow have been disappointed for a number of years. This is even more surprising as private equity funds are actively pursuing these opportunities. Across France and Germany, about € 35 billion are targeted at buyout opportunities and readily available for investment.[3]

The objective of this research is to build and refine a conceptual model, linking company performance, exit strategy and process variables to the achievement of the entrepreneur's financial, personal and corporate objectives. Such a model will serve as a framework for entrepreneurs and investors in the future waves of business transfers.

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[1] See Freund (2004).

[2] See Petty (1997A), p. 72.

[3] The total European buyout capital available for investment as of the end of 2006 can be estimated around € 100 billion. France and Germany represent about a third of those volumes. See Wright et al. (2006) and EVCA (2007).

1.1 Practical Relevance

1.1.1 Small and Medium-sized Entrepreneur-led Companies

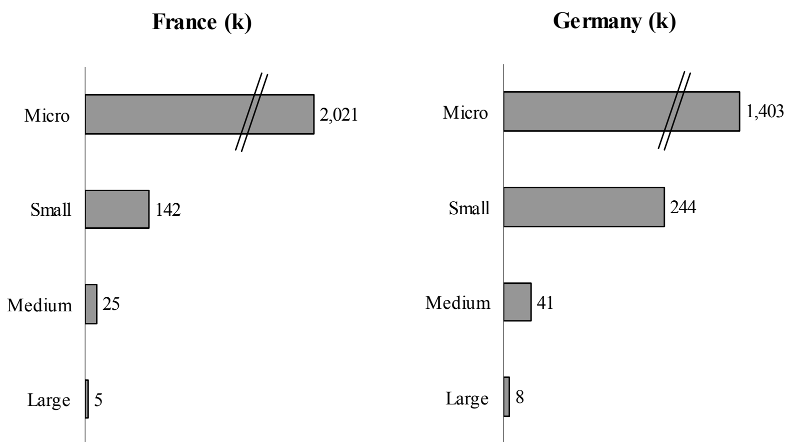
Throughout Europe many companies have been set up in several foundation waves since the Second World War and have been able to grow in the absence of well-developed takeover markets. This segment of medium-sized entrepreneurial businesses is the backbone of many European economies. This applies particularly to the French and German economies, which are characterised by strong entrepreneurial cultures and a combined stock of more than 450,000 small and medium-sized enterprises (SMEs), representing about 40 percent of the GDP and employment of both countries, as shown in Exhibit 1.

***Table 1**: Definition of firm size classes*

Size Class	Full-time Employees	Revenues (€ million)
Micro	0 – 10	0 – 2
Small	11 – 50	2 – 10
Medium	51 – 250	10 – 50
Large	251 +	50 +

Source: European Commission

***Exhibit 1**: Firm population by size class*



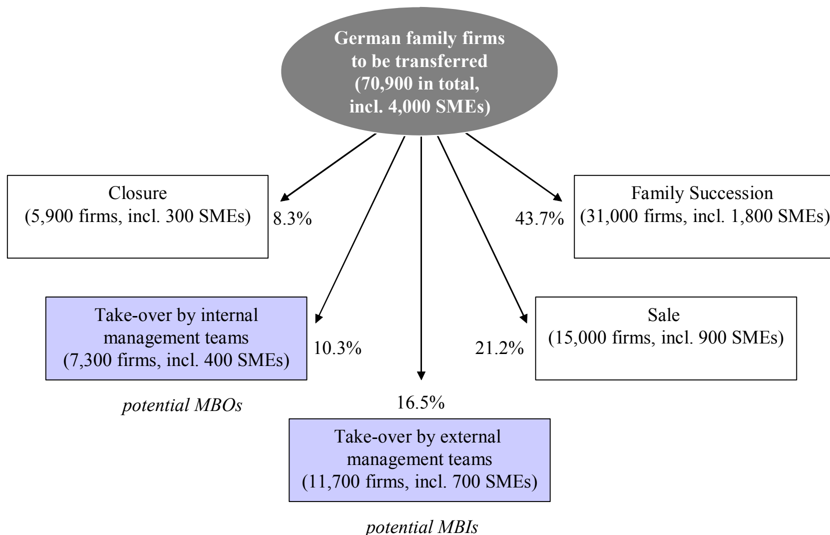
2003 data; Source: Eurostat (2006)

1.1.2 Business Transfers and Entrepreneurial Exits

Many founders are approaching retirement or wish to harvest their investment. Within a total number of successions largely exceeding 100,000 per year in France and Germany, SME transfers can be estimated at around 10,000 across both countries, and with the upcoming wave of business transfers, this number is forecast to grow significantly.

These business transfers represent an important issue for each exiting entrepreneur and at the same time an opportunity for outside investors to acquire attractive businesses. Whereas, for example, in Germany more than half of all exits are transfers to family members (44%) and closures (8%), the other half is transferred to external investors, employees and incoming management teams, as illustrated in Exhibit 2.[4] The most common form of family-external transfers remains a company sale involving strategic corporate investors. However, the alternative exit options of buyouts and initial public offerings (IPO)s have gained significant importance in continental Europe over the last decade.

***Exhibit 2**: Distribution of business successions in Germany*



The total number includes successions of all firms with revenues above € 50,000.
Small- and medium sized businesses represent about 4,000 of the 70,900 firms.
Source: Freund (2004)

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4 See Freund (2004).

Compared to IPOs, which might continue to be perceived as the superior exit route, buyout activity has proven to be less volatile and overall represents a larger number of transactions, especially in France. Whereas IPOs tend to follow cyclical patterns of "hot" and "cold" issue markets, the number of SME buyouts is rather stable and, since the mid-1990s, has reached a level of 200 to 300 transactions per year throughout France and Germany.

1.1.3 Private Equity and Buyout Investment Activity

Private Equity as a concept has developed rapidly across Europe, with an estimated € 112 billion having been raised and € 71 billion having been invested in 2006, representing between one and two percent of GDP in most European countries.[5]

Management buyouts (MBOs) have become an important development in both international finance and entrepreneurship in the last decade. The sub-segment of large leveraged buyouts (LBOs) is often associated with the restructuring of under-performing corporate divisions being spun-off. However, the buyout concept has also come to represent an innovative exit channel for entrepreneurs as well as for family business owners with unresolved succession issues. As such, MBOs are the most significant element of private equity investments in many countries. In continental Europe, France leads the buyout market, both in terms of the number of transactions and investment values, ahead of Germany and the Netherlands.[6]

However, even considering the significant number of MBOs in exit situations over the last few years, which has proven the applicability of this concept for exiting business owners, this number has probably been below their theoretical potential and the expectations of buyout investors. These buyout opportunities are targeted by more than 100 private equity investment teams in France and Germany, with a total amount of about € 35 billion readily available for investment. This represents a significant overhang of funds compared to the annual amount of capital invested on average in recent years.[7]

The performance-enhancing impact of buyouts on the firms has been widely recognised.[8] Buyouts tend to lead to significant performance improvements and produce profitable growth compared to both past levels of the individual firm and its industry peers. Whereas buyout funds tend to invest in above-average performing firms, they continue to outdo their

---

[5] See EVCA (2007).

[6] See CMBOR (2006).

[7] Between 2001 and 2005 average annual buyout investments were € 12.8 billion in France and € 11.7 billion in Germany.

[8] See Kitzmann (2005), p. 55 – 127 for a comprehensive review of buyout performance measurement across the USA, UK and Germany.

industry peers in growth and profitability by unlocking hidden potential, mainly through clear business focus, controlling and monitoring systems and the reorganisation of operative and administrative processes.[9]

1.1.4 Buyouts in Entrepreneurial Exit Situations

Even though a number of prominent examples can be reported from entrepreneur-run and family businesses, the application of the buyout concept to firm exit and succession appears to be in the early stages of its development, with the vast majority of buyouts still originating from corporate divestments. Only about 30 percent of French and 20 percent of German buyouts can be linked to founder-run and family businesses.[10] Given average annual buyout numbers between the years 2000 and 2007 of about 350 in France and 100 in Germany a total amount of less than 1,000 buyouts in entrepreneurial exit situations can be estimated for that period.[11] If compared to the stock of companies to be transferred, this clearly indicates a significant growth potential for such transactions.[12]

Well-publicised larger examples in Germany include the bakery business Kamps, the yacht builder Bavaria Yachtbau, the gardening equipment manufacturer Gardena and the high-end consumer electronics manufacturer Loewe. In France, the fashion label Agent Provocateur or the consulting firm Alma belong to this category.[13]

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[9] The sources of performance improvements in buyouts have moved from primarily financial engineering in the early 90s to operative improvements, with some of the performance also being attributable to the increase in valuation multiples on financial markets. See also Kraft (2001), p. 288.

[10] See CMBOR (2006).

[11] See AFIC (2008), BVK (2008).

[12] From 2000 to 2007 in Germany 160 buyouts can be related to founder-run or family businesses. If compared to the stock of 19,000 firms to be transferred by MBO or MBI, this represents less than 1%, clearly indicating a potential for growth.

[13] Other less well-known businesses include Otto Sauer, LEWA, Heim & Haus Holding, Polytan, Alukon, in Germany and Progimed, Azia, SNAAM and Fondis Electronique in France.

Exhibit 3: *Examples of recent MBOs in an exit situation*

OaseWübker – Germany:

> *In December 2002 the family owners of Oase Wübker, a German-based manufacturer of fountain pumps and filtration systems for garden ponds since 1966, sold their equity stake within a leveraged management buyout to Electra Partners Europe, valuing the company at EUR 150m.*

Groupe Philippe Bosc – France:

> *In December 2002 Philippe Bosc, the founder and majority shareholder of Groupe Philippe Bosc, a French at-home hairstyling services business launched in 1985, sold his 65% equity stake within a leveraged management buyout to Atria Private Equity, valuing the company at EUR 51m.*

1.2 Definition of Entrepreneurial Exit and Buyout

The French economist Richard de Cantillon first used the term "entrepreneur" two centuries ago, describing those willing to bear risk for potential economic gain. Many later definitions of entrepreneurship share the idea of value creation, economic wealth attainment and psychic benefits for the entrepreneur as a reward for the development effort and investment made. Entrepreneurial profits must compensate opportunity seekers for the options they have bypassed, lack of liquidity of investment and need to provide a premium for risk and uncertainty.[14] This economic reward can occur during the entrepreneurial activity or at its end in the form of an entrepreneurial exit, harvesting the value created.

1.2.1 Entrepreneurial Exit

In the more recent literature entrepreneurship is often defined as a distinct process, starting with the identification of a business opportunity and ending with the harvest of the firm.[15] It is this exit or harvesting phase that is the focus of the proposed research.

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[14] See Venkataraman (1997), p.132.

[15] Recent research has even suggested exploring entrepreneurship within the framework of a parenthood metaphor, with firms being entrepreneurs' babies from conception to maturity, helping to better identify the emotional aspects of entrepreneurship. See Cardon et al. (2005).

Exhibit 4: *Entrepreneurial exit definitions*

> *"Harvesting an entrepreneurial firm is the approach taken by the owners and investors to realise terminal after-tax cash flows on their investment"*[16]
>
> *"Exit is the final piece necessary in creating the ultimate value to all the participants in the venture, especially the owners, and employees."* [17]
>
> *"The harvest is the owners' and investors' strategy for achieving the terminal after-tax cash flows on their investment. It does not necessarily mean that the entrepreneur will leave the company; it merely defines how she will extract some or all of the cash flows from the investment to be used for other purposes. Nor should it totally disregard the personal and non-financial aspects of the transaction."*[18]
>
> *Entrepreneurial exit can also be viewed as part of the universal organisational problem of leadership succession, where a "clash between an organisation's goals and a leader's personal goals" occurs.*[19]

Common to most exit definitions is the idea of reward for earlier investment in the venture, the nature of these rewards being both financial and non-financial, and the distinction of an ownership and a management dimension throughout the exit process.[20] Whereas the shareholding can in some cases be reduced rapidly, entrepreneurs are often linked to the future management of their businesses, primarily to ensure transition, integration and the achievement of predefined milestones in the further development of the company.

For the purpose of the proposed research, the term exit will be clearly delineated from the term failure, a situation where the entrepreneur has no other option but to discontinue the firm.[21]

Different types of exits can be distinguished along four criteria: the reasons or motivation to exit, the type of exiting shareholders, the nature of the new owner and the exit option chosen. Reasons and motivations to exit can be the desire to harvest past investments, the need to diversify investment away from one single entity, succession issues, as well as negative events, such as business failure, closure or bankruptcy. Different typologies of

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[16] See Petty (1997 A), p.71.

[17] See Bygrave, W.D. (1997), p. 416.

[18] See Bygrave, W.D. (1997), p. 416.

[19] See Sonnefeld (1988).

[20] See Crijns and Ooghe (1997).

exiting shareholders can be specified as internal and external investors. Internal investors such as founders, non-founder owner-managers or family shareholders combine ownership and an active management role. External investors like venture capitalists or business angels provide primarily capital and, only sporadically, management support to the business. New shareholders after the exit can be family members, as in the case of a family transfer, or external investors. The most common harvest options are family transfers, trade sales to strategic investors, different forms of buyouts, IPOs, gradual divestment, and an orderly liquidation.

Entrepreneurial, owner-manager-run and family businesses

The commonalities and differences between founder-run, owner-manager-run and family businesses need to be clarified. All three have in common that a very significant ownership stake (in most cases even majority ownership) is combined with operational management responsibilities for the company. Given their entrepreneurial nature, all three types should be included in this research.

However, different starting points for an entrepreneurial exit can be distinguished, depending on the age and funding history of the company, which will impact its shareholder structure. On the one hand, there are first generation founder-run entrepreneurial businesses, which are self-funded or externally funded through Venture Capitalists (VCs), friends, business angels or other types of external investors. On the other hand, there are later generation entrepreneurial businesses, such as family businesses and owner-run businesses.[22] Additional differences linked to the motivation to exit cannot be ignored. Whereas in family business it will be primarily a succession issue, for entrepreneurs it can be both succession and/or harvest motivations.[23]

For this research, first generation founder-run business exits as well as later generation owner-run and family business exits should therefore be considered.[24]

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[21] See Sten (1998). In their review of past research, Watson and Everett (1996) distinguish four types of failure: discontinuance of a business for any reason, bankruptcy or loss to creditors, disposed of to prevent further losses, and failing to "make a go of it".

[22] In the case of the owner-run business, the current owner is not necessarily the founder of the firm and might have acquired it himself.

[23] For a review of family business definitions see also Bergamin (1997), p 13 ff.

[24] For founder-run businesses primarily companies without or post VC-investment will be considered.

1.2.2 Buyout

Buyouts, in general, can be characterised as a subset of company acquisitions mostly performed by specialised private equity (PE) funds, so-called buyout funds.

> *"Buyout is the purchase of a controlling interest in one corporation by another corporation or an investor, in order to take over assets and/or operations. The term buyout is often complemented by words that explain the specific structure and allow differentiating various forms of buyouts (e.g. management buyout, leveraged buyout)."*[25]

> *"Private equity is a form of corporate financing where mostly non-public companies are provided with medium- to long-term risk capital by specialised financial intermediaries. Private equity financiers take an active role in the control and advisory of their portfolio companies and provide management support where required. To realise capital gains, investments are undertaken from the very beginning with the intention to resell the equity stake."*[26]

Different buyouts typologies can be distinguished along three criteria: type of financing, company-internal or external buyers, and the organisational role of the buyer within the business.[27] Buyouts can be structured as leveraged buyouts (LBOs), if a significant amount of debt is employed to finance the purchase price of the transaction. However, the option to use financial leverage depends on the cash-flow and asset base of the company to secure interest payments and provide collateral for debt lenders. The term LBO also often includes the notion of the management of the company holding less than 10% of the firm's capital.

When differentiating by buyer or role of management, several types of buyouts can be identified.[28] The main characteristic of an MBO is that the existing management, or parts of it, acquires either the entire company or a large part of it, investing a significant share of their net worth.[29] Often, a large company divests one of its subsidiaries by selling it to its management team. Another source of MBOs can be entrepreneurial and family businesses whose owners retire.

Within a management buy-in (MBI), the management who takes over a significant share or the company comes from outside the firm. In both cases the management can be supported by external equity investors contributing capital to take over the remaining equity stake. A

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25 See Jakoby (2000), p. 11.

26 See Kraft (2001), p. 34.

27 See Then Berg (1997), p.13.

28 See Achleitner and Fingerle (2003) and Schwien (1995).

29 See Schwien (1995), p. 15, and Then Bergh (1997), p. 11. Further definitions Luippold (1991), pp. 9 ff.

buy-in management buyout (BIMBO) is a combination of an MBI and an MBO. An entrepreneurial manager buys into a company and teams up with members of the incumbent management team to run it as an independent business.

In an owner buyout (OBO), the current owner initiates a buyout of his own business by creating a holding company in which he will retain an important stake and that takes over the firm, financed through capital contributed by external equity and debt investors.[30] An OBO can be a tool for entrepreneurs seeking to realise a significant part of the value locked into their business, while remaining at the helm of the company.

In an employee buyout (EBO), the staff of the company acts jointly as the buyer of a significant share of the company. Management and employees can also act jointly, driving a management and employee buyout (MEBO).[31] A specific type of employee buyouts are employee stock owner plans (ESOPs), which are particularly tax efficient, allowing employees to become owners of the productive assets of the company. ESOPs can also take the form of a leveraged ESOP if involving a debt funding through a financial institution, pledged against assets or stock of the company, or in case employees require an external partner to help fund the transaction.

Buyouts can be further differentiated based on the type of selling shareholders and the motivation of the sale, as shown in Exhibit 5.[32]

***Exhibit 5**: Differentiation of buyouts by motivation and type of seller*

	Type of Seller		
Motivation	**Corporate**	**Independent**	**Public**
Strategic reorientation	• Spin-off/ divestment		• Spin-off/ divestment
"Special situation"	• Turnaround	• Entrepreneurial exit • Family business succession • Turnaround • Delisting of publicly listed company	• Turnaround

Source: Own graph based on Luippold (1991), pp. 18 ff.

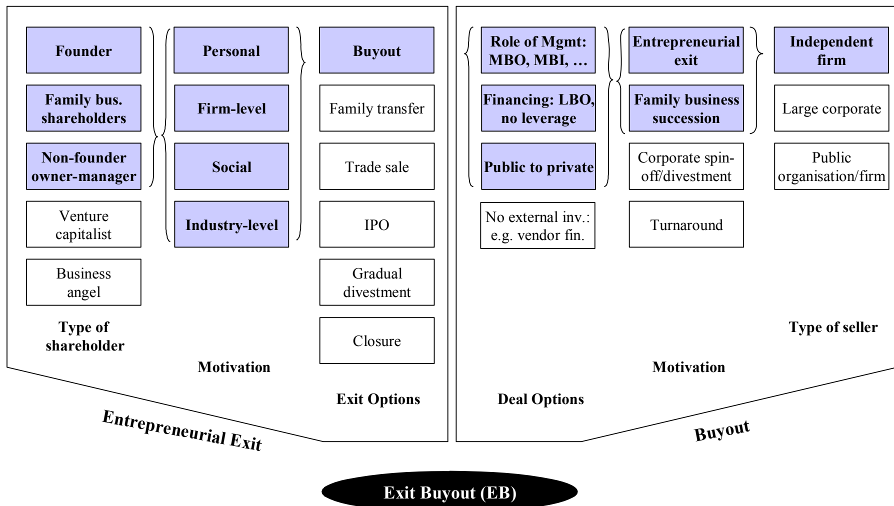
30 See Becker (2000).

31 See Koch (1997), p. 26.

32 See Jakoby (2000), p. 165.

1.2.3 Exit Buyout

***Exhibit 6**: Exit buyout definition*



Source: own graph based on Kensinger et al. (2000), Petty et al. (1994), Petty (1997A) and Luippold (1991).

In the context of this research, the exit buyout concept can be defined as MBOs, MBIs, OBOs or BIMBOs of independent private and publicly listed companies, controlled by their founders, owner-managers or family shareholders and driven by an entrepreneurial exit or succession-related motivation, as shown in Exhibit 6. The future management is thereby accompanied by external investors, co-investing equity as well as debt into the firm.

The main focus of this research will be put on exit buyouts of SMEs in France and Germany, firms with revenues between € 2 and 50 million.[33]

[33] See above definition of firm size classes in chapter 1.1.1.

1.3 Underlying Theories

There is a wide range of underlying theories that can be linked to the entrepreneurial exit process. The most relevant groups of theories are agency theories and theories of information asymmetry, other finance-related theories and behavioural theories.

Agency theory and theories of information asymmetry

Agency theory is based on the concept that a principal delegates a task to an agent who commits to exercising the task against remuneration. Within the principal-agent relationship, problems of motivation and control occur which are opposed to the assumption of homogenous expectations and goals in neoclassical finance theory. In reality, information is distributed asymmetrically between both parties and can create three different types of imbalances in the relationship.[34] There is uncertainty about the quality of the execution by the agent, as the principal cannot access all relevant information or only at an over-proportionally high cost. There is a risk of moral hazard, where the principal cannot assess the level of effort and commitment of the agent. There is also a risk of hold-up, where the principal has to factor in potential unfairness of the agent, as their interests might diverge. In response to these imbalances, specific monitoring and control mechanisms have to be put in place.

Within the context of this research, it can be said that the entrepreneurial firm and the exit process is the classic case of agency problems and asymmetric information, characterised by multiple principal-agent relationships.[35] Existing MBO literature emphasises the positive agency effect due to motivation, alignment and reduction of agency cost of MBO-type owner-manager run businesses. However, in the exit buyout process leading to this positive MBO "end-state", several issues have to be investigated.

In the pre-exit relationship between seller and incumbent management, there is a risk of hold-up. The management might see themselves as buyers and future business owners and therefore have an interest in impacting short-term company performance to achieve a lower valuation of the business at the time of the exit. The new owners, including the management team, should therefore be encouraged to put up significant amounts of their own equity to "bond" their commitment to the deal's success.[36]

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[34] See Spreemann (1996), p. 622 ff.

[35] See Petty and Bygrave (1993), p. 133.

[36] See Petty et al. (1994).

In the post-exit relationship between seller and the future management and participating external investors, there is a twofold agency problem. On the one side, the seller needs to control for quality uncertainty and hold-up. If the terms of the deal include an earn-out where the final amount of the payment depends in part on the subsequent profit performance of the company, the buying owner/managers have incentives to take measures to reduce the firm's profits during the earn-out period. The seller needs to take great care in structuring the deal to guard against such a possibility. On the other side, future management and investors need to control for moral hazard if the seller has committed to a continuing operational involvement in the company over a transition period.

In the relationship between seller and external advisors, the primary issues relate to the uncertainty about the quality of services provided and moral hazard questioning the commitment of the advisor. This can be controlled by a thorough due diligence of service providers, rigorous contractual commitments and monitoring of the service delivery.

Other finance theories

Four additional finance theories are closely related to entrepreneurial businesses and can make an explanatory contribution to the exit process: option theory, pricing and valuation theory, market efficiency theory and signalling theory.[37]

- Option theory provides an explanation of the long-term financial strategy of the entrepreneur from creation to harvest. Founders can be viewed as purchasing call options on the harvest proceeds.[38]

- The financial market for entrepreneurial companies is inherently incomplete. Market efficiency theory therefore suggests that it is likely that the full information about the return characteristics of the business becomes available to the buyer only after the transfer of the asset and that the transactions costs associated with entrepreneurial exits are quite high.[39]

- While it is the entrepreneur who manages the business, it is the investors in the capital markets who assign the value. However, most entrepreneurial companies are closely held and not traded in public asset markets. Pricing and valuation

[37] See Petty and Bygrave (1993), p. 126.

[38] See Kensinger et al. (2000), p. 82.

[39] See Hintermaier and Steinberger (2002), p. 3.

theories need to be applied to price privately held assets and to identify potential pricing anomalies.[40]

- Signalling theory provides explanations about signals used by sellers to convey information to the market during the exit process. These signals can be related to the financial performance and strategic positioning of the business.

Behavioural theories

Most valuation situations will occur between a willing buyer and seller, but may involve asymmetric information. Since the transaction is a single game, it may become a win-lose scenario, putting the seller at risk. Negotiation and game theory can help to identify different negotiation tactics. Rational models like the model of reasoned action and the model of planned behaviour can also be applied to the exit process from a behavioural perspective.[41]

1.4 Problem Definition

Specific characteristics do apply to the exit phase of the entrepreneurial process: It is initiated by an act of human volition; it occurs at the level of the individual firm; it involves a state of change and discontinuity; it is a holistic and dynamic process; it is unique; it involves numerous antecedent variables; and its outcomes are extremely sensitive to the initial conditions of these variables.[42] This poses significant issues for the seller, who seeks to identify the optimum decision, as well as to entrepreneurship research, which is trying to explain this phase.

The literature recognises that “a material amount of the economic value created over the life time of the venture can be preserved (or lost) at the time of the harvest,”[43] and that “there is a real chance that an entrepreneur will be disappointed with the final phase of the investment process, which comes when he tries to harvest the venture.”[44]

For further investigation, the issues related to a successful entrepreneurial exit management and a larger application of the exit buyout concept can be differentiated on two levels: a micro-perspective, covering individual stakeholders and, foremost, the problems sellers are

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[40] See Brophy and Shulman (1992), p. 61.

[41] See Leroy et al. (2007), Desroches (1992), p. 405.

[42] See Bygrave and Hofer (1991), p. 17.

[43] See Petty et al. (1994), p. 48.

[44] See Bygrave (1997), p. 415.

facing, and a macro-perspective related to the rather slow take-off of the exit buyout concept in general, despite significant motivation on the buy side.

The exit process is critical to the entrepreneur, as "the availability and effectiveness of the exit ultimately determines the value to be realized from the venture."[45] At the same time it represents multiple obstacles.

If analysed from a cognitive perspective, the entrepreneur is confronted with risk taking, tradeoffs, and opportunity cost considerations, similar to other stages of the entrepreneurial process.[46] However, the task of actively presenting and selling his own business is new to the entrepreneur, and the exit remains a one-time experience for most entrepreneurs, with limited possibilities for corrective actions throughout the process. At the same time sellers are confronted with private equity investors, who are a major stakeholder on the buy side and have accumulated significant experience by regularly investing in those types of opportunities. Entrepreneurship and private equity represent two different management paradigms and work with different principles, as laid out in Table 2.

Table 2*: Comparison of the entrepreneurial and private equity paradigm*

	Entrepreneurial Paradigm	**Private Equity Paradigm**
Goal	Create, build, implement idea	Identify and exploit unrealised growth and/or profit potential prior to divestment
Key person	Entrepreneur	CEO, in conjunction with investors/board
Key stakeholders	Firm & family	Management & investor
Time horizon	Long-term, up to several generations	Medium- and long-term (mostly 4-6 years) but always limited
Financial risk / incentive	Net worth locked up in firm	Some value locked-up (management, investor), financial incentives
Shareholder role	Owner-manager	Equity investor, board-level control
Operational role	Hands-on full-time management	Typically hands-off, occasional management support,
Strategy	Intuitive, visionary, some professional tools	Focus on professional strategy development & implementation
Financing	Primarily equity, limited debt	Primarily debt, limited equity

Source: own graph based on Haarmann (2006), p. 15 and SECA (2006)

45 See Petty (1997A), p. 72.

46 See Shane (2001), p. 6.

The significant gap between the two cultures needs to be bridged throughout the exit process by promoting a fit between entrepreneurs and investors. However, match-making appears to be rarely systematic, with entrepreneurs lacking significant experience in that area, which potentially leads to delays in the process.

Information asymmetries between the owner and incumbent or incoming management, external advisors and potential investors further complicate the management of the exit process. The steering and resource management of the rather complex process and timing is critical. Additionally, many individual factors can also impact the success of the process.

Therefore, it is critical to identify key success factors related to the entrepreneur himself, the management, the potential buyers, the market environment, the company itself and to external advisors in order to optimise the outcome and avoid putting the ongoing operations and performance of the business at risk.

From a macro-perspective, while considering the entirety of all firms that need to be harvested and transferred, it is not clear why a motivated buy-side party has not managed to further develop the exit buyout option and promote it more successfully to sellers.

1.5 Research Objective

The impact of entrepreneurs' experience on the performance and development of the venture has been extensively researched, and evidence of a positive impact has been found. This opens up the question of role played by experience and the decision-making within the exit strategy and process, compared to company performance and external variables.

The objective of the proposed research is to build and refine a conceptual model linking company performance, economic environment, personal success factors (with regard to both entrepreneurs and investors) as well as exit strategy and process variables to the achievement of the entrepreneur's financial and personal objectives. This model should then serve as a framework for entrepreneurs and investors in the future waves of business transfers. Therefore, it is important to build an integrated framework rather than to concentrate on selected factors.[47]

[47] "Practioners and researchers should consider the dynamic interplay among business characteristics (e.g., size or industry), behavioural aspects of business financing (e.g., business objectives), and financial factors (e.g., gearing levels) when working with and researching family enterprises." Romano et al. (2001), p. 288.

Even if the entrepreneur is the main focus of this research, it is important to analyse the interactions with and implications for other stakeholders involved, above all, investors, but also advisors and firm management. For all investors planning to enter into an exit buyout, an understanding of success factors will provide guidelines for structuring and adapting their approach in order to increase acceptance from entrepreneurs, to limit their own risks and to increase the chances of a successful buyout transaction.

This research should also investigate whether the exit buyout represents a well-adapted option for realising investment value in general or whether particular situational, regulatory or personal factors have a significant impact on the outcome.

1.6 Research Questions

In order to provide entrepreneurs and investors with the necessary framework and practical advice, to ensure achievement of exit objectives and to remove barriers to an increase in exit buyout deal-flow, it is necessary to answer the following questions within an empirical research:

- What are the determinants of an exit buyout strategy and process?
  - How do entrepreneurs approach their exit buyout?
  - What drives differences between strategy and process options?

- What are the key success factors for a successful exit buyout?
  - What is the (relative) importance of company performance, economic environment, personal factors on the entrepreneur- and investor-side as well as exit buyout strategy and process variables?
  - Which factors facilitate the "match-making" and fit between entrepreneurs and investors in an exit buyout process?

- What can the entrepreneur do to enhance the probability of a successful harvest and what remains beyond his control?

1.7 Research Structure

This document is structured as follows. In the introduction, the practical relevance of this research, related definitions and theories are discussed, followed by the definition of the research objective and research questions. In a literature review, the concept of exit buyouts is examined with respect to relevant existing entrepreneurship and finance research.

An explorative research methodology is proposed. This is followed by a discussion of the explanatory model integrating potential success factors as well as the data collection and analysis techniques that have been applied. Results are then presented for different clusters of potential success factors, and an integrative analysis of factors driving exit buyout success is synthesized. In the final section, conclusions and implications for entrepreneurs, investors and future research are highlighted.

***Exhibit** 7: Research structure*

2 Review of Related Research

Research has evolved around the understanding of entrepreneurship as a business development process, with the entrepreneur initiating and directing a venture that develops under the influence of surrounding factors through a continuum of distinct phases.[48] Considerable research in entrepreneurship is organised around the process of acquiring and allocating resources to exploit opportunities. However, while a number of theories have been proposed concerning the early stages of opportunity recognition and initial implementation and their financial implications within the functional perspective of entrepreneurial finance, examinations of the exit phase, and more particularly the exit buyout option, have been far less theoretical and systematic.

Therefore the review of research related to factors driving exit buyout success has been organised in four steps, as illustrated in Exhibit 8. The four sections include the current market environment in France and Germany, the exiting entrepreneur characterised by his motivation and behaviour, the exit strategy and process options available to entrepreneurs as well as the issues and potential success factors related to entrepreneurial exits that have been identified to date. The literature covering the entrepreneurial exit is rather limited and varies in focus from practical "how-to" guides, to conceptual and theoretical studies as well as a small number of empirical studies focusing on individual success factors.[49] Hence, additional research has been reviewed that examines success factors of corporate transactions which show similar characteristics if compared to exit buyouts, such as family firm successions, buyouts in situations other than entrepreneurial exits and corporate M&A transactions.

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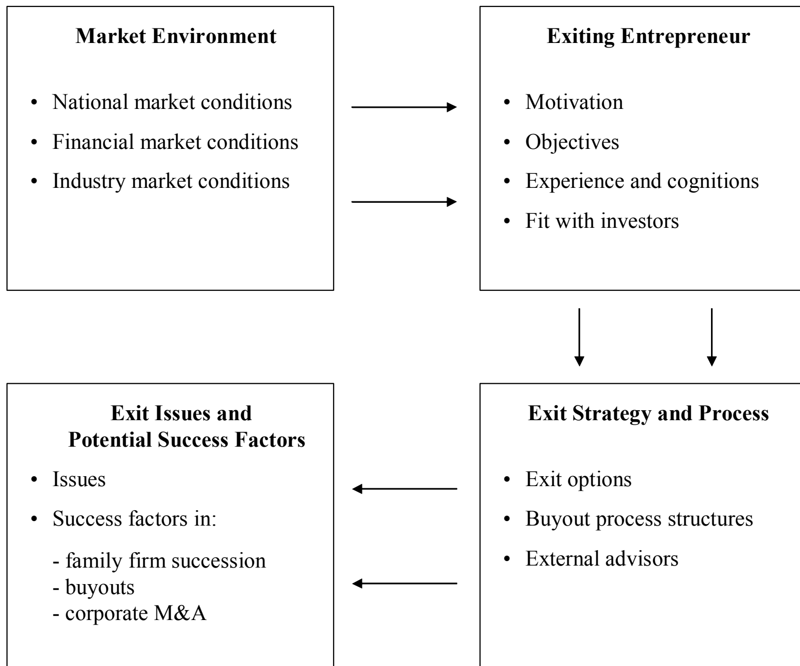
48 See Bygrave (1993), p. 256.

49 See for example Gabriel (1998).

Exhibit 8: *Literature map*



Source: own graph.

2.1 Market Environment

2.1.1 National Market Conditions

Although the U.K. is by far the most prolific buyout market in Europe, significant activity can be observed in France, Germany, Italy, Spain and the Netherlands. However, different national markets, with their specific financial and managerial cultures as well as regulatory frameworks, have led to different levels of development across countries.

> *"Despite the growth in the U.K. and Continental European markets, the maturity of the different (national) buyout markets varies markedly.…*
> *…The U.K. represents the most mature market with France closely following. Germany represents the less developed, though large PE economies, …"*[50]

Whereas some suggest that France adopts foreign ideas more readily, it is likely that two factors were involved in facilitating the development of a relatively prosperous buyout market in France: a legal and tax environment that was, by design, advantageous and a certain "equity-culture" facilitating the fast development of private equity and venture capital markets.

In 1984 the French government adjusted existing legislation to foster MBOs in France.[51] It did so because it was aware that enabling family firms to solve their succession problems would be important to the economy and it recognised a solution in the form of MBOs in the U.S. and U.K. At the same time, France became the third largest venture capital market. That market was globally driven by corporate capital structures and banking markets favouring comparably high equity levels combined with little debt, attractive tax regimes, exit opportunities created through the "second marché" compartment of the Paris stock exchange, and the presence of experienced foreign investment firms. Following the venture capital development, an active buyout market emerged. Playing an important role were both independent investment firms as well as captive funds, attached to the larger French banks. As a result, the considerable flow of MBOs in France is predominantly fed by family businesses which apply the concept as an instrument to solve succession and reorganisation issues.[52]

In Germany during the early 1990s, a number of important preconditions for the take-off of buyouts were also in place: the structure of many industries characterised by a large number of small and medium-sized "Mittelstands"-companies, a reasonably well developed set of players providing equity and debt financing, a legal and tax environment that was not actively promoting, but also not hampering, MBOs, and a reasonably well-developed stock market providing exit opportunities for MBO investors with the "geregelter Markt" compartment of the Frankfurt stock exchange.[53] Despite this fertile environment the

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[50] See Wright et al. (2006), p. 14. The combined value of all European buyouts in 2005 was in excess of € 100 billion, a fivefold increase compared to 1996.

[51] See Green (1988), p. 60 and Luippold (1991), p. 100. The "Delors-law" from 22.11.1984 and its extension from 1987 supported the application of MBOs in family business successions.

[52] This contrasts with other countries such as the U.K. and Germany where (at least to date) corporate divestments represent the main source of MBOs.

[53] See Bleackley and Hay (1994) identified similar relevant factors as having driven the initial development of the U.K. buyout market from 1980 – 1984.

development of buyouts in Germany was held back by two main factors. Firstly, there was little knowledge about MBOs and their capabilities as an instrument of corporate transactions. Secondly, the cultural environment led managers to prefer and retain their employment status instead of actively pursuing entrepreneurial careers.[54] This seems to have continued and can be illustrated by a decline in firm creations since 2005, especially in the knowledge-intense service sector and research-heavy industries, indicating that entrepreneurship might be a less developed concept in Germany when compared to France, the U.K., the U.S. or Japan.

Reasons for a less developed entrepreneurship culture in recent years are often linked to the economic growth that followed the slowdown between 2002 and 2005. That growth development caused employees to realise their career path in larger firms as opposed to favouring their own entrepreneurial projects. A decrease in firm creations was driven by the rise in unemployment following the recent reorientation of labour market instruments. Resistance of managers to move into MBO careers can also be attributed to the high growth and profitability pressures that buyout investors impose on management teams.[55] As a result the flow of MBO-opportunities in Germany is significantly less pronounced compared to France, with entrepreneurial and family business exits representing a relatively small share compared to corporate divestments. As shown in Tables 3 and 4 this structural difference leaves France with a higher total number of buyouts, although at a smaller average investments size, especially in the very large buyout segment.

***Table 3**: Comparison of buyout volumes – France and Germany*

	France			Germany		
Number of MBOs/MBIs	2004	2005	2006	2004	2005	2006
size range: € 0 - 50m	128	176	150	73	87	102
size range: € 50 - 250m	16	33	43	22	21	40
size range: over € 250m	16	19	21	16	16	13
Total	**160**	**228**	**214**	**111**	**124**	**155**

Source: CMBOR (2006).

54 See also Luippold (1991), p. 267, who suggests an impact of the German "Sozialstaat" principle.

55 See Haarmann (2006) and Achleitner et al. (2005b).

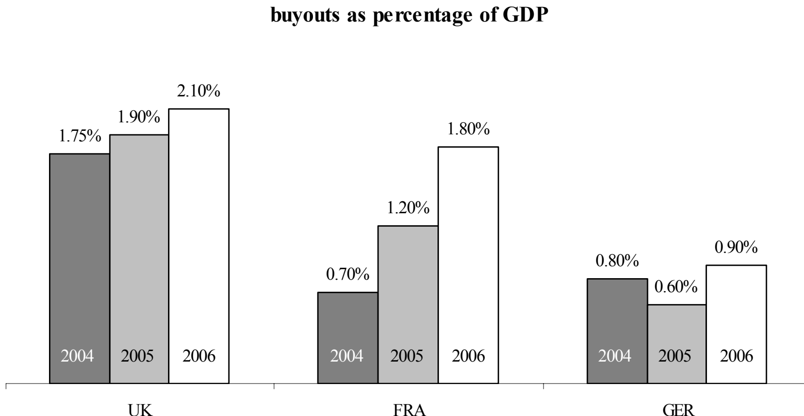
***Table 4**: Comparison of buyout sizes – France and Germany*

Avg. MBO/MBI size (€m)	France 2004	France 2005	France 2006	Germany 2004	Germany 2005	Germany 2006
size range: € 0 - 50m	7	12	9	5	8	7
size range: € 50 - 250m	116	124	113	97	123	97
size range: over € 250m	549	811	1,210	964	603	1,311
Total	**72**	**95**	**147**	**161**	**104**	**139**

Source: CMBOR (2006).

The above review suggests that the significant difference in buyout activity between France and Germany is predominantly driven by cultural issues and structural differences on the supply-side, i.e. residing within the domain of exiting business owners and potential future MBO-managers. The demand-side and a slightly less advantageous regulatory environment would support a significant increase in activity in Germany.[56] If the maturity of the buyout concept in a national market is to be judged by the proportion of buyout values to GDP, especially Germany's SME segment but also France shows a significant growth potential for buyouts, as shown in Exhibit 9.

***Exhibit 9**: Maturity of buyout concept across Europe*



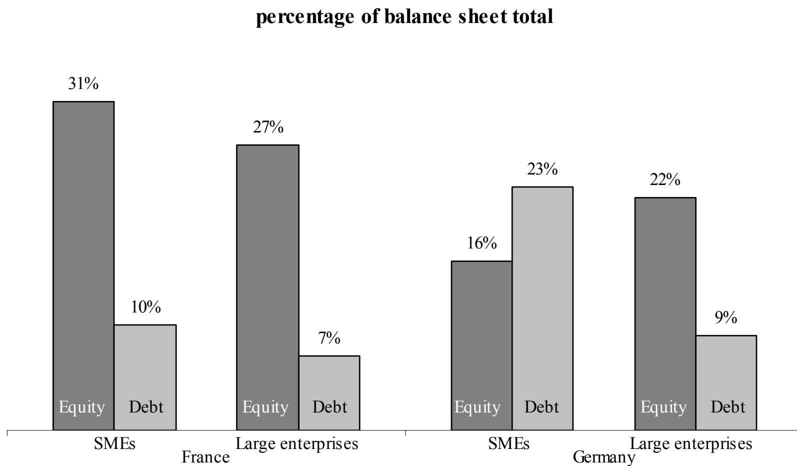
Source: CMBOR (2006) and Wright et al. (2006), p. 33.

56 See Kitzmann (2005), p. 127. Little existing research could be found on the direct impact of national regulatory environments on buyout activity levels and performance.

Expectations of the continued development of the German market prevail and are driven by several factors. An awareness and acceptance of private equity increased to some degree as a result of a well-publicised wave of venture capital-funded Internet-startups in the late 1990s and an animated public debate about the role of larger-scale buyouts in the economy.[57] Additional momentum is building due to the low equity ratios of German SMEs if compared internationally, as illustrated in Exhibit 10.[58] Recent empirical evidence for Germany suggests that 36% of German industrial manufacturing SMEs have an equity ratio of less than 15%.[59] The increasing cost of debt financing driven by the Basel equity backing practices for bank lending and the continuously high number of medium-sized businesses to be transferred further support hopes that German buyout activity will increase.

It remains to be explored in the proposed research to what extent the above differences in buyout activity have an impact on entrepreneurs' individual exit buyout success in France and Germany.

Exhibit 10: *Comparison of capital structures across Europe*



Manufacturing, construction and retail; SMEs: sales < € 40 million, Large enterprises: sales >= € 40 million.
Source: Bundesverband Deutscher Banken (2005), Eurostat, Bach-Database 2004.

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57 However, Achleitner et al. (2005b) suggest that in 2005 only 3/23% of SMEs were very well/well informed about private equity as a financing option, with smaller firms being less informed than larger firms.

58 A significant number of empirical studies compare the capital structures of French and German firms and give the impression that the results derived are often contradictory, a fact often linked to the poor comparability of the data sets used (see Paranque and Friderichs (1999), p. 18). However, for the sector of SMEs it becomes visible that German firms are characterised by a rather high degree of leverage and very low accumulation of their own funds mainly due to a traditional bank-based financing market (see Friderichs et al. (1999), p. 129).

59 See IfM (2007), p. 48.

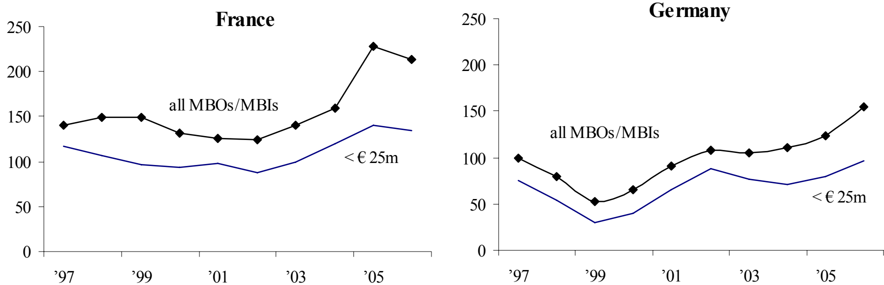
2.1.2 Financial Market Conditions

From 2005 to 2007 European buyout markets were entering a third phase of significant growth, both in terms of total number and size of investments, after two prior waves of buyouts in the latter half of the 1980s and 1990s.[60]

> *"I've never seen so much interest in LBOs. Managers, academics, family business heads, bankers, public sector officials – everybody is interested in LBOs, ..."*[61]

More specifically, buyout markets seem to follow cyclical patterns, similar to other exit options such as IPOs and trade sales,[62] and have completed an entire cycle over the period of 1995 to 2006.[63] In fact, activity has evolved at two speeds. Whereas larger transactions followed a particularly cyclical pattern, smaller buyouts were more stable over time, as shown in Exhibit 11.

***Exhibit 11**: Buyout activity levels – France and Germany 1995 – 2006*



Number of MBOs/MBIs per year; Source: CMBOR (2006).

Along with a quantitative analysis of activity levels, qualitative instruments can complement the assessment of buyout markets. The German Private Equity Barometer (GPEB) represents a proposal for a qualitative indicator of the private equity market climate.[64]

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[60] See Wright et al. (2006).

[61] Gonzague de Blignières, co-head of Barclays Private Equity Europe and ex-chaitman of AFIC, the French private equity industry association, in an interview with the Financial Times, 12.03.2007.

[62] For evidence of cyclical IPO markets and their impact on volumes and pricing, see also Ibbotson and Jaffe (1975) and Ritter (1984). For evidence of cyclical M&A markets, see Scouller (1987) and King (1989).

[63] See also Bleackley and Hay (1994).

[64] The German Private Equity Barometer (GPEB) is a business climate indicator jointly developed by the bank KfW and the German association of venture capitalists BVK in 2003. The relevance and importance of the factors influencing the GPEB have been tested empirically by KfW (see Zimmermann and Karle (2005)).

Attempts at explaining the cyclical patterns on the buyout market could be made from a sell- or supply-side as well as from an investment- or demand-side perspective. From a supply-side, the number and quality of investment opportunities seems to play an important role and are driven by specific industry trends and macroeconomic conditions which at the bottom of the business cycle might lead to forced sales and substantially discounted prices.[65]

From a demand-side perspective, macroeconomic as well as microeconomic factors need to be considered. On a macroeconomic level, the availability of capital to invest or the ease of fund-raising might play an important role. The current total European fund volume available for buyout investments can be estimated at about € 35 billion compared to average annual investment activity from 2001 to 2005 of € 12.8 billion in France and € 11.7 billion in Germany, resulting in a significant "investment pressure".[66] Other possible determinants include interest rates, stock market performance and the availability of public funding aids. On a microeconomic level, the availability of qualified investment managers to conduct deals and monitor investment firms appears to be of considerable importance.

European buyout market valuations have increased significantly over the last few years. While stock market valuations are driven by earnings levels, interest rates, inflation, commodity prices, and political circumstances, the determinants of private equity valuations differ. They are characterised by on average smaller-sized firms, non-public markets with very limited liquidity and significantly less transparency regarding company performance. Pricing is typically determined in a situation with one seller and a limited number of bidders, which makes the underlying performance and demand for the firm's capital together with a link to certain "reference points" on the public stock markets the key drivers of the valuation. [67]

The evolution between 1998 and 2007 shows that buyout valuations are less volatile then their counterparts on the stock markets, as illustrated in Exhibit 12. However, between the average valuation of an EBITDA-multiple of 6.9 in 2001 and 9.0 times EBITDA in 2007 is an increase of 30%. Driven by a significant overhang of capital to be invested and only a small increase in deal volumes, a sellers' market has developed. As a result, valuation levels have risen and bargaining power has shifted towards sellers.

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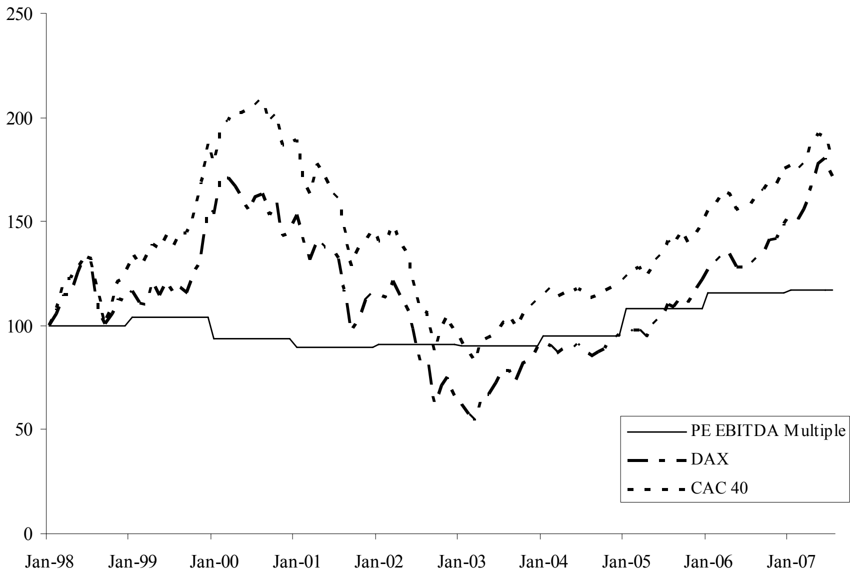
65 For factors related to industry market trends and conditions, see also the following paragraph.

