

## Buying a Business Tips for Business Buyers



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## INTRODUCTION

Are you planning on buying your own business? Buying your own business can be a complicated procedure. Throughout the buying process, it's important to keep an open mind while searching for a business that will fit your needs, talents, skills and lifestyle. A business broker has many different types of businesses for you to consider; however, you need to remember that there is no such thing as that "perfect" business. Another vital thing to keep in mind is that at some point you must be able to make the "leap of faith" that separates you from being a "looker" to a "doer." This isn't easy, but it must happen if you are ever going to be in business for yourself.

Going into business for yourself is a big step, one that can be full of apprehension and even fear. Almost 90 percent of all those who purchase a small business have never owned a business. Most of them bought a business that was different than what they had been looking for. These buyers had the opportunity to explore the marketplace and subsequently found a business more to their liking. In most cases, the seller financed the sale.

As you begin your search, keep in mind that running your own business is more than a job; it is a lifestyle change. In most cases, it is a very big lifestyle change. Usually, you will be working longer hours, making all of the decisions, and, as the expression goes, "you will be the chief cook and bottle washer." In other words, you will be doing all of the work from running the business to, in many cases, sweeping the floor and changing the light bulbs.

### **Most buyers are looking for many of the following in considering the purchase of a business:**

- Pride in the service or the product
- Flexibility
- Income
- Control of your own destiny
- Recognition
- Security
- Privacy
- Status
- Customer and employee contact

## WHAT TO LOOK FOR

### **1. How long the business has been in business.**

A business with a long track record means there are good reasons to be operating. It will be well known in the area, and people will be used to patronizing the business or using its services. The longer it has been in operation, generally, the better the business.

### **2. How long the present owner has owned the business.**

The longer the present owner has been in business, the more likely he or she has been successful. People don't stay in business if they are not making money.

### **3. Why the present owner is selling.**

If the owner has been in business for six months, is 37 years old, and wants to retire, you should be suspicious. The more valid the reason for sale, the more realistic the seller will be in considering your offer. However, keep in mind that after five or six years or more, people do get restless, "burn-out" sets in, and people look for new challenges. Why the seller is selling is an important question - get the answer.

### **4. Why books and records are important.**

The financial records are a good indication of how well the business has been doing over the years. Keep in mind that tax records are not designed to show the business in the best light: no one likes to pay more taxes than they have to, and owners of businesses are no different. Generally, tax returns are a worst case scenario. You need to be able to look at the expenses and discover which ones are non-cash items, such as

depreciation, and business use of home and vehicles. How important was the business trip to Las Vegas? A professional business broker can point these items out to you. When in doubt, however, seek outside assistance.

Keep in mind that financial records are only history. There are no guarantees that they will or can be duplicated or repeated. All of your profits are future. In the final analysis, the financial records of the business are an indicator of what the business has done; what you do with its future is up to you.

#### **5. How to determine if the seller is reporting all income.**

The simple answer is - that you can't! Not reporting income is against the law. You should consider only the income that the seller can show you. We all know, of course, especially in cash type businesses, that there is the possibility that the seller is not reporting all of his or her income for tax purposes. This "underground economy" has been well-documented and is in the billions of dollars. Many sellers will tell you about how much they are "skimming," but you should ignore their statements, since they have no way of proving these amounts. In determining whether a business is the right one for you, you should base the decision on the figures actually supplied to you by the seller.

#### **The Bottom Line**

Being in business for yourself can be a daunting prospect. There are no guarantees. At some point, after all of your investigation is completed, you will still have to make that "leap of faith" that is necessary to proceed with the purchase of the business. You will have to work hard, perhaps even "tighten your belt" a little and perform many different jobs to be successful in your own business. But, if running your own show, making your own decisions, not having to worry about job security (remember, no one can fire you from your own business), and just being on your own are important - then owning a business is for you. After taking this leap of faith, almost all business owners will tell you that they would never go back to being an employee.

#### **LOOKING AT THE NUMBERS**

##### **What should you look for when considering a business to purchase?**

Unfortunately, too many prospective buyers want to know the asking price first and then ask how much money they can make. These are the wrong questions to ask initially. You need to know how much cash the seller requires as a down payment. No matter how good the numbers are there is no point in looking at a business if the seller wants three times as much cash as you are willing to invest. Remember, the actual amount of money a business earns is usually much more than just the bottom line. A smart approach is to get more information on the business, and even make a visit, before ruling it out or getting too involved in the numbers. It's all part of the learning process.

