Should You Sell Your Business to a Strategic or Financial Buyer?

In general, there are two types of buyers in a business sale: strategic and financial. Because the buyer types' strategic objectives, financial goals and cultural fits with organizations differ, it is critical to understand which buyers best suit for your business sale goals.

The Two Types of Buyers

Strategic buyers are companies that want to acquire your business to meet their business needs. They may be interested in entering new geographic markets, eliminating competition, improving their supply chain, or addressing weaknesses in other business areas. They acquire your business to supplement and enhance their current operations.

Financial buyers are investors seeking to acquire your business to generate a return on investment. These investors typically look to purchase your business, operate it for a period, and then "exit" their investment by selling your business for a profit.

Financial Buyers Enter the Lower Middle Market

Historically, financial buyers have focused their investment strategies on large corporations. However, increased competition in that space has driven financial buyer activity to the lower middle market (LMM), causing a surge in demand for businesses with values from $5 to 50 million. Over the past three years in this market, financial buyers have executed an average of over 800 transactions per year at a cumulative value of over $50 billion.

The sheer size of the LMM, which consists of more than 175,000 businesses, and that sellers are mostly event-driven (wanting to retire, liquidity needs, etc.) creates an ideal market for financial buyers to purchase strong, well-run companies.[1]

So which type of buyer is right for you?

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[1] Data sourced from Pitchbook.

Understanding the different strategies of financial and strategic buyers is essential when determining which buyer type best meets your goals.

- Cultural Fit

  Strategic buyers have a history in the industry, so they understand its challenges and opportunities. Because strategic buyers have similar knowledge and experience to the sellers, the parties tend to establish a stronger connection than with financial investors. This common understanding fosters a friendly environment where you can share past experiences and plans on an emotional level.

  On the other hand, financial buyers may not completely understand the industry, but if their financial model suggests they can generate their targeted returns, they are interested. Since financial buyers are often more focused on the financials than the operations, sellers may not feel an emotional connection with them. After all, you will feel differently about a buyer who spews numbers and percentages than one who connects with you on a more personal level.

  Since financial buyers do not typically have the management expertise to operate the company, they tend to retain most if not all of the employees to execute the company's operations. Financial buyers often elect for the seller to remain in a management role to continue to run the business efficiently. In this scenario, part of the deal compensation is typically tied to meeting specific goals, called an earn-out. Strategic buyers may be less likely to retain all of the personnel because they do not wish to duplicate roles in areas such as accounting, sales, and others. Since a strategic buyer may already have employees performing these functions, they can realize value by eliminating the associated costs of those in overlapping roles, which can mean layoffs.

- Financial Incentives

  Strategic buyers are often willing to pay more for your company due to the value-add opportunities created by combining the companies. The more value a strategic buyer believes your company brings to the table, the more they are willing to pay to achieve it. For example, if a strategic buyer believes that your company will help it capture market share in a new region, it will be willing to pay up for that value-creation.

  Financial buyers typically pay less for your company because they are interested only in the company's earnings and not the value derived from combining two companies. Since they are looking to achieve the highest return on investment, they attempt to do so by purchasing at the lowest price possible.

There isn't necessarily a "right" or "wrong" type of buyer since it depends heavily on the seller's goals for the sale. Do you want to maximize value? Do you want to take chips off of the table but continue to work in the business? To answer such questions similar and to satisfy your goals, it is important to consult with your investment banker who can match you with the right buyer for your business.