66 See Wright et al. (2006), p. 16 and EVCA (2007).

67 The German Entrepreneurial Index (GEX), for example, helps to make the performance of entrepreneurial mid-sized companies more transparent and serves as a valuation benchmark for buyout investors who become involved in entrepreneurial firms. The GEX tracks the performance of about 100 owner-managed medium-sized firms that went IPO not longer than 10 years ago and are listed on the Frankfurt stock exchange Prime Standard. The average GEX firm has annual revenues of about € 300 million (see Kaserer et al. (2006)).

The proposed research should help to identify the extent to which cyclical buyout patterns and valuation levels do have an impact on the success of an individual exit buyout transaction.

***Exhibit 12**: Buyout valuation levels – 1998 – 2007*



Rebased to 100 for January 1998;
Source: S&P, Deutsche Börse, Euronext.

2.1.3 Industry Market Conditions

Existing data on buyouts in France and Germany shows varying levels of transactions in different industries. As shown in Table 5, in France, buyout transactions are concentrated in the manufacturing, business services, TMT, food and retail sectors, whereas in Germany, the manufacturing sector is even more dominant, with lower levels of activity in service sectors.

***Table 5**: Buyout activity by industry – France and Germany*

	France			**Germany**		
Number of MBOs/ MBIs	2004	2005	2006	2004	2005	2006
Manufacturing	52 33%	75 33%	72 34%	46 41%	58 47%	86 55%
Bus. & Support Services	18 11%	30 13%	26 12%	7 6%	9 7%	18 12%
TMT	15 9%	24 11%	22 10%	13 12%	13 10%	12 8%
Food & Drink	12 8%	14 6%	11 5%	5 5%	4 3%	2 1%
Others	63 39%	85 37%	83 39%	40 36%	40 32%	37 24%
Total	**160**	**228**	**214**	**111**	**124**	**155**

Source: CMBOR (2006).

Empirical research by Jakoby (2000), Ambrose and Winters (1992), Chiplin et al. (1991) is in line with the above observations and identifies an early concentration of MBOs in certain manufacturing industries, with a more recent broadening of scope and evolution toward service industries. Davidson (2005) found that almost 80% of a group of Swiss buyout investors did not focus on a specific industry. The smaller the market is, the more restraining such a strategy might also be. Other than covering the above sector focus, little empirical research has investigated the impact of industry-related variables on other exit variables and outcomes.[68]

It remains to be explored in this study to what extent industry characteristics have an impact on the availability and the success of an individual exit buyout transaction.

[68] See Leroy et al. (2007).

2.2 Exiting Entrepreneur

2.2.1 Motivation

New business formation is a potential path for upward social mobility. Entrepreneurship enables individuals to accumulate wealth, expand social contacts, and improve social and economic standing. One could ask the question of why some entrepreneurs cut themselves off from future access to the financial and social benefits that come with being involved in their companies.[69]

In accordance with Le Breton-Miller et al. (2004), the transfer of a firm is driven by motives on different levels of analysis, including a personal, social, firm and industry level, as illustrated in Exhibit 13. In the context of the exit buyout, the entrepreneur's motivation can be driven by a multitude of individual factors along the above four dimensions.

***Exhibit 13**: Entrepreneurs' exit motivation*

Personal motives	Firm-level motives

• Age / succession
• Optimised capital allocation (i.e. diversify portfolio)
• Value realisation
• Decreasing motivation
• Decreasing fit with growing business
	• Strategic
	  – partnerships
	  – structural performance issues
	• Financial (i.e. re-capitalisation)
	• Organisational: ("in order to grow must the founder go?")
	• Shareholder conflicts

Social motives	**Industry-level motives**
• Reputation capital (me-too with respect to industry peers) • Employee participation	• Consolidation • Innovation • Globalisation

Source: own graph.

[69] See Aldrich et al. (2003), p. 1.

Personal Motives

Personal motives can include several elements. First, the increasing age of the entrepreneur as well as the lack of a successor among family members may play a role.

Second, the desire to realise value created by the entrepreneur may also be involved. Partial value realisation allows for an optimised capital allocation, with high shares of entrepreneurs' net worth often locked within their firms. Total value realisation corresponds to the harvest-aspect of exiting the firm, a key constituent of entrepreneurship as such.[70] It can be viewed as a monetary reward for the substantial financial, career, social and health risks entrepreneurs are carrying.[71] Entrepreneurial profit must also compensate opportunity seekers for the options they have forgone and the lack of investment liquidity they have incurred.[72] Therefore, in addition to the rewards received during their active involvement with the firm, entrepreneurs expect to harvest substantial value from their investments and the efforts undertaken.[73] From this perspective entrepreneurs have an interest in maximising exit value, limiting risk exposure and diversifying their invested net worth away from one single asset. Building up a business to the point of diminishing returns and then selling it to others better able to carry it to a higher plateau is a proven formula for value maximisation. Hence, the assessment of the valuation and the ability to realise cash gains might play an important role as factors of exit buyout success.[74] However, the issue of harvesting is not exclusively about money, but also involves personal and non-financial aspects of the exit.[75]

Third, motivation may decrease due to a declining interest in an entrepreneurial career or the desire for a change in work-life balance. Bleackley et al. (1996) point out that an entrepreneur's attitude toward his exit is shaped by his career objectives and his desire for continuing involvement in the business following the change in ownership structure. After a number of years of developing his business, the owner might become tired, too independently wealthy, or too bored to continue trying to create value in the firm. Therefore, he might seek to reduce his involvement in every day business life or may want to pursue another opportunity.

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[70] Schumpeter defined entrepreneurial profit as the "expression of the value of what the entrepreneur contributes to production in exactly the same sense that wages are the value expression of what the worker 'produces'... It attaches to the creation of new things, to the realization of the future value system" (Schumpeter (1936), p. 153).

[71] See Fueglistaller et al. (2004), p. 44 ff.

[72] See Venkataraman (1997), p.132.

[73] See Petty (1997b) p. 71, Bygrave (1997), p. 416.

[74] See Bleackley et al. (1996), p. 40.

[75] See Petty (1997A), p.71. Also in this respect, empirical results by Amit et al. (2000), p. 126, indicate that money is not the most important motive for entrepreneurs' decisions to start new ventures.

Fourth, the fit between the founder or owner-manager and his growing business may also be in decline. In line with the literature on organisational life cycle and stages of growth, entrepreneurs are confronted with different challenges along the growth path of their businesses.[76] However, success at earlier stages of the company's evolution does not automatically imply success in later stages.[77] Entrepreneurs might therefore have an incentive to hand over the management and retire in the best interest of their firm.[78] Considerable research has investigated the hypothesis that founders are of diminishing value to their organisations over time. Willard et al. (1992) investigated the hypothesis that an evolving business quickly outgrows the entrepreneur's managerial capabilities. However, in a comparison of 110 fast-growing publicly listed companies run by founder-CEOs in the USA with a control group of 45 equally dynamic firms run by non-founder CEOs, no significant differences among the tracked accounting, market and managerial criteria could be identified. Daily and Dalton (1992) as well as Jayaraman (2000) obtained similar results as they could not identify a significant difference in financial performance of founder-managed versus professionally-managed small to medium-sized corporations.

Firm-level Motives

Considering that the long-run health of the enterprise might matter as much to the entrepreneur as the economic returns and the realisation of personal objectives, business imperatives also need to be considered as exit drivers.[79] Firm-level motives can be of strategic, financial or organisational origin.[80]

Strategic motivations can include structural performance issues, such as limited growth prospects, aging product portfolios or limitations of distribution channels which drive the need for functional, financial or geographic synergies with an external partner who can provide a strategic contribution. This can be a proactive approach but may also be motivated by defensive strategies of pre-empting acquisitive, competitive or regulatory pressure.

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76 e.g. Hanks et al. (1993); Covin and Slevin (1997).

77 This may, among other factors, also be linked to the diminishing positive impact of biases and heuristics often displayed by an entrepreneur's management styles as the firm reaches higher levels of maturity Busenitz and Barney (1997), p.25.

78 A comprehensive body of literature examines empirical evidence for the organisational fit hypothesis. Willard et al. (1992) cannot identify performance differences within a set of 155 later-stage high-growth technology firms between founder-managed and professionally managed companies. However, Jayaraman et al. (2000) suggest that, based on the comparative analysis of 94 founder- and nonfounder-managed firms, founders may have diminishing value to their organisations over time. Westhead (2003) supports this hypothesis and suggests that CEOs in family firms are not always rigid and reluctant to plan their succession. Evidence from their research suggests that CEOs in family firms are aware of their own life-cycle dynamics and actively seek to ensure smooth succession to protect personal and family wealth.

79 See Petty et al. (1994), p. 48.

80 Kaufmann (1990), p. 52.

Financial motivations can include weak earnings positions, low levels of equity and restrained investment capacities, whereas organisational motivations might be based on quantitative or qualitative resource constraints, conflicts within the staff or shareholder base, know-how gaps, or the decreasing fit between the entrepreneur and his growing firm, as indicated above.

Empirical research suggests that corporate imperatives tend to dominate the entrepreneur's personal aspirations. Holmberg (1991) confirms this in a study covering 100 computer software CEOs whose companies went IPO between 1980 and 1990. The main drivers for their IPO decision were the ability to raise capital and to enable the company to acquire other businesses. On the other hand, factors such as the ability to cash out or the increased status attached to a public company were considered unimportant. However, the particular focus on IPOs must not be neglected, as they, by definition, tend to be driven by considerations of both company development and exit.

Social Motives

Social motives can be rooted in an entrepreneur's desire to gradually relinquish control in favour of the firm's management and employees. In this way, he can maintain continuity, which reflects an entrepreneurial control imperative beyond the person of the entrepreneur himself.[81]

Industry-level Motives

Industry-level motives can include industry trends toward consolidation, innovation or globalisation that the firm might find difficult to cope with.

Balance of Motives

Bull and Willard (1993) suggest that personal gain plays a central role in motivating entrepreneurship but find that task-related motivation is important as well. Existing research on a broader range of MBO typologies in Germany and Switzerland underlines the importance of motives related to age, succession and entrepreneurs' desire to diversify their investment portfolio.[82] This is echoed by Bergamin (1995) in reference to family business succession motives. However, if compared with motivations for corporate divestments – or

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81 Abetti (2003) examined a case of the "entrepreneurial control imperative" by analysing the evolution of Steria, a French IT services and consulting provider, from creation to IPO.

82 See Davidson (2005) p. 107, Jakoby (2000) p. 165, Then Bergh (1997), p. 25, Huydts (1992), p. 28, and Luippold (1991), p. 22 for motivations from an MBO research perspective.

corporate exits – results are in contrast with each other. Haynes et al. (2003) identified financial underperformance and industry-level take-over pressure as motivators for corporate divestments in the UK. It remains to be explored within this research to what extent a specific balance of motives can impact exit buyout success and if a link between motivations and results can be established at all.

Triggers

Whereas the vast majority of exit processes might be triggered by an active decision of the entrepreneur himself based on the above motivations, the launch of an exit process can also be triggered by other internal and external stakeholders, industry and firm level events or by an attractive opportunity presenting itself.[83] Internal stakeholders in the above mentioned group include family members requesting a change, the current, longstanding senior management team expecting a handover and threatening with informal or formal dismissal, as well as external advisors close to the entrepreneur.

External stakeholders who might trigger an exit can include core clients and suppliers requesting proof of business continuity, existing investors and banks questioning the security of their financial engagement, industry peers having recently successfully exited their firms, as well as potential investors or external advisors proposing an exit opportunity.[84]

Events can exercise "positive" pressure on exiting entrepreneurs as a result of continued growth, which requires substantial financing and constraining cash flows over a longer period of time. Similarly, exit triggers can be driven by "negative" pressure linked to internal changes in the firm, such as the loss of key personnel, expiration of patents, deterioration of financial conditions or changes in the cost base. Negative events can also be related to changes in the external environment, such as evolving customer demographics or customer needs, new entrants into the market, cheaper substitute products, more intense competitive rivalry, new technology, barriers to distribution channels, or changes in the social context.

No indications about the most important triggers of exit buyout transactions and their potential impact on success have been identified in prior exit research.

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[83] Schröer and Kayser (2006) found that in about 74% of all cases the entrepreneur himself is the trigger for the exit process.

[84] See SECA (2006), p. 14.

2.2.2 Objectives

Existing empirical research reports varying results regarding the balance between the financial and sustainability aspects forming entrepreneurs' objectives. This applies to earlier phases of the firm's development as well as during the exit and succession phases.

A comparably lower importance of financial objectives is suggested by Amit et al. (2000), who could not confirm the common perception that financial rewards are the only or the most important factor in the entrepreneur's decision to start a new venture. Similar results with a somewhat varying importance of financial objectives and values such as independence and challenge have been proposed by Kurato et al. (1997), Monroy and Folger (1993), Campbell (1992) and Roberts (1991). More recent survey results on exit objectives by PWC (2005) and BDI (2006), displayed in Table 6, show sustainability dominating financial objectives, whereas Giannetti and Simonov (2003) indicate that entrepreneurs might be sensitive to reputational capital and eager for esteem.

A slight dominance of financial objectives was identified by Schröer and Kayser (2006). Achleitner et al. (2006b) suggest that a third of all private equity investment proposals to SMEs are rejected because of a higher offer, indicating that entrepreneurs do consider price and might even switch between offers according to price.

DeTienne and Cardon (2006) found that exit objectives and strategies might be moderated by the personal traits and experience of the entrepreneur rather than factors related to the firm.

Whereas the above studies give a detailed picture of the ex-ante distribution of entrepreneurs' exit objectives in different industries and geographies, the balance between financial and sustainability objectives remains inconclusive. The results also fail to determine how objectives can determine the entrepreneurs' exit processes and impact their outcome.

Table 6: Empirical results on entrepreneurs' exit objectives

	PWC (2005)	Schröer & Kayser (2006)	BDI (2006)
Geography	Switzerland	Germany	Germany
Focus	all sectors, all sizes	all sectors, all sizes	all sectors, all sizes
Ensure sustainability	4.28	81.2%	4.49
Harvest/secure/diversify financial assets	4.02	83.6%	2.50
Maintain image	na	na	4.20
Secure employment	3.84	na	4.04
Generate growth	3.71	na	2.91
Redefine company strategy	2.98	na	na
	1: not important 5: important	share of responses indicating "high importance"	1: not important 5: important

Source: PWC (2005), Schröer and Kayser (2006), BDI (2006).

2.2.3 Experience and Cognition

Experience

The existing research seeking a link between experience and entrepreneurial exit and financing processes shows varying results. DeTienne and Cardon (2006) researched the impact of human capital variables on the intention and decision to exit. The authors suggest that older entrepreneurs are more likely to have an exit strategy, and those with industry-specific training are less likely to do so. Moreover, entrepreneurial experience, age, level of education, area of educational study and industry experience seem to relate to the specific exit strategy chosen. Comparing novice, serial and portfolio entrepreneurs, Westhead et al. (2005) identified a significant impact of prior experience on entrepreneurial cognition, which might itself impact behaviour and therefore success.[85] However, Hustedde and Pulver (1992) could not identify a significant impact of experience or education in their examination of a group of entrepreneurs seeking venture capital funding at earlier stages in the lifecycle of the firm.

In remains to be examined in this research to what extent a specific set of skills and experiences can help entrepreneurs to successfully conclude their exit buyout.

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[85] Portfolio entrepreneurs are defined as individuals who currently have minority or majority ownership stakes in two or more independent businesses that are either new, purchased and/or inherited Westhead et al. (2005).

Cognition

Two broad categories of cognition can be distinguished: heuristic-based, i.e., automatic thinking, and systematic, i.e., rational thinking.[86] Entrepreneurial cognition is often associated with manifesting heuristics and individual beliefs in judgements and decisions.[87] While heuristic-based thinking has its merits, particularly under conditions of complexity and environmental uncertainty, it may lead to a number of errors and biases in decision-making, such as over-confidence and representativeness. Systematic thinking can overcome some of these biases. It can, however, often be time-consuming and costly. While it is suspected that heuristic-based cognition has positive effects in the early stages of the venture, such as time gain in decision-making, it might have a negative impact on the management of more mature firms due to overly rapid decision-making, which ignores a part of the relevant fact base.[88] The specific balance between heuristic-based and systematic cognition applied by the entrepreneur throughout the exit process might be either a driver of success or even represent a risk for the exit buyout transaction.

Bryant (2007) indicates that entrepreneurs frequently use heuristics in relation to the evaluation of opportunities, but rely on more systematic means of decision making during the exploitation phase. Forbes (2005) shows that individual age, firm decision comprehensiveness, and external equity funding affect the degree to which entrepreneurs are overconfident. Simon and Houghton (2002) propose that entrepreneurs in smaller, younger firms who are considering pioneering are more likely to exhibit the illusion of control, law of small numbers, and reasoning by analogy. By applying Ajzen and Madden's model of planned behaviour, Desroches and Chebat (1992) determined that an entrepreneur's decision to choose the IPO exit route is partially impacted by attitudes and perceptions regarding IPO process difficulties.

2.2.4 Fit between Entrepreneur and Investor

The concept of fit is central to theories in both the fields of strategic management and organisational behaviour. Many questions in the field of entrepreneurship might also be

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[86] See Busenitz and Barney (1997). Heuristics are simplifying strategies that entrepreneurs might apply in complex situations where extensive information is not available.

[87] See Alvarez and Busenitz (2001) and Krueger et al. (2000), p. 426. Intention theories such as the model of planned behaviour proposed by Ajzen (1991) might be better suited to explaining entrepreneurial acts than either individual (such as demographics or personality traits) or situational (such as employment status or informational cues) variables. The author explains individuals' intentions through three factors: their values and attitude toward the act, their subjective norms as well as the perceived feasibility of the act.

[88] See Tversky and Kahnemann (1981), who argue that entrepreneurs' biases and heuristics might be applied over the entire lifetime of their careers, from founder to manager of their firms.

addressed through a fit approach.[89] With respect to the exit buyout process, the fit between entrepreneurs and the potential investors as an organisation and as individuals appears to be of particular importance.[90] A potential misfit would refer to the degree of mismatch between the entrepreneur's preferred and dominant working style and the demands of investors. This can include the aspects of goals, values, ethics, personality characteristics as well as management and decision-making styles.[91]

Fit can be observed on a socio-emotional level, i.e., cultural or cognitive level, as well as on a factual-rational level, i.e., business strategy. The question of fit in the exit buyout process is therefore dominated by the aspect of trust, with the entrepreneur seeking a viable investment partner to ensure the sustainability of the firm and actual payment of proceeds, as well as by information asymmetries, with investors seeking to obtain a realistic and comprehensive view of the firm and its performance

A large body of theoretical literature examines the relationship between entrepreneurs and investors in the earlier stages of the firm.[92] Existing empirical research suggests that the level of cooperation, fairness, trust and commitment are important drivers of success.[93] Focusing on the relationship between owner-managers of businesses with revenues between € 100 and 500 million and private equity firms, Achleitner et al. (2005a) indicate an assessment similar to the above results. The authors identify balance of power, transparency and clear rules, the credible demonstration of investors' capacity to add value, and the use of advisors trusted by the entrepreneur as important factors. It is also suggested that investors can enhance fit through an active focus on trust, a careful selection of investment managers, and the inclusion of qualitative investment assessment criteria. Lastly, investors might consider ensuring a learning effect from multiple points of contact with entrepreneurs through knowledge management and process control tools.

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89 Brigham and De Castro (2003) introduced the concept of cognitive misfit, initially proposed by Chan (1996), to the field of entrepreneurship within a person – organisation fit framework.

90 The difference between the entrepreneurial paradigm and the private equity paradigm has been identified above as a key problem in the context of exit buyouts. See also chapter 1.4 of this document.

91 See Brigham and De Castro (2003), p. 40.

92 See, for example, Shepherd and Zacharakis (2001) and Cable and Shane (1997).

93 See Howorth et al. (2004).

2.3 Exit Strategy and Process

2.3.1 Exit Options

Exit planning has received a fair amount of attention in previous exit literature.[94] Petty et al. (1994) were among the first to discuss the entrepreneurial exit conceptually. Four generic exit options beyond a business transfer within the family and orderly liquidation are discussed in the literature and shown in Table 7: trade sales, IPOs, different forms of buyouts, mainly MBOs and ESOPs and the option of gradual divestment/increase in cash flows.

***Table** 7: Overview of exit options*

Exit Option	Main Attractions	Main Issues
Trade Sale	• Strengthen the firm's strategic and/or financial positioning • Immediate (partial) cash-out	• Loss of independence • Timing dependent on M&A market cycle • Integration of management, employees and entrepreneur
IPO	• Retain (partial) ownership • Secure future access to capital • Immediate (partial) cash-out	• Availability dependent on IPO market cycle and geography • In general no immediate exit • Complex transaction • Regulatory requirements
Buyout (MBO & ESOP)	• Retain independence of company • Performance impact through management and employee incentives • Immediate (partial) cash-out	• Potentially lower valuation level compared to trade sale • Complex transaction • Debt burden, depending on leverage • Agency problems
Increase Cash Flows	• Retain ownership of company • Little impact on organisation	• Impact on growth potential and competitiveness • Double taxation of income

Source: own graph based on Kensinger et al. (2000), Petty et al. (1994) and Petty (1997A).

Significant national differences in the market environment and attitudes toward different exit options between the USA and Europe and within Europe have to be taken into account. After the U.K., both the IPO and buyout markets are the most developed in France and the

94 For a review of the existing literature, see Kesner and Sebora (1994).

Netherlands, with Germany and Switzerland lagging in these areas.[95] Muzyka et al. (1993) investigated entrepreneurs' perceptions of alternative harvest options from a pan-European perspective. The empirical study is based on 291 responses from entrepreneurs across Europe prior to selling their business and supports the hypothesis that national market differences have a significant impact on available exit options and the success of the exit process.

The differences in available exit options between industries were investigated by Spak (2002). The author highlights a significant link between exit availability and industry in an analysis of the USA industrial design profession. This is another indication that the firm's industry sector and activity might have an impact on exit buyout success.

Prior to embarking on the exit buyout route, entrepreneurs might consider different options.[96] In contrast to family succession, the gradual divestment through an increase in cash-flows and firm closure, several exit options involve the transition of both management and shareholding to external parties. The exit options examined below belong to this category and include IPOs, trade sales to strategic investors, and buyouts. Buyouts can be further differentiated depending on whether an external equity investor is involved or not.[97]

This indicates that the exit buyout concept is competing with several other exit options. A brief review of the strengths and weaknesses, necessary preconditions, potential variables and issues related to the above options will allow assessing their attractiveness and applicability.

According to public belief and statements in many business plans the most sacred of exit options is taking the company public.[98] Even though the principal purpose of IPOs is to facilitate the raising of future capital, IPOs can also be applied to realise an at least partial exit. Unlike with other exit options the rationale for going public rests largely on the contention that IPOs provide higher valuations. Such a position is particularly popular during times of "hot" IPO markets. However, this implies that its availability is subject to volatile financial markets and that the window of opportunity for IPOs might not be in synch with the timing of the entrepreneur and his firm. In addition, the phenomenon of IPO underpricing might undervalue the firm, at least during the initial phase of market

95 See also chapter 1.1 of this document for a comparison of IPO and MBO activity between France and Germany.

96 For a review of exit options, see Kensinger et al. (2000), Petty (1997b) and Petty (1994).

97 A significant number of management and employee buyouts are directly funded by the stakeholders, possibly including elements of debt and vendor financing.

98 See Timmons (1999).

introduction.[99] While some firms might never qualify due to size and activity, others might find the process heavy and costly.

Exhibit 14: *Assessment of IPO exit option*

	Corporate Level	Personal Level
Strengths	• Access to capital (growth lever) • Acquisition currency • Corporate image	• Initial cash-out (however limited) • Potential upside linked to future growth prospects • Personal image
Weaknesses	• High initial and recurring cost (IPO, investor relations) • Regulatory constraints (accounting/publication)	• Financial exit phasing • Risk linked to financial market exposure (equity markets)

Preconditions & Variables	• Strong medium-term sales and earnings growth prospects • Financial structuring: o Share sale vs. capital increase o Level of floatation o Selected market segment
Issues	• Cyclical IPO markets • IPO underpricing • Post-IPO underperformance • Missing liquidity

Source: own graph based on Kensinger et al. (2000) and Petty (1997b).

The trade sale to a strategic investor is certainly the most commonly applied exit option. Typically, the firm can benefit from synergies with a strong partner. However, following financial markets somewhat, the markets for corporate acquisitions also tend to be volatile and the performance history of corporate acquisitions is at best mixed.[100] While the disclosure of confidential information to potential competitors might be a hurdle to be overcome, negative impacts on the motivation of the incumbent management team and a

[99] Empirical evidence for IPO underpricing and its effects on entrepreneurs' wealth creation has been suggested, for example, by Ibbotson et al. (1994), Certo et al. (2001), Habib and Ljungqvist (2001) and Loughran and Ritter (2002) for the U.S. market and by Stehle and Erhardt (1999) for the German market.

[100] See, for example, Pritchett et al. (1997).

typically disruptive integration process with another entity and culture might also need to be considered.

Exhibit 15*: Assessment of trade sale exit option*

	Corporate Level	Personal Level
Strengths	• Strong strategic partner • Synergy and growth prospects	• Initial cash-out • Potential upside linked to future growth prospects (in case of earn-out)
Weaknesses	• Loss of corporate identity • Typically declining role of current management team	• Handover to long-standing competitor • Risk linked to performance of acquirer (in case of earn-out)
Preconditions & Variables	• Strong market (niche) positioning and/or competitive advantage • Corporate structuring: o Vertical or horizontal alliance o Merger vs. acquisition/being acquired o Active or passive role for current management team	
Issues	• Operational integration (managerial competence of acquirer) • Financial viability of acquirer (structuring and financing capability)	

Source: own graph, based on Huydts (1992), p. 15.

The opportunity for management and employees to invest in employer shares, while potentially realising tax savings compared to other retirement plans, makes a buyout an attractive option to the firm's staff.[101] It might also offer a simple and efficient way to organise the exit as the related process does not involve many external participants and thus can be realised independently of volatile IPO and corporate acquisition markets. However, given the typically limited financing capacities of management and employees, this option tends to rely on leverage or vendor financing, implying an only gradual financial exit for the entrepreneur.

[101] An example of a successful MEBO/ESOP program is the case of Steria the French IT-Consulting firm. After the IPO in 2000 the founder of Steria held 14.8% and the employees 32% of the company's shares. Through a complex legal structuring, the combined 46.8% control the majority of voting rights. See Abetti (2003), p. 137.

***Exhibit 16**: Assessment of exit through buyout without external investors*

	Corporate Level	Personal Level
Strengths	• In-house management team • Typically positive performance impact	• Initial cash-out (however limited) • Potential upside linked to future growth prospects
Weaknesses	• No outside partner (strategic or financial) • High debt levels/leverage	• Limited initial cash-out • Risk linked to performance of management team (in case of vendor financing) • Risk linked to financial market exposure (debt/leverage)

Preconditions & Variables	• Strong market (niche) positioning and/or competitive advantage • Strong and entrepreneurial management team/employees • Substantial financial contribution of management/employees required
Issues	• Vendor financing might be required • Leverage might be hard to apply

Source: own graph based on Kensinger et al. (2000) and Petty (1997b).

The initial perception of buyouts involving external equity investors is often dominated by larger scale buyouts associated with financial engineering, high leverage, restructuring and sell-off of company assets. However, the analysis of longer-term performance of buyouts across various geographies, industry sectors and size classes has indicated a significantly positive performance impact related to the involvement of private equity investors.[102] On the contrary, performance expectations might be high, and information asymmetries and cultural differences between seller and incoming investor can lead to frustrations during the due diligence process. Investors might also exercise pressure on future management teams with regard to performance expectations that not all managers would be willing to accept.

[102] See for example the results of Kitzmann (2005) for the case of Germany.

***Exhibit 17**: Assessment of exit through buyout with external equity investors*

	Corporate Level	**Personal Level**
Strengths	• Strong financial partner • In-house management team (in case of MBO) • Typically positive performance impact	• Availability less dependent on market cycles, e.g. OBO (compared to IPO or M&A) • Initial cash-out • Potential upside linked to future growth prospects (in case of earn-out)
Weaknesses	• No strategic partner (except investor has further interests in the same industry) • Change in management team (in case of MBI/BIMBO) • High debt levels/leverage	• Limited initial cash-out • Risk linked to performance of management team (in case of phased payments) • Risk linked to financial market exposure (debt/leverage)

Preconditions & Variables	• Strong market (niche) positioning and/or competitive advantage • Clear medium-term development perspective (organic growth, build-up, organisational or financial restructuring) • Ideally strong asset base (to apply leverage) • Financial structuring (type of buyout)
Issues	• Investor might initiate major restructuring • Leverage might be hard to apply

Source: own graph based on Kensinger et al. (2000) and Petty (1997b).

Whereas extensive research covers the IPO and trade sale (M&A) exit options, the exit buyout alternative has received far less attention in both the entrepreneurship and corporate finance literature.[103]

2.3.2 Buyout Process Structures

Three generic types can be distinguished with respect to buyout processes: exclusive negotiations, open auctions or controlled auctions.[104] The main differences are the rigidity of

[103] As an illustration can serve the extensive research covering IPO underpricing and "hot and cold" IPO issue markets. No comparable phenomenon of exit buyouts has received similar attention to date.

[104] See analogy of corporate acquisitions in Müller-Stewens et al. (1999), p. 43.

the process, the level of confidentiality of firm information disclosed throughout the process, and the effectiveness of market-making through auction elements.

A process aimed at exclusive negotiations commences with informal contacts, with several investors helping to identify the best fit candidates. Against a letter of intent and a non disclosure agreement, a single investor is granted an exclusivity period during which he can conduct due diligence and negotiations. Confidentiality is guaranteed for the entrepreneur, thus protecting the existing business, and the depth of personal contacts and information shared allows maximising the fit between the firm and potential investors. However, other potential investors might be pushed away, and, due to little competition, the valuation might not be optimised.

In the case of an open auction process, the intention to sell is well publicised, targeting the entire market of investors. Based on indicative offers and strategy proposals, a number of bidders are pre-qualified to enter into a due diligence phase and are allowed to assess data and management of the firm, including confidential information. Based on subsequent binding offers, negotiations with typically two to three investors, primarily focused on price, lead to a final selection. This approach allows for maximising valuations; however, it also discloses the exit motivation to a broad public and is intense in preparation and coordination.

A controlled auction process represents a mix of the above. A number of potential investors are pre-qualified by the entrepreneur and informed about the opportunity with a short company profile. After qualification of initial interest and due diligence, a one- or two-stage auction process is initiated.

Open and controlled auctions have the disadvantage of due diligence processes with multiple potential investors, challenging the resources of the firm, especially of smaller firms. The auction process also requires a minimum number of interested bidders and is therefore only applicable in a seller's market and for companies soliciting sufficient interest. At the same time, auctions can accelerate the overall process through rigorous structuring and offer the advantage of an effective valuation maximisation through auction components.

Bulow and Klemperer (1996) compared the results of a company sale through an auction with a multi-round negotiation process. The results show that negotiating optimally with N buyers yields a lower selling price than an English auction with N + 1 buyers.[105] This

[105] An English auction is an auction in which the price rises continuously until only one bidder remains. The process is transparent for the bidders, as at each pricing step all bidders know how many other bidders remain active. See Bulow and Klemperer (1996), p. 182.

implies that the value of competition exceeds the value of negotiation skill in a company sale.

Auction processes are typically reserved for larger-scale corporate and buyout transactions.[106] However, through a combination of increases in buyout capital and a somewhat limited deal flow for investors, this type of structured sales process has recently been applied more frequently to the segment of SMEs in France and Germany.

No literature could be found that has empirically examined the impact of auction processes applied in an exit buyout context, from either the entrepreneur's or investor's perspective.

2.3.3 External Advisors

In addition to family members, friends and the firm's management team, a multitude of external advisors can be involved in an exit buyout process, both on the entrepreneur- as well as on the investor-side. This includes professional intermediaries, auditors, tax advisors, lawyers, and in the case of larger firms, strategy consultants. The roles of different advisors can be defined by the scope of their contribution, with intermediaries having a more transversal function of match-making and coordination and specialist advisors contributing primarily in their specific domain.

While a body of literature exists on the assessment of the impact of expert advisors, limited empirical research is available on the impact of the match-making and market-making roles of intermediaries. Based on an adaptation of the theoretical emitter – receiver model, Poech et al. (2005) suggest that intermediaries can play the role of catalysts in the relationship between buyout managers and family firm principals. This moderator function seems to be based on a deep knowledge of both the entrepreneur's and the investor's culture. Schröer and Kayser (2006) identify a high importance of moderating and coordination functions of external advisors in their empirical research of German business succession practices.

The potential impact of expert advisors on buyout processes beyond entrepreneurial exit situations has yielded different perspectives to date. Whereas Jakoby (2000) suggests that an involvement of experts – expert legal advisors – has a negative impact, at least in the early stages of the process, Luippold (1991) stresses the positive effects of professional support throughout the process. Hustedde and Pulver (1992) identified a significant impact of the

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[106] Structured auctions in a corporate environment as researched and applied by Klemperer (2004) and Milgrom (2004) played, for example, a significant role in the sale of UMTS telecommunications licences in the late 1990s as well as in large buyouts.

implication of external advisors when they examined a set of entrepreneurs seeking venture capital funding in the early stages of the lifecycle of the firm. The authors suggest a positive impact of legal advisors in developing marketing plans and in referring entrepreneurs to private investors. However, advice from accountants and bankers appeared to be of little benefit in obtaining funding for start-up businesses.

2.4 Exit Issues and Potential Success Factors

In addition to the in-depth analysis of specific factors that can affect exit buyouts and which have been outlined above, a number of studies identifying exit issues from a broader perspective and trying to model multiple factors of success are reviewed below.

2.4.1 Exit Issues

Potential issues for a successful exit can be related to factors which are under the control of the entrepreneur, such as exit strategy and process variables or the entrepreneur's personal experience and capabilities. On the other hand, there are factors which the entrepreneur can impact only indirectly or not at all, such as company performance, the economic environment and factors related to investors and external advisors.

Several studies attempt to identify problem areas with regard to the entrepreneurial exit process and its participants. One grouping of studies examines entrepreneurial exits; however excludes the buyout option. Petty et al. (1992) investigated a sample of 31 acquisitions of privately held companies in the USA between 1987 and 1990 with a questionnaire-based qualitative approach. Following the extensive research of the IPO exit option in the 1980s, the authors analyse issues related to the trade sale option. An initial set of problem areas from an entrepreneur's perspective could be identified. However, the number of individual factors analysed remains limited.

Bergamin (1995) investigated the process of selling a family business in the succession process through a trade sale. The qualitative empirical research is based on explorative interviews with 31 Swiss family business owners. The author draws a broad net of strategy- and process-oriented factors and provides in-depth insights on the potential impact of external advisors, he does neither provide an integrated framework linking success ex-post to its drivers nor does he focus on the exit buyout option.

Petty et al. (1999) conducted interviews with 12 entrepreneurs, ten investors and two investment advisors to qualitatively identify key exit issues across different exit options. The authors derive 12 practical lessons, without the foundation of a conceptual framework or paying specific attention to the exit buyout option.

A second group of studies specifically analyses the issues surrounding exit buyouts. Howorth and Westhead (2002) analysed eight case studies of MBOs/MBIs of family firms in the U.K. The MBO/MBI process is examined within an agency theory framework and utilises complementary theoretical frameworks relating to trust and negotiation behaviour. The authors provide evidence of widespread information asymmetries and therefore trust and relationships were important influences on the level of satisfaction. However, the importance of the detected effects with respect to a multi-dimensional overall exit buyout success remains to be explored. Equally based on agency theory, information asymmetries and game theory, Scholes et al. (2007) investigated 114 former European family businesses that were subject to MBOs/MBIs. While the authors identify that first generation family firms are morel likely to share information with investors, their research neglects other factors impacting exit buyout success, such as company performance and the market environment.

Whereas the above research does not propose a comprehensive conceptual framework, based on an empirical foundation, it is highlighting the following areas that potentially have an impact on exit buyout success:

- Correct **timing** and **early identification of the exit** issue with respect to company performance, valuation and interest rate levels, in order to be able to actively pursue the exit rather than being driven into it.[107]

- **Entrepreneurs' level of experience** with the exit process has been identified as a significant factor directly impacting success.[108] Even entrepreneurs who had established acquisition experience within their business have been challenged by the specific requirements of the exit process.

- Trust and good **relationships between sellers and buyers** allow mitigating information asymmetries during the sales process and have a positive impact.[109]

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[107] See Kensinger et al. (2000), p. 82 and Petty (1997), p. 418.

[108] See Bygrave, (1997), p. 436, Petty et al. (1999), p. 56 and Petty et al. (1992), p. 673.

[109] See Howorth and Westhead (2002), p. 202.

- A lack of involvement or low quality of the **support of external advisors** has been found to be part of the explanation for negative exit results.[110]

- Advance **preparation of the company** for the exit from a strategic, financial and organisational perspective. In particular, potential financial restructuring and data gathering consume significant, dedicated resources.[111]

- **Management of the exit process** and, more specifically, the resource split between ongoing operations and a time-demanding exit transaction, which affect both the entrepreneur and the management.[112]

- **Communication throughout the process** and **professional presentation of the company** have been confirmed as a success factor due to the importance of accurate information on the firm and the communication process between sellers and buyers.[113] Especially within trade sales, entrepreneurs tend to lack a deeper understanding of the buyer's motivations and do not adapt their communication strategy accordingly.[114]

- The conflict of different **valuation methodologies** has a direct impact on success. Whereas management and investors are focused on cash flows and earnings, entrepreneurs often have a certain value in mind, which often cannot be substantiated by computation.[115] This can represent both problems of over- and undervaluing the company, and therefore the entrepreneur risks surrendering part of the value to be harvested.[116]

- **Structuring of the transaction** and **payment terms** has been found to be a key criterion for success that often leads to complications.[117] A thoroughly thought-out deal structure can minimize moral hazard and adverse selection problems. Whereas entrepreneurs value a significant amount of cash upfront, buyers often

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110 See Bergamin (1995), Howorth and Westhead (2002), p. 202, Petty et al. (1992), p. 673 and Petty et al. (1999), p. 59.

111 See Bergamin (1995), Bygrave (1997), p. 436 and Petty et al. (1999), p. 61.

112 See Petty et al. (1999), p. 58.

113 See Howorth and Westhead (2002), p. 202.

114 See Petty et al. (1999), p. 60.

115 See Spak (2002), p. 34., Petty et al. (1992), p. 673.

116 See Petty et al. (1999), p. 57.

117 See Petty et al. (1999), p. 51.

prefer earn-out clauses and an equity share to remain with the seller in order to align interest over the transition period.

Despite a rising interest in private equity and succession across France and Germany in the late 1990s, it is surprising that so little conceptual and empirical research has been conducted on exit buyouts in these two geographies to date. Since 2003 a number of research projects, often empirical in nature, have been undertaken, mainly by industry organisations such as investor associations, in order to identify key issues and strategies applied within the exit process. Such projects are mainly driven by a motivation to prepare for the future wave of business transfers. Active sponsors are, for example, the European Venture Capital Association (EVCA) and the Institut für Mittelstandsforschung (IfM).

Recently completed studies include reviews of the succession practices of German SMEs by Schröer and Kayser (2006), BDI (2006) and Freund (2004) as well as for Switzerland by PWC (2005). However, their main focus remains on highlighting current trends and problem areas, rather than building a complete model explaining exit buyout success.

2.4.2 Success Factors in Family Firm Succession, Buyouts and M&A

With limited literature available that conceptually models exit buyout success, a number of frameworks trying to identify success factors in transactions similar to an entrepreneurial exit buyout have been reviewed. This includes family firm successions, buyouts beyond entrepreneurial exit situations and corporate M&A transactions.

Family Firm Succession

The field of entrepreneurship has often been associated with the creation of new firms, and less literature can be found on firm exit. However, family business research is quite frequently linked to the issue of succession.[118] Theoretical research has focused on the dynamics within the family and firm and particularly on the problems that family-business managers have in relinquishing control. Empirical model-building research has focused on examining succession practices and highlighting key issues regarding the preparation of the vast portfolio of family businesses to be handed over in the coming years.

Morris et al. (1997) model success in family business succession through three variables: “preparation of heirs”, “nature of family and business relationships” and “planning and

[118] See Brockhaus (2004) and Birley (2002).

control activities”. The results of their model lend tentative empirical support to the positive impact of all three factors, with a dominance of the family relationship components.

Based on a comprehensive literature review, Le Breton-Miller et al. (2004) suggest a synthesis of factors impacting family business successions. The analysis on a personal, social, firm and industry level suggests the importance of characteristics related to the successor and incumbent, the nurturing of successors, family relationships, and succession planning.

Buyouts

A main stream of buyout literature focuses on the positive impact of MBOs on company performance, which has been empirically validated across different geographies, including the USA, the UK as well as continental Europe.[119] Out of the large body of literature covering the concept of MBOs, key success factors and their adaptation in specific countries, the work at hand has reviewed the specific research that allows for deducing success factors for exiting entrepreneurs.[120]

In his work, based primarily on a comprehensive literature review and a deductive approach, Huydts (1992) investigated the MBO concept as an option for resolving succession issues for family businesses. Overall, he identifies the quality of financial engineering as a dominating success factor. With regard to the entrepreneur, he identifies management style, expected valuation levels and the handling of the valuation as the main success factors. On a company level, the probability of positive cash-flows is the main success factor. From a process perspective, timing, the quality of the business plan, support from external advisors, as well as external communication management are highlighted. From a market environment perspective, he identifies the overall economic conditions and, more specifically, interest rate levels as key elements.

In an empirical study of 133 MBOs in Switzerland between 1988 and 1994, Koch (1997) investigated the post-MBO experience of buyout managers, the national specifics, and the market environment for MBOs in Switzerland. The author draws insights from his analysis for entrepreneurs potentially considering a MBO exit. He identifies national tax legislation as a key issue, as the seller loses his tax exemption on capital gains if he sells his stake in the company as a private individual.

[119] See Jakoby, S. (2000), p. 51ff. and Achleitner and Fingerle (2003) p. 13 ff.

[120] For a presentation of the MBO concept, success factors and national particularities, see also Schwien 1995, Luippold 1991.

Birley and Muzyka (1999) and Muzyka and Hay (1994) examined what criteria MBO-funds use in evaluating potential investment opportunities. They provide important insights into success factors for the exit process, as most management teams within an exit buyout are supported by an MBO-fund. Both studies include exploratory as well as quantitative analysis and cover mainly UK investors. Among the five dimensions of financial, product/market, strategic/competitive, MBO management team and deal structure-related factors, the management team was identified as the most important element. This indicates that entrepreneurs have a valid interest in developing a strong management team before considering the exit.

Jakoby (2000) investigates success factors impacting the post-buyout performance of the company in an empirical study of 67 West-German MBOs between 1976 and 1995. The dependent variable of this research is different from the exit research in that the company's future success is one among several goals for the harvesting entrepreneur. The author cannot identify any significant impact related to the type of seller (family, large corporation, entrepreneur, or public entity), the motivation, or the decisions taken by the seller that significantly impact the success of the MBO. However, there is evidence that factors related to the process management of the buyout have a significant impact. The most important success factors identified are related to the economic conditions and, more specifically, low interest rates.

Jugel (2003) investigates the success factors related to the trade sale exit of MBO companies from an MBO-manager's perspective and the contribution of co-exiting MBO-funds within the exit process. The research is based on questionnaire responses from 71 German MBO-managers who exited their businesses between 1999 and 2000. The key factors contributing to a successful trade sale are identified as a company's market-leading position, even though market growth is not relevant, and the support of transaction-experienced MBO-funds throughout the process.

Mergers & Acquisitions

A main stream of mergers & acquisitions literature deals with the empirical phenomenon of no, or even a negative, post-acquisition performance impact. Of the large amount of literature covering the concept of acquisitions, key success factors, and their adaptation in specific countries, the work at hand has reviewed the specific research that allows for deducing success factors for exiting entrepreneurs.

Kaufmann (1990) investigates key success factors of acquisitions in a qualitative empirical study and identifies strategic fit, synergies, cultural fit and the perception of management

resources as key success factors determined in a pre-acquisition phase. This, in turn, implies that the identification of potential buyers needs to take into account considerations of strategic and cultural fit.

Jung (1993) reviewed a broad range of studies to identify the success factors of acquisitions. The author investigates the acquisition process from strategy definition to integration and monitoring. For each process step, success factors are identified which might also be relevant for exit management. However, a differentiation or prioritisation of the different factors is not provided. As the conditions surrounding acquisitions might vary substantially, the author emphasises that it might be difficult to identify generic success factors. Therefore, the suggested focus on investigating a narrower segment of transactions, with a broad focus on different factors, appears applicable for the proposed research.

Kim (1998) investigated the determinants of successful acquisition management in the lodging industry through empirical and quantitative analysis, based on a survey of 71 senior industry executives with significant acquisitions experience. Success criteria for acquisitions can, at the same time, be viewed by sellers as indications how to make their company as attractive as possible. The author found that within the range of factors observed prior to the acquisition, company performance was the most significant indicator of later success. This included the target firm’s cash flows as well as the company’s financial information. This implies that entrepreneurs might need to focus on company performance and solid financial communication throughout the exit process.

2.5 Research Gap

The exit buyout option, as analysed from a seller’s point of view, has not yet received particular attention in the literature. In particular, a gap in the existing research exists with respect to the definition of success, the scope of factors to be considered, the integrated nature of the factors, and more holistic research designs.

Definition of success

To date, there is no clear analysis and definition of the outcome variables of the exit process from either the seller’s personal or financial perspective. More particularly there is no distinction between different aspects of success, such as the availability of an exit buyout, the financial result and the sustainability of the firm longer term.

Scope of factors to be considered

The existing literature shows that the entire set of potential factors has been analysed to a highly varied extent. Research has focused on the strategic choice of higher-level exit options, with a particular focus on IPOs, company valuation, information asymmetries between entrepreneurs and investors and the role of external advisors. On the other hand, drivers related to the economic environment, company performance and organisation, the sellers' and buyers' personal characteristics and the overall process management have received far less attention. In addition, research in related areas has shown the importance of the geographical dimension, with the significant impact of national regulatory environments and cultural attitudes. However, most exit research so far has been focused on the USA and the U.K.

Integrated nature of factors

It is necessary to take an integrated and holistic viewpoint that includes the most critical issues simultaneously and in a multi-dimensional framework. However, to date, no end-to-end conceptual model has been established. Such a model would link drivers and outcome variables to a descriptive model that identifies differentiating key success factors.

Research design

The significant number of theoretical and descriptive empirical studies is contrasted with the small number of model-building qualitative and quantitative empirical studies, particularly throughout Europe.

3 Research Desgin

3.1 Methodology

The nature of the research question and the limited availability of existing empirical literature on buyouts in an exit situation required a holistic and explorative model-building approach. The author listened to informants and built a picture based on their ideas while applying a predominantly qualitative research paradigm.[121] A methodology combining five exit case studies with an investor survey was developed in line with the explorative nature of the research question, the availability and accessibility of data.[122]

The purpose of this study was the description and exploration of interactions between different variables impacting the success of exit buyout transactions. The investigation aimed to establish causal relationships between a set of variables.

The unit of analysis was the exit buyout transaction from the initial exit decision of the entrepreneur to the completion of the sale to the investor.[123] As with most sales transactions, the success of an exit buyout cannot be determined unilaterally by the entrepreneur but is rather the result of the interaction between entrepreneur, investor and the variables surrounding the exit buyout. Even if the viewpoint of the entrepreneur has been the primary focus, a single perspective can hardly explain the phenomenon.[124] This applies, for example, to the analysis of the exit buyout process that takes into account potential conflicts of interest between entrepreneurs and investors based on information asymmetries during the due diligence phase, or the evaluation of entrepreneurs' financial and personal objectives

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[121] Qualitative research is defined as an inquiry process of understanding social problems, based on building a complex, holistic picture, formed with words, reporting detailed views of informants, and conducted in a natural setting. Creswell (1994), p. 1.

[122] A methodology can be defined as a general approach to study a research topic. To be relevant, a methodology has to be useful for examining the research question. Silverman (2005), p. 98.

[123] Units of research can be of various natures: individuals, attributes of individuals, actions and interactions, behaviour, settings, incidents and events. See Brewer and Hunter (2006), p. 84.

