# HOW THE EXPECTED PAYOUT FROM DIFFERENT BUYER TYPES INFLUENCES A PRIVATE SELLER'S HARVEST STRATEGY

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ABSTRACT

Demographic forces in the U.S. economy can be expected to have a significant impact on the behavior of small business owners, particularly as it relates to their ownership transitions and exiting from their privately held firms (the development of "harvest" strategies). The ability of business owners to identify entity value and communicate this to the market (market signaling) could be a key determinant in maximizing sellers' payouts at the dispositions of their businesses. Historically, payouts have been maximized through transactions with *strategic* buyers, who have pre-existing knowledge of the seller's industry or market thereby permitting rapid value accretion for buyers. However, a current unprecedented level of capital available in the private equity market has created a sea of *financial* buyers who, despite having available capital, may not have the industry or firm specific knowledge which permits the rapid value accretion in an acquisition as it would a strategic buyer. In turn, seller payouts may be suppressed because of selling to financial buyers. The primary focus of this paper is to explore how sellers view the differences between the two types of buyers and the implications for seller payouts. More broadly, it addresses the importance of market signaling and its impact on seller payouts.

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# CHAPTER 1

# INTRODUCTION

Demographic forces are expected to have a significant impact on private business ownership transitions in the coming decade. It is currently estimated that 10,000 Baby Boomers reached retirement age each day (U.S. Census, 2020). Meanwhile, individuals from this generation, now aged 55–75, are estimated to own more than 12 million businesses in the United States (Generational Equity, 2015). We have also witnessed a decade of quantitative easing and low interest rates in the U.S. economy, which has resulted in over two trillion dollars in funds available for investment in private equity transactions alone (Bain & Company, 2019). The combination of these factors suggest that we may see an increase in both the number of business exits (Cembalest, 2018) as well as potential business purchasers in the coming years.

This research focuses on the sellers of small businesses. More specifically, the focus is on their perceptions regarding different buyer types and the extent to which this understanding influences the sellers' harvest strategy development and payout expectations. Additionally, this research explores the extent to which sellers believe that the existence of information asymmetry between different buyer types influences buyer behavior and consequently seller's payouts.

In part, developing harvest strategies challenges a seller to understand the mindset of different buyer types. Private business owners inevitably reach a point in their lives where they wish to leave their business, and their harvest strategy (DeTienne, 2010) has a significant impact on their personal financial health (Schaper et al, 2010). Harvest strategies are plans and processes designed to help owners realize the value in their business as they exit through arms-length transactions between motivated buyers and sellers, mergers, generational transfers, or corporate restructuring, which are all actions that fundamentally change the orientation an owner has with his or her business (DeTienne & Cardon, 2012). By understanding the motivations and goals of each type of buyer, a seller can better prioritize which buyers fit certain situations, and in turn, focus on more appropriate transactional relationships.

Generally, in both the academic (Martos-Vila et al., 2014) and practitioner (Mercer Capital, 1999; Corporate Finance Institute, 2020) worlds, potential buyers can be categorized into two broad categories, strategic buyers and financial buyers. *Strategic buyers* are typically operating firms that may be the competitors, suppliers, or customers of a business seller. The goal of a strategic buyer is to identify companies whose products or services can synergistically integrate with their existing profit and loss calculations (P/L) to create incremental, long-term shareholder value. (Hege et al. 2009). In contrast, *financial buyers*, which include private equity firms (also known as “financial sponsors”), venture capital firms, hedge funds, family offices, and high net worth individuals, are organizations focused on financial return. These firms and their executives are in the business of making investments in companies that can realize a return on their investments within 5–7 years with a sale or an initial public offering (Mercer Capital, 1999).

This research relies on the important assumption that all buyers can be expected to seek and negotiate the best deal possible for themselves. Sellers can count on the fact that whether a buyer is financial or strategic, they will always seek the best deal, which is usually denominated in dollars, but the elements could also include terms, timing, or other personal benefits.

However, because strategic buyers and financial buyers have fundamental differences, the way they approach transactions can differ in significant ways. In a market context, strategic buyers are usually industry insiders presumed to have the knowledge and acumen to rapidly generate value for sellers in an acquisition. Strategic buyers are generally expected to provide a higher payout to sellers than financial buyers (Hege et al., 2009). Incumbent industry knowledge suggests that strategic buyers would experience fewer operating inefficiencies than financial buyers upon concluding a purchase (National Center for the Middle Market, 2014). This is because knowledge of the processes and methods associated with business operations in a specific industry will help strategic buyers effectively deploy their recently purchased assets.

Strategic buyers identify target businesses to acquire generally because they are competitors, suppliers, or customers of the target. Their objective is the synergistic integration of the target with their businesses. Although strategic buyers may be unrelated to the target business and from different geographic locations, strategic buyers are often ready and able to take economic advantage of an acquisition based primarily on organizational and industry knowledge. Hence, the strategic buyer will focus on how the acquisition can provide relatively quick, measurable incremental gains to their existing operations (Mercer, 1999; Corporate Finance Institute, 2020).

Alternatively, financial buyers' relative deficiency in specific firm or related industry knowledge could impact their assessment of the business's value and suppress the payout offered to sellers (National Center for the Middle Market, 2014). This information asymmetry between financial buyers and sellers can represent a meaningful hurdle for sellers eager to maximize their return from the sale of their business. Financial buyers are not usually industry insiders and therefore are not presumed to have the knowledge permitting easily accelerated value generation from a specific acquisition. Additionally, sellers may believe that financial buyers, not having the synergistic potential that strategic buyers have, will tend to offer lower payouts to sellers.

This research hypothesizes that sellers believe that this information asymmetry affects the payout generated through the sales process. Although increased knowledge is assumed to produce increased value, does the small business owner believe that this simple equation is relevant to them? If so, sellers should develop strategies to respond to this expectation. In any given transaction, sellers likely have certain knowledge and awareness about the buyer type and how that could impact payout. Their belief that reducing information asymmetry could potentially increase payout influences harvest strategy development. Researchers have hypothesized that entrepreneurs thrive on a sense of personal self-efficacy to execute their vision. This describes an individual's belief in their ability to perform tasks and fulfill roles, and it is related to expectations, goal setting, and personal motivation (Kerr, et al, 2017). This sense of self-efficacy is an important and defining attribute of entrepreneurial small business owners (Chen et al, 1998).

A seller's tendency to pursue self-efficacy becomes significant when viewed from the perspective that sellers may be required to invest time and resources to reduce information asymmetry. At a minimum, reducing asymmetry requires a seller to possess reasonably well-developed business acumen and personal commitment as well as the deployment of often scarce firm resources. The literature is clear about the challenges that these constraints place on small business owners (Wennberg et al, 2010; Prisciotta & Weber, 2005). In this scenario, sellers become challenged to balance the ability and the cost of reducing information asymmetry with the potential benefit of increased payout.

The relevance of this research will be established through a direct analysis of harvest strategy development and exit experiences from the perspective of sellers. Current literature is limited by the difficulty in finding information related to private company strategy development and transactional records. Certainly, there is a great deal more information available regarding public companies (Terrell, 2003), but privately held companies greatly outnumber public companies (U.S. Small Business Economic Profiles for 2018, Thomas 2017). The ability to access private company data in this research study permits applying academic rigor to address practitioner concerns in an important way.

The impetus for this research comes from over 30 years of professional experience selling and restructuring private businesses. The researcher's direct knowledge of the specific attributes that define "private business" and the development of hundreds of harvest strategies over the years provide the means to analyze and interpret data collected from small business owners. In addition, new methods of qualitative comparative analysis are increasing the relevance of small study research into entrepreneurial businesses (Kraus, et al, 2017). These factors suggest that this research may offer not only a meaningful way to impact practitioners involved in business exit, but further questions for academic study.

# CHAPTER 2

# LITERATURE REVIEW

Most small businesses in the United States are privately held and owner operated (BizBuySell Owner Reports, 2019). This means owners are the primary drivers behind governance decisions, create and manage product and service models and often serve as key administrative managers as well (Gerber, 1995; Le-Breton-Miller et al., 2015).

When the principals of privately held firms seek to exit their businesses, the transitions are often complicated business deals requiring careful preparation and thoughtful negotiations. Significant time and resources must be expended to ensure that value-driven objectives are met. The transition process also has emotional motivations for the owners as well as value-driven realities. The investment of both personal and economic resources insures that exiting from a small business is a significant emotional decision for the owner (DeTienne & Cardon, 2012).

Academic literature regarding private business exit typically presume an owner's personal motivation and suggest the inevitability of an exit process. (Le-Breton-Miller et al. 2015; Wennberg & DeTienne, 2014; Gerber, 1995; Ang, 1991). These observations may help support an understanding of the nature of privately held small businesses and the reasons stimulating an exit process. What begs further understanding is the means by which owners connect these motivations and circumstances with the practical requirements and objectives that potential buyers bring to the marketplace.

Practitioner literature goes further and suggests that the nature of privately held businesses may complicate the owners' exit (Prisciotta & Weber, 2005). These structural and managerial attributes may be specific to these businesses, as is the nature of the owner's personal commitment to their businesses. The skills and talents that likely prompted business ownership in the first place, along with the complex and intertwined aspects of personal drive and capability, help define small business ownership (Gerber, 1995).

The owners of privately held businesses are sometimes considered *entrepreneurs* in the literature, defined as risk takers who are focused on future performance and willing to tolerate less certain results. These entrepreneurs attempt to empower management teams and engage expert support as available. This commitment to developing the business' infrastructure represents activity which can reduce information asymmetry (Axial Government and Finance, 2014). In contrast, *small business owners* are characteristically focused more on individualized, personally motivated decisions and ensuring technical competence within the company. Although usually not risk averse, they tend to have strong feelings about control, either through themselves or through family members (BizBuySell Owner Report, 2019). These characteristics can have the effect of reducing information transfer (Leland & Pyle, 1977).

Practitioner literature goes so far as to suggest that not all self-employed people are true business owners and not all business owners are elevated to entrepreneurs (Lane, 2018). The path which traces a progression from technician to businessperson to entrepreneur describes a business which can thrive on its own, leaving the entrepreneur to focus on value creation (Lane, 2018).

Because an exit process represents a sobering reality that all private business owners will someday face (Generational Equity, 2015), the distinction between entrepreneurs and small business owners implies an important difference which could have an impact on the exit process. Table 2.1 highlights some of the differences in identified characteristics between the entrepreneur and the small business owner and how they might impact an owner's exit process.

**Table 2.1**

*Privately Held Ownership Characteristics*

| ***Area of Attention*** | ***Entrepreneurs*** | ***Small Business Owners*** | ***Potential Impact in Exit*** |
|---|---|---|---|
| Risk | Risk-takers focused on future performance | Problem-solvers more committed to current operations | Premium placed by buyers on future performance |
| Management and Leadership | Empowered management teams and use of external support | Personal control perhaps using family support | Management teams are more transferrable and valuable; family control is not replicable |
| Growth | Often committed to growth at expense of current performance | Typically adopts management approach related to continued stability | Growth is highly valued to ensure ROI; historical profitability is less important |
| Exit | Strategy is developed as company matures. Usually better developed market signaling behavior. | Often lifestyle businesses for owners – strategy is an afterthought and signaling is sporadic | Strategic versus reactive approach will lead to better outcomes |

*Note*. Reprinted from *Raising Capital and Developing Exit Strategies for the Closely Held Business Owner: A Tutorial for Financial Professionals* by Prisciotta, D.A. and Weber, R.M. Copyright 2005.

The term “small business uniqueness” (Ang, 1991) is used to describe many of the systemic constraints or stressors that plague many private owners. Additionally, capital constraints limit owner’s resources and increase the uncertainty they are confronting. Moreover, small business operating expenses as a percentage of revenues are often higher than their public company counterparts, so their ability to scale-up is limited. An extra stressor for privately held business is the difficult position of vying for talent with bigger, more sophisticated competitors and this, in turn constrains growth.

Small business uniqueness also has a personal component. Five macro traits have been identified as characterizing entrepreneurial career choices and levels of success (Kerr, et al, 2017):

- Openness to experience - which speaks to an individual’s originality and their breadth and depth of mental and experimental life
- Conscientiousness – which describes socially prescribed impulse control
- Extraversion - which describes sociability, assertiveness, and positive emotionality
- Agreeableness – which contrasts orientation to others with antagonism and includes altruism, trust, and modesty
- Neuroticism – which contrasts emotional stability with negative emotionality

Understanding these traits provides guidance in small business research. It is difficult to disentangle personal attributes and motivations from entrepreneurial ownership. When looked at in relation to Table 2.1, these traits help put a face to entrepreneurial ownership.

