

Strategic vs. Private Equity

THIS WHITEPAPER EXPLORES:

We'll discuss the key differences between strategic and private equity buyers, highlighting how each can impact valuation, deal structure, and long-term outcomes. We'll also explore the pros and cons of both to help business owners make informed decisions when considering a sale.



Strategic & Private Equity Buyers

The labels “Private Equity Buyer” and “Strategic Buyer” are frequently brought up when contemplating prospective buyers for a business. Both have their advantages and disadvantages but, depending on the details of the deal, a sale to one or the other has important implications, both in valuation and in deal structure. A competent investment bank will spend significant time analyzing the potential impacts and educating the seller on all the variables concerning each type of buyer. Each has a different position in the market, with different motives for buying and different opportunities for the seller.

Strategic Buyer

A strategic buyer is a buyer within the same industry (or a closely-related industry) as the selling party. Often this could even be one of the seller’s direct competitors. Their interest is typically for the purpose of growing their business through acquisitions with the purpose of increasing clientele base, acquiring new technology, expanding market reach etc.

Pros

- Strategic buyers will often be willing to pay more for companies than private equity buyers.
- They are usually more familiar with the sellers’ market and industry than a PE firm.
- A strategic buyer may more easily find economies of scale, with the potential elimination of several expenses for which it already has good solutions.
- They are better situated to implement or improve the business that is being acquired since they are experienced and know the industry in great detail.
- Strategic buyers are usually large and established companies, with easier access to capital.

Cons

As you can see, there are several benefits to approaching a strategic buyer, but this is equally matched with the downsides such as confidentiality concerns and overall market exposure.

1. Approaching competitors in the same or similar industry can sometimes get back to the seller’s current customers or employees.
2. Unless very careful, the due diligence process can give a competitor market intelligence into the selling company which, should the deal fall through, could allow it to more effectively compete with the seller.
3. Managing confidentiality through comprehensive non-disclosure agreements and by carefully selecting who you decide to approach is the only way to mitigate these risks.
4. Less autonomy. The buyer most likely has a variety of systems and protocols in place the seller will be required to follow post transaction.

Private Equity Buyer

Private Equity Buyers are investors interested in the potential profit of owning all of or part of a business. They may have many motivations for purchasing a business:

- They may feel an acquisition target is poorly managed and plan to replace it with new management and a new business plan.
- They may wish to keep management and use it as a core for future strategic acquisitions in the industry, or they may wish to add new properties to an existing core.
- They may determine that the company's assets are better used for alternate purposes, either in a related but different industry, or with certain underperforming assets broken out and sold off.
- They may have identified trends in the economy that suggest the seller's industry will expand, and they wish to ride the wave of a great business as a long-term hold.
- Private equity firms often have a set date for divestiture –with a 5 to 7-year time horizon for a liquidity event. Others wish to buy and hold for an indefinite period.

Private Equity Buyers tend to be very open minded and open to investing in a wide array of industries, strengthening their portfolios with diversity.

Pros

- Autonomy. The acquirer usually wishes to keep effective management, with existing management participating in the growth of the company post-sale.
- The seller often “rolls” some of their existing equity (15-40%) into the new enterprise, which can be lucrative if the PE firm plans to invest capital and expand operations.
- If the PE firm is attempting to “roll up” a fractured industry, they may be willing to pay a strategic price if the target represents a particularly enticing part of that industry, has intellectual property vital to reducing costs, or owns a recognized brand name.

Cons

- The main pursuit of a private equity investment is to increase the cash flow of the business, which can be accomplished through a variety of techniques. While this can be accomplished by investment into the business and expansion, sometimes the acquirer wishes to cut costs to the bone and heavily leverage their acquisition to maximize their investment return – hurting employees in the short-term and adding risk to any equity roll.
- Since PE firms are looking to maximize the equity return of their investors, many will often try to acquire businesses at the lowest price possible.

Contact Us

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