#### **THE BUYING PROCESS**

One of the most common questions asked by those who have never purchased a business (which is incidentally about 90 percent of those looking to buy a business) is how do you actually buy a business. There is no right or wrong way to buy a business. However, it is important that you get answers to all of your questions and that you have all the information necessary to make an informed decision. Here are the steps to buying a business that over the years have become the most efficient and practical:

##### **Get the Basic Facts**

Get preliminary information on price, terms, income, cash flow, and general location. There is no point in continuing the buying process if the amount of cash necessary to buy the business is more than you are willing to invest. At this point, don't worry about the full price. It's important, but the key factor is the amount of cash that is necessary to buy the business. There is very little outside financing available such as banks, etc., for those who are purchasing businesses. The great majority of business purchases are financed by the seller. This is why the amount you are willing to invest is a key issue.

Also, the business has to be able to meet your basic financial needs. You always expect a business to improve under your ownership, but you have to be able to meet your living expenses as well as meet the debt service of the business. It is also important to remember that almost all purchase prices and down payments are negotiable. In fact, businesses generally sell for about 15 percent to 25 percent less than the original asking

price. There is an old adage that says, "the more cash you are willing to invest in a business purchase, the lower the full price; the less cash you are able to invest the higher the full price.

### **Visit the Business**

Visit the business to see if you like the location and the looks of the business itself - both inside and outside. This is a visual inspection. Pretend you are a customer. It's not time yet to talk to the owner. If the business is the type that does not lend itself to a visit, make an appointment with the seller to inspect the business, or have the seller's representative schedule a visit. There is no point in going any further if you don't like the physical location of the business or the appearance of it.

### **Get Questions Answered**

If you like the business so far, it's time to get your questions answered. For example: What is the rent? How long is the lease? What have been the sales for the past few years? Can the seller support the figures you have been told? Now is not the time to have the seller's books and records completely checked. There will be plenty of time to do that and review other important issues during the due diligence phase. This is the time to get those questions answered that have a bearing on whether you may want to own and operate this particular business. It is also the time to visit with the seller to get your questions answered about the business itself.

### **Make an Offer**

If you now have your basic questions answered and you want to proceed with purchasing this business, it is time to make an offer, subject, of course, to verification of all the information you have received. The main purpose in making an offer is to see if the seller will accept your terms, price, and structure of the sale itself. Remember, you will have the offer subject to your verification of the important information. It doesn't make sense to employ outside advisors and go through the time and expense of due diligence unless you can come to financial terms with the seller.

### **Due Diligence**

At this point, you hopefully have arrived at a meeting of minds with the seller, and you are ready to begin removing the contingencies, performing what is commonly called due diligence.

#### **\*Insider Tip**

Unless you are completely familiar with the type of business purchased, it is beneficial to include as part of the agreement that the seller will stay with you (30 days is fair, with perhaps another 30 to 60 days of telephone consultation) a sufficient length of time to teach you the business - at no charge. If you want the seller to stay longer, it may be best to offer to pay him or her a consulting fee of some type.

### **IS BUYING RIGHT FOR YOU**

The next step to buying your own business is to make sure it is the right move for you and your family. Owning one's own business is still very much "the great American dream," but it's not for everybody. Here are some questions that you should ask yourself before taking the next step. How long have you been thinking about buying a business? Many people are interested in buying their own business, but are not willing to make the commitment necessary to move forward. They continue to look just like those who continue to look at new and expensive automobiles, but will never spend the money necessary to buy. One veteran observer has said that the longer you look the less likely you are to buy.

#### **What is your time-frame to find a business?**

If you're thinking of buying a business in two years, it's good to start your education. BizBuySell is a good place to start. Keep in mind that it really doesn't make much sense to start your search now, since any business you find now will have been sold by the time you are ready to buy. It's important, however, to arm yourself with all of the information and education available before you begin the search.