As a result, they suggest that personal attributes and motivations may impact entrepreneurial exit and harvest strategy development.

Small privately held businesses may possess incomplete management teams, which can result in having insufficient resources to complete projects (Hillman and Dalziel, 2003). Accordingly, under-trained owners may attempt to bring value in areas where they are ill equipped to participate. Le Breton-Miller et al. (2015) suggest that private ownership and its influence on leadership and management are the root causes of the difficulties in small business' growth and subsequent financial success.

Because small business owners often have personal limitations in business and management skills, this can create complications in times of exit transitions (Hillman and Dalziel, 2003). To compensate for the owner's limitations, leadership models are created which rely on multiple constituencies, not just owners or shareholders. We observe that to develop and maintain an effective business, owners often employ these additional leadership resources to provide the sophisticated skills necessary to effectively run the business (Pouryousefi & Frooman, 2017). The exit transition process requires an equitable treatment of the various constituencies who contribute to the wealth and well-being of a business including employees, customers, business partners and the community (Bower and Paine, 2017). These management and leadership constituencies can represent a significant source of competence and value for the owner. In fact, Le Breton-Miller et al. (2015) further suggest that a small business is rarely maintained independent of a network of leadership resources. This view of business value creation and ownership obligations can have significant implications for harvest strategies during the exit transition process.

During small business exit transitions, business owners attempt to realize their financial potential (Pies et al. 2014). However, these owners have often achieved self-actualization by building a business imbued with their passion and commitment (Afrahi & Blackburn, 2019). If the owners' vision, passion, and control is what drives their business' value, then personal motivation is a key variable in the exit process (Wennberg & DeTienne, 2014). If it is financial performance that informs entrepreneurs as to whether their business strategies are effective or not, the decision to revisit strategy and eliminate a business is very much personal (Afrahi & Blackburn, 2019). Overall, small businesses are notable for the high level of personal identification that owners maintain with their business, which often represent a conduit for acquiring valuable resources and capabilities (Wennberg et al., 2009). Devaney (2003) reported that small businesses often reflect their owners' personalities (e.g., vision, passion, and control). These attributes help drive a company's culture and usually influence the business' entity value as well. These myriad ways in which owners are emotionally invested in their businesses can make identifying and valuing these firms difficult. These considerations stem in part from an information gap (information asymmetry) between the highly personalized firms and prospective buyers (Ragozzino, 2013).

The owner's ability to envision and inspire value does not necessarily insure its creation. Agency theory suggests that business owners hire managers or engage resource networks to drive firm performance, and it is this performance will subsequently create firm value. In this context, owners attempt to provide incentives and oversight to ensure that the managers achieve this task (Jensen & Meckling, 1976). Especially in small businesses, the importance of agency relationships is amplified because scarce resources ensure that the roles that managers and other agents play will have an out-sized impact on the businesses value (Gerber, 1995). But access to these resources likewise implies that the value must be shared in the transition process, usually at the cost of the business owner.

Various researchers find that owners play multiple roles in their businesses. In this case, the assumption of a simple dyadic relationship between business owners and their managers may not be realistic (Shapiro, 2005; E-Myth Blog, 2009). If the owner is both principal and agent, the objective of value creation becomes confused. Consider the owner who creates a personal lifestyle that influences management decisions and allows more temporal motivations (a higher salary) to challenge alignment with value creation. Lifestyle businesses are examples of situations where the ongoing operation of the business may serve multiple agendas (Gerber, 1995). This internal conflict of interest can reflect a significant hurdle to successfully handling an ownership exit transition.

For an owner, business exit may represent failure as easily as it represents the natural next step in the ownership lifecycle of the company. This is an important distinction, especially for owners who consider themselves to be the primary instrument for their company's operating success (Wennberg & DeTienne, 2014). Prisciotta and Weber (2005) suggested that if owners view exit transitions as a viable alternative in response to less promising options, they may be more willing to embrace their exit transitions. Additionally, recent research suggest that early exits from less promising ventures is important for the business owner (DeTienne, 2010): If an owner never considered an exit from the business as a desirable or likely outcome, they will be more likely to attach a sense of failure to ownership transition, strongly influencing how their motivation impacts the exit transition process (DeTienne, 2010).

Exit planning and exit strategy are important initial aspects of the transition process and permit information signaling by business owners to prospective buyers (Ragozzino, 2013). Numerous researchers explore the positive relationship between exit planning and economic outcomes for small business owners in transition (Wennberg & DeTienne, 2014; Gerber, 1995). These subjects are explored in depth in both academic and practitioner literature particularly as they relate to owners' intentions and the impact of the transition process for creating value for the sellers. Signaling is the way in which information asymmetry is reduced between strategic and financial buyers and owners who are attempting to sell their businesses (Ang & Brau, 2002; Devaney, 2003). Signaling can also be the result of financial due diligence undertaken by financial buyers prior to acquisition, and further could be the result of due diligence performed by sellers on their own behalf to impact the value of a transaction (Neves, 2005). Hence, signaling can be an important means to increasing a business owner's payout in an exit transaction.

One of the reasons that signaling is such an important concept is that small businesses often have under-developed leadership processes and operating systems. Even with mature products, strong customer relationships, valuable assets and operations, owners may find the ability to generate a desired transition result may not exist

(Shepherd, 2003). If the objective of the exiting owner is to present the business to the market in a manner that will maximize the sale price, then the owner will want to convey this to potential buyers in a clear and understandable way (Devaney, 2003). Presumably, the exiting owner’s transparency will decrease a potential buyer’s uncertainty and increase the payout to the seller (Ang & Brau, 2002).

To summarize this review of pertinent academic and practitioner literature, small businesses are often characterized by highly personalized endeavors that suffer from insufficient resources, systemization, and reporting (Gerber, 1995). This in turn reinforces the potential information asymmetry between business sellers and potential financial buyers. The circumstances of private ownership mean that financial reporting requirements are reduced, and the verifiability of operating information is lessened. The marketplace has less access to accurate firm data, which can reduce the value of the company to a buyer who is not knowledgeable about the business or its industry.

This research proposes to examine private business sellers’ beliefs and thoughts about different types of potential buyers as they seek to exit their business and generate harvest payouts. Few studies have examined how private sellers view different types of buyers and the impact that information asymmetry may have on payout. Strategic buyers are defined as those with industry or firm knowledge that potentially offsets the effect of information asymmetry. Financial buyers usually will not have the same level of knowledge as their strategic buyer counterparts, because they are looking primarily to achieve a target rate of return, independent of specific operating synergies.

These concerns produce several key research questions to guide this study. Research regarding information asymmetry suggests that if sellers offer a higher level of verifiable knowledge to buyers, then their payouts will increase. So, do the sellers of private businesses believe that this principal applies to them? Will buyers of a business with greater knowledge of the target company offer a higher payout for the acquisition? And, if sellers believe that there are relatively more financial buyers than strategic buyers, could sellers increase their payout by reducing information asymmetry thereby increasing the pool of knowledgeable potential buyers?

# CHAPTER 3

# PILOT STUDY

## Methodology

To test the research question, a qualitative pilot test was conducted using a sample of seven clients selected from a population of 93 ownership transactions, with the assistance of a large West Coast professional services firm. The method of selection used was opportunistic sampling. The clients were approached based on availability and expressed a willingness to engage in the study. The clients received services from 2014 to 2018. Services provided to the clients were in Corporate Finance (Mergers and Acquisitions, Valuations and Restructuring) and Financial Leadership Services (Litigation Support and Fiduciary Support). All respondents had either gone through an ownership transition or were contemplating the process. They were all leaders within their organizations and had (or have) an ownership stake in the business. They were chosen based on the depth of their involvement with the transition process and a stated interest in participating in the study.

Client data is proprietary to the firm, and a confidentiality agreement exists between client and firm in each case. The firm received specific approval from its clients to conduct these interviews and anticipates that the results will be used for research only. Approval for this process was received in an email from an IRB administrator at Temple, indicating that formal submission of the study was not necessary. This email is referenced in Appendix A.

The goal of the pilot study was to gain insight into the motivations and value considerations that influence small business owners when they exit their businesses. It is typical in business transitions that a checklist is developed by owners (or their professionals) to organize and manage the process (Howson, 2003). An example of a checklist (Table 3.1) is included. The actual interview questions are also provided (Table 3.2). These permitted consistency for the interview sessions with individual respondents and a means to initiate more in-depth conversation.

**Table 3.1**

*Checklist for Managing Business Transition*

| | |
|---|---|
| 1. | Financial Information |
| 2. | Products |
| 3. | Customer Information |
| 4. | Competition |
| 5. | Marketing, Sales, and Distribution |
| 6. | Research and Development |
| 7. | Management and Personnel |
| 8. | Legal and Related Matters |

| **Table 3.2** <br><br> *Open-ended Interview Questions* |
|---|
| 1. Please describe your transition objectives |
| 2. What is the relationship between your ability to signal the market and payout? |
| 3. Did (do) you feel that you had the ability to signal the market and maximize a harvest strategy? |
| 4. Were there specific business skills you identified as critical? |
| 5. How did the ability to communicate these signals impact your strategy? |
| 6. Why did you ultimately reach out to an external resource for help? |
| 7. Did these services provide a value-add in the context of the transition? |

If an owner's motivation is an initial driver of exit transitions, understanding how the owner links personal considerations and harvest strategy development is important. This relationship can influence the seller's emphasis on an increased payout that may substantially rely on information asymmetry between the seller and prospective buyers. While consulting and applied problem exploration absent scientific methods are not necessarily considered academic research (Myers, 2013), this type of interview process does permit a research understanding as it produces relevant and value-added practical knowledge. To develop a better understanding of the research questions, a qualitative process is employed (Elden & Chisholm, 1993).

Because qualitative research requires an interpretive philosophical assumption, the data supported looking at each small business subject as having their own identity and behaviors (Kelemen & Rumens, 2008). An attempt was made to adhere to a social constructive approach integrating owner experiences and empirical data. This is important for understanding small businesses, particularly those in exit transitions. The interviews attempted to synthesize an understanding of how the different factors that influence business transitions inform one another and impact activity. The goal of the study was to uncover theoretical knowledge and understanding. The literature suggests there may be a gap between understanding owner motivation and in executing ownership transitions to maximize payouts that current research has not filled.

There is no definitive guide for exiting a small business, but there are expectations for financial reporting, asset management and operating standards which drive transactions. The observed tension created by the gap between the owner's motivations and their operational ability to navigate and communicate the basis for a transaction is the qualitative driver behind this pilot study.

## Results

Table 3.3 shows the respondents characterized by ownership status, corporate structure, company size, and role as a buyer or seller in an ownership transition. The objective of the interviews was to explore the subject's perceptions of transition decisions and harvest strategies. The process was intended to shed light on the owner's perception of how market value factors and signaling can impact harvest strategies, as well as clarifying the respondent's opinions and feelings about their ability to navigate a business exit to maximize the owners' payouts and their transition decisions. The respondents also expressed their feelings about personal motivation in the context of perceived market value. With these respondents, an owner's motivation was an important factor stimulating transition decisions. The respondents share their own thoughts and feelings about the carefully interwoven nature of their personal motivation, information asymmetry, market signaling, and an owner's realized payout.

**Table 3.3**

*Respondent Descriptive Data*

| Respondent | Owner Demographics | Industry | Corporate Structure | Employees | Annual Revenues | Transaction Role |
|---|---|---|---|---|---|---|
| R 01 | 56 years old. Co-owner with brother (45%) | Metal Fabrication | S Corp | 50 | $10M | Seller |
| R 02 | 53 years old. Co-owner with brother (55%) | Metal Fabrication | S Corp | 50 | $10M | Seller |
| R 03 | 74 years old. Entrepreneurial owner | Conference Management and Travel | C Corp | 75 | $32M | Seller |
| R 04 | 38 years old. Equal thirds partner | Media Support | LLC | 20 | $6M | Buyer |
| R 05 | 64 years old. Name partner, minority interest | Law | LLC | 15 | $8M | Undecided |
| R 06 | 75 years old. Second generation | Retail | C Corp | 125 | $90M | Seller |
| R 07 | 40 years old. Minority owner (27%) | Trade Advisory | S Corp | 6 | $3M | Buyer |

### *Respondent's Personal Motivation*

The respondents were clear about the role that personal motivation played (or continues to play) in their exit process. This drove home the interrelated nature of small business – it is not possible to look at the business without also looking at the individual owners. The respondents discussed the underlying drivers behind their desire to exit the business and reflected on how the nature of the personal motivations impacted their view of the marketplace.

