



What are the pitfalls of the buy-in management buyout and how can hostile staff be brought on board with the new regime? Paul Harrison investigates

In a management buyout there is often a piece missing from the puzzle and so an outsider can join the team. With a buy-in management buyout (BIMBO) you get the consistency of the existing management team knowing the business, and the incoming expertise of the buy-in team to add that essential element. But this is not without its pitfalls, not least how the existing staff will feel about the shake-up.

Lauren Roberts, from HURST's corporate finance team, says clear communication is vital to prevent uncertainty among the workforce. She oversaw the BIMBO at Salford traffic management and civil engineering firm Utilities Design & Planning in November 2016.

"A buyout can be the key to unlocking difficult transactions, particularly when the company requires further resources to enable the next phase of growth, whether this is with money or expertise," she says. "A sale can also be an uneasy period for employees but with a BIMBO you get the consistency of the existing management team knowing the business, and the incoming expertise of the buy-in team to drive the business forward. Success requires effective communication – employees need to buy in to the new management team and their plans.

Sarah Bennett, solicitor at gunnerbloom, agrees that employees must be involved. She says: "A BIMBO may be the right decision for the business but you can't just tell the employees to be different."

She cites the example of global communications agency Ketchum where the chief executive sought input from all 2,000 client-facing staff. Using a social learning platform, they developed an understanding in small teams of mixed seniority and markets. One lesson that can be taken from Ketchum's approach is that genuine, open dialogue can improve employees' understanding of and their commitment to a strategy.

"When a BIMBO is done right, it can provide an ownership stake for management, fill in any skills gaps from the management

“Start early and fully understand the goals of the vendor and buyout team. The later you leave it, the narrower the options.” **Brian Higgins**

team and ensure the future success of the business, resulting in a win-win scenario for everyone involved," says Bennett.

The North West buyout market is the most buoyant outside London and the South East. Nineteen deals worth £523m were completed in 2016, according to research by Equistone Partners Europe and Investec Specialist Bank – higher than Yorkshire, the South West and the Midlands.

With an institutional buyout (IBO), an investor, such as a private equity or venture capital firm, would acquire a controlling interest but also be looking to dispose of its stake within a certain time frame.

Rickitt Mitchell has advised on many deals covering all types of deal structure, including the £40m management buyout of Stockport travel company On the Beach. Partner Brian Higgins says: "The message is to start the process early and fully understand the goals of the vendor and the buyout team. The later you leave it, the narrower the options."

"There are a range of structures to consider based on the motivations of the exiting owner, the motivations of the management team and level of funding required. It may be that an existing management team wants to acquire a controlling stake in the business. Or it may be led by a private equity firm that

## CASE STUDY CITY AIR EXPRESS

City Air Express is one of the latest North West businesses to complete a management buyout.

The Trafford Park-based courier was founded in 1975, employs 80 people and has a turnover of £14m. The company delivers to more than 400 cities in 170 countries. As well as Manchester, City Air Express has offices in New York, London, Dublin, Belfast and Amsterdam.

The buyout in December was led by group managing director Jamie Knapper and his brother Jason with a 'seven-figure' funding package from the Allied Irish Bank.

Jamie had been a shareholder for 16 years and bought out founding director Adrian O'Connell, who has left the business.

Jamie says: "I wanted to expand the business and the only real way to do that was to take control with a buyout. So about 18 months ago I approached Adrian about buying his share of the business.

"I now want to grow the business by between £5m and £10m over the next couple of years. It's still very early days but I have a very good team around me."



Brothers lead buyout at City Air Express

wants majority control, an institutional buyout, but the remaining management team will have sufficient shareholdings to stay with the business, drive growth and realise their value when the private equity firm exits.

"If legacy or family succession is important, the exiting shareholders may seek to finance the buyout through providing loan notes and a retained minority equity stake."

## CASE STUDY WORKFORCE PEOPLE SOLUTIONS

Brexit presented an opportunity for Simon Hayton, managing director of Euroforce People Solutions in Bolton. The company, which is now called Workforce People Solutions, supplies European workers for companies in the furniture, textiles, automotive and logistics sectors.

Hayton had been working with advisers to prepare for the sale of the company since January 2014, with private equity investment the likely route, but the EU referendum in June last year changed all that.

He says: "We had three or four private equity offers on the table. But with Brexit looming, it became obvious that a deal wasn't going to be concluded in the timescale we required. I realised there was an opportunity to do a full takeover. I had quickly assemble a team of advisers who could put the bank funding in place and build the legal and financial framework of the deal. We also had to run the full process of due diligence all over again."

The £13m management buyout in October 2016 resulted in chairman and founder Patrick McBride leaving the company as part of the deal.

Any deal will need funding, whether it's from existing shareholders, or from a bank loan or private investment.

"Selling a business to an incumbent management team should be the most straightforward way for an owner to exit," says John Jones, head of corporate finance at Beever and Struthers. "But it can become difficult if the process is not managed properly and if the deal collapses there can be real damage to the ongoing working relationship."

If sufficient research and due diligence is done, a BIMBO can provide the best of both worlds.

