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**STRATEGIC INVESTMENT VERSUS FINANCIAL INVESTMENT IN
M&A**- Arnab Paul¹**ABSTRACT**

Want to know more about the distinction between financial and strategic buyers? To help you increase the value of your company understanding the attitude of various sorts of purchasers is essential to your preparation and decision-making processes, whether you're thinking about selling your business right now or making plans for a future transaction. Understanding the objectives of each type of customer can help you identify who best fits your needs and concentrate on the proper connections.

Discussions of investment banking activities commonly refer to "Financial Buyers" and/or "Strategic Buyers," particularly when talking about the sale of a firm. This article explores some of the differences between each type of buyer as well as various scenarios in which one could be preferable to the other.

Keywords: Strategic investment, Financial Investment, Business, Profit, Value.

INTRODUCTION

The question of strategic versus financial investment often arises while buying or selling a business. Understanding the attitude of various sorts of purchasers is essential for preparation and decision-making processes if someone is thinking about selling their business instantly or making plans for a future transaction². Understanding the objectives of each type of investor

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² Axial team, 'Governance and Finance' (*Middle Market Center*, 8 September 2014) <<https://www.middlemarketcenter.org/expert-perspectives/4-key-differences-between-financial-and-strategic-buyers#:~:text=One%20of%20the%20most%20significant,the%20capacity%20for%20earnings%20growth.> > accessed 10 September 2022

can help someone identify who best fits their needs and concentrate on the right relationship. Potential investors and buyers typically invest in the following two ways:³

STRATEGIC INVESTMENT

Strategic investing is a long-term game; it's not just for the money, even if that's the usual mode of operation. A more "strategic" view of investing is seen, investment done in the view that the new business complements them and adds value in some way, or to suppress competition, they are simply ready to buy again. Strategic investors are often looking for horizontal or vertical expansion, looking for a tactical alliance that would strengthen their operations.⁴ Strategic investors are capable of taking a liberal and patient approach when it comes to their development.⁵ They would not make any haste to get their share of profit on their investment. Sales business owners, entrepreneurs, or founders can have the freedom to continue growing your business the way you have without too much pressure to hit milestones within quarterly deadlines. The acquired company plays an active role in the acquired company in the belief that the value created by the two entities together will be greater than they could achieve alone.⁶

FINANCIAL INVESTMENT

A financial investment, on the other hand, is a little different because the end goal is often more lucid and specific. The ultimate goal is to achieve a financial return that exceeds the cost of providing this capital, while the investment reduces the risk of the overall portfolio. Conventional financial investors are the private equity firms using leverage to secure huge monetary profits. Therefore, a financial buyer tries to identify businesses with magnificent development capacity and, as a result, they could be profitable in a decade or less. They can look at the market opportunity, product, track record, team, and most importantly, exit potential. And the last point is very important for them to figure out how they would sell, long before they would buy. They can function with a large number of firms even simultaneously, due to their

³ ibid

⁴ Axial team, 'Governance and Finance' (*Middle Market Center*, 8 September 2014) <<https://www.middlemarketcenter.org/expert-perspectives/4-key-differences-between-financial-and-strategic-buyers#:~:text=One%20of%20the%20most%20significant,the%20capacity%20for%20earnings%20growth.> > accessed 10 September 2022

⁵ ibid

⁶ ibid

short-term investment strategy, so more and get a treasure trove of information, unlike a targeted strategic investor.⁷

DIFFERENCES BETWEEN THESE TWO FORMS OF INVESTMENT:

Assessment of the Potential of the Company

A notable difference between the two forms of investments is how it values a business. Since strategic investors usually integrate the acquired undertaking into a larger trade, they must consider the acquisition based on how the targets will "connect" to the business and business unit. For example, strategic investors would often ask you about things like:

1. Whether the product interests their customer?
2. Is the business serving new customer segments to them?
3. Is it possible to achieve economies of scale in production?
4. Are there any developed intellectual property or trade secrets that they would like to possess or prevent their business rivals from having?⁸

Financing buyers, on the contrary, usually evaluate the opportunity as a separate unit because it will not be integrated into a larger business. They are mainly interested in the capacity of the business to develop rapidly as soon as possible. Moreover, financial investors usually invest in semi-leveraged companies, causing them to consider the company's ability to generate a return on investment to repay debt.⁹

Impact of Investment Time Duration

Another notable difference between strategic and financial acquirers is the length of time they want to keep an acquired company. Strategic investors have an intention to hold on to a freshly acquired business permanently. However, financial buyers usually have an investment plan which will continue for less than a decade. This unlimited or limited retention period will affect

