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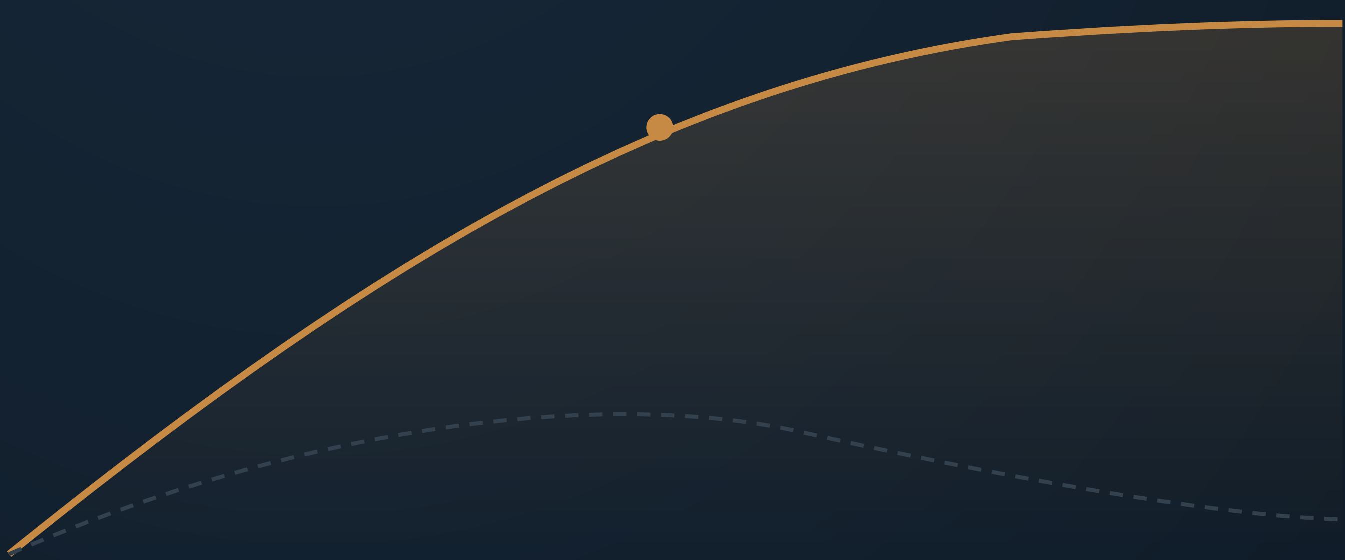
WORKING PAPER · No. 004 · TRACK B

The Preparation Frontier

Allocating a Finite Preparation Budget in Lower-Middle-Market Transactions

THE MISALIGNMENT TAX SERIES



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Abstract

Owners of lower-middle-market businesses are routinely advised to "get ready" before a sale, and the advice is almost always a checklist: clean the financials, tidy the contracts, modernize the systems. The checklist has a hidden assumption. It treats preparation as a set of tasks to be completed rather than a budget to be allocated, and it treats every buyer as interchangeable. Neither holds. Preparation time, capital, and owner attention are bounded, typically to a window of twelve to twenty-four months, and buyers price the same business against different underwriting models. This paper introduces the Preparation Frontier, a framework that treats readiness as a constrained allocation problem. It defines return on effort as the value recovered per unit of scarce resource, evaluated against four objectives at once: the certainty of closing, the protection of the downside, alignment with the buyer most likely to pay a premium, and the preservation of strengths the business already holds. The central proposition is that a preparation program selected by return on effort dominates uniform readiness effort, and that preparation calibrated to a generic or median buyer can reduce realized value rather than raise it, because it moves the business away from the specific buyer whose model rewards it. The framework is developed as a set of testable propositions rather than a measured result. It builds on three prior Cordis Institute papers: the aggregate post-LOI gap documented in Working Paper No. 001, the buyer-archetype divergence in Working Paper No. 002, and the execution-stage compression in Working Paper No. 003.

