

Episode 3 - The Buyer Universe

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Transcript

Russell:

In episode three of our Beyond Business Ownership Series, we're exploring The Buyer Universe - a crucial topic for owners considering an exit. Identifying the right buyers for your business can be extremely challenging - from competitors looking to acquire your business to gain market share, to private equity firms looking to improve your business performance and sell it for a higher value later. So how do you know which type of buyer is right for you?

Andra:

Our leading industry and HSBC experts are here to help. Examining the different types of internal and external buyers, their motivations for purchase, and the key steps and considerations to securing a sale that aligns with your personal and business goals.

Russell:

You can view the full episode now or watch selected chapters of interest at a time that suits you. And if you missed the first two episodes in our series, you can catch-up on those, as well. Just visit the Beyond Business Ownership page on the HSBC Global Private Banking website.

Chapter one - Understanding the scope of the buyer universe

Andra:

Understanding the types of buyers who might be looking to purchase your business is pivotal for any sale. Our expert panel kicks things off by defining the buyer universe and its key characteristics.

Alisdair:

The buyer universe is wider than many business owners realise, and comprises both external and internal exit routes. Focusing on external buyers, there have historically been three main options for owners of businesses seeking outside capital or an exit strategy, including strategic buyers, financial buyers, including family offices and the public exit route. Strategic buyers are large corporations that acquire other businesses to seek synergies, market expansion, or technological advancements, believing the combined entities will be stronger together. Whilst financial buyers, such as private equity firms, focus on financial returns and scalability. Taking the company public through an IPO is an option typically available to a limited pool of businesses demonstrating public company readiness.

Susie:

I would see buyers falling into one of four categories. So, you know, trade or strategic buyers, private equity buyers, or financial institutions, a management team, and that might include an EOT, an Employee Ownership Trust, and then a family for family businesses.

Purvi:

You also have some wild cards, which are sometimes great to add competitive tension in a process, such as international groups or businesses in other sectors.

Russell:

So we have a greater understanding of what the buyer universe looks like now. We asked our panel how has it changed over the last ten years?

Purvi:

In the last ten years, we've seen huge amounts of capital put to work by private equity. This has really changed things for financial buyers. The competition for assets, particularly primary deals, businesses which haven't been owned by private equity before are scarce. These are hard to come by and highly sought after. At the same time, we've seen a sharp increase in the number of family offices who are actively investing in private businesses. Meanwhile, in terms of trade buyers, a lot of industries have converged, so the definition of a strategic investor can be quite broad. This is emphasised by trends such as globalisation, digitalisation, so that net for a strategic buyer or even a wild card, becomes huge.

Mike:

The buyer universe of businesses has expanded quite a lot in the last ten years. The classic examples of private equity and trade sale are still most common, but other forms of transactions are also growing. Employee Ownership Trust sales, which act a little bit like a management buyout, but with a whole employment base taking ownership of the business are growing. Part of the reason for that is the tax breaks that are available for those types of transactions. Also, we're seeing increasing growing prevalence of what we call debt funds or credit funds that act a little bit like private equity, but with debt, and they will offer management and owners quite attractive stretch debt packages, which mean that an owner can take a lot of money off the table without diluting their equity too much.

Alisdair:

Technological advancements have also attracted tech-focused buyers, both strategic and financial. Additionally, there's been a growing investor emphasis on sustainability and ESG criteria influencing buyer preferences.

Andra:

It's really interesting to hear how the buyer landscape has developed and diversified over the years. Now, let's look at the types of potential buyers in more detail. What are the key differences between external buyers, including trade, private equity, family offices, and Initial Public Offerings or IPOs and internal buyers, for example, management, employees, and family members?

Susie:

With an internal buyer, you know, a management team or a family, they already know the business quite well, so it's a lot of the due diligence probably doesn't come up in the same way. But what you've got now is parties who were previously very closely aligned with the same goal, now acting in their own interest, which may not be aligned.

Peter:

External ones like PE, they look for an exit, they look for building on their equity, on increasing their stake, and looking for an IPO secondary sale, trade sale. And that's the key difference between internal and external. Internal buyers, so management employees, family, they look to the long term in relation to building the business and keeping it in the family or in the ownership for a long period of time.

