

Exit Path

How to Win the Startup End Game

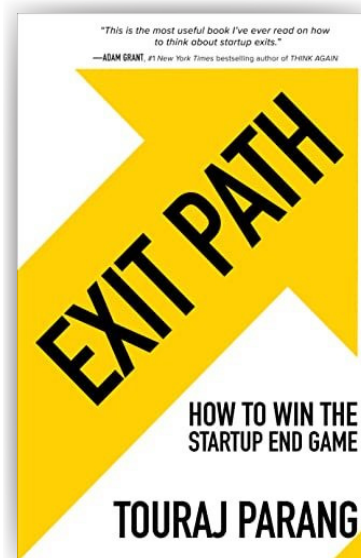
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KEY TAKEAWAYS

- *It's never too early for entrepreneurs to start developing an exit strategy.* Sale to a strategic acquirer is an effective way to achieve an organization's mission. Planning and implementing an exit strategy early can improve the odds of a positive outcome in the future. It also gives teams additional freedom to innovate and think more strategically.
- *A successful exit results when there is a willing buyer, a willing seller, and terms that both parties agree with.* To create an effective exit strategy, you must follow these steps: gather relevant information, align with your key stakeholders at an offsite, document your plan using the *Exit Strategy Canvas* framework, and iterate on the strategy over time.
- *Implementing your exit strategy entails playing the long game.* It's important to build relationships with potential acquirers. Internally, you must build an exit team that will help run the acquisition process while the leadership team keeps company operations going. An exit team should also include capable legal and strategy advisors.
- *Once you expect to sell your company in a year or less, you enter the short game.* During strategic discussions, don't lose sight of prioritizing the relationship with your counterparts and your overall objectives for a sale. The transaction itself will have two phases: the term sheet phase and the agreement phase. Both are intense periods that need to be handled delicately and effectively.

OVERVIEW

Silicon Valley investors and seasoned entrepreneurs alike know that acquisitions are the most probable path to success for startups. As a result, it's never too early for entrepreneurs to begin working on exit strategies for their companies. In **Exit Path**, Touraj Parang provides practical guidance on how to

effectively create the strategy, relationships, capabilities, and leverage that will lead to the best possible outcome in a sale.

PART I: A NEW PERSPECTIVE ON EXIT PLANNING

Often, entrepreneurs are reluctant to discuss exit planning with their investors and key stakeholders. Some feel that contemplating a sale is counter to the idealism of a new venture. Others believe that talking about an exit strategy is a distraction from the immediate work at hand. Both of these viewpoints have their flaws, however. Most startups don't operate as independent entities forever, so selling to a strategic acquirer is an effective way to achieve an organization's mission. With regard to planning an exit strategy, an early start will improve the odds of a positive outcome in the future.

One of the biggest and perhaps unexpected benefits of an exit strategy is that it enables teams to build stronger organizations that have less need to be acquired. When entrepreneurs know that selling is a viable path forward, they feel less stress and have greater ability to innovate, experiment, and think in more strategic ways. A viable exit strategy helps ensure that the startup team will create something with lasting impact. Even when pursuing an IPO, having viable sale options to acquirers improves the valuation and terms in an IPO.

As an entrepreneur, you can start taking proactive steps at any point in your journey to increase the chances of success and survival, which in many cases involves selling. The sooner you and your team act, the greater influence you'll have over the outcome.

PART II: CREATING YOUR EXIT STRATEGY

A successful exit has three elements: a willing buyer, a willing seller, and terms that all parties can agree to. You must establish how you'll evaluate potential acquirers. You must also determine how to develop the maximum amount of negotiation leverage. To create an effective exit strategy, you and your team should engage in the following steps:

- *Gather.* Create a realistic picture of where your organization belongs in the market and then brainstorm about your go-forward strategy. An offsite strategy meeting can be a helpful way to begin the exit strategy planning process and align on key objectives and outcomes with your team.
- *Document.* Capture the results of your brainstorming. The *Exit Strategy Canvas* is a helpful framework to use. This one-page document includes your definition of success, core hypotheses that must be true for a successful exit, strategic opportunities, key acquirers, risks and challenges, and key mitigants that would improve the chances of a successful sale.
- *Iterate.* Good exit strategies are living documents that teams continually revisit and revise. Gauge progress toward your exit strategy goals by using a red/yellow/green assessment for each of the Exit Strategy Canvas building blocks. By keeping your exit strategy top of mind, you'll find that "lucky coincidences" may be more likely to arise.

PART III: PLAYING THE LONG GAME

When you play the long game, you focus on implementing your exit strategy in an intentional and methodical way. The key to long-term strategy execution is building momentum. Momentum focuses the organization on immediate action, such as creating business connections and building new organizational competencies.

Four key activities are associated with playing the long game:

1. *Building relationships.* Before a meaningful business transaction can occur, the parties involved must know, like, and trust one another. Personal connections are the key to trust and credibility. Before a company is sold, the acquiring organization will spend an enormous amount of time and resources to evaluate the startup. Acquisitions rarely occur without a significant “courtship” period during which the acquiring organization learns more about the integrity, transparency, and competence of the team at the company they want to buy.

To build relationships, it’s essential to adopt a networker mindset, grow your network, create alliances, and cultivate champions among your allies. Great relationship builders tend to be humble and dependable, have high integrity, and act transparently. When it comes to champions, you should look for people who have the right combination of authority, influence, drive, and experience to make strategic initiatives happen.

