Business Best Practices

The "Wedding" Planner: Considerations When Selling Your TPA Firm

Selling a TPA firm to an outside party is very much like entering into a marriage. Once a TPA owner decides to sell the firm, significant planning must take place before any deal is closed. You want to make sure you find the right "mate," because "business divorces" can be very painful. The more you know about your own firm, the easier it will be to determine whether or not a prospective buyer is appropriate for your firm. Owners should inform their attorney and accountant of any plans to sell in advance of entering discussions with buyers to be alerted to special circumstances that could impact the sale of the firm.

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Profiling Your Ideal "Mate"

"Know thyself first." Take a close look at your own firm. Is it important to you to preserve the current culture? For example, if you are a high-touch "Nordstrom-like" personal service firm, then you might not want to sell to a high-volume, low-touch "Walmart-like" firm. Firms of either type can be very successful on their own, but when you merge two opposite types together, culture clashes can prevent long-term success. Think about where your firm falls on the Nordstrom-Walmart service spectrum, and then determine how that relates to the type of buyers you will consider. You may want to engage a consultant to help you prepare yourself and position your firm for a buyout.

Before you consider potential buyers, do your homework. Articulate the reasons you want to sell and what you want to accomplish and then prioritize these things in order of importance. You may not find a buyer that can meet all your criteria, so determine which things are "non-negotiable." Are you selling simply to cash out, or do you want your firm to become part of a larger entity for a reason? Is the timing of the buyout—or when you receive the cash payouts—important? Would you like to merge with someone because of services they offer to which you currently have no access? Does your firm serve a niche market that would be a nice addition to another firm? Would you like your prospective buyer to be geographically convenient, which might mean they are a current competitor, or are you thinking it would be more advantageous to expand into other geographic areas by joining forces? Are there any employees you would like to "protect" as part of any sale agreement? How long are you willing to work after the buyout? Explore all the reasons for selling and try to anticipate issues before they arise. Then think about what firms could be a good match for what you are trying to accomplish.

The "Courting Phase"

Buyers come in all shapes and sizes. You can find them through peers, networking, consultants, business brokers—and frequently they will seek you out directly. Once you enter into conversation with a prospective buyer, things can happen very quickly. In the first few conversations, you will likely offer some details about your firm. You may be comfortable discussing services offered, systems, employees, and perhaps even annual revenue. However, confidentiality at this stage becomes extremely important, so be careful. Protect yourself early in the discussions by asking the prospective buyer to enter into a "non-disclosure agreement" (NDA) to protect confidentiality.

Otherwise, word can get out to your employees or competitors that you are trying to sell and that type of information can be very damaging. A prospective buyer will want to gain knowledge in many areas of your business and will likely want to review three to five years of financials. Decide ahead of time what you want to know about the prospective buyer. An NDA should not be just about you confidentially disclosing information to the prospective buyer, but also should lay out terms for you to review more intimate details and the financial stability of the prospective buyer.

During this phase, you will want to determine who else, if anyone, in your firm will be privy to discussions with a prospective buyer. If you have one or more partners or there are other shareholders in your firm, you should inform them as soon as possible of any discussions regarding the potential sale. Sometimes senior managers are included early in the process so they can help you anticipate issues or help you do due diligence on the prospective buyer. It is usually best, however, not to include too many employees as this process can be very unsettling for most employees.

The "Prenuptial" Agreements

If the courtship goes well and progress continues, the discussions get much more serious. When a relationship gets serious, the two people often talk about "not dating others." When two firms consider a buyer/seller relationship, sometimes the buyer asks for "exclusivity," meaning that the prospective buyer may want you to stop entertaining any other offers until it is determined whether or not you can reach an acceptable agreement.

During this period, a letter of intent (LOI) is drafted, which is where any exclusivity clause would be noted. The LOI is not a legally binding document and does not have all the details that the final purchase agreement would have, but it provides a basic good-faith understanding of what the agreement would entail. It is good practice either in the LOI or in a separate document to outline the items and terms most important to you and reach an understanding on those before getting the attorneys involved in drafting the final agreement. During this time, it is best to "talk amongst yourselves" to work out many of the details, taking the time to understand positions each side is taking and determining what is important to each side. These documents then serve as a roadmap to assist the attorneys in drafting the final agreement.

As the owner, you will need to think about what your role will be if the sale is completed. Will you stay on—if so, how long? How would your compensation be determined after the buyout? What is your future role—rainmaker, COO, relationship manager? Will you work full-time or part-time? How much impact would you have on fees, operations, relationship management, and revenue going forward? Your ongoing role can be very important if you are going to be paid out over several years, based on current and future revenues, especially if there is an "attrition clause" that could lower your future payments if revenue goes down and/or clients are lost after the sale.

Planning the "Wedding"

Sometimes the details of the deal fall into place and the process moves very quickly at this point. Most often, however, the timing of everything is complicated and getting everyone in agreement on each piece of the plan can be very time consuming and even frustrating at times. There are certain things that will need to happen before any purchase agreement can be finalized. A business valuation may be required by the buyer. Also, in nearly all circumstances, a buyer (or representative) will come onsite to the seller's firm to perform due diligence. The due diligence can include inspection of the property as well as plan reviews, analysis of systems, reviews of processes and procedures, interviewing employees, review of billing processes, and so forth. You will need to think in advance about how to handle the logistics of this review and what, if anything, you will tell some or all of your employees. Get a complete understanding in advance of what exactly the buyer will require so you can anticipate any issue before the due diligence process begins. Many employers choose to limit the number of employees that are involved to only those critical to the process. You can make arrangements with the buyer to inspect the site during off hours or a weekend. You can also set up an offsite "data room" to maintain confidentiality while the buyer's representatives are reviewing plans.

Ideally by now, you and the buyer have worked out the main terms of the buyout along the way. Assuming the buyer is satisfied with the outcome of the due diligence review, it is time to fine-tune the final purchase agreement. It is customary that the buyer will present the seller with a contract. You will need to work very closely with your attorney at this point, making sure that the most critical issues are satisfactory. You will want to ensure proper indemnification clauses and latent liability clauses are designed to protect you in light of something

going awry in the deal. You will also want to review the terms of the deal with your accountant, making sure that the purchase price and the payout terms are acceptable and that you properly plan for the taxation impact. A purchase price usually is determined as a multiple of revenue or a multiple of "EBITDA" (Earnings Before Interest and Taxes less Depreciation and Amortization). The price can be affected by how much cash is paid upfront and the length of the payout term, as well as future revenues and attrition. Spell out the fine details regarding revenue generated from any accounts receivable and work in process at the time the deal closes as these items can represent a significant amount of revenue. It should be very clear which entity will collect and receive these proceeds.

At this time, you will likely want to finalize your own employment agreement for the future, as well as protecting any employees that you want to protect if the deal closes. If there is real property involved, you may need another agreement to specify any terms related to the purchase of buildings, equipment, and so forth.

Be sure to anticipate any costs associated with changes in, for example, hardware, system license agreements, personnel, and benefits. These can directly affect the profitability of the firm going forward and may potentially positively or negatively affect your payout. You also will want to work closely with the buyer at this point to develop a communication plan, taking into consideration getting information out to managers, employees, advisors, clients, the press, and other stakeholders. Determine who will deliver each message. Consider the impact on various individuals and decide if any special advance notice should be considered. Do you have any key employees who may feel threatened by the sale? Will the sale put any referral sources at risk? ■