Business exit can be viewed in terms of relative levels of success, typically measured by financial payout or timeliness of the transaction (DeTienne, 2010). The respondents communicated their understanding of the inter-relationship between their personal motivation to exit and the expected results of a process.

The implications of the comments below express an underlying belief in each respondent's own ability to influence the exit process. This may not be necessarily because they believe, as individuals, that they have the skills required to successfully complete an exit. They express the belief that they are motivated and can properly signal the market to maximize value.

> R 03: I had gotten old and was frankly bored. It was hard to retain the entrepreneurial spirit after I had moved away (from Washington DC to San Francisco).

> R 04: I viewed the buyout as a (positive) opportunity... I was emotional. My feelings had been hurt... I was ready for a break (with my partners), but I questioned my own business savvy.

> R 06: I was done. I'm 75 and had been doing this all my life... Besides, we weren't making any money.

> R 05: The greatest motivation is that I'm 64 years old and I've had to start

> contemplating retirement. I’ve got to think my partner will want to retire sooner than me. That will compel me to have a greater focus on value.

*Information Signaling*

Each respondent expressed an understanding about the difference between having the acumen to create value in the business and having the ability to successfully signal the market. Market signaling for the respondent group could include financial reporting, preparing operating reports, developing organization processes and systems, or even creating and job descriptions. The relationship between value (ultimately exit value) and market signaling at a certain level was implicit in the responses, but in some cases, respondents explicitly offered a more significant understanding.

> R 02: Question: Do we have a team to do it (exit), by ourselves? Answer: No, no, okay. Why do you think you’re here? Somebody who has been to this rodeo before, somebody who has been there and able to strategically get things done quicker.

> R 05: Question: Is there a difference in your mind between do and can’t do (regarding strategic management and signaling)? Answer: Yes, don’t want to.

> R 06: Yes, value issues exist associated with information signaling. It’s too hard and I don’t know what to do.

> R 04: Regarding information signaling: Perceived gap in capability, perceived by all.

> R 05: I need to walk into an environment in which a lot of business considerations will be attended by others.

> R 03: The necessary skills to create value through information signaling are legal and accounting.

*Harvest Strategies and Perceived Buyer Types*

During the interviews, the respondents closed the loop linking market signaling with exit payout and buyer type. In this small study, the respondents discuss having learned from experience. In some cases, a certain sense of remorse or frustration is expressed regarding a missed opportunity. But the respondents clearly articulated their belief that a buyer's knowledge of their organization or the market has the potential to increase their exit payout.

> R 06: I foresaw problems with operations and communications and took action…in anticipation of a strategic sale. Which didn't work out.

> R 01: We have not had a financial audit done. People may not realize the added value we have.

> R 07: You know the thing about valuation is that it's hard to envision as we sit here about financial buyers and strategic buyers. A strategic buyer like I've been talking to is anybody who really knows your business and can step in. A financial buyer is a money professional who just comes in for the investment. I would look at this business and say, I can't do that. I don't know how to do that business. The valuation cuts both ways – it's nice to have the information, but you're putting a stake in the ground.

> R 04: We all perceived a (skills) gap associated with leadership and management. Filling it caused problems. Ultimately viewed buyout as an opportunity to reinforce culture and find value in future revenue.

> R 06: The issues exist. Acumen helps, third-party availability helps.

> R 07: It's just like when you have a realtor come in …to stage a house. You want someone who can help. I paid $25,000 and worth every penny. You really need somebody to help you – it's why you have an open house…you've hit the marketplace and you're ready to sell and you've got to talk the language…of the money folk.

Table 3.4 shows that each respondent is pursuing a harvest strategy that has evolved from their originally identified strategy. It is difficult to generalize a conclusion as to why this is, but there are indicators that may help to explain. The respondents were open about information asymmetry and its impact on the exit process and payout. The inability to effectively signal value impacted the original strategies. But the personal motivation for a business transition remained strong, and respondents reacted by adjusting their harvest strategies and ultimately their payouts.

**Table 3.4**

*Summary of Results*

| Respondent | Demographics | Industry | Owner Motivations | Original Harvest Strategy | Ultimate Harvest Strategy | Outcome |
|---|---|---|---|---|---|---|
| R 01 | 56 years old. Co-owner with brother (45%) | Metal Fabrication | Retirement Age | Sale to Financial Buyer | ESOP | In Process |
| R 02 | 53 years old. Co-owner with brother (55%) | Metal Fabrication | Retirement Age | Sale to Financial Buyer | ESOP | In Process |
| R 03 | 74 years old. Entrepreneurial owner | Conference Management and Travel | Under Performance | Sale to Strategic Buyer | Restructuring | Chapter 11 |
| R 04 | 38 years old. Equal thirds partner | Media Support | Owner Dispute | Sale to Financial Buyer | Consolidation | Partner Buy-out |
| R 05 | 64 years old. Name partner, minority interest | Law | Retirement Age | Wind Down of Partnership interest | N/A | None |
| R 06 | 75 years old. Second generation | Retail | Under Performance | Sale to Strategic Buyer | Restructuring | ABC |
| R 07 | 40 years old. Minority owner (27%) | Trade Advisory | Family Business | Consolidation | Strategic Sale | In Process |

Small business owners have a high degree of self-efficacy (Chen et al., 1998). The respondents each expressed what they felt they could contribute to the process and focused on fulfilling those identified needs. They all confirmed a continued desire to exit the business. Even if they were unsure whether they had the skills to execute a transition that would maximize their payout, they were confident they could ultimately adopt an effective harvest strategy.

The presence of information asymmetry suggests that buyers with different needs, skills and knowledge could offer different payouts to sellers. If this is true, then an owner's ability to successfully navigate a harvest strategy that maximizes payout comes from having the business savvy or skill to clearly communicate their business' value proposition to the market. In turn, this reduces the information gap, improving the likelihood of successful outcomes for buyers and increasing payouts. Payouts are measured not just as better financial results, but reduced risk and shorter time frames for consummation (Prisciotta, 2005).

## Discussion and Contribution

The initial implications of this pilot study point the way to additional research. It suggests that sellers believe that different types of buyers may be motivated to offer different payouts. Further, it suggests that sellers believe that market signaling might have an impact on their payout in an exit from the business.

The interviews emphasized the respondent's belief that closing an information gap between the seller and buyer in a private transaction could increase the payout to the seller. This point of emphasis suggests the respondents recognize the perceived power of market signaling. However, the interview respondents also stated that reducing information asymmetry is challenging for them as sellers, as it requires a level of business acumen and commitment to transparency that is difficult to achieve. However, through signaling, sellers could act for their own benefit. This coheres with research stating that small business owners are characterized by independence, control, and self-efficacy.

The respondents acknowledged that an owner that is unable or unwilling to properly signal the market with their company's readiness for sale or transition may have more difficulty maximizing their enterprise value. Reducing information asymmetry (by providing knowledge through market signaling) is a way to increase value. The implications are clear and compelling. If sellers believe they are able (through their own effort or through the effort of professionals) to increase the value of their business through market signaling they can be expected to engage in the process.

It is reasonable to posit that business owners might take this understanding and engage in fruitful and productive exit planning from their businesses. It appears that strategies to manage market signaling can be developed to make transition more fruitful. Small business owners can also develop a better understanding of how information asymmetry and personal motivations are likely to interact to influence the actual exit process.

Interestingly, each respondent's original transition intention ended up changing. Understanding how the respondent's viewed this circumstance was not part of the study, but upon analysis, it suggests an important point. The respondents' privately held organizations are greatly influenced by owner motivations. Was the ultimate transition decision driven by information asymmetry (i.e., driving for the best outcome possible), or was it made for unrelated reasons? The research question implies that sellers are primarily motivated by payout, but additional research could explore this question further.

The respondents did not speak to the idea of "a little" knowledge, or "enough" knowledge and how this might impact value. This idea that knowledge could be parsed to influence value could be especially important to a business owner. Further study could reveal how sellers view (and label) potential buyers and their beliefs regarding incremental information. A question could be, "how much information is enough?"

The next step in this research is expand the view and refine the story. Further probing of the labels "strategic" versus "financial" buyer will be an area of focus. What is the role that information asymmetry plays in distinguishing the two? The relative ability or willingness of sellers to reduce information asymmetry is critical – does it impact harvest strategies? Sellers are looking primarily to increase payouts, but they may be more motivated by other factors. They may simply be looking to "get out" of their business.

# CHAPTER 4

# FOCAL STUDY

## Objectives

This research study is a follow up to the pilot study and addresses how the expected payout from different buyer types influence a private seller's harvest strategy. Although there are similarities to the pilot study itself, the new study explores important differences that both advance the previous research and further inform our understanding of a seller's exit from their business. In the focal study, the development of a priori assumptions, informed by both the literature review and the researcher's own experience, permits the application of a pattern matching methodology to further explore the ownership transition process and harvest strategy development.

This research focuses directly on a seller's *perceptions* about different buyer types, why they believe these differences exist, how this understanding influences payout expectations, and ultimately how it shapes their harvest strategies. The literature has suggested that buyers with a strategic orientation similar to the seller's business likely have greater knowledge about the target business (Hege et al., 2009; Prisciotta & Weber, 2005; Devaney, 2003). If knowledge equates to value, then sellers should be motivated to ensure that all types of potential buyers possess the same knowledge as that of that strategic buyers. It follows that a seller's understanding of different buyer types and why these differences exist could influence harvest strategies and have a meaningful economic impact on an exit transaction.

This study assumes that sellers will always attempt to maximize the payout received for their businesses. Historically, one of the ways they have accomplished this was through transactions with strategic buyers (Hege et al., 2009). However, the current level of capital available in the private equity market has increased the opportunities for transactions with different types of potential buyers (Menghi, 2020). If sellers understand and believe that strategic buyers will offer a greater payout in an exit transaction because of their specialized knowledge, then sellers should be motivated to reduce potential information gaps across different buyer types (e.g., a financial buyer) by identifying and communicating company value to potential buyers.

Potential buyers can have an interest in a target company, but not yet have significant knowledge about the company's operations, performance, or market. Knowledge of a company can be developed slowly or rapidly with varying degrees of thoroughness (Devaney, 2003). We know that much of the knowledge which is available to strategic buyers can be made available to financial buyers through market signaling (Devaney, 2003).

Important markers of a company's value may not be understood equally by all potential buyers. This idea suggests that company value can perhaps be viewed on a continuum of relative company knowledge. It follows then that in the context of a business exit, a potential buyer's knowledge of the business represents a variable construct. The payout is of the utmost importance to the seller; hence, this research explores whether sellers believe that different buyer types will offer different payouts and the role that buyer's knowledge (information) plays in shaping that payout. If sellers believe that the primary difference between a strategic or financial buyer of a privately held company is rooted in a knowledge gap, a harvest strategy to reduce information asymmetry between the seller and prospective buyer should positively impact a seller's payout.

Figure 4.1 offers a graphic representation of this proposition. The underlying measures are intrinsic company value and degree of information asymmetry. In this representation, value is a measure that reflects payout or consideration paid to sellers in a transaction. There should be a direct relationship between the amount of information that potential buyers possess about a company and the buyer's valuation of that company. As a result, an information gap is the key factor in determining the transaction value. Market signaling is seen as the tool by which the information gap is reduced. Therefore, reducing information asymmetry through market signaling will increase value for the seller.

