Buying A Business - The Basics

Buying a business in today’s economic climate requires that you, the buyer, be on the ball, with regard to business basics. This economic climate, as far as businesses are concerned, is a sellers market.

With the corporate downsizing, economic downturn and other factors, there are a lot of very knowledgeable buyers out there looking for one of the very few good business to buy. This means that you, as a buyer have a lot of competition. Consequently, you need to be well prepared. Professional business buyers, report that it takes anywhere from 3 months to 3 years to find the right business. So, if anything, what can be done to speed this looking process and at the end finally get a good business?

The decision – the first step is deciding to buy a business. Once you have made this decision and you are definite and firm about the fact that you are definitely buying a business, the process has started.

The second step is to decide what kind of business. This is really really important. What are the criteria for this business you are looking to buy? Do not make a wish list or what would be nice. Make a list of what is important. For example, if your standard of living requires $100,000 income, do not compromise by looking at businesses that make only $50,000.

That is unless you consider yourself a knowledgeable business manager and marketing person who knows that any business they buy will double in income and sales. That kind of buyer can buy a business that makes no profit and probably should.

Other criteria include; is it something you can handle? What kind of work are you willing to do? If you like sales and do not like running a factory, buy a distribution company, or sales organizations, and do not buy a manufacturing firm, unless you have a partner that likes running a production line.

I have people call me to inquire about buying a body shop that have no automotive experience at all. You can buy an auto repair shop, muffler shop, brake shop or lube store, and learn the business, with no experience to start. You probably should not buy a salvage yard body shop, or scrap yard with out being raised in the business. If you are a salesman you can buy almost any business.

All manufacturing, distribution or retail sales require good personal sales skills. If you are poor at communication skills or English is a second language, consider buying a liquor store, gas station or hamburger stand, just a few of the businesses that do not require, personal selling, or do they?

About you - There are some things you need to prepare for the brokers when they start coming to you with possible businesses. You need to make sure that you have your down payment sorted out. Expected down payments are anywhere from 25% to 100% of the selling price. So make sure you know what you want to spend and then make sure you have the down payment easily available.

Then you need to get your financing options determined. You can get yourself pre-qualified for a business loan or an SBA loan if the business you are buying is required by you to show a profit on the books. SBA loans are only available to businesses that have shown a 5-year profit on their tax returns. If you are looking at businesses that are heavily unrecorded income, you must have cash or seller financing.

Being your own broker - You should determine who is going to make your offer. A broker, or yourself? If it is you then you should locate the necessary offer forms and study them carefully. Determine what must be in your offer so that you can put in an offer, the instant you find a business that meet your requirements. This is an important step, as putting in an offer tends to lock out other buyers while you look over the business. Make sure you have contingencies in your offer, which means you have lots of “get out of the deal” clause.

I would like to suggest, for the less experienced buyer to hire as a consultant the sharpest attorney or business broker you can find and pay him for his time to watch your rear end, in negotiations and in reviewing the companies you are considering buying. In real estate we call this a buyers agent, except with businesses the listing agent will not always co-operate in splitting the commission. This means you need to be willing to pay your agent an hourly fee for helping you. Let me give you a real example.

David and his father were looking for a business to buy. They were interested in a Scrap yard that I was selling. I asked their buying agent to bring them over so I could interview them and to explain this business to them. In 3 minutes it was clear that they should not even consider this business. We spent the balance of the meeting talking about the businesses they had looked at and the pros and cons of each. I gave them my honest suggestions about each from their description. They thanked me and left.

Two months later David calls and asked if he could come talk to me. He told me about an FSBO “For Sale by Owner,” who would never pay any agent a commission unless he got his price + the commission. That of course doesn't make sense to a buyer. David told me about the deal and I gave him my honest opinion about it. David asked what my time was worth and gave me a check for an hour's time.

Two months again passed and David called and said, "I need to see you today." He proceeded to tell me about a Car Wash Soap manufacturing company that was suppose to be making $500,000 profit per year. The asking price was $2 Million. David wanted several things from me. He wanted my opinion of the business, he wanted me to help get the price down to a more reasonable amount and he wanted me to verify the income. It took me 30 hours of reviewing the books and talking to the seller to determine that the business was making only $350,000 per year including what was not on the books. The books were made complicated, intentionally so that no one could understand what was going on.

I related my findings and told David he had to do his own negotiations but I would coach him every step of the way. David paid my fee and I didn't hear from David for one year. When he called, I asked what happened to the car wash soap business. He filled me in on the story.