2. *Building your exit team.* All too often, startups ignore the need for a strong exit team. Don’t make this mistake. Strong exit teams are mandatory for executing a successful company sale. The exit team will focus on the acquisition process, while the leadership team focuses on keeping company operations going. It’s useful for at least one member of the exit team to have experience leading transformational change.

Legal advisors are also crucial members of your exit team. When it comes to legal advisors, you tend to get what you pay for, so don’t be too cost sensitive. A seasoned legal team will help you respond to diligence inquiries and guarantee that your interests are reflected in the acquisition documentation. One way to mitigate legal costs is to help your legal team work more efficiently. Identify the work that your internal team can do on its own and what work must be done by attorneys.

Strategy advisors are another important element of the exit team. They act as a sounding board and offer guidance during negotiations. Look for a strategy advisor who’s been through several acquisitions themselves in the past and understands the post-closing integration process.

In most M&A transactions, private sellers don’t work with an investment banking advisor. These team members are more useful for large and highly complex transactions. Investment banking advisors generate interest for a sale and serve as a buffer during negotiations and the subsequent sale process.

3. *Creating leverage.* Leverage refers to your ability to influence outcomes. If you have leverage in a business negotiation, you’ll be more likely to achieve an outcome that’s to your advantage. Ways to build leverage include expanding your options, cultivating your insight, and enhancing the appeal of your company. With leverage in an M&A deal, you’ll have more alternatives, and you’ll understand the other party’s needs. Remember that an acquisition only makes sense to a buyer if the value created by the transaction exceeds the costs that they’ll incur for the purchase. If you know what truly matters to a potential buyer, you can proactively clarify any issues that might be creating concern for them. The key is to listen carefully and ask good questions.
4. *Learning and tweaking your exit strategy.* Monitor your momentum related to creating business relationships, developing capabilities, cultivating champions, and generating leverage. Keep the leadership team engaged over time with regular meetings. If you can create forward momentum via incremental progress, you’ll win the long game.

PART IV: MASTERING THE SHORT GAME

You find yourself in the short game when you expect to sell your startup company in one year or less. The short game can last anywhere from four to twelve months and the pace is fast. Remember that playing the short game requires different skills than playing the long game. There are three important areas to focus on:

1. *Your opening gambit.* The best time to sell your startup is when you're willing to sell, there are multiple interested parties, and you have strong leverage for negotiation. During strategic discussions, prioritize the relationship with your counterpart and focus on your high-level goals. These conversations should be a joint inquiry about how you can achieve your objectives and why a sale makes sense for the particular acquirer in question. A good rule of thumb is to put the *why* before the *how*. Remember that these discussions need to be well scripted ahead of time.
2. *Transaction phase 1: The term sheet.* A term sheet documents the general terms and conditions of a sale. It lays out the financial and nonfinancial terms, but a term sheet is usually nonbinding. Once a startup receives one term sheet, other interested parties may also offer competing term sheets for consideration. The sale process for a startup can be likened to a closed auction—buyers don't have insight into the other bidders or their bids. The typical process for a company sale consists of the following phases:
 - *Buyer outreach.* During this stage, seize momentum and plan for success.
 - *Preliminary diligence.* It's important to be as transparent as possible during the preliminary diligence phase—this will help you build a compelling case for potential buyers. Focus on building bridges by finding areas of strategic alignment, exploring how your company would fit into the acquirer's organization, and conveying excitement about the potential deal.
 - *Term sheet collection.* Establish a deadline for potential acquirers and convey that information to them. It's also essential to clarify the format of the term sheet that your team expects.
 - *Term sheet negotiation.* You must view every interaction with a potential acquirer as a negotiation. Assume good intent and use the negotiation to strengthen your mutual understanding with the team. Before acting, take time to think carefully.
3. *Transaction phase 2: Agreement.* After signing the term sheet, you must negotiate, sign, and close the deal. Your goal should be to get through this stage in an efficient manner. To keep things moving, anticipate and plan for the things that could slow the process down, strive to create bandwidth, and keep the deal team small.

An important aspect of transaction phase 2 is *confirmatory diligence*. This process enables the buyer to thoroughly evaluate the purchase and their assumptions. The more you can disclose, the better. Remember to get the acquirer to sign a nondisclosure agreement in advance, however. Gather documentation and data early, even before the term sheet is signed. During the term sheet negotiation phase, ask for a prioritized diligence request list; you can then get a head start on creating a virtual data room for the acquirer.

Integration planning needs to begin before the definitive agreement is signed. Integration activities typically focus on the value drivers for the transaction. Examples include the team and organizational structure; products, technology, and platforms; sales and support; and business enablement functions.

All acquisitions have a "Day One," which is the day after the transaction closes and the two organizations are joined under one umbrella. Announcement planning is usually handled by the acquirer's commu-

nications and investor relations teams. You should also be involved in the Day One planning, since you want to understand the experience that your team will have on the first day after the acquisition. The messaging must be consistent across all channels—this is the true key to success.

ABOUT THE AUTHOR

Touraj Parang is a veteran Silicon Valley dealmaker, seasoned entrepreneur, investor, advisor, and M&A expert who has sat in almost every seat around the table structuring and negotiating strategic transactions. Parang is currently the President and COO at Serve Robotics, which he helped spin out of Uber, and an Operating Advisor at Pear VC, an early-stage venture capital firm.

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