FROM THE FOUNDER'S HUB

For Sale by Founder: A High-Risk Endeavor

According to the National Association of REALTORS®, 5.64 million homes were sold in 2020 and **93% of sales involved a real estate agent.** The average sale price with an agent was $318,000.
Now compare that to middle-market tech M&A. According to Pitchbook, 4,504 middle market tech companies ($20-$250M enterprise value) were sold in 2020 and **only 18% of those transactions involved an investment banker.**

It's irrational that nearly everybody uses a real estate agent when selling their home but so few use an investment banker when selling their business – a transaction that typically involves many multiple dollars and infinite complexity. Here's why these numbers just don't make sense, and why "for sale, by owner" is never the right approach for M&A or raising business capital.

The efficiency of residential real estate

According to the Wall Street Journal, there has been an "explosion" of home sales over $100 million – at least eight sold for more than that amount in 2021. Compare that to tech M&A where according to Pitchbook, at least 600 tech companies sold for over $100 million in 2020.

Residential real estate is a highly efficient business. According to Statista, the 90-day average of sale price to list price ratio for homes in the United States was 98.8% in 2020. This implies that, on average, few real estate agents are able to materially improve sale price. That's not surprising given the volume of transactions and transparency of sales data.

Further, nearly every home listing pegs value by posting an asking price (which in an inefficient market would be a poor strategy for maximizing value). Home prices are further constricted by the simple fact that homebuyers (unlike company buyers) are typically limited in their ability to materially improve home values. Finally, home sales (unlike company sales) are relatively cookie cutter; typically, there are only a few variables to negotiate and fewer still that are material.

Therefore one could deduce that the primary value that a real estate agent brings to the typical transaction is that they help sellers navigate an (often) emotional decision and facilitate a (hopefully) quick transaction with minimum effort by the seller. Make no mistake, this is a valuable service and it makes sense that 93% of sales involve a real estate agent. (Full disclosure: my wife is a licensed Realtor® in Austin).

The inefficiency of (most) middle-market business transactions

Middle market M&A is a highly inefficient business. Annual transaction volumes are measured in thousands rather than millions. Unlike real estate, there are few statutory requirements around disclosure resulting in extremely limited data transparency. Middle market transaction values ($20-$250M enterprise value) exceed all but a minute fraction of residential real estate deals. In nearly every instance the financial stakes for the founders are life changing.

And unlike real estate, M&A transactions involve many material variables to negotiate beyond price. Rarely, for example, does the sale of your primary residence require you to live in the home with your buyers for years after the sale or roll a portion of your equity in with the buyer.

But perhaps the most fundamental difference lies in the ability of the future business owner (unlike the future homeowner) to exponentially increase future value. Few rational people purchase a home with the expectation that they can increase the value of the home by a multiple of at least 3x in 5 to 7 years. For middle market private equity investors, that is typically the minimum expectation when underwriting a new investment. And by definition, private equity (financial) investors have more conservative underwriting criteria than strategic buyers. In the middle market, the expectation of future value is measured in at least the tens of millions of dollars. This is value that is traded between sellers and buyers.

Investment bankers maximize and demonstrate value

An investment banker can help the seller capture this value by crafting the story of your business and vision for the future into a concise narrative that resonates with buyers. They also help the seller engage with the highest number of qualified buyers in the deal process, driving competition and, ultimately, the best outcome.

Beyond securing a premium valuation for your business, a great banker will take into account your goals around cultural fit, strategic vision, and other non-economic considerations. In today's expanded marketplace, even the most savvy sellers can miss out on potential buyers within their industry. Your banker will also be instrumental in running an efficient and structured process that enables you and your executive team to continue focusing on the business throughout the transaction process.

Become part of the 18% of transactions that result in premium valuations with the help of expert guidance. **Talk to a partner at Scaleview Partners to learn how our approach to investment banking unlocks value and creates exceptional outcomes.**

ABOUT THE AUTHOR

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