[124] The subjects studied, in this case entrepreneurs, can give, upon request, an account of the context of their actions. However, problems can arise if a privileged status is attributed to that account. There is little reason to assume that the subjects have a privileged status as commentators on their actions. Their feedback cannot be taken as a direct validation or refutation of an initial observation but should be rather treated as yet another source of data. See Fielding and Fielding (1986), p. 43, Bryman (1988), p. 78.

which might be biased when data is collected from entrepreneurs only.[125] Therefore, the units of observation chosen were entrepreneurs and investors who participated in exit buyout transactions.[126]

The first step of the study was exploratory: drafting a conceptual framework, "casting a broad net" of topics. The large number of factors potentially impacting the outcome of an exit buyout was reduced to a workable number of potential key success factors in order to allow for subsequent empirical analysis.[127] The key success factors of exit management may be viewed differently by the different stakeholders involved. Therefore, an initial round of ten explorative expert interviews with entrepreneurs, investors and external advisors was conducted.[128] In addition the literature review of existing models describing and explaining entrepreneurial behaviour and firm succession also served as a basis for formulating the conceptual exit buyout framework.[129]

An explanatory case study approach was chosen to reveal the way multiple factors interact in order to create the character of the exit buyout transaction under study.[130] The case study method has a proven ability to generate new insights that would normally not emerge from quantitative analysis. Case studies can illuminate a decision or a set of decisions around exit buyouts: why they were taken, how they were implemented and with what result. They can provide rich contextual evidence surrounding sensitive issues and can give meaning to processes that have not previously been explored in depth, especially when the boundaries between phenomenon and context are not clearly evident, as it is the case of exit buyouts, given the multitude of independent variables to be examined.[131] An important limitation to the case study approach is that generalisation can only be applied with a considerable risk of

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[125] Entrepreneurs might question or deny the need for a detailed due diligence and see it more as a source of concern than success. However, given the existing information asymmetries, investors will not be able to proceed without some form of due diligence. Entrepreneurs might also not openly discuss the importance they attach to financial objectives. Therefore, a second external perspective obtained from investors proves to be important.

[126] Observational units can be defined as those units from which data are collected. Following common practice, a study's units of observation can be different from the unit of analysis. See Brewer and Hunter (2006), p. 88. The existing literature on private equity transactions involving two participating parties includes Davidson (2005) (MBO managers and investors) and Hagenmüller (2004) (private equity limited and general partners).

[127] Kim (1998) expressed similar concerns and reduced more than 300 identified factors to about 60 main elements through a series of expert interviews.

[128] The initial round of interviews included three entrepreneurs, three investors, two intermediaries and two legal advisers.

[129] See chapter 3.2.1 Conceptual Framework.

[130] Entities that can be the focus of case studies can be of various sorts, such as individuals, groups, organisations or actions, processes and events. See Yin (2003) p. 23 and Thomas (2003), p. 33.

[131] Explanatory case studies are the preferred strategy when "how" or "why" questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon in a real-life context. See Yin (2003) and Eisenhardt (1989).

error.[132] This risk can be reduced by examining more than one entity in order to identify similarities and differences between entities. Hence, in this study, five cases were examined in the form of a “collective case” study or “multiple case study”.

The in-depth analysis of the exit buyout case studies helped to assess entrepreneurs’ behaviour and interactions with investors throughout the process and allowed the establishment of evidence in the complex environment of the entrepreneurial exit. The results helped to empirically refine the conceptual framework into an exit buyout model, allowed the prioritisation of a set of key success factors, and facilitated the formulation of propositions for further research.

However, identifying a set of sample exit buyout cases and accessing the corresponding entrepreneurs proved to be a difficult task. Establishing empirical data in significant quantities and on the appropriate level of detail to allow for meaningful analysis was also a challenge. This is in line with data gathering issues encountered by earlier studies in the entrepreneurial exit field.[133]

The population of exit buyout entrepreneurs was difficult to identify by means of typical instruments such as M&A databases, private equity association listings or through the financial press. A review of M&A databases, which typically also list buyouts, showed that this approach was ill-suited to the proposed research, as no specific information about the motivation of a transaction was listed, data to clearly distinguish exit buyout transactions from other types of buyouts was lacking, and the names of entrepreneurs were most often not indicated.[134] Contacts with private equity associations and research institutes showed that these either also use the above M&A databases or consider their individual data sets to be proprietary and confidential.[135] A review of the financial press helped to identify a number of exit buyouts. However, it was difficult to obtain access to the entrepreneurs involved, as they could not be addressed ex-post through their former companies and personal contact details were most often not publicly available.

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[132] This corresponds to the aim of obtaining representative and generalisable results from qualitative research, which is often difficult to achieve when only studying a single case. See Silverman (2005), p. 128.

[133] Research in the field of entrepreneurial exit decision-making is faced with a number of empirical challenges, mainly because accessing the required information is no small matter in this area. See Petty (1997A), p. 91.

[134] The following databases were reviewed: Dealogic. M&A Review, Mergermarket, Zephyr - Van Dijk. Exit buyouts were not identifiable among buyouts motivated by other factors (i.e., MBIs, MBOs, OBOs, corporate buyouts).

[135] The following institutions were contacted: European Venture Capital Association (EVCA), Bundesverband Deutscher Kapitalbeteiligungsgesellschaften (BVK), Association Francaise des Investisseurs en Capital (AFIC), Swiss Private Equity and Corporate Finance Association (SECA) and Center for Management Buyout Research (CMBOR).

In contrast, the population of exit buyout investors was much easier to identify and access. Organised to a large extent in industry associations such as the AFIC in France, the BVK in Germany and the EVCA on a European level, investors were identified based on membership listings.

An investor survey was established to identify potential cases and corresponding entrepreneurs, given that no other sources were readily available. This indirect approach has been employed successfully by earlier research when contacting entrepreneurs ex-post via buyout funds or external advisors.[136] Funds were questioned to identify entrepreneurs with exit buyout experience and to obtain their contact details. Subsequently, a long-list of entrepreneurs to be contacted and cases to be studied was established.[137]

In addition, the investor survey was also aimed at providing additional data on exit buyouts from a complementary angle. A combination of multiple methods in one research design can enhance overall results through triangulation and comparison of results.[138] The fundamental strategy of research combining multiple methods is to address a research problem with several methods that have non-overlapping weaknesses in addition to their complementary strength.[139] Studies that combine multiple methods have been successfully applied in the management and business literature in general and in the research of the quickly evolving field of private equity in particular.[140]

The survey of investors was based on a structured questionnaire and helped to gather data on key issues and success factors of the exit process from the perspective of investors as well as from their perception of entrepreneurs' objectives. As shown in Exhibit 18, the data collected was able to be compared with case study data and helped to challenge the results obtained from the case study analysis. Furthermore, the accuracy of description enhanced

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136 A similar approach can be found in Bleackley et al. (1996) and Muzyka et al. (1993). Petty et al. (1992) applied this approach and used the Mergerstat database.

137 The sampling procedure applied to select the five individual cases is described in chapter 3.4.

138 Greene et al. (1989) advance five reasons to combine methods into a single study:
- triangulation in the classic sense of seeking convergence of results;
- complimentary, overlapping and different facets of a phenomenon may emerge;
- the first method can be used sequentially to help inform the second method;
- contradictions and fresh perspectives may emerge;
- mixed methods can add scope and breadth to a study.
Several schools of thinking arose around mixed methods. Whereas "purists" argued that paradigms and methods should not be mixed, "situationalists" pointed out that certain methods are appropriate for specific situations; "pragmatists" attempted to integrate methods, underlining that a false dichotomy existed between qualitative and quantitative approaches and that research should make the most efficient use of both paradigms in understanding social phenomena. See Creswell (1994), p. 176.

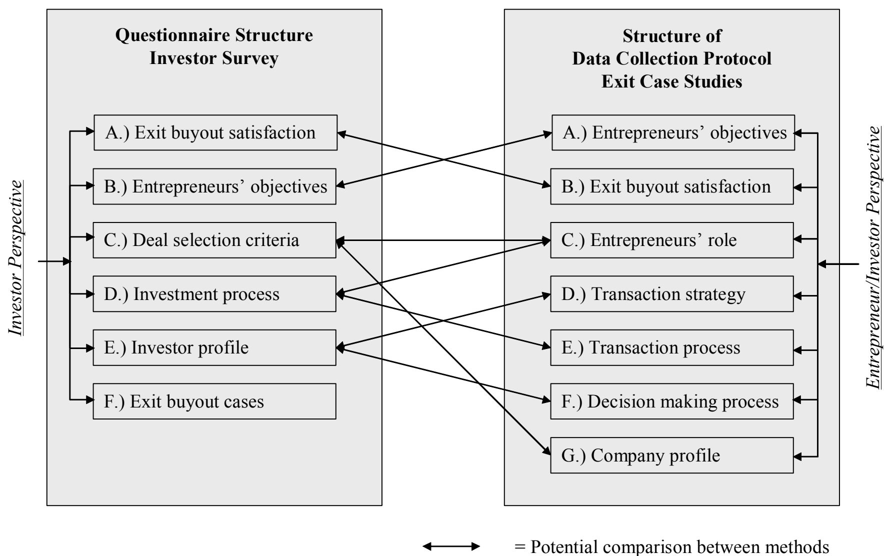
139 See Brewer and Hunter (2006), p. 4.

140 Tashakkori and Teddlie (1998) identified an active area of multi method research in management and business sciences. Hagenmüller (2004) chose a multi method approach, combining an investor survey with five case examples in an explorative study of investor relations of private equity partnerships.

the status of certain variables if cast in numerical form (percentages, averages, extent of variability). That stands in contrast to the less accurate results reported by means of verbal expression only. The survey also served as a control group. As the cases were proposed by investors, there existed the possibility that they would only have suggested cases with a particularly positive outcome, both from the entrepreneurs' and the investors' perspectives. That might have impacted results through a selection bias and have limited the learning experience typically associated with less well planned and executed transactions.

At the same time the survey report failed to show the unique way that different variables fit into the pattern of the researched exit buyout and therefore could not describe all of the features that were covered by the case studies. This again underlines the complementary strength of the two approaches.[141]

Exhibit 18*: Survey questionnaire and case study data collection protocol*

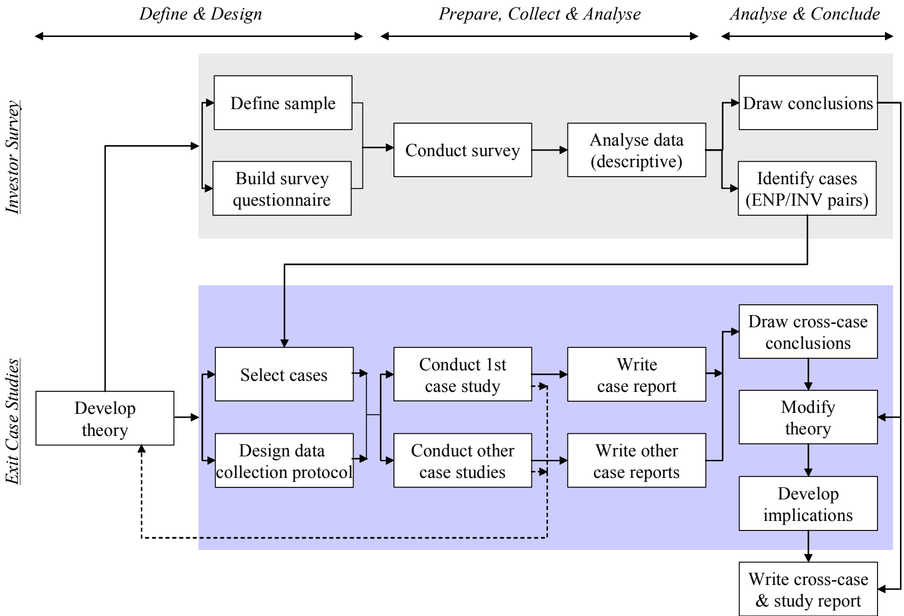


Source: own graph based on Davidson (2005), p. 14.

In a "dominant-less dominant" design, the methodology developed, as shown in Exhibit 19, followed a qualitative paradigm, combining five exit case studies with a survey of 116 investors in France and Germany. The advantage of this approach was that it presented a

consistent paradigm throughout the study and still allowed the gathering of information to probe certain aspects of the study.[142] The survey results were used to identify a long list of potential case studies and the analysed survey data was mirrored to the case study results, helping to address the generalisability of results. Both methods were applied in parallel within a "parallel mixed design".[143]

***Exhibit 19**: Research Methodology*



Source: own graph based on Yin (2003), p. 50 and Teddlie and Tashakkori (2009), p. 152.

3.2 Explanatory Model

3.2.1 Conceptual Framework

Based on a review of the existing literature, a conceptual framework was developed that links the level of achievement of the entrepreneurs' financial and personal objectives to

[141] See Thomas (2003), p. 44.

[142] See Creswell (1994), p. 177.

[143] See Teddlie and Tashakkori (2009), p. 26.

company performance, market environment, personal traits of entrepreneurs and investors and exit strategy and process variables.[144]

Several existing models describing and explaining entrepreneurial behaviour and firm succession served as a basis for formulating the proposed exit buyout framework. In accordance with the concepts of Le Breton-Miller et al. (2004) and Klein (2004) on family business succession, a broad framework based on macro-factors involving key participants, aspects of the firm, strategy and process variables as well as the surrounding market environment was established.

Several additional elements were integrated on a more granular level. Rubenson and Gupta (1996) developed a basic contingency model to conceptualise the events leading to initial succession and to help determine the right timing for succession to strengthen the organisation and adapt to changing external conditions. Succession is modelled as being contingent on three criteria: (1) Is the organisation changing? (2) Is the entrepreneur able to adapt to those changes? and (3) Can the entrepreneur hinder succession? The aspect of timing was equally addressed in an executive succession model by Dyck et al. (2002), highlighting the importance of timing and sequencing. Leroy et al. (2007) applied the theory of planned behaviour to explain micro business entrepreneurs' exit decisions and strategies, suggesting that personal, social, firm and industry variables might have an impact that is mediated through behavioural intentions. Morris et al. (1997) modelled the success in family business successions and suggest that the "preparation of heirs", "nature of family and business relationships" and "planning and control activities" can be determinants for the outcome of family business transitions. Two of these factors could be transposed into the exit process as "preparation of organisation and management" and "planning and control of the exit".

None of the more granular models investigated above proposes variables linked to the success of the exit process as the dependent variable. However, most models consider individual blocks of independent variables that need to be examined to understand and explain a successful entrepreneurial exit.

The set of factors defining the conceptual framework, as shown in Exhibit 20, can be distinguished into dependent, independent and moderating variables.

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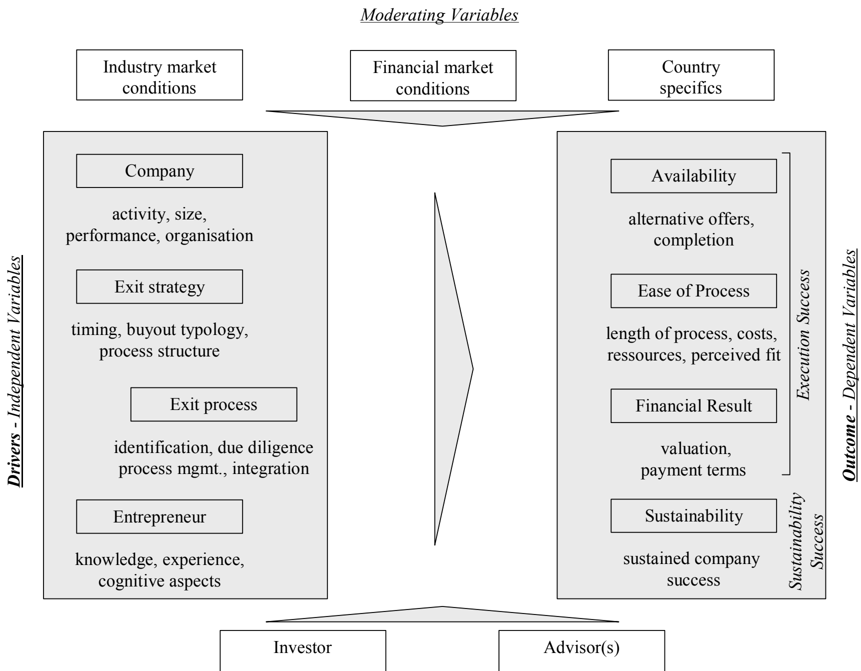
[144] A model can be defined as an overall framework for looking at reality. To be relevant, a model has to be useful in examining the research question. Silverman (2005), p. 98.

Exhibit 20: *Conceptual framework*



Source: own graph.

3.2.2 Variables

Dependent Variables

The dependent variables model the success of the exit buyout. They have to allow the measuring of the level of achievement of both the financial and non-financial goals of the entrepreneur.

To be able to assess entrepreneurs' satisfaction with their exit buyout, the motivation for such a transaction needs to be understood as well as both the trigger initiating the process and the set of objectives entrepreneurs and investors seek to realise throughout the process. Only then can satisfaction be measured and criteria instrumental to success analysed.

According to discrepancy theory, which was developed in the context of industrial and organisational psychology, an individual's satisfaction is driven, at least in part, by whether there is a gap between actual achievements and the initial set of objectives.[145] Empirical research by Cooper and Artz (1995) provides some evidence that the objective-achievement gap theory may apply to the entrepreneurial population.

An entrepreneur's exit motivation together with the factors determining the exit process translates into a set of exit objectives. They can be regrouped into objectives related to execution success, the successful completion of the exit transaction, and sustainability success, which aims at the longer-term viability and competitiveness of the firm, which in turn drives the satisfaction of all stakeholders involved.[146] For the purpose of this research, the term execution success will be represented by three aspects: the availability of the exit buyout option and its completion, the satisfaction with the entire exit process, and the – mainly financial – results of the exit.

The availability and completion dimension refers to being able to identify a viable exit option at a given moment in time and the ability to close the exit process closing. It can also include the goal of being able to choose between several offers with different proposed valuations and structures. The process dimension represents the length, the resources deployed, and the cost of the process and can include softer factors, which can be described as the perceived ease of the process. That perception reflects the entrepreneurs' level of satisfaction or frustration throughout the process and the fit with investors that is achieved.[147] The dimensions of financial results include the valuation agreed upon, the phasing (in the case of several payments), as well as the structuring and guarantees negotiated.

Objectives of sustainability success reflect entrepreneurs' desire to ensure the successful further development of the firm after the exit transaction. This can be linked to the goal of continuity, trying to maintain the interests of stakeholders such as employees, clients, suppliers and to some extent the community in which the company is situated.

Similarly to entrepreneurs, investors' objectives might be linked to a combination of execution success, the successful completion of the exit buyout transaction and subsequent investment success, which is driven by the longer-term evolution of their exit buyout investment.

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[145] Michalos (1986) shows, in his extensive literature review, that 90% of the studies investigating discrepancy theory find a significant link between satisfaction and the "gap" between actual rewards and objectives.

[146] See Huydts (1992), p. 29.

Execution success can be defined along three dimensions.[148] The availability and completion dimension reflects the necessity for investors to conduct a certain number of investments to achieve targeted returns on the capital managed. The process dimension aims to ensure an efficient process management, with due diligence representing a costly task for investors, especially when it involves external resources of auditors, lawyers and other experts. The process also needs to provide a detailed and transparent picture of the firm based on which investors can make an investment decision and define an offer. The dimension of financial results includes the valuation agreed on, with an entry valuation determining to some extent the return that can be realised from the investment, as well as the structuring and guarantees negotiated, which potentially distribute risks and aligning interests with exiting entrepreneurs.

Independent Variables

The review of the existing literature has shown that the exit process can be impacted by a multitude of independent variables related to the key stakeholders involved, the company itself, and the quality of the strategy and execution of the exit process. The main elements that need to be considered are the individual's experience and exit know-how, the company's maturity, structure, performance and future potential. With respect to the strategy level, one must consider the exit timing, the envisaged post-exit structure, and numerous exit process variables, from process management to valuation techniques, negotiation, legal structuring, financial engineering and support from external advisors.[149]

Moderating Variables

The most important moderating variables in this research context are the financial and industry market conditions at the time of the exit and the specific national characteristics of the two geographies examined.[150] The economic climate might be particularly important as it determines valuation levels and interest rates, which both have a direct impact on the effectiveness of an exit buyout. National characteristics relate to the different structure of capital markets for medium-sized companies across the two countries, different legal and tax

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147 See Morris et al. (1997), p. 392.

148 See Then Bergh (1997), p. 28.

149 A list of independent variables is provided in Appendix A. See also Morris et al. (1997), p. 392 for variables concerning organisational preparation and process planning and control.

150 A list of moderating variables is provided in Appendix A.

regulations, and the significant variations in cultural attitudes toward the exit buyout option.[151]

3.3 Sample Frame

The investigation focused on exit transactions following the exit buyout definition. However, as entrepreneurship, by definition, is a very diverse field, with entrepreneurs pursuing opportunities in many different ways, a segmentation and limitation to a specific target area was an important prerequisite for empirical research and consistent reflection on entrepreneurial phenomena.

The proposed analysis of exit transactions therefore had a clearly defined focus to ensure valid results and recommendations. The targeted sample frame was defined as predominantly founder-run but also owner-manager-run and family businesses valued between € 5-250 million, with shareholders handing over a very significant or preferably even a majority stake within an exit buyout to the future management and financial investors across France and Germany. This sample was selected because only with a certain size and maturity of the business can the process be expected to be structured and managed professionally, allowing for meaningful and replicable insights. An upper limit to the company size was introduced at € 250 million to focus on the large population of SMEs in France and Germany and to separate off very large buyouts valued up to several billion Euros. These follow different processes and are typically pursued by a different set of investors focusing on very large transactions.

Additional criteria regarding industries or future growth potential have not been defined to allow for a broad set of experiences in different situations. It was also taken into consideration that events before and after the exit need to be tracked, and therefore only completed exits were investigated ex-post.

A time horizon of 2000 to 2007 was selected since different stages of the economic cycle had to be included in the analysis to test the impact of moderating variables and because it was necessary to identify a minimum number of transactions. This is in line with the increase in buyout activity over the last decade, and ensures a reasonable proximity of exit events.

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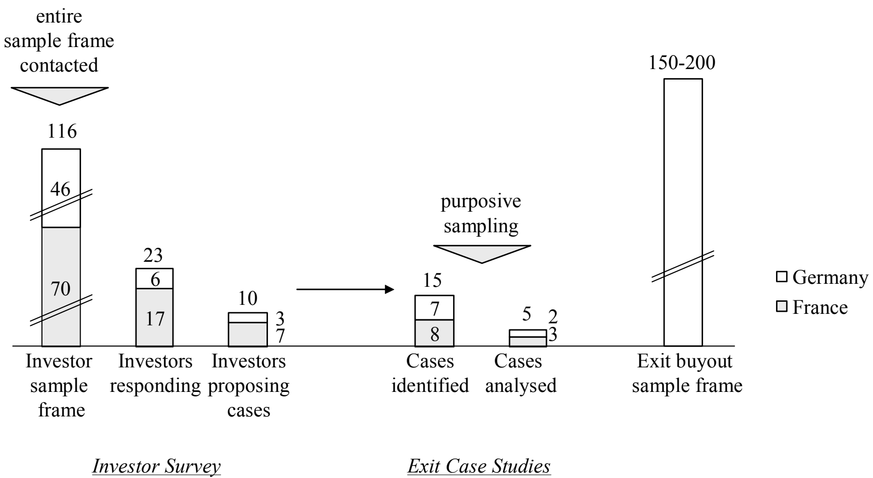
[151] See Muzyka et al. (1993), p. 279.

The population of exit buyout investors targeting the above deal selection criteria was identified as 70 in France and 46 in Germany.[152] All 116 investors were included in the survey sample.[153] The population of exit buyouts and the related entrepreneurs was more difficult to determine and was estimated at around 150 – 200 for the period between 2000 and 2007, following the criteria outlined above.[154] As shown in Exhibit 21, 15 of these exit buyouts were identified through ten investors, and five cases were selected for analysis through purposive sampling.

***Exhibit 21**: Overview of sample frames and case study sample*



The known problem in this area is the given, rather limited number of exits. The question of empirical research reliability and validity within small sample sizes will be addressed separately in the following sections on case study and survey results.

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152 The total number of investment companies, as listed by the national industry associations in 2007, is 270 in France and 197 in Germany. After deducting early-stage venture capital, large buyout and fund of funds, a list of 70 potential exit buyout investors in France and 46 in Germany was identified, corresponding to about 25% of all investment companies. This corresponds to the subgroup of about 120 investors, members of the EVCA, targeting mid-market buyout opportunities in France and Germany. See also AFIC (2008), BVK (2008), and EVCA (2007).

153 For a list of funds included in the survey, see Appendix B.

154 Ten investors had listed 15 exit buyout cases. This implies that the total population of 116 investors might have participated in a total of 150 – 200 transactions. This estimation is in line with earlier research indicating that only about 20% of buyout activity is linked to founder-run and family businesses, and only a subgroup of this share will correspond to the above criteria (CMBOR (2006)). Average annual buyout numbers over that period are 350 in France and 100 in Germany; thus a total number of 150 – 200 exit buyouts is supported by the data (AFIC (2008), BVK (2008)).

3.4 Exit Case Studies

The objective of the case study analysis was to empirically refine the proposed conceptual framework into an exit buyout model, prioritise a set of key success factors and facilitate the formulation of propositions for further research. The fact that five cases were examined allowed testing for external validity by applying a replication logic and cross-case comparisons.[155]

A non-probabilistic purposive sampling technique was chosen because it allowed generating a wealth of detail from a few cases and facilitated building a sample that represented as closely as possible the broader group of cases in the sample frame.[156] A typology of exit buyouts was established according to three criteria, including geographical location, activity and size of the company, to ensure that the selected cases represent the overall population.[157] This allowed for a comparison of exit buyouts across countries, industries, company maturity levels and entrepreneurial lifecycle stages. Out of the 15 cases identified through the investor survey, five were selected. The sample included three companies in France and two in Germany, three manufacturing and two service businesses, four SMEs with € 5 - 20 million in annual revenues and one significantly larger firm with revenues of € 250 million, as shown in Table 8. Predominantly smaller-sized transactions were selected because this size class represents the largest share of the population and with decreasing size, a successful transaction might be further complicated due to higher cultural barriers and high relative transaction costs. None of the five firms had received significant levels of outside equity investments before, particularly not from venture capital or buyout investors.

The selection of cases based on a long list proposed by investors left room for a potential selection bias toward cases with a particularly positive outcome. However, the analysis of the five cases showed that all of them had to overcome significant obstacles before reaching closing and therefore could be considered representative of a natural setting, as required for case study analysis

[155] See Yin (2003), p. 37 and Creswell (1994), p. 167.

[156] A key factor determining how generalizable or representative the research results are is the sampling method. Sampling is typically aimed at identifying a representative subsection of the relevant population. However, quantitative and statistical procedures are usually unavailable in qualitative research.
Purposive sampling is a nonprobability sampling strategy. It is based on the claim that theoretically significant, but not necessarily statistically significant, units have been selected for the study. It allows choosing a case because it illustrates some features of interest. It demands thinking critically about the parameters of the population being studied and to choose a sample carefully on that basis. See Teddlie and Tashakkori (2009), p. 174, Silverman (2005), p. 127 and Brewer and Hunter (2006), p. 93.

[157] See Stake (2000), p. 446.

The entrepreneurs were contacted through their buyout investors in France and Germany. Corresponding investors were also questioned. All five entrepreneur-investor pairs accepted an invitation to participate in the study. One entrepreneur requested to keep his identity as well as the name of the company and the corresponding investor confidential.[158]

***Table 8**: Overview of case studies*

Company	Country	Activity	Company creation	(Initial) Exit transaction	Revenues (yr. of initial exit)	Investor
Maier Chem	DE	specialty chemicals	1870s	2001	ca. € 250 M	AB Capital
CFC Audit	FR	operational consulting	1991	2002	ca. € 13 M	Initiative Finance
Sofilab/La Buvette	FR	industrial manufacturing	1947	2003	ca. € 11 M	Alliance Entreprendre
Divalto	FR	software editor	1982	2006	ca. € 7 M	Before
Wakame	DE	fresh food production	2003	2007	ca. € 5 M	European Capital

The data collection was based on a combination of two different methods: interviews as well as document collection and analysis.[159] One- to two-hour face-to-face interviews, based on a mix of "loose" and "tight" questions were conducted with entrepreneurs and investors. While the informants could not be directly observed during the exit process, they were able to provide historical information about their personal exit buyout experience. The interviews provided in-depth information and allowed the author to question informants and "control" the line of questioning according to a data collection protocol.[160] Typical issues associated with in-person interviews were addressed by holding meetings in a third-party office, rather than at the entrepreneurs' or investors' own offices. The unavoidably "indirect" information filtered through the views of each entrepreneur was contrasted with the perspective of the corresponding investor and vice versa. Finally, the author's presence represented a potential bias which we sought to contain by thoroughly preparing for each interview. This was achieved using the available documents and a non-intrusive, rather than too proactive, interview style.[161] During the interviews confidentiality issues required assessing financial success in an indirect way, as entrepreneurs and investors were reluctant to disclose payment details and company valuations. The measurement of cognitive factors related to personal satisfaction required a broad range of elements, as each entrepreneur might value different aspects. We also had to consider that there might be a significant difference in the

[158] The case has been renamed Maier Chem and the investor AB Capital.

[159] When methodological triangulation is applied, different methods or sources allows the various methods to serve as corroboration for each other (Mason (1996)). However, mapping different data sets upon another may be a non-trivial task and often data cannot simply be aggregated to arrive at an overall "truth"(Silverman (2005)), p. 122. Therefore, it should be ensured, that triangulation always begins from a theoretical model and that the methods chosen give an account of structure from within that model (Fielding and Fielding (1986)).

[160] A copy of the data collection protocol can be found in Appendix C.

[161] For a review of interview methods see Thomas (2003), p. 63, Silverman (2005), p. 154.

perception of success right after the exit compared to a longer-term perspective. To ensure construct validity, multiple sources of evidence (i.e., entrepreneurs and investors) were used and draft reports were reviewed by informants.[162]

The document analysis was conducted based on the financial and industry-specific press, company and investor websites and transaction databases logging the sale of private companies. This method allowed for an unobtrusive way of data gathering and information was analysed that mostly journalists had given attention to compile. However, the information has been handled cautiously, as the documents may not all have been authentic or accurate. Further on, a number of variables proved difficult to measure; for example, a particular company's pre-exit performance was difficult to assess and required indirect assessment, as financial results for private entrepreneurial companies tend not to be available, either through official databases or through direct contact with entrepreneurs.[163]

A case study database was created including case study notes, documents and tabular materials, helping to establish a chain of evidence from the initial research question to a refined exit buyout model. The reliability of the data collection process was ensured through the use of a data collection protocol and the documentation of case profiles.

The general strategy for analysing the data was based on the initial version of a conceptual exit buyout framework. For analysis the collected data was categorised, coded, reduced and interpreted based on the initial conceptual framework.[164] The information was transcribed and displayed systematically in tables illustrating the relationship among variables and facilitating a comparison of individual cases.[165] Internal validity was addressed through two analytical techniques: pattern-matching between cases as well as explanation-building and iterative graphical refinement of relations between variables of the conceptual framework throughout the data analysis.[166]

3.5 Investor Survey

The objective of the conducted survey was twofold: Identifying exit buyout transactions and the corresponding pairs of entrepreneurs and investors as well as generating a set of data for the triangulation of case study results.

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[162] See Yin (2003), p. 35.

[163] Other authors expressed similar problems, for example, Jakoby (2000), p. 99.

[164] See Creswell (1994), p. 154. Tesch (1990) called this process "de-contextualization" and "re-contextualization".

[165] Miles and Huberman (1984) support the concept of representing information systematically in matrices.

The survey was aimed at collecting information about:

- Investors' satisfaction with recent exit buyout transactions;
- Entrepreneurs' objectives as perceived by investors;
- Investors' deal selection criteria;
- Investors' preferences and practices throughout the investment process;
- Investors' organisational structures and investment activity;
- Sample exit buyout cases.

Because of the workable size of the sampling frame, a total number of 116 mid-cap buyout investors identified across France and Germany were contacted in April 2007. Investors were identified based on membership listings of the national and European investor associations AFIC, BVK and EVCA and subsequently qualified as exit buyout investors based on their focus areas (i.e., investment situation and size, geographical and industry focus) as published on the investment companies' websites.

The data of the mail survey was collected through a standardised written questionnaire with predominantly closed questions.[167] The operationalisation and measurement of variables in the survey instrument were based on earlier research by Davidson (2005) and Hagenmüller (2004) for items concerning entrepreneurs' (sellers') objectives, deal selection criteria, investment process, and investor profile. The items covering different aspects of investors' satisfaction with exit buyouts were developed based on expert interviews. The items were then pretested with a subset of six investors, which subsequently led to the refinement of the formulation of several questions. A five-point Likert scale was employed, with a score of 1 suggesting "not important at all" or "very unsatisfied" and a score of 5 suggesting "very important" or "very satisfied" in reference to the different aspects of the exit buyout process.

A range of descriptive statistics, including mode, mean, median, standard deviation, variance and correlation coefficients were employed to analyse the data.[168] In addition, a list

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[166] See Yin (2003), p. 36.

[167] For a copy of the investor survey questionnaire, see Appendix D and E. See also Atteslander (2003), p. 145, on the application of standardised written questionnaires.

[168] Descriptive statistical methods include techniques for summarizing numeric data into easily interpretable tables and graphs, understanding the data, detecting patterns and relationships. See also Teddlie and Tashakkori (2009), p. 258.

of 15 exit buyout transactions was gathered from ten survey responses, building the basis for the subsequent selection of five case studies.

Exploitable responses were received from 23 investors, corresponding to a response rate of 20 percent, as indicated in Table 9. While this number is too low to allow for comprehensive statistic modelling and testing, it does represent a significant share of total market activity in the exit buyout segment when compared to the number of transactions completed and the total amount of funds under management. It appeared that a multitude of recent empirical studies had reduced the readiness of investment firms to participate in such surveys and the willingness of associations like AFIC, BVK or EVCA to support such initiatives.[169]

***Table 9**: Response rates*

	Number of investors	**Percent of total**
Sent questionnaires	116	100%
Returned questionnaires	26	22%
Poorly completed questionnaires	3	3%
Complete questionnaires	23	20%

The main characteristics of the sample corresponded to other recent surveys, such as the one proposed by Achleitner et al. (2006a) for the structure of German buyout investors, especially with respect to fund size and age of funds.[170] Hence, further stratification of the sample was not required. The two groups of French and German funds participating in the survey appear to be rather homogeneous with respect to their operations and average age of the organisation, as shown in Table 10. The investment targets appear to be similar in size and valuation. Some differences can be identified regarding the number of investments made per year and the size of the funds.

***Table 10**: Overview of participating funds*

	France (n=17)	**Germany (n=6)**
Average target investment size (enterprise value, € m)	70	91
Average target entry valuation (EBIT-multiple)	6.1	6.2
Average number of investment proposals received per year	193	163
Average number of investments made per year	8	2
Average age of fund (years)	15	13
Average of total funds raised since inception (€ m)	268	519

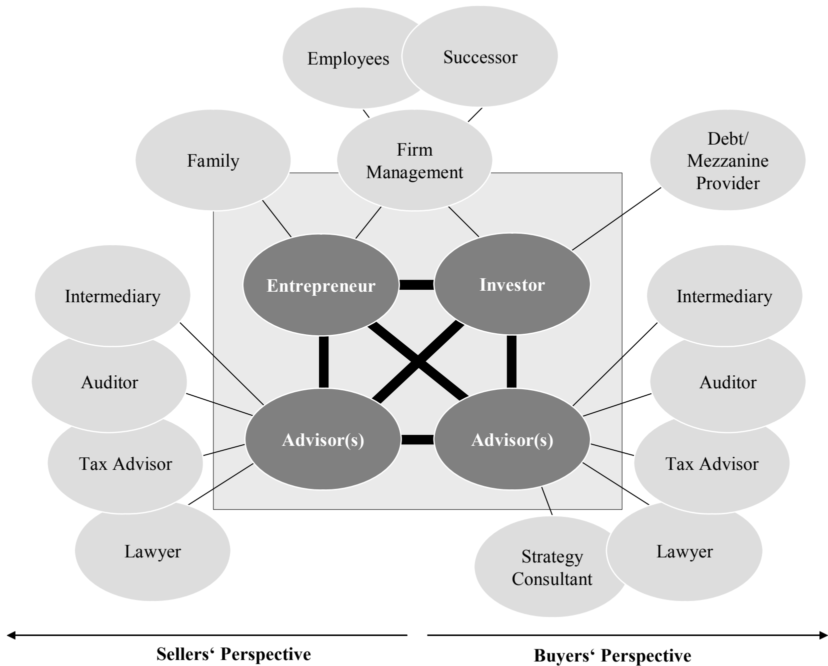
[169] Achleitner et al. (2006a) obtained a response rate of 47% in a private equity investor survey officially supported by the German BVK. Hagenmüller (2004) obtained a response rate of 40% in a private equity investor survey officially supported by the EVCA.

[170] Target investment size was typically a rather wide range of € 5 – 10 million up to € 100 – 150 million, covering the main target segment of SMEs.

4 Factors Related to the Key Participants

The exit buyout process unfolds in a complex universe of relationships between numerous participants, as shown in Exhibit 22. Choosing from the entire set of protagonists, this research focused on the entrepreneur, the investor, their specific relationship and the role of external advisors in moderating this relationship.

Exhibit 22*: Overview of participants in the exit buyout process*



Source: own graph based on Kitzmann (2005), p. 21 and SECA (2006).

4.1 Entrepreneur

The behaviour of entrepreneurs throughout the exit buyout is driven by a specific motivation and their exit objectives. In a broader sense, entrepreneurs' human capital can be defined to include experience as well as cognitive styles. The degree to which entrepreneurs can leverage previous experience to enhance their chances of success will likely depend on a number of intangible considerations such as cognition and learning.[171] Therefore, it could be hypothesised that the entrepreneurs' objectives, experience and cognitive effects can impact exit buyout success.

4.1.1 Motivation and Objectives

Case Study Evidence

Exit motivation in the cases examined was most often related to age, career-change, firm strategy and industry trends, with the desire to harvest and diversify investments present as well. However, in none of the cases did financial, organisational or social pressures seem to have driven an important part of the motivation. Often strategic reasoning seemed to have played an important role, with personal motivations remaining important but not always dominant. Defensive motives, such as a diminishing fit between the entrepreneur and his firm or pre-empting acquisitive pressure from competitors, played only a limited role. Overall, it seemed to be difficult to identify a single dominant motive in each of the cases. It was much more a mix of different personal and corporate motivations that were identified. Therefore, it might be suggested that motivations can vary in many different configurations, similar to a rating on a multidimensional scale, with the personal situation of the entrepreneur and the industry conditions being important determinants of a specific motivational profile.

All of the entrepreneurs appeared to be positively motivated to exit and were open to considering an exit solution; three entrepreneurs had started the process based on their intentions to exit. This is an important difference to large parts of the family business literature, where family managers often seem to delay successions due to their desire to retain control.

[171] See Ucbasaran et al. (2003b).

The family shareholder of Sofilab commented:

> *"I have no children and I didn't want to work until I became 65 years old. So I started considering my exit in my late 50s."*

Similarly the Founder of CFC stated:

> *"From the start I knew that I didn't want to run my company until my retirement. So when the business had reached a certain level of maturity I contacted a number of consulting and audit firms that might have been interested in acquisitions. But my intention to sell made them suspicious and I did not have a strong autonomous management team in place. By the time I had prepared a management succession I again contacted potential strategic investors. At about the same time financial investors approached me, driven by recent buyouts in the consulting sector. I took the opportunity, continued discussions with them and finally ended up down that road."*

However, in two other examined exit buyout cases, the decision to finally launch the exit process or to consider the exit buyout option had been triggered by opportunity rather than planning. After having considered changes on a firm and personal level for a while, entrepreneurs started to actively pursue their exit and the exit buyout option when contacted by investors. The importance of passive triggering might indicate that the exit buyout concept lacks visibility, preventing it from being perceived as a viable option by entrepreneurs at the beginning of their exit considerations. However, it also indicated that entrepreneurs were open to considering and able to recognise the attractiveness of the exit buyout when confronted with an actual opportunity.

The founder of Wakame declared:

> *"I had been continuously in discussions with potential strategic partners and competitors about production and distribution partnerships as well as selected opportunities to sell the business to strong industrial players. In such discussions I was approached by a mid-cap investment bank proposing a build-up with the French market leader of industrial sushi production. This company happened to be a portfolio company of a private equity fund."*

Sustainability of the company appeared to be an important objective in all five cases examined. In all of the cases, the entrepreneurs also focused on the valuation of their company and the payment structure agreed upon. Preferences or the balance between sustainability and financial objectives appeared to be moderated by a number of factors.

The family shareholder of Sofilab stated:

> *"Two objectives dominated my exit. First I wanted to ensure the sustainability of the business. I owed that to my family and the loyal staff of the company. And secondly I wanted to realise a certain value, to reimburse the debt I had used to fund growth and to unlock a sum, guaranteeing my retirement."*

An orientation toward financial objectives might be moderated by time. The case analysis suggests that entrepreneurs might be focused on a specific valuation expectation at the beginning of the process, whereas they are more ready to compromise at more advanced stages of the process as they approach closing. The focus on price can also be interpreted as the result of a defensive strategy of entrepreneurs who find themselves confronted with investors professionally hunting for bargains and renowned for low valuations and tough negotiation strategies. Preferences might also be impacted by cultural change and the changing importance of values in the society at large, where financial objectives might have gained importance over preceding years. Additional indications were found that a minimum value to be realised from an initial sale in the case of staged exit is of high importance to entrepreneurs, mainly due to the desire to harvest and secure parts of the value created.

The founder of Divalto said:

> *"I had fixed myself a valuation target. This was important to me. However, there were many funds that only offered valuations 15-20% below my expectations. From either side a compromise didn't appear viable. One investor signalled more flexibility and once we had reached an advanced stage of negotiations we were able to find a compromise, reasonably close to the target I had set myself."*

Process objectives appeared to be of some importance as well: the time dedicated by entrepreneurs to the process and fit with investors is clearly important, however, on a somewhat lower level than sustainability and financial objectives.

Table 11: Case summary of entrepreneur's motivation and objectives

Company	Entrepreneur's Objectives
Maier Chem	• Motivation based on strengthening the firms' positioning on the market longer term. • Objectives dominated by sustainability and fair value to be realised.
CFC Audit	• Motivation based on desire to change lifestyle. • Objectives dominated by ease of process and fit with investor.
Sofilab	• Motivation based on succession issue and the desire to secure the company's future. • Objectives dominated by sustainability to ensure employees' future and minimum value to be realised.
Divalto	• Motivation based on desire to change lifestyle and succession issue. • Objectives initially dominated by valuation expectation. More balanced set of objectives later on in the process.
Wakame	• Motivation based on desire to change professional focus and exit opportunity window. • Objectives dominated by the availability of an exit and a minimum value to be realised.

Based on the above case study evidence, it can be suggested that profit motives are not only a crucial element in the drive to do business, but they remain of high importance throughout the exit process. They can even hamper the availability of the exit buyout option if valuation expectations are too high and play a dominant role. However, the strong focus that is put at the same time on sustainability indicates that it is not the only or final goal of the exit or doing business.[172] Other than high valuation expectations, which prevented several potential investors of Divalto from making binding offers, the entrepreneurs' set of objectives did not impact the success of the transactions.

Table 12: Relevance of entrepreneur's objectives

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Focus on sustainability				
CFC Audit	• Focus on ease of process and fit				
Sofilab	• Focus on sustainability				
Divalto	• High valuation expectation	--			
Wakame	• Mix of availability and valuation				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

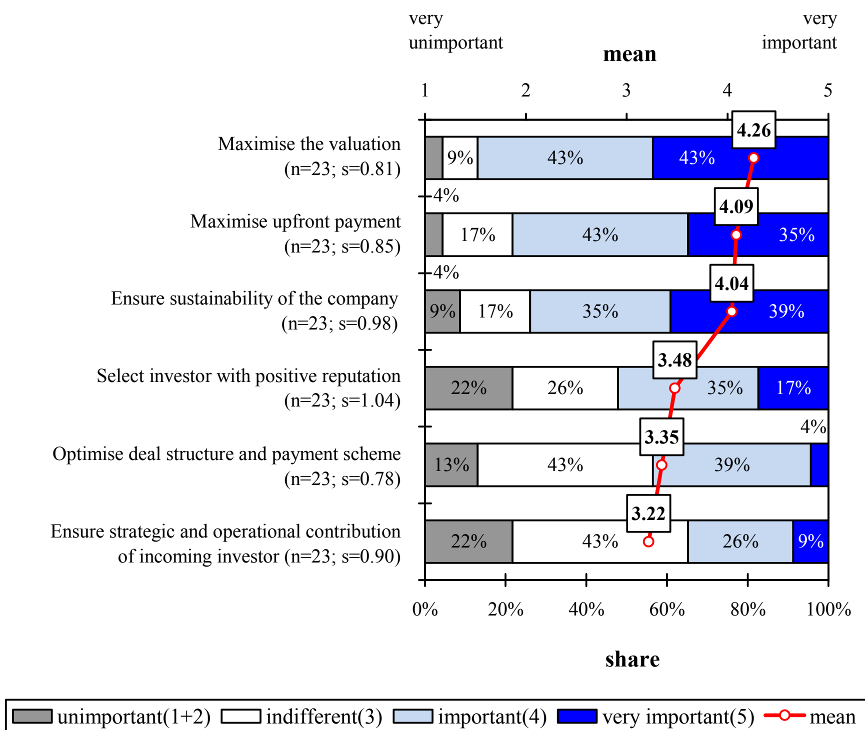
Existing empirical research reports varying results regarding the balance between the financial and sustainability aspects forming entrepreneurs' objectives. This applies to earlier phases of the firm's development as well as during the exit and succession phases.

172 See Klerk and Kruger (2002) for a discussion of the importance of the profit motive in entrepreneurship.

Survey Results

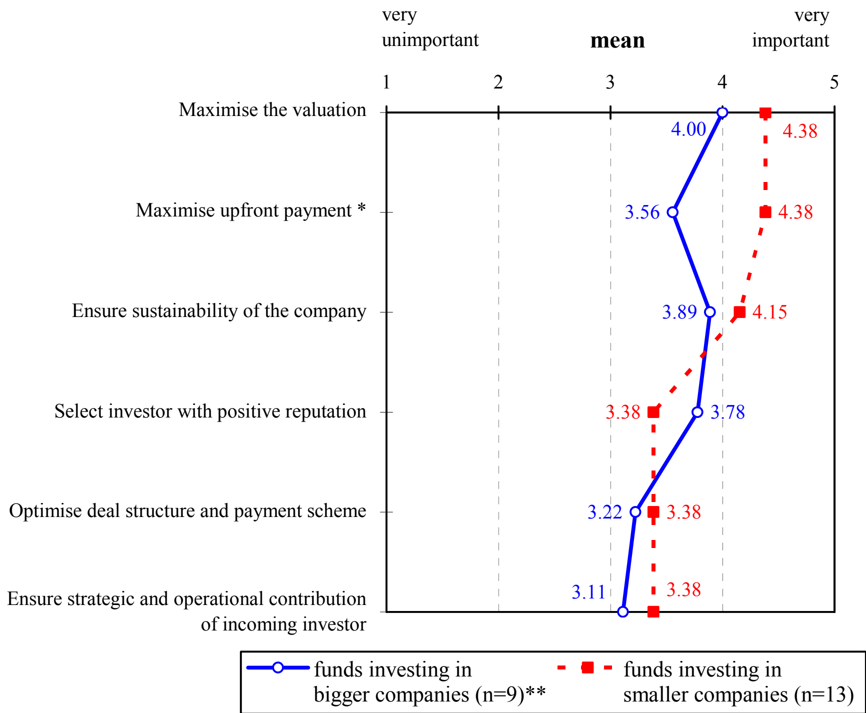
The investors were questioned regarding how they perceived entrepreneurs' exit buyout objectives. As shown in Exhibit 23 the sample of investors sees a dominant role of financial objectives, closely followed by sustainability objectives. The importance attached to working with reputable investors might also be linked to sustainability and risk considerations: entrepreneurs try to limit the downside risk of post-exit firm underperformance by relying on experienced investors. The structuring of the transaction appears to be of lower importance. A potential strategic and operational contribution of incoming investors plays the least important role in the evaluated set of objectives. This criterion might be of higher importance to the remaining or incoming management team than to the exiting entrepreneur.

***Exhibit 23**: Entrepreneurs' exit objectives as perceived by investors*



The slight preference for financial objectives identified above can stimulate interest in further analysis of the balance between financial and sustainability objectives. A comparison of the entrepreneurs' objectives depending on firm size might be able to provide additional indications thereof. The focus on financial goals could be moderated by the size of the company and therefore the absolute amount to be realised from the exit. When comparing the objective profiles of entrepreneurs in smaller and larger firms as perceived by investors, some differences can be identified. The entrepreneurs of smaller firms appear to have a more pronounced preference for financial objectives than their counterparts in larger firms, as shown in Exhibit 24.