"The transfer is often more efficient because existing members of the management are familiar with the business, while the new team are likely to bring with them a new set of skills and expertise," says Alison Brennan, partner at DTM Legal.

But this is not always the case. Three

common issues often arise during the process. The first is due diligence. It is essential to establish from the outset how the process will work and what warranties the sellers will provide. Where buyers have been involved in the day-to-day operation of a business many of the standard warranties will not be appropriate, but equally there will be areas where the buyers have not been involved and in these areas it is appropriate for warranties to be sought and given.

The next is funding. Brennan says it is important to establish what those funding the BIMBO require from the sellers – in terms of to what extent the funder will be happy to accept limited warranties – and from the buyers. For instance, are the buyers putting in loans, or giving personal guarantees? And are these to be backed by charges secured over property? If so, this may necessitate a fair amount of additional work and potentially the need to instruct independent lawyers.

The final element to consider is the relationship dynamic within the team. Buyers can often get caught up in the purchase process and fail to consider how their relationships will work on completion of the deal. Without proper planning, tensions can arise between the new owners.

"Ensure that appropriate service contracts and shareholder's agreements are in place on completion of the BIMBO so that the new owners understand their respective entitlements and obligations to each other and the business," says Brennan.

Richard Stark, director, corporate finance at KPMG in Manchester, says the BIMBO model is not one they see often, with the majority of mid-market private equity houses preferring to back an incumbent management team to deliver their plan. "BIMBOs carry more risk because the incoming management team can be unfamiliar with the 'nuts and bolts' of the business, and this is often reflected in the lower multiples achieved on transactions of this kind," he says.

"SMEs in the industrial sector have traditionally been more frequent targets. For example, we've come across high-net-worth individuals, or groups, looking to leverage their general industry experience and contacts to lead buyouts. These are often funded with the support of asset-based lending against the company's asset base.

"We generally recommend that shareholders put a succession plan in place when they are considering an exit and don't have the appetite to lead a buyout themselves. This provides an alternative route to a trade sale,

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# MBOs: OFTEN THE BEST OPTION

**BRIAN HIGGINS - PARTNER**

For owner-managers who have built up businesses over several decades through to large PLCs with subsidiaries that are no longer core to their operations, some form of management buy-out ("MBO") may be the right option. For a management team an MBO can offer them the chance to own the business that they have helped to grow.

Rickitt Mitchell has advised on a range of MBOs, from private equity backed deals where the management team take a minority position through to family succession deals where both family and non-family management members take full control with no external equity funder.

Our approach is to tailor the deal to fit the aims of our client. A management buyout is just one option available to business owners looking to reduce their financial exposure and their workload, but if it is the right option there are numerous forms it can take. Owners often do not realise how good the MBO option can be. Sometimes they may feel their team is not quite strong enough, but new senior management can be attracted as part of the deal if required.

A sale to a trade buyer inevitably tells members of your market that your business is up for sale and often requires educating a professionally cynical audience about the value of your company.

With a sale to the existing management everything can remain confidential and the MBO team has the advantage of understanding the real value of the business, as well as personally risking less cash in the deal. As such, the value can often be at least as high as a sale to the trade.



Once a value has been agreed for the deal, the key issue is how the transaction will be funded. This funding can come via a number of sources including various types of debt or a private equity investment and will be a key factor in how the buyout is structured. An experienced corporate finance adviser can both help prepare the business for seeking funding and also advise on the most appropriate funding structure.

Where the current owner and the team are looking to minimise the impact of external influence on the business it is common for the vendor to choose to help fund the transaction.

Such vendor financed MBOs can allow ongoing independence for the business and be an ideal form of succession planning, where the exiting owner retains an interest in the business for a period after handing control over to the team. Again, an experienced adviser can provide guidance on the appropriate balance of control for the management team and protection for the vendor until full payment has been made for the business.

potentially underpinning competitive tension and maximising value. Doing this early provides time for a smooth transition."

For managers trying to buy in to a company, James Dow, of Dow Schofield Watts, has this advice: "MBIs are notoriously tricky and can produce poor private equity returns, to such an extent that many firms and senior lenders will not support them."

"MBIs tend only to succeed where there is no natural existing leader in the business and this is recognised by the rest of the management team, or the situation is more of an institutional buyout and the institution brings its own management. In either scenario, MBIs only ever succeed when the business has such strong underlying fundamental economics that almost any fool could run it."

## BUYOUT TIPS

**ANDREW MOSS**  
corporate partner, DSG

1. Management shouldn't assume they're first in line. Owners will still want the best possible deal and inexperienced management teams may not be able to match external offers.
2. Don't assume it's a 'friendly deal' just because they have one foot in the door. Approaching the acquisition with as much background information as possible is crucial to showing they are a serious contender and, more importantly, a reliable buyer.
3. A common misconception is that management won't be able to afford to buy the business, but there are a variety of funding options available.
4. Don't underestimate the effect of taking time away from the business to do the deal on operations. Business can dip during and immediately after.
5. The final cost may come down to what is affordable. There is very little point in gearing the company up to the point where the debt can't be serviced or where there is nothing left to reward the management going forward.



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