

Twelve Laws of the Business Buying and Selling Jungle

(excepted in part from the book "[Strategies for Successfully Buying or Selling a Business](#)")

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I've worked with many business sellers and many more potential business buyers over the years and let me tell you; it's never easy getting a deal accomplished! I strongly believe and firmly advocate that the absolutely best way for an entrepreneur to successfully get into business, or expand what they already have, is buy an existing profitable company. But there are many obstacles and pitfalls along the way that must be overcome. It really is a jungle out there!

To help those who are considering buying or selling a business, I offer the following overview of what I think are the twelve most important Laws of the Business Buying and Selling Jungle. These have been excerpted in part from my book, *Strategies for Successfully Buying or Selling a Business*, in which each Law is examined and discussed in much greater detail.

Jungle Law #1: Lawyers Are Deal Killers!

There certainly is an important role for a competent commercial law attorney to advise and prepare the legal structure of a business purchase and sale transaction. The problems arise when lawyers see themselves as business negotiators whose mission is to get the "best deal" for their clients. They frequently forget that the "best deal" has to involve both parties, the buyer and the seller, and that compromise is usually the best solution. Lawyers generally have a very difficult time with compromise in this type of situation because they often see their role as advising their clients on how to get the better deal. Usually, an attempt at a lopsided deal for either party will result in "no deal" at all.

Jungle Law #2: Caveat Businessus Emptor; (Let The Business Buyer Beware!)

As a matter of basic principle (and law in most States), all business brokers dealing with the public are bound to be honest and forthright in their conduct concerning the businesses that they represent for sale. But they also have a fiduciary relationship (position of trust) to uphold

between themselves and their clients (the business seller, in most cases). They must present a business for sale in its "best light" without misrepresenting any significant facts but at the same time not pointing out all of the potential business pitfalls. This usually establishes an adversarial relationship between the buyer and the broker as well as between the buyer and the seller. The best course of action for a buyer is to trust only what they can verify during a rigorous due diligence process and the best approach on the part of the seller/broker is full disclosure of all pertinent information.

Jungle Law #3: A Business Is Worth Only Whatever Someone Is Willing To Pay For It At A Particular Point In Time!

Buyers and sellers are natural adversaries; the sellers want as much as they can get and the buyer wants to pay as little as possible. The broker is intensely interested too, because the commission amount is usually based on a percentage of the total selling price. So, what process should you use to value a business? Forget about putting a value on the assets based on resale value. Forget about comparing the business to the one in the next town that sold for a particular amount. Forget about all the "rules of thumb" like X times earnings or Y times gross income or some dollar amount per account or any other shortcut formula. A business value, and therefore its selling price, only makes sense when it's based on the capitalized earnings stream. Capitalization is simply the process used to determine today's value of a stream of future earnings. In the case of valuing a business, "today's value" is the value of the business, and the "stream of future earnings" is the expected future years' profit of the business based on current earnings. Most small businesses sell for a price in the range of 2-5 times earnings before interest and tax expenses are deducted.

Jungle Law #4: A Business Buyer Is Really Buying A Stream Of Earnings!

The assets of the business are just the tools of the trade that enable an earnings stream to be realized. Without the earnings stream, the business essentially has no value. You should note that in using this method, a business may actually be worth less than its fair market asset value or in many cases worth substantially more. A seller will be able to get the most they can for a business by showing a buyer the true investment value in the business based on provable earnings.

Jungle Law #5: Ignore All Claims Of Unreported Income!

This is a very sensitive subject known as unreported (to the IRS) cash sales. Some business sellers may try to get you to accept their claim that they had significant amounts of cash income that did not show up on their IRS Tax Return and accordingly want you to include this phantom income in your valuation of their business. I highly recommend that you totally ignore these claims and deal only with the business's reported income. Who is to say if the business owner's claims are true? If the business owner will lie to Uncle Sam might they not also lie to you?