***Exhibit 24**: Differences in entrepreneurs' objectives by company size*



Mann-Whitney-U-Test: Significant mean difference † p <= 0.1; * p <= 0.05
** funds investing on average in companies valued above € 30M

This might indicate that valuation and upfront payments are particularly important in the context of smaller exit buyouts, as the total amount of proceeds is limited. This coincides with the observation that entrepreneurs sometimes have a preconceived idea about the

minimum value to be realised from their exit. This minimum value can be realised more easily in an overall larger transaction than in a smaller transaction.

Additional explanations might arise from examining different types of entrepreneurs. The entrepreneurship literature has classified entrepreneurs with different sets of objectives into typologies.[173] These classifications distinguish, among other dimensions, individuals with a more or less pronounced focus on financial goals. When comparing funds that typically pay higher valuations with their counterparts that remain at lower valuation levels, it becomes apparent that there might be two distinct groups of entrepreneurs with respect to exit objectives: valuation-driven and sustainability-driven entrepreneurs.

A second indication for a potential differentiation of priorities between different groups of entrepreneurs can be found when examining the relationship between the importance of a maximised valuation and the desire to secure a strategic and operational contribution from incoming investors. Whereas overall the importance of financial objectives is high, entrepreneurs who are particularly interested in identifying an investor to contribute to the future success of the business are less ambitious about maximising the valuation of their firms. However, the suggested relationship would need to be further investigated in a larger sample. Moreover a direct analysis of the preferences expressed by entrepreneurs would have to be conducted before drawing further conclusions.

4.1.2 Knowledge and Experience

Entrepreneurial human capital, such as education and experience, has been found to impact important outcomes throughout the lifecycle of the firm, such as firm growth and survival.[174] Prior business ownership experience can typically contribute various assets, including managerial and technical skills as well as a network of contacts. However, the entrepreneurial exit differs substantially in nature and complexity from other management processes. The rather broad experience in general management that can be assumed for exiting entrepreneurs might therefore be of only limited value. Additional exit-specific knowledge might have been acquired passively through discussions with experts and the review of past transactions. It may be actively acquired through past transactions, such as prior firm exits in the case of serial entrepreneurs or acquisitions of the firm.

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[173] See, for example, Smith (1967), Braden (1977), Filley and Aldag (1978) and Cooper and Dunkelberg (1984), who distinguish two main types of entrepreneurs: the “craftsman” seeking task-related fulfilment and independence, and the “manager” driven by a profit-motivation and the desire to manage and exert power. In their critique of the concept, Lafuente and Salas (1989) indicate that these two types may not be sufficient to classify the entire population of entrepreneurs. Hence they propose a set of four distinct types.

[174] See Davidsson et al. (2005).

Case Study Evidence

For all five entrepreneurs, the exit process represented a considerable personal and management challenge. Whereas the entrepreneurs had spent significant time as the most senior salesmen of their businesses, selling the firm appeared to be much more challenging than selling their products or services. In contrast to the day-to-day management of their firms, the exit process was characterised by a large set of external and less familiar participants, technical, legal and accounting terminologies and little routine in coordinating the entire process. Thus, the exit buyout required considerable attention from the entrepreneur himself, with limited opportunities to delegate responsibilities to other management team members.

The entrepreneurs applied different strategies to acquire knowledge and reduce complexity. Some prepared by conducting literature research and through initial contacts with external advisors. Less experienced entrepreneurs proceeded in a staged process, acquiring additional knowledge in an initial round of contacts with investors, followed by other iterations. Complexity was reduced by delegating the most technical issues such as finance and accounting-related tasks. To this end, assembling a capable team appeared to be instrumental, potentially further developing the roles of existing management team members, but also identifying and involving qualified external advisors.

The founder of CFC stated:

> *"I had no prior experience in corporate transactions. However, throughout the process I was able to learn quickly. By the time I had met and negotiated with 2 or 3 investors and received their proposals I had understood the basic structuring options."*

Similarly the founder of Divalto said:

> *"Initial discussions with potential investors were quiet technical. Although the company was listed on the stock exchange between 1988 and 1993, I needed to become more familiar with the potential structuring of the transaction. Therefore I bought a number of books to further my knowledge in this area."*

Three of the entrepreneurs had relevant experience from earlier jobs in investment banking and private equity or from the corporate finance transactions of their firms, such as IPOs and acquisitions of other businesses. The related exit processes were typically concluded within 12 to 18 months, while credibly defending the entrepreneur's target valuation. The comparably longer process duration of several years in the other two cases can suggest that

the entrepreneur must undergo a learning curve prior to successfully completing the exit buyout.

***Table 13**: Relevance of entrepreneur's knowledge and experience*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• M&A experience		+		
CFC Audit	• No experience, self-learning		-		
Sofilab	• Limited experience, self-learning		-		
Divalto	• IPO experience, self-learning				
Wakame	• M&A/private equity experience				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Prior experience and extensive knowledge therefore does not appear to be an absolute precondition for the availability of the exit buyout option because it might be acquired during the process. However, a significant impact on the duration and perceived smoothness of the exit process can be suggested. Further negative impact of limited experience on the valuation might also be hypothesised.

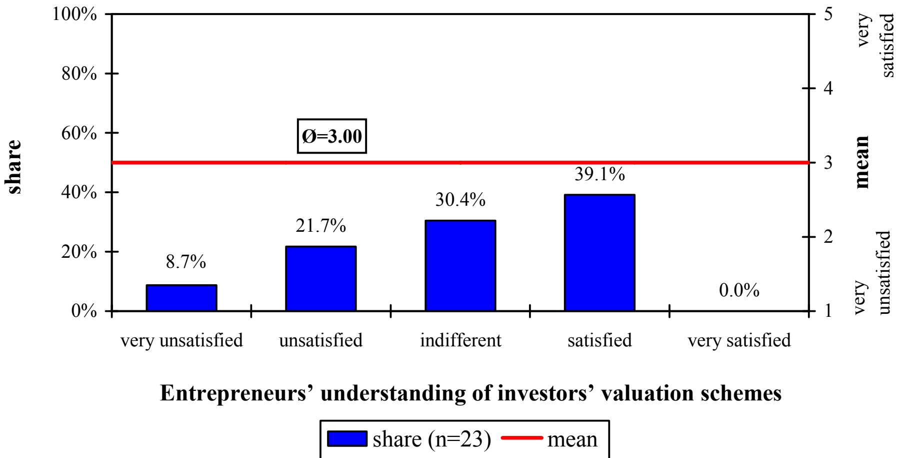
Survey Results

Investors have been questioned about their perception of entrepreneurs' relevant knowledge. The understanding of company valuation schemes, often viewed by entrepreneurs as complex and technical, was used as an indicator of the broader comprehension of buyout concepts. As shown in Exhibit 25 almost 40 percent of the sample of investors reported being satisfied, whereas slightly more than 60 percent were neutral, dissatisfied or even very dissatisfied with the level of knowledge displayed by entrepreneurs.

Compared to earlier statements by investors, this might indicate a positive evolution and learning process of entrepreneurs over time. Public discussion of private equity as a financing instrument and its potential role in European economies as well as the increasing importance and sophistication of financial products in a professional and private context might have contributed to a better understanding of proposed deal structures and valuation schemes by entrepreneurs.[175] Further support for a learning effect can be seen in the growing application of the OBO concept, particularly in France, which seems to be increasingly accepted by entrepreneurs as an attractive option to partially realise the value created in their firms.

175 See, for example, the public discussion of risks as well as advancements in the German economy driven by private equity investors, referred to as "locusts" by the Social-Democratic politician Franz Müntefering in April 2005.

Exhibit 25: *Entrepreneurs' understanding of investors' valuation schemes*



4.1.3 Cognitive Aspects and Decision Making Process

Entrepreneurship is often described as an "enactment" process where acting precedes thinking. Entrepreneurs are often characterised as opportunistic and as acting on an idea with limited information.[176] Thus, existing theory and evidence in entrepreneurship research argue for the importance of cognitive issues in describing and predicting entrepreneurial behaviour. Transposed into the context of the exit process, this implies that entrepreneurs' values, normative beliefs and the perceived feasibility of the exit might form an important part of their decision to exit and their behaviour throughout the exit process.[177]

Case Study Evidence

All five entrepreneurs were able to be associated with entrepreneurial attributes such as appetite for risk, strong personality and broad vision. However, cognition was not homogeneous across individuals. Various cognitive styles, strategies and processes existed and might have been impacted by the individual experience of the entrepreneur.[178] Some

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[176] See Gartner et al. (1992) and Weick (1979).

[177] Leroy et al. (2007) suggest, for a set of micro-business owners, that the theory of planned behaviour is applicable to entrepreneurs' decisions to transfer a business rather than abandon it.

[178] See Westhead et al. (2005) for a similar apprehension.

entrepreneurs might have applied biases and heuristics more than others, often in an unconscious manner.

Heuristics and cognitive biases that were identified throughout the process included: certain levels of planning fallacy when assessing and planning the timing prior to the launch of the exit process; hyperbolic discounting when reasoning the trade-off between upfront cash payments and potential later cash flows in the context of earn-out agreements; a type of endowment effect when stating comparably high levels of satisfaction with the global outcome of the exit process.[179]

Other heuristics and biases appeared to be particularly present during the early stages of the process, as entrepreneurs had significantly adapted their behaviour by later stages. Into this category fall, on the one hand, heuristics related to a rather ad-hoc launch of the process without considerable planning or strategy. This led to several iterations of "trial and error" before the entrepreneur embarked on a more structured process. On the other hand, intuitive value was attached to the firm but was not necessarily representative of the rational valuations made by investors. Later in the process, those valuations often became the object of compromise, once the closing and potential payments had become more tangible.[180]

No evidence was identified for other biases often linked to entrepreneurial behaviour such as overconfidence, illusion of control or replication of actions that were successful previously. This indicates that entrepreneurs approach their exit with a distinct balance of heuristic and systematic cognitions.[181]

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[179] "Planning fallacy": the tendency to underestimate task-completion times; "hyperbolic discounting": the tendency to have a stronger preference for more immediate payoffs relative to later payoffs, the closer to the present both payoffs are; "endowment effect": the tendency for people to value something more, as soon as they own it.

[180] Reasoning about valuation formed by personal beliefs can also be found in the behavioural finance literature, arguing that psychological forces interfere with the traditional paradigm and concepts of corporate finance: rational behaviour, applicability of the capital asset pricing model and efficient markets. See Shefrin (2001). Evidence of such behavioural effects on entrepreneurs' financing decision-making at earlier stages of the firm lifecycle can be found in Zellweger et al. (2006).

[181] Experience could even represent a liability to performance if moderated by cognitive biases. See Ucbasaran et al. (2003a).

__Table 14__: Relevance of cognitive aspects and decision making process

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Planning fallacy				
CFC Audit	• Intuitive start, no preparation	--	-		
Sofilab	• Endowment, hyperbolic discount				
Divalto	• Intuitive valuation, too high	--			
Wakame	• Planning fallacy				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

The identified heuristics and biases can have a direct impact on exit buyout success. Whereas an intuitive start in the process might increase total duration, hyperbolic discounting could limit the realisation of financial objectives in cases where an earn-out agreement would significantly increase total proceeds and endowment effects might at least partially question the positive assessment of exit buyouts overall.

Comprehensive research supports evidence of different heuristics informing entrepreneurs' behaviour.[182] In line with the above observations, the more recent literature suggests that entrepreneurs moderate the application of heuristics as a function of their environment.

Survey Results

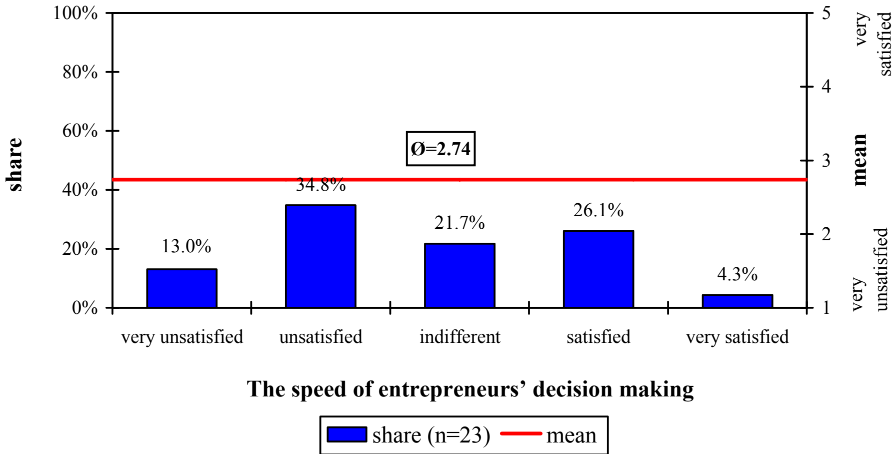
To identify the potential presence of entrepreneurs' heuristics and biases, investors were questioned about three aspects: their satisfaction with the speed of entrepreneurs' decision-making, the importance of entrepreneurs' determination to close a transaction, and the importance entrepreneurs might attach to the reputation of a potential investor.

As shown in Exhibit 26 only 30 percent of investors were satisfied with the speed of entrepreneurs' decision-making, indicating issues in this area. Whereas the management of a complex and unfamiliar process might explain parts of possible delays, other reasons might be rooted in entrepreneurs' hesitation to compromise or part with their firms. Some entrepreneurs might be more or less willing to accept an available offer that does not fully meet their initial expectations. Others might be confronted with the fear of losing control, power and even part of their identity and stature in the community when exiting their

182 See, for example, Busenitz and Barney (1997), who empirically tested two biases and heuristics – overconfidence and representativeness – and found that entrepreneurs and non-founder managers display significant differences in the application of biases and heuristics.

business.[183] When exiting a firm, entrepreneurs do not only remove themselves from legal and financial ownership, but from psychological ownership as well.[184]

***Exhibit 26**: Speed of entrepreneurs' decision making*



The high importance attached to dealing with entrepreneurs who are strongly motivated to close an exit transaction might suggest further support to the hesitations hypothesised above. The fact that more than 70 percent of the investors stress the importance of a fully motivated entrepreneur, can be based on the importance of the actual availability of deals to the business model of investors. However, it can also indicate that entrepreneurs might not always be fully determined to exit their firms when entering the exit process.

According to the perceptions of more than 52 percent of the investors, reputation is an important criterion for entrepreneurs, as shown in Exhibit 27. Entrepreneurs' sensibility to investors' image might be linked to a potential gain in personal reputational capital if dealing with a renowned fund. However, selecting a partner with a solid reputation and track record can also indicate an attempt to limit the risk of a potentially negative evolution of the firm post-exit.

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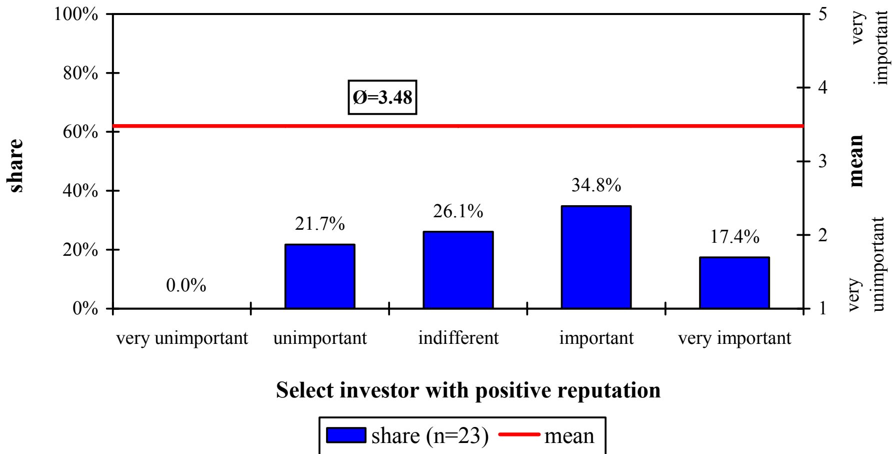
[183] See Leroy et al. (2007).

[184] The entrepreneur's inability to let go is the single most frequently cited obstacle to effective succession in family firms. See Sharma et al. (2003).

Exhibit 27: Entrepreneurs' preferences for investors with a positive reputation



The results underline that entrepreneurs' exit decisions and behaviour might be impacted by cognitive heuristics and biases, implying an impact on the timing of the process and the selection of potential investors.

4.2 Case Study Divalto: Entrepreneur's Valuation Expectations

4.2.1 Company

Divalto is a software editor focused on integrated enterprise resource planning (ERP) packages for small and medium-sized companies. The company was founded in 1982 in Strasburg, France, and has since been led by its founder, Maurice Vallet. It has developed a leading position in its national market, even though its financial performance over the last 10 years was somewhat volatile. However, recently, with a product launch and rebranding initiative, the company managed to come back to the earlier growth path.

Exhibit 28: *Summary of Divalto case study*

company	Divalto, Strasburg	***company creation***	1982
country	France	***(initial) exit transaction***	2006
activity	software editor (ERP for SMEs)	***revenues (yr. of initial exit)***	ca. € 7 million
age of ENP at exit	60s	***ENP's share before exit***	90%

buyer	Before, Paris	***funds under management***	€ 20 million
deal structure	OBO		
ENP's share after	30% ('06)	***process duration***	18 months

key drivers	age/succession, financial partner to drive further product innovation and sales expansion
key issues	entrepreneur's valuation expectation

4.2.2 Buyer

Divalto's buyout partner was BEFORE, a French investment house. BEFORE is a buyout investment company with capital resources of € 60 million. Unlike a typical fund, BEFORE is structured as a holding company and invests a share of the personal funds of 14 French entrepreneurs who have joined forces to contribute financial resources as well as their management experience to SMEs with strong growth. Founded in 2001, BEFORE invests, without a specific industry focus, from € 2 million to 10 million per transaction in equity and currently manages seven active investments.

4.2.3 Motivation & Strategy

Vallet's motivation to consider an exit was mainly age- and succession-related. By the time he turned 60, he had started to prepare the company for his succession. This was important as the company had a somewhat complex product portfolio, necessitating a capable management. However, Vallet was at the same time hoping to find a strong partner to drive further product innovation and sales expansion, particularly since the firm had returned to its former growth path.

The commercial director of the firm was a credible succession candidate in Vallet's eyes. Although he was not familiar with the concept of MBOs, Vallet sensed that his manager would play an important role in the process. However, concerned about rumours within the firm, he kept his initial approaches quiet and only involved that single member of his management team.

4.2.4 Transaction Structure & Process

Heavily occupied with his day-job, Vallet assigned an intermediary to identify potential candidates. The initial search focused on industrial partners. However, responses were limited, and thus buyout investors were also considered. After six months only one fund had been identified.

However, the valuation proposed was significantly below Vallet's expectations. Unhappy with the financial proposal, he stopped the negotiation process and continued to search for suitable candidates. Three additional funds presented proposals with a similar valuation, about 20 percent below his expectations. Only when BEFORE introduced the idea of an earn-out agreement that could bridge the valuation gap the process could be unblocked. Together with a good personal fit, the basis for a deal was found.

Vallet and BEFORE agreed on an OBO structure with an earn-out agreement based on the EBITDA result of the following two years. Whereas other investors had requested comprehensive financial liability guarantees, the due diligence and structuring process with BEFORE proved to be pragmatic, presenting no major issues. This was probably also due to the fact that Vallet had prepared an initial documentation of the firm. In addition he was accustomed to financial reports, following a period in the past when Divalto was listed on the stock exchange.

After the transaction the founder moved on to the board, but remained involved on a daily basis. The new CEO (ex head of sales) ensured continuity and managed to achieve a sustained growth of the firm. BEFORE closely monitored the performance of Divalto but did not interfere other than helping to evaluate options for external growth.

4.2.5 Summary

The key drivers for the transaction were the motivation of the entrepreneur to prepare his succession and to strengthen the firm that had found back to a growth path. Therefore the exit process was launched with no specific trigger, other than the entrepreneur being in his early 60s.

The key issue in the 18-month process from initial contacts to the sale of a 70 percent stake in the company was the intuitive valuation expectation of the founder that was about 20 percent higher than investors' proposals.

From the perspective of an exiting entrepreneur, this transaction indicates that not only the upfront payment, but the entire deal structuring should be taken into account when selecting investors. Early rejection of proposals can limit the availability of the exit buyout. At the same time can optimised divestment structures and earn-out agreements substantially increase the total proceeds in a way investors often find easier to accept.

From a buyout investor perspective, this transaction shows that an early focus on valuation can block the process. Entrepreneurs might be more willing to compromise at later stage of the process, closer to the completion of a transaction.

4.3 Investor

4.3.1 Objectives

This research is primarily developed from the perspective of an exiting entrepreneur. However, by examining investors' objectives, insights on their behaviour throughout the process and a potential impact on the success of the transaction might be identified. The assessment of investors' objectives can also be an important input to form an effective exit and negotiation strategy for entrepreneurs and might help to address potential conflicts upfront.[185]

Case Study Evidence

The cases examined have shown that the availability and completion dimension of the exit buyout process play an increasing role, as more capital becomes available on the market and competition between investors increases. Availability constraints can facilitate ease of process and fit on both sides through a "softer" approach of investors during the early stages of the process. The process dimension remains important, as an increasing number of structured sales processes tend to limit personal contact with exiting entrepreneurs. Thus, a detailed understanding of the particular opportunity and the building of a personal relationship with the entrepreneur becomes more difficult, while the risk of misjudgement increases. The financial dimension also gains further importance, as market conditions from 2005 to 2007 favoured the selling entrepreneurs while valuation levels were rising.

[185] See Kaufmann (1990), p. 50.

A team-member of the investor in Wakame stated:

> *"We follow a pre-defined due diligence procedure allowing us to achieve a maximum level of transparency. Trust is good but a thorough audit is better. We also owe that to the investors in our fund."*

While some objectives are aligned between entrepreneurs and investors, such as sustainability and process efficiency, others are not, such as objectives linked to the initial valuation and information transparency. If focusing too much on the limitation of information asymmetries, due diligence processes can get so heavy and resource-consuming that they have a negative impact on the ease of process.

Table 15*: Relevance of investor's objectives*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Availability of deal, valuation				
CFC Audit	• Fit with ENP, limited competition				
Sofilab	• Availability of deal, fit with ENP				
Divalto	• Fit with ENP, balanced process				
Wakame	• Limitation of info. asymmetries		--		

[ ]: no impact +: positive impact - : negative impact --: blocking impact

4.3.2 Strategy, Organisation and Structuring

Buyout funds differ with respect to their investment strategy, experience, organisation and processes, sources of funding as well as legal structuring.[186] These differences might facilitate or hinder exit buyout success.

Investment strategies can include a broad generalist approach or a focus on certain sectors and size classes as well as an emphasis on financial engineering or strategic contributions. As with entrepreneurs, investors' experience might be a facilitator for exit buyout success. Investor organisations vary by the composition of their decision-making committee and rules governing the co-investment opportunities or obligations of the fund management team. Funds to be invested are solicited from various sources, including institutional investors, family offices or (ex-)entrepreneurs, fund of funds or specific sponsors such as, for example, large banking and insurance institutions. Lastly, legal structures can be based

[186] In contrast to larger buyout transactions, where on average about three equity providers form a consortium, in small- to medium-sized buyout transactions there is typically only one or a team of two equity investors.

on a fixed-end limited partnership, evergreen fund, or investment company continuously reinvesting its capital.

Case Study Evidence

The investors involved in the cases examined followed different strategies. Build-up and long-term investment approaches had a positive impact on the sustainability of the firm, as investors had a precise vision from the outset.

A team-member of the LBO investor in Maier Chem stated:

> *"We have made positive experiences with build-ups in the past and try to replicate these in order to achieve superior returns."*

A team-member of the investor in Divalto said:

> *"For us the long-term potential of the firm is key. We don't have a specific investment horizon of three or five years in mind. We are happy to stay invested over a very long period and will do everything to help the firm perform in the long run."*

The investors also displayed a large diversity in terms of size, experience, organisation, and investor base. Smaller funds that were characterised by predominantly entrepreneurial capital, outside participation in their investment committee, and co-investment of their management team members appeared to be particularly well-suited to dealing with exit buyouts of firms valued below € 50 million. Whereas other funds contributed equally to satisfactory exit buyouts, they were more often identified to have caused slight process issues. Such issues most frequently related to legal and accounting matters during due diligence and final negotiations. This might imply that, in addition to the fund's strategic, organisational and structural setup, the individual fund manager and his ability to create a strong relationship – or fit – with the entrepreneur may represent an important precondition for success.

***Table 16**: Relevance of investor's strategy, organisation and structuring*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Value creation through build-up				+
CFC Audit	• Broad focus, common structure				
Sofilab	• Broad focus, common structure				
Divalto	• Long term focus		+		+
Wakame	• Value creation through build-up				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Survey Results

Several strategic, organisational and structural aspects have been examined with respect to their potential impact on the investors' approach to the selection and due diligence of exit buyout opportunities.

Target investment size, if analysed in conjunction with the number of investments completed per year, seems to have an impact on the importance attached to the professional management of the firm and a thorough legal due diligence.[187] Funds making few but larger deals (average target firm valuation of € 105 million) assign higher importance to the above two criteria than funds making more but smaller investments (average target firm valuation of € 32 million). Sector-specialists do not appear to display any differences in deal selection and due diligence criteria if compared to generalists.

Experience of funds, if measured by the total amount of capital raised to date, indicates that more experienced funds, raising on average about € 500 million in total, focus significantly less on the assessment of entrepreneurs' personalities and their business plans. They stress, however, the importance of a thorough legal due diligence in comparison to less long-standing funds raising on average about € 150 million. However, it should be noted that more mature funds tend to invest in significantly larger firms, with an average target firm value of € 127 million compared to €40 million. This might explain part of the difference in focus. Small firms can be characterised by a more dominant role of the entrepreneur within the business and a typically less complex legal situation. Funds with higher ratios of transformation from due diligence to investment appear to be less demanding with respect to controlling processes and thorough legal due diligence, which suggests that these aspects can often become deal-breakers or at least cause frustration and lead entrepreneurs to prefer other investors.

Investment committees that include external members, such as limited partners, entrepreneurs or industry experts, tend to pay greater attention to the assessment of the entrepreneur's project and his business plan. However, again, the firm size might be part of the explanation, with funds with exclusively internal investment committee members displaying a higher average target firm valuation of € 92 million compared to € 40 million.

Co-investment schemes for fund managers seem to be significantly more prevalent in funds founded during the last ten years, compared to older funds, which indicates that the idea of

[187] The firm's level of maturity and professionalism has been approximated in the survey by a statement about the importance of controlling processes and ERP tools.

aligning interests between fund managers and MBO managers is gaining more practical relevance. The impact appears to be an increasing focus on a thorough legal due diligence, which might be explainable by an increasing motivation to limit legal and contractual risks. However, the identified relationship might again be impacted by a difference in firm size, with € 97 million for funds with co-investment schemes and € 33 million for funds not expecting co-investments.

Evergreen funds and investment companies with a longer-term investment horizon appear to attract significantly more entrepreneurial capital and less institutional investors. Money raised from family offices and entrepreneurs was 66 percent for such longer-term investors, compared to 11 percent for typical limited partnerships. At the same time, they tend to focus on smaller-sized firms with an EV of on average € 44 million compared to € 86 million. A difference in investment selection or due diligence criteria according to the legal structure of the fund could not be identified.

4.3.3 Cognitive Aspects and the Fit between Entrepreneur and Investor

While establishing a relationship and trust is an important challenge in the earlier stages of the process, handling information asymmetry typically becomes a key issue in the more advanced stages of the process. Investment fund managers, similarly to managers in large corporations, usually seek to acquire a large amount of information to reduce the level of uncertainty they are confronted with in their decision-making.[188] Investors develop procedures and policies to ensure homogeneous, transparent and responsible investment decision-making, which limits the managers' ability to rely on biases and heuristics.[189] Entrepreneurs rarely follow the same structured approach. This can potentially create conflict and frustration and therefore impact exit buyout success.

<u>Case Study Evidence</u>

The entrepreneurs appeared to attach great importance to fit in their selection of investors. The main causes of cognitive misfit were investors' limited understanding of the entrepreneur's industry sector, signs of dominant behaviour, a focus on quantitative data, differences in planning horizons and technical terminology. The external advisors appeared to be able to moderate behaviour and beliefs and make them more transparent to both parties. However, the entrepreneurs' reaction to significant misfit often appears to be

[188] See Mintzberg (1973).

[189] Nelson and Winter (1982) describe these decision-making practices as "routines" and stress their ability to simplify the complex decision-making processes.

rejection, as was demonstrated when an important number of investors were no longer considered.

The founder of CFC declared:

> *"I had identified and contacted a number of funds that worked with companies in my industry. Out of the ten funds I had met initially, I then selected three, mostly based on the personal fit I had with the respective fund managers. The other funds were slow and didn't really get involved too much."*

A team-member of the investor of Maier Chem stated:

> *"We try to ensure an optimum fit between our investment team and the exiting entrepreneur, mainly based on personal experience and best guess."*

The investors appeared to be conscious of the problem of fit and often saw it as a factor of competitive advantage and a core competence required from them. This assessment might have been moderated by investment size, with investors in smaller companies potentially being more sensitive to the issue. The investors retained in the cases examined applied a number of specific strategies to create fit:

- Increasing in-person contact while listening and trying to understand entrepreneur's motivations in order to start building a personal relationship;

- Gathering sector experience to build credibility;

- Building reputational capital such as recommendations, personal and professional networks, as well as industry experts to stipulate trust;

- Putting the firm and its future development in the middle of the discussion, while avoiding a focus on quantitative data and firm valuation at earlier stages of the process.

However, rational explications may only partially achieve the fit and bridging the gap; a personal relationship must be established and cultivated in order to completely achieve them. In this context, the positive contribution of external advisors to match-making and moderating the entrepreneur-investor relationship has been observed. Also fit on a strategic level can help to reinforce the relationship and bridge declining or missing personal fit.

***Table 17**: Case summary of entrepreneur – investor fit*

Company	*Entrepreneur – Investor Fit*
Maier Chem	• Excellent strategic fit with retained investor, due to existing portfolio company in the same sector, was able to bridge diminishing personal fit.
CFC Audit	• Potential strategic fit with strategic and financial investors (industry presence); • Good personal fit with short list of selected financial investors (motivated, quick); • No personal fit with remaining financial investors (slow, not proactive).
Sofilab	• No strategic fit with retained financial investors; • Good personal fit with short list of selected financial investors (motivated, quick); • No personal fit with remaining financial investors (slow, not proactive).
Divalto	• No personal nor strategic fit with strategic investors (no grasp of business model); • Good personal fit with financial investors due to their sector knowledge/ investments; • But in many cases good fit was not able to bridge valuation gap and structuring issues.
Wakame	• Good personal fit with the small number of strategic and financial investors contacted. Personal fit diminished during due diligence (risk avoidance vs. entrepreneurial culture). • Excellent strategic fit with retained investor, due to existing portfolio company in the same sector, was able to bridge diminishing personal fit.

Ensuring fit and actively bridging the gap between an entrepreneurial and a private equity culture might therefore be considered as an important factor impacting the availability and process length of the exit buyout option. The creation of fit is also an important basis for later stages of the exit buyout process, when information asymmetries will become the acid test of the growing relationship between entrepreneur and investor, for example during the due diligence phase. For investors the results seem to imply that specific strategies, experience and a certain sensitivity to entrepreneurs' concerns rather than a dominant approach might be important factors for ensuring a personal fit with entrepreneurs. A good strategic fit can further enhance the relationship.

***Table 18**: Relevance of entrepreneur – investor fit*

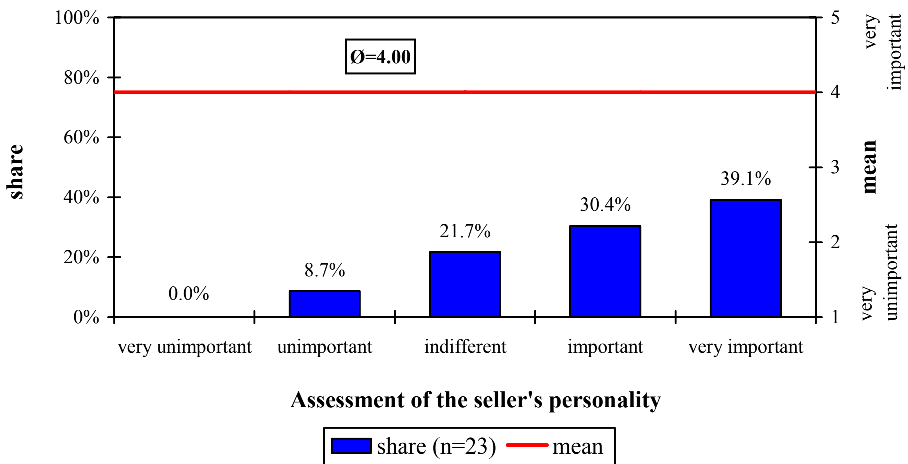
Company	**Main Aspects**	**Avail-ability**	**Ease of Process**	**Financial Result**	**Sustain-ability**
Maier Chem	• Strategic fit bridges declining personal fit	+	+		
CFC Audit	• Good personal fit		+		
Sofilab	• Good personal fit		+		
Divalto	• Good personal fit		+		
Wakame	• Strategic fit bridges personal misfit	+	+		

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Survey Results

The investors were questioned about the importance they attach to the assessment of the entrepreneur's personality during the exit buyout process. This statement was used as an indicator of the importance of personal factors in helping to build fit from the perspective of investors. As shown in Exhibit 29 almost 70 percent of the sample of investors attached a high level of importance to this dimension, whereas only 9 percent considered it to be unimportant. This might indicate that investors seek to better understand entrepreneurs' motivations and beliefs in order to be able to build trust and respond to entrepreneurs' expectations. Doing so may help investors to position themselves as an attractive partner. In addition, investors may try to mitigate information asymmetries by assessing entrepreneurs' exit motivations and understanding entrepreneurs' personalities. In this way, they can play the important role of the ultimate source, and potentially of a moderator of the available information on the firm.

***Exhibit 29**: Importance of assessment of entrepreneurs' personalities*



4.4 Case Study Wakame: Process Management Putting Transaction at Risk

4.4.1 Company

Wakame GmbH is a fresh food supplier focusing on sushi production for retailers, food wholesalers and catering providers. The company was founded in 2003 in Kerpen, Germany, and has since been led by its co-founder, Christian Kraft.

***Exhibit 30**: Summary of Wakame case study*

company	Wakame GmbH, Kerpen	***company creation***	2003
country	Germany	***(initial) exit transaction***	2007
activity	fresh food production (sushi)	***revenues (yr. of initial exit)***	ca. € 5 million
age of ENP at exit	30s	***ENP's share before exit***	85%
buyer	European Capital buyout fund through its existing portfolio company Marco Polo Foods, France	***funds under management***	€ 750 million
deal structure	direct acquisition, with leverage		
ENP's share after	49% ('07), 24% ('08), 0% ('09)	***process duration***	13 months
key drivers	strong strategic fit with portfolio company		
key issues	loose process management by investor, heavy due diligence		

After a career in the mergers and acquisitions department of a global investment bank and as a leveraged buyout investor in London, New York and Frankfurt, Mr. Kraft, 32 years old at the time, had decided to set himself an entrepreneurial challenge. Motivated by the success stories and innovative concepts of then recently launched food businesses in the UK and the US, he started surveying the German food market for similar opportunities. He identified an attractive business proposition in moving the labour-intensive sushi production process to an industrial scale while ensuring high quality standards. His analysis showed that sushi would find a solid market among retailers because it combines a rather small product size that requires only limited shelf space with attractive gross margin levels. When its first production site opened in September 2003, Wakame was one of the first companies in Germany to make sushi available outside of Japanese restaurants.

After having secured a first large retail account in 2003, additional client relationships were able to be built, and the business grew rapidly from sales of € 0.7 million in 2004 to about €5 million in 2007. During that time production assets and staff were ramped up to about 70 FTEs in 2007. The company became profitable in its third year of operations in 2006.

Since the company's creation, Kraft has held the majority of Wakame, with his founding partners, holding the remainder of the capital. The business was launched with the founders' private funds, complemented by a "Gründerdarlehen" of € 65 thousand that was provided by the KfW Bank[190]. In 2004 a complementary debt funding of € 140 thousand was provided by KfW Bank and Kreissparkasse Köln. In 2005 Mr. Kraft took over the shares from his founding partners to become sole proprietor of Wakame. In 2006 the need for a new production facility, better tailored to the company's specific needs, was identified. To finance the purchase and fit-out of a new site, the company raised a combined € 1.65 million in equity, mezzanine and debt from Kreissparkasse Köln, its commercial banking partner. A large regional bank and Germany's third largest savings bank, Kreissparkasse Köln had taken the initiative to propose equity and mezzanine financing in addition to the standard debt instruments typically provided. Conditions were such that an extensive search for alternative investment proposals was not undertaken. This capital increase left Mr. Kraft with 85% of the company's capital, while the bank held 15%.

Today, Wakame is one of the two market leaders in industrial-scale sushi production in Germany. Both Wakame and its main competitor, Tsunami Sushi Bars, have secured major contracts with large national retail groups and are now solidly positioned to lead the market, as sushi consumption continues to rise. However, the sushi market will remain a niche food market segment, which implies a certain limit to the growth of the existing business model in the long term.

4.4.2 Buyer

The buyer of Wakame was European Capital through its existing portfolio company Marco Polo Foods.

European Capital is a buyout and mezzanine fund with capital resources of € 750 million and invests in management and employee buyouts of private and mid-sized public companies. European Capital invests from € 5 million to € 125 million per transaction in equity, mezzanine and debt to fund growth, acquisitions, and recapitalizations. The differentiating "one stop shop" buyout concept,[191] which makes equity, mezzanine and debt available through one single investor, allows companies to save time in the investment

[190] KfW Mittelstandsbank, owned by the German federal government (80%) and the Länder (20%), offers SMEs, business start-ups and the self-employed support in the form of loans, mezzanine financing, equity capital, and consulting services.

[191] European Capital is one of the few "one stop shop" investment houses in Europe.

processes, as lengthy information sharing and decision processes on both the equity and debt side can be significantly accelerated.

As a consequence, European Capital's organisation is driven by a mix of an equity and debt investment culture, typically having different risk profiles and investment requirements. Whereas equity investors seek potential growth assuming a certain level of risk, debt investors primarily aim to minimise risk.

European Capital invested approximately € 29 million in the buyout of Marco Polo in the form of common equity as well as senior term debt, senior subordinated debt and redeemable bonds, while Marco Polo's management co-invested in common equity and redeemable bonds.

Marco Polo Foods was established in 1999 in Contres, France, as the first commercial producer of fresh and frozen sushi products to the French retail market. In 2006 the company's 120 employees produced more than 300,000 pieces of sushi per day, realising revenues of € 22 million. The company's ISO-certified and newly built production site is located approximately 150 kilometres south of Paris.

Marco Polo proved to be a particularly strong strategic partner to Wakame considering its production and logistics know-how as well as its commercial network. The company was the first to introduce and develop commercially produced high quality fresh and frozen sushi in continental Europe and created YEDO, the only established brand on the market. Marco Polo has mastered the logistics of fresh sushi production and continues to innovate, having recently introduced a seven-day shelf-life sushi product with the potential to expand the market further to hyper and supermarket chains.

After the rapid growth of Marco Polo in France, the company began actively pursuing external growth in other European markets through a build-up strategy and is now developing its sushi concept for expansion to North America.

4.4.3 Motivation & Strategy

The initial trigger for Kraft to consider his exit was accidental and driven by the buyer rather than by himself. In August 2006 Wakame was investigating a potential acquisition in the neighbouring field of fresh meat production in Germany. While Wakame was analysing this opportunity, Lincoln International, a mid-market corporate finance house and advisor to the

potential target, introduced Wakame to European Capital and its portfolio company Marco Polo.

From a growth perspective, an alliance with Marco Polo, the leading continental European player in industrial sushi production, gave Kraft's company access to additional know-how, economies of scale and access to capital to continue to develop Wakame's leading position in Germany.

From a defensive perspective, the rejection of an investment proposal by Marco Polo and European Capital could have left Wakame with a very well-funded competitor, continuing to seek growth in the German market through a potential alliance with a competitor or through organic growth. Both options would have represented a significant threat to Wakame's development in the longer term and would at least have hampered future growth levels. Alternative considerations to form an alliance or merge with a strong German competitor were not conclusive, mainly due to differences in strategy[192], valuation issues related to the asset base of the potential partner, and difficulties in defining a future organisation and management structure.

From a personal perspective, Mr. Kraft had built his start-up business into a leading, fast growing and profitable company. He had successfully implemented and managed the entrepreneurial challenge he had set for himself. Knowing that in the very long run he might be interested in another career change, he carefully investigated European Capital's investment proposal. It combined a strong strategic fit with financial terms offering an interesting valuation mechanism as well as good visibility on the payment of proceeds over a period of two years.

4.4.4 Transaction Structure & Process

After an initial contact had been established through Lincoln International in September 2006, a series of meetings between Wakame, European Capital and Marco Polo allowed the three parties to assess a potential fit. As outlined above significant synergies between Marco Polo and Wakame were identified. In further discussions a valuation of Wakame, satisfactory to buyer and seller, was rapidly agreed on.

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[192] Wakame has a business model that delivers through a retailer's distribution center, not allowing returns. Tsunami, one of its competitors, follows a logistics-focused full-service strategy, including delivery to the shelf in each shop and the acceptance of returns.

The transaction was structured as an acquisition of Wakame's capital through Marco Polo, combining a capital increase of € 0.3 million, with a staggered share sale over a period of two years. European Capital's initial proposal to Kraft, which included an at least partial swap of his shares in Wakame against a share in the holding company of Marco Polo, was renegotiated as a cash remuneration. The acquisition was leveraged, however, on the level of Marco Polo's holding company, in order not to further increase Wakame's existing debt levels.

The chosen structure resulted in a shareholding for Marco Polo / European Capital of 51% after the initial transaction in 2007[193], 76% in 2008 and 100% in 2009. The valuations for each transaction were based on a formula directly linked to Wakame's EBITDA results in the respective fiscal year. Kraft will retain the management of the company until the end of 2009 and can therefore directly impact his payout in the second and third tranche. The longer-term succession of Kraft as general manager of Wakame was been defined at the time of the transaction.

Following a basic agreement on valuation and structuring, a due diligence was initiated by European Capital in December 2006. Driven by the mezzanine and debt investment culture of European Capital, also typically targeted to larger size transactions, a comprehensive team of two investment managers, two members of Marco Polo's management team, two external advisors from Lincoln International, and two external accountants from KPMG were assigned to audit Wakame and manage the transaction. The audit process created negative signals to both parties involved, because of an imbalance between the size of Wakame's operations and its resources to contribute to the due diligence and the scope and depth of information requested by the audit team. Frustration originated from a long list of formal data requests to be prepared by Wakame and unsatisfactory additional information obtained for European Capital.

In April 2007 the due diligence came to a standstill. This breaking point in the process with European Capital led Kraft to investigate alternative options, mainly alliances with German competitors, which themselves were not conclusive due to differences in strategy, proposed valuations and future organisation. In June 2007, after a break of several weeks, the management team from Marco Polo proposed to take over the leadership from European Capital's investment team. The process was subsequently finalised to the satisfaction of buyer and seller and a closing was held in October 2007. The entire process required

[193] Acquiring the post capital increase equivalent of 36% of Wakame's capital from Kraft and 15% from the Kreissparkasse Köln.

significant resources from Wakame and a large share of Kraft's attention, who dedicated between 15% and 25% of his time to the transaction over the entire period of 13 months.

4.4.5 Summary

The key driver and motivation of the transaction was a solid strategic reasoning based on sustainable competitive advantage in a market with longer-term decelerating growth prospects and a very limited number of leading players. European Capital, with its existing portfolio company Marco Polo, represented the strongest potential partner to the seller on a European level from a growth as well as a defensive perspective. An alternative alliance between Wakame and a German competitor would have led to an overall weaker player as well as a much less certain and attractive financial proposal to Wakame's founder.

The key issue, which was also almost a deal breaker in the transaction, was the process management through European Capital and its advisors. European Capital, characterised by its "one stop shop" buyout concept and mezzanine/debt culture, had employed very formal and resource-consuming operational, accounting and legal due diligence for a company the size of Wakame. This sent negative signals to the seller, did not yield the desired validation of company information, and slowed down the process to a complete standstill for several months. The process could only be restarted and concluded once the management of Marco Polo took a leading role in the transaction.

The positive market environment, stable sales growth and the underlying performance of Wakame as well as an entrepreneur very familiar with the strategies, structuring and processes of buyout transaction facilitated the realisation of the transaction.

From the perspective of an exiting entrepreneur this transaction indicates that a combination of strategic as well as personal and financial objectives can be realised in an exit buyout, especially when the buyout investor is already invested in the respective sector.

From a buyout investor perspective, this transaction shows that a balanced and well-managed due diligence process remains a key success factor in an exit buyout transaction, even if the entrepreneur possesses a wealth of experience himself. Investors can also benefit from sector experience and strong strategic synergies when already present in an industry with portfolio companies. Built-up strategies therefore provide the advantage of facilitated access to further investments.

4.5 External Advisors

4.5.1 Intermediaries

Intermediaries can contribute in several ways to the exit buyout process.[194] Prior to launching the exit process, they can assist entrepreneurs in structuring an exit strategy and serve as a sparring partner. In the early stages of the process, intermediaries might assist in preparing a company presentation and profile as well as identifying and contacting the most suitable investors. This match-making role might be important for entrepreneurs in avoiding losses in time and resources if dealing with investors with a potentially lower fit. During the key phases of due diligence and negotiation, intermediaries can contribute technical know-how in process management, deal structuring, negotiation, and valuation of the business. In this context a market-making role might improve the entrepreneurs' position on the sell-side if structured processes such as auctions are being applied. Throughout the entire process, intermediaries can coordinate internal and external cross-disciplinary teams and information flows and moderate the entrepreneur-investor relationship.[195]

The above roles can be filled by a formal M&A advisor who is appointed and remunerated by the entrepreneur but also through informal advisors such as accountants or law firms that might play parts of the role of an intermediary, especially in smaller transactions. Similar to the focus of investors on different size classes, intermediaries can be grouped into three clusters according to the size and complexity of the transaction: For transactions of up to € 5 million, the role of intermediaries is often played by independent legal and tax advisors, auditors and boutique corporate finance firms. In the range from € 10 to 50 million, national and international consulting and audit firms as well as corporate finance boutiques and the corporate finance teams of lending banks will be active. Only for transactions above € 50 million will investment banks get involved.[196] In some situations, entrepreneurs might also opt not to involve a formal intermediary, especially when using a trusted informal intermediary or in an initial approach to test the market.[197]

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[194] See Müller-Stewens et al. (1999), p. 44.

[195] See Poech et al. (2005).

[196] See Müller-Stewens et al. (1999), p. 67. However, the network of intermediaries might be more fragmented in Germany than in France. See Wright et al. (2006), p. 29.

[197] See Mole (2002) for agency-theory-based research on the selection and potential impact of advisors on SMEs.

Case Study Evidence

Only one of the entrepreneurs used intermediaries from the start of the process. It appeared that entrepreneurs rarely identify the need to involve a professional intermediary in the early phases of an exit process. However, the intermediaries appeared to be able to play an effective role in match-making at later stages. The entrepreneurs recognised the value of the intermediaries' experience in helping them to identify which type of investor were most likely to be interested in their firm, given that the investor market does not appear transparent to entrepreneurs and that there are different groups of investors who target different opportunities and focus on different criteria in their assessment. Support in presenting the investment opportunity and adapting the storyline to specific investors was of equal importance.

A team-member of the investor in Sofilab stated:

> *"The smaller the company the more important a good intermediary."*

The founder of CFC declared:

> *"If I would have to do it again I would engage an experienced intermediary from the start. They know a much larger set of potential investors, can help prepare the necessary documents and help defend my valuation expectations."*

A team-member of the investor in CFC declared:

> *"Without the implication of an intermediary the deal will be less expensive but also less likely and require significantly more resource from the investor."*

From a market-making perspective, it appeared that the intermediaries were able to strengthen the entrepreneurs' position and mitigate a potential imbalance of transaction experience in which repeat-investors are dealing with most often one-off entrepreneurs. However, none of the entrepreneurs had applied a formal auction process, mainly in order to be able to better assess potential investors through personal contact. Also, investors acknowledged a positive impact of intermediaries' contributions to strategy and deal structuring while helping to translate and manage expectations of entrepreneurs and investors.

From a process management and coordination perspective, the added value for both entrepreneurs and investors was significant. Whereas entrepreneurs valued the reduction of complexity and one single point of contact and coordination, investors benefited from a structured process and formatted information packages facilitating quick understanding.