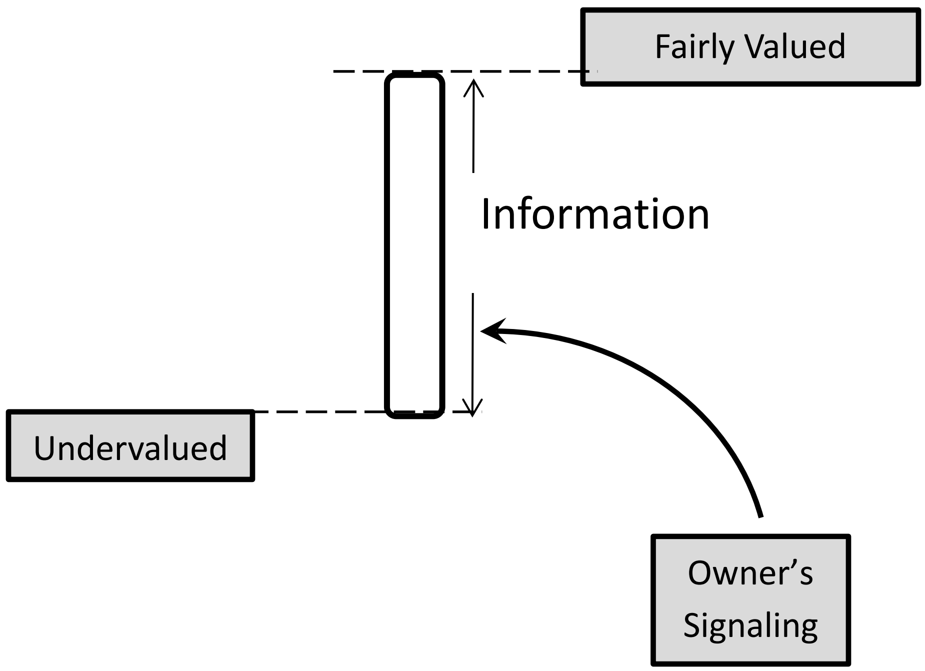


Figure 4.1. Private Business Buyers Information and Value Gap

Harvest strategies are developed when small business owners are determined to exit their business (DeTienne, 2010). In the initial pilot study, the views of seven private business owners regarding their business exits were explored including their opinions regarding harvest strategies. The implications of that research were promising, but incomplete. The objective of the pilot study was to gain insight into how sellers perceive the differences between financial and strategic buyers and then determine whether this understanding might influence their harvest strategy. However, the relationship among expected payout, buyer-type, and harvest strategy was not directly established.

The respondents in the study expressed a general belief that their actions were influenced by expected or potential payouts. The literature suggests that harvest strategies have many influencing factors, of which payout is a key consideration (Wennberg and DeTienne, 2014). Furthermore, the literature suggests that harvest strategies are often developed with different buyer types in mind (Brau, et al. 2008). However, the respondents in the pilot study did not link buyer type with their perceptions about payout.

While generally clear about an expected benefit associated with increased knowledge of the seller’s business, the respondents did not speak directly as to how this information might influence payouts. The implication of their observations was that increased payout could be more about the seller’s ability or willingness to reduce information asymmetry, not their perceptions regarding buyer type. In part, this result may have been influenced by the line of questioning pursued in the research. The questions in the pilot study were related primarily to the seller’s actions and their response to the resulting exit process. The focal study research put a greater emphasis on questions connecting perceived buyer type to expected payout and the development of harvest strategies. This permitted more significant observations relative to the defined research objectives. Ultimately the goal is increased understanding about how business owners view different buyer types and how they link this belief to expected payouts and subsequent harvest strategies.

Figure 4.2 shows a hypothetical relationship between knowledge and value while introducing an important modifier: a seller’s belief about the relationship between a seller’s perception of buyer type and expected payout. This presents a framework for allowing sellers to assess how information and value work together to influence payout. Figure 4.2's underlying measures are the seller's payout on the y-axis and company information on the x-axis in a private exit transaction. Seller payout represents the total proceeds to the owner, and company information represents financial and operating information that influences buyer decision-making. A solid line (a) represents the seller's belief that there is a direct relationship between the information provided to a buyer and the payout they receive. Broken line (a) 1 suggests a higher degree of efficiency in reducing information asymmetry, as payout increases at a greater rate than the rate at which the seller provides information to the buyer. Conversely, broken line (a) 2 suggests that reducing asymmetry has a lesser impact on payout.

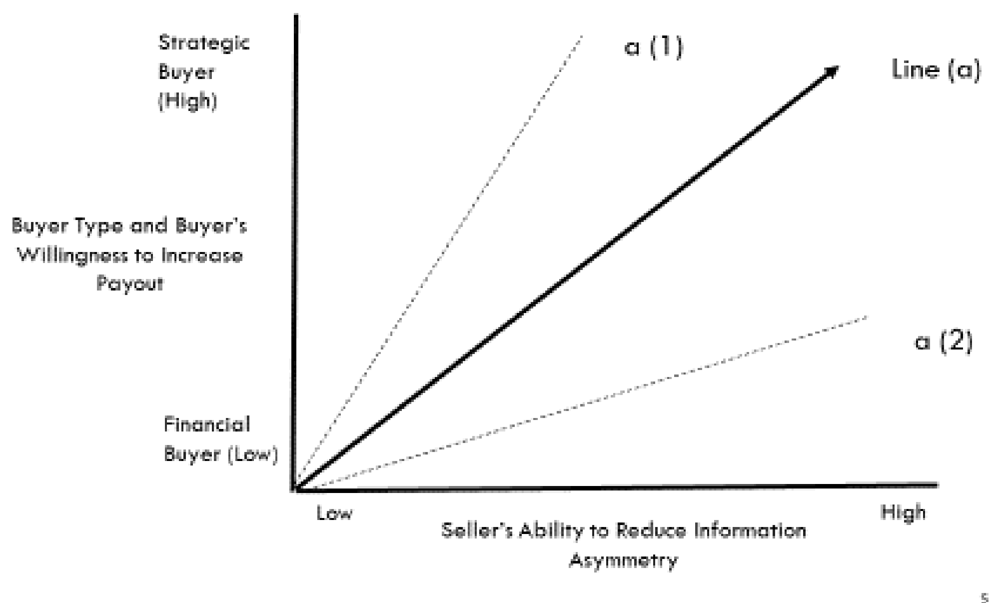


Figure 4.2. Seller's Belief about the Relationship between Buyer Type and Payout

The purpose of the graph is to not to illustrate the impact of specific information on the value of a transaction. Instead it is to show how a seller's beliefs about the relationship between information asymmetry and value could influence their harvest strategy development and behavior. If a seller believes that certain buyer types increase payouts based on reduced information asymmetry, this will likely influence their harvest strategy. The literature shows that private business owners (entrepreneurs) are motivated by personal considerations, motivations, and limitations (DeTienne and Cardon, 2008; Prisciotta & Weber, 2005; Neves, 2005). Thus, while specific transactions will produce different relative relationships between information asymmetry and value, a seller's belief in the underlying relationship is a reasonable proposition.

If sellers *believe* that different buyer types have higher levels of company knowledge leading to higher payouts, this could impact their behavior and the development of their harvest strategies. Sellers also have different levels of willingness and ability to provide information; if it is perceived that the act of reducing information asymmetry is linked to increased net payout (the increase in payout *minus* the cost of reducing information asymmetry), this should influence harvest strategies.

This allows us to frame an important question which helps to focus the way in which this research has a practical application to private business owners and other practitioners: To what extent do the sellers of private businesses believe that payout is related to a buyer's level of knowledge about their company and does this impact the development of their harvest strategy?

# Methodology

The focal study employs a deductive qualitative approach based on data drawn from interviews with business owners supported by original company information. Underlying propositions were developed as a product of professional observations, significant practical experience and a review of existing literature. Thematic analysis and pattern matching were used to help uncover and interpret support for these propositions in the context of the respondent's perceptions and beliefs (Pearse, 2019). This methodology demonstrates the underlying rigor of the research while permitting natural relevance and practical application. Pattern matching occupies a position between strictly subjectivist and strictly objectivist approaches to social science thereby providing uniquely structured flexibility (Burrell & Morgan, 1979). Likewise, this method allows for consistency in the data interpretation, which permits other researchers or practitioners to arrive at similar conclusions (Sinkovics, 2017).

The purposeful application of pattern-matching logic provides the structure for this research process. In this case, flexible pattern matching techniques apply because this research is exploratory in nature. Although there are identified research questions and propositions, there will also be an emphasis placed on the patterns and the explanation that emanates from the collected data. Because this methodology provides for the direct comparison of data collected compared to existing propositions, a priori conceptualizations based on practical experience can be included alongside current thinking as represented by the literature review (Sinkovics, 2017).

Flexible pattern matching matches theoretical and observational patterns and allows for the continued development and maturation of research questions and propositions as data collection conflicts and corroborates the validity of identified constructs (Sinkovics, 2017). Specifically, data collection includes in-depth interviews with business owners supported by relevant company information as necessary.

The starting point of any information gathering is usually a verbal interchange between analyst (researcher) and client (respondent). The researcher/respondent relationship is…essentially the crux of the matter (Urquhart, 1997). This relationship is buttressed by an analysis of available data; in this case company information as provided by respondents. The researcher's knowledge of a shared language of business ownership and transition provides an important ability to interpret findings. The researcher's professional experience and the review of available literature leads to the following propositions regarding this research:

(P1) Sellers can assess whether a potential buyer is a strategic or financial buyer.

(P2) Sellers believe their payout from financial buyers is less than from strategic buyers because of the financial buyer's reduced company and industry knowledge.

(P3) Sellers believe they can signal the market thereby reducing the information asymmetry between themselves and potential buyers.

(P4) The effect of reducing information asymmetry will be to increase the Seller's expected payout from financial buyers.

As stated, pattern matching provides the framework for exploring and testing the above propositions. This is a process of identifying key words and concepts from the responses of those interviewed. The technique specifically permits the researcher to determine each individual respondent's qualitative emphasis on the key words and to identify suggested themes. The researcher's understanding of industry-specific concepts and terminology permits an understanding of the data to insure maximum effect and increased accuracy (Pearse, 2019).

Pattern matching requires the development of a coding method and a coding memorandum to provide guidance in interpreting the research data and support its application to the propositions of the paper (Pearse, 2019). The coding method takes key words and phrases and attaches a simple code to them, which provides a method for analyzing the research data. Interviews with respondents are recorded and then reduced to text for analysis. Processing the data and searching for key words and phrases provided a more systematic approach and facilitated contextualizing individual respondent's thoughts and perceptions regarding their own business exit experience. See Table 4.1 for the coding memorandum.

**Table 4.1**

*Coding Memorandum*

| Code | Term | Definitions | Measures |
|---|---|---|---|
| OT | Ownership Transition or Exit Process: | Represents a transaction between the majority owner of a privately held business and a third-party buyer. This can also include ownership succession or restructuring. An ownership transition or an exit process are usually the result of a harvest strategy. | Generally, a binary measure indicating a business owner's decision to end the relationship with their business and the activities associated with executing this objective. |
| SP | Seller's payout: | Seller's financial return on completion of exit process. This includes direct sale proceeds, deferred returns and incentive returns. Payout can also include "softer" items such as employee retention or other favorable terms to seller. | Qualitative construct which may contain financial metrics impacting sellers. It likely includes non-financial factors as well. Data regarding seller payout is gathered primarily through interviews. |
| FB | Financial buyer: | Financial buyers do not have a common industry or a complimentary business relationship with seller. Acquisitions are based on financial considerations and estimated returns. Financial buyers generally have less knowledge of the seller's business. Transactions are typically valued on a stand-alone basis and how they serve the value of investment portfolios. This may be tempered by an assessment of the value of a future disposition. | Determination of buyer type is a qualitative construct maintained by the seller. Seller's assessment of buyer types will be gathered through interviews. |

| Table 4.1 *(continued)* | | | |
|---|---|---|---|
| SB | Strategic buyer: | Strategic buyers are competitors, have an industry connection or are in the seller's supply-chain. Awareness of the sellers' business permits rapid accretion of value for buyer. Typically, buyers absorb the seller's operations and seek synergies to either reduce costs or increase revenue. Strategic buyers generally have significant knowledge of the seller's business. | Determination of buyer type is a qualitative construct maintained by the seller. Seller's assessment of buyer types will be gathered through interviews. |
| IA | Information Asymmetry | Information asymmetry describes the gap in information or knowledge regarding specific company and industry information existing between sellers and buyers. It may also describe the differing levels of Information or knowledge maintained by different buyer types. There is a presumption reducing information asymmetry provides value. | This is a qualitative construct that reflects the relative understanding that sellers have regarding a buyer's access to and possession of information, knowledge about their company or industry. |
| S | Signaling: | Signaling (or market signaling) speaks to a seller's effort to reduce information asymmetry. This includes the ability to demonstrate effective operating systems, accurate financial reporting and documented management processes. A seller's observable ability to provide this information signals the company's true value to potential buyers or the broader market. | This is a qualitative construct of the seller. Seller's assessment of the importance and ability to communicate with the market will be gathered through interviews. |
| HS | Harvest Strategy: | A harvest strategy is the seller's plan to maximize payout while facilitating personal transition and providing a shift in control of the business. Harvest strategies describe a process which are generally initiated by an owner's personal motivations. They may be well-developed and considered, likewise, harvest strategy development can be reactive and incomplete. | Harvest strategies attempt to define a behavioral process which will be revealed through interviews with sellers |

Finding data based on private company transactions is often a challenge. A large West Coast accounting and consulting firm was willing to provide access to this type of data. Since 2013, the firm (with over 12,000 clients) had worked on more than 500 separate projects related to ownership transition. This included business combinations, mergers, acquisitions, corporate restructuring, and corporate valuations. From this population of 500, a subset of approximately 160 projects were specific to sell-side transitions. The services provided included accounting support and business consulting.

