Parting ways

Selling to a third party may be the perfect exit strategy. **Interviewed by Jerry Roche**

According to Joel J. Guth, an advisor in Smith Barney's Citigroup Family Office, selling to an outside third party is actually easier than selling the business to a family member or a group of key employees. "You can have open negotiations without feelings getting hurt," Guth says. "There is less emotion involved."

Smart Business, as part of its continuing series on exit strategies for business owners, talked to Guth about selling to a third party.

When you refer to a third-party buyer, what do you mean?

There are two kinds of third-party buyers. One is a strategic buyer who makes the purchase because it's a strategic fit for another existing business. The other is a financial buyer, a pure investor who is buying the business because he thinks the cash flow can grow and he can generate a return on his investment.

Joel J. Guth
Advisor, Citigroup Family Office
Smith Barney

What are the differences between a strategic buyer and a financial buyer?

Many times the strategic buyer is looking to cut costs and take advantage of synergies with existing businesses. This may mean the new owners will close locations, move offices and reduce jobs to eliminate any overlaps. As the new owner, a strategic buyer may ask the prior owner to leave immediately after the sale closing.

The financial buyer is usually looking for a business that can operate 'as is.' This usually means keeping the current facilities, management team and the bulk of the employees. Many times, a financial buyer will want the prior owner to continue to run the business and may offer lucrative incentives to help continue the success of the business.

Historically, one of the main differences between the two buyers has been the price each is willing to pay. Strategic buyers have been known to pay a higher multiple than financial buyers. However, as more and more money has flowed into private equity firms, the multiples private equity firms are paying has increased.

What are the advantages to, or benefits of, selling to a third party?

You can have open negotiations with a third party without feelings getting hurt because you're selling an asset in a truly open market. Also, multiple bidders can create a higher value and better terms for the seller because of the competitive process. Selling to a third party can be extremely attractive for owners who want their cash upfront and want to have very little of their financial future tied to the future success of the business.

The main reason people sell to third parties is they realize a third party is willing to pay a significant amount more than employees or family can pay. Many times, in order to give the owner what he needs to accomplish his objectives, the only solution is to sell it to a third party.

What are the drawbacks to selling to a third party?

The immediate concern can be the culture, mission or vision of the company that the owner has spent 25 years cultivating. You give up most control when you sell to a third party.

As mentioned before, the employees are always a concern because a third-party owner may come in and wipe out a portion of your work force.

It comes back to the seller's goals and objectives. If he is ready to walk away, then a strategic buyer may be a better fit. If he is not ready to walk away, he may need to pursue financial buyers.

Has the number of businesses being sold increased in recent years?

Movement has increased dramatically. A successful business owner may get three or four phone calls a week. It is all a function of the good economy, generous lending standards, demographics and the huge increase of capital in private equity funds. In other words, credit is readily available, baby boomers that started companies are now getting ready to do something else, and there are billions of dollars waiting on the sidelines to buy good businesses.

The rise of private equity capital has increased the flexibility an owner has when selling his business. A private equity firm is willing to buy 100 percent of the business or allow the owner to retain a portion of the equity in the business. For owners who think they are three to five years away from permanent retirement, a private equity group may offer a way to take some money off the table today, and owners can still run the business for a few more years.

Finally, with the dollar weakening, we're starting to see an increasing number of foreign investors coming into the marketplace. U.S. businesses have become cheaper for these foreign investors.

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JOEL J. GUTH is an advisor in Smith Barney's Citigroup Family Office. Reach him at joel.j.guth@citigroup.com or (614) 460-2633.