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Selling your business to private equity group vs. strategic buyer

If you own a business, it can be overwhelming to think about selling it. One way to gain some control is to learn about your alternatives so you better understand what is best for you, your family, and your company. While buyers come in all shapes and sizes, perhaps the most sophisticated are private equity groups (PEGs) and strategic buyers.

Private equity group

A PEG is made up of financial professionals who have raised money to buy — and eventually sell — companies.

Key considerations: It is important to consider your financial and timing goals to determine if a PEG sale is a fit. Your continued involvement will be based on your current role in the company. Are you comfortable running the company with another majority owner? PEGs usually target a three-to-five year holding period, after which the PEG attempts a second sale of the company (in which you may be able to completely exit).

What happens: As a simple example, assume you sell for $1,000. Assume also that the PEG funds the transaction with $500 debt and $500 equity and asks you to roll over $100 to own a 20% equity interest. Your existing management — and likely you — will be tasked with growing the business while paying down the debt.

Now, let's say you double the profits while completely paying off the debt and then the business is sold. Assuming the same valuation multiple of profit/cash flow, the business would be valued at $2,000 and you would get 20%, or $400, for your $100 investment because all the debt was paid off.

Risks: Of course, there's no guarantee the business will grow while paying down the debt or it will then sell on favorable terms. In the meantime, you will have a majority owner that is looking to exit in a few years, so its goals may not align with yours. When considering a PEG, you want to be comfortable with its level of involvement in the running of the company and how decisions will be made.

Strategic buyer

A strategic buyer is usually a company in the same or related industry that has some overlap or synergy that would result in incremental savings or revenue if it bought your company.

Key considerations: Your company may be absorbed, which is important to consider if you value legacy. There may be a heightened risk for job loss, especially among senior leaders, as your team may overlap with that of the buyer. The flip side is you may find it easier to walk away after a strategic sale.

What happens: Unlike a PEG, you will usually not be asked to reinvest in the company, and depending on your current role, you may be involved in a transition period of only a few months. What happens to your management team and the rest of your workforce depends on the overlap with the buyer and its strategic direction.

Risks: If you are paid in the acquiring company's stock, you need to consider the risk of owning that much of one security. If the buyer is a public company, you may be able to sell that stock and diversify over time, but that can be delayed if the stock is restricted. In that case, you can be prohibited from selling until after a vesting period or certain conditions are met.

If the buyer pays with private company stock, you need to know your path to liquidity. Until you do so, you will own shares in a larger company you no longer control, and it likely will represent a large percentage of your personal assets.

Transitioning your ownership of a company is more complex than a typical retirement, but it can be less daunting if you understand your options.

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