This group included public companies and larger privately held organizations. For the purposes of this research, privately held businesses that maintained revenues of less than $100 million and had fewer than 250 employees were the point of focus. These parameters ensured that the group fit the definitions of small business (roughly defined as less than $500M in revenues and fewer than 500 employees). Based on this information, a group of 30 potential respondents were identified. Emails were sent by the firm to the individuals in this proposed respondent subgroup inviting them to participate in an interview with this researcher. The result was a group of 10 respondents who expressed a willingness to participate in the qualitative research process.

All knowledge and data discussed in the interviews is proprietary to the firm and the respondent. The existing relationship between the firm and the respondents is predicated on non-disclosure and confidentiality. There are underlying agreements between the respondents and the firm insuring this. The firm and the researcher received specific approval from each respondent to conduct the interview, confirming anonymity and the intention that results are to be used for research purposes only. None of the research explores information which falls outside of the existing relationship between the firm and the respondent. See Appendix B for formal approval from the IRB to engage in this follow-up research.

The resulting group of 10 respondents were small business owner/operators who were relevant for the size of their organizations and the fact that they had had a sell-side experience. These were the key distinguishing factors of the group. The firm's willingness to identify and confirm the participation of the respondents provided valuable assistance. This factor can be duplicated or mitigated by subsequent researchers who have access to small business clients or contacts.

The specifics of the working relationship between the firm and the respondents was not relevant to the research process or results. Industry representation as well as transition results are included in tabular form in the summary of respondents, but specifics were not addressed in the research process. Kerr et al.'s (2017) working paper speaks to the fact that heterogeneity across entrepreneurs suggests that researchers should consider providing a unified discussion focused on key topics and concepts. For example, management structure, industry or locational qualifiers might not be as relevant in determining a respondent group of entrepreneurs as the selection of a meaningful subject or topic of conversation. The interview and coding protocols were agnostic as to these specifics helping to insure the replicability of the research.

The interviews were completed through Ring Central video conferencing, recorded through the system, and saved digitally. Subsequently, the interviews were transcribed into text files and preserved. The video files were uploaded to NVivo, which is a qualitative data analysis (QDA) computer software package. NVivo is a recognized tool which helps researchers to organize and analyze unstructured or qualitative data. It permitted an in-depth level of analysis on the data generated. A copy of the video recording or transcription file were made available to the respondents as requested.

Each respondent was asked to answer several key questions to provide insight into their specific transition experience and led to unique discussions with each respondent. Reliability constructs required that every respondent be asked to address each of the key questions. This provided a replicable and consistent platform from which the individual responses could be contextualized thereby providing the framework for data analysis.

The process described permitted a level of consistency in the interview sessions and a means to initiate more replicable in-depth conversation. This led very naturally to consultative discussions regarding the relationship between the respondent's perceptions, beliefs, and behavior. While consulting and applied problem exploration without employing scientific methods are not usually considered academic research (Myers, 2013), this type of interview process does permit a research understanding as it produces relevant and value-added practical knowledge (Elden & Chisholm, 1993).

Since flexible pattern matching was the chosen method for testing the research propositions, an engaged role for the researcher including active participation in the process was necessary. The researcher's knowledge and experience of private business ownership transitions further contextualized observations and explanations for the motivations and behavior of respondents. The ability to employ the associated language of this activity permitted identifying and clarifying respondent (seller) insight and permit theory identification (Myers, 2013). Thus, key words and concepts could be coded according to the coding memorandum to identify uncovered themes, beliefs, and observations.

Because the respondents are business owners (sellers) for whom ownership transitions or harvest strategy development is not a primary skill, the above process for interpreting data is appropriate. Recognition, organization, and the ability to cope with apparent ambiguity in the data are all necessary for the process of interpretation (Saldana, 2013). Interpreting results requires coupling the open communication process utilized with respondents and the researcher’s own industry knowledge, making a collaborative approach critical for identifying and recognizing themes and data points.

Developing a seller’s harvest strategy represented an unfamiliar business process for most of the respondents in this study. Therefore, an ancillary goal of this research is to further the knowledge of a seller’s transaction process and gain an understanding that permits practical applications (Kiraly, 2000). As necessary and appropriate, company information including company emails, financial statements and market data was made available to support the research. It is typical in business transitions that a functional checklist is employed to organize and manage transactional consulting engagements (Howson, 2003). As will be noted in the Results section of the paper, some specific company information was made available and reviewed by the researcher. An example of a functional checklist in Table 4.2 is provided to help contextualize the interview data.

Table 4.3 represents the roadmap employed in the interviews and relates the questions to the propositions being explored and codes being used to analyze the data generated by the research process.

**Table 4.2**

*Functional Checklist*

| *Functions* | *Key Reports or Materials* | *How it Informs the Transaction Process* |
|---|---|---|
| **Financial** | Income Statements, Balance Sheets, Cash Flow Reports, KPI Report | Financial data permits an assessment of company performance; quality of financial reports and ability to produce them routinely indicates commitment to financial health and value creation. |
| **Customer Information** | Customer Lists; Customer Profile and Analysis; Direct Customer Contact | Accessing customers and understanding their needs is a key to company value. The ability to evidence this creates value for buyers and may increase payout. |
| **Competition** | Proprietary Data; Performance Comparisons; Market Intelligence | Competitive data is an important benchmark for assessing value. This can be difficult to develop in markets with privately held competitors. |
| **Marketing, Sales and Distribution** | Market Analyses; Production Analyses; Pricing Materials; Distribution Data | Market information and corporate intelligence are a crucial building block in value creation. |
| **Research and Development** | Product Development Plans; Basic Research Results | A qualitative assessment of a company's pipeline of new products or services supports opinions of viability and evidences future value potential. |
| **Management and Personnel** | Employee Lists; Employee Manuals; Organization Charts | Entrepreneurial organizations tend to rely on an individual's vision and drive; the ability to attract talent and evidence cohesive resource structures creates value. |
| **Legal and Related Matters** | Pending Litigation; Corporate and Organizational Documents | Understanding the implications of existing litigation or corporate structural issues can have a critical impact on value and seller's payout. |

**Table 4.3**

*Interview Roadmap*

| Relevant Key Word or Concept (Code) | Interview Question | Associated Research Proposition |
|---|---|---|
| OT;FB;SB | Do you recognize a difference between strategic and financial buyers? Please characterize this difference. | P1 |
| FB;SB;IA | Is existing company or industry knowledge an important distinguishing factor for financial or strategic buyers? How might evidence of this knowledge be apparent? | P1; P2 |
| OT;FB;SB | Did the differences between strategic and financial buyers which you identified affect your decision-making regarding an ownership transition? | P1; P2 |
| FB;SB;IA | Do you believe the relative level of company or industry knowledge is an important factor for determining seller's payout? How might knowledge of this be apparent? | P4 |
| SP;FB;SB | Were your payout expectations influenced by your understanding of the differences between strategic and financial buyers? | P1; P2; P4 |
| FB;SB;SP;HS | Was your ability to understand different buyer types an important factor in developing your harvest strategy? | P1; P2 |
| OT;FB;SB | Can you conclude that strategic buyers possess relatively more company or industry knowledge than financial buyers relevant to a transaction? Do you believe this could increase seller's payout? | P2; P4 |
| OT;IA;S | Do you believe that generally speaking sellers have the ability to signal the market and increase a potential buyer's knowledge of the company? | P3; P4 |
| S;SP | Then, does it follow that signaling the market has the ability to impact seller's payout? | P3; P4 |

**Table 4.3**

*Continued.*

| | | |
|---|---|---|
| OT;S;HS | . Did you believe that you had the ability and necessary resources to effectively signal the market? Did this impact your harvest strategy? | P2; P3; P4 |
| SP;S;HS | . Did you believe that an investment in market signaling would be worth a potential increased payout? | P4 |
| FB;SB;IA;S | . Do you believe that signaling the market can reduce information asymmetry and influence financial buyers to increase seller's payout? | P2; P4 |

See Table 4.1 for Coding Memorandum. OT=Ownership transition or exit process; SP=Seller's payout; FB=Financial buyer; SB=Strategic buyer; IA=Information asymmetry; S=Signaling; HS=Harvest strategy.
P1: Sellers can access whether a potential buyer is a strategic or financial buyer.
P2: Sellers believe that their payout from financial buyers is less than from strategic buyers because of the financial buyer's reduced company and industry knowledge.
P3: Sellers believe they can signal the market thereby reducing the information asymmetry between themselves and potential buyers.
P4: The effect of reducing information asymmetry will be to increase the Seller's expected payout from financial buyers.

# Results

The interviews with the respondents were intended to explore the question “To what extent do the sellers of private businesses believe that payout is related to a buyer’s level of knowledge about their company and does this impact the development of their harvest strategy?” Moreover, they aimed to provide insight into the propositions with the hope of providing sellers with a better understanding of ownership transition and the means to positively affect their harvest strategies. In the words of one respondent:

When I go back to the days when my dad ran the company, he ran it in a way that didn't allow easy access to the kind of information that would paint the picture of security and opportunity for a potential buyer. But in reality, the private equity firms (potential buyers) really needed to be told what was going on, they really needed a higher level of information ultimately for the purpose of transition. The data are notable for the industry heterogeneity of the respondents, while initial harvest strategies and owner motivations show similarities. This reflects an important aspect of the research criteria; respondents chose to participate because they were engaging in an ownership transition. The underlying fact of their business circumstances likely influenced views regarding motivation and very broadly, strategy. The data suggests that to a degree, personal motivation and the strategic concerns of ownership transition can transcend different industries and business models.

These similarities, when viewed in the context of a heterogeneous group, validate the chosen research method. Matching key words and concepts can be expected to provide insight when a varied group of respondents engage in a specific process that although driven by complex variables, seeks a well-defined outcome

Table 4.4 summarizes the interview respondents providing industry demographics, current ownership status and stated motivations to pursue an ownership transition. In the table, the term “sale” refers to third-party, arm’s-length transactions; “generational shifts” are transfers of the business to family members from subsequent generations and business combinations are the merger of operating companies.

Table 4.5 summarizes the research process for each respondent and provides the chosen harvest strategies and a brief description of the respective ownership transition results. The term “sale” refers to third-party, arm’s-length transactions; subsequent employment refers to situations where the seller remains with the business under new ownership.