⁷ ibid

⁸ Axial team, 'Governance and Finance' (*Middle Market Center*, 8 September 2014) <<https://www.middlemarketcenter.org/expert-perspectives/4-key-differences-between-financial-and-strategic-buyers#:~:text=One%20of%20the%20most%20significant,the%20capacity%20for%20earnings%20growth.>> accessed 10 September 2022

⁹ ibid

a buyer's willingness to pay for a business.¹⁰ When a financial buyer purchases and then leaves a business, especially in the context of the overall business cycle, this will have a significant impact on its performance. For example, if a company is purchased at the height of the business cycle for a price and the buyer can only sell for less than that price five years later, it is unlikely to make a considerable profit. Therefore, As a result, they would be more prone to business cycle risks than strategic investors, and they would be considering plans to sell off a business eventually before making a final decision to invest in that business.¹¹

Investment Advantages of the Industry

The commercial enterprise in which the company functions would have to consider different situations depending upon the type of investor investing in it. Since strategic acquirers are often hitched to the conventional industry, by the nature of their primary good or service, they would invest a lot of time observing how the acquired company can fit into their gross business plan. As an example of strategic investment, Intel (hardware) acquired Mobil Eye (self-driving cars) for \$15 billion in 2017 because it wanted to get into the self-driving car industry and thought to buy Mobil Eye which was easier and cheaper. Typically, these strategic buyers are looking to make an acquisition that can have a quick and clear effect on profitability.

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Financial investors, on the contrary, look for the big picture which comprises both the business and the industry in which it operates. They are usually not associated exclusively with a single industry, so they must decide based upon both the attractiveness of that particular company and the attractiveness of the broader industry. It is not unconventional for financial acquirers to employ consulting firms from outside to help with the aforementioned assessment.¹³

Relevance of Back-Office Infrastructure

¹⁰ ibid

¹¹ Axial team, 'Governance and Finance' (*Middle Market Center*, 8 September 2014) <<https://www.middlemarketcenter.org/expert-perspectives/4-key-differences-between-financial-and-strategic-buyers#:~:text=One%20of%20the%20most%20significant,the%20capacity%20for%20earnings%20growth.> > accessed 10 September 2022

¹² ibid

¹³ ibid

The strategic buyer will be less focused on the relevance of the acquired company's existing "back-office" support (Information Technology, Human Resources, Accounts Payable, Legal, etc.) because it will be Eliminated during and after the amalgamation period since the acquiring company would have these already and it would be needless to hold onto them both. nevertheless, since financial investors might not possess these functionalities, they may need this back-office support system to sustain themselves.¹⁴

WHAT KIND OF AN INVESTOR WOULD BE BEST FOR THE ENTREPRENEURS?

- **If the business owner only wants a good price for selling off his business:**

If business owners want to get the most out of the sale of their business, they must opt for a auction arrangement, resulting in increases in the value of the business. Moreover in this case the strategic investor is the best solution, as he can offer more to the company in comparison to financial investors.¹⁵

- **If the business owners require some terms and conditions to be met:**

If individuals want a premium investment for their company and in addition to that are concerned about their plant and employees' well-being a strategic buyer would be a better choice. That said, sellers would be required to have limits for the buyback to make it work in their favor.¹⁶

- **If the business owner wants to sell the business without being made to discontinue as a part of the business:**

In such cases, financial buyers would be a sound choice. Strategic investors might not need any extra expertise as they usually have their own. On the other hand, financial buyers might have the money that they need to acquire a particular business, but they may not have the skill and experience to run the business. Hence, they may keep the managerial staff of the acquisitions.¹⁷

¹⁴ Axial team, 'Governance and Finance' (*Middle Market Center*, 8 September 2014) <<https://www.middlemarketcenter.org/expert-perspectives/4-key-differences-between-financial-and-strategic-buyers#:~:text=One%20of%20the%20most%20significant,the%20capacity%20for%20earnings%20growth.> > accessed 10 September 2022

¹⁵'Strategic-buyer-Vs-financial-buyer'(CFI,8September2021) <<https://corporatefinanceinstitute.com/resources/knowledge/deals/strategic-buyer-vs-financial-buyer/>> accessed 10 September 2022

¹⁶ibid

¹⁷Ibid

- Which type of investor is more inclined to spend more for your company?¹⁸

The answer to that is that strategic purchasers typically make larger purchases than financial buyers.¹⁹

This is so because, as I already indicated, a strategic acquirer would certainly value your business higher than a financial one.²⁰

A financial purchaser is probably aware of a path to long-term revenue growth through efficiency, product enhancements, or growth marketing spending.²¹

However, a strategic investor recognises a method to use your company to significantly and rapidly boost the value of its whole organisation. In other words, when the two enterprises are united, their worth rises.²²

