SKIN IN THE GAME:
NAVIGATING POST-ACQUISITION STAKES
BENCHMARK
INTERNATIONAL

The concept of “skin in the game” in the business world is not just a catchphrase; it’s an ideology that defines the level of commitment and risk one has in a particular venture. Particularly in acquisitions, where future trajectories can be as diverse as they are uncertain, having a vested interest becomes paramount.

But whose interest should that be? The seller who’s stepping back? Or the buyer taking charge?

Both perspectives carry merit.

The Seller’s Angle: More than Just a Sale

From the seller’s viewpoint, having skin in the game means they’re not entirely cutting ties. Their legacy, passion, and future potential rewards stay anchored. They remain linked to the company’s successes, navigating unforeseen challenges, and reaping the fruits of post-acquisition growth. This ensures a smoother transition, continued guidance, and often a comforting signal to employees and clients that there’s unwavering trust in the acquisition.

The Buyer’s Perspective: An Investment Beyond Dollars

The buyer, on the other hand, may advocate for the seller to retain some stakes as it usually guarantees the seller’s commitment to the successful continuation of the business. It can be a safety net ensuring they get the full value from their investment, particularly if the seller’s involvement is crucial for growth, client relationships, or proprietary knowledge.

Practical Mechanisms: How it Works in the Deal Room

There are several tried and tested mechanisms for aligning buyer and seller objectives post-deal. Here are some of the most common.

Earn-Outs

Often chosen as a tool to bridge valuation gaps and mitigate buyer risk, earn-outs are contingent payments made to the seller based on future performance metrics of the business. It ensures the buyer isn't overpaying for potential that may not materialize, while the seller gets rewarded if they meet or surpass set targets post-acquisition. In essence, earn-outs can be a great mechanism for keeping the seller's skin in the game, aligning their financial incentives with the ongoing success of the business.

Retained Shareholding

Choosing to retain a share in the sold company allows the seller to still have a foothold in its future direction. This not only ensures performance under their partial influence but also provides financial benefits if the company's valuation rises. Key documents like shareholder agreements, consultancy, or employment contracts demarcate the exact terms and conditions.

An interesting facet here is the provision of exit strategies. The use of put and call options, defined by pre-agreed valuation mechanisms, gives predictability for future transactions.

- Put option: A mechanism that gives the sellers the option to sell ('put') their remaining shares back to the buyer at a pre-agreed valuation or valuation formula, within an agreed window.
- Call option: A mechanism that allows the buyer the choice to purchase ('call') the remaining shares from the seller at a pre-determined valuation or valuation formula, within an agreed window.

From a tax perspective, depending on the jurisdiction and always subject to tax advice, the sale of these retained shares normally becomes the taxable event.

Roll-Over into the Buyer (or into a Newco Established for the Deal)

In the landscape of acquisitions, the tactic of rolling over a portion of the sale proceeds into either the acquiring company or a newly formed entity post-acquisition offers compelling advantages. This approach not only synchronises the interests of all parties involved, but also stakes the seller's ongoing commitment to collective success.

Execution, however, comes with its own set of complexities. The formulas involved in calculating the exact percentage of shares from the roll-over value is influenced by a myriad of strategic factors – the amount rolled, the multiple applied to the new group, cash, and debt valuations in the new group, to name just a few.

In many jurisdictions, subject always to tax advice, it may be possible to delay the taxable event until the value of the rolled shares is realised.

Seller Financing

With seller financing, the seller essentially becomes a lender, effectively providing a loan to the buyer to complete the acquisition. Often referred to as deferred consideration, or simply 'defcon'.

This structure offers multiple benefits: it can expedite (or simply facilitate) the transaction, mitigate the buyer's financial risk, and offer tax advantages to the seller. Moreover, it keeps the seller engaged in the business, ensuring they have a financial interest in its sustained success.

As with any 'loan', credit risk needs careful assessment.

The Dance of Mutual Interests

In conclusion, the strategy of keeping skin in the game post-acquisition is as much about financial prudence as it is about trust, transition, and mutual growth. Both buyers and sellers need to weigh their options, preferences, and strategic goals to decide on the best path forward. It's a dance of negotiation, assurance, and foresight, ensuring both parties walk away feeling they've struck a harmonious chord for the future.

The idea isn't just to shake hands and part ways, but to continue shaping a shared vision. After all, the true measure of a successful acquisition isn't just the price on the closing documents; it's how both parties collaboratively add value in the chapters that follow.

ABOUT THE AUTHOR

TIAAN SMIT
TRANSACTION DIRECTOR
BENCHMARK INTERNATIONAL
T: +27 (0) 63 693 7741
E: SMIT@BENCHMARKINTL.COM