**Table 4.4**

*Summary of Respondents*

| Respondent | Industry Demographics | Ownership Status | Stated Owner Motivations |
|---|---|---|---|
| R 01 | Manufacturing | Operating business; unsold | Sale or generational shift |
| R 02 | Consumer Products; Professional Services (2) | Two businesses sold; retired | Sale (1); Business Combination (2) |
| R 03 | Financial Services | Two businesses sold; retired | Sale |
| R 04 | Artisanal Manufacturing | Business sold (post-coronavirus) | Sale |
| R 05 | Advertisement and Brand Building | Operating business; unsold | Sale |
| R 06 | Technology Support Services | Successful sale | Business Combination |
| R 07 | Technology Security | Successful sale | Business Combination |
| R 08 | Penetration Testing | Successful sale | Business Combination |
| R 09 | Human Resource Services | Successful sale | Business Combination |
| R 10 | Software Development | Business dissolved | Sale |

Table 4.5

*Result Summary*

| Respondent | Complete Interview | Company Information | Initial Harvest Strategy | Transition Result |
|---|---|---|---|---|
| R 01 | Yes, Spring/Summer 2020 | Financial Statements; Customer Profile and Analysis; Production Analyses; Employee Lists | Sale | Harvest strategy being executed. Interest from financial buyers |
| R 02 | Yes, Spring/Summer 2020 | None | Two sales; one with subsequent employment | Successful third-party sales to strategic buyers (2) |
| R 03 | Yes, Spring/Summer 2020 | None | Two sales | Successful third-party sales to strategic buyers (2) |
| R 04 | Yes, Spring/Summer 2020 | Financial Statements; Customer Profile and Analysis; Production Analyses; Employee Lists | Sale with subsequent employment | Successful third-party sale to strategic buyer |
| R 05 | Yes, Spring/Summer 2020 | Financial Statements; Corporate Documents | Sale to Financial Buyer | Harvest strategy continues – no transaction yet. |
| R 06 | Yes, Spring/Summer 2020 | Financial Statements; Employee Lists | Sale with subsequent employment | Successful sale/business combination |

Table 4.5

*Continued.*

| | | | | |
|---|---|---|---|---|
| R 07 | Yes, Spring/Summer 2020 | Financial Statements; Employee Lists | Sale with subsequent employment | Successful sale/business combination |
| R 08 | Yes, Spring/Summer 2020 | Financial Statements; Employee Lists | Sale with subsequent employment | Successful sale/business combination |
| R 09 | Yes, Spring/Summer 2020 | Financial Statements; Employee Lists | Sale | Successful sale/business combination |
| R 10 | Yes, Spring/Summer 2020 | None | Sale | Sale was unsuccessful; Assignment for the Benefit of Creditors was result |

*Frequency Analysis*

The identified key words and concepts were used in each respondent's interview. Although the words and concepts were introduced and part of a dialogue with the researcher, the frequency with which each appeared would suggest both a respondent's understanding and their belief in the relevance of the key word or concept. The software selected for data analysis permitted the development of a tool for this purpose. The resulting frequency analysis is presented in Table 4.6 to give context for this analysis, comments and observations which were offered by the respondents about each of the seven key words and concepts are provided (key words in italics).

**Table 4.6**

*Key Word or Concept Frequency*

| Respondent Number | Ownership Transition | Seller's Payout | Financial Buyer | Strategic Buyer | Information Asymmetry | Signaling | Harvest Strategy |
|---|---|---|---|---|---|---|---|
| R 01 | 0 | 9 | 54 | 56 | 4 | 3 | 5 |
| R 02 | 0 | 6 | 45 | 46 | 9 | 4 | 0 |
| R 03 | 2 | 14 | 29 | 25 | 7 | 2 | 12 |
| R 04 | 0 | 11 | 40 | 41 | 0 | 1 | 11 |
| R 05 | 0 | 9 | 29 | 29 | 0 | 4 | 3 |
| R 06 | 0 | 14 | 37 | 42 | 0 | 0 | 9 |
| R 07 | 2 | 0 | 30 | 27 | 0 | 2 | 3 |
| R 08 | 2 | 8 | 21 | 27 | 0 | 1 | 15 |
| R 09 | 4 | 8 | 16 | 16 | 0 | 8 | 4 |
| R 10 | 0 | 0 | 42 | 43 | 10 | 8 | 11 |
| **Total** | **10** | **79** | **343** | **352** | **30** | **33** | **73** |
| **Average** | **1** | **8** | **34** | **35** | **3** | **3** | **7** |

*Ownership Transition*

The frequency analysis indicates that each of the respondents were familiar with the key words and concepts, with the surprising exception of ownership transition. However, ownership transition in this context is a binary concept that made the discussion about it during the interviews less relevant. All respondents had been involved in an ownership transition: It was a predicate for their involvement and was treated as an assumption.

Respondent R 06 said, "And in doing so, you know, I learned a long time ago, when you start a business, you should always see an exit strategy from day one." And, Respondent R 10 offered, "I think any good company leader is thinking about the myriad of exit strategies (available) when growth options are available to her. I am always thinking about, you know, what are my options? Who would be my buyer?" The analysis to follow certainly supports these conclusions.

*Financial Buyer and Strategic Buyer*

The terms financial buyer and strategic buyer as measured by usage in the interviews were quite familiar to the respondents. Since these key terms describe alternative buyer types and form the basis of this research they are best analyzed together. By frequency alone, the respondents uniformly indicated awareness of these terms and they consistently used the different buyer types to help define the other. In other words, if a buyer was deemed strategic, this meant they weren't financial.

In a series of three comments, Respondent R 01 shared a clear perspective on strategic and financial buyers:

> So strategic buyers are going to be looking to expand upon their operations, not necessarily look for an opportunity to capitalize on growth. It'd be more so... something that fits in to their ultimate strategic direction...
>
> For a financial buyer, I would expect that we'd have to prove to them that there are opportunities on the horizon for growth. And then then it becomes a little bit more subjective...
>
> Like right now, those companies that would be interested in taking this on as strategic are currently our customers (are) so much intimately familiar with the operations of the company and the history of the company...

Likewise, Respondent R 02 stated,

> I don't think I would have found a financial buyer because I had a business that was not robust enough in terms of the number of large clients that we had. So, if I put myself in the shoes of a financial buyer and I was going to buy the future cash flows of a going concern, I would have a hard time predicting those cash flows with any certainty.

Respondent R 07 shared an awareness and a personal perspective about the differences between financial and strategic buyers:

> It would have always had to have been a strategic (buyer). Always. Well, first, I want to partner with somebody that is strategic because I'm strategic. It would be of no value to me to receive a cash buy-out and then my participation is over. There had to be a longer-term strategy that felt like I was needed and wanted (to create) value.

*Seller's Payout*

The term seller's payout also suggested familiarity based on frequency. As will be seen in the qualitative analysis, there was significant consistency in the interpretation and utilization of this term. This is particularly important because it represents a critical objective for each of the sellers.

The comments from the respondents are particularly revealing. Respondent R 09 stated,

> Yeah, I mean the interesting scenario in my particular situation was the potential for upfront payment vs. tail end payment. Larger potential on the commitment to a long-term scenario. And so, it came down to risk. What was my stomach for risk? - I absolutely had to weigh those different combinations.

Respondent R 10 was particularly open about their objectives regarding seller’s payout:

> Well, in my situation, we started off thinking we can actually sell this for some money, right? We think we can sell that for a couple of million bucks at least. And then it ended up being on ABC. So, I'm not sure if it applies to this particular situation. We ran a sales process for, I don't know, four months with strategic buyers as well as financial ones. And, you know, I had a few there at the end. But you know it ended up being a fire sale, an asset sale. It wasn’t a financially beneficial sale to anyone.

*Harvest Strategy*

The term harvest strategy refers to a penultimate culminating step in the transition process for business owners. The respondents expressed this understanding and offered some important qualifying comments. Respondent R 02 stated:

> But I had prepared the business for sale before and not (yet) found an adequate buyer. So, I had the financials and the projections, and the strategy all packaged up very tightly. And when I talked with the buyer, I was able to educate him on the comparatives of what a retail store within this category, with these kinds of revenues and these kinds of EBITDA numbers would typically sell for. Actually, I was able to show, I think a seven- or ten-year history of sales; it was a very enlightening picture of value.

Respondent R 03 summarized his interview with:

> I think that the advice I would give to somebody is, make your company look the way you'd want it to look if you were the buyer. If you were coming in to do due diligence on yourself, thinking whether or not you're willing to

> pay, you know, 25 or 30 million for this company. Make your company look that way and make sure that you can answer every question.

*Information Asymmetry*

This is a more sophisticated concept that was less familiar to the respondents in general, although it seemed to resonate. While there was less familiarity with the term, there was universal acceptance of its meaning. The understanding is more than simply, “providing knowledge creates value.” Implicit in the respondent’s message is a sense of self-efficacy that suggests enhanced value through their own specific effort to reduce information asymmetry. This belief extends through the understanding of signaling as well.

Respondent R 03 stated (reducing information asymmetry),

> It creates, it creates non-monetary value and maybe creates monetary value as well. It creates value in the sense that the due diligence process that you have to complete is significantly less. We also knew the challenge that we were going to run into going out to the market. We had no doubt we would be able to sell. But when you sell, how long is the process? How in-depth is the due diligence? What are the costs to get to that point?

Likewise, Respondent R 07 said, “Absolutely, for sure. I believe educating them (buyers) may provide a financial aspect that may have had them see something other than 1 X (earnings multiple), they may have seen a 2 X, 3 X or 4 X.”

*Signaling*

Likewise, the term signaling was obviously less familiar, but it was a concept that was recognized by almost every respondent. Respondent R 05 stated, “I think market's signaling really has to come from the perspective of the things that we're doing that are ‘firsts.’ And if we are not telling the story, we will miss that opportunity to have a differentiated moment.”

Respondent R 09 may have summed it up best, stating,

> The communication about what I was creating and what our vision was, is knowledge transfer. But there was also an innate understanding, I think an openness to it from the buyer. It's been a 100 percent successful (the sale of the business) and I wouldn't have traded it for the world. And I think it was because of knowledge that was created in the communication between the two entities that was synergistic.

*Respondents’ Understanding*

Frequency analysis was supplemented with an analysis of how the interview content affected the individual respondents. Obvious enthusiasm, direct comment and endorsement served to emphasize each respondent’s beliefs and understanding. The quotes that have been provided substantiate a qualitative assessment of the degree of the respondents’ engagement with the concepts of the study. In general, the respondents were engaged and knowledgeable business owners with a genuine interest in the process of selling their businesses. Although not professionals (R 02 had been a business consultant in his career), the interviews provided the type of feedback that made the qualitative assessment both possible and meaningful.

The first step in the appraisal of the interview was to analyze the data in a way to help reveal how each of the key words and concepts impacted the individual respondents. To facilitate this process, a comparison of the responses was employed by the researcher to help evaluate and interpret each respondent’s recognition and understanding of the key words and concepts. Since pattern matching aims to externalize implicit mental models and assumptions as much as possible in order to validate data findings (Sinkovics, 2017), a method for understanding the qualitative import of the key words and concepts is a critical component of the research.

Based on the interviews the researcher generated a scale ranging from one (1) not used or minimal understanding of the key words or concepts to ten (10), which represented frequent usage and a very clear understanding of the relevance of a specific key word or concept. The application of this technique in Table 4.7 provided a valuable tool for analysis.

**Table 4.7**

*Qualitative Appraisal of Respondent's Understanding of Key Words and Concepts*

| Key Word Qualitative Assessment | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Respondent | Ownership Transition | Seller's Payout | Financial Buyer | Strategic Buyer | Information Asymmetry | Signaling | Harvest Strategy | **Total** |
| R 01 | 8 | 9 | 9 | 9 | 9 | 7 | 7 | **58** |
| R 02 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | **70** |
| R 03 | 9 | 9 | 9 | 9 | 9 | 8 | 9 | **62** |
| R 04 | 7 | 6 | 7 | 7 | 2 | 2 | 4 | **35** |
| R 05 | 5 | 8 | 6 | 6 | 5 | 2 | 4 | **36** |
| R 06 | 8 | 7 | 8 | 8 | 3 | 3 | 7 | **44** |
| R 07 | 9 | 8 | 9 | 9 | 3 | 3 | 7 | **48** |
| R 08 | 9 | 9 | 9 | 9 | 4 | 3 | 8 | **51** |
| R 09 | 8 | 7 | 7 | 7 | 3 | 3 | 6 | **41** |
| R 10 | 6 | 7 | 7 | 7 | 3 | 3 | 3 | **36** |
| **Total** | **79** | **80** | **81** | **81** | **51** | **44** | **65** | **481** |
| **Mean** | **7.9** | **8** | **8.1** | **8.1** | **5.1** | **4.4** | **6.5** | **48.1** |

This analysis offers important insights. Three of the respondents' total scores were significantly higher than the others. In particular, one respondent had a "perfect score", which meant that their level of understanding of all key words and concepts was uniformly high, representing relevance and meaningfulness to this individual. These “scores” are wholly subjective, and hence do not lend themselves to a quantitative analysis. However, it is possible to see how both how the qualitative analysis reasonably reflects the frequency analysis in terms of usage and understanding. Moreover, the relative level of qualitative understanding is quite interesting when juxtaposed with the outcomes which each respondent achieved in their ownership transition.

