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Why Your Board of Directors Should Consider Selling (or Buying) Distressed Assets

By Frank Williamson

The start of 2021 looks very different from the start of 2020. The COVID-19 pandemic was a “make or break” as many already-struggling companies went bust while others boomed.

Within some businesses, a clear line appeared between divisions positioned to do well and those that were not. The term “distressed assets” — which usually refers to assets that are in or near default — can also refer to units or divisions that are no longer strategically important, competitive or profitable enough. It doesn’t necessarily mean that the assets in question are inherently of low quality, though. One company’s misfit might be another business’s missing piece.

continued next page

At the board level, members have an important role in helping management identify and make long-term decisions about their company's distressed assets, as well as how to allocate resources to areas that might thrive with additional investment. Board members' perspective and wisdom about a company's portfolio help executives plan and implement their organization's fundamental long-term objectives.

One out of many

A business can be viewed as a portfolio of smaller units or even as groups of customers, and part of managing any portfolio is getting rid of the parts that have a less favorable outlook over the long term and growing the parts that show continued strength. In the 1960s, Boston Consulting Group created a matrix to help organizations categorize their portfolio divisions into four groups based on market growth and relative market share:

- "Stars" have high growth and high market share, deserving additional investment.
- "Question marks" have high growth but low market share. Although they currently cost more than they bring in, some with potential growth might be worth investing in further.
- "Cash cows" have low growth but high market share. The money they generate could be used to invest in other areas of a company. Any investment in them should be only to maintain current trends or "milk" the division's potential as much as possible without causing harm.
- "Dogs" have low growth and low market share, making them prime candidates for a sale.

This template is still helpful today in simplifying what is often a complex evaluation. Viewing a business as a portfolio makes it simpler to measure success versus failure and to reallocate resources accordingly.

Questions for sellers and buyers

Once an organization has a clearer idea of where it needs pruning and where it should focus resources, the next step is to explore the possibility of a sale or purchase. Depending on its circumstances, a company might simultaneously

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seek a buyer for its distressed assets — usually “cash cows” and “dogs” — while investigating possible purchases of assets to further strengthen its “stars.”

Board members are often more familiar with the mergers and acquisitions process than their executive teams, whether they’ve worked as an adviser or participated in transactions as corporate executives themselves. As such, they can offer an important perspective.

Working in partnership with the executive team, board members should consider several questions when their business contemplates selling off a business unit, division or product category. Although some of these questions might seem rudimentary, not all of them have easy answers.

- Who would be the ideal buyer for these assets and how can we reach them?
- What’s the most effective way of communicating the assets’ value to prospective buyers?
- Is there risk in these assets, and how should that be explained to the buyer?
- If a transaction takes place, what’s a realistic timeline, and what would be the selling company’s profit?
- What are investors and creditors entitled to know before a transaction takes place?
- Who will be responsible for shepherding this project to completion?
- What will be the immediate and long-term effects of a sale?

Key decisionmakers for acquisitive companies should ask a different series of questions to ensure that any purchase of a distressed asset is handled in a prudent, purposeful way.

- When looking at potential acquisition prospects, what companies might most benefit from the cash generated from a sale?
- Who in our industry might consider a conversation about a potential sale?
- Do we have suppliers or distributors who tend to succeed when we do, and could we reach greater success through a merger?
- What can we do to set ourselves apart from competitors for potential acquisition prospects
- What would make sellers interested in taking part in a transaction?
- What details will our banker and investors want to know to gain their confidence and secure needed financial resources?

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- Who will manage the work of identifying potential sellers and negotiating a transaction?

What happens next

Although working through these questions will help your organization understand what a good deal might look like, it only scratches the surface of what turns a potential transaction into a reality. Your organization will need to put resources toward finding promising partners, researching the terms of similar deals and estimating the financial effects on your organization.

Frank Williamson is the founder of Oaklyn Consulting, a consulting firm that helps investor groups and private businesses, from startup to middle market, with mergers, acquisitions, capital-raising, investor relations, succession and other strategic corporate finance decisions. Oaklyn Consulting does not work as a broker but as an extension of clients' boards and management teams, charging time-based fees for investment banking advice.