#### **What is your primary reason for buying a business?**

If you are not motivated to buy a business, you won't. You must go into business for yourself and for the right reasons. If you're tired of the corporate world, just have a "job-job," or perhaps even a dead-end job, then business ownership may be right for you. Certainly if you're unemployed or being transferred to a place where you don't want to go - buying your own business can be a viable solution.

#### **Are you willing to invest a majority of your liquid assets in a business?**

Buying your own business requires a serious financial investment. If you're the type who does not want risk, you might want to rethink owning your own business. It is not for the faint-hearted.

#### **Are you independent enough to make your own decisions and be in control?**

Operating a small business requires continual decision making. You're the boss, and you are in control. All of the decisions are yours - right or wrong. And, you will make a lot of wrong ones. The question is, can you recover and keep going forward? If you brood about poor decisions or they keep you awake at night, owning your own business may not be for you.

#### **Is your family supportive of your owning a business?**

If your family, especially a spouse, is not behind you 100 percent, then you should think twice about business ownership. It's very important that you have the support of your spouse. He or she has to understand that running a business can be time-consuming. On the plus side, however, many businesses do allow for flexibility so you can attend the afternoon little league game.

#### **Are you open-minded about different opportunities, or are you looking for a specific type or business?**

It's best if you are open-minded, especially if you are a first-time buyer. There are many types of businesses available, and you don't want to limit your choices. You should be looking for a business that will provide the income you need (or ability to do so), that you can afford, that has numbers that work, and, most importantly, that you can see yourself running.

#### **Do you have reasonable expectations?**

Do you think that you can buy a business with lots of cash flow for \$100? It's important that you have realistic expectations about what your money will buy. Many sellers are willing to assist in financing the sale of their business, but remember, they're not going to give it away. Keep in mind that many business owners have spent years building their business, and it may represent the biggest financial asset they have. They're not going to just hand it over to you.

#### **Can you make the "leap of faith" necessary to buy a business?**

Many prospective business owners do their homework, do everything necessary to begin the purchase process, and then back out of the transaction. They just don't have the courage to go forward. There is nothing wrong with that; not everyone should buy and own their own business. However, if you don't think you can part with your money and take over operating the business on your own, you may want to take a second look at business ownership.

#### **Do you need a guarantee?**

If you are looking for a guarantee or a sure thing, then business ownership is not for you. You can and should look at all of the financials, tax returns, and all of the books and records. Remember, however, that they all represent history. You can't buy anyone else's history. A new owner makes changes, no matter how subtle. Their management style is different, and times change. You have to look at the business with the attitude of how you can improve things. The financial history of the business is certainly important, but it does not guarantee the future of the business - you do.

### **COMMON BUYER QUESTIONS**

#### **Why should I buy a business rather than start one?**

An existing business has a track record. The failure rate in small business is largely in the start-up phase. The existing business has demonstrated that there is a need for that product or service in a particular locale. Financial records are available along with other information on the business. Most sellers will stay and train a new owner and most will also supply financing. Finding someone who will teach you the intricacies of running a business and who is also willing to finance the sale can make all the difference.

### **What is the real reason people go into business for themselves?**

There have been many surveys taken in an attempt to answer this question. Most surveys reveal the same responses, in almost the same identical order of priority. Here are the results of a typical survey, listed in order of importance:

**To do my own thing, control my own destiny.**

**Don't want to work for someone else.**

**To better utilize my skills and abilities.**

**To make money.**

\*It is interesting to note that money is not at the top of the list, but comes in fourth.

### **How are businesses priced?**

Generally, at the outset, a prospective seller will ask the business broker what he or she thinks the business will sell for. The business broker usually explains that a review of the financial information will be necessary before a price or a range of prices can be suggested for the business.

Most sellers have some idea about what they feel their business should sell for - and this is certainly taken into consideration. However, the business broker is familiar with market considerations and, by reviewing the financial records of the business, can make a recommendation of what he or she feels is what the market will dictate. A range is normally set with a low and high price. The more cash demanded by the seller, the lower the selling price; the smaller the cash requirements of the seller, the higher the price.

Since most business sales are seller-financed, the down payment and terms of the sale are very important. In many cases, how the sale of the business is structured is more important than the actual selling price of the business. Too many buyers make the mistake of being overly-concerned about the full price when the terms of the sale can make the difference between success and failure.