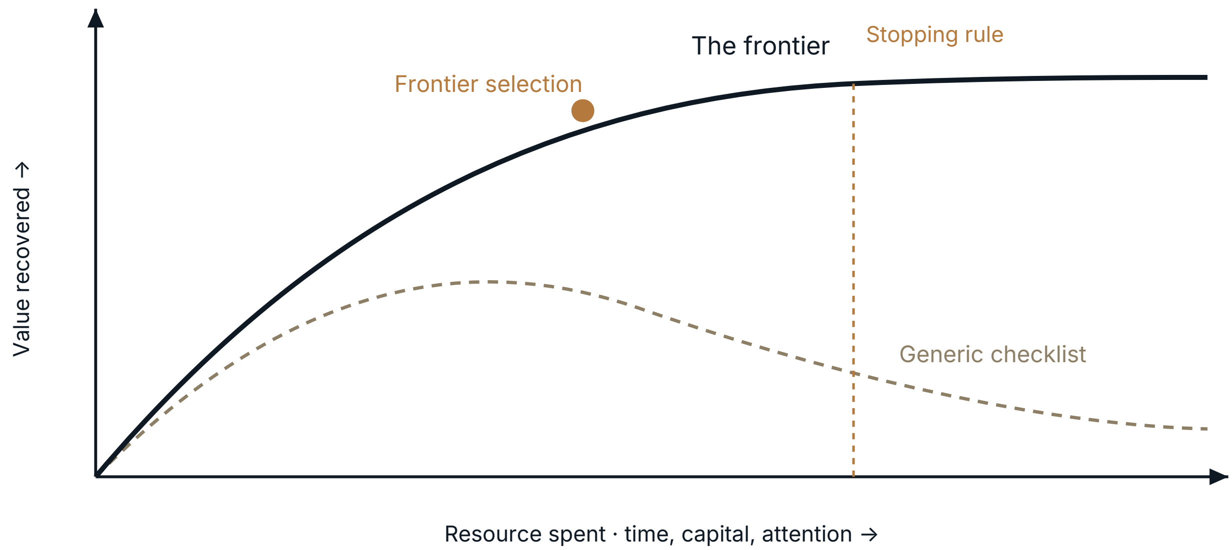
Keywords: mergers and acquisitions, lower middle market, transaction preparation, resource allocation, buyer archetypes, post-LOI adjustment, exit planning, private equity
JEL Classification: G34, G32, D81, L26

KEY FINDINGS

- Preparation is a budget, not a checklist. Time, capital, and attention are finite, and cannot be spent on everything.
- Return on effort is the deciding metric: the value a fix recovers per unit of scarce resource.
- A fix must earn its place against four tests at once: certainty, floor, buyer-lane fit, and preserved strength.
- Preparing for the median buyer, who does not exist, can move a business away from the buyer who would have paid a premium.

EXHIBIT 1

The frontier recovers more value per unit of effort; the generic checklist spends more to recover less.



Cordis Institute framework. Illustrative; axes are conceptual, not measured.

1 The preparation budget is finite

Most writing on sale preparation describes what a well-prepared business looks like. It rarely asks what a specific owner should do first, given that no owner can do everything. That omission is the whole problem.

> *A checklist implies that the goal is completion. A budget implies that the goal is selection.*

An owner preparing a company for an eventual transaction spends from a fixed account. There is a limited number of months before a process begins, a limited amount of capital that can be diverted from operations, and, scarcest of all, a limited amount of the owner's own attention. The Exit Planning Institute's readiness research has long observed that most owners arrive at a sale underprepared despite believing otherwise, which is what one would expect when preparation is framed as a checklist with no budget attached. A checklist implies that the goal is completion. A budget implies that the goal is selection.

The distinction matters because the items on a readiness checklist are not equal in value, and the owner working the list has no way to tell which ones move the eventual price and which ones are decoration. Some interventions change what a buyer will pay. Many do not. A framework for preparation has to begin by admitting the constraint the checklist ignores: the account is finite, and spending it well is a choice, not a chore.

2 From impact to priority

A prior step is required before allocation can begin. The owner needs to know, for a given business, where a buyer is likely to revise the price after a letter of intent is signed. Cordis Institute Working Paper No. 001 documented that these post-signing revisions are common rather than exceptional in the lower middle market, and that their aggregate magnitude is large enough to dominate the difference between a good outcome and a disappointing one. The mechanism is not fraud or error. It is the buyer's underwriting model applying a different lens to the same financial statements the owner has run the business on for years.

Mapping those likely revision points, and attaching a magnitude to each, produces a diagnostic. It answers the question of where value is exposed. It does not answer the question this paper is concerned with, which is what to do about it. A ranked list of exposures is an input to a decision, not the decision itself. On an unlimited budget the distinction would not matter, because the owner would simply address everything. On a real budget it is the only thing that matters.

3 Return on effort and the objective it serves

Define the return on effort of a candidate intervention as the value it is expected to recover, or protect, per unit of the scarce resource it consumes. Two features of that definition do the work.

EXHIBIT 2

Every fix is scored on return on effort, then tested four ways.