Your company is probably worth more to the strategic buyer than to the financial buyer because the latter does not see a way to use it to create considerably more revenue than it did prior to the acquisition.²³

That's why the majority of sellers will seek out a strategic buyer before allowing a financial buyer in, or do so after a financial buyer approaches them unexpectedly. Because a strategic buyer sees your firm more favorably than a financial buyer, they are more likely to offer you a higher price.²⁴

It's another reason why you want to try to secure more than one offer for your business. The first offer you get might not be the greatest one, especially if it was unsolicited. Your company

¹⁸ They Got Acquired team, 'Strategic vs. financial buyer: What's the difference, and which one is best?'(theygotacquired, 29 June 2022)< <https://theygotacquired.com/resources/strategic-vs-financial-buyer/>> accessed 10 September 2022

¹⁹ ibid

²⁰ ibid

²¹ ibid

²²ibid

²³ ibid

²⁴ ibid

might be worth more to someone else depending on the buyer's plans for the company following the acquisition.²⁵

A financial buyer is a better option since they are more likely to give a subsequent payout in the near future. A strategic buyer may offer a higher purchase price for your company, though.²⁶

Here's the reason why. Imagine you sell a financial buyer a majority stake in your business, but you keep 20% of the company and continue to work there in some capacity. The financial buyer wants to expand your business over the following three to five years so that it can be sold for not only a greater price but also perhaps for a higher multiple. You might get a second paycheck as a result of that.²⁷

No matter what kind of buyer shows interest, knowing the reasons for that desire will set you on the right path to maximise the value of your company.²⁸

FEW MORE EXAMPLES TO SUBSTANTIATE ON FINANCIAL AND STRATEGIC INVESTMENTS;²⁹

A specific illustration of a strategic acquisition is the 2021 sale of The Hustle to Hubspot.³⁰

The Hustle was a newsletter startup with 1.5 million email subscribers before it was purchased by marketing software provider Hubspot. When coupled with HubSpot, The Hustle would generate significantly more income, as founder Sam Parr revealed on our podcast, because HubSpot could market to The Hustle audience.³¹

One plus one does not equal two in this situation, hence the acquisition was strategic because the value of the combined assets increased significantly. According to Parr , HubSpot ultimately

²⁵ They Got Acquired team, 'Strategic vs. financial buyer: What's the difference, and which one is best?'(theygotacquired, 29 June 2022)< <https://theygotacquired.com/resources/strategic-vs-financial-buyer/>> accessed 10 September 2022

²⁶ ibid

²⁷ ibid

²⁸ ibid

²⁹ ibid

³⁰ ibid

³¹ ibid

paid more than \$20 million for the media company. (The precise sale price was not made public.)³²

Here is an illustration of a financial investment.

In 2021, Laura Roeder sold the social media scheduling app MeetEdgar. SureSwift Capital, a private equity company that purchases and then runs SaaS (software as a service) enterprises, bought it.³³

She stated that "strategic purchases normally do have a greater multiple, if you can get one, but we hadn't really had strategic interest." She claimed that because "we are a profitable SaaS company," a financial buyer was a better fit after MeetEdgar sold for seven figures.³⁴

Even though we'd categorise Sure Swift as a financial buyer, the acquisition was obviously strategic for them in certain aspects. They can use the staff and systems they've already established to expand Meet Edgar because they own and run a number of other software businesses.³⁵

CONCLUSION

Different business sellers have different missions in mind. Therefore, the decision to choose between strategic and financial buyers is unique to each company. Sellers need to have a brief knowledge of the investor's world so that they can judge their decisions from their rational opinion.³⁶ The word "investment" can provide answers for a million different purposes, but what they all have in common is that they want to achieve their goals with as little risk as possible. Investors and sellers both want to grow more in the market and earn profits and

³² They Got Acquired team, 'Strategic vs. financial buyer: What's the difference, and which one is best?'(they got acquired, 29 June 2022)< <https://theygotacquired.com/resources/strategic-vs-financial-buyer/>> accessed 10 September 2022

³³ ibid

³⁴ ibid

³⁵ ibid

³⁶'Strategic-buyer-Vs-financial-buyer'(CFI,8September2021)

<<https://corporatefinanceinstitute.com/resources/knowledge/deals/strategic-buyer-vs-financial-buyer/>> accessed 10 September 2022

market share hence they interchange roles or substitute their roles to experiment with every permutation and combination possible to achieve this goal.³⁷

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³⁷Strategic-buyer-Vs-financial-buyer'(CFI,8September2021) <<https://corporatefinanceinstitute.com/resources/knowledge/deals/strategic-buyer-vs-financial-buyer/>> accessed 10 September 2022