*Expanded Understanding Assessment*

Frequency analysis and understanding analysis clarified the relationship that each respondent had with the key words and concepts allowing a deeper dive into the data. The next step in the pattern-matching process was to create a more in-depth qualitative assessment and link it with the actual results of each respondent’s specific ownership transition experience.

Table 4.8 provides an expanded qualitative assessment includes a summary of each respondent’s beliefs and ideas as presented in the interviews. The outcome of each respondent’s ownership transition is included for comparison. Although qualitative and anecdotal by its nature, this data suggests that a higher qualitative score is akin to a higher level of business experience and a broader business management skill set (business acumen) and suggests that higher levels of business acumen results in more successful ownership transitions.

A quote from Respondent R 06 is insightful for the recognition of what business acumen can mean: “If you're the expert in your industry (or running your business), you can tell this story however you want to tell it. Right?”

**Table 4.8**

*Expanded Understanding Assessment*

| Respondent | Qualitative Score (from above) | Qualitative Assessment | Result |
|---|---|---|---|
| R 01 | 58 | Clear understanding of buyer types; belief in process (commitment to planning); belief in seller's ability to influence | Harvest strategy has been developed. Interest from financial buyers |
| R 02 | 70 | Strong commitment to process and planning; strong belief in different buyer types; strong belief in seller's ability to influence payout | Successful third-party sales to strategic buyers (2) |
| R 03 | 62 | Strong commitment to process and planning; strong belief in different buyer types; strong belief in seller's ability to influence payout | Successful third-party sales to strategic buyers (2) |
| R 04 | 35 | Understanding of different buyer types; less committed to belief in payout influence; strategic planning is an afterthought | Successful third-party sale to strategic buyer |
| R 05 | 36 | High focus on payout; less emphasis on buyer types; less regard for signaling; value quotient is more random | Harvest strategy being developed |

**Table 4.8**

*Continued.*

| | | | |
|---|---|---|---|
| R 06 | 44 | Clear understanding of buyer types and influence on process; less appreciation for seller's ability to influence; emphasize ability to assess market; lower commitment to planning | Successful sale/business combination |
| R 07 | 48 | Clear understanding of buyer types and influence on process; less appreciation for seller's ability to influence; emphasize ability to assess market; greater commitment to planning | Successful sale/business combination |
| R 08 | 51 | Very clear understanding of buyer types and influence on process; less appreciation for seller's ability to influence; emphasis on ability to accurately assess market | Successful sale/business combination |
| R 09 | 41 | Some understanding of buyer types and influence on process; less appreciation for seller's ability to influence; emphasis on ability to accurately assess market and planning | Successful sale/business combination |
| R 10 | 36 | Some understanding of buyer types and influence on process; less appreciation for seller's ability to influence; reduced belief in relationship between knowledge transfer and planning | Sale was unsuccessful; Assignment for the Benefit of Creditors was result |

The final step in the pattern matching methodology is to pair the observations generated by the frequency analysis and the qualitative assessment to determine whether the research propositions were supported by the data (Sinkovics, 2017). The power of the methodology comes from this process. The ability to assess a priori concepts and theories which were developed through professional experience and a review of available literature with “living data” from relevant sources offers validity and context to the research (Sinkovics, 2017; Pearse 2019).

Table 4.9 shows each research proposition along with the relevant key word or concept codes. Based on either key word frequency or qualitative assessment, a determination of support is made for each proposition. This qualitative process relied on the expertise of the researcher to complete. Without the knowledge of the language of ownership transition and the researcher’s own professional experience, the process might have been less effective.

The interviews also yielded insights and themes that extended well beyond the pattern matching methodology to tell “a story”. Each respondent was generous in their level of thoughtfulness and engagement, which resulted in an opportunity to learn about ownership transitions in the respondent’s own words. The discussion section of the paper expands on this analysis and provides a treatment of some of themes and “stories” which were uncovered by the process. This may have been the most valuable result of the research.

**Table 4.9**

*Proposition Support and Thematic Suggestions*

| Research Propositions: | Key Words or Concepts | Key Word Frequency | Qualitative Assessment | Suggested Insights or Themes |
|---|---|---|---|---|
| **(P1)** Sellers can assess whether a potential buyer is a strategic or financial buyer. | SB; FB | Yes | Yes | Identifying buyer types as a means of initiating process |
| **(P2)** Sellers believe their payout from financial buyers is less than from strategic buyers because of the financial buyer's reduced company and industry knowledge. | SP; SB; FB; IA | No | No | Market forces play a critical role in value determination and seller payout |
| **(P3)** Sellers believe they can signal the market thereby reducing the information asymmetry between themselves and potential buyers. | S; IA | Yes | Yes | Ownership transition is a life-style decision |
| **(P4)** The effect of reducing information asymmetry will be to increase the Seller's expected payout from financial buyers. | IA; SP; FB | No | Yes | Motivation and seller urgency impact harvest strategy |

See Table 4.1 for Coding Memorandum. OT=Ownership transition or exit process; SP=Seller's payout; FB=Financial buyer; SB=Strategic buyer; IA=Information asymmetry; S=Signaling; HS=Harvest strategy

*(P1) Sellers can assess whether a potential buyer is a strategic or financial buyer.*

This was the case for these respondents; hence, the proposition is well supported. Each respondent spoke in the affirmative about their ability to assess strategic and financial buyers, but they did not always agree about the application. Respondent R 08 stated,

> It's also (that) strategic buyers to me represent more resilience in their investment, more accommodation in their investments. To me, it's not as much knowledge as it is resilience in the transaction and in the long run, commitment. Yeah, more commitment

Similarly, Respondent R 10 added, “My assumption would be if a financial buyer is looking purely at the unit economics, (it’s) because they aren't savvy in the industry.”

Respondent R 07 juxtaposed the different buyer types directly: “Right. I think there are some financial buyers out there that are sophisticated in that way. I mean, I was lucky that I had studied both financial and strategic buyers for several years and tried to understand their mindset.” From both a “hard” standpoint (frequency) and a “soft” standpoint (qualitative assessment), the respondents revealed a clear and consistent understanding of different buyer types.

*(P2) Sellers believe their payout from financial buyers is less than from strategic buyers because of the financial buyer’s reduced company and industry knowledge.*

This proposition was not fully supported from either a frequency or qualitative standpoint. The broad understanding of buyer type was not fully reconciled to the respondents’ understanding of payout and information asymmetry. In other words, the respondents recognized certain market realities and nuances that are not in their control. Respondent R 03 states,

> But it seemed like the financial buyers understood enough that they were actually willing to pay more than the strategic partners. That's probably not always the case. But in this case, it was. I think it comes down to something as simple as their cost of capital. Some of these guys represent PE firms and they have massive holdings. Wall Street connections. I just think they were able to bring in capital a lot less expensive than some of the strategic partners so they could afford it.

Respondent R 10 provided a further view of the inter-relationship of payout and buyer type:

> My assumption would be if a financial buyer is looking purely at the unit economics because they aren't savvy in the industry. I don't think it is so much information asymmetry as they don't have the education or the even purpose to be able to make a holistic evaluation of a company beyond its financials.

These responses suggest that different buyer types may be influenced by factors other than information asymmetry which can impact seller’s payout. This uncovered an important theme which will be addressed in the discussion section.

*(P3) Sellers believe they can signal the market thereby reducing the information asymmetry between themselves and potential buyers.*

The respondents clearly affirmed this proposition from both a frequency and qualitative perspective. This proposition fed into both the logical – “increased knowledge equals value” and the business owner’s (seller’s) well-developed sense of self-efficacy. This belief in the ability to signal the market was strong and recognized for the power it provided. Respondent R 10 stated,

> It’s something you have to intentionally do. (Devote) the time and resources of the company to build that knowledge and ability. And it's iterative. I would think it’s a best practice… Yes. Yeah, I think you can use market

> signaling, maybe not to close it (the knowledge gap), but to inform it, certainly.

Respondent R 06 offered a simple, clear understanding and belief in the basis of this proposition. Question: "…then do you believe that that is important for a seller to have the ability to signal the market?" Response: "Oh, absolutely. And I think I've had business failures in the past for an inability to pull that off."

*(P4) The effect of reducing information asymmetry will be to increase the Seller's expected payout from financial buyers.*

This proposition was not fully supported from either a frequency or qualitative standpoint. Although the respondents consistently supported their ability to signal buyers to reduce information asymmetry, the causal relationship between this ability and its impact on expected payout from financial buyers was not the sole factor influencing outcomes. Given that Proposition 4 implies agency, the effectiveness of which was not fully affirmed by the respondents. The sense that reducing information asymmetry would necessarily increase the expected payout from financial buyers was supplemented by other issues.

Although subtle, the respondents expressed a certain humility when it came to payout from financial buyers. Respondent R 10 stated,

> My assumption would be (that) a financial buyer is looking purely at the unit economics because they aren't savvy in the industry…they don't have the education or the even purpose to be able to make a holistic evaluation of a company beyond its financials. Sometimes if they have the right analysts working with them or, you know, someone who has some inside knowledge of industry, they can make better decisions.

R 04 provided a view that bordered on fatalistic:

> [Financial buyers are] more focused on kind of what you've done as opposed to influencing them. Did you follow that? If they're the right buyer, they're going to understand us better, understand your industry and understand what you are and what you're about.

The respondents did not share a belief that through reducing information asymmetry a seller would necessarily “close the loop” and make a financial buyer something other than what they are, despite their strong belief in the ability to signal the market. These results set the stage for an interesting discussion about conclusions which have become apparent in the above analyses and the themes which have likewise become apparent. In addition, the urgency in our current markets associated with the pandemic will be explored. The effect of these circumstances on business owners (sellers) is enormous.

# CHAPTER 5

# DISCUSSION

One of the measures of valuable qualitative research is how it is integrated with current thought paradigms. The research in this study may not provide dramatic enlightenment or precipitate significant change on its own. Instead, it broadens our current understanding and suggests paths for further research. One significant contribution of this research was its focus on private business owners. When viewed in the context of existing thought, this research's unique approach with regard to access to business owners offered rich opportunities for exploring the ownership transition process.

Table 5.1 shows the key words and concepts listed according to their relevance score (combining frequency with the qualitative assessment). The table juxtaposes key words and concepts with citations from the literature as discusses previously. This analysis grounds the research to the terms and ideas that have been the topics of academics and practitioners in the past. It suggests that the language of this study should be familiar and easily integrated into the current body of thought.

**Table 5.1**

*Key Word and Concept Relevance*

| Rank | Key Word and Concept Relevance | Code | Relevance score | Citation examples for use of terminology |
|---|---|---|---|---|
| 1 | Strategic Buyer | SB | **434** | Mercer, 1999; Howson, 2017; Prisciotta, 2005; Hege, 2009 |
| 2 | Financial Buyer | FB | **425** | Mercer, 1999; Howson, 2017; Prisciotta, 2005; Hege, 2009 |
| 3 | Seller's Payout | SP | **161** | Richomme-Huet, 2008; Bruce, 2006 |
| 4 | Harvest Strategy | HS | **140** | DeTienne et. al, 2015,2016 |
| 5 | Ownership Transition | OT | **93** | Wennberg, 2014; 2010; DeTienne, 2010 |
| 6 | Information Asymmetry | IA | **80** | Leland, 1977 |
| 7 | Signaling | S | **76** | Connelly, 2011; Gerber, 2017 |

See Table 4.1 for Coding Memorandum. OT=Ownership transition or exit process; SP=Seller's payout; FB=Financial buyer; SB=Strategic buyer; IA=Information asymmetry; S=Signaling; HS=Harvest strategy

Previous research served as the conceptual basis for this study and yielded the key words and concepts employed in the methodology. The relevance of these terms as determined in this study validates the earlier research and informs it. Specifically, the use of private company data to identify and explore the relevance of these terms and their application in actual ownership transitions marks a unique addition to the current body of research. My findings support and extend some of the key themes in the existing literature. Particularly notable is the prevalence of key word and concept usage, which includes support for both academic (Hege, 2009) and practitioner research (Prisciotta, 2005).