RETURN ON EFFORT

value recovered per unit of scarce resource, scored against four tests

Certainty	Floor	Fit	Strength

Cordis Institute framework.

The first is that the numerator is not a single quantity. An intervention can raise value along more than one axis, and the axes are not substitutes. Four are load-bearing. An intervention can raise the certainty of closing, meaning it narrows the room a buyer has to revise the price downward or to walk away after signing; the execution-stage importance of this axis is the subject of Working Paper No. 003. It can raise the floor, protecting the worst plausible outcome rather than only the headline number. It can align the business with the buyer archetype most likely to pay a premium, keeping that buyer credibly in the process; the divergence across archetypes is the subject of Working Paper No. 002. And it can be executed without weakening a strength the business already possesses. A move that lifts the apparent multiple while eroding an existing strength can carry a negative net return, and a framework that scores only the headline effect will select it anyway.

The second feature is that the denominator is real. Time to season is part of the cost. Diversifying a concentrated customer relationship cannot be done in the final quarter before a process; a normalization of working capital can be done quickly. Two interventions with identical value can therefore carry very different priorities, because one must be started early to have any effect at all and the other can wait. Sequencing is not a refinement of the allocation. It is part of it.

4 The averaging trap

The strongest claim in this paper is that the conventional checklist is not merely inefficient but can be value-destructive, and the reason is specific.

No such buyer exists.

A generic readiness program optimizes for a buyer with no particular model, which in practice means the average of the models a business might encounter. No such buyer exists. Averaging across buyer archetypes produces a business that is broadly acceptable to many and specifically compelling to none. That is a poor trade in a market where a single premium buyer, correctly matched, can pay well above the median. Working Paper No. 002 established that the same business is underwritten differently by a private equity add-on, a platform, a strategic acquirer, a family office, and a search-funded operator, and that the features one of these rewards can read to another as a risk to be discounted. Preparation aimed at the average therefore does more than waste effort. It can move the business away from the lane of its best-fit buyer and dilute the very features that would have earned a premium from that buyer.

Stated as a proposition: preparation calibrated to the median buyer weakly reduces expected realized value relative to preparation calibrated to the owner's most probable premium buyer, and the reduction grows as the dispersion of buyer models widens. In segments where the buyer pool is homogeneous, the penalty is small. In the lower middle market, where five active archetypes underwrite against materially different constraints, it is not.

5 Sequencing and the stopping rule

Two operating consequences follow from treating preparation as a budget.

The first is order. Because time to season is a real cost, the interventions that must age are started first, even when their measured value is no higher than that of faster fixes. The correct sequence is not "highest value first" but "highest value among the things that cannot be done later, first." A gap table that quantifies exposures without regard to seasoning will mislead an owner into leaving the slow, high-value work until a point at which it can no longer be done.

The second is a stopping rule, which the checklist framing lacks entirely. Past a point, additional preparation does not change what a buyer will pay, and effort spent beyond that point is drawn from the same finite account without a return. The disciplined program stops when the interventions that move the number have been made. A checklist, by construction, does not stop until the list is complete, which is precisely why it overspends on the decorative items near the end of the list while the account that should have funded the high-return work is already empty.

6 What the evidence cannot yet settle

The framework is advanced here as structure rather than measurement, and its limits should be stated plainly. The magnitude of the averaging penalty is not directly observed in existing data. Deal-terms datasets such as those maintained by SRS Acquiom and GF Data record the prevalence and size of post-signing adjustments and structures, and the Pepperdine Private Capital Markets Report records the frequency with which processes fail and the reasons owners give, but none of these was built to compare matched businesses prepared against a specific buyer versus a generic one. The counterfactual that would size the penalty exactly does not exist in public data. Research on the private phase of the deal process supports the direction of the argument, in that more aggressive and less specific positioning tends to draw more subsequent revision, but the segment-specific magnitude remains a proposition to be tested rather than a figure to be cited.

A disclosed engagement panel, with stated size and methodology, would allow the return-on-effort ranking, the seasoning schedule, and the averaging penalty to be estimated directly. Until such an estimate exists, the contribution of this paper is a decision structure: preparation is a constrained allocation across a multi-objective return, not a checklist to be completed, and the owner who treats it as the former recovers value the owner who treats it as the latter leaves on the table.

> **NAMED FINDING**
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> Preparation is a constrained allocation problem, not a checklist. Under a finite budget of time, capital, and attention, interventions selected by return on effort against a four-part objective dominate uniform readiness

effort, and preparation calibrated to the median buyer can reduce realized value by moving a business away from the specific buyer whose model would have paid a premium.

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AFFILIATION

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