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**Role Play**

**Licht aus (Lights out):**

Role of Haldermann

06/2024-6913

This role play was written by Eva Shen, John Rizzetto, Jusuf Merukh, and Tobias Funke, INSEAD MBA Alumni, under the supervision of Martin Schweinsberg, Associate Professor of Organisational Behaviour at ESMT Berlin, Horacio Falcão, Professor of Management Practice of Decision Sciences at INSEAD, and Eric Uhlmann, Professor of Organisational Behaviour at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

The authors gratefully acknowledge funding from the Hoffmann Institute.

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General Information (For All Parties)

Intelligente Beleuchtungssysteme (IBS) is a fast-growing German manufacturer of home automation products. IBS’s products are sold via electronic wholesalers who sell to electricians. Electricians sell and install the product both in new build residential as well as new build commercial buildings. The European electric wholesale market is dominated by a few large traditional (mainly brick and mortar) players with a high market share and strong customer loyalty. Recently, new pure-play online wholesalers have emerged and are growing rapidly. Due to their low-cost structure, they can be competitive on price, despite selling less volume than the large players. Any savings from cheaper procurement will not be passed through to the ultimate customer but will stay with the electrician, and in most cases the end-costumer will not know the brand of product installed in her/his home.

IBS competes with large, diversified electronics and industrial companies. The competition is mainly servicing the market via the top 2 traditional wholesalers, while IBS found its niche in online wholesalers as well as in smaller local wholesalers.

The underlying market for home automation products is growing above 10%. The main drivers for market growth are increased penetration of home automation solutions in new built residential buildings, driven by consumer preferences (increased connectivity) as well as increased regulation for energy efficiency.

Over the past years, IBS has significantly outgrown the market with annual revenue growth of 20-35%. IBS’ successful strategy centers around self-developed innovative products at a significantly lower price point than competing products, which makes them highly popular among electricians. IBS has further focused on a particular technological niche in the home automation space, targeting the high-end segment. Despite the significant scale and resource disadvantages vs. its competitors, IBS managed to gain substantial market share. Given the very lean and focused product portfolio, the company operates at a very high level of efficiency resulting in EBITDA margins of more than 50%, which is unheard-of in this industry.

Ms. Fischer has founded IBS about 20 years ago and has led the company ever since. While refurbishing her home, she increasingly became frustrated with the high market prices of home automation products and the lack of desired features. Being an electrical engineer by training and convinced that she could develop better products at a lower price point herself, she launched IBS. Since then, Ms. Fischer has run the company as CEO and has developed some of the most innovative products in the current portfolio.

As Ms. Fischer is approaching her 55th birthday, she is considering selling the company. She does not have any children who could take over the firm. She has hired the investment bank GT Corporate Finance to advise her on the potential sale of the business. Erika Haldermann, who is leading the sales process, has been working in the industry for many years and has focused on the construction segment in the past. As customary in this industry, the investment bank will be paid a certain percentage of the transaction value upon the successful sale of the company.

Over the past weeks, Ms. Fischer had several discussions with leading private equity firms in Europe that would be interested in acquiring IBS. After initial rounds with a broader group of potential acquirers, the field has been narrowed down to few potential parties. Also, competitors of IBS would be highly interested in acquiring the company.

Today Ms. Fischer and Ms. Haldermann are meeting with Ms. Preiss and Mr. Trachtner, both Partners at TCP Capital Partners, to negotiate acquisition terms. The parties have met during the due diligence on IBS, where Ms. Fischer has presented TCP Capital Partners with her business plan for IBS. However, they have not yet discussed the concrete terms of the potential deal. TCP Capital Partners is a leading European private equity firm with several offices around Europe. They have been interested in acquiring IBS for a long time and have signaled strong interest to Ms. Fischer and Ms. Haldermann over the previous weeks while conducting due diligence. Given their strong footprint and experience in this sector, they seem like a good partner to accelerate growth for IBS and expand its operations into new geographies.

On their way to this important meeting, both parties are discussing their strategy for the upcoming negotiation, hoping to be able to sign this deal ahead of the approaching Christmas break.

Role of Ms. Erika Haldermann – Managing Director at GT Corporate Finance and Advisor to the Seller for this Deal

You are Erika Haldermann, Managing Director at GT Corporate Finance, a boutique investment bank focusing on M&A advisory in the field of construction and building technology. You have been with the firm for more than a decade and have successfully executed many high-profile transactions in this industry. Due to your strong track record, you are well known in the industry and have particularly strong contacts within the large, diversified electronics and industrial companies that are the key players in the building technology sector and competitors to IBS. In the past, you were mandated various times by these players to advise them on acquiring new and fast-growing technology companies.

