Who will buy my business?

Once a business owner decides to start the process of selling his/her company, one of the first considerations is who will purchase the business. Each potential buyer will approach an acquisition opportunity with a different view of the business' strengths, weaknesses, opportunities, and threats. In addition, the type and number of buyers interested in acquiring the same business may have a significant impact on its perceived value, and purchase price. Understanding the types of buyers and potential advantages and disadvantages of engaging with each, may help business owners determine their priorities when selling their business.

Strategic buyers

Strategic buyers include those in your industry such as competitors, suppliers, or customers. Because of their deep industry knowledge, the sales process may proceed more quickly than with a non-strategic buyer who may need to spend more time understanding the competitive landscape, regulatory considerations, and other value drivers. Given their industry knowledge and potential synergies, such as lower costs due to increased buying power, strategic buyers may perceive the business and industry risk to be lower, therefore allowing them to justify a higher purchase price.

The challenge for sellers soliciting interest from strategic buyers is the requirement to disclose information that may be strategically sensitive, not the least of which is that the business is for sale. If other stakeholders in the industry are aware that the business is for sale, there could be a significant disruption in the business, such as customers seeking goods or services from competitors, or suppliers changing payment terms. Despite having appropriate legal documentation in place, such as a confidentiality agreement, it is vital that confidential information only be disclosed to trusted parties, especially when engaging with strategic buyers.

Financial buyers

Financial buyers, such as private equity investors, typically partner with the business' existing management team. To enhance the performance of the business, the management team may be required to maintain a minority ownership position after the transaction closes. If there is not a strong management team in place, the financial buyer may require the seller to remain engaged in the business for a transition period.

Most private equity investors establish a limited timeframe for holding their business investment, in order to obtain a return on their investment. They generally acquire a business, grow it (organically and/or through acquisition), and then sell the business at a premium to another private equity fund or large strategic buyer after five or ten years. Financial buyers may be willing to pay a premium if a business is part of a larger strategy to consolidate and gain scale in a particular industry, but overpaying for a business may put their return at risk. Private equity investors are experienced in completing transactions and are likely to have a rigorous due diligence process. They will expect sellers to validate forecasts and capacity constraints to obtain a full understanding of the target company's growth potential.

Management/employees

Transitioning ownership to the existing management team or employees may seem like the simplest transaction because these individuals already have a deep understanding of the business; however, there are some inherent complexities that should be considered. Firstly, business owners will have to provide information that is typically not shared broadly with employees, such as detailed financial statements, including owner salaries and dividends. Secondly, it is unlikely that management team/employee buyers would be able to provide full payment of the purchase price upon

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closing, and payment is more likely to be made over time. A key question for business owners to consider is whether a lump sum payment is needed right away to fund retirement, or if smaller payments over time are acceptable. Lastly, if negotiations do not go as planned, the business may end up without a buyer, and without its key employee(s). If you are certain that you want to pursue a transaction with management or employees, communicate your desires clearly and solicit interest and feedback from them well in advance of any planned sale. If executed well, a transition to management or employees will cause little disruption in operations, and give the owner peace of mind that the business will be in good hands.

Family

For many business owners, transferring the company to the next generation and continuing the legacy of the family enterprise is the preferred outcome. When it comes to a family transaction, it is possible to be more creative with the transaction structure, which may include payments over time, an estate freeze, or funding through a mix of sweat equity and bank debt. When considering a sale of a business to a family member(s), it is especially important to balance the buyer's ability to pay with the seller's need for liquidity.

The complexity of a family transaction typically stems from family dynamics. Often, a first generation business owner may not be ready or willing to give up total control of the business, while the second generation may not be fully prepared, willing, or even have an interest in taking on the responsibility of ownership. Common themes in these situations include perceived inflexibility and resistance to change on the part of the first generation owner, and lack of maturity for the second generation.

Additionally, it is important to consider any other children who may not be actively involved in the business to ensure a fair distribution of their parents' estate. Clear and open communication among all family members is critical for ensuring continued success for both the family and the business.

Seek professional advice

There are many types of potential buyers when a business owner decides it is time to sell the business. Often, the selling options can be combined, such as selling: concurrently to management/employees and a financial buyer; to family and management; or to family and a financial buyer. Whichever route makes the most sense, preparing in advance helps ensure a smooth transition. It is equally important to engage the right professional advisors to provide guidance and advice throughout this often complex and life changing transaction.

! If you are considering selling your business, please speak to your BMO financial professional.

BMO Wealth Management

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