



THINKING OF BUYING A BUSINESS? BUYER BEWARE!

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In this rickety economy, you would think everyone would batten the financial hatches and lay low till the storm blows over... not so.

It appears that some people still want to spend too much to purchase functioning businesses.

This is confusing, until you realize that buyers are trying to purchase solutions to a number of problems. To the onlooker, an operating business can give the impression that it does this, even more so to desperate people.

Prospective buyers see an operating business and tend to think that they can simply buy it and it will continue to operate as it does under the ownership of the seller. As a buyer, you might imagine the business will allow you to be your own boss, pay you a great salary, raise your self-esteem, afford you an attractive lifestyle, and eventually make you rich. If this is to be your destiny, you've got some serious homework to do... before signing your equity.

If you are thinking about buying a business, please take a few important moments to consider the following:

- 1) Determine why the business is for sale. Every seller will have a story, but the truth is - if a business is doing all of the things it should for its owner it should be very difficult to part with. There has to be a very credible reason for selling. Poor health and retirement are believable rationales. Most anything else should raise your suspicions and cause you to dig deeper.
- 2) The most important information available to you will likely come from the financial history. Insist on accessing the past three years of statements and if you can't get them without a fuss, walk. This is usually the first sign of trouble. If you can't get the financials easily and quickly, your seller may be dishonest or disorganized, either of which is bound to bring you sorrow. Unless you are an accountant, turn the financial statements over to a qualified, trusted accountant for interpretation.
- 3) If the business location is leased and if it is important, what are the terms of the lease? How long is the term of the existing lease? Are there any hooks that tie the lease rate to your revenue/sales? Are there any stepped increase-type clauses that could cause you to be paying more to the lessor than you can afford to pay yourself? I'm aware of at least one lease that resulted in the business owner paying in excess of \$8,000 per month, far more than this owner could ever pay themselves. This is clearly a rent-seeker out of control and one stressed, broke business owner.
- 4) If the business is in a strip mall or a hotel, does the lease allow the landlord to lease to another similar business in their facility or does it protect you with a clause that prohibits the landlord from doing this?
- 5) Can the business pay down the cost of the purchase and still pay you a reasonable salary? This is critical to you from a personal perspective but also when selling the concept to a lender.

- 6) Determine what you are paying for. When purchasing a business you can choose to purchase the entity or the assets. Purchasing the assets is often less risky from the buyers perspective. Purchasing the entity is the cleanest and easiest from the sellers perspective.
- 7) If you purchase the entity (for example, the corporation), you may be buying some liabilities that you might not wish to take on. For example, have the taxes been paid? Can the seller provide proof that taxes have been paid? Are there any outstanding lawsuits or employee or customer claims? Be sure to get a clean bill of health in writing.
- 8) If you are purchasing assets, how much of the purchase price is inventory and how much is equipment? You will want to place your own value on these items but it is stronger to get a third party assessment of assets when trying to gain the vote of a lender. When it comes to assessing values, lenders might have a preference as to who does the assessments.
- 9) Determine what value the seller places on 'goodwill'. Most lenders place zero value on goodwill. If you are attempting to borrow money to purchase the business, you will likely find it difficult to sell the lender on any significant amount of 'goodwill'.
- 10) It is important to understand that the process of 'being in business' is very different than it appears to an onlooker. Once you have become enamoured with the notion of owning and operating a particular business, it gets difficult to be objective. Try to imagine what it would be like to work in the business. Can you see yourself standing serving customers in this business for the next 5 to 10 years? Is it something you will enjoy doing?
- 11) You should definitely check the sellers product or service sources, the companies or individuals he or she purchase from. Determine how stable they are and if they will do business with you (at the same rates as they give him).
- 12) If you are planning to borrow the money to purchase the business, where will it come from? Do you have at least 10% to put in of your own money/equity? Whether you're going through a chartered bank or an alternate lender, 20% of your own equity makes a stronger application. To avoid surprises, know your target agencies and determine what they expect.

I'm not trying to create the impression that business sellers are dishonest or less than ethical. As an owner who might want to sell one day, I know that we place a high emotional value on our investment in our business. We pay for it each day with our energy and our lives and when it comes to selling, we expect and hope to get top dollar for our efforts. For me, ultimately it will be most rewarding if the new owner is able to pay a fair price and then succeed.

Buyers often ask me if a business plan is as important or necessary when purchasing a business. Yes, it is. Your business planning should be made somewhat easier by the fact that some of your market research should come from the existing owner. I shamelessly recommend our Dream Catcher Business Planning System to develop your plan. Learn more at <http://www.macrolink.bc.ca/dreamcatcher>.

I know this is an old cliché, but the rule with purchasing a business is 'buyer beware'. Take off those rose coloured glasses and take the time to get a clear picture.

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