The relevance of small business uniqueness (Ang, 1991) as a factor in business ownership and harvest strategy development came up consistently in the responses. Likewise, ownership transition and harvest strategy as broad topics (see DeTienne, 2010; 2014; 2016) were bedrock concepts for the respondents. Each respondent maintained their own *a priori* understanding of owner exit and recognized that it was a process they would necessarily be engaging in. This generated an openness to engaging in the research.

As stated earlier, current research offers newer methodological approaches to entrepreneurial theory with a potential impact on harvest strategies. Recognizing the limitations of employing symmetrical correlational methods for analyzing entrepreneurial ownership, Douglas et al. (2020) employed a comparative qualitative approach – case-based in his instance – that recognizes the changing landscape of small-business and entrepreneurial research. The methodology and analysis employed in this study should advance this thinking.

Entrepreneurial exit and harvest strategy development is relevant to practitioner journals as well. Practitioners, such as consultants and accountants, help entrepreneurs build a business with an exit strategy in mind (Lane, 2018). This can include helping business owners develop the characteristics necessary for them to adopt in order to successfully complete an exit. Approachable qualitative studies such as this one will add to this body of knowledge and should adapt readily to practitioner acceptance.

Historically, the relationship between harvest strategy, buyer type and payout in private business exits has not received close academic study. This is primarily because it has been difficult to get reliable data. Newer methodologies may have a positive impact on this; they will facilitate novel and reliable data collection. And, qualitative research methods are currently being adapted to fit the circumstances of entrepreneurial ownership.

Necessarily, research regarding privately held businesses is considered from the inside, as opposed to viewing the subject from a detached, objective distance. However, the relevance of this study and its methodology is that uniquely valuable qualitative data is made more accessible to contribute to the growing body of research associated with private business exits. In this research and in other areas of social research, stories that emanate from business owners inform the culture and actions within an environment. Anecdotal history and the associated stories impact company knowledge and business value (Brockmeier & Meretoja, 2014). At the core of small business leadership, narratives form easily and are passed on organizationally over time (Gerber, 2017). Understanding this input required a knowledgeable researcher. The results of this research validate the approach taken.

Drawing together the results of these two studies indicates several rich themes which were suggested by the data. These themes were sometimes identified through the direct expression of the respondents, but often became apparent through the interpretation of the coding process and the subsequent qualitative analysis of results. Four themes stood out in the analysis. Each one represents an opportunity for further research, but it is in looking out them together that the story becomes clearer. Like a hologram, each element (theme) stands alone and offers insight. But when viewed together, a broader understanding is possible, and the story gains a personal element: Identifying buyer types as a means of initiating process; Market forces play a critical role in value determination and seller payout; Ownership transition is a life-style decision; Motivation and seller urgency impact harvest strategy.

During their interview, Respondent R 03 offered an insightful comment, stating,

> I think first and foremost, the decision about selling the business is a lifestyle decision. Right now, how do you go about doing it? Because it could be a lifestyle decision. In our case it was a bit of a hedge and a strategy. Let's get somebody to fund the company. Let's take some money off the table so we can get rewarded for bringing it to this point. But let's not take everything off the table so we can really be rewarded later on for setting up a really good company.

This comment offers important insight into the relationship that an owner’s motivation has on developing a harvest strategy. It suggests that individual motivation (“lifestyle decision”) has a significant impact when developing a strategy.

The literature review painted a picture of the private business owner as an engaged participant in their business. Usually the founder, often the chief executive and consistently passionate about achieving success. Private business owners are challenged to develop and execute exit strategies. For most of these individuals, the investment in their business represents the majority of their life’s wealth creation. It is natural that motivation and lifestyle decisions would come together in strategy development.

Further, this idea of motivation and lifestyle has another aspect. Here, R 07 expresses critical thoughts about the intangible aspects of ownership transitions:

> First and foremost, there were some intangible things that I would have been looking for if I had been looking, but I wasn't looking, which is always when you find the thing that you're not looking for. Right. Trust is one and the

> other is cultural fit. In 2010, we had a technology partner who came to us who wanted to acquire us, acquire us straight out. And they started out with a partnership. And during that partnership, we found that it wasn't a cultural fit. And I pulled out of the agreement before the merger occurred…we did not become part of that company.

Strongly personal and broadly motivated, this helps us get started in understanding harvest strategies that the owners of privately held businesses develop. But what are the implications for the transition process? The interviews revealed expected levels of self-confidence, but it was nuanced. In response to the question, “Does that difference (financial vs. strategic buyer-type) make sense to you? I mean, are you familiar with it?” Respondent R 03 offered: “Very familiar. I've been on both the sell-side and buy-side, so I'm familiar.”

But a certain humility was also expressed that suggests an appreciation for a bigger force (the power of the market). Respondent R 03 stated:

> You know, we knew there was the possibility of getting a little bit more in the marketplace, but we would have to expend significantly more energy and time to make it happen… I think it comes down to something as simple as their cost of capital. Some of these guys represent PE firms and they have massive holdings. Wall Street connections.

Our respondents were confident of their ability to identify buyer types and recognize that knowing buyer types, reducing information asymmetry, and signaling are the elements of an effective and participative harvest strategy. But ultimate confidence in the ability to positively influence and drive transition outcomes is measured. Certain elements associated with ownership transition can be controlled by sellers and certain elements cannot.

## Coronavirus Complications

The surge in Baby Boomer retirements means that more private businesses will be coming on the market as individual business owners seek to move onto another phase of life. This is a demographic reality which is not going to change. This factor has been and will continue to be, sharply impacted by the effect of COVID-19 and the various Shelter-in-Place (SIP) and modified economic reopening requirements being experienced nationwide. The anticipated recession will place additional stress on a small business owner's financial resources and will complicate developing a coherent harvest strategy.

The focal research for this study was conducted during the first six months of the coronavirus pandemic. It is fair to ask what impact this may have had on the respondents and the data generated by the research. I believe the fair answer to the question is two-sided. The impact on some was significant and not too much for others. In the case of seven of the respondents, the reference transactions had occurred prior to the pandemic and most associated earn-outs or tail opportunities had been realized. These respondents were speaking about their recent history and any discussions about the pandemic were closer to conjecture.

The situation was different for the other three. In one case, a deal had been negotiated pre-pandemic but had not closed. Subsequently, the deal was renegotiated and is scheduled to close in late-August. The purchase price has been reduced by approximately 20%, with more onerous terms established. Another respondent had completed an initial transaction approximately four years ago, with an additional step identified. This sales effort has been delayed by the pandemic and the potential for this next step is open-ended. Finally, one of the respondents is still in the initial process of harvest strategy development. This process will be extended indefinitely. Obviously for these three respondents, the pandemic feels like an existential threat for their business. Tellingly, these three spoke about their personal motivation and lifestyle considerations. The pandemic is serving almost as a crucible uncovering their most important issues.

So, will the future transition process look more like what the seven experienced, or more like what the other three are dealing with? The crucible of the post-pandemic marketplace will likely serve to ramp up the urgency of a seller's personal motivation. While challenging to individual sellers, this can be expected to require a greater consistency in small business harvest strategies. Post-pandemic market realities will likely force sellers to provide more and better company information. We can expect buyers to practice high levels of scrutiny, particularly when contemplating the acquisition of risky small businesses. Business owners may need outside help to understand and create an effective harvest strategy.

The current pandemic economy is impacting the potential sellers of small businesses enormously. Sellers are challenged by immediate term liquidity issues, medium-term operational concerns, and long-term business model viability. During this time, buyers have been reluctant to accept risk and are waiting for the dust to settle to see the depth of the recession. At the same time, the level of liquidity in the buyer and investment marketplace is at unprecedented levels. The pressure to cultivate investment in assets is very high and can be expected to increase. This fact may help keep the market for privately held businesses afloat.

The academic question that summarized the objectives of this focal study ("To what extent do the sellers of private businesses believe that payout is related to a buyer's level of knowledge about their company and does this impact the development of their harvest strategy?") remains relevant. The fundamentals of ownership transition have not changed. The current pandemic will likely act as an accelerant. Motivations will be enhanced, scrutiny will be increased, and a seller's business acumen will be needed to achieve an outcome that just nine months ago might have been preordained.

The thoughts and perspectives developed during this pandemic not only impact a seller's eventual expectations, but they will also likely lead to behaviors that impact the development of harvest strategies. The question then for business owners/sellers becomes simpler: "how can I learn to be more effective at selling my business?" The relevance of well-considered research into private-company transactions is compelling. This study can act as an example of the way in which academic research can inform and be translated into practical application.

## Next Steps

One of the benefits of this research is the way in which the respondent's validated the underlying questions and propositions associated with the study. Although not all of the propositions were supported, the language and concepts of ownership transition were clearly relevant to the respondents. That is positive, but it may be possible to take it further. One limitation of this research that suggests deserves follow-up was that only 10 business owners were interviewed. Although the methodology was sound, the research could be expanded in several ways. A survey methodology could reach more business owners, though it would require resource significant commitment by an institution with access to many privately held businesses. This would require that there was confidence that the research process would not negatively impact client relationships.

It is also possible to further explore this topic using additional individual respondents. Topics like ownership transition lend themselves to case studies. Identifying a willing participant seems unlikely to be difficult. Based on the knowledge acquired in this study, the ability to provide a broad view of ownership transition integrated with an in-depth analysis of an individual owner and their company seems very possible.

Beyond further research, application beckons. Strategies are created to be implemented. Are there ways that professionals can assist business owners? Translating this research into meaningful business results is the true next step. This means educating, consulting, and monetizing – helping owners turn a privately-held business into value.

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APPENDIX A.

IRB APPROVAL FOR PILOT STUDY

David M Comalli <david.comalli@temple.edu>

Hi Edward,

Thanks for the clarification. Given the information provided in this email chain, I do not believe you need to submit this study to the IRB. As described, your project does not meet the regulatory definition for human subjects' research: It is not designed to generate or contribute to generalizable knowledge.

If your design changes, that determination may change.

Thanks, and have a great rest of the day!
-David

On Fri, Dec 7, 2018 at 5:54 PM Edward Webb <EWebb@bpmcpa.com> wrote:

Hi David,

Since these are BPM clients, I don't anticipate asking questions outside of the relationship they have with the firm. These are individuals who are known to me and I expect we will end up having an engaged conversation. Please let me know if I can clarify further and thanks for your help. Have a great weekend!

**Edward Webb**

**Partner**

**Advisory Practice Group**

BPM

10 Almaden Blvd., Suite 1000, San Jose CA 95113

APPENDIX B

IRB APPROVAL FOR FOCAL STUDY

Research Integrity & Compliance

Student Faculty Center

3340 N. Broad Street, Suite 304

Philadelphia PA 19140

Institutional Review Board

Phone: (215) 707-3390

e-mail: irb@temple.edu

Not Human Subject Research Determination

Date: 14-Apr-2020

Protocol Number: 26742

PI: SCHMIDT, STUART Sponsor: NO EXTERNAL SPONSOR

Project Title: How the Expected Payout from Different Buyer Types Influences a Private Seller's Harvest Strategy.

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On 14-Apr-2020, the IRB reviewed the protocol 26742:

The proposed activity is not research involving human subjects as defined by DHHS or FDA regulations. Consequently, Temple IRB review and approval is not applicable. You are welcome to pursue the activity, obtaining any applicable administrative or departmental (non-IRB) approvals.

This determination applies only to the activities described in this IRB submission and does not apply should any changes be made. Changes could affect this determination, therefore please contact the IRB for guidance.

**DHHS Definitions**:

Research - a systematic investigation, including research development, testing and evaluation, designed to develop or contribute to generalizable knowledge.

Human subject - a living individual about whom an investigator (whether professional or student) conducting research:

Obtains information or bio specimens through intervention or interaction with the individual, and uses, studies, or analyzes the information or bio specimens; or obtains, uses, studies, analyzes, or generates identifiable private information or identifiable bio specimens.

**FDA Definitions**:

Research - any experiment that involves a test article and one or more human subjects, and that either: a) must meet the requirements for prior submission to the Food and Drug Administration; or b) the results of which are intended to be later submitted to, or held for inspection by, the FDA as part of an application for a research or marketing permit.

Human subject - an individual who is or becomes a participant in research, either as a recipient of the test article or as a control. A subject may be either a healthy individual or a patient.

For additional information, please see HRP-001 Policy - Definitions and HRP-421 Worksheet – Human Research on the IRB Forms & Standard Operating Procedures page.

Please contact the IRB at (215) 707-3390 if you have any questions.