An oft-quoted anecdote may better illustrate this point: If you could buy a business that would provide you with more net profit than you thought possible even after subtracting the debt service to the seller, and you could purchase this business with a very small down payment, would you really care what the full price of the business was?

### **What should I look for?**

Obviously, you want to consider only those businesses that you would feel comfortable owning and operating. "Pride of Ownership" is an important ingredient for success. You also want to consider only those businesses that you can afford with the cash you have available. In addition the business you buy must be able to supply you with enough income - after making payments on it - to pay your bills. However, you should look at a business with an eye toward what you can do with it - how you can improve it and make it more productive and profitable. There is an old adage advising that you shouldn't buy a business unless you feel you can do better than the present owner. Everyone has seen examples of a business that needs improvement in order to thrive, and a new owner comes in and does just that. Conversely, there are also cases where a new owner takes over a very successful business and not soon after, it either closes or is sold. It all depends on you!

### **What does it take to be successful?**

Certainly, you need adequate capital to buy the business and to make the improvements you want, along with maintaining some reserves in case things start off slowly. You need to be willing to work hard and, in many cases, to put in long hours. Unfortunately, many of today's buyers are not willing to do what it takes to be

successful in owning a business. A business owner has to, as they say, be the janitor, errand boy, employee, bookkeeper and "chief bottle washer!" Too many people think they can buy a business and then just sit behind a desk and work on their business plans. Owners of small businesses must be "doers."

### **What happens when I find a business I want to buy?**

When you find a business, the business broker will be able to answer many of your questions immediately or will research them for you. Once you get your preliminary questions answered, the typical next step is for the broker to prepare an offer based on the price and terms you feel are appropriate. This offer will generally be subject to your approval of the actual books and records supporting the figures that have been supplied to you. The main purpose of the offer is to see if the seller is willing to accept the price and terms you offered.

There isn't much point in continuing if you and the seller can't get together on price and terms. The offer is then presented to the seller who can approve it, reject it, or counter it with his or her own offer. You, obviously, have the decision of accepting the counter proposal from the seller or rejecting it and going on to consider other businesses.

If you and the seller agree on the price and terms, the next step is for you to do your "due diligence." The burden is on you - the buyer - no one else. You may choose to bring in other outside advisors or to do it on your own - the choice is yours. Once you have checked and approved those areas of concern, the closing documents can be prepared, and your purchase of the business can be successfully closed. You will now join many others who, like you, have chosen to become self-employed!

### **Why should I go to a business broker?**

A professional business broker can be helpful in many ways. They can provide you with a selection of different and, in many cases, unique businesses, including many that you would not be able to find on your own. Approximately 90 percent of those who buy businesses end up with something completely different from the business that they first inquired about. Business brokers can offer you a wide variety of businesses to look at and consider.

Business brokers are also an excellent source of information about small business and the business buying process. They are familiar with the market and can advise you about trends, pricing and what is happening locally. Your business broker will handle all of the details of the business sale and will do everything possible to guide you in the right direction, including, if necessary, consulting other professionals who may be able to assist you.

Your local professional business broker is the best person to talk to about your business needs and requirements.

### **Do I need an attorney?**

It may be advisable to have an attorney review the legal documents. It is important, however, that the attorney you hire is familiar with the business buying process and has the time available to handle the paperwork on a timely basis. If the attorney does not have experience in handling business sales, you may be paying for the attorney's education. Most business brokers have lists of attorneys who are familiar with the business buying process. An experienced attorney can be of real assistance in making sure that all of the details are handled properly. Business brokers are not qualified to give legal advice.

However, keep in mind the fact that many attorneys are not qualified to give business advice. Your attorney will be, and should be, looking after your interests; however, you need to remember that the seller's interests must also be considered. If the attorney goes too far in trying to protect your interests, the seller's attorney will instruct his or her client not to proceed. The transaction must be fair for all parties. The attorney works for you, and you must have a say in how everything is done. If you know someone who has owned their own business for a period of time, he or she may also be a valuable resource in answering your questions about how small business really works.

You have to make the final decision that "leap of faith" between looking and actually being in business for yourself is a decision that only you can make!