A positive impact of the intermediaries' involvement on the identification of a suitable investor and the ease of the process can be suggested. A positive impact of the market-making role of intermediaries on entrepreneurs' financial objectives could not be further examined, as none of the entrepreneurs had chosen a structured auction process. Entrepreneurs might therefore balance and apply intermediaries' competences as a function of their own financial and fit-related sustainability objectives.

***Table 19**: Relevance of intermediaries*

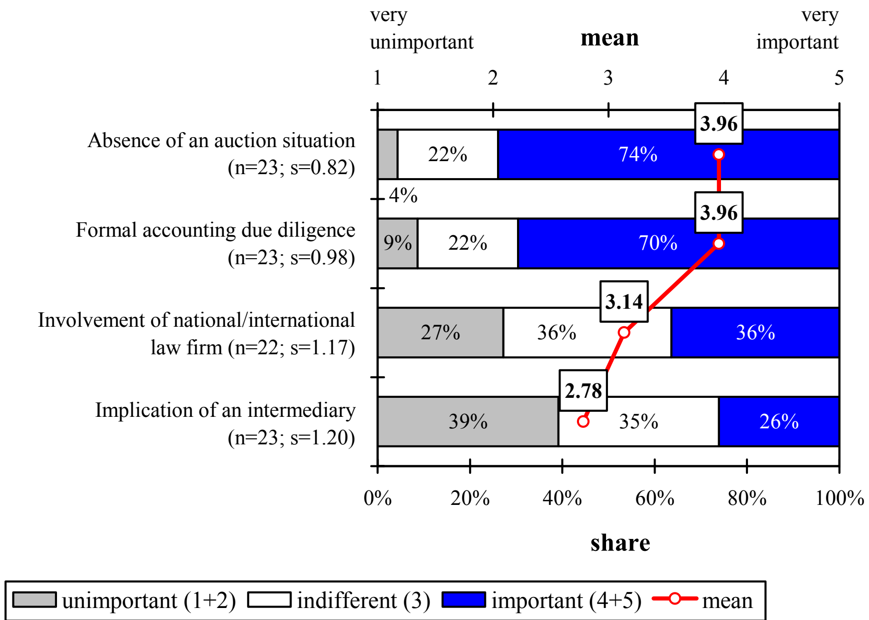
Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Informal intermediary (law firm)				
CFC Audit	• No intermediary		-		
Sofilab	• Formal intermediary (match-maker)	+	+		
Divalto	• Formal intermediary (match-maker)	+	+		
Wakame	• Formal intermediary (match-maker)	+			

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Survey Results

Investors were questioned about the importance they attach to the involvement of different types of external advisors during the exit buyout process. Their responses were used as an indicator of the perceived importance of different functional roles that might facilitate the exit buyout process. As shown in Exhibit 31, 74 percent of the investors attached a significant importance to the absence of an auction situation in the exit buyout process, whereas only four percent considered this to be an unimportant aspect. This might indicate that intermediaries can play an effective market-making role in favour of the entrepreneurs' interest when helping to maximise the firm's valuation within an auction process. However, it might also indicate investors' preference to be able to assess the entrepreneur and his firm in a less structured negotiation process, providing deeper insight into the firm's situation and hence helping to limit information asymmetries.

***Exhibit 31**: Importance of external advisors as perceived by investors*



On further examination the survey results, investors' preferences do not seem to be homogeneous across the sample. While one group of investors favours intermediated transactions, the other group does not. Surprisingly, funds that do not favour the participation of intermediaries appear to display a higher global level of satisfaction with recently completed exit buyouts accompanied by a higher level of satisfaction with the valuations achieved. This could indicate that funds are able to extract a better pricing from entrepreneurs without the involvement of intermediaries. Moreover, if there were a disadvantage due to the lack of a moderator-function, it would be overcompensated for by the valuation advantage on a global level of satisfaction.

Investors might appreciate the translator and coaching function of intermediaries, but see very critical their potential implication in structured sales processes limiting personal interactions with entrepreneurs and driving up valuations.

4.5.2 Expert Advisors

Functional advisors on the entrepreneur-side can include auditors, tax advisors and law firms. On the investor-side, in addition to the above-mentioned advisors, strategy consultants might be involved. From an investor's perspective, expert advisors can contribute to the reduction of information asymmetries and therefore play an important role in the later stages of the process. The working relationship between all parties involved might impact exit buyout success.

It should be noted that expert advisors can also take the role of intermediaries, especially in smaller transactions, when entrepreneurs select their trusted accountants and legal advisors to act as match-makers and moderators throughout the process.

Case Study Evidence

In each of the cases, expert advisors were involved on the sell- as well as on the buy-side. The functions involved were predominantly accounting and legal support on both sides. Only one investor reported the use of strategy consultants, a decision mainly linked to the larger size of the transaction.

While the entrepreneurs seemed to work with their long-standing local or regional partners, often a single party who was responsible for each of the roles, the investors, in most cases, assembled a team of several experts from national or international audit and law firms. Significant issues were reported in at least two of the five cases. These were related to investors' advisors requesting large amounts of data and highlighting a multitude of potential risks on a level of detail that the entrepreneurs did not always consider to be relevant.

It might appear that the investors, in their quest to minimise risk, hired highly professional advisors. These advisors are typically trained on much larger and more complex transactions, and since they have a highly analytical working style, they tend to identify a multitude of potential issues. When confronted with such issues (which had not prevented entrepreneurs from successfully running their businesses in the past), entrepreneurs were put on the defensive, often resulting in overreaction. Thus, lengthy discussions and frustrations on both ends ensued.

The founder of Wakame stated:

> *"You need advisors who think in terms of solutions, not in terms of problems."*

The family shareholder of Maier Chem said:

> *"Being an Anglo-Saxon fund, AB Capital's (the investor) legal counsel requested a framework of legal guarantees (product liability, financial liability), that we found hard to accept. It took us a significant amount of time and resource (legal advisors) to negotiate an acceptable compromise."*

In their function to limit risk, external advisors might therefore in some cases become a liability to the exit process. Hence, they themselves may represent a risk to exit buyout success if they do not moderate their working style to the specific context of exit buyouts.

The cases examined have underscored that a balance of means, especially with respect to buy-side accounting and legal support, is an important factor impacting the length and the smoothness of the process.

Table 20*: Relevance of expert advisors*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Demanding guarantees requested by investor's legal advisor		-		
CFC Audit	• Pragmatic approach on both sides				
Sofilab	• Pragmatic approach on both sides				
Divalto	• Pragmatic approach on both sides				
Wakame	• Overly exhaustive due diligence of investor's audit firm		-		

[ ]: no impact +: positive impact - : negative impact --: blocking impact

5 Factors Related to the Company

Timmons (1999) suggested that the best way to successfully harvest an entrepreneurial firm is to build a great company. In many sales processes, product characteristics and quality play an important or even dominant role.[198] Within the context of exit buyouts, one might therefore argue that factors related to the company itself – the product to be sold in this case – could have a significant impact on the success of the exit buyout process. To determine the validity of that argument, four factors were investigated: the activity of the firm, its size, performance and organisation.

5.1 Activity

The firm's product or service offering and the industry sector within which it is active are a main determinant of each business. Different levels of buyout activity across industries can be explained by strategic, financial and operational considerations. From a strategic perspective, industry growth levels, fragmentation, ongoing consolidation, competitive pressure and innovation can impact the attractiveness of a sector to buyout investors.[199] From a financial perspective performance variations between different industries are well known in theory and practice. In addition, some industries require substantial levels of investment while others are more suited to applying leverage, based on their asset-base and cash flow profile. Lastly, from an operational perspective, the complexity of the firm's management processes and the importance of intangible assets for the operations of the firm need to be considered. In service-intense industries it might be more difficult to hand over intangible assets such as specific knowledge, and, therefore, a successful business transfer might be hindered.[200] Funds might also specialise in specific industries to gain competitive advantage and save time and resources on individual transactions.

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[198] This can apply to corporate sales of multi-million € items, for example, high-value investment goods with a long lifetime such as industrial machinery, but also to large service projects such as consulting projects or marketing initiatives.

[199] Whereas buyout strategies typically focus on firm growth, conditions in a specific industry can support that goal. Further analysis of the potential contribution of industry market conditions to Exit Buyout success can be found in chapter 6.3.

[200] See Kogut and Zander (1992).

Case Study Evidence

The five cases examined cover a wide range of industries: manufacturing businesses of industrial and consumer goods as well as service businesses in the software and consulting sector. These industries differ substantially in maturity, asset base, cash-flow and operational complexity. However, all of the entrepreneurs managed to realise an exit buyout they considered to be successful.

This suggests that, within the set of investors present in the market, at least some had an appetite for a variety of firm activities and proved able to accommodate the firms' specificities and risks such as for example small assets bases and complex knowledge-transfers in the case of service businesses. This is in line with earlier research identifying that buyout investors are not a homogeneous group but can form different clusters following their strategies and impacting their investment opportunity selection criteria.[201] Whereas there appear to be investors specialising in specific industries who seek to gain in-depth knowledge and improve economics in the investment and subsequent monitoring process, there might also be generalists with no industry focus.[202] Entrepreneurs are therefore confronted with the challenge of identifying and selecting either a generalist or specialist, based on their firms' activity and their initial set of exit objectives. External advisors and in particular professional intermediaries were able to assist the entrepreneurs in identifying either category of fund based on their comprehensive knowledge of actors in the market and their specific experience with selected investors.

It appears to be less the activity as such and more the immediate recognition of the strategic development options that can be applied to the firms that appeal to investors.[203] Niches in mature industries with significant growth or mature industries with build-up potential seem to attract exit buyout investors. At the same time, the activity of the firm might be more related to the question of finding the right partner, focused on the individual sector, rather than being an issue in itself.

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[201] See Muzyka and Hay (1994), p. 353.

[202] See for example Capvis (2006), p. 7.

[203] See also chapter 6.3 for a discussion of the industry- and firm-level development patterns that investors are looking for.

__Table 21__: Relevance of company activity

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Manufacturing, heavy investments, strong asset base				
CFC Audit	• Services, no investment, few assets				
Sofilab	• Manufacturing, few investments, few assets				
Divalto	• IT services, some investment, few assets				
Wakame	• Manufacturing, few investments, few assets				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

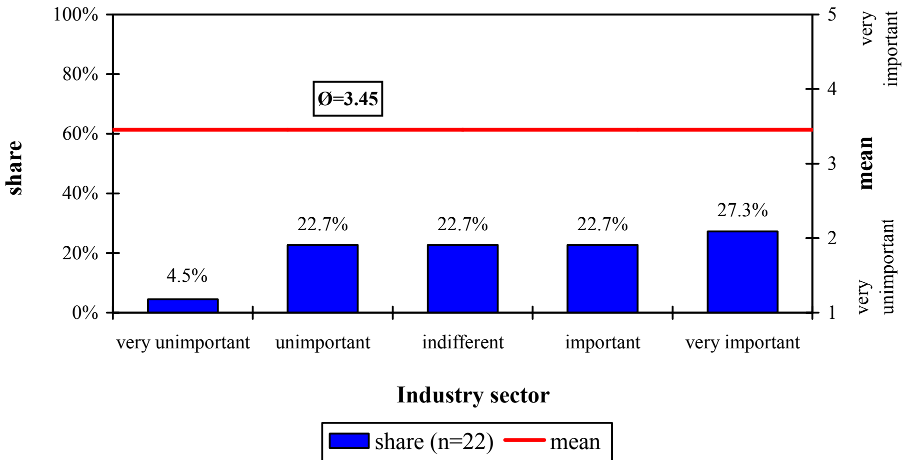
Empirical research studies by Jakoby (2000), Ambrose and Winters (1992), Chiplin et al. (1991) are in line with the above observations and identify an early concentration of MBOs in certain manufacturing industries, with a more recent broadening of scope and evolution towards service industries. Davidson (2005) finds that almost 80% of a set of Swiss buyout investors do not focus on a specific industry. The smaller the market is, the more restraining such a strategy might also be.[204]

Survey Results

As shown in Exhibit 32, the industry sector was perceived by a combined 50% of the investors surveyed as an important or very important investment opportunity selection criterion. The remaining 50% stated to be indifferent or considered the industry as an unimportant or very unimportant deal selection criterion, suggesting that both industry-specialist and generalist investors may be active in the exit buyout segment.

204 See Leroy et al. (2007).

Exhibit 32: *Importance of industry sector as perceived by investors*



5.2 Size

Firm size can be interpreted as an indicator for maturity. Smaller companies tend to be financially more fragile and vulnerable to external shocks but offer higher growth potential, whereas larger companies often diversify risk across different product-market combinations, are managed more professionally but might offer less growth potential. This risk-return trade-off might play a role in the preference of exit buyout investors, and therefore, size is a factor to be considered.

In addition to risk considerations, investors encounter a number of challenges with decreasing investment size.[205] Transaction costs are to some extent non-compressible and represent an ever-increasing share of the transaction value with diminishing size. Debt required for leverage is more easily available in larger allotments for the same transaction cost reasoning from the side of bank lenders. A larger portfolio of smaller firms may be more difficult to monitor compared to a more concentrated portfolio.

On the other hand, a focus on smaller investments can imply less competition for investments, a fact that has challenged many funds between 2005 and 2007 through its impact on the chances of successfully closing a transaction and an increase in valuation

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[205] See also Davidson (2005), p. 92.

levels. Smaller-sized investment targets also allow targeting a larger population of firms, representing a potentially higher deal-flow.

Case Study Evidence

Four of the five firms examined had sales between € 5 and 15 million at the time of the exit. Some entrepreneurs found it challenging to identify investors focusing on their size class throughout the early stages of the process. Also here, the match-making function of external advisors appeared to be of value to the entrepreneurs in identifying the right set of candidates.

This provides support to the hypothesis that the exit buyout can be a successful instrument also for smaller companies. At the same time size has also proven to be an important criterion for other exit buyout options. Some smaller firms were not able to solicit interest from strategic buyers at the time of the initial exit. However, the companies were sold several years after their exit buyout was implemented to larger competitors who had already been targeted at the time of the initial buyout but had shown no interest at that time. Across different types of buyers, this might indicate a preference for companies beyond a certain size or maturity level. This preference might be even more pronounced for strategic buyers, if compared to exit buyout investors.

As size differences were moderate and precise valuation data not available, no evidence for a potential relationship between firm size and valuation could be identified within the set of case studies. In any case, a potential valuation premium for larger firms would translate into several years of delay in exit timing to be able to yield a significant effect. Also, entrepreneurs typically were searching for a solution short- to medium-term.

Firm size can also have an impact on the exit buyout process. The due diligence of a larger firm tends to be more in-depth and focuses on aspects that are less critical in smaller firms, resulting in significantly more time and resources required from both seller and buyer.[206] However, in practice, investors and their external advisors found it often difficult to downscale their procedures to be suitable to smaller firms, specifically with respect to legal issues. Expectations of different levels of professionalism and process heaviness caused frustration and loss of time and resources.

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[206] A similar approach in varying criteria and depth of analysis dependent on firm size can be found in the rating approaches of banks and external rating agencies. See Christians (2006), p. 76 for the specific weighting of factors for different SME size classes.

Entrepreneurs of smaller firms might be able to mitigate size-related issues by paying particular attention to a professional presentation of their firms and a pre-selection of potential investors targeting and adapting their practices to the respective size class.[207]

***Table 22**: Relevance of company size*

Company	Main Aspects	Availability	Ease of Process	Financial Result	Sustainability
Maier Chem	• Revenues of € 250 million				
CFC Audit	• Revenues of € 13 million				
Sofilab	• Revenues of € 11 million				
Divalto	• Revenues of € 7 million				
Wakame	• Revenues of € 5 million		-		

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Existing research seems to identify investor preference for larger transactions. Davidson (2005) identified company size as having an impact on MBO investment. The author suggests that private-equity backed buyouts in Switzerland tend to be significantly larger in size – both in terms of employees and revenues – compared to MBOs without external equity investment.[208] Another reason may be the fact that smaller sized buyouts can be financed by the management teams themselves or with the help of bank lending and may not require outside equity financing. Similarly, Hustedde and Pulver (1992) suggest that entrepreneurs who seek larger amounts of venture capital are more likely to succeed at earlier stages of the lifecycle of the firm.

Survey Results

Within the set of participating investors, two distinct groups can be recognised. The investors focusing on firms valued either below or significantly above € 50 million. Whereas 45% of the investors are considering investments in firms valued below € 10 million, 59% focus mainly on firms valued between € 10 and 50 million, and 18% concentrate exclusively on firms valued above € 50 million, as shown in Exhibit 33. This indicates that if there were to be a minimum investment size, it would probably be significantly below the € 10 million or even € 5 million mark.[209]

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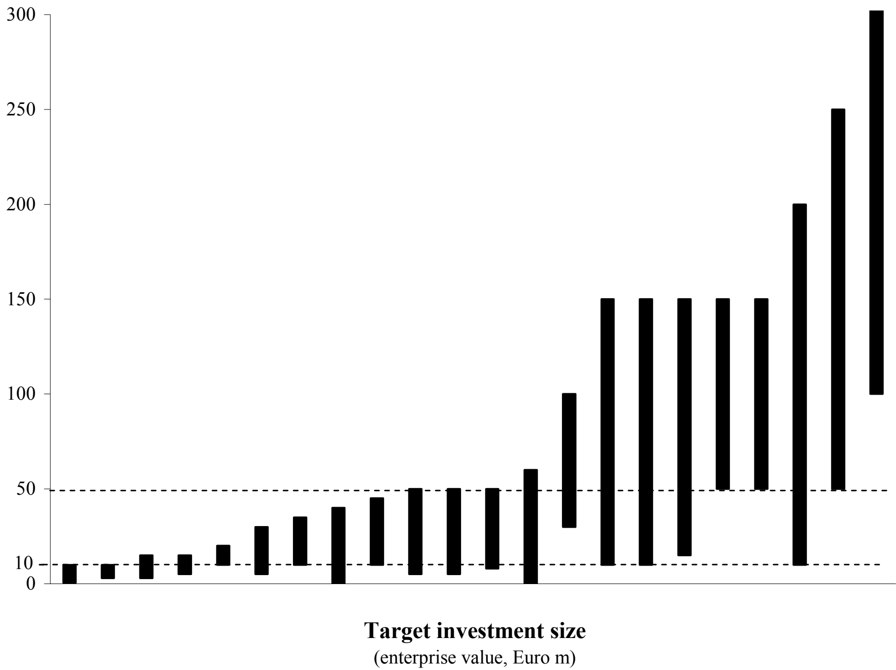
[207] Empirical research shows that investors define a certain minimum size for their investments. This implies that firms need to target investors focused on their size range Achleitner et al. (2006b).

[208] See Davidson (2005) p. 110.

[209] This is consistent with earlier findings by Achleitner et al. (2006b), suggesting that 39% of German buyout investors do not consider investing in firms with less than € 5 million in revenues.

***Exhibit 33**: Target enterprise values considered by investors*



A relationship between firm size and relative valuation levels could not be examined in depth due to the small sample size. However, discussions with investors hint toward a positive impact of company size on valuation. The premium attached to larger investments might provide support to the arguments outlined above that smaller investments can represent higher levels of risk and a less efficient process to investors. Confirmation for such an argument has been obtained by CMBOR (2006) for European buyout pricing measured by P/E ratios.

5.3 Performance

Firm performance and especially performance improvement potential are a key driver of any investment. Performance requirements can include improvement of various criteria over time, such as growth and profit levels. In the context of an entrepreneurial exit, the better a firm is performing, the greater the number of outsiders interested in taking over a successful business may be. Therefore, current and potential future performance is likely to have a

major impact on the transfer of the business.[210] Within the broader concept of firm performance, financial and strategic performance aspects can be distinguished.

To assess financial performance, different criteria can be defined and evaluated. With respect to SMEs, indicators of growth and profitability are measured most often.[211] However, in many situations, a trade-off has to be made between the two. High growth is often not a goal in itself but a means to achieving other goals, e.g., increases in market share or competitive advantages, and thus can impact profitability in the longer term. As a result, entrepreneurs are often faced with the decision of whether to manage for growth and/or profitability in the phase prior to exit.

Because financial measures tend to be lagging indicators that report on the outcomes from past actions, an exclusive reliance on financial criteria might give an incomplete picture of the longer-term value creation potential of the firm.[212] Therefore, additional strategic performance measures might be applied and interpreted as a precursor of future financial performance.[213] To assess strategic performance, the firm's strategy, competitive position, internal processes and staff management need to be investigated.[214]

Case Study Evidence

A wide range of absolute levels of financial performance were observed across the cases examined. Whereas all firms could be considered to be operating successfully in their industries, growth as well as profitability levels varied between low single-digit and double-digit figures of up to 20 percent. This draws attention to the assessment of relative performance compared to industry standards and market conditions in addition to a focus on absolute performance levels.[215] Overall, it appeared that investors were keen to select firms with above industry-average performance to further develop a leadership position through a profitable growth path while unlocking hidden potential.

Most of the entrepreneurs were facing situations of significant growth and the related trade-offs between growth and profitability prior to their exit. However, the entrepreneurs did not

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210 See Butler et al. (2001).

211 Extensive research on small-firm performance focuseson assessing potential growth and profitability determinants. See, for example, Cowling (2004), Cox et al. (2002) and Markman and Gartner (2002).

212 See Porter (1992).

213 See for example Levie (1995), who, from empirical research on a set of young manufacturing firms, suggests that narrow market strategies in industries with significant growth are more likely to yield sustainable growth than other strategy-industry combinations.

214 See Porter (1980), and Porter (1985).

215 See Kitzmann (2005), p. 278.

seem to specifically target a growth-profitability balance with the exit event in mind, but where rather following the historic path of their business or their personal commitment to one pursuit or the other. Even if the below survey evidence suggests that exit buyout investors favour growth over profitability as a performance criterion, most of the entrepreneurs were cautious about a universal and one-dimensional growth focus and thus secured profitability before choosing growth.[216]

***Table 23**: Case summary of company performance*

Company	***Performance Characteristics***	
	Market Position	**Financial Performance**
Maier Chem	• One of six leaders in a quickly consolidating segment of the global specialty chemicals market.	• Growth: limited sales growth (< 5%); • Profitability: profitable.
CFC Audit	• Leader of a niche market in cost reduction consulting, benefiting from a variable remuneration scheme.	• Growth: awarded the first price of the most dynamic/highest growth firms in France (Plus Belles Enterprises 2000); • Profitability: highly profitable.
Sofilab	• Leader of a niche industrial manufacturing market in France, with growth potential across Europe.	• Growth: 10% p.a., clearly above industry average; • Profitability: profitable, above average.
Divalto	• One of the leading ERP providers for SMEs in France (ecosystem with € 95M of annual sales and 1,050 FTEs).	• Growth: Doubled software licence sales in the 3 years leading to the transaction; • Profitability: profitable.
Wakame	• One of two industrial-scale sushi producers/distributors in Germany; • High strategic value for European market leaders.	• Growth: € 5M in revenues after 4 years, aiming to double that by 2011; • Profitability: profitable.

The somewhat limited capacity of business plans to accurately display performance prospects and the investors' attitudes toward the reliability of business plan data might help to explain the difference in focus on current vs. future performance between investors outlined above. While most of the investors viewed quantitative business plans as broad planning scenarios rather than precise estimates of future financial results, others almost excluded the information from their analysis, considering the data to be vague estimates with little predictive power for future results. It can be deducted that entrepreneurs should be as credible as possible in explaining future performance within a bottom-up approach, which can be based on estimates and comparables linking back to the past, in order to fully value their business.

[216] For additional empirical evidence on securing profitability before growth, see Davidsson et al. (2005).

The family shareholder of Sofilab stated:

> *"When I embarked finally on the exit I also got back in touch with investors I had met a number of years ago. They were comparing the business plan of two years ago with the actual performance, and were positively surprised that our growing position on the European market had allowed us to achieve the growth and profitability levels that we had forecasted. And these predictions had already been a few percentage points higher than the industry average."*

The founder of CFC Audit said:

> *"The fact that the company had an exceptional performance and had won an award clearly solicited interest from private equity fund managers, who started to contact me. The business model that I had put in place and that was at the origin for such exceptional results was also the basis for a good performance of the firm after my departure. The variable remuneration model worked really well, and my successors were able to continue to benefit from it."*

The founder of Wakame said:

> *"Within four years we had become one of the two leaders of industrial scale sushi production in Germany. This had given us quiet some visibility. Private equity investors in the consumer goods market are always screening the market for high-potential opportunities. Hence we were a very interesting investment target when European Capital (the investor) was aiming to get involved in the German market."*

In addition to financial performance, the cases examined highlighted the importance of strategic performance: market leadership, strong competitive positioning, defensible competitive advantage, and a compelling strategy in line with the company's skills, and assets appeared to be an important precondition to securing the exit buyout option, and the sustainability of the firm longer term, probably more so than the activity or size of the firm.[217]

[217] Based on empirical research of a set of young manufacturing firms, Levie (1995) suggests that narrow market strategies in industries with significant growth are more likely to yield sustainable growth than other strategy-industry combinations.

__Table 24__: Relevance of company performance

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• One of 6 leaders on global market	+			
CFC Audit	• Exceptional profitability and growth	+			+
Sofilab	• Potentially dominant in Europe	+			
Divalto	• One of 5 leaders on French market	+			
Wakame	• One of 2 leaders on German market	+			+

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Above-peer financial and strategic performance with significant future growth prospects has been identified as an important driver in making the exit buyout option available.[218] However, as investor clusters differ in strategy and preferences, opportunities should also exist for entrepreneurs who do not fit the above-average performance model. Firms with performance issues might be able to identify investors focused on special situations, an aspect not further considered in this research.[219] A specific impact of performance on the exit buyout process could not be identified.

Survey Results

The investors were asked to state the focus of their performance assessment along two dimensions: growth vs. profitability as a predominant driver of value and a focus on current vs. future performance.[220] A preference for growth vs. profitability and for future vs. present performance was identified.

Across the sample of investors, future performance potential seems to be perceived as even more important than current performance, as shown in Exhibit 34. Future growth was ranked as the most important criterion, followed by future profitability potential. This might indicate that, from an investor's perspective, the key driver of value for SMEs is to create a growth dynamic within the firm, acquire customers, increase sales, and therefore build a stronger franchise. Profitability, which is equally important to driving up the company's valuation, might be perceived as the less complex problem to be solved, as it is often related

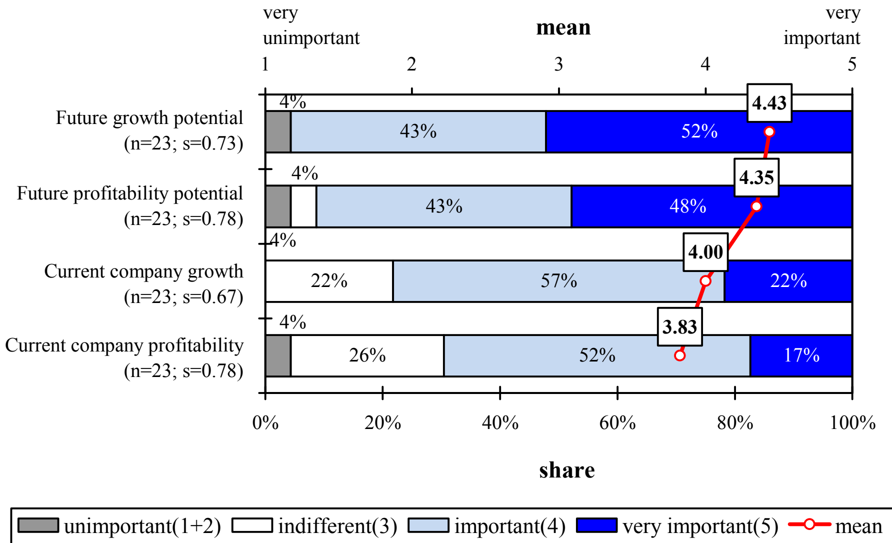
[218] Empirical research shows that investors set performance benchmarks or hurdle criteria in screening investment opportunities. This implies that firms need to outperform these criteria in order to be considered (Achleitner et al. (2006b)).

[219] "Special situation" investors focus on firms facing specific atypical challenges, the most common situations being turnaround pre-IPO and pre-merger.

[220] The survey used revenue growth as an indicator of the firms' growth. Based on a significant amount of research on small firm growth, there appears to be agreement that growth in sales is the most universally applicable indicator of the firm's level of growth (see Davidsson et al. (2005)). Other indicators suggested in the literature are focused on the growth of market share, employment, physical output, assets and profits.

to a rigorous management of the operations of the company, a task that often appears less difficult to accomplish than driving dynamic growth.

***Exhibit 34**: Importance of performance aspects as perceived by investors*



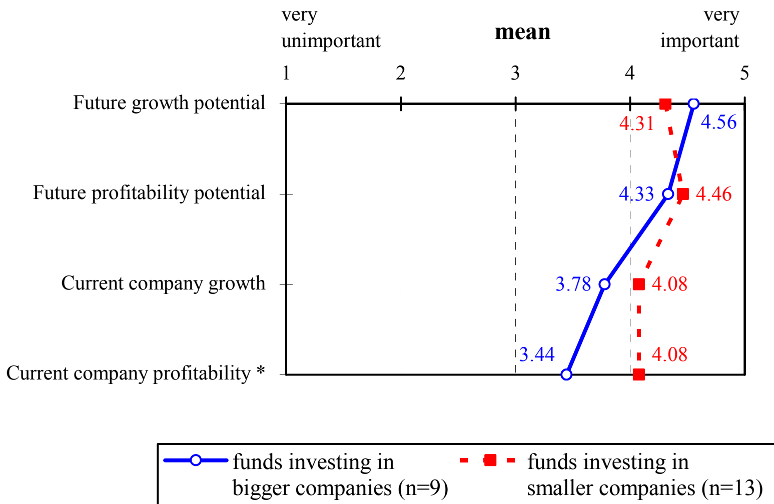
Within the data set it became apparent that the investors' performance preferences might not be homogeneous. Similar patterns of investor clusters following different strategies and preferences concerning firm activity and size have been identified in the existing literature and above.[221] About 61% of the investors showed a preference for future performance, the remaining 39%, for current performance. A preference for current performance might be explained by the perception that only past results can be a solid indicator of the management's capabilities to deliver performance, whereas future projections tend to be overstated and hard to achieve in practice. This idea can be supported by the high importance attached by investors favouring future performance to legal due diligence and law firm involvement throughout the process, a means to limit asymmetric information distribution and to solidify the prospects presented. For the distribution of preferences regarding growth vs. profitability focus, equally specific preference profiles and strategies can be identified among investors.[222]

221 See Muzyka and Hay (1994), p. 351.

222 See, for example, Capvis (2006), p. 10 for the funds orientation toward profit.

The differences in importance attached to future vs. current performance might also be at least partially explained by firm size. If analysed by target investment size, investors focusing on smaller investments tend to value current performance significantly higher than investors of larger firms, as shown in Exhibit 35. This is in line with the earlier assessment that small firms might be perceived to be more risky, with investors aiming to limit downside risk by ensuring a viable "no-loss" starting point to their investment in smaller-sized firms.

***Exhibit 35**: Performance criteria preferences by company size*



Mann-Whitney-U-Test: Significant mean difference † p <= 0.1; * p <= 0.05

In addition to the review of growth and profitability, the potential importance of cash flow as a performance criterion in the context of an exit buyout must be considered. A high and stable cash flow is an important precondition to servicing the debt involved in a leveraged buyout transaction and will therefore be closely monitored and highly valued by any investor. More generally, it should be noted that in the context of high-growth entrepreneurial firms the reliance upon singular performance dimensions such as simple efficiency, growth, profit, size or liquidity measures can be overly simplistic and might limit specific conclusions.[223] Therefore, the inclusion of multiple dimensions and criteria of performance as well as the consideration of control variables, such as size, age and industry

[223] See Murphy et al. (1996).

of the firm, in future research might contribute further results on the impact of firm performance on the exit buyout process.

5.4 Organisation

The firm's organisation can be another indicator of the maturity and professionalism of a business. Therefore, organisational factors might play an important role in supporting the entrepreneur throughout the exit buyout process but, even more importantly, can serve as a facilitator and enabler of the post-exit performance of the firm.

Relevant aspects might include the organisational structure, qualitative and quantitative staffing levels, as well as the firm's current and potential future management team. However, the design of core processes such as sales, production or service delivery as well as support processes – mainly finance and accounting – and the supporting tools and IT systems can also play an important role.

Case Study Evidence

Management team continuity often caused issues in the cases examined. In several firms entrepreneurs launched the exit process without having identified a succession candidate within or beyond the firm. Even when the need for a successor was identified upfront, it appeared to be difficult to identify candidates combining the right skill set with the motivation to take over entrepreneurial responsibilities within the existing management teams. External searches proved to be difficult as well, with time-consuming "trial and error" iterations in some cases. The investors had a clear vision of the post-exit organisation, looking for effectiveness in the management team taking over. Next to industry- and firm-specific know-how, management successors should therefore display leadership skills and effectiveness, and be able to make things happen.

The founder of CFC Audit stated on the subject of management succession:

> *"If I would have to do it again I would prepare my organisation much better, so that it would be visible for investors that performance can be sustained after my departure."*

The family shareholder of Sofilab commented on organisational maturity:

> *"The head of finance played a pivotal role throughout the exit process. He prepared business plans and followed-up on analytical accounting so that investors had access to the requested data. This gave me the time to focus on the overall strategy, negotiations and running the company at the same time."*

Support processes, such as financial planning and accounting, rarely received a lot of attention, especially within smaller and fast growing firms. While in most cases it did not represent a risk to the exit as such, it appears to have had an impact on the timing and resources required within the process. Some smaller organisations suffered a significant drain of resources, with up to 50 percent of the management team's time dedicated to the process during peak periods. The entrepreneurs found it helpful to involve selected management team members in the process to compensate for less developed tools and systems and make information available to investors. Especially the role of the CFO, even if staffed only informally, played a critical role in several cases.

***Table 25**: Case summary of company organisation*

Company	***Organisational Characteristics***	
	Organisational Maturity	**Management Succession**
Maier Chem	• Settled organisation (750 FTEs); • Well developed finance function; • Corporate transaction experience.	• Future management ensured through acquiring company and transition period with involvement of family shareholders.
CFC Audit	• High-growth organisation (30 FTEs); • Sales- and delivery-focus, not finance and accounting.	• Initially no candidate identified, which blocked any interest from investors; • Externally recruited manager failed; • Two senior employees have grown into leadership role.
Sofilab	• Settled organisation (65 FTEs); • Well developed finance function; • Head of finance played key role throughout the process.	• Initially no candidate identified, but 6 senior managers informed about process; • None of them became a CEO candidate; • Externally recruited manager performed; • Investor accepted newly hired manager.
Divalto	• Settled organisation (55FTEs); • Well developed finance function due to earlier IPO.	• Initially no internal candidate identified; • Investors didn't bring in right candidate; • Sales director has grown into CEO role.
Wakame	• High-growth organisation (80 FTEs); • Sales- and production-focus, not finance and accounting.	• Initially no internal candidate identified; • Less critical, due to takeover through portfolio company and founder earn-out.

The selection of a qualified and motivated successor from within the existing management team or through external recruiting appears to be a key success factor with respect to the

availability, length and resources required for the exit process.[224] The non-availability of a management successor was able to be mitigated in cases of buyout investors applying a buy & build strategy, when the qualified management team of the existing portfolio company was able to absorb responsibilities.

***Table 26**: Relevance of company organisation*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Management through acquiring co.; • Large and mature organisation.	+	+		+
CFC Audit	• Initially no successor; • Later internal management team.	--	-		+
Sofilab	• Initially no successor; • Later external candidate recruited	-			+
Divalto	• Internal successor	+	+		+
Wakame	• Management through acquiring co.	+			+

[ ]: no impact +: positive impact - : negative impact --: blocking impact

The quality of the management successor also proved to be an important precondition for the sustainability of the firm. Internally recruited successors were familiar with business models and company stakeholders and therefore able to ensure continued success. Externally recruited successors were only retained when they proofed to be able to manage the company successfully and received full support of the exiting entrepreneurs during a transition period. In the cases of acquisitions through private equity portfolio companies the firms benefited from their integration into a larger, equally professional and potentially even more mature organisation.

Survey Results

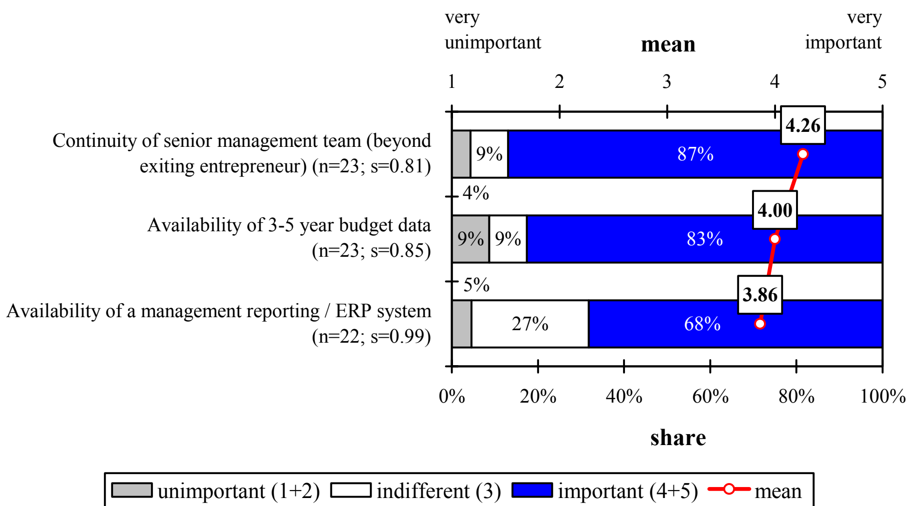
The investors were questioned about the importance they attach to different organisational aspects of the firm when selecting and evaluating exit buyout opportunities. The continuity of the management team beyond the entrepreneur's exit was highlighted as a dominant factor, as illustrated in Exhibit 36. In fact, the corresponding statement was rated with one of the highest preference levels across the entire survey. This reflects suggestions in the existing literature that exit buyout investors invest in management teams and team leaders

[224] See also Finance (2005), p. 13 for the case of Katjes Fassin GmbH & Co. KG, a German sweets manufacturer, which underlines the importance and impact of the selection of future management on the success of the succession process.

and implies that the presence of a qualified management successor to the entrepreneur might be considered a key success factor.[225]

The availability, completeness and transparency of business planning and reporting data also appear to be of high importance. This result should be put into perspective by considering the diverging assessment of the credibility of business plan data between different groups of investors, as indicated above. However, the related processes, tools and systems can be of support during the due diligence and also to effectively guide and monitor the post-exit evolution of the firm.

***Exhibit 36**: Importance of organisational aspects as perceived by investors*



5.5 Case Study CFC: High Performance Service Business

5.5.1 Company

CFC Audit is an operational consulting firm assisting companies in reducing employers' contribution to professional risk insurances, such as work accident insurance. The company was founded in 1991 by Claire Franzoni, a lawyer by education. After having worked as a consultant for a larger firm in a similar field, Mrs. Franzoni had decided to build her own

225 See Muzyka and Hay (1994), p. 351 and Tyebjee and Bruno (1981).

business, centred on a rather narrow niche market but characterised by a transparent value proposition to her clients.

CFC Audit focuses on challenging the quotation imposed by the regional health insurance organisms in France.[226] This typically results in lowering its clients' insurance bills and helping them to reclaim a share of the overpaid contributions of the past, while handling all aspects of the administrative and legal process, often too complex and resource-intensive to be managed by the clients themselves. Given the transparent bottom-line impact of its services CFC's remuneration model is primarily based on success fees, a variable share of financial gain provided to the client.

Since its creation, the company was characterised by a particularly strong performance, both in terms of growth and profitability. Recruiting and teambuilding was therefore a priority for Mrs. Franzoni. In 1999, CFC achieved revenues of FRF 55 million and a net profit of FRF 20 million (36 %), leading to the firm being named a "plus belle enterprise de France" in 2000, by L'Entreprise, the French business publication, and Ernst & Young, the international audit firm.

***Exhibit 37**: Summary of CFC Audit case study*

company	CFC Audit S.A., Pantin	***company creation***	1991
country	France	***(initial) exit transaction***	2002
activity	operational consulting services	***revenues (yr. of initial exit)***	ca. € 13 million
age of ENP at exit	40s	***ENP's share before exit***	100%
buyer	Initiative & Finance, Natixis, Paris together with co-investor Alliance Entreprendre	***funds under management***	€ 130 million € 160 million
deal structure	OBO		
ENP's share after	30% ('02), 0% ('06)	***process duration***	36 months
key drivers	aspiration of entrepreneur for career change, personal fit with acquiring buyout fund		
key issues	central role of entrepreneur for continued company success		

5.5.2 Buyer

The buyout of CFC Audit was led by Initiative & Finance with Alliance Entreprendre acting as co-investor. Both institutions are French mid-market buyout funds.

Initiative & Finance was created as a buyout fund in 1984, with capital resources of € 130 million, and invests in management and employee buyouts of private and mid-sized

[226] CRAM caisses régionales d'assurance-maladie.

public companies in France. The fund invests up to € 10 million per transaction in buyout, buyin, build-up, succession, restructuring or spin-off situations in any business sector.

After being transformed into an "evergreen" investment firm, the company was floated on the Second Marché of the Paris stock exchange in 1988. Initiative & Finance is today listed on Eurolist B, with Natixis[227] owning 92% of the share capital. Since its creation Initiative & Finance has completed more than 300 buyout transactions and currently has a portfolio of about 60 active investments, which makes it one of the most experienced small business LBO specialists in France.

Alliance Entreprendre is a captive buyout fund created in 1995 which primarily invests the capital of two large French banks, with resources of € 250 million. The fund has no sector focus and invests between € 1 and 7 million per transaction in French private and mid-sizes public companies valued between € 5 and 50 million in buyout, buyin, build-up, succession, restructuring or spin-off situations. Alliance Entreprendre concludes about ten transactions per year and has a current portfolio of about 100 investment companies.

5.5.3 Motivation & Strategy

After several important achievements in her career, first as an employee and later as an entrepreneur, Mrs. Franzoni was aiming for a new phase in her professional and private life. In 1999 she started to consider exiting her firm, eight years after launching the business.

From a personal perspective, she aimed at a better work-life balance. She had taken considerable pleasure in building her firm, employing a team of about 20 consultants at that time. However, continued growth of the firm would imply increasingly formal management together with a more structured approach to leadership and organisation. This prospect was of less appeal. To ensure sustainability for the firm and its team and to allow it to move to the next level, a strategic partner and trade buyer appeared to be the logical option.

From a business perspective, the late 1990s were characterised by buoyant consulting markets. The consulting industry was in a phase of strong growth, and acquisitions of smaller firms as well as IPOs were frequent. Therefore, the timing with respect to financial and industry market conditions in retrospect appears good, but in reality, it was more a coincidence than a distinct choice.

[227] Natixis was created in 2006 by merging the finance, investment banking and service activities of Banque Populaire and Caisse d'Epargne in France. Natixis is quoted on the Paris stock exchange, with 34% of Natixis' capital retained by each of the two founding groups.

However, when in 1999 Mrs. Franzoni approached a number of larger consulting firms in the quest for a partner and trade buyer, she was able to solicit little interest despite the strong performance of her firm. The intention to exit seems to have made the deal suspicious to potential buyers. After a second round of contacts with potential strategic investors in 2001, a number of buyout funds approached Mrs. Franzoni with deal proposals. It was finally this opportunity that determined the exit transaction.

5.5.4 Transaction Structure & Process

In 1999, Mrs. Franzoni initiated direct contact with a number of larger consulting firms in neighbouring fields to explore their interest in potentially acquiring the business. It quickly became apparent that her organisation was very focused on one key person, herself. As with many service businesses, potential buyers were put off by the idea that, after an acquisition, company performance would suffer if Mrs. Franzoni did not stay on. She was the key asset of the company at the time, owning the most important client relationships and insuring the day-to-day operations of the company. As a consequence, a manager was hired to take an important role in the management of the company and potentially lead the firm after her departure. However, the candidate had difficulties identifying with the very specific niche consulting proposition and did not grow sufficiently quickly into his role. He left the company instead of becoming the sought-after general manager.

In 2001, CFC Audit launched a second approach, and a number of potential strategic buyers were contacted. Similar to the reactions of two years earlier, the feedback did not lead to any further discussions. At the same time, CFC Audit was contacted by two buyout funds that had noticed the outstanding growth and profit levels of the company. Without involving an intermediary, Mrs. Franzoni seized the opportunity and enlarged the circle of potential investors by directly contacting funds that had previously made investments in the consulting sector. Out of the ten funds involved, three were retained for further discussions, mainly based on personal fit.

By 2002, the team had grown to 30 consultants, and negotiations and deal structuring with Initiate & Finance and Alliance Entreprendre were approaching finalisation. An OBO was agreed upon as the most favourable deal structure. Three senior team members took over the management of the firm, with Mrs. Franzoni remaining involved and ensuring the transition during a 12-month period. The structure was based on an initial sale of 70 percent of the company’s capital, with the 30 percent retained by Mrs. Franzoni being transferred into the buyout’s Newco. The process benefited from the pragmatic approach of the legal advisors on both sides.

After the transaction, the firm continued to prosper. In 2005, the team had grown to 50 consultants, and the debt employed for the buyout's leverage had been reimbursed out of the company's strong cash flows. The two buyout funds identified the opportunity to harvest their investment, hired a professional intermediary, and in 2006, CFC Audit was sold to Alma Consulting Group, a European consulting firm with revenues of € 150 million and more than 700 employees. Interestingly, Alma Consulting is an OBO itself, with its founder having teamed up with a buyout investor to realise an ambitious external growth strategy. When finally exiting the remaining 30 percent, Mrs. Franzoni received a payout comparable to the initial sale of her 70 percent stake, indicating the potential attractiveness of such earn-out agreements.

5.5.5 Summary

The key driver for the transaction was the personal motivation of the entrepreneur to shift the focus from her business to her personal life and family. The trigger, after a series of non-concluding contacts with potential strategic buyers, was an opportunity that presented itself when buyout funds approached the company.

The key issue in the 36-month process from initial contacts to the sale of a 70 percent stake in the company was the preparation of the company for the transition away from its founder-manager. While the company had achieved highly attractive growth and profitability levels, potential buyers where shying away from a company ill-prepared for the transition to a management successor.

The initially positive market environment had changed by the time of the transaction. However, this had little impact given the outstanding financial performance of the firm and its related ability to quickly reimburse the debt required for leverage.

From the perspective of an exiting entrepreneur, this transaction indicates that even exceptional performance cannot carry a successful exit alone. It must be accompanied by the necessary organisational preparations. The substantial increase in total proceeds realised from the exit demonstrated the potential effectiveness of earn-out agreements and optimised divestment structures.

The founder of CFC Audit stated:

> *"If I had to do it again, I would only change two things: prepare the organisation better and involve an intermediary who knows investors and can help to better prepare the company for the transaction."*

From a buyout investor perspective, this transaction shows that a focus on personal fit and a certain patience in awaiting the organisational readiness of an exit buyout can provide privileged access to attractive investment opportunities.

6 Factors Related to the Market Environment

6.1 National Market Conditions

The above literature review suggested that the flow of MBO-opportunities in Germany is significantly less pronounced compared to France, with entrepreneurial and family business exits representing a relatively small share compared to corporate divestments. This is predominantly driven by cultural issues and structural differences on the supply-side, i.e., residing within the domain of exiting business owners and potential future MBO-managers, while the demand-side and a slightly less advantageous regulatory environment would support a significant increase in activity in Germany.[228]

Case Study Evidence

Examining a set of entrepreneurs who ran their own companies can, by definition, provide little support for the hypothesis of a general dearth of entrepreneurial culture. However, several French entrepreneurs were faced with challenges around the internal or external identification and integration of suitable long-term successors for the management of their firms. This does not correspond to the assessment of a more developed buyout activity in France, and somewhat hampered or at least delayed the availability of the exit buyout option. It remains inconclusive whether this lack of motivation to take entrepreneurial risk is a general phenomenon of the French or German culture or whether it was only linked to the managers of the examined companies.

The family shareholder of Sofilab stated:

> *"Initially I was hoping that an employee buyout could become a viable exit option for me, as I was very close to my staff. But it turned out that they were not really motivated to step up to the entrepreneurial challenge."*

All firms examined in both France and Germany managed to solicit significant interest from potential buyout investors and were confronted with similar process issues. Also, no differences due to the legal or financial environment in both countries, such as, for example,

[228] See Kitzmann (2005), p. 127. Little existing research could be found on the direct impact of national regulatory environments on buyout activity levels and performance.

lending practices, were identified. Therefore, it can be suggested that a workable exit buyout ecosystem is in place in both countries and that country-specific factors, at least in these two countries, do not play a dominant role in the success of the exit buyout process.