Russell:

So we understand the key differences between internal and external buyers. But why is it important for a business owner to consider the full range of buyer types before selling?

Mike:

An owner's objective should define what type of buyer and transaction structure is right for them, but they should be informed about their options. Sometimes, we see people quite focused on one type of transaction without knowledge of what another transaction could mean, and importantly, not just how the consideration is structured, but what the post-transaction world will mean for them, their level of involvement, etc. We find working with a corporate finance advisor who can explain the different types of structures can be really helpful in helping owners consider their broader options.

Alisdair:

It's crucial for business owners to consider different types of buyers before going to market, because each buyer type has distinct motivations and valuation methods. Strategic buyers might pay a premium for synergies, while financial buyers focus on return on investment and growth potential. Understanding these differences helps tailor the marketing approach, negotiation strategy, and deal structure to align with the specific goals of potential buyers. This increases the likelihood of a successful sale, maximises value, and ensures a smoother transition post-sale. Additionally, identifying the right buyer type can help maintain company culture and protect employee interests.

Andra:

Notwithstanding the differences, motivations and objectives among buyers vary significantly. So we asked our experts: "Are certain buyers better suited to a particular type of business?"

Purvi:

Selecting a buyer for a business is like finding the right home for your business, and this is more about the objectives of the owner. So this includes what I call soft objectives, objectives that go beyond pure value maximisation.

Susie:

So, perhaps a family office investor might look for a more steady state business that's throwing off returns, you know, paying income out annually, and got a more proven track record.

Alisdair:

Financial buyers, like private equity firms are better suited for owners wishing to remain for future upside in companies with strong cash flow and growth potential as they focus on financial returns and scaling the business.

Susie:

And then a strategic or trade buyer is looking for an asset, a business, a particular kind of asset, perhaps to enhance their business. Perhaps, it's a tech business looking for a particular kind of tech that they don't already have.

Russell:

The buyer universe has clearly developed and diversified over the last ten years. The different types of buyer come with different motivations and objectives. It's clear for our experts that considering the range of potential buyer types, and understanding the potential appeal of your business to them can be a very worthwhile investment of your time. Our experts have highlighted some of the key differences between them, and we hope given some indications as to how you can identify which would be more suited to your line of business.

Chapter two - Exploring external buyers**Russell:**

In chapter two, we take a closer look at external buyers, examining and comparing the different types, including trade, family offices, private equity, and IPOs, and their appeal to business owners looking to sell. We asked our panel of experts: "If a business owner wants to proceed with an external buyer, where should they start?"

Alisdair:

Start by clearly defining your goals for the sale, including financial, strategic, and personal objectives, and make sure to engage advisors, including M&A advisors, lawyers, and accountants to guide you through the process. Advisors can help with development of a detailed information memorandum, showcasing your business's strengths, financial performance, and growth prospects, and will include a comprehensive business valuation to demonstrate the company's worth. Identify and research potential buyers considering strategic fit, financial capacity, and track record. Use confidentiality agreements to protect sensitive information before engaging in discussions.

Purvi:

Any contact with buyers should be carefully considered and managed because those early conversations can pave the way to a successful transaction down the line.

Andra:

If you are thinking that the external buyer route might be right for your business, seeking professional advice is clearly a good place to start. In the next part of this chapter, our experts examine the different types of external buyers in more detail, starting with trade sales - where a company is sold to another business, typically operating in the same industry or sector. Now, in this type of transaction, the buyer is often looking to strengthen their market position to expand their market presence, diversify their product or service offering, or create synergies to improve their operations. It's a very common exit strategy.

Peter:

Trade buyers definitely have specific types of characteristics in the sense that they understand the businesses, they understand the market which they operate in, and therefore, can sometimes, see the value, see the opportunity, and business owners may choose to go for that kind of sale on the basis that they can get normally better terms potentially and better value.

Russell:

So on the positive, a trade buyer may bring sector familiarity, clarity of purpose, and possibly better terms and value, but that can, sometimes, mean integration with their existing operations. Next up is private equity where PE firms raise funds from investors and banks to acquire and increase the value of businesses through restructuring, growth and, ultimately, exit.

