

Essentials of Small Business Acquisition

A Primer for Potential Buyers

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Most of us have the basic inherent desire to control our own destiny. We want to set our own schedules, we want unlimited earning potential, and we want to chart our own course through life. Many times, however, those who once had such dreams are either stuck in the “traditional job” rut – living for the “security” of the next paycheck and dependent upon the benevolence of an employer for health insurance and other benefits. For most however, there ultimately comes a time of decision: Do I want to continue this employee/employer relationship for the remainder of my career, or is it now time to make the jump into self-employment? Oftentimes that decision is forced upon the employee by job loss or other event that suddenly places doubt upon future job status.

For those who are in the midst of such a decision, either immediate or somewhere down the road, the following should help to sort out both the benefits and the pitfalls of one solution to the dilemma – the purchase of an existing business.

Striking Out On Your Own

Once you have made the decision to start out on your own, you will be faced with three avenues to consider: starting your own business, buying a franchise, or buying an existing business.

Of the three, starting your own business is the riskiest proposition – you need ample capital, a well-thought-out business plan, and a marketable concept and the time to put everything in place. Sometimes being such a trial blazing “pioneer” can be both fun and fruitful. Too often however, being such pioneer can be fatal. As a friend once put it, “You can always tell the pioneers. They’re the guys with arrows in their back.” Statistics have proven that up to 80% of new business start-ups fail within the first five years of operation.

Buying a franchise can provide the thrill of a start-up business but with significant risk reduction. The value of the franchise is the brand name, tested and proven marketing and operating systems, and the support and training offered by the franchisor. Realize however, that any business start-up starts at zero and builds its business over time. The owners’ cash flow will follow this pattern. Be prepared for no or little income over-and-above operating expenses for a period of up to several years.

Buying an existing business can provide the best of both worlds: the product and the concept has been tested and refined during previous ownership, cash flow is immediate, relationships have been established with vendors, bankers, and customers, employees have been trained, and you – as the buyer – have a historical financial record of the business to minimize operating “surprises.” Oftentimes, buying an existing business can allow the buyer to benefit from the organization put together by the previous owner, yet be creative in growing the business to reflect his personality and take advantage of new opportunities. Just remember: when you buy a business, you’re not just “buying a job,” you’re buying a lifestyle, the chance to build your future, and the opportunity to leave your kids something of real value – the business you’ve built and nurtured.

Financing the Acquisition

Banks are notoriously leery of financing business purchases. Sure, they’ll fund your car loan and give you a mortgage to purchase your house, but they’ll generally shy away from funding business acquisitions, especially for borrowers with little or no direct operating experience with the business in question. Why? The answer is simple – most businesses have few hard assets that could be sold if need be to repay the loan in the event of default. Their “worth” is in their continuous, profitable operation. The last thing the bank wants is to have to operate your business successfully in order to secure repayment. Banks are in the business of lending money – not operating small enterprises.

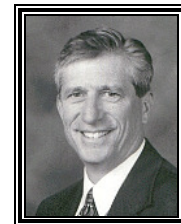
Oftentimes Small Business Administration (SBA) backed loans are available to fund start-ups and business acquisitions. The pluses and minuses of SBA loans are many and could be the subject of a separate article in-and-of itself. Suffice it to say, you should investigate SBA loan arrangements through your local banker or visit the Small Business Administration web site at www.sba.gov for more information or current lending requirements.

The easiest and most effective business acquisition financing is often available through the seller himself. Owner financing has become more commonplace in the business exchange marketplace as owners have come to realize that it represents the

quickest, easiest – and sometimes the only – way to ease the transfer process. As a buyer, always remember this: **The only rule about seller financing is that there are no rules.** The structure of the financing can take many forms: a traditional loan with normal repayment schedules, an “earn out” with payments based upon a percentage of future revenues or Net Operating Income (much like a franchise fee royalty), or any other formula that makes sense for you and the Seller. That is, in fact, the beauty of seller financing – as long as it makes economic sense for you and the seller and both parties are willing to be creative, it can be done and the deal can be sealed. Additionally, it should provide you with some comfort that the Seller now has a very tangible stake in your on-going success with his business.

Easing the Transition

Not only do you buy into a business to benefit from the on-going cash flow and the relationships that are already in place with employees, vendors, and customers, you also buy into an existing business to benefit from the knowledge of the Seller. All too often, a business owner operates by “rote” – the operating knowledge and “tricks of the trade” are in the owner/operator’s head with little in the way of written policies or procedures. As an essential element of your business acquisition, be sure to negotiate with the Seller to remain with the business for a short period of time – for most businesses, a few weeks should do – to allow yourself the opportunity to benefit from the practical operating experience the Seller has gained over the years.



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