***Table 27**: Relevance of national market conditions*

Company	Main Cultural/Structural Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• na				
CFC Audit	• No buyout motivation of staff				
Sofilab	• No buyout motivation of staff				
Divalto	• No buyout motivation of staff				
Wakame	• na				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

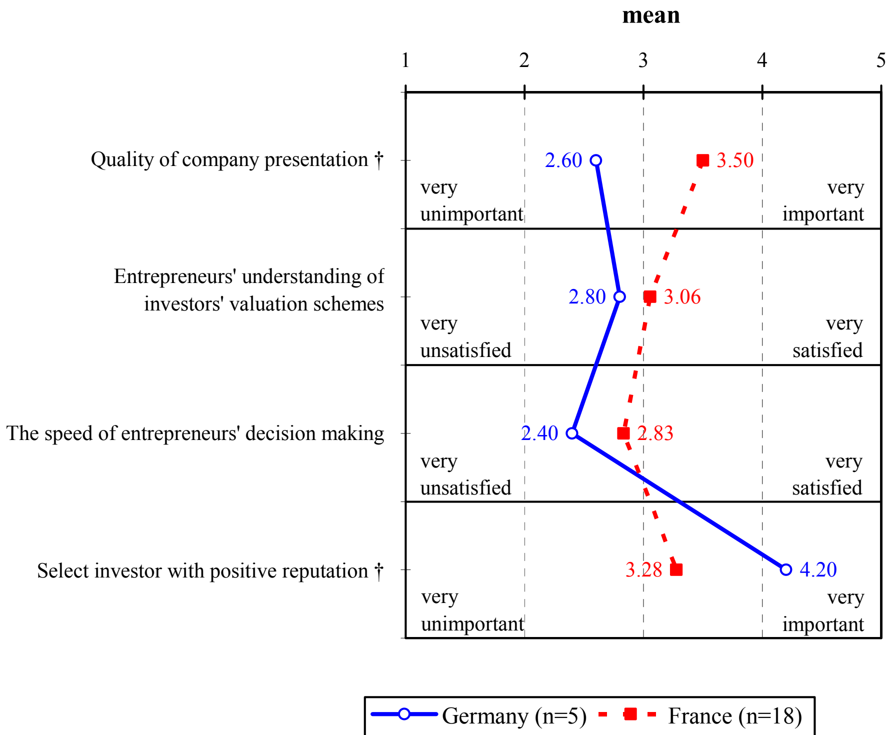
Survey Results

Few significant differences between French and German investors in the assessment of targeted deal size, structuring preferences or key success factors along the exit buyout process have been identified. This is in line with the existing literature, which indicates that differences in buyout levels might be more a supply- than demand-side issue. Additional evidence comes from the fact that investors see differences in the entrepreneurs' preferences and attitudes. As shown in Exhibit 38, German business owners are perceived as being less proficient in their interactions with buyout investors, more hesitant throughout the buyout process and as attaching higher value to working with investors with a strong, positive reputation. However, a caveat needs to be made regarding the small sample size, specifically for Germany.[229]

Research by Wright et al. (2004) supports the hypothesis of few differences between the practices of French and German investors by analysing valuation methods and information sources used by venture capitalists in both countries. The authors attribute their results to only limited differences in the underlying philosophy of the country's regulatory systems.

[229] The survey included 17 French and six German exit buyout investors.

***Exhibit 38**: Differences between entrepreneurs in France and Germany*



Mann-Whitney-U-Test: Significant mean difference † p <= 0.1; * p <= 0.05

6.2 Financial Market Conditions

The health of financial markets over time follows bullish and bearish phases.[230] This cyclical nature can also be found in buyout markets.[231] It might determine the availability of the exit buyout option as well as its attractiveness through the levels of valuation applied at a given moment in time.

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[230] See Wagner and Mull (2001), p. 3.

[231] See Frommann and Dahmann (2003).

6.2.1 Buyout Activity Levels

Case Study Evidence

Examining a set of entrepreneurs who decided to harvest their firms through an exit buyout can, by definition, provide little support for the hypothesis positing a cyclical constraint to the availability of the exit buyout option. Three of the five entrepreneurs examined completed their exit buyout in the period from 2001 to 2004, which is typically associated with a less buoyant buyout activity. Despite the market conditions they managed to solicit significant interest from several potential buyout investors, whereas the potential strategic buyers they had approached in parallel showed significantly less interest. Therefore, it can be suggested that a strong and rather stable demand for exit buyouts is, in large part, resistant to macroeconomic and supply-side shocks, which are mainly driven by a volatile flow of corporate divestments and much less by entrepreneurial and family business exits. In addition, anti-cyclic investment strategies and the comparably low leverage of up to 50% of the total transaction value helped to close transactions, even during slow periods of the overall market.

This would make the exit buyout option potentially available across the entire buyout market cycle, and buyout activity levels therefore do not seem to play an important role in the success of an individual exit buyout process.

***Table 28**: Relevance of buyout activity levels*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• 2001/2005: slow/strong market				
CFC Audit	• 2002: slow buyout market				
Sofilab	• 2003: accelerating buyout market				
Divalto	• 2006: strong buyout market				
Wakame	• 2007: very strong buyout market				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Existing research similarly suggests that buyout market cycles are predominantly driven from the supply-side, with one of the main factors being the level of corporate divestments. On the other hand, demand-side elements showed less explanatory power and were

considerably favourable over a large period of the last buyout cycle, with a significant fund overhang to be invested as well as stable and relatively low interest rates.[232]

6.2.2 Valuation Levels

Case Study Evidence

While it was suggested above that the exit buyout option was available across the entire financial market cycle, this was probably not the case at the same valuation levels. The entrepreneurs showed considerable reluctance to disclose the detailed valuation of their exit transaction. However, based on publicly available data on the company results and equity investments made, it can be suggested that the exit buyouts in the sample conducted between 2001 and 2004 were valued at lower EBIT and EBITDA multiples compared to valuation levels practiced between 2005 and 2007 in the respective industries.

A team-member of the investor in Wakame stated in September 2007:

> *"We have seen a significant change since 2002. It really has become a sellers' market. Transactions are more and more intermediated, auction processes lead to a further increase in valuations and entrepreneurs seem to be more and more focused on price."*

For entrepreneurs the timing with respect to market valuations can therefore have an important impact on the total proceeds to be realised from the harvest. In that respect, the payment of the proceeds over time, based on the actual valuation at a specific time and earn-out mechanisms, can represent a good tool for entrepreneurs to bridge periods of lower valuations and benefit from the evolution of bullish buyout markets.

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[232] Bleackley and Hay (1994) suggest a supply-side view for explaining variances in the cyclical nature of U.K. buyout levels predominantly driven by corporate divestment.
Wright et al. (2006) found little evidence for the hypothesis that interest rate levels impact the financing structure of UK buyouts.
Jakoby (2000) could not find a significant link between GDP growth and the longer-term development of buyout firms.
Zimmermann and Karle (2005) suggest that the business climate assessment of investors correlates positively with fund raising possibilities, public programmes and attractiveness of investment opportunities. Less important appear to be factors such as stock market levels and related exit options and interest rate levels.

Table 29: *Relevance of valuation levels*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• 2001/2005: lower/high valuations				
CFC Audit	• 2002: lower market valuations			-	
Sofilab	• 2003: increasing market valuations				
Divalto	• 2006: high market valuations			+	
Wakame	• 2007: very high market valuations			+	

[ ]: no impact +: positive impact - : negative impact --: blocking impact

6.3 Industry Market Conditions

The state of a business sector or industry can be characterised by its degree of maturity, growth, innovation, competitive pressure, concentration or fragmentation and consolidation. These factors might play a role in the exit buyout investor's ability to shape a value-creating strategy for the firm and thus might facilitate or hamper the availability or attractiveness of the exit buyout option to entrepreneurs. Industry market conditions can represent an important lever to buyout investors who often seek to apply a number of generic strategies such as, for example, a "build-up" approach on the level of the individual firm.[233]

Case Study Evidence

The five cases, spanning several manufacturing and service industries, suggest that industry market conditions can play an important role in making the exit buyout option available and in strengthening the entrepreneur's bargaining power. Firms active in industries with either strong growth, such as specialised software, consulting and niche consumer-goods, or rapid consolidation, such as specific industrial manufacturing sectors, solicited high levels of interest from potential investors.

A team-member of the investor in Maier Chem stated:

> *"We started a build-up in the specialty chemicals industry just a few years ago. So we always followed the company and made attempts to approach them. When the owner was finally ready to sell, our existing involvement in the industry helped us to assess the opportunity, define a compelling value creation strategy and gave us more credibility in the discussions with the family shareholders."*

[233] The "build-up" or "buy-and-build" approach is a strategy used by a number of buyout investors. Similar to a platform build-up, investors attempt to drive consolidation in an industry through bolt-on acquisitions to an earlier investment.

It appears to be less the industry as such and more the immediate recognition of the strategic development options that can be applied to the firms that appeal to investors. To them, the possibility of leveraging proven "strategic plays" had an effect of risk limitation. As a result, the exiting entrepreneurs found themselves in a strong position and could transfer their businesses at a point where a clear strategy for the future role of the firm within its industry could be defined. However, entrepreneurs will not be able to switch industries just to accommodate an exit. Hence, the exit buyout will represent a more favourable option for entrepreneurs in industries showing the above patterns. However, specific industry market conditions can be considered to be an important catalyst for a successful exit buyout transaction.

***Table 30**: Relevance of industry market conditions*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Mature industry/PE build-up	+			
CFC Audit	• Evolving industry/growth niche				
Sofilab	• Mature industry/post-consolidation				
Divalto	• Evolving industry/growth niche	+			
Wakame	• Mature industry/growth niche	+			

[ ]: no impact +: positive impact - : negative impact --: blocking impact

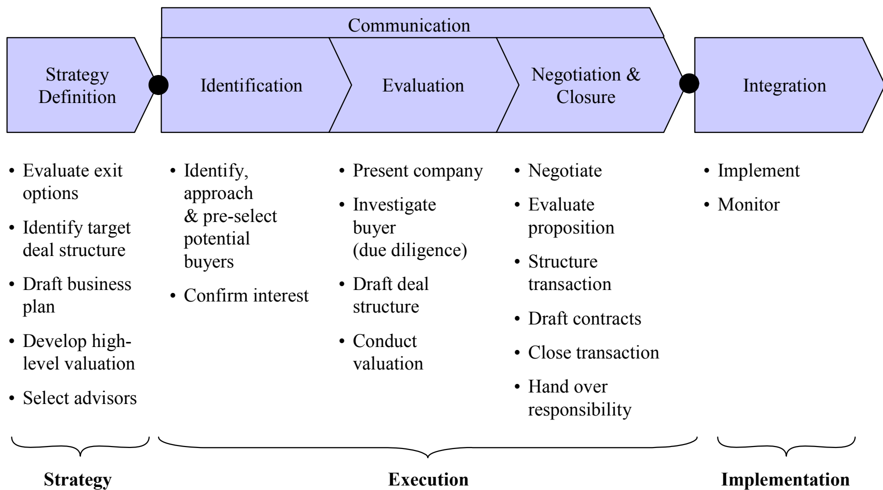
Existing research from a population ecology perspective supports the suggested importance of industry market conditions. Empirical results show that the rate of exit increases as the number of firms in an industry increases because of higher levels of competitive rivalry.[234] However, the higher the extent of competitive rivalry, the more difficult it becomes to transfer the firm successfully.

234 See Carroll and Hannan (1989).

7 Factors Related to the Exit Strategy & Process

In addition to characteristics relating to the participants, the firm and the surrounding market environment the design and execution of the exit process, as illustrated in Exhibit 39, might have an important impact on the outcome. The related aspects are examined along four steps: upfront strategy definition, initial identification and selection of potential investors, subsequent due diligence, negotiation and transaction closing as well as the post-transaction transition of the firm to a management successor under the influence of the new shareholders.

***Exhibit 39**: Overview of exit process*



Source: own graph, based on Achleitner and Fingerle (2003).

7.1 Strategy Definition

Entrepreneurs' exit strategies can be decomposed into four components: the timing, the exit options as well as buyout typologies and the structure of the exit process.

7.1.1 Timing

Driven by the entrepreneurs' motivations and potentially impacted by external triggers, the timing chosen can be analysed along three distinct lifecycles: from a personal and professional lifecycle perspective with respect to the entrepreneurs' work-life balance preference and the fit between the entrepreneur and the life cycle stage of his firm;[235] from a firm development perspective with respect to firm size, growth potential and maturity; and from a market cycle perspective with respect to financial and industry market trends and conditions.[236]

To assess the role of timing within exit buyouts, two angles of exit strategy development need to be investigated: first, by asking whether and how entrepreneurs choose specific timing strategies for their exit, and second, by examining the potential impact of time-related changes in both the financial market and industry environment on exit success.

Case Study Evidence

Most of the exits examined had been timed based on predominantly personal, firm and industry-level phasing. However, the timing chosen appeared to be the result of an evolutionary process leading gradually toward the exit rather than an ad-hoc decision with respect to certain conditions of the environment. Age and the desire for a career change, on one hand, and strategic imperatives such as attaining the next growth level, industry consolidation trends and moves of direct competitors on the other hand appeared to have impacted the timing of the examined exit buyouts. Financial market conditions that are often brought into relation with waves of entrepreneurial IPO exits seemed to have had little influence on the choice of timing, with several exit buyouts having been initiated under comparably weak financial market conditions from 2001 to 2004.

The founder of CFC stated:

> *"When I approached investors initially in 1999 and then again in 2001 I didn't really have a specific market timing in mind. It was more that I felt my company had reached a certain size and that I was ready to hand it over."*

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[235] Jayaraman et al. (2000) suggested a diminishing value of founders to their firms over time.

[236] Factors potentially determining the impact of timing on exit buyout success such as firm size and financial market conditions are examined above in chapter 4.1 for entrepreneur-related factors, in chapter 5.2 and 5.3 for company size and performance and in chapter 6.2 and 6.3 for financial and industry market conditions.

The family shareholder of Sofilab said:

> *"The timing of my exit was not only driven by my desire to focus on my private life. My employees expected an answer to the latent succession issue I had and the company had reached another level of size and internationalisation."*

The impact of a chosen timing on exit success appears to be mixed. No direct relation to the availability of the exit buyout option could be identified, as the exit buyout option was applied successfully across different financial and industry market phases.[237] However, an impact on valuation levels can be hypothesised. Even if the entrepreneurs displayed little active effort at timing beyond personal- and firm-level aspects, it might be suggested that timing can have an impact on valuation with respect to financial market conditions, as individual transactions followed the trend of private equity valuations on the market.

***Table 31**: Relevance of exit timing*

Company	Main Triggers	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Industry dynamics				
CFC Audit	• Personal considerations			-	
Sofilab	• Approaching succession issue				
Divalto	• Personal considerations				
Wakame	• Strategic & personal considerations			+	

[ ]: no impact +: positive impact - : negative impact --: blocking impact

The somewhat underdeveloped role of timing within entrepreneurs' exit strategies is also reflected by studies in neighbouring areas. Petty (1997b) found that 60 percent of entrepreneurs give thought to their harvest strategy prior to entering the exit process, whereas 40 percent did not. In a conceptual model developed in analogy with the relay race concept, Dyck et al. (2002) suggested that timing with respect to the development phase of the firm is only one of four factors determining success in executive succession.

7.1.2 Exit Options

Four generic exit options beyond a business transfer within the family and orderly liquidation can be distinguished: IPOs, trade sales, different forms of buyouts, mainly MBOs and ESOPs, and the option of gradual divestment/increase in cash flows. This indicates that the exit buyout concept is competing with several other exit options.

[237] The limited impact of timing on the availability of the exit buyout option corresponds to the demand- rather than supply-side-driven changes in the buyout levels identified in chapter 2.1.2.

<u>Case Study Evidence</u>

Some of the entrepreneurs made a distinct choice to pursue a specific exit option; others were considering several options in parallel. Most entrepreneurs initially considered a sale to strategic investors. This could be attributed to the dominance of this option in practice but appears interesting if we consider the aspect of competition that often governed the relation with potential trade buyers at earlier stages of the firm's development. Some entrepreneurs found it difficult to solicit interest from strategic investors despite attractive firm performance mainly because of difficulties in accessing decision makers and long response times. Only in a second step, when feedback was somewhat mixed, was the exit buyout option more actively examined. Buyouts lead by managers without the involvement of equity investors were examined in some cases. However, from the perspective of both entrepreneurs and managers, such a structure appeared to be challenging and attached to significant risk without the support of a strong financial partners.

The founder of CFC Audit stated:

> *"When I had decided to sell out I contacted quiet naturally a number of Anglo-Saxon consulting and audit houses, knowing that they had bought up smaller firms in the past. However, I didn't really get very far. The fact that I wanted to exit my business medium-term somewhat blocked their interest. After two years I made a second attempt with strategic buyers but again ended up with no lead. By that time I had read in the press of a number of funds investing in my sector. So I contacted them."*

The family shareholder of Sofilab declared:

> *"At the beginning of the process I considered three options: the sale to a strategic investor, an employee buyout or a buyout through financial investors. While selling out to one of our direct competitors was never an option to me, I was willing to discuss with much bigger groups that could have been interested to acquire us. But they didn't really react. The employee buyout would probably have been my preferred option, but neither was there a clear motivation of potential successors within the team, nor was it financially viable, involving high levels of debt. Therefore I ended up talking to a number of buyout funds."*

The somewhat low initial priority assigned to buyout options can be surprising. Assuming a potentially significant size difference between organisations in the case of a trade sale, especially for smaller firms, a buyout fund might appear to be a more suitable partner. Such funds can propose a more entrepreneurial project, even considering major differences in paradigms, compared to a significantly larger strategic investor. Limited knowledge about

the buyout option and its perceived image might be possible explanations despite recent improvements in this area.[238]

None of the entrepreneurs targeted an IPO, even though one of the firms had been listed before but pulled back from the stock market due to low liquidity of its shares. This appears mainly related to entrepreneurs' perceptions of the sub-critical size of their firms and an overly complex and costly IPO process.

***Table 32**: Relevance of exit options*

Company	Exit Options Considered	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Trade sale. Buyout only indirectly				
CFC Audit	• Trade sale first, buyout later	-			
Sofilab	• Trade sale and buyout in parallel				
Divalto	• Trade sale first, buyout later	-			
Wakame	• Trade sale. Buyout only indirectly				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Overall the choice of exit options at the outset did not have a significant effect on the exit buyout other than delaying the process when testing different options at the beginning of the process. The rather low priority attached to the buyout option initially is a phenomenon that has also been identified beyond the exit buyout context. Muzyka and Leleux (1993) suggest that entrepreneurs perceive trade sales as less costly and easier to execute than IPOs, while MBOs are thought to increase the motivation of the management team but are only successful for high-performing profitable firms. However, their results differ somewhat between countries across Europe. Bleackley et al. (1996) also suggest that entrepreneurs' choice of the exit option can be moderated by the institutional context of a country, potentially impacting the availability and entrepreneurs' bargaining power in different options.

7.1.3 Buyout Typologies

Within the exit buyout option, several typologies can de distinguished mainly based on the origin of the future management of the firm.[239] Whereas in MBOs and MEBOs the current management will lead the firm, in OBOs the entrepreneur will remain involved (at least for a certain period), and in MBIs and to some extent in BIMBOs, external managers will take

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[238] See also chapter 2.1 for the demand-side evolution of buyout markets.

[239] For the definition of different buyout typologies see also chapter 1.2.2.

over. Information asymmetries and risk considerations might impact exit buyout success of the above typologies.

Case Study Evidence

The entrepreneurs appeared not to be very sensitive to the application of a specific buyout typology to their exit strategy. Different structuring options became transparent only at later stages of negotiations with investors. This might be related to limited knowledge about less often applied and more recent forms of buyouts such as OBOs and BIMBOs.[240] As a result the internal or external origin of management successors and their willingness to share entrepreneurial risk became in several cases the differentiators between typologies. Internally available successors that were not interested in equity participation led to OBOs, whereas external managers interested in an equity stake led to MBI/BIMBO configurations. The investors' clear preference for the MBO and OBO typologies appeared to be little known to entrepreneurs upfront.

The founder of CFC Audit stated:

> *"Anyway I learned about the detailed structuring options only in the negotiations with investors. Based on the specific situation that three team members would jointly lead the firm in the future, but had no appetite for an entrepreneurial involvement, we decided in favour of an OBO setup.*

A team-member of the investor in CFC Audit said:

> *"We actively seek OBO opportunities and were glad that we could structure such a transaction around CFC Audit. It structurally aligns the objectives of the entrepreneur and the investor in the strongest possible way."*

Buyouts in the form of acquisitions through existing portfolio companies of a buyout investor were another variant, applied in the case of Wakame. The management of the existing portfolio firm took over management responsibilities. Hence an internal successor was of lower importance.

[240] See also chapter 4.1.2 for further analysis regarding entrepreneurs' knowledge and experience impacting exit buyout success.

Table 33: *Relevance of exit buyout typology*

Company	Buyout Typologies Considered	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Acquired by competitor/LBO				
CFC Audit	• Internal successor; OBO	+			
Sofilab	• External succesor; BIMBO	-	-		
Divalto	• Internal successor; OBO	+			
Wakame	• Acquired through portfolio co.		+		

[ ]: no impact +: positive impact - : negative impact --: blocking impact

MBO and OBO buyout typologies appear to positively impact the availability and the ease of process. Significant availability and process length penalties could be identified in configurations without readily available internal succession candidates leading to MBIs/BIMBOs.[241] No differences between buyout options regarding the sustainability of the firm were identified, hinting toward the careful selection of both internal and external management successors.

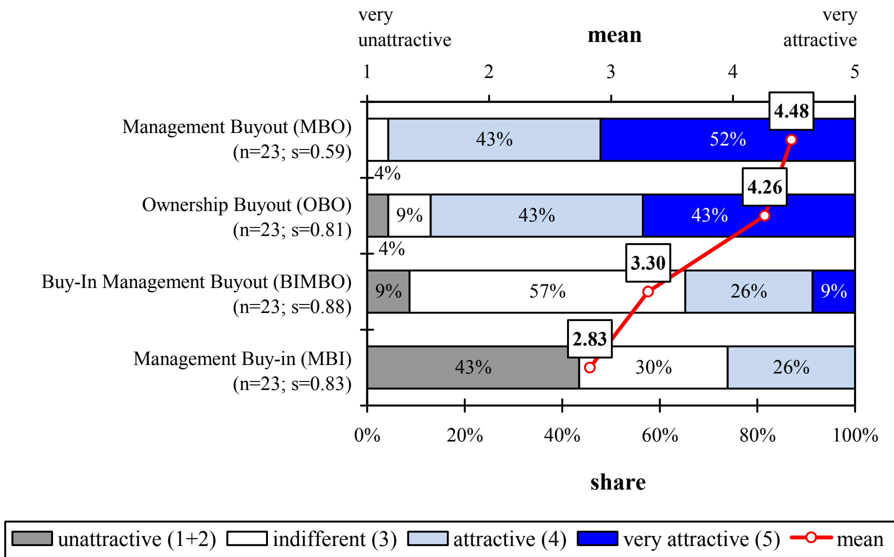
Survey Results

The investors were questioned about the attractiveness of different buyout typologies. As shown in Exhibit 40, a strong preference for MBOs became apparent, which confirms that investors perceive the continuity of senior management as a key success factor to exit buyouts. OBOs were considered to be attractive, however, not as much so as MBOs. Investors highly value the continued involvement of the entrepreneur but might appreciate less the partial exit aspect of OBOs, which leads to a lower level of alignment of interest between management and investor compared to MBOs. BIMBOs and especially MBIs were considered to be significantly less attractive, with MBIs even rated as being, on average, unattractive. The low level of attractiveness of MBIs also manifests itself in the comparably low levels of private equity funded MBIs on the buyout market.[242]

[241] See also chapter 5.4 for further analysis regarding the firm's organisation impacting exit buyout success.

[242] See also Klemm (2006), p. 24 for the low levels of MBIs in Germany.

***Exhibit 40**: Attractiveness of different buyout typologies*



7.1.4 Process Variables

Three generic types can be distinguished with respect to buyout processes: exclusive negotiations, open auctions or controlled auctions.[243] The main differences that can potentially impact exit buyout success are the rigidity of the process, the level of confidentiality of firm information disclosed throughout the process, and the effectiveness of market-making through auction elements.

Case Study Evidence

All of the processes examined were designed to lead to exclusive, multiple-round negotiations. None of the entrepreneurs had selected an auction approach at the outset or applied auction elements at later stages of the process. Moreover, the intermediaries participating in some of the cases did not seem to actively promote such an approach. This

243 See analogy of corporate acquisitions in Müller-Stewens et al. (1999), p. 43.

might appear surprising as the auction principle is well known and the exit buyout represents a single-round game for entrepreneurs with little to lose.

The founder of CFC said:

> *"When I started the process, I was focused on the individual investors I wanted to contact, first strategic and then also financial investors. But I didn't really think about an auction at all."*

A team-member of the investor in CFC Audit stated:

> *"One of the aspects we would like to see more often in other transactions is the fact that we have been put only into limited competition with other funds (i.e. no auction situation). That allowed for a transparent process and interactions with the entrepreneur and her management team."*

The founder of Divalto stated:

> *"The intermediary I had involved suggested to contact several waves of five to ten investors and hold individual meetings with the funds showing an interest in the firm. This allowed me to get to know them, build an initial relationship and learn from meeting to meeting."*

Even though a significant number of interested bidders were identified, initial valuation proposals and personal fit often led the entrepreneurs to make the obvious choice of retaining only one or two potential investors for final negotiations. The potentially surrendered difference in price did not seem to worry the entrepreneurs. In any case, they were not able to identify how much value they might have left on the table. According to the balance of their exit objectives, they might have intentionally favoured a process helping to identify the right partner for their firms rather than exclusively focusing on the best financial offer.

Table 34: *Relevance of process variables*

Company	Main Aspects	Availability	Ease of Process	Financial Result	Sustainability
Maier Chem	• Negotiations, one investor				
CFC Audit	• Negotiations, multiple investors				
Sofilab	• Negotiations, multiple investors				
Divalto	• Negotiations, multiple investors				
Wakame	• Negotiations, one investor				

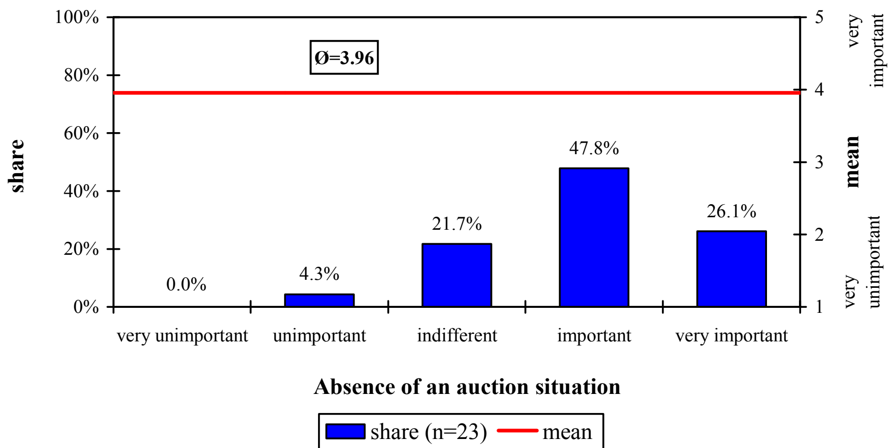
[ ]: no impact +: positive impact - : negative impact --: blocking impact

In the examined cases only multiple-round negotiations have been applied and did not lead to any specific issues. A comparison with the outcome of an auction process is therefore not possible. However, given the related theoretical and empirical research, it might be assumed that auctions can have a positive impact on valuation, also in the case of exit buyouts. This should be the focus of future empirical research on exit buyouts.

Survey Results

The investors were questioned about their assessment of buyout auction processes. As indicated in Exhibit 41, the vast majority, 74 percent, identified the absence of an auction situation as an important precondition to investors' buyout success. The key issues driving this apprehensive attitude toward auctions might be the so-called winner's curse phenomenon as well as the constrained access to information and the company's management throughout a structured auction processes.[244] Investors are also penalised by the resource-intense and costly participation in auction processes without being able to assess their chances of success. Hence, the overall costs of each investment that is finally realised increase and hamper overall returns of the fund.

Exhibit 41: *Investors' assessment of auction situations*



[244] The winner's curse is a phenomenon akin to a Pyrrhic victory that occurs in common value auctions with incomplete information. The winning bid in an auction tends to exceed the intrinsic value of the item purchased. Because of incomplete information, emotions or any other number of factors regarding the item being auctioned, bidders can have a difficult time determining the item's intrinsic value. As a result, the largest overestimation of an item's value ends up winning the auction. The severity of the winner's curse increases with the number of bidders. This is because the more bidders there are, the more likely it is that some of them have overestimated the auctioned item's value. Savvy bidders will try to avoid the winner's curse by bid shading, or placing a bid that is below their ex ante estimation of the value of the item for sale — but equal to their ex post belief about the value of the item, given that they win the auction. See also Klemperer (2004).

7.2 The Case of Maier Chem: From Merger of Family Businesses to Exit Buyout

7.2.1 Company

Maier Chem GmbH was a global provider of a broad range of specialty chemicals to the printing industry, integrating research, development and production, with sites in Germany, Austria, Poland, Hungary, Canada and China.[245] The company was founded in Western Germany at the end of the 19th century and was afterwards run by four generations of the Maier family. In his mid-40s, Kurt Maier, CEO since 1995, had spent the majority of his career in different leading positions of the family business after having started his professional life in a global consulting firm.

By 2000, Maier Chem was one of the market leaders in Europe, also present in North America and China, and had reached annual revenues of about € 250 million, with about 1,000 employees. In an increasingly competitive market driven by globalisation, Mr. Maier and his family decided to strengthen their franchise through a strong partnership. In 2002, Maier Chem merged its operations with the European activities of its American competitor, Miller Inc. In 2005, within a second transaction, the Maier family exited from its business, when the merged entity became part of a global MBO of Miller by a leading private equity fund.

***Exhibit 42**: Summary of Maier Chem case study*

company	Maier Chem	***company creation***	1870s
country	Germany	***(initial) exit transaction***	2001
activity	specialty chemicals manufacturing	***revenues (yr. of initial exit)***	ca. € 250 million
age of ENP at exit	40s	***family's share before exit***	100%
1st Transaction			
strategic partner	Miller Inc.		
deal structure	joint venture of both firms' EU operations		
family's share after	minority stake in JV	***process duration***	24 months
key drivers	strong strategic fit with largest family business in the industry		
key issues	legal guarantees		
2nd Transaction			
buyer	AB Capital	***funds under management***	€ 20 billion
deal structure	MBO; technically an acquisition by a portfolio company		
family's share after	minority stake in JV ('04), 0% ('05)	***process duration***	12 months
key drivers	strong strategic fit with existing portfolio company, competitive pressure on performance		
key issues	due diligence by investor		

245 For confidentiality reasons the identity of all firms and persons involved has been disguised.

7.2.2 Strategic Partner & Buyer

Miller Inc., also a family business, was founded in the U.S. in the 1920s and realised in 2001 global revenues of about € 900 million, with about 3,000 employees. On the global market, which was characterised by a comparably high level of fragmentation and a large share of long-standing family businesses, Miller was the number two player. Miller's European operations had been strengthened earlier with an acquisition in the U.K. in 1998. Until early 2005, the company had bee run by the Miller family over three generations. Following the retirement of Michael Miller – in his 60s at the time – the family had installed a family-external but longstanding senior manager of the firm as CEO. When Mr. Miller suddenly passed away later in 2005, the family and the business had lost an important personality and integrator.

The buyout transaction was concluded with AB Capital, the investment fund. AB Capital Partners is a global private equity group founded in the early 1980s and owned by its partners since the early 1990s, with more than 15 offices across Europe, the U.S. and Asia. The firm manages equity capital of more than € 20 billion, representing an investment portfolio of more than 40 companies with combined sales of almost € 40 billion. AB Capital is a recognised market leader in Europe, with a track record of top-quartile performance. The fund invests without a specific industry focus in companies valued at between € 300 and € 10 billion and displaying market-leadership, stable cash flows as well as opportunities for growth by acquisition.

In 2004, AB Capital became involved in Maier Chem's industry for the first time. The company sought to foster consolidation in a fragmented market through the initial acquisition of two competing manufacturers: a German company, at the time still a division of a large global chemicals conglomerate, and a Swedish company, formerly also part of a global chemicals group. The newly created company named Onyx had annual sales of about € 800 million and became the third largest player globally.

7.2.3 Motivation & Strategy

For years Maier Chem's industry was a relatively stable market. After a wave of mergers and acquisitions in the 1970s and 1980s, the global market, with a total volume of about € 10 billion, appeared to be divided up between players: two global leaders with revenues around and above the € 1 billion mark, five to ten companies significantly above € 100 million, and a number of smaller firms with significantly lower revenues.

In the late 1990s, Maier Chem's products were very successful and made for a profitable business, but the entire industry was in a state of upheaval, as the mature and highly competitive market became increasingly global. A potential future wave of consolidation would have imposed additional pressure on medium-sized players and posed the risk of reducing them to niche specialists. This made it necessary to give the business a stronger global thrust, potentially implying considerable investment.

By looking for a partner, Mr. Maier was endeavouring to give his business new opportunities to grow its market position and to further expand its activities world-wide. It was obvious that one company would provide an excellent fit: Miller, the global number two and largest family business on the market. The product portfolio and international coverage of both firms was highly complementary. In addition, being a family firm itself, Miller would ensure continuity for Maier Chem's business through similar vision, values and management style.

While strategic considerations clearly dominated this first transaction, it was also a move to proactively protect the financial assets of the Maier family by integrating them into a larger group. This would prevent large investments that might place the firm in debt and would limit the risk of value erosion if a new wave of consolidation were to create ever larger competitors.

Prior to the buyout transaction in 2005, things had taken a dramatic turn. The merger of Maier Chem and Miller's European business had indeed triggered a new wave of consolidation and mergers of medium-sized European players, culminating in the creation of Onyx by AB Capital, the new number three on the market.

In 2004, the Miller family shareholders as well as the management started considering options for the future following increasing competitive pressure from the market leader. Motivated by the potential upside of a transaction, the new Miller CEO suggested – with the support of large parts of the Miller family – testing the interest of potential investors. Just a few months later, AB Capital launched Onyx. By the time AB Capital was invited to join the process and bid for Miller, the fund was able to present an appealing strategy. From a corporate perspective, combining Miller, the world's second-largest manufacturer, with Onyx, the third-largest company, AB Capital would create a very solid setup. With revenues in excess of € 2 billion, Miller would strengthen its operating position in its battle with the global market leader and the gap between itself and all other competitors, significantly below the € 1 billion revenue level, would widen.

Whereas the strategic rationale was compelling, the personal and financial objectives of Miller's stakeholders were probably equally important, as the attractive valuation levels paid by AB Capital the year before had not gone unnoticed in the industry.[246]

When the initial approach for a partner was launched by Mr. Maier, a buyout did not represent a suitable option, either in terms of availability or, even more importantly, in terms of fit. At the time of the second transaction, he was impressed with the profound industry knowledge AB Capital displayed. However, he became hesitant when it was suggested to him that he should reinvest part of the sale proceeds into the buyout. The family business and private equity cultures were too different from his perspective with regard to leverage, short-term orientation and cash-focus. In addition, being invested in a company without having its entrepreneurial responsibility was of little appeal. As a result, Mr. Maier decided to take the opportunity to divest from the business, reinvesting part of the proceeds in several entrepreneurial projects in neighbouring industries at earlier stages of their development.

7.2.4 Transaction Structure & Process

Around 2000, having identified Miller as the preferred and probably most value-enhancing partnership candidate, Mr. Maier established direct contact with Mr. Miller based on earlier discussions the two families had conducted. Following a confirmation of initial interest from both sides, a lightly resourced structuring and negotiation process was launched. Only Mr. Maier and the three most senior members of the Miller management team where involved, with some legal support but no involvement of intermediaries or investment banks. Discussions centred mainly on the strategic focus and future organisation of the new entity, with the agreement on product guarantees representing a considerable hurdle from a legal perspective. Both companies were valued according to sales, results and net equity determining the shareholding of each party in the new firm.

After an evolutionary process of talks and negotiations in several phases over a period of 2 to 3 years, an agreement was reached. By merging both firms' European operations, a joint venture with about € 450 million in revenues was created in 2002. Miller retained the majority of the entity named Miller-Maier and Mr. Maier led the business as CEO from 2003 on. In parallel, Miller continued its U.S. operations under its name, Miller Inc., also integrating Maier Chem's former Canadian subsidiary.

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[246] According to the Handelsblatt newspaper, ABC paid between € 650 and 700 million for the business, which had sales of € 690 million.

In 2004, the second transaction was initiated by the family shareholders and CEO of Miller, who were familiar with corporate transactions after a series of earlier acquisitions. The second process was significantly more structured than the first. Assisted by an investment bank, Miller had initiated a bidding process with about ten to 15 potential buyers. A number of candidates were shortlisted, among them also AB Capital. The recent creation of Onyx and a financially attractive offer resulted in AB Capital being retained along with several investors. Subsequent to a full due diligence, in line with the complexities of a global business, AB Capital offered a package deal for the entire business, leaving the Miller and Maier families to structure the distribution of proceeds between them. Mr. Maier, who had a veto right according to the conditions of the initial merger, agreed to the deal while declining an offer by AB Capital to reinvest part of the proceeds into the newly formed group.

At the end of 2005, with the help of AB Capital, Onyx acquired Miller Inc. of the U.S. and Miller-Maier of Europe and subsequently renamed the combined entity Miller Group. Today, Miller Group is a diversified supplier of specialty chemicals to the global printing industry and ranks either number one or number two in each of its markets. The Group has 170 sites in 35 countries and realised revenues in excess of € 2 billion in 2006. The leadership team for the Miller Group is a combination of Miller and Onyx management teams, with Miller's CEO having retained the leadership of the new group. Mr. Maier accompanied the integration process as CEO of the European operations until the beginning of 2006. A bolt-on acquisition in early 2007 documents the group's ambition for continued growth.

7.2.5 Summary

The key driver and motivation of the initial merger was based on strategic considerations and the goal of securing the long-term future of Maier Chem. As the largest family firm on the market, Miller represented the potential partner with the best possible fit. The key driver of the subsequent buyout transaction was a combination of the strategic and financial objectives of the Miller stakeholders in an increasingly competitive environment which had hampered the firm's future prospects and its financial performance. The ambitions of the new external Miller CEO, who had identified the potential upside of an MBO, contributed to the exit decision.

The key issues of the comparably easy process of the first transaction were extensive negotiations on product guarantees from a legal perspective, which at times put the transaction at risk, as well as some coordination problems in the communication between the

small group of senior managers involved. The second transaction was characterised by a large-scale due diligence, where issues surfaced when the buyer tried to renegotiate the agreed valuation toward the end of the process.

The specific industry conditions, which were characterised by a latent wave of consolidation in a mature market facing globalisation and a high level of fragmentation, played an instrumental role in attracting buyout investors. The extensive experience of industrial and investor management teams in corporate transactions facilitated the process.

From the perspective of an exiting entrepreneur, the two transactions illustrate that different sets of exit objectives and changing market conditions can drive entirely different exit options and processes. Confident with the outcome, the Maier family managed to adapt their initial strategy to rapidly changing market conditions.

Mr. Maier stated:

> *"Had we known in advance that Miller would be sold to a buyout firm, we would have never agreed to merge our business with them. However, in retrospect it was probably the best possible scenario for the family and the firm."*

Interestingly, Mr. Maier has since set up an investment firm, targeting growth as well as entrepreneurial exit buyout opportunities in industrial markets.

From a buyout investor perspective, this transaction shows that industry experience and existing sector involvement can greatly enhance credibility and access to buyout opportunities. The sensitivity of external family firm managers to a potential MBO upside also played an important role in moving toward the buyout.

7.3 Investor Identification, Selection

Identification and selection in the context of exit buyouts can be viewed from two perspectives: Entrepreneurs seek to identify and select potential investors and investors need to identify and select exit buyout opportunities.

Entrepreneurs might be faced with issues identifying investors and a marketplace that they are not particularly familiar with and that might not appear transparent to them. The selection of investors might be driven by different criteria such as personal fit and an initial assessment of risk as well as by strategic and financial considerations. Investors might apply

specific strategies to identify and select potential investment firms. A better understanding of the related criteria can help entrepreneurs to better position their firms and thus solicit more interest, increase demand and potentially enhance valuation and fit.

Signalling effects, typically important in markets with asymmetric information distribution, might play an important role for both entrepreneurs and investors.[247]

Case Study Evidence

The entrepreneurs' seemed to have difficulties in identifying potential exit buyout investors. Given their limited market knowledge, which was primarily formed by earlier transactions in their sector, they relied on intermediaries to build a list of potential investors. At the beginning of the processes, before the involvement of intermediaries, investors were presenting themselves to the firm rather than entrepreneurs actively identifying them. The further selection of investors appeared to be primarily driven by their initial reaction to the entrepreneurs' valuation expectations and the personal fit that could be established between entrepreneurs and investors.

***Table 35**: Relevance of investor identification and selection*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Direct contact of investor/ directly contacted by investor				
CFC Audit	• Small number of direct contacts/ directly contacted by investors				
Sofilab	• Small number of direct contacts/ broad search through intermediary	+	+		
Divalto	• Broad search through intermediary				
Wakame	• Directly contacted by investors				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

In their initial presentations to investors, the entrepreneurs focused on qualitative rather than quantitative data and often did not attach high levels of priority to the format of written or oral presentations. Signalling, if present at all, appeared to be concentrated on the personality of the entrepreneur himself, his track record and the firm's development prospects. Comparable signalling effects have already been studied in other areas of the

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[247] The use of signalling in economics derives from the pioneering work of Spence (1973). Under asymmetric information, entrepreneurs and managers (insiders) know more about the firm than investors. Consequently, when investors have to transact with better informed insiders, they infer that all firms are of average quality, potentially neglecting particularly positive aspects of the individual firm examined. Thus, there is a need for entrepreneurs to signal quality.

entrepreneurship literature.[248] No signalling could be identified with respect to upfront propositions from the entrepreneurs' to share financial risks, such as, for example, a staged exit.

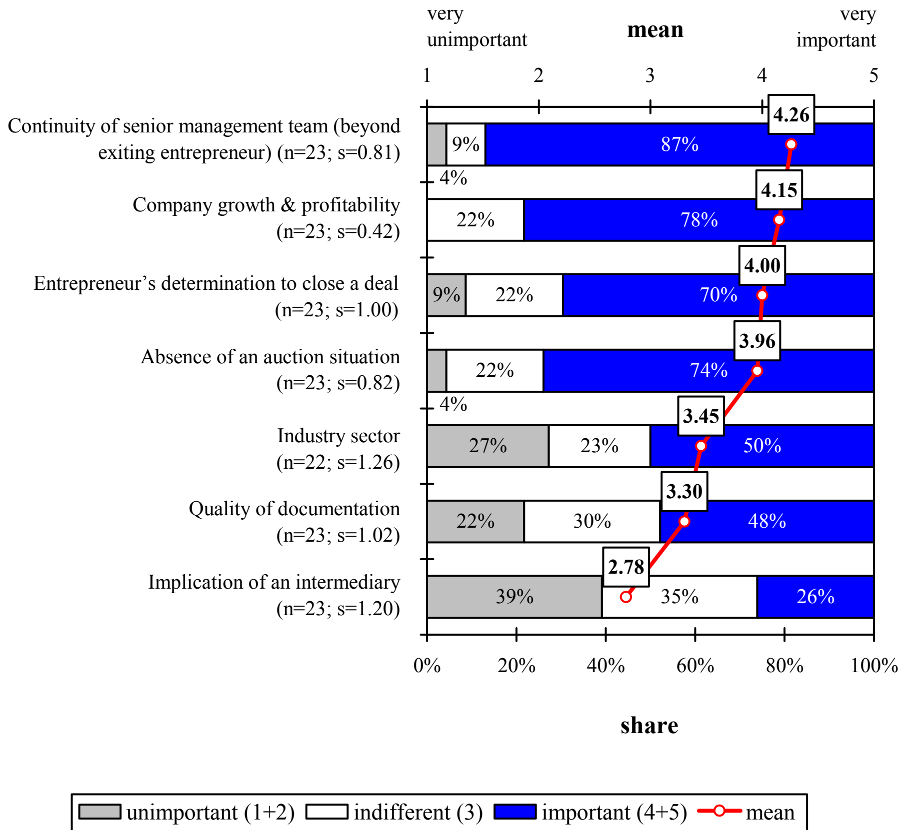
Investor identification and selection had no significant impact on exit buyout success in the examined cases, other than slightly delaying the process when not being able to identify potential investors. This issue could be resolved through the involvement of intermediaries, who were also able to assist entrepreneurs in preparing company presentation, in the light of signalling towards investors.

Survey Results

The investors were questioned about the importance they attach to different criteria when reviewing and selecting investment opportunities. As shown in Exhibit 43, the continuity of senior management and firm performance received the greatest attention. This can be an additional indication that both criteria might be important determinants of investment success. The entrepreneurs' determination to close a deal and the absence of an auction situation were equally highly rated. This might be explained by the impact on investors' execution success and valuation levels. Company sector and the quality of the company presentation seemed to be of lower priority. This corresponds to the above results, which indicate that not the firm activity as such, but industry dynamics might be a key driver of exit buyout success. The least important criterion within the examined set appeared to be the implication of an intermediary. This might again be linked to the negative perception of their market-making functions and could dominate with respect to potential positive contributions of intermediaries in moderating the process.

[248] Wu et al. (2006) suggest that firm owners who seek financing for their business use a personal credit line as a signal to other stakeholders of their financial and psychological attachment to the business. Cooley and Quadrini (2001) show that the public nature of IPOs can have a signalling effect, as it seeks to mitigate the conflict of interest between the agent who controls the firm's funds (the entrepreneur) and the agent who provides the funds (the investor).

Exhibit 43: Deal-screening criteria



The findings correspond to earlier empirical research by Birley and Muzyka (1999), Muzyka and Hay (1994) and Tyebjee and Bruno (1981), suggesting that investors focus in their selection on the management team and its future leader, the firm's ability to retain or improve its competitive position, and the completeness of business data in order to limit information asymmetries and support the longer-term investment monitoring and management. Market- and sector-related variables appeared to play a less important role in their results.

7.4 Due Diligence, Negotiation & Closure

7.4.1 Due Diligence

The central objective of investors' due diligence is the assessment of development potentials and risks of an investment in the firm.[249] Due diligence often takes the form of an in-depth audit involving hard and soft, internal and external factors and can cover various dimensions such as strategic, commercial, financial, tax, operational, organisational, human resources, technical, legal and environmental aspects.[250] The personality and skill set of entrepreneurs and potential management successors might also be evaluated.

From a theoretical perspective, due diligence is driven and characterised by an asymmetric information distribution between the entrepreneur and the investor. Together with an often significant gap between entrepreneurial and private equity cultures, due diligence can be a challenging phase within the exit buyout process, potentially causing frustration and delays on both ends, and thus impact success.

Case Study Evidence

The entrepreneurs' experiences with investor due diligence appeared to be dominated by an often unexpectedly heavy and in-depth audit. This created a challenging workload for the entrepreneur and his firm as well as frustrations with the process, especially concerning legal and accounting aspects that appeared to be poorly adapted to the comparably small size and low complexity of the firms' operations.

The founder of Wakame said:

> *"The due diligence became a major obstacle for the transaction. A large team had been assembled by the investor, including members from European Capital (investor), Marco Polo (portfolio company), a mid-cap investment bank and KPMG, the global audit firm. However, the process was poorly coordinated and managed loosely. They (the investor) seemed to be overly driven from a "risk avoidance" perspective and by the time they were physically auditing our very limited stock levels it came to a clash and I stopped the process. Only when Marco Polo took the lead after a 2 months break, the due diligence was completed. They showed a much more "opportunity-driven" attitude."*

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[249] For a conceptual review of due diligence concepts, see Berens et al. (2002) and Strauch (2005).

[250] See Kraft (2001), p. 158.

A team-member of the investor in Sofilab said:

> *"The insufficient preparation of many companies' financial and legal documentation prior to a potential transaction often causes important delays. Fortunately at Sofilab an initial set of documents was available. The remainder we managed to establish during the due diligence process. It also helped that we had been in discussion with the firm two years before. We were glad to see that the business plan presented to us at that time had been achieved."*

The family shareholder of Maier Chem reflected on the comparably larger transaction:

> *"Due diligence was not really new to us. We had run through similar processes in earlier acquisitions and sales transactions. Our finance department and legal counsel were busy for quiet some time fulfilling data requests, but could answer all questions to the satisfaction of the investors."*

The identified issues might partially be related to the investigated SME size segment, with smaller firms having less developed management processes and being less focused on quantitative reporting. The largest firm examined clearly benefited from prior transaction experience and the organisational resources to handle large amounts of data. Part of the problems might also be driven by a lack of preparation and knowledge about the process on the part of the entrepreneurs who seemed to be constantly trying to catch up with ever increasing demands of additional and more detailed data. Intermediaries appeared to be able to absorb part of the shock, but were not always successful in moderating different management cultures and expectations.