Alisdair:

A private equity buyer differs from other buyers and their focus on financial returns and growth potential. PE firms typically invest in businesses with strong cash flow, aiming to enhance value through operational improvements, strategic bolt-ons, and financial restructuring. They often hold investments for three to seven years before exiting. A business owner might choose this route for the potential to scale the business rapidly, access the capital and expertise, and the opportunity to retain a stake in the business for future upside. PE buyers can also provide strategic guidance and professionalise the business, making it more competitive and valuable over time.

Andra:

There are certainly a number of benefits of selling to a private equity firm, especially if you want to remain involved in your business, scale at speed, and have a wealth of experience behind you. Now, we look at selling to a Family Office - which is a private investment firm that manages a family's wealth. Family Offices are typically viewed as more passive investors as they're often more concerned with preserving capital rather than seeking the highest returns, and typically, they don't take control of management and operations.

Purvi:

What's particularly interesting about this group of investors is that, one, they only answer to themselves, so they have flexibility on transaction structure, time horizon. Secondly, they have a quick and simple decision making structure as a result of that. And they are a really exciting pool of investors to consider in a process, because there are more Family Offices investing in private markets, and there's more capital within this group being put to work to invest directly in private businesses.

Russell:

Family Offices as a buyer group have grown in significance in more recent times. Relatively, they're able to make swifter decisions and their approval processes are in-house, but clearly, this doesn't make their due diligence any less detailed or terms less onerous. Finally, we analyse IPOs.

Alisdair:

An IPO or Initial Public Offering differs from other exits as it involves selling shares of the company to the public on a stock exchange. This route can significantly increase capital, enhance company visibility, and provide liquidity for shareholders. A business owner might choose an IPO to raise substantial funds for expansion, gain a higher valuation due to market dynamics, and benefit from the prestige and credibility associated with being a publicly traded company. However, it also involves regulatory scrutiny, ongoing public reporting requirements, and potential loss of control, making it suitable for businesses ready for these challenges.

Andra:

Listening to our experts, it's essential that business owners looking to sell to an external buyer understand the different types of buyer and the buyer motivations. By doing so, you should be better prepared for your sale, understanding which best aligns with your objectives. You can focus on the best buyer fit and hopefully secure the best deal.

Chapter three - Exploring internal buyers**Andra:**

In chapter three we look at internal buyers - from management buyouts, to Employee Ownership Trusts and selling to family members. Let's start with management buyouts, also referred to as MBOs. How does this type of sale compare to others?

Susie:

A management buyout really is most suitable for a business with a really strong management team, who are really desperate to take the business forward and have got the skill and ability to do that. The key difference for me, for a management buyout, often, is that the consideration will be partly funded by the exiting seller. So they will be waiting, sometimes for a long period of time to get all that consideration.

Russell:

A sale to your management team might appeal positively to those looking for peace of mind when it comes to exiting your business. But as Susie says, you have to remember that in such a sale process, your management team are now on the other side of the table. Let's move on to another type of internal sale, to an Employee Ownership Trust or EOT.

Susie:

The purpose is to sell a business to a trust that's for the benefit of all employees. So not a small management team who will exit in three to five years, but the employee base. So for me, it's a question of culture. Do you have a business that is about the continued benefit of all of the employees on a long term basis?

Peter:

Selling to an Employee Ownership Trust is very different, and there are special tax advantages in doing so. They also know what they're doing in the sense that they are selling to people they've normally hired themselves, employees in the business, and they're looking after those employees and giving back.

Russell:

So an Employee Ownership Trust could be an alternative way to sell your business. Where your employees could be rewarded for their hard work and loyalty.

Andra:

Let's move on to the final type of internal buyer - selling to family, which brings its own set of challenges by adding an emotional layer to the transaction.

Mike:

Selling to your family is very much an internal transaction. Maybe with an older generation taking some value off the table.

Peter:

Selling to your family is different and that's mainly because of the emotion involved. The fact that family members will want to buy a business off of each other doesn't remove the fact that going forwards, they normally have a relationship together, and the emotion, therefore, gets involved in trying to achieve the best terms, negotiating the types of contracts and the warranties which are required on doing a sale.

