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# Buyer Profiles: Strategic vs. Financial

In most companies, founders and shareholders will want to unlock the value of their holdings and create liquidity for themselves at some point. The decision to tap into this store of value is often a complex and challenging one for many founders, shareholders and board members. Once a decision to sell the business is taken, determining the best buyer for the business can be a daunting task. Buyers have different motivations for seeking acquisitions and a better understanding of these motivations can enhance the seller's position. It is commonly thought that financial buyers are synonymous with private equity groups (PEGs) and only business corporations are strategic in nature. While that used to be a valid distinction, the lines have been blurred as private equity has expanded its ownership of corporate America. Today, a private equity fund invested in a current portfolio company may well be a strategic buyer. Similarly, companies pursuing conglomerate growth strategies will act much like financial buyers (eg. Berkshire Hathaway). For this discussion we would consider the traditional strategic buyer to be a corporation engaged in the same or similar line of business, while the financial buyer being PEGs.

**Strategic Buyers:**

Strategic buyers are interested in a company's fit into their own long-term business plans. Their interest in acquiring a company may include horizontal expansion (into new geographic markets or product lines, brand), vertical expansion (toward the customer or supplier and consolidating supply chain), eliminating competition, or enhancing some of its own key weaknesses (technology, marketing, distribution, research and development, etc.). Their goal is to identify companies whose products or services can synergistically integrate with their existing product line to create incremental long-term shareholder value. For the same reason, strategic buyers may not require consistent earnings growth to enter into a transaction. The intention to integrate two businesses means that the strategic buyer needs to own 100% of the target business. For small and mid-market transactions, strategic buyers will give the best chance of 100% cash transactions.

Because strategic buyers are looking to extract synergies and strengthen their existing business they will not be looking to sell the business again and thus the investment horizon is long term, in most cases perpetuity. However they may move the production facilities of the acquired company to their existing facilities if they have excess capacity. Strategic buyers are often willing to pay more for a company as they believe that the transaction will immediately create either revenue enhancements or reduce costs (or both) as a result of synergies. Because the strategic buyer already has a leadership team in place before the acquisition this may mean that the target's current management team may not be needed. If the owner of the business is looking to retire and exit the business, strategic buyers are the best bet.

Differences in corporate culture has proved to be the primary reason for failure of mergers and acquisitions and so assessing and finding the strategic buyer with similar culture fit becomes critical for future success. Since strategic buyers in most cases are not expert in executing mergers and acquisitions, they tend to be slow in executing deals.

**Financial Buyers:**

Financial buyers can generally be classified as investors interested in the return they can achieve by buying a business. They are typically individuals or companies with money to invest, and who are willing to look at many different types of businesses or industries. Their goals may include growing cash flow through revenue enhancement, expense reductions, or creating economies of scale by acquiring other similar companies. Since they operate on a "Buy Low and Exit High" strategy, by their very nature, investment firms must eventually sell their investment to return capital and profit to their investors. Therefore, they are in a hurry to grow the acquisition to several times its original purchase price in a short time frame of 5-7 years. Many financial buyers are agnostic to the industry as long as the investment looks financially attractive.

Financial buyers need consistent earnings, reasonably high growth rates, effective management team and leverageable assets and cash flow to make an investment. Since the investment objective is purely to earn higher returns, financial buyers are less likely to pay high valuations as compared to a strategic buyer. Financial buyers engage in extensive due diligence to conduct a comprehensive business review, market studies, quality of earnings and background checks on managers. This can be laborious and time consuming. However since these buyers are expert in executing deals in a timely manner, they take less time as compared to strategic buyers. It is common to see financial buyers using high leverage to finance the acquisition. Since many financial buyers support the transaction by high leverage, post-closing focus is on cost reduction and payment of interest and debt and less on reinvestment in the acquired company. High debt in many cases has known to burden the company's cash flow and limit its financial and operating flexibility.

A financial buyer is usually focused on its determination of the profitability of a business as it currently operates, meaning current management, structure and culture may be maintained. This typically means that the transaction is not an exit opportunity for the management team and key employees, who may be required to stay on with the company and may even be asked to make an equity investment, generally in the range of 20%. This keeps the management committed to the Company even after sale of majority stake. The management however gets a second opportunity at higher valuation at the time of financial buyer's exit.

**Conclusion:**

Whether a strategic buyer or financial buyer is the right choice for a specific company depends largely on the seller's motivation and goals in selling the business. Does the seller want the highest price possible; or a high price but is concerned about the future of the employees; or wants to cash out but will remain involved for few years; are some of the questions that need to be answered. Every buyer, whether strategic or financial, brings a unique perspective to the business transaction and should be considered. In most cases, it makes sense to consider both types of buyers. By evaluating both alternatives simultaneously business owners can make the best decision for themselves and the company.