***Table 36**: Case summary of due diligence*

Company	Due Diligence Characteristics	
	Process Management / Preparation	**Balance of Power**
Maier Chem	• Very complex process management by investor; comprehensive documentation available	• Entrepreneur: national law firm • Investor: own team, portfolio company, investment bank, global audit firm
CFC Audit	• Professional process management by investor; little documentation available	• Entrepreneur: local law firm • Investor: own team, national auditor
Sofilab	• Professional process management by investor; initial documentation available	• Entrepreneur: local law and audit firm, intermediary • Investor: own team, national auditor
Divalto	• Professional process management by investor; initial documentation available	• Entrepreneur: local law and audit firm, intermediary • Investor: own team, national auditor
Wakame	• Loose process management by investor with important delays; little documentation available	• Entrepreneur: regional law firm • Investor: own team, portfolio company, investment bank, global audit firm

Due diligence can represent a significant hurdle to a smooth and quick exit buyout process. The fit and trust between entrepreneurs and investors established earlier on in the process is challenged if a "balance of power" and "equality of means" is not respected. Equally, entrepreneurs can contribute to a smooth process through the preparation of company data upfront. The resolution of information asymmetries appears to by a complex challenge in the exit buyout context and can only partially be resolved through fit. Industry and investor associations could develop jointly accepted due diligence standards and a predefined set of criteria to mitigate the identified issues in the future.

***Table 37**: Relevance of due diligence*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Prior due diligence experience		+		
CFC Audit	• Little documentation available		-		
Sofilab	• Initial documentation available		+		
Divalto	• Balance of power		+		
Wakame	• Unbalance of power; loose mgmt.		--		

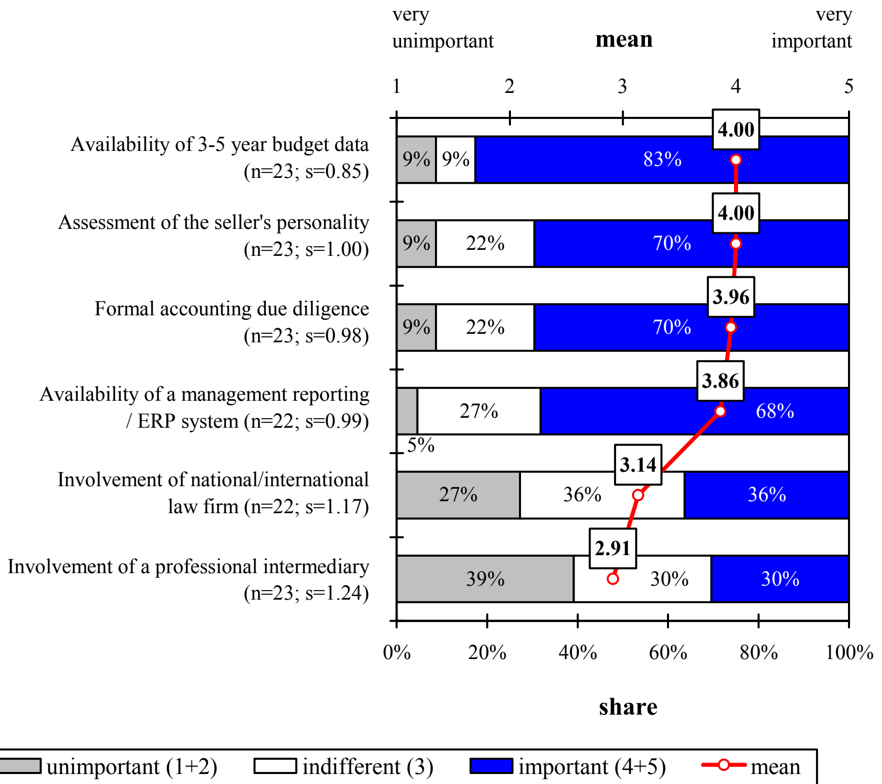
[ ]: no impact +: positive impact - : negative impact --: blocking impact

Survey Results

Investors were questioned about the importance they attach to different aspects of due diligence. As shown in Exhibit 44, financial and personal assessments were rated as important. This is in line with the investment selection criteria examined above and underlines the importance of solid financial planning and monitoring tools to ensure the firm's expected cash-flow, which is also instrumental for reimbursing debt. The assessment of entrepreneurs' personalities and accounting data might also help to avoid misjudgements of the firm's actual situation and thus limit risk.

Legal aspects and potential support through intermediaries appeared to be of lower importance. This comes somewhat as a surprise and might be linked to the small to medium-sized investment segment examined, where overall legal situations tend not to be overly complex. The rather indifferent attitude toward intermediaries with respect to their moderator functions throughout the due diligence phase might remain without specific explanation in this context.

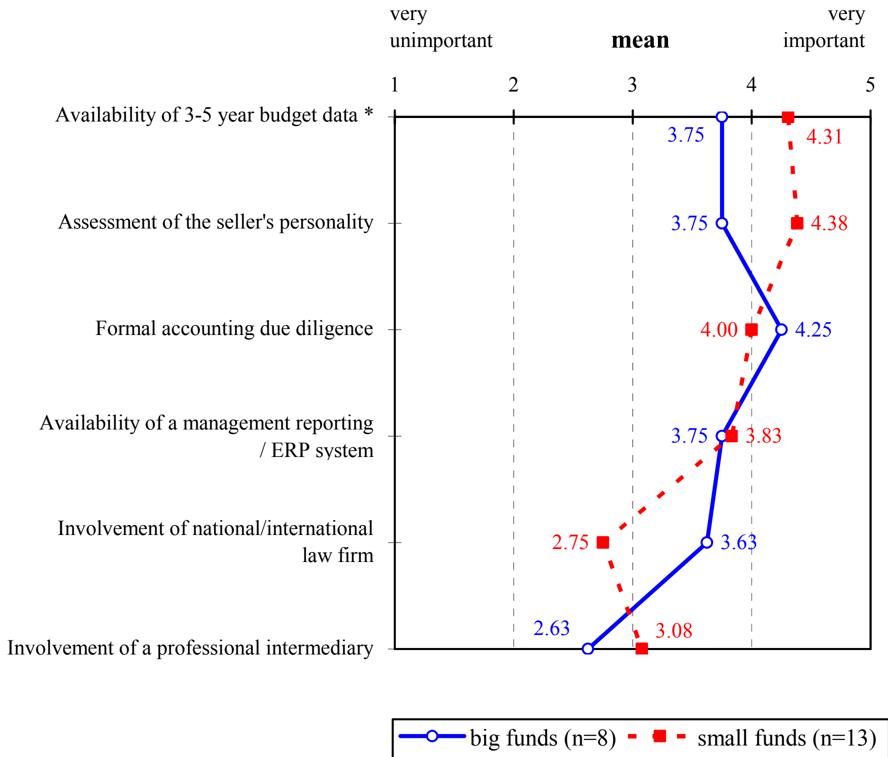
Exhibit 44*: Focus of due diligence*



A comparison of due diligence priorities by size of fund can underline some of the above results. As displayed in Exhibit 45, smaller funds, with on average € 158 million under management, attached a higher priority to quantitative business plan data and a personal assessment of the entrepreneur but less importance to legal aspects, if compared to larger funds with on average a total of € 513 million of funds under management. This could be partially explained by the difference in average targeted firm size, with smaller firms being perceived as less mature and more risky but less complex with regard to legal aspects.[251]

[251] Smaller funds stated an average targeted firm size of € 41 million compared to € 127 million for larger funds.

Exhibit 45: Different due diligence priorities between large and small funds



Mann-Whitney-U-Test: Significant mean difference † p <= 0.1; * p <= 0.05

Little empirical research has evolved on due diligence in an SME buyout context. Achleitner et al. (2006b) found similar priorities of German buyout investors, with the most important aspects being management, accounting data and product- and market-level information. Scholes et al. (2007) suggest that first generation founder-family business managers are more likely to also share information with potential investors compared to later generation managers. Entrepreneurs strongly motivated by financial objectives equally appeared to be more ready to disclose information.

7.4.2 Valuation

Valuing businesses has received much attention in the finance and entrepreneurial finance literature. Many different concepts have been proposed. Most commonly used in the context of buyouts appear to be market-, earnings- or cash flow- and asset-based models.[252] However, none of the existing models appears to be ideal. Market-centred methods that rely on multipliers struggle with the identification of relative valuation benchmarks. Cash-flow-based models, good approximations from the perspective of finance theory, are highly sensitive to discount rates and residual values. Asset-based approaches might be challenged by the marketability of certain assets and the backward perspective of such a model. Therefore, multiple approaches are typically used in valuing the firm rather than relying on a single method.[253]

Valuation in an exit buyout context might represent additional challenges. The valuation of firms which are closely held are often characterised by the lack of publicly available information both on actual valuation and underlying performance. Therefore, valuation might not be approached in the same way as for larger firms.

However, entrepreneurs might also reason differently about the value of their firms based on behavioural and cognitive aspects. The total value of the firm, as perceived by the entrepreneur, might not correspond to investors' perceptions. In addition to the market value estimated by the above approaches, entrepreneurs might attach value to individual financial gains as perks and payments they receive from their firm as well as the emotional value of the firm to its owner.[254]

Case Study Evidence

In most of the cases examined, the entrepreneurs seemed to have entered the exit process with rather intuitive valuation expectations for their businesses. These appeared to be significantly higher than investors' valuation perceptions. This might be driven by a mix of factors. A high initial valuation might have been a way for entrepreneurs to signal strength at the beginning of the process. However, many investors rejected the significant valuation discrepancies and stopped the process. Secondly, the entrepreneurs in smaller firms and with less experience in corporate finance showed a strong focus on a minimum absolute value to

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[252] For a review of valuation methods applied in an exit and buyout context, see Petty (1997a) and Then Bergh (1997).

[253] See results of an empirical survey of valuation of closely held firms by Dukes et al. (1996).

be realised from the sale, which was also driven by future personal and professional financing needs.[255] Thirdly, entrepreneurs' might attach a certain emotional value to their business that market valuations do not reflect, as suggested above.

A team-member of the investor in Divalto said:

> *"Often entrepreneurs have unrealistic valuation expectations. That also seemed to have blocked the interest of other investors in Divalto for some time. Only when we were able to propose a payment in several instalments (i.e. an earn-out agreement) that in total came somewhat closer to the entrepreneur's initial estimation, we were able to unblock the deal."*

While valuation represented a threat to exit buyout availability in earlier phases of the process, it became apparent that entrepreneurs were able to adapt their expectations, as they were willing to compromise in later stages when a closing became more tangible. Intermediaries also seemed to be able to moderate valuation expectations effectively, also by promoting the use of staged payments which in many cases allow for an increase in the total proceeds to be realised from the sale.

A team-member of the investor in Sofilab said:

> *"We tried to avoid discussions about the valuation early on in the process. Once we had a better understanding of the entrepreneur and after auditing the business, we had a much better idea of what price we are willing to pay for the company."*

Therefore, an early focus on valuation, where entrepreneurs are tempted to test the market, might not enhance exit buyout success. Furthermore, it can be suggested that credible business plan data appears to have a positive impact on valuations, as otherwise, investors might apply significant discounts to future performance in their valuation models.

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[254] For the concept of total value of privately held firms see Zellweger (2006). For an empirical test see also Zellweger (2005) and E&Y (2006). The authors identify an increase in total value due to individual financial gains of 14 percent in a sample of Swiss privately held firms. Potential additional emotional valuation elements were not considered in this differential.

[255] i.e. past experience through earlier-stage investments, acquisitions or IPOs in their company.

Table 38: *Relevance of valuation*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Familiar with valuation schemes		+		
CFC Audit	• Intuitive but flexible valuation				
Sofilab	• Les familiar with valuation schemes				
Divalto	• Intuitive valuation too high	--			
Wakame	• Familiar with valuation schemes		+		

[ ]: no impact +: positive impact - : negative impact --: blocking impact

The idea that multiple methods are being applied to value exit buyout businesses was confirmed for the cases examined, with multiples-based valuations playing a dominant role. A review of the existing literature shows similar results. Davidson (2005) finds discounted cash-flows and multiple-base valuation methods to be dominant compared to book value and other approaches in a MBO context. Dukes et al. (1996) reports similar results for closely held manufacturing firms in the US.

Survey Results

The investors' moderate satisfaction with the recently negotiated valuation, also impacted by recently increasing private equity market valuations, has already been examined above.[256]

7.4.3 Transaction Structuring

The structuring of an exit buyout transaction can include financial aspects, such as payment structures and conditions as well as levels of leverage. From a legal perspective, factors such as the object of the sale, representations and warranties, closing conditions, control rights and various seller guarantees might be considered.[257] Whereas legal factors play an important role in determining the risk sharing between entrepreneurs and investors, this research focused also on two financial aspects with a possible impact on financial and sustainability objectives.[258] Payment structures, potentially including earn-out components,

[256] See chapters 6.2.2 and 8.2.2.

[257] From a legal perspective, the firm sale can typically be structured as a share deal, implying the acquisition of the firm's shares or as an asset deal, implying the acquisition of the firm's assets. See Davidson (2005), p. 121.

[258] See Levin (1998) for a comprehensive review of legal structuring options.

need to be aligned with entrepreneurs' financial objectives.[259] Financial leverage can potentially represent a risk to the firm and might impact sustainability.[260]

Case Study Evidence

Four of the five entrepreneurs agreed to an earn-out structure. However, it appeared that such a structuring was not necessarily their goal at the outset but was rather a result of negotiations with investors who were seeking to align the interests of entrepreneurs with their own. It appears that during the exit phase entrepreneurs might switch objective functions. Instead of forgoing current cash flows for future returns, they seem to seek the highest immediate payoff. They might also look for a clean break with their previous role as a manager and majority shareholder of the firm. It can appear difficult to be associated with a project that, at least in part, is driven by the buyout fund, an investor applying a different financial and management paradigm than the entrepreneur.[261]

The founder of CFC said:

> *"Initially I wanted to sell 100% of the company immediately. But investors would not accept that and asked me to retain 30%. In the end this proved to be a very favourable structure. When the fund sold the company to a strategic investor I was able to cash-in on my remaining 30%. In fact these 30% represented a larger sum of money, compared to the initial stake of 70% I had sold a few years ago."*

The founder of Divalto stated:

> *"They (the retained investor) were more flexible in accommodating my valuation expectations and suggested an earn-out agreement to reach my personal target level."*

While initially not overly happy with the idea of remaining invested, two of the four entrepreneurs who accepted an earn-out had in the meantime realised their terminal exit with success. Total proceeds significantly exceeded their initial expectations due to a strong performance of the firm. Earn-outs were also utilised to bridge the gap between the initial valuation expectations of entrepreneurs and investors. Investors appeared to feel more comfortable sharing the upside, compared to entering an investment at a valuation level considered to be high.

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259 Earn-out can be defined as a provision sometimes written into the terms of a transaction that the entrepreneur will receive further payments if the business sold achieves specified performance levels.

260 Following the definition of Kelly et al. (1986), a buyout should be considered "leveraged" if at least two-thirds of the purchase price is funded by debt.

Given the extensively researched performance improvement impact of buyouts in general and MBOs in particular, entrepreneurs might want to consider participation in the future performance improvements of their firms more systematically in order to maximise their financial return through an optimised payment and divestment structure.[262] However, on the contrary, earn-outs appear to become less frequently applied since 2005, due to a shift in bargaining power toward sellers. This might imply for some entrepreneurs surrendering a substantial share of financial returns. However, OBO structures which have a similar effect continue to rise in popularity, especially in France.

***Table 39**: Case summary of transaction structuring*

Company	Transaction Structure	
	Main Characteristics	**Key Issues**
Maier Chem	• Acquisition through competitor, then LBO	• Investor requested comprehensive legal guarantees
CFC Audit	• OBO with leverage; • Earn-out (until exit of fund, 30% remaining shareholding).	• A pragmatic approach by the lawyers of both parties allowed for a simple legal structure.
Sofilab	• BIMBO with leverage; • Earn-out (until exit of fund, 25% remaining shareholding).	• Investors refused extensive participation of senior management team in the capital of the company.
Divalto	• OBO • Earn-out (2 years, 30% remaining shareholding)	• Investors requested comprehensive financial liability guarantees.
Wakame	• Acquisition through portfolio company; • Earn-out	• Investors requested comprehensive financial liability guarantees.

Leverage in the cases examined appeared to be moderate, with levels of 50 to 65 percent of the purchase price being financed by debt.[263] This helps to reduce the financial risk linked to interest rate changes and reduces the burden of interest payments on the firm's cash-flow. The fact that two of the firms had reimbursed the debt employed for leverage after two to three years might indicate that financial leverage was neither excessive nor did it impact firm performance. This was reported during a period when interest rates were rather low and

[261] See also chapter 1.4 Problem Definition of this document.

[262] For a review of performance improvements linked to buyouts see for example Kitzmann (2005), Jensen (1993) and Bull (1989).

[263] This is in line with debt-levels of 56.8% to 67.5% for U.K. buyouts below £ 10 million in the period from 1988 to 1991 (see Bleackley and Hay (1994), p. 123). Results obtained by Wright et al. (2006) suggest that since the early 1990s U.K. buyouts on average have been funded between 30 and 40 percent through equity, with the remainder being debt and mezzanine, independent of interest rate changes. In the average U.K. buyout transaction in 2005, 51 percent of the purchase price was provided in debt. For a sample of U.S. LBO firms with a valuation of between one and U.S. $ 50 million, Malone (1989) showed that 93 percent of the respondents used debt financing for more than 60 percent of the purchase price.

would have allowed for higher levels of leverage. Therefore, no potential negative impact on entrepreneurs' sustainability objectives could be identified.

A team-member of the investor in Sofilab stated:

> *"Especially for investments up to € 25 million, we tend to avoid an overly important leverage effect, limiting debt to about three times EBITDA."*

The family shareholder of Maier Chem stated:

> *"AB Capital's (the investor) legal counsel requested a framework of legal guarantees (product liability, financial liability), that we found hard to accept. It took us a significant amount of time and resource (legal advisors) to negotiate an acceptable compromise."*

This corresponds to the statement by the founder of Wakame for a much smaller transaction:

> *"Lawyers from both sides tend to build in so many buffers that a closing becomes more and more difficult, especially for smaller transactions. Therefore legal advisors should be given more incentives to close a transaction."*

Similar to the above discussed due diligence, legal contracting represented in two cases a substantial concern to entrepreneurs. Investors' desire to limit risk confronted entrepreneurs with demanding guarantees regarding product, legal and financial liability guarantees. A "balance of power" and "equality of means" needs to be maintained to be able to negotiate an agreeable compromise.

***Table 40**: Relevance of transaction structuring*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Comprehensive legal guarantees requested by investor		-		
CFC Audit	• Earn-out increased overall proceeds			+	
Sofilab	• Earn-out increased overall proceeds			+	
Divalto	• Straightforward structuring				
Wakame	• Straightforward structuring				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Survey Results

The survey results with respect to payment structures discussed above suggest that maximising the upfront payment appears to be of high importance to entrepreneurs. Therefore, their willingness to consider alternative options might be limited.[264]

7.5 Process Management

Managing an important but unknown process might be a challenge for most entrepreneurs. Effective strategies for information management and the coordination of many participants throughout the process can therefore be an important factor for exit buyout success.

Case Study Evidence

The process management of the examined exit buyout processes was characterised by two tasks: coordination of numerous participants and making information available to potential investors. The length of processes varied between 12 and 36 months from initial steps to closing, implying significant delays in some cases. However, delays were caused by issues in areas other than process management itself, such as the non-availability of a management successor or slow response times from potential investors. During the key phases of due diligence and negotiations, multiple information flows were difficult to monitor and control.

Most of the entrepreneurs did not create a specific role for the management of the process, but assumed the responsibility themselves. As a result, the dual responsibility for an ongoing business and a challenging process appeared to represent a significant challenge for the entrepreneurs, who had to dedicate over periods of several months up to 60 percent of their time to the process.

The founder of Divalto also stated:

> *"The whole process of investor search and due diligence was more intense and much longer than I had anticipated. It took me about 3 months of full-time attention over a period of 18 months, often leaving my day-to-day business behind."*

[264] See also chapter 4.1.1 for the importance entrepreneurs' attach to a maximised upfront payment.

Similarly the founder of Wakame said:

> *"During the entire process I dedicated about 25% of my time to negotiate and gather the requested data. Far more than I had expected, especially when taking into account my prior professional experience in investment banking and private equity."*

Unhappy with the burden, some involved management team members of the firm; others entrusted external intermediaries or expert advisors with the task. Whereas internal resources found it easier to make the required financial and legal data available, external resources were more effective in managing relationships with investors and their advisors. Upfront preparation of information packages also proved to be a time-saving strategy. In this context, CFOs or their equivalents within smaller organisations played an important role and typically dedicated a significant share of their time to the process, which created conflicts with their day-to-day tasks of closing annual accounts, auditing, acquisitions or closing of large client contracts.

Therefore, it might be suggested that process management needs to be well prepared in order for it not to become a liability to the firm's operations during the process. At the same time, process success seems to be driven by many factors beyond the actual process management itself, so that a positive impact of process excellence might be limited.

Table 41*: Relevance of process management*

Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Large organisation provides support				
CFC Audit	• Firm suffers due to intense process				
Sofilab	• Entrepreneur overwhelmed				
Divalto	• Entrepreneur overwhelmed				
Wakame	• Entrepreneur overwhelmed				

[ ]: no impact +: positive impact - : negative impact --: blocking impact

7.6 Case Study La Buvette: Exit Buyout of a Family Business

7.6.1 Company

La Buvette, founded in 1947 in Tournes, France, is an agricultural equipment manufacturer, specialising in animal drinking devices. In 2006, the company, with a staff of 65 employees, achieved sales of € 15 million. It has one recently built manufacturing site and has developed a strong export franchise in Europe, representing about a third of total sales.

***Exhibit 46**: Summary of La Buvette case study*

company	Sofilab/La Buvette	***company creation***	1947
country	France	***(initial) exit transaction***	2003
activity	industrial manufacturing	***revenues (yr. of initial exit)***	ca. € 11 million
age of ENP at exit	60s	***ENP's share before exit***	90%
buyer	Alliance Entreprendre	***funds under management***	€ 160 million
deal structure	BIMBO		
ENP's share after	25% ('03), 0% ('07)	***process duration***	36 months
key drivers	age/succession, financial partner to develop export		
key issues	no internal succession candidate		

7.6.2 Buyer

The buyout of La Buvette was led by Alliance Entreprendre, the French mid-market buyout fund.

Alliance Entreprendre, created in 1995, is a captive buyout fund primarily investing the capital of two large French banks, with resources of € 250 million. The fund has no sector focus and invests between € 1 and 7 million per transaction in French private and mid-sizes public companies valued between € 5 and 50 million in buyout, buyin, build-up, succession, restructuring or spin-off situations. Alliance Entreprendre concludes about ten transactions per year and has a current portfolio of about 100 investment companies.

7.6.3 Motivation & Strategy

In 1999, Mr. Gustin identified the need to address the issue of succession. Without a successor within his family, he began seeking options that would ensure the independence and sustainability of La Buvette longer-term. Approaching a strategic buyer, such as Suivia,

a long-standing competitor in Germany, was therefore not considered an option by Mr. Gustin.

As he was close to the staff of his company, he considered opening the company's capital to a group of senior employees. He communicated his plan within the company and subsequently in 2000 set up a seminar informing his senior staff about the concept of MBOs through a corporate finance firm. However, within the group of six managers, none was sufficiently motivated to carry the risk of taking over the business. As he did not obtain the results he expected, Mr. Gustin enlarged his search for a potential partner to neighbouring industries that applied similar technologies but in client sectors not linked to La Buvette. At this stage, a number of entrepreneurial investors and family offices were contacted as well. However, the proposals received were not of specific appeal, either in terms of valuation or in terms of potential synergies.

7.6.4 Transaction Structure & Process

Whereas the initial approach of potential partners in neighbouring industries and regional family offices did not yield any proposal that was financially or strategically sufficiently interesting to be considered, it at least helped Mr. Gustin and his team to prepare a thorough presentation of the company's activities and its financials as well as to present to potential outside partners.

In 2002, after non-conclusive discussions with his local bank about supporting a company sale, Mr. Gustin selected Transaction R, the mid-market intermediary of Banque Rothschild, following an introduction through an acquaintance, to help him to identify a potential partner. Two potential sets of acquirers were identified: private equity funds and significantly larger plastic manufacturers with different product applications to La Buvette. While the industrial partners showed little interest, seven investment funds were presented by Transaction R. However, they initially questioned the potential of the six senior staff members identified by Mr. Gustin to takeover the operations. The need to find an external candidate had thus been identified. Candidates were presented by the funds as well as by Mr. Gustin himself, who had received an application from a candidate presenting himself. After a thorough search a management successor was identified.

Based on this important precondition, negotiations with buyout investors progressed. Alliance Entreprendre was retained based on a good fit with the culture of the firm and a financial proposal that was not significantly lower then the best bid. In 2003, the BIMBO transaction was closed. While Mr. Gustin retained 25 percent of the firm's capital, he moved

on to a board-level advisory role, with the new management taking over the leadership of the firm. In a second transaction in 2007, the investors and Mr. Gustin finally exited La Buvette successfully through a secondary MBO, financed without the help of another private equity buyer.

7.6.5 Summary

The key driver and motivation for the transaction was related to age and succession issues. At the same time, Mr. Gustin was strongly motivated not to leave the company in the hands of a strategic buyer or competitor and wanted to involve his staff in the exit. This left him primarily with the buyout option.

The key issue of the transaction was the readiness of the organisation. As the management team was not fully motivated or qualified, an external candidate needed to be identified. Only then could the exit buyout transaction concluded successfully.

7.7 Post-Transaction Management

A key driver of sustainability success might be the transition and integration of a new firm leader and shareholders after the entrepreneur's exit transaction. It can be important to understand why, after the exit of entrepreneurs, some firms continue to succeed under new ownership and management while others do not. This is particularly interesting as research suggests that most corporate acquisitions are failures.[265]

Case Study Evidence

In the cases examined, the entrepreneurs appeared to be quite satisfied with the transition and future evolution of their firms after the exit buyout transaction. Moderate change occurred in the organisations and processes of the firms. Successors were selected by the entrepreneurs, if the firms were not acquired by private equity portfolio companies. In one case, an external candidate had been recruited several years before with the exit in mind. None of the investors changed – or had to change – the management team.

Limited and only positive changes were identified with respect to the strategic and financial performance of the firms. The five businesses kept their business models, were financially

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[265] In the sense of "corporate acquires corporate" as opposed to "private equity acquires corporate". See for example Pritchett et al. (1997).

successful, and entrepreneurs viewed that success to be, at least partially, a product of their earlier achievements and the selection of the right investor for their firms.

The family shareholder of Sofilab said:

> *"Even if they (the investor) didn't interfere on an operational basis, they monitored closely the financial performance and took part in more strategic decisions. Clearly they were motivated to prepare the business for a secondary buyout in three to five years time. And it was also to my benefit as I still held 25% of the firm's capital."*

The founder of CFC Audit stated:

> *"Initiative & Finance (the investor) assisted us in moving on to the next level, mainly in making our own organisation more professional. Based on their experiences with other fast growing firms, they helped me establish a number of management processes in finance and recruiting, before I handed over to my successors."*

A change of culture became apparent to the entrepreneurs but was not perceived as a shock. The introduction of more systematic management processes and tools was seen as positive input from investors. The shift toward a financial focus, and more particularly a cash-flow orientation, was clearly visible but did not further impact the entrepreneurs' satisfaction. The founders who continued to be invested in their firms were positively surprised by the positive contribution of investors to financial engineering and results.

The positive results might also relate to the entrepreneurs' continued support for their firms. The entrepreneurs remained involved during periods of between one to five years after the initial exit transaction, most of them with a decreasing role over time, reducing their input to board-level advice. The investors typically dedicated a team member to support and monitor the firm ad-hoc as well as using regular on-site meetings. They challenged the firms' evolution with respect to the business plan but also served as a partner for brainstorming and advancing projects within the firm. Some investors proposed realising synergies across different firms in their portfolio. Their help in structuring and contributing rigour in high-growth entrepreneurial organisations was also valued.

***Table 42**: Case summary of post-transaction management*

Company	Integration Characteristics	
	Exiting Entrepreneur	**New Management & Investors**
Maier Chem	• Family shareholder left after LBO transaction.	• Investor took control through management of portfolio company.
CFC Audit	• Founder accompanied firm for 12 months on a daily basis; • Moved on to the board thereafter.	• New management team (ex senior employees) ensured continuity and managed sustained growth; • Investor contributed rigour and advice in an entrepreneurial organisation.
Sofilab	• Family shareholder accompanied firm for 6 months on a daily basis; • Moved on to the board thereafter.	• New CEO was recruited by entrepreneur and had accompanied process for 12 months prior to the transaction; • Investor did not interfere other than regarding financing and external growth.
Divalto	• Founder moved on to the board, but remains involved on a daily basis.	• New CEO (ex head of sales) ensured continuity and managed sustained growth; • Investor did not interfere other than regarding external growth.
Wakame	• Founder accompanied firm for 12 months on a daily basis.	• Investor took control through management of portfolio company.

Whenever an exit buyout transaction was closed, important preconditions such as a capable successor and a performing business were assumed, so that further risk during a transition and post-transaction phase was limited.[266] A good strategic and cultural fit between entrepreneur, investor and firm as well as the ongoing support through the entrepreneur can further enhance sustainability success. However, the positive perception of entrepreneurs might also be related to a lower involvement and a certain detachment between the entrepreneur and his former firm after the exit and a particularly positive market environment in many industries over the last few years.

[266] A significant body of literature reviews the performance aspects of MBOs and typically identifies a positive impact on firm performance, also longer-term. Loos (2005) suggest a positive impact for larger firms and Kitzmann (2005) for SMEs.

Table 43: Relevance of post-transaction management

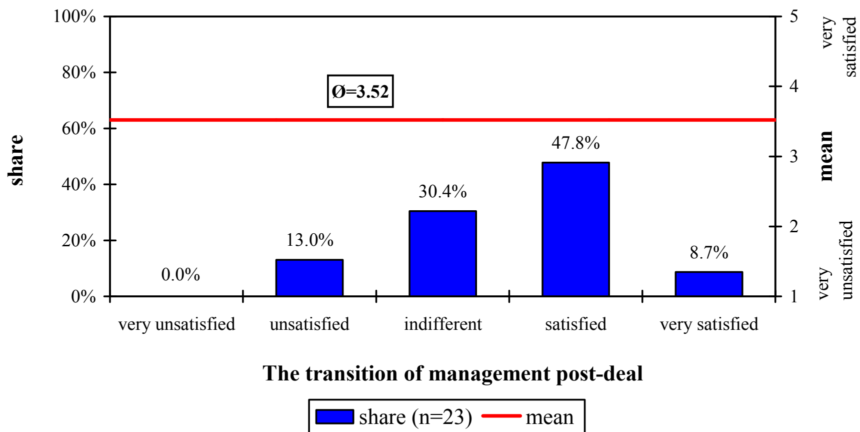
Company	Main Aspects	Avail-ability	Ease of Process	Financial Result	Sustain-ability
Maier Chem	• Integration with portfolio company, stronger market position & cost base				+
CFC Audit	• Unchanged business model, professionalisation of organisation, focus on secondary buyout				+
Sofilab	• Capable successor; investor's focus on secondary buyout				+
Divalto	• Capable internal successor, unchanged business model				+
Wakame	• Integration with portfolio company, accelerated growth				+

[ ]: no impact +: positive impact - : negative impact --: blocking impact

Survey Result

Investors were questioned about their satisfaction with the post-deal transition of the exit buyouts recently conducted. As shown in Exhibit 47 a majority of the investors, more than 56 percent, reported being satisfied or very satisfied. This is a positive and encouraging result. It might be related to the high preference and actual share of MBO deal types, with existing internal management teams taking over the leadership of the firm from entrepreneurs in a capable manner. It could also be linked to a selection bias, with the investors focusing on particularly well-prepared organisations. It might also be related to the back-up role many entrepreneurs play during the transition phase, offering support and corrective measures where required.

***Exhibit 47**: Investors' satisfaction with post-deal management transition*



8 Integrative Assessment of Individual Factors

Based on the above analysis of individual factors an attempt has been made to integrate the multitude of aspects into a single framework in order to better identify and explain the key factors driving exit buyout success.

***Table 44**: Factor impact matrix*

Success Factor	***Sub-Factor***	***Availa-bility***	***Ease of Process***	***Financial Result***	***Sustain-ability***
Entrepreneur	motivation and objectives				
Entrepreneur	knowledge and experience		direct		
Entrepreneur	cognitive aspects	direct			
Investor	objectives				
Investor	Strategy, organisation, structure				
Investor	**entrepreneur-investor fit**	**direct**	**strong**		
Advisors	intermediaries	direct	direct	hypoth.	
Advisors	expert advisors		direct		
Company	activity				
Company	size			hypoth.	
Company	**performance (strat. & financial)**	**strong**			**direct**
Company	**organisation**	**strong**	**direct**		**strong**
Market	national – market conditions				
Market	financial – buyout activity levels				
Market	financial – valuation levels			direct	
Market	industry – market conditions	direct			
Exit strategy	timing			direct	
Exit strategy	exit options	direct			
Exit strategy	buyout typologies	direct	direct		
Exit strategy	process variables			hypoth.	
Exit process	identification, selection				
Exit process	**due diligence**		**strong**		
Exit process	valuation		direct		
Exit process	structuring, earn-out			direct	
Exit process	process management				
Exit process	**post-transaction management**				**strong**

"direct" impact: the factor had an impact in two or three of the examined cases;
"strong" impact: the factor had an impact in at least four of the five examined cases;
"hypothesised" impact: initial indications based on survey results, interviews and literature review; to be examined in future research.
This assessment is based on the individual analysis of factors across the five cases, outlined in chapters 4 to 7.

8.1 Entrepreneurs' Perspective

8.1.1 Key Success Factors

Key success factors can be identified with respect to their impact on the two main determinants of entrepreneurs' exit buyout success: execution success and sustainability success.[267] In this context execution success can be decomposed into three aspects: the availability of the exit buyout option and its completion, the satisfaction with the process moving toward the exit, and the – mainly financial – results of the exit.

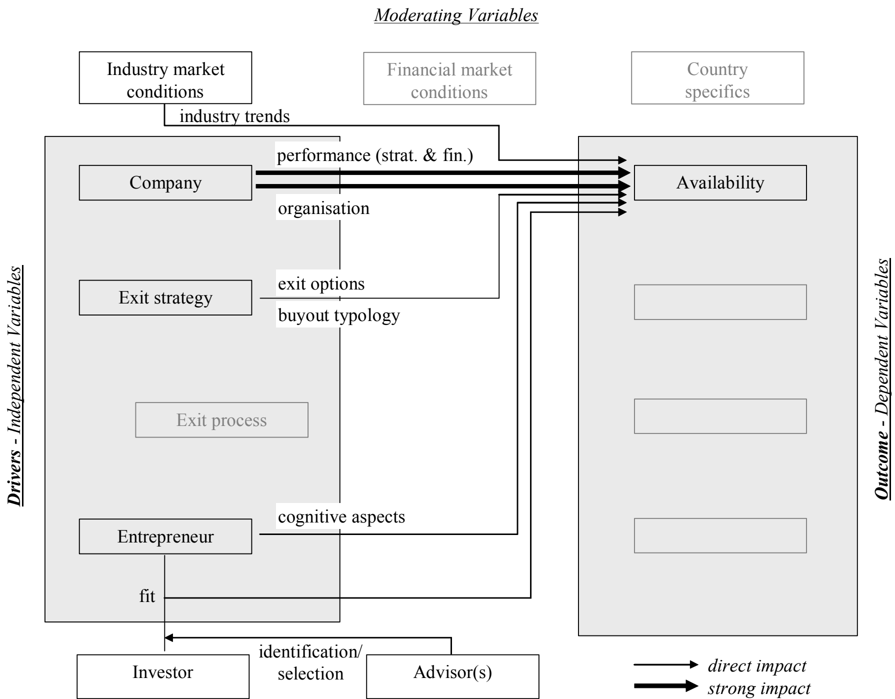
Availability and Completion

The most important factors driving the availability of the exit buyout option appear to be the firm's performance and its organisational readiness for succession, as illustrated in Exhibit 48. In addition to financial performance, the cases examined highlighted the importance of strategic performance such as strong competitive positioning and a compelling strategy. The identification, selection and development of a qualified and motivated successor from within the existing management team or through external recruiting also appeared to be a key success factor with regard to availability. This aspect also drives the impact of buyout typologies on availability, with MBOs and OBOs being the models preferred by investors.

Somewhat less important drivers of availability appear to be the entrepreneur-investor fit and industry market conditions. Ensuring fit between entrepreneurs and investors might be considered as a factor impacting availability, as entrepreneurs tend to respond with rejection in cases of misfit in early stages of the process. Specific industry market conditions such as consolidation trends could be considered to be a catalyst for the availability of an exit buyout transaction.

[267] For a review of entrepreneurs' exit objectives, see chapter 4.1.1.

***Exhibit 48**: Key success factors driving availability and completion*



Process Satisfaction

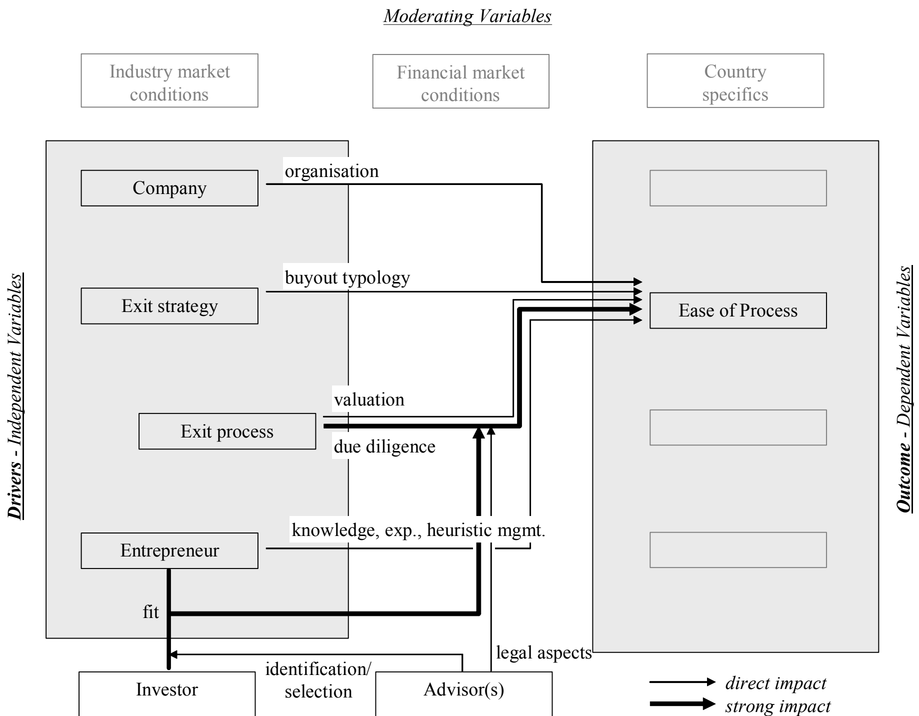
It can be suggested that investor-driven due diligence and, more specifically, its legal and accounting components represent a significant hurdle to a smooth and quick exit buyout process, as shown in Exhibit 49. This factor appears to be moderated by investor size. Particularly well-suited to dealing with exit buyout firms valued below € 50 million appear to be smaller funds that can be characterised by predominantly entrepreneurial capital, outside participation in their investment committee, and co-investment of their management team members. Therefore, ensuring fit between entrepreneurs and investors and actively bridging the gap between an entrepreneurial and a private equity culture could be considered a key success factor impacting the length and perceived smoothness of the exit buyout process.

Within the set of external advisors, sell-side intermediaries might have a positive impact through match-making and the moderation of expectation levels, whereas buy-side experts such as legal advisors can represent a significant challenge to a quick and smooth process.

A well-prepared organisation with established management processes appears to be a success factor with respect to the length and resources required for the exit process.

Prior experience and extensive knowledge of entrepreneurs does not appear to be an absolute precondition for the availability of the exit buyout option, because it might be acquired during the process. However, an impact on the duration and perceived smoothness of the exit process can be suggested. The identified heuristics and biases such as an intuitive – little prepared – start in the process might increase total duration significantly.

***Exhibit 49**: Key success factors driving process satisfaction*



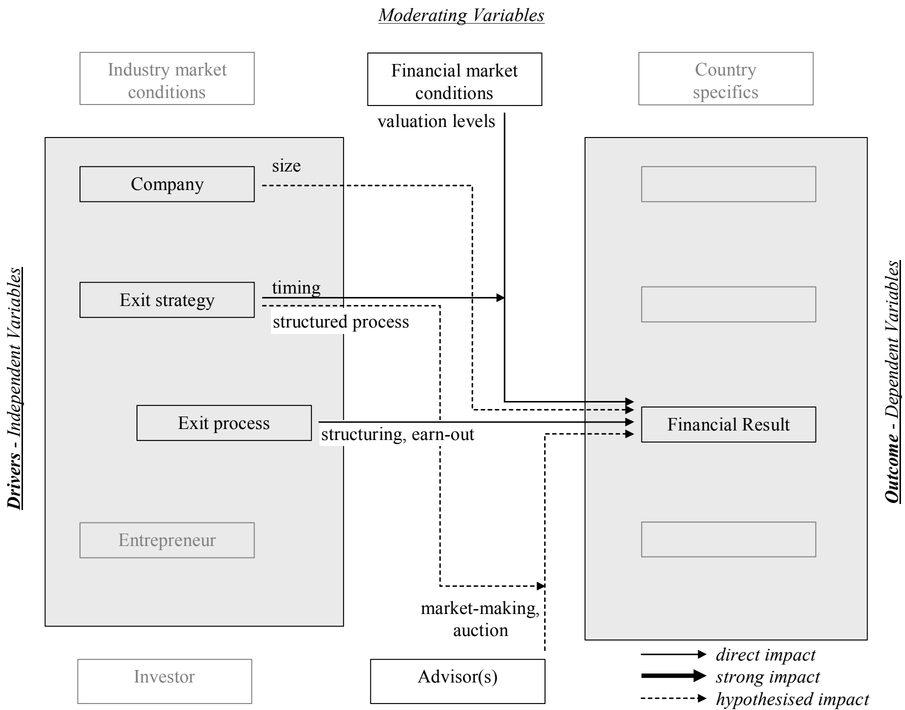
Financial Results

Cyclical markets and private equity valuations can have an important impact on the total proceeds to be realised from the harvest. Timing with respect to financial market conditions can therefore have an important impact on the financial results of the exit, as shown in Exhibit 50. Based on existing research it might be hypothesised that size can also drive valuation levels. However, it might be impacted by the entrepreneur only over a longer period of time.

Structuring variants with payments in several instalments linking part of the valuation to future performance might offer a way to increase total proceeds significantly given the empirically examined positive track record of the buyout industry. However, biases in entrepreneurs' decision-making such as hyperbolic discounting appear to limit the application of such concepts.

A potential positive impact of intermediaries' market-making function on realised valuation levels could not be examined, as none of the entrepreneurs had chosen a structured auction process. However, the survey and the existing empirical and theoretical evidence support the hypothesised relationship.

***Exhibit 50**: Key success factors driving financial results*

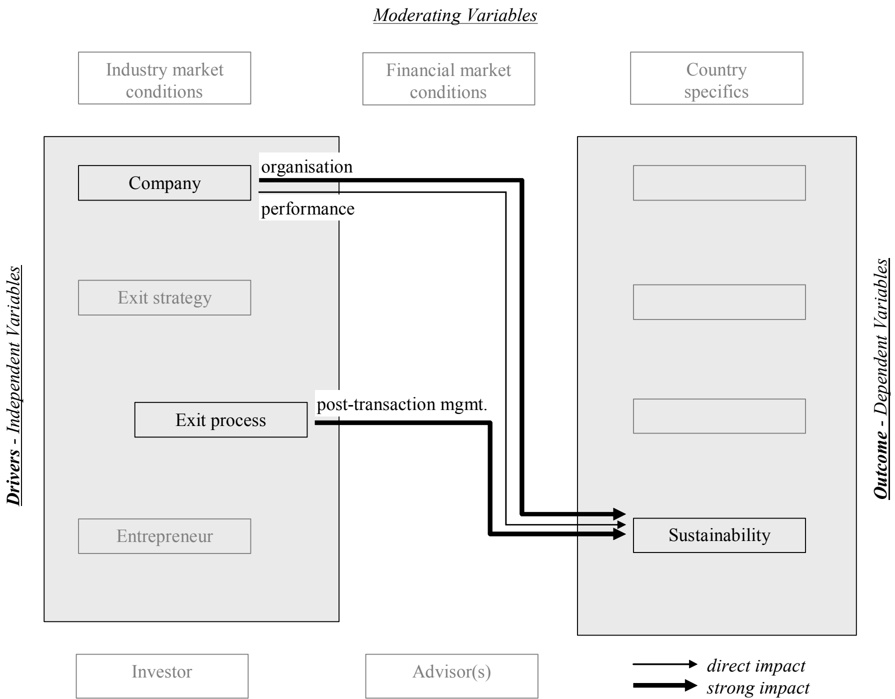


Sustainability

A selection bias appears to positively impact the longer-term success of exit buyouts. Through rigorous selection, investors tend to identify firms satisfying high levels of performance and organisational readiness for the buyout. This implies that the risk of failure might be considerably smaller compared to the average firm.

This effect can be further enhanced through the positive impact of both a well-managed transition from the entrepreneur to his successor and a good fit between the incoming investor, the entrepreneur, and his firm, as illustrated in Exhibit 51.

Exhibit 51: *Key success factors driving sustainability*



Summary

On the whole, it appears that factors related to the company, mainly its performance and organisation and the fit that can be established between entrepreneur and investor – to a good extent facilitated by intermediaries – do impact the availability and smoothness of the exit buyout process.

In cases where financial results are the dominant objectives, significant value can be added with careful timing in regard to financial market conditions, with the inclusion of a an earn-out structure and with the market-making function of intermediaries within structured processes. Sustainability appears to be less of an issue, as, overall, the performance of exit

buyouts might be quite satisfactory but can probably be further enhanced by a well-executed management transition and strong fit between entrepreneurs and investors.[268]

8.1.2 Satisfaction of Entrepreneurs with Exit Buyouts

To assess the level of entrepreneurs' satisfaction, discrepancy theory might be applied to the objectives discussed above and related to the three dimensions of execution success as well as sustainability success.[269]

Case Study Evidence

All of the entrepreneurs involved in the case analysis were globally satisfied with the results of their exit transaction. They proactively prepared and addressed their exit and were as a consequence in the driver's seat. None was passively pushed into the exit by negative events or external stakeholders. They appeared to have successfully embarked on a new phase in their careers after an intense period of building and growing their companies. This is an interesting fact when considering the dramatic change in their personal and professional lives that was triggered by the exit.[270] Typically, the transition from an active role involving multiple responsibilities to a much less busy lifestyle can be the cause of frustration.[271]

One might suspect a certain bias triggering a particularly positive assessment based on the accomplishment of the exit transaction itself. This might be attributable to the fact that the global satisfaction of having concluded the desired exit overrides lower satisfaction or even dissatisfaction with certain individual aspects of the transaction. However, satisfaction levels appeared to be comparably high for entrepreneurs having completed transactions more recently as well as for those who had undertaken exits a number of years earlier. The latter group had enough time to digest and gain more distance from the process and to be able to evaluate the longer-term aspects of the sale.

The decomposition of global satisfaction into its constituents might yield additional indications. Seen from an availability perspective, satisfaction was moderate, as during the

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[268] The results correspond, to some extent, to earlier research by Morris et al. (1997), underlining the importance of the organisational preparation of the firm when modelling success in family business successions through "preparation of heirs", "nature of family and business relationships" and "planning and control activities". The authors find tentative empirical support for the positive impact of all three factors, with a dominance of the family relationship components. Transposed into the exit process, it would imply the importance of a well-prepared organisational transition toward the future management of the firm as well as a rigorous process management.

[269] See chapter 3.2.2.

[270] For example, Schröer and Kayser (2006), p. 31 found that up to 38% of entrepreneurs ignore the necessity of exit considerations due to difficulties in parting with their business, fear of aging and an unknown future.

early phases of their exit, some entrepreneurs found little interest from both buyout but also strategic investors, leading to relatively long processes of several years in some cases.

