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An introduction to management buy-outs

A management buy-out (MBO) occurs when a company's existing management team purchases the company, moving from employees to entrepreneurs, and offers the existing owners the opportunity to exit and retire. It can be a challenging experience, but with carefully selected advisors and investors, an MBO can result in an acquisition that is successful for the long-term.

How an MBO works

MBOs are similar in all major legal aspects to any other acquisition, except that due diligence is limited, since the buyers already know so much about the company. As such, the negotiation process also differs slightly than in traditional acquisitions, with the seller typically giving only the most basic warranties to buyers.

An MBO is usually funded through debt financing or private equity investment. In the former, the management team may be asked by a bank to invest a large portion of their personal capital into the acquisition, with the bank loaning the difference.

Alternatively, in a private equity investment, the buyers seek the necessary funds from private equity investors who will either grant a straightforward loan, or invest the money in exchange for a proportion of the company's shares. In this scenario, the buyers are often still asked to invest as much of their personal funds as possible into the acquisition, to assure investors of their vested interest in the company's long-term success.

Private equity investment is the more common route to funding an MBO, as banks consider MBOs high-risk, and are subsequently less willing to lend.

Benefits of an MBO

MBOs are highly attractive to sellers, as they will be more confident in the management team's ability to run the company skillfully and with dedication, thus minimising the risk of failure after completion, compared to if the business was to be sold to a third party.

For the management team buying the company, an MBO is appealing because it provides the opportunity for the team to gain greater financial rewards from the company's future growth.

An additional benefit of an MBO is that the management team already knows and understands the company, so due diligence is much less time-intensive and there is a minimal adjustment period after completion.

Tips for going through the MBO process

Maintain a unified vision

To start with, the management team must have a unified vision for the acquisition. This vision must be clearly communicated to all parties, including staff, to ensure that the business continues to run smoothly during the MBO. The team should also have a thorough understanding of all parties' expectations and concerns with respect to the buy-out, holding regular meetings with all stakeholders and advisors at every phase of the MBO.

Know what your investors want

When seeking investors, the management team must be prepared to show their competency as future business owners; investors will want assurances that the team is reliable, consistent, and capable of excellent leadership.

Additionally, investors will be looking for a business with a strong track record, solid market position, and lots of growth potential. The management team should therefore have everything in place to demonstrate these factors prior to meeting prospective investors. The team will also need to prepare and submit evidence of consistent profitability, robust financial systems and controls, a sound customer base, and any other factors deemed relevant to the business's ongoing success.

Work as a team

From the outset, each member of the management team should be delegated a different responsibility to progress the MBO. This will ensure that each team member is fully committed to the buy-out and willing to contribute towards its completion. Similarly, this will keep the entire team focused on its collective vision for the acquisition.

Get the right advice

Having experienced legal and financial advisors is essential to a successful MBO. The management team must be willing to collectively take on board the advice given, hold regular meetings with advisors, and must never hold back from asking questions.

Is an MBO right for you?

An MBO is often as challenging as it is rewarding, but having the right legal and financial guidance will reduce much of the stress and time demanded of a management team.

For more information, or for expert advice on business or personal legal issues, call us on 020 3475 6751 or via email at info@carterbond.co.uk

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