The Essentials of Business Acquisition

Most of us have an 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 have such dreams have resigned themselves to living for the security of the next paycheck and depending on an employer for health insurance and other benefits. For others, there may come a time of decision: Remain employee for the remainder of their career or consider self-employment? Often, that decision is forced by job loss or another event that suddenly places doubt upon future job status. For those who are in the midst of such a decision, one viable option is business ownership.

Considering Business Ownership

There are three avenues to consider for business ownership: 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. Taking risks can be both fun and fruitful. Too often however, it can be fatal. 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 the risk significantly reduced. 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 can take up to two years to yield a profit.

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. When you buy a business, you are not just “buying a job,” you are buying a lifestyle, the chance to build your future, and the opportunity to leave your kids something of real value.

Conducting Due Diligence

Your due diligence on a business acquisition should be conducted with care and is typically divided into two stages. A preliminary due diligence is performed prior to making an offer and will include a review of general company information and detailed financial records. In your offer to purchase, you will want to list numerous contingencies allowing you an “out” if any one of the contingencies is not met. Upon acceptance of your initial offer, you will conduct a second phase of due diligence where you will be allowed to review and audit any information pertaining to the business.

Utilization of advisors, such as accountants and attorneys, is highly recommended, but you need to keep in mind that advisors are concerned about legal liability so they will most likely point out discrepancies with the business and be overly cautious about recommending a business acquisition. Your job will be to analyze their recommendations, review the data and facts pertaining to the business and determine whether the acquisition meets your own goals, options and risk factors.

Securing Financing

Banks are leery of financing business purchases, especially for borrowers with little or no direct operating experience with the business in question. Most businesses have few hard assets that could be sold 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.

Small Business Administration (SBA) backed loans are often available to fund start-ups and business acquisitions. However, SBA loans can be difficult to obtain due to financial, operational and collateral issues. You can investigate SBA loans through your local banker or visit the Small Business Administration web site at www.sba.gov for more information on current lending requirements.

Business acquisition loans are easier to obtain if they are combined with seller financing or earn-outs. Seller financing and earn-outs are common in business transfers. The structure of the financing can be designed as a traditional loan with normal repayment schedules or an earn-out with payments based upon a percentage of future revenues. Seller financing or earn-outs will provide you with some comfort that the seller now has a vested interest in your on-going success with the business.

Learning from the Previous Owner

You buy into an existing business to benefit from its income stream and the relationships that are already in place with employees, vendors, and customers. You also buy into a business to benefit from the experience of the seller. All too often, the operating knowledge gained by the owner is not documented and there are few written policies or procedures. As an essential element of your business acquisition, be sure to negotiate for the seller to remain with the business for a certain period of time to benefit from the operating experience the seller has gained.

Purchasing an existing business is a big decision and one you should consider very carefully. Make sure you utilize advisors, conduct a thorough due diligence of the company, negotiate seller financing and try to learn as much as you can from the existing owner. Like many business owners, you should find the experience to be very rewarding!