From a process perspective, entrepreneurs were not particularly satisfied, as the process in most cases took not only considerably longer than initially planned but also required a significantly higher dedication of the entrepreneur and his management team, sometimes even representing a risk to smaller firms' operational business. In addition, discrepancies in cultures between entrepreneurs and investors have led to frustrations during the due diligence phase, in some cases with legal and accounting issues often being the root cause.

From a financial perspective, results appear to be satisfactory. They were particularly positive in cases where exiting entrepreneurs were able to benefit from the value generated after their exit through earn-out agreements or a phased exit process. Payments sometimes seem to have exceeded initial valuations and entrepreneurs expectations in these cases.

From a sustainability perspective, success appeared in all cases to be satisfactory, in most cases even exceeding entrepreneurs' expectations. Entrepreneurs valued the presence of a professional outside investor, not only ensuring the sustainability of the company but also helping to further develop the franchise. In all five cases, the companies have continued and sometimes accelerated their significant growth path.

The overall positive assessment might therefore be driven by the dynamic evolution of the business and a potential financial upside through the exit of a remaining stake at a significantly higher valuation, potentially overcompensating issues that have been lived through during the process.[272]

8.1.3 Implications for Entrepreneurs

Before launching their exit buyout project, entrepreneurs might want to ensure the presence of two important preconditions: a well-prepared firm with respect to performance and organisation and a clear set of objectives which will drive the process. While considering their exit, entrepreneurs might need to balance a strategic and financial perspective with personal goals, as shown in Exhibit 52.

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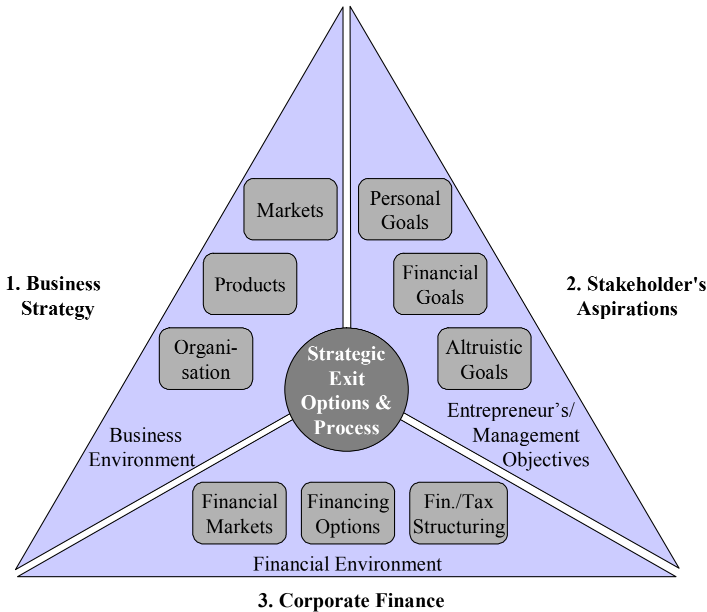
[271] SECA (2006), p. 12.

[272] The positive evaluation of the exit buyout process above corresponds to recent empirical research by Freund and Kayser (2007) evaluating the success of family business successions. A higher level of satisfaction for entrepreneurs driven by non-economic objectives, as suggested for earlier stages of the firm's lifecycle by Cooper and Artz (1995), compared to entrepreneurs with dominant economic objectives, could not be identified.

Exhibit 52: *Framework for entrepreneurs' objective setting*



Source: own graph.

Based on entrepreneurs' objectives, a number of choices might need to be made. A preferred exit option can be selected while potentially considering several in parallel during the early stages of the process. The identification and selection of key participants also appear to promote the process. Investors can be strategists or financial engineers, sector fans or generalists, driven by a quantitative or rather qualitative approach; intermediaries can be match-makers or market-makers; legal advisors can be deal facilitator or risk identifiers. In any case, ensuring considerable fit appears to be a key factor.

Entrepreneurs' individual balance between financial and non-financial objectives can determine large parts of the following process. If financial objectives are dominant, a number of value drivers should be considered. Valuations will be focused on future growth and related to current private equity valuation levels. Therefore, a credible business plan showing considerable growth and a distinct timing with respect to cyclical financial markets might increase the valuation significantly. A structured auction process might contribute

equally to maximising the valuation if a significant number of bidders can be identified and qualified.

Seeing the exit as a development project for their firm rather than a singular exit event can provide additional value when considering staged exits through earn-out or OBO structures. Worries about future performance and sustainability might not necessarily be justified.[273] Exit buyouts have proven to further enhance the performance of already successful entrepreneurial projects. This can be partially due to a selection bias, with funds investing in firms with significantly above-peer performance. However, it can also be linked to the development of more systematic management processes within a growing firm, creating significant value and preparing the business for a successful second "terminal" exit for both entrepreneurs and buyout investors.

A number of tools might also assist entrepreneurs in facilitating the process. SME rating approaches developed within the context of Basel bank lending practices can have signalling effects, reduce asymmetric information and help with preparing and limiting the time and resources deployed to due diligence.[274] Stock indices of entrepreneurial companies such as the German GEX, which are often used by investors as a reference point, can help entrepreneurs to assess valuation levels and optimise timing.[275] Refined and more transparent auction approaches such as English light or clock auctions can help to mitigate the fit- and resource-penalty as well as winners'-curse issue often attached to heavily structured processes while preserving the market-making effect.[276]

8.2 Investors' Perspective

8.2.1 Key Success Factors

When analysing the decomposition of investors' global satisfaction with recently conducted exit buyouts, the particularly satisfactory evaluation of management transitions and the positive assessment of legal conditions can be remarked, as illustrated in Exhibit 53. Whereas entrepreneurs' knowledge about the buyout concept and the achieved valuations

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[273] Empirical research on buyout performance shows significant increases in value. Malone (1989) suggests that smaller company LBOs are focused on increases in marketing and revenue improvements, rather than selling off assets and laying off personnel.

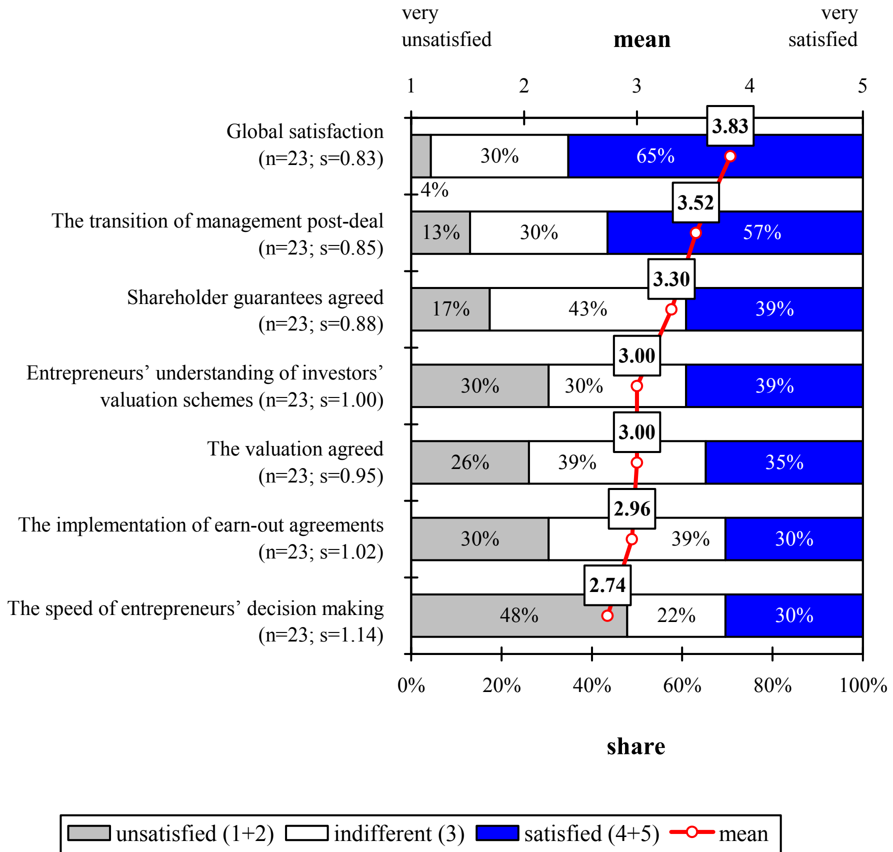
[274] See Kley (2006), p. 116. For the concept of a succession or exit ratings, see Klemm (2006), p. 13. For a proposed structure of such a rating, see Stämpfli (2006), p. 280.

[275] See Kaserer et al. (2006).

[276] See Berz (2007), p. 179 and p. 186.

appeared to be acceptable, the implementation of earn-out agreements and the speed of entrepreneurs' decision-making seemed to be less satisfactory.

***Exhibit 53**: Investors' satisfaction with different exit buyout aspects*

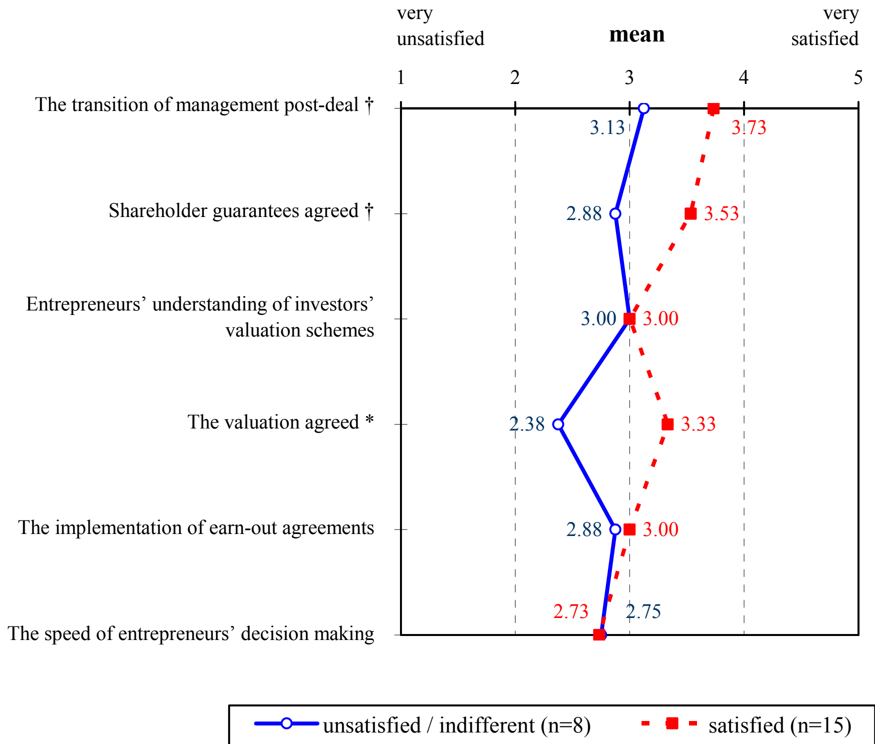


In distinguishing between more and less satisfied investors, it can be identified that the differences in global satisfaction seem to be linked to three distinct factors: the management transition as well as the legal guarantees and valuations agreed upon.[277] Little difference was found in the other three aspects between the two groups, as shown in Exhibit 54. This might indicate that management transition, legal guarantees and valuation levels drive different

277 The groups display an average global satisfaction of 4.33 for the more satisfied and 2.88 for the less satisfied investor cluster.

levels of satisfaction and thus could be considered success factors from an investors' perspective.

***Exhibit 54**: Differences in investors' satisfaction*



Mann-Whitney-U-Test: Significant mean difference † p <= 0.1; * p <= 0.05

8.2.2 Satisfaction of Investors with Exit Buyouts

To assess the level of investors' satisfaction, discrepancy theory might be applied to the objectives discussed above and related to the three dimensions of execution success as well as investment success.[278]

[278] See chapter 3.2.2.

Case Study Evidence

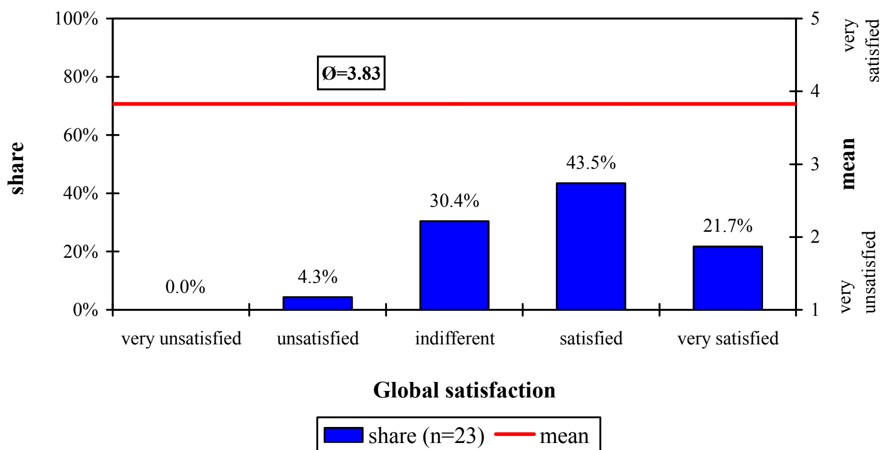
The investors participating in the cases examined showed high global satisfaction levels. They were particularly satisfied with process aspects such as personal contact, time spent with management in the non- or slightly intermediated transactions examined, and entrepreneurs' willingness to compromise in order to close the transaction.

Lower satisfaction and concern resulted from several factors. There were difficulties in accessing attractive exit opportunities at reasonable resource levels and excessively long processes due to insufficient preparation and management of the exit process on the part of the entrepreneurs. There were also challenges in creating a competitive advantage in a sales situation, where the entrepreneurs perceive price – the company valuation – as a dominant criterion in the early stages of the process.

Survey Results

The investors were questioned about their global satisfaction with exit buyout processes conducted since 2000. As shown in Exhibit 55, more than 65 percent stated that they were satisfied or very satisfied with the results. However, a significant share of the responses termed indifferent and dissatisfied (8 out of 23 investors) might indicate that at least certain aspects are not always completed to the full satisfaction of investors. Hence, a further analysis of satisfaction along certain execution and investment objective dimensions might be helpful.

***Exhibit 55**: Investors' global satisfaction with recent exit buyouts*



From an availability, closing and process efficiency perspective, investors indicated satisfactory transformation rates, with 76.2 percent of the investors realising, on average, more than one out of three deals that had passed the due diligence phase and 38.1 percent realising on average more than two out of three deals at an offer stage. However, increases in competition, especially from 2005 to 2007, could moderate this assessment, and a longitudinal approach might be required to identify increasing or decreasing trends over time.

From a valuation perspective, only about a third of the investors were satisfied, with about 26 percent very dissatisfied or dissatisfied and about 39 percent indifferent about recently realised valuations. This might indicate that a prior shift in bargaining power toward entrepreneurs, driven by the increases in available investment capital, the number of funds present on the market and the more frequently applied structured auction processes, might have impacted valuations, leaving investors with less attractive entry valuations.[279]

From an investment success perspective, the investors appear to be considerably more satisfied, with more than 56 percent of the investors confirming high satisfaction or satisfaction and only 13 percent dissatisfaction. This might be driven by the effective handover-preparations of the entrepreneurs and the predominant focus of investors on MBO investment structures, where the transition from the entrepreneur to an already existing internal management team might facilitate the otherwise risky and time-consuming handover to external management.[280]

8.2.3 Implications for Buyout Investors

The results somewhat confirm the hypothesised differences between entrepreneurial and private equity cultures, which represent a significant challenge to exit buyout success. While investors' satisfaction appears to be mainly driven by the hard facts characterising the conditions surrounding the entry into their investment, the above analysis of key success factors also attributes a high level of importance to the fit between entrepreneurs and investors.

For investors to enhance access to attractive exit buyout opportunities and to foster levels of success for all participants in the process, it might therefore be suggested to address three specific issues. First, a personal fit with the entrepreneur during the early stages of the process should be emphasized in order to create trust. Second, investors should be aware of

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[279] See also chapter 6.2.2 for further evidence on increasing buyout valuations.

[280] See also chapter 7.1.3 for investors' preferences on buyout typologies.

the potentially negative impact of an imbalance of means between investors and entrepreneurs, especially with respect to legal and financial due diligence. The level of detail audited should remain in a reasonable relationship to the size and complexity of the business. Standards typically applied to large and mid-cap companies might be disproportionate for smaller companies and will probably create frustration on the buy- as well as the sell-side. Third, entrepreneurs' knowledge of the buyout concept should be further enhanced to increase the visibility of exit buyouts as a preferred exit option. This also applies to specific aspects such as payment structuring through earn-out agreements that can allow aligning interests between entrepreneurs and investors, but can also help to maximise the total value to be harvested by entrepreneurs.

8.3 Propositions

Three propositions were formulated for further research in order to refine the conceptual framework, presented above.

Proposition 1 – "An exit buyout is rarely planned but develops from the context"

The exit buyout option is not planned as such and perceived upfront as a valid exit option by entrepreneurs. This is an indicator of an often more "evolving" than "planned" exit process in which objectives, timing and strategy change over time.

Proposition 2 – "It is not only 'product quality' that makes the difference"

Company performance, deal type and sector attractiveness ("product quality") are a highly facilitating but not sufficient condition for a successful exit and can therefore not be the only determining factors of success. Financial results also depend on timing, structuring and process variables. Managing the exit process effectively (i.e., creating competition, obtaining professional advice) does add significant value.

Proposition 3 – "The selection of investors with 'best fit' is key"

Entrepreneurs and investors have per se different approaches to risk taking (entrepreneur vs. fund manager) and management culture (entrepreneurial/ intuitive vs. highly structured and formalised). In addition information asymmetries can lead to important issues, such as during the due diligence phase. The resulting discrepancy can only be bridged if vision, values and management practices are aligned.

9 Summary and Conclusion

The research presented examines the entrepreneurial exit in the form of an exit buyout, involving an internal or external management team as well as private equity investors. An explorative approach was employed to develop and refine a conceptual framework to define success and the key factors leading to a successful outcome of the exit buyout process. The model includes independent and moderating variables related to company performance, the key participants, the market environment as well as exit strategy and process determinants. The results are based on a literature review, the analysis of five case studies of entrepreneurs who had recently exited their small- and medium-sized firms and the analysis of a questionnaire-based survey of 23 exit buyout investors across France and Germany.

9.1 Summary of Findings

The determinants of the entrepreneurs' exit strategy and process choices were examined. An individual balance of personal, financial and firm level aspects appears to be the main motivator and driver of different exit strategies. Entrepreneurial heuristics and biases seem to impact the early stages of the exit buyout process. However, entrepreneurs appear to be "learning" throughout the process and adapt their behaviour to ensure success. This drives the proposition that an exit buyout is rarely planned but rather developed out of the context.

The satisfaction of the entrepreneurs appears to be driven by both maximising firm valuation and ensuring the firm's sustainability. The entrepreneurs appear to be satisfied shortly after a closed transaction with their exit and the results achieved, but also longer-term, witnessing the most often positive evolution of their firms under a new management and ownership. Satisfaction with sustainability objectives appears to be high, possibly also due to a selection bias, with exit buyouts mainly occurring within firms of above-peer performance.

During the exit phase, entrepreneurs might switch their objective function. Instead of giving up current cash flows in favour of future returns, their preference for a total sale seems to indicate that they seek the highest immediate payoff. This suggests that face value might dominate structuring and payment schemes in the entrepreneurs' preferences. However, the empirical evidence underscores that payment structures involving staged cash-outs and a

link to the future performance of the firm through earn-out agreements can substantially increase the total proceeds to be harvested from the firm.

The satisfaction of the investors with the exit buyout process is generally positive and driven by a smooth transition of the firm's management to a successor as well as by limiting information asymmetries throughout the process through due diligence and contractual guarantees. However, a balance of means needs to be respected especially with respect to potentially complex legal and accounting due diligence in order not to negatively impact the overall process.

With respect to the most important factors driving exit buyout success, it appears that aspects related to the company, mainly its performance and organisation and the fit that can be established between entrepreneur and investor (to a good extent facilitated by intermediaries) do impact the availability and smoothness of the exit buyout process. Investors actively try to mitigate cultural differences through personal contact and team composition. This leads to the propositions that not only "product quality" defines exit buyout success, but also the fit achieved with incoming investors. It implies at the same time that entrepreneurs can, to a large extent, impact the process outcome by mastering their firm and the relationship with investors.

In cases where financial results are the dominant objectives, timing with respect to cyclical financial market conditions (especially private equity valuation levels), the inclusion of an earn-out structure, and the hypothesised market-making function of intermediaries within structured processes can add significant value.

Exit strategy and process variables were also identified as potential levers. For example, MBOs represent a more attractive and less risky exit buyout option to investors compared to MBIs, and structured processes, including auction components, might help to maximise value for financially-oriented entrepreneurs.

9.2 Limitations

The present research displays certain limitations, and hence, the findings need to be considered tentative. These limitations also suggest areas for future research. First, the research design is explorative, and the argumentation is based on five case studies and a survey with a relatively small sample size which, even within an overall small market, have little predictive power. Enlarging the sample size and examining a larger set of individual exit buyouts would be appropriate in future studies. Second, the survey relied on attitudinal

data. More detailed analysis might also be carried out using archival data on quantitative and qualitative firm and market data. However, obtaining such data is challenging, and relevant information might not be easily available on a firm level. Third, the study concentrated on a limited number of factors while developing and refining an initial framework of factors contributing to success in exit buyouts. Other aspects may need to be considered to fully explain the dynamics of the process. Fourth, further research from an entrepreneurial finance perspective should examine entrepreneurs' financial tradeoffs and an optimisation of capital allocation between a full or gradual divestment of the firm as a function of the availability and return characteristics of alternative investment opportunities.

9.3 Outlook

It can be concluded that exit buyouts represent for entrepreneurs an attractive exit option which is characterised by success factors that can be directly impacted by the entrepreneur: the performance and organisation of his firm and the fit with potential investors. Therefore, the exit buyout concept shows the potential to become a more widely applied alternative to trade sales, IPOs, and MBOs, with no involvement of private equity investors in the upcoming wave of business transfers across Europe. Better informed entrepreneurs together with an oversupply of capital have led to a stronger position of entrepreneurs and build a strong basis for the anticipated growth in exit buyouts despite recent turbulences on financial markets.

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Appendices

A. Overview of independent and moderating variables

Factors related to the market environment
Economic conditions
interest rate level
Valuation levels
Capital market conditions for mid-cap companies
market efficiency for mid-cap transactions
liquidity and demand for mid-cap companies
Factors related to the key participants
Seller
Motivation & goals
personal considerations
financial considerations
business imperatives
Transaction experience
Personal network
Buyer
Market knowledge
Transaction experience
Financial strength
Third Party Advisors
Market knowledge
Transaction experience
Functional know-how
Factors related to the company
Company size and maturity
Market attractiveness
Market position
Product and service proposition
Operational excellence
Financials
financial performance
capital structure
Legal and organisational structure
Quality of management team & staff
Recent performance trend

Factors related to the exit strategy
Fit of chosen exit option
Timing
Target structure
shareholding
future role
Factors related to the exit process
Preparation of the company
management
legal & tax restructuring
Process management
sequence and timing of exit steps
parallel management of exit and operations
management empowerment & transition
post-exit involvement
Identification of potential buyers
profile of potential buyers
number of potential buyers
Valuation
Due diligence
Communication
managing confidentiality
presentation
disclosure of information
negotiation
Deal structure
transacted shares
payment structuring
Financial engineering
financial leverage
Legal structuring
contracting
legal guaranties
Management of external advisors
selection of advisors
contracting & management of advisors
communication with advisors

B. List of private equity funds and external advisors

French Private Equity Funds

- 21 Centrale Partners
- 3i Gestion S.A.
- ABN AMRO Capital France
- Acland
- Activa Capital
- Advent International
- Alliance Entreprendre
- Alpha Associes Conseil
- Apax Partners
- Aquasourca
- Argos Soditic
- Astorg Partners
- Atria Capital Partenaires
- Avenir Finance
- Axa Private Equity
- Banexi Capital Partenaires
- Banque de Vizille
- Barclays Private Equity France SA
- Baring Private Equity Partners
- BBS Finance
- Before
- Bridgepoint Capital
- Burelle Participations
- CDC IXIS - Services Industrie
- CDC IXIS Equity Capital
- Chequers Capital
- CIC Finance
- Ciclad
- CPR Private Equity
- Creadev
- Credit Lyonnais Private Equity Corporate
- Credit Lyonnais Private Equity Marche Secondaire
- Capital Système Investissements SA
- DI Euridis / IDIA Participations
- Duke Street Capital
- EFG
- Cognetas / Electra Partners Europe
- EPF Partners
- European Capital
- Finama Private Equity
- Fonds Partenaires Gestion
- Family Office Ghosn
- IDI
- IDI - Euridi
- IGF Innovation et Gestion Financière

- ING Parcom Private Equity
- Initiative & Finance
- IPO Capital
- Langholm Capital
- LBO France
- Legal & General Ventures SA
- MBO Partnenaires
- Montagu Private Equity
- Natixis Industrie
- Natixis Investissement
- Naxicap / Natixis Private Equity
- Orkos Capital
- Paluel-Marmont Capital
- Perfectis Private Equity
- Phenix Partners
- PPM Ventures
- Quatras Gestion
- Quilvest
- Robertsau Gestion (Groupe Fortis)
- Siparex
- Socadif
- SPEF LBO
- TCR Industrial Managers
- Turenne Capital
- X-Ange

German Private Equity Funds

- 3i GmbH
- ABN AMRO Capital GmbH
- Advent International
- Afinum Management GmbH
- Alpha Associes Conseil
- Apax Partners Beteiligungsberatung GmbH
- Arcadia Beteiligungen Bensel Tiefenbacher & Co. GmbH
- baF business angel Fondsverwaltung GmbH
- Baring Private Equity Partners
- BayBG Bayerische Beteiligungsgesellschaft mbH
- Beteiligungsgesellschaft für die deutsche Wirtschaft
- BLB Equity Management GmbH
- BPE Private Equity GmbH
- Bridgepoint Capital GmbH
- Capiton AG
- CBG Commerz Beteiligungsgesellschaft Holding mbH
- Cognetas / Electra Partners Europe
- Cornerstone Capital AG
- Deutsche Beteiligungs AG
- DIH Finanz und Consult GmbH
- DZ Equity Partner GmbH
- ECM Equity Capital Management GmbH
- Econa AG
- EQT Partners Beteiligungsberatung GmbH
- Equita
- European Capital
- FINAT€M Beteiligungs GmbH
- Granville Baird Capital Partners
- Hannover Finanz Gruppe
- Heptagon Capital Beteiligungsgesellschaft der Freien Sparkassen mbH & Co.
- HGU Hamburger Unternehmensbeteiligungs AG
- Industri Kapital GmbH
- KERO Holding AG
- Montagu Private Equity GmbH
- NORD Holding Unternehmensbeteiligungsgesellschaft mbH
- Orlando Fund
- Pari Capital AG
- PPM Ventures GmbH
- Quadriga Capital Eigenkapital Beratung GmbH
- RBK Regionale Gesellschaft für Beteiligungs Kapital der Sparkasse Hannover
- SBG Sparkassenbeteiligungsgesellschaft Sachsen-Anhalt mbH
- S-REFIT AG
- S-Siegerlandfonds GmbH & Co.KG
- S-UBG AG UBG für die Regionen Aachen, Krefeld, Mönchengladbach
- WGZ Initiativkapital GmbH

External Advisors and Financial Press

- Aforge Finance
- August & Debuzy
- Bank Sarasin & Cie.
- Capital Finance
- Capital Système Investissements
- Cleary Gottlieb
- Deloitte Corporate Finance
- Doertenbach & Co.
- Dr. Ferber & Partner Corporate Finance
- Drueker & Co.
- EIKON Beratung und Beteiligungen
- Ernst & Young Corporate Finance
- Financial Times Deutschland
- Fuchs Consult
- Gide Loyrette Nouel
- Goldman Sachs
- Greenhill
- Haarmann Hemmelrath
- Handelsblatt
- Herbert Smith
- KPMG Corporate Finance
- Lazard
- Les Echos
- Linklaters Oppenhoff & Rädler Peters Associates
- Price Waterhouse Coopers Corporate Finance
- Rawlings Giles Sher
- Remaco Merger
- Sal. Oppenheim
- Simon - Kucher und Partners
- Skadden Arps
- Translink Corporate Finance

C. Case study data collection protocol

Exit Buyout Case Study Research – Guideline for Questions

A. – Motivation and Objectives

What was your motivation and trigger to search for an investor in your company?

What role played the following aspects?
- Solve succession issues
- Finance and stabilise company growth
- Diversify personal investments
- React on proposal by investors
- Amount of M&A transactions in the sector
- Leverage positive market environment
- Start a new business

B. – Your Satisfaction

How satisfied are you globally with the exit transaction?

How would you describe your present relationship with the investor who bought out your firm?

What would you do differently if you would have to undertake another exit transaction?

What would you do the same way again if you would have to undertake another exit transaction?

How satisfied are you with the following aspects of the exit transaction?
- The valuation achieved
- Investors appreciating the real value of the co.
- The payment structure
- The shareholder guarantees agreed
- Investors understanding of your business
- The strategy for the company post-transaction
- The speed of investors decision making
- The contribution of the intermediary
- The contribution of the legal counsel

C. – Your Role

Did you create the company or how did you get involved with the company?

What was/will be your personal role in the company after the transaction?

D. – The Transaction

Which exit options did you consider initially or throughout the process?

In case of a buyout which type did you consider initially or throughout the process?

What was/will be your personal shareholding in the company prior and after the transaction?

How long did it take to close the exit transaction, from the initial approach of potential buyers to the signature of a sales agreement?

Are you satisfied with the valuation realised in the transaction?

What share of the total consideration was paid upfront?

E. – The Process

Did you work with an intermediary to generate, evaluate and negotiate investment proposals

Did you work with a legal advisor to evaluate and negotiate investment proposals?

Did you run an auction?

Have you had prior experience in company acquisitions or sales?

F. – Your Decision

How important where the following aspect in making the final choice of the investor retained

- The valuation proposed by the investor
- The deal and payment structure proposed
- The proposed strategy for the company
- The ability of the investor to add value
- The track record of the investor
- The ability of the investor to act quickly
- The personal fit with the investor

G. – The Company

What was the market position and how would you describe the development goals of the firm at the time of your exit?

How did you prepare your organisation and your staff prior to your exit?

Did you employ a full-time CFO?

Did you work with a formalised 3-5 year budget or business plan?

D. Survey questionnaire – French version

Exit Buyouts – Investissements lors de sorties entrepreneuriales

Introduction

Cette enquête fait parti d'un projet de recherche de l'Université de St. Gallen (partenaire de HEC) et est supervisée par le Prof. Dr. Thierry Volery et le Prof. Dr. Dr. Ann-Kristin Achleitner.

L'objectif en est d'analyser les pratiques actuelles et les facteurs de succès des ***Exit Buyouts*, c'est-à-dire le processus d'investissement d'un fonds de *Private Equity* dans des situations de sortie entrepreneuriale** (OBO, MBO, MBI, BIMBO).

TOUTES LES INFORMATIONS RECUES
SERONT TRAITEES AVEC LA PLUS GRANDE CONFIDENTIALITE

AUCUNE des informations que vous nous soumettrez ne sera identifiée comme provenant de vous ou de votre société.
Seuls des résultats agrégés pour l'ensemble de l'étude seront publiés.

Si vous souhaitez recevoir une copie des résultats du projet, merci d'indiquer vos coordonnées ci-après :

Société ______________________________________

Nom ______________________________________

Téléphone ______________________________________

Adresse E-mail ______________________________________

Adresse postale ______________________________________

____

Section A – Satisfaction

Etes-vous globalement satisfait par le processus d'investissement dans les Exit Buyouts auxquels vous avez participé depuis 2000 ?
*Veuillez indiquer votre satisfaction globale en sélectionnant **une seule** réponse*

	pas satisfait				*très satisfait*
Satisfaction globale	O	O	O	O	O

Quels aspects aimeriez-vous changer pour de futurs investissements d'Exit Buyouts?
Veuillez indiquer votre réponse texte ci-dessous

Quels aspects aimeriez-vous retenir pour de futurs investissements d'Exit Buyouts?
Veuillez indiquer votre réponse texte ci-dessous

Etes-vous satisfait avec les différents aspects du processus d'investissement d'un Exit Buyout ?
*Veuillez indiquer votre satisfaction en sélectionnant **une seule** réponse pour chaque aspect*

	pas satisfait				*très satisfait*
Valorisation retenue de l'entreprise	O	O	O	O	O
Compréhension des schémas de valorisation par les entrepreneurs	O	O	O	O	O
Garanties d'actif et passif négociées	O	O	O	O	O
Vitesse de prise de décision par l'entrepreneur	O	O	O	O	O
Mise en oeuvre d'un mécanisme d'earn-out	O	O	O	O	O
Transfert de la gestion de l'entreprise après la réalisation de l'opération	O	O	O	O	O

Section B – Objectifs des Entrepreneurs

De votre point de vue, que sont les objectifs principaux qui motivent les entrepreneurs pendant le processus d'un Exit Buyout ?
*Veuillez sélectionner **une seule** réponse par objectif*

	pas important				*très important*
Maximiser la valorisation	O	O	O	O	O
Maximiser le paiement initial	O	O	O	O	O
Optimiser la structure et les échéances de paiement de la transaction	O	O	O	O	O
Assurer la pérennité de la société	O	O	O	O	O
Assurer une forte contribution stratégique et opérationnelle de l'investisseur	O	O	O	O	O
Sélectionner un investisseur avec une bonne réputation	O	O	O	O	O

Autres motivations et objectifs:
Veuillez indiquer votre réponse texte ci-dessous

Section C – Critères de Sélection de Dossier

Que sont vos critères les plus importants dans la sélection des dossiers d'Exit Buyout ?
*Veuillez indiquer les importances en sélectionnant **une seule** réponse par critère*

	pas important				*très important*
Secteur d'activité de l'entreprise	O	O	O	O	O
Volonté réelle de l'entrepreneur de réaliser une transaction	O	O	O	O	O
Croissance actuelle de l'entreprise	O	O	O	O	O
Future potentiel de croissance de l'entreprise	O	O	O	O	O
Profitabilité actuelle de l'entreprise	O	O	O	O	O
Future potentiel de profitabilité de l'entreprise	O	O	O	O	O
Continuité de l'équipe de Direction (hormis l'entrepreneur sortant)	O	O	O	O	O
Implication d'un intermédiaire	O	O	O	O	O
Absence d'une situation d'enchères	O	O	O	O	O
Documents de présentation du dossier	O	O	O	O	O

Quelles typologies de transactions vous intéressent particulièrement?
*Veuillez indiquer l'attractivité relative en sélectionnant **une seule** réponse par typologie*

	pas attractive				*très attractive*
Ownership Buyout (OBO)	O	O	O	O	O
Management Buyout (MBO)	O	O	O	O	O
Management Buy-In (MBI)	O	O	O	O	O
Buy-In Management Buyout (BIMBO)	O	O	O	O	O

Section D – Processus d'Investissement

Pendant le processus de due diligence et la prise de décision d'investissement, quelle est l'importance des aspects suivants ?
*Veuillez sélectionner **une seule** réponse par aspect*

	pas important				*très important*
Compréhension de la personnalité du vendeur	O	O	O	O	O
Disponibilité d'un budget (3-5 ans)	O	O	O	O	O
Disponibilité d'une comptabilité analytique/ERP	O	O	O	O	O
Due diligence comptable et juridique	O	O	O	O	O
Implication d'un intermédiaire professionnel	O	O	O	O	O
Implication d'un avocat national/international	O	O	O	O	O

Veuillez préciser la composition de votre comité d'investissement.

	oui	*non*
General Partners uniquement	O	O
General Partners et Limited Partners/investiss.	O	O
General Partners et conseils externes, merci de préciser : ____________________________	O	O

Comment assurez-vous la meilleure adéquation entre la personnalité de l'entrepreneur sortant et les membres de votre équipe d'investisseurs ?
Veuillez indiquer votre réponse texte ci-dessous

Section E – Profil des vos Activités

Veuillez indiquer quelques informations générales sur vos activités.

Année de création	______________	
Siège social (pays)	______________	
Montant total des fonds levés (depuis la création)	______________	EUR m
Nombre d'investissements actifs dans votre portefeuille	______________	#
Taille d'investissement ciblée (valeur d'entreprise)	_______ - _______	EUR m
Multiples de valorisation ciblés (valeur d'entreprise)	_______ - _______	x EBIT
Cash-on-cash Net IRR (def. EVCA, 5 dernières années)	______________	%

Veuillez fournir quelques informations concernant le deal flow annuel de votre structure.

Combien de dossiers recevez-vous au total chaque année ?	______________	#
Combien de dossiers analysez-vous en détail ?	______________	#
Combien de processus de due diligence entamez-vous ?	______________	#
Combien d'offres faites-vous par an ?	______________	#
Combien d'investissements réalisez-vous par an ?	______________	#

Veuillez fournir quelques informations sur les investisseurs dans vos fonds.		
Combien d'entités individuelles comptez-vous parmi vos investisseurs ?	_____________	#
Quelle est la partie:		
- d'investisseurs « captive »	_____________	%
- d'investisseurs « fonds de fonds »	_____________	%
- d'investisseurs institutionnels	_____________	%
- d'investisseurs de type *Family Offices* ou (ex-) entrepreneurs	_____________	%
	100	**%**

Les membres de votre équipe co-investissent-ils une partie de leur fonds personnels dans les sociétés du portefeuille du fonds ? (oui ou non) _____________

<u>Section F – Identification d'Exemples d'Exit Buyouts</u>

Afin de nous permettre d'interroger également des entrepreneurs ayant récemment cédé la majorité de leur entreprise à des fonds, nous vous serions reconnaissants de nous indiquer trois exemples d'Exit Buyouts (OBO, MBO, MBI, BIMBO) dans lesquels vous avez investi ou que vous connaissez par ailleurs.

<u>Exit Buyout 1:</u>
Nom de la société ______________________________________
Investisseur ______________________________________
Secteur ______________________________________
Chiffre d'affaires ______________________________________ EUR m

Nom de l'entrepreneur ______________________________________
Téléphone ______________________________________
Adresse E-mail ______________________________________
Adresse postale ______________________________________

<u>Exit Buyout 2:</u>
Nom de la société ______________________________________
Investisseur ______________________________________
Secteur ______________________________________
Chiffre d'affaires ______________________________________ EUR m

Nom de l'entrepreneur ______________________________________
Téléphone ______________________________________
Adresse E-mail ______________________________________
Adresse postale ______________________________________

<u>Exit Buyout 3:</u>
Nom de la société ______________________________________
Investisseur ______________________________________
Secteur ______________________________________
Chiffre d'affaires ______________________________________ EUR m

Nom de l'entrepreneur ______________________________________
Téléphone ______________________________________
Adresse E-mail ______________________________________
Adresse postale

E. Survey questionnaire – German version

Exit Buyout – Investitionen in Unternehmerischen Exit-Situationen

Einleitung

Diese Studie ist Teil eines Forschungsprojekts der Universität St. Gallen zum Thema "**Unternehmerisches Exit Management: Schlüsselfaktoren im Fall von Private Equity Buyouts**" und wird von Prof. Dr. Thierry Volery und Prof. Dr. Dr. Ann-Kristin Achleitner betreut.

Ziel ist es Erfolgsfaktoren und Dealbreaker beim **Exit Buyout, dem Verkauf von mittelständischen Unternehmen an Private Equity Fonds zu identifizieren** (OBO, MBO, MBI, BIMBO).

IHRE ANGABEN WERDEN STRENG VERTRAULICH BEHANDELT

KEINE der von Ihnen angegebenen Informationen wird mit Ihrem Unternehmen in Verbinding gebracht. Es werden nur zusammengefasste Ergebnisse veröffentlicht.

Sollten Sie an einer Zusammenfassung der Ergebnisse der Studie interessiert sein, geben Sie bitte nachstehend Ihre Adresse an:

Unternehmen ______________________________

Kontaktperson ______________________________

Telefon ______________________________

E-mail Adresse ______________________________

Postadresse ______________________________

A. – Zufriedenheit

Wie zufrieden sind Sie mit dem von Ihnen seit dem Jahr 2000 durchgeführten Investitionsprozessen in Exit Buyout Situationen?

	sehr unzufrieden				*sehr zufrieden*
Globale Zufriedenheit	O	O	O	O	O

Welche Aspekte des Investitionsprozesses würden Sie gerne bei zukünftigen Exit Buyouts ändern?
Bitte geben Sie Ihre Antwort untenstehend an

Welche Aspekte des Investitionsprozesses würden Sie gerne bei zukünftigen Exit Buyouts beibehalten?
Bitte geben Sie Ihre Antwort untenstehend an

Wie zufrieden sind Sie mit verschiedenen Teilaspekten des Investitionsprozesses von Exit Buyouts?

*Bitte bewerten Sie jeden Aspekt mit **einer** Aussage von „sehr unzufrieden" bis „sehr zufrieden"*

	sehr unzufrieden				*sehr zufrieden*
Vereinbarte Unternehmensbewertung	O	O	O	O	O
Verständnis der Bewertungsschemata durch den Unternehmer	O	O	O	O	O
Vertragliche Verpflichtungen/Garantien des Unternehmers	O	O	O	O	O
Zeitrahmen der Entscheidungsfindung des Unternehmers	O	O	O	O	O
Umsetzung einer Earn-Out Vereinbarung	O	O	O	O	O
Unternehmensübergabe nach Abschluss	O	O	O	O	O

B. – Ziele der Unternehmer

Was sind aus Ihrer Sicht die wichtigsten Ziele, die ein Unternehmer während des Investitionsprozesses des Exit Buyouts zu realisieren sucht?

*Bitte bewerten Sie jeden Aspekt mit **einer** Aussage von „sehr unwichtig" bis „sehr wichtig"*

	sehr unwichtig				*sehr wichtig*
Maximierung der Unternehmensbewertung	O	O	O	O	O
Maximierung einer ersten Zahlung	O	O	O	O	O
Optimierung von Dealstruktur und Zahlungsmodalitäten	O	O	O	O	O
Sicherstellung der Unternehmenszukunft	O	O	O	O	O
Sicherstellung eines strategischen und operativen Beitrags des Investors	O	O	O	O	O
Wahl eines Investors mit positiver Reputation	O	O	O	O	O

Andere Motivationen und Ziele:

Bitte geben Sie Ihre Antwort untenstehend an

C. – Kriterien bei der Auswahl von Unternehmen

Welches sind für Sie die wichtigsten Kriterien bei der Auswahl von potentiellen Exit Buyouts?

*Bitte bewerten Sie jeden Aspekt mit **einer** Aussage von „sehr unwichtig" bis „sehr wichtig"*

	sehr unwichtig				*sehr wichtig*
Branche in der das Unternehmen tätig ist	O	O	O	O	O
Motivation des Verkäufers zum Abschluss	O	O	O	O	O
Aktuelles Wachstum des Unternehmens	O	O	O	O	O
Zukünftiges Wachstumspotential	O	O	O	O	O
Aktuelle Profitabilität des Unternehmens	O	O	O	O	O
Zukünftiges Profitabilitätspotential	O	O	O	O	O
Fortbestand des Management-Teams (über den ausscheidenden Unternehmer hinaus)	O	O	O	O	O
Beteiligung eines Intermediärs	O	O	O	O	O
Abwesenheit einer Auktionssituation	O	O	O	O	O
Qualität der Unternehmenspräsentation	O	O	O	O	O

Welche Transaktionstypologien sind aus Ihrer Sicht besonders interessant?
*Bitte bewerten Sie jeden Transaktionstyp mit **einer** Aussage von „sehr unattraktiv" bis „sehr attraktiv"*

	sehr unattraktiv				*sehr attraktiv*
Ownership Buyout (OBO)	O	O	O	O	O
Management Buyout (MBO)	O	O	O	O	O
Management Buy-in (MBI)	O	O	O	O	O
Buy-In Management Buyout (BIMBO)	O	O	O	O	O

D. - Investitionsprozess

Wie wichtig sind für Sie folgende Aspekte bei der detaillierten Prüfung (Due Diligence) und Entscheidungsfindung einer Exit Buyout Investition?
*Bitte bewerten Sie jeden Aspekt mit **einer** Aussage von „sehr unwichtig" bis „sehr wichtig"*

	sehr unwichtig				*sehr wichtig*
Einschätzung der Persönlichkeit des Unternehmers	O	O	O	O	O
Verfügbarkeit eines 3-5 Jahres-Budgets	O	O	O	O	O
Verfügbarkeit eines Management Reporting / ERP Systems	O	O	O	O	O
Formale buchhalterische und juristische Prüfung	O	O	O	O	O
Beteiligung eines professionellen Intermediärs	O	O	O	O	O
Beteiligung einer nationalen/internationalen Anwaltskanzlei käuferseitig	O	O	O	O	O

Wie ist das entscheidungsbefugte Investitionsgremium Ihres Fonds zusammengesetzt?

	Ja	*Nein*
Nur General Partners	O	O
General Partners und Limited Partners/ Investoren	O	O
General Partners und Externe Berater, bitte beschreiben Sie: ________________________	O	O

Wie stellen Sie einen optimalen persönlichen Fit zwischen dem verkaufenden Unternehmer und den Investment Professionals Ihres Fonds sicher?
Bitte geben Sie Ihre Antwort untenstehend an

E. – Kurzprofil Ihres Fonds

Bitte stellen Sie uns folgende Informationen über Ihren Fond zur Verfügung:
Bitte geben Sie in Ihrer Antwort den Status vom März 2007 wieder.

Gründungsjahr	______________
Hauptsitz (Land)	______________
Anzahl der Investment Professionals in Ihrem Team	______________
Summe des bis heute geraisten Fondsvolumens	______________ EUR m
Aktuelle Anzahl der Portfoliounternehmen	______________ #
Zielgrösse der Portfoliounternehmen (Unternehmenswert)	_______ - _______ EUR m
Zieleintrittsbewertungspanne für Ihre Investitionen in Portfoliounternehmen (Unternehmenswert als EBIT-Vielfaches)	_______ - _______ x EBIT
Cash-on-cash Net IRR Ihres Fonds (nach EVCA, letzte 5 Jahre)	______________ %

Bitte beantworten Sie folgende Fragen bezüglich des jährlichen Deal Flows Ihres Fonds:

Wie viele Investitionsanfragen erhalten Sie jährlich?	______________	#
Wie viele davon unterziehen Sie einer detaillierten Analyse?	______________	#
Wie viele Due Diligence Prozesse durchlaufen Sie?	______________	#
Wie viele verbindliche Investitionszusagen machen Sie?	______________	#
Wie viele Investitionen tätigen Sie?	______________	#

Bitte beantworten Sie folgende Fragen zu den Investoren Ihres Fonds:

Wie viele einzelne Investoren hat Ihr Fonds?	______________	#
Welchen Anteil des Gesamtfondsvolumens repräsentieren:		
Sponsor (im Falle eines captive Fonds):________________	______________	%
Fund of Funds	______________	%
Institutionelle Investoren	______________	%
Family Offices und (Ex-) Unternehmer	______________	%
	100	**%**

(Co-)Investieren die Investment Professionals Ihres Fonds einen Teil Ihres persönlichen Vermögens in einzelne Portfoliounternehmen? (Ja/Nein) ______________

F. – Exit Buyout Beispiele

Um Unternehmer zu idenitifizieren, die in den letzten Jahren eine mehrheitliche Beteiligung an ihrem Unternehmen an einen Fonds veräussert haben, wären wir Ihnen dankbar, wenn Sie uns drei Exit Buyout Transaktionen Ihres Fonds nennen könnten:

Exit Buyout 1:
Name des Unternehmens ____
Investor ____
Branche / Aktivität ____
Umsatz ____ EUR m
Name des Unternehmers ____
Telefon ____
E-mail Adresse ____
Postadresse ____

Exit Buyout 2:
Name des Unternehmens ____
Investor ____
Branche / Aktivität ____
Umsatz ____ EUR m
Name des Unternehmers ____
Telefon ____
E-mail Adresse ____
Postadresse ____

Exit Buyout 3:
Name des Unternehmens ____
Investor ____
Branche / Aktivität ____
Umsatz ____ EUR m
Name des Unternehmers ____
Telefon ____
E-mail Adresse ____
Postadresse

Curriculum Vitae **Johannes Schmohl**

Professional Experience

2002 – Present	Artemis Partners Partner, Geneva
2002 – Present	Capital Système Investissements Founder, Geneva
2000 – 2001	marchFIRST Senior Engagement Manager - Strategy Practice, Paris & London
1998 – 1999	Mitchell Madison Group Engagement Manager, Paris & London
1996 – 1997	Mitchell Madison Group Associate, Munich
1995	Technologie Management Gruppe Business Analyst, Munich

Education

2009	Universität St. Gallen (HSG), Switzerland PhD / Doctor Oeconomiae
1995	Universität Augsburg, Germany Master of Science / Diplom Kaufmann