Jungle Law #6: Most Sellers Are Fibbers! (Or They At Least Stretch The Truth)

Of course, this is not a completely true law of the jungle. Most sellers are honest people trying to get by in life like everyone else. However, a buyer should approach all information provided in the sale with some skepticism. Buyers are making a major financial decision and should carefully consider all information presented during a detailed due diligence process. If a buyer approaches the purchase of a business with a good healthy dose of "prove it to me," then it will be difficult for them to get burned.

Jungle Law #7: If A Seller Really Wants To Sell, You Probably Shouldn't Buy!

Whenever you look at any business for sale, you should approach the situation with a great deal of caution. You should make it your business to verify all of the facts possible about the business, including determining the reason for sale. There are some very good motivations for sellers to sell and other ones that are not so good. Usually, the best reason for a sale from the buyer's perspective is the planned retirement of the owner or a sale necessitated by illness. By far, the best potential purchase is a long-standing single-owner profitable business where the owner is approaching (or at) retirement age and is generally reluctant to sell but realizes that he eventually has to.

Jungle Law #8: 99% Of Potential Business Buyers Never Buy A Business!

This alone may be reason enough for a seller to retain a business broker to represent him in selling the business. A professional broker

knows how to sort through the many non-qualified potential buyers to get to the few who actually do have the means and motivation to buy a business. Once the unqualified potential buyers have been culled out, still only somewhere around 50% of these folks eventually buy a business. For this and many other reasons, I strongly recommend that sellers use a professional business broker to represent them in selling their business.

Jungle Law #9: Always Assume There Are Skeletons In The Closet!

Most businesses have some negative feature(s) that the seller will be reluctant to talk about. You can be sure that any problems will come out later as buyers begin analyzing the business (due diligence), and it could kill the sale if the problems are perceived as cover-ups. This is because buyers will ask themselves (logically) "if they hid this fact from me, what else are they hiding?" If the negative aspect(s) is clearly presented and discussed with the buyer, it may not be a serious problem because the buyer may feel that it can be overcome, avoided, or changed. The seller should strongly consider this and determine all of the possible negative factors that could affect the sale of the business. If the problems are very serious and non-correctable, the business may not be salable.

Jungle Law #10: Someone Will Always Get Cold Feet Just Before The Closing!

Closing the deal is always difficult, but usually the shortest part of buying or selling an operating business. After all, the valuations, investigations, and negotiations are complete and now it's a matter of getting everything into writing in a form that satisfies everyone so that the transfer of ownership of the business can take place. However, you can definitely count on someone getting cold feet just before the closing. Be prepared for this! The seller and buyer may both start to wonder if they are really getting a fair deal. The best way to get ready for this is to anticipate it happening and then to deal logically, reasonably and unemotionally with it at the time.

Jungle Law #11: Negotiations Must Stop At The Signing Of The Purchase And Sale Agreement!

Once the Purchase and Sale Agreement has been signed by both the seller and buyer, there is an excellent chance that the sale will actually take place. But, there must be an end to the negotiation process or

things will begin to unravel. The deal at this point is like a house of cards with many parts of the negotiated deal contingent on another part. Trying to reopen negotiations after a Purchase and Sale Agreement has been signed will most likely lead to a collapse of the entire deal.

Jungle Law #12: After Buying A Business, Do Not Change Anything (At First)!

Of course, this doesn't hold true if you're buying a turnaround situation; but in general, if the business you are buying is profitable, leave it alone while you learn how to manage it in accordance with the status quo. One of the experiences I have had that best illustrates this point is as follows: One buyer of a fast food chicken franchise soon after the closing changed meat suppliers because he found that he could get the chicken at 10¢ a pound cheaper. What the new owner did not realize was that these chicken pieces were 25% larger than those provided by the original supplier. The problem with this is; the franchise doesn't sell chicken by the pound; it sells it by the piece. The new franchise owner completely wiped out his profit margin by paying a smaller price per pound but delivering to the customer 25% more chicken at the same retail price!