You have been talking to Ms. Fischer about the sale of IBS for more than three years after finally receiving the mandate following a pitch earlier this year. You are very impressed by the growth trajectory, the innovative products, and the very high margins of the business. Knowing the competitors well, you are convinced that this company is a true gem, and competitors would be willing to pay a high price to access IBS’s innovative product portfolio. In addition, private equity firms have increasingly been investing in this space. However, they are generally more conservative on the price.

After having done some informal sounding in the market, you conclude that a competitor would be willing to pay between 350-400 million EUR for IBS, while a private equity investor would most likely pay between 325-375 million EUR. You have not yet shared these figures with Ms. Fischer, who while a genius at developing innovative products appears to have an incredibly poor sense of the financial value of her firm. In general, a competitor can pay more than a private equity fund due to the potential synergies a competitor could realize from combining the two businesses. You are further convinced that a private equity player will ask for a commitment from Ms. Fischer to stay with IBS in the future, while a competitor would prefer a clean cut with the previous owner.

From your experience you know that it is very important to create the impression in a potential buyer of a strong alternative buyer at a potentially higher price point, preferable a competitor. You are concerned that stating a preference for a private equity buyer may significantly reduce the price a potential private equity firm may offer. At the same time, you hope that an overly low offer from a private-equity fund would make Ms. Fischer more willing to sell to a competitor at a higher price.

The Fee Structure

The amount of fee you and your team will receive is directly related to the valuation of IBS (1.5%). Selling to a competitor would consequently yield a higher fee for GT Corporate Finance than selling to a private equity firm. You would therefore benefit from either a high offer by a private equity firm or no deal at all, allowing you to open negotiations with competitors. At the same time, sellers often decide to grant a discretionary bonus payment on top of the 1.5% fee if they are highly satisfied with your service. Your contract specifies an additional potential payment of up to 0.25%, which you are hoping to achieve. However, the person who ultimately holds decision power over the sale and the discretionary fee is Ms. Fischer, who does not require your approval for a deal.

A Robust Offer

Before the meeting with TCP Capital Partners, you are planning to brief Ms. Fischer on the nature of a robust offer for her company. In general, a private equity firm has two options to structure their deal.

Option A: Negotiate and sign the deal now with a full guarantee by TCP Capital Partners to pay the purchase price. A private-equity firm normally pays the purchase price with a mix of equity (money from their fund) and debt (money lent from a bank). The use of debt to pay parts of the purchase price is customary and is often referred to as using leverage (this is why private equity transactions are often called leveraged buyouts). While the leverage increases the return for the private equity fund, the seller should be indifferent about this issue as long as she/he will receive the full agreed price. Consequently, the buyer takes the risk for being able to find a bank to lend money for the transaction. Failing to do so will decrease the private equity fund’s returns.

Option B: Negotiate and sign the deal now but make its execution contingent on TCP Capital Partners’ ability to find a bank to finance the deal within the next weeks. In this case, the seller carries the risk. If TCP Capital Partners is not able to find a suitable bank to finance the transaction, they have the option to withdraw from the signed deal. Consequently, there is execution risk born by Ms. Fischer.

Consequently, Option A is a lot stronger offer than Option B from your perspective and more beneficial to both Ms. Fischer and your bank.

In addition, sometimes private equity players make a certain part of the purchase price contingent on the company’s next year’s financial performance as per the presented business plan. While you have successfully closed various transactions with a contingent payment component in the past, it introduced additional uncertainty for the result of your client and with that for your fee. Despite her optimism about the future performance of IBS, you are planning to advice Ms. Fischer to limit the amount of contingent payment to a maximum of 10% to protect your bank and your fee.

In the past you had already informed with Ms. Fischer that a private equity buyer will most likely also request Ms. Fischer to continue working for IBS in some form as well as ask her to stay invested in the firm. You have not yet discussed concrete levels with Ms. Fischer, but you plan to do so ahead of the meeting with TCP Capital Partners.

To be clear, you should aim to agree on an **equity valuation** of the firm, in other words its total financial value [of all shares] in the company, as well as what percentage of the company the seller will retain (if any). The payment from the buyer to the seller will be less than the equity valuation, if the seller retains some percentage equity.