He bought the business for more than I suggested because he saw where he could improve the business instantly. The profit turned out not to be $500,000 as the seller guaranteed, but exactly $350,000 as I had determined. David took over sales and marketing and within 1 year had the company profit up to the $500,000 he was promised.

David now had found a related business that had been listed with an agent who did not understand the business he was marketing and could not sell it. David was now talking to the seller directly. The seller wanted $550,000. David wanted me to negotiate, on a consulting fee bases with the seller to get the price down.

I instructed David that I would appraise the business, and convince the seller that my appraisal was accurate, but David had to do the negotiations. The seller would never talk to me about the inside details if he was negotiating with me directly. This time I spent 5 hours with the seller, not the books, to determine the business was worth $350,000. The seller would not take the price, but felt I had done an excellent appraisal. I suggested to David to wait 60 days and open discussions again. I also told him the seller would eventually take the $350,000.

I again didn't hear from David, this time for 6 months. When David called I asked for his report on what happened. The seller called him after one month and sold the business to him for my appraised amount, just as predicted. What did David want this time? Two guys wanted to buy the business and David wanted me to justify a price of $500,000? I did my updated analysis and got paid. I will not find out what happened until David calls me with my next assignment.

Get the word out - Now that you have got all of your preliminary work done you are ready to go looking for businesses. You are ready to look for businesses for sale. Go on to the Internet and look at sites that have businesses for sale. Look in the classified section of your county newspapers and look at what is for sale. Contact business brokers and tell them what you are looking for in detail. Call on broker listings and FSBO (For Sale by Owners.) When you find something interesting you move through the steps with a broker, accountant or attorney or without a broker, accountant or attorney.

Find out what financial records they have. This will eliminate 75% of the businesses. The records are false because of cash sales and/or cash payroll. A lot of auto repair shops pay their mechanics a base salary on the books and the balance in cash. This is crazy and illegal. They have cash sales, which are illegal, and not reported and then they give this money to the employees illegally. Have fun figuring out the profit on these businesses. Some businesses do not want to give you any financials. They do not even want to lie to you about the numbers; they just do not give them to you. You need financials even to just see what the operating expenses are.

Cash income -- The problem with cash income, besides being illegal is it is unconfirmed. Jack bought a body shop doing $60,000 sales on the books. The seller showed Jack records that proved to Jack, an experienced body shop owner that the business was really doing $125,000 a month in sales. After escrow closed Jack was given the production records for the last 5 years by the general manager that stayed with the company. The business was doing $60,000. Exactly what was on the books! There was no cash. The seller reported every dime. I hate to say it but if someone were willing to lie to the government and their business broker, why would they tell you the truth?

Find out what the seller wants – the next key step is to ensure that you find out exactly what the seller wants. You have already stated what you wanted when you got the word out. Now, you need to make sure you understand what the seller wants. Make sure you get full information on this from the broker or seller. On this step, you are basically finding out what the seller wants for his or her business exactly. That includes, down payment, seller carry back terms, time he is willing to train you to run the business, and what he is including in the price. Inventory can be included or extra. Leased equipment basically has you as the buyer assuming the debt, where financing on owned equipment is paid off in escrow or the price is lowered because you are assuming the debt. With all of this information, you can begin your negotiations.

Negotiate – Ok, now you know what the seller wants and you know what you want. On this step, the objective is to get the two wants to match up and agree with each other, so that the deal can take place. What you are trying to do at this stage is decide if you are going to go ahead with the deal or if you are going to continue talking with the broker and the seller until what they want is closer to what you want. The key here is keeping the conversation going (negotiate). As long as the conversation is going, it is much more likely to result in the deal taking place. So keep the conversation going!

Almost the final action – after the negotiations and an agreement has been reached, there is one final action that is vital. Your offer is in, but you are not done yet! Due diligence is required. Here you must get documentation on the financial figures you have been given. You want to verify that what you have been told is indeed the case. Get Profit and loss statements, business tax returns and other important documents. If you have been told that a body shop has a contract with the local city to service all their vehicles, or some such story, ask for and see the contract and verify that a valid contract does indeed exist. Part of this final action is ensuring that you have the advise of a competent professional as well.

Escrow - Never buy an asset sale purchase without an escrow. We have already established that the sellers may be lying to you about any number of things, but they may have debts that they do not even know about. The escrow will do a “bulk sale notice” that gives creditors of the business a chance to file their claims, and if they do not the buyer cannot be held liable. The escrow also makes sure that the payroll taxes; sales taxes; federal and state income taxes are paid in full. The IRS has come into companies and assessed for many years of unpaid taxes. As the buyer you would get stuck with this bill, if you didn’t do an escrow.

Conclusion - Following the above steps will see you through most of the pitfalls in buying a business.

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