Russell:

Selling your business to an internal buyer can appear to be very rewarding with the business moving forward and the leaders you've helped develop. It may work well if price isn't the defining factor. However, like any sale, there are challenges. Disagreements over price or other sale terms are still likely to arise, and this may become very heated between the parties. As this is between internal parties or even family, it can come as a surprise and be quite a burden. So make sure you do your preparation and research, understand all of your options, and consult with legal and financial experts before making an informed decision.

Chapter four - Making the right decision on your buyer

Russell:

In our final chapter, our experts discuss the steps that business owners might take to ensure they make the right decision when deciding who to sell to.

Alisdair:

Business owners should, to the extent possible, identify potential buyers or successors through a systematic approach. Start by defining the objectives of the sale to help understand the ideal buyer profile, engage advisors, such as M&A consultants or investment bankers to leverage their networks and expertise, and to assist with conducting targeted outreach to strategic and financial buyers.

Susie:

I would say that if you're thinking about selling your business, work out what you're trying to achieve. Selling your business is a very emotional journey and it's very difficult.

Alisdair:

They should also use industry contacts, attend relevant trade events and conferences. Confidentiality is maintained through non-disclosure agreements during preliminary discussions, ensuring a secure and professional process for finding the right buyer.

Andra:

Listening to our experts before deciding who to sell to, it's important to define your personal, financial, and business objectives, but what can happen if these objectives clash?

Peter:

We do see a clash between personal and commercial objectives on transactions from time to time, and it really depends upon the buyer and their team as to which one takes precedence. We do find that those who want to maximise their return will normally take the commercial objectives over the personal ones, but we also see certain buyers who have got very key strong personal drivers in relation to why and how they're selling, and that those do sometimes override certain commercial and value objectives.

Susie:

I definitely see personal and commercial objectives clash. Last year for the first time in a long time, I saw a founder pull out of a deal with a private equity house, because he came to realise that he didn't want to work with that private equity house for three to five years. He thought it would fundamentally change his business, and he wasn't willing to do that.

Russell:

Really important insights from Peter and Susie, stressing the importance of carefully considering personal and commercial objectives during a sale and making sure they align to your goals, not only now, but in the future. Next, we asked our experts: "How do different exit routes impact valuation?"

Alisdair:

Different exit routes can significantly impact the valuation of businesses. An IPO can offer the highest valuation due to market dynamics and investor demand, but involves significant costs and regulatory scrutiny. Strategic buyers might pay a premium for synergies and strategic fit, potentially offering a higher valuation compared to financial buyers who focus on return on investment and cash flow.

Andra:

Alisdair has clearly explained the impact of valuation for IPOs and strategic buyers, but what about private equity and management buyouts - what are the valuation implications of these types of exit?

Alisdair:

Private equity buyers may value the company based on growth potential and the ability to implement operational improvements. A management buyout might offer a lower valuation, but ensures continuity and a smoother transition similar to other internal buyers, such as Employee Ownership Trusts, family, etc.

Russell:

Our experts have spoken about the different types of internal and external buyers, their motivations, common pitfalls, and the implications of different exit routes on valuation. So to close our third episode on The Buyer Universe, we asked them: "What critical piece of advice would they give to owners looking to sell with regards to finding and choosing a buyer?"

Peter:

The key piece of advice I would give to a business owner who's looking to sell or to exit is to make sure that they've got the right advisors around themselves.

Susie:

It's really important to get to know people in the market, to understand who the buyers are, and understand who the advisors are.

Purvi:

Outline your objectives. Be really clear going into that process - what is it that you want to achieve from the process?

Alisdair:

The most critical piece of advice for any business owner considering an exit is to conduct thorough research, to understand the different types of buyers and their motivations.

Andra:

Some excellent closing pieces of advice from our experts. When it comes to selecting the right buyer for your business, preparation is crucial, and that means due diligence is vital, ensuring you conduct thorough research on the different types of buyers, and seeking advice from professionals to help guide you through the process.

Andra:

We hope you've gained lots of invaluable advice from our experts from what's been an incredibly insightful episode on the buyer universe.

Russell:

Understanding the buyer universe is crucial for a successful exit. Not only does it increase your chances of finding the right match for your business, but can help you secure the optimum sale price and arrangements for years of hard work.

Andra:

In our final episode in the series, Business Transition to the Next Generation, our experts weigh up the pros and cons of keeping it in the family to help you shape a solid succession plan, and ensure a smooth transition.

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