Steps to Buying a Business – Part I

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Although the economy has begun to improve, there is still a narrow window open to purchase a business at historically low multiples. There are many things to consider when purchasing a business, and this article provides an overview of the general steps involved. This article is the first of a two-part series of how to buy a business.

Step One: Know What Type of Buyer You Are

The first step occurs before you even begin to look at specific industries or businesses. Define the type of buyer that you are, or why you're considering buying a company. It's important to define this because it affects the type of business you should consider, the type of seller you should target, the amount of due diligence that should be performed, as well as the type of financing you should consider.

A *Strategic Buyer* is one who is most typically buying a business to add on to another existing business. Most commonly, the business is the same type as a currently-owned business (such as an auto repair shop owner purchasing another auto repair shop). However, there can also be supplier/vendor strategic purchases (such as a home builder purchasing a sawmill). The strategic buyer is betting that the two businesses together will outperform the total of the two businesses individually. Although the strategic purchase is great in theory, the synergies and cost savings seldom occur, even in large publicly-traded company strategic combinations. For this reason, the strategic purchase is the most risky type of transaction, and requires much due diligence and a very long time (sometimes over 2 years) to complete. Even then, according to some studies, 65% of these types of transactions fail to deliver the synergies expected.

An *Investment Buyer* is one who is purchasing the business with no intention of working in the business, but holding it either as an income-generating vehicle or value-appreciation vehicle. This type of purchase is very similar to buying stock in a publicly-traded company. This type of transaction requires less operational due diligence than a strategic purchase, but more financial due diligence to ensure the cost of the investment given its risk is mitigated by the expected financial return and the ability to sell the business for a profit at a future date.

Another type of buyer is the *Market Value Buyer*, or sometimes called "buying a job". This is the most common type of small business buyer, where the purchaser is buying the business to provide income from working in the business. Here, the focus is on the ability of the business to pay the working owner a reasonable income and also be able to pay for its own purchase. The most common examples of these types of transactions are found in the professional trades, retail, restaurant, and professional services areas. This type of transaction requires a moderate amount of both operational and financial due diligence. Also, this type of transaction requires more negotiation than other types of transactions. With this type of purchase, unlike other types of purchases, the purchaser must have the technical expertise required to work in the business. It's also critical that the buyer reject the seller's notion that the buyer can grow the business – why should the buyer pay the seller to grow his own business? The buyer should not pay for his own efforts to grow the business.

Step Two: How to Find Businesses for Sale

Two old sayings are appropriate here. First, the best businesses are those that "aren't for sale" (i.e., advertised as for sale), and second "everything is for sale…at the right price".

There is a great deal of truth in both of these ideas. The first thing most potential buyers do is to look in the "businesses for sale" classifieds or more likely any of the dozens of online sites like bizbuysell.com, etc. A large percentage of the businesses that are formally listed for sale have some type of negative reason they are on the market. For example, the business may be experiencing decreased revenues or income, key management may have left, the market is becoming too competitive, etc. Of course there are exceptions, and looking to these sources for businesses will at least educate you to what is on the market.

Many buyers outsource finding businesses for sale to a professional. There are three basic types of professionals that directly assist the buyer in finding a business.

The first is the *business broker*. The business broker is similar to a real estate broker, although business brokerage is generally unregulated in most states. A business broker may be helpful in locating businesses for sale, but always keep in mind that the business broker works solely for the seller, not the buyer, and will always have the seller's best interest in mind, not the buyer. One advantage is that the business broker fee (typically 10% or more) is almost always paid by the seller, not the buyer. There is an emerging professional designation referred to as the *Small Investment Banker*. This type of professional is certified (Series 77 FINRA examination) by the SEC/FINRA, and although they still represent the seller, they are held to higher legal and professional standards than business brokers.

At the other end of the scale, another type of professional is the *buyer's broker*. This type of broker works exclusively for the purchaser, and will have the purchaser's best interest in mind. A buyer's broker typically contacts companies that are not listed for sale, and over a period of time develops a database of potential sellers that they can match to buyers. The buyer's broker is typically paid a monthly fee of anywhere from a few hundred to a couple of thousand dollars while the search commences, and also charges a commission on the purchase price once the sale is consummated (typically 10% or less). Most searches take from six to eighteen months from start to closing. The advantage to a buyer's broker is that they are typically professionally-credentialed (such as the ABBR – Accredited Business Buyers Representative), and they have a duty to represent your best interests in any negotiations. The disadvantage is that the full cost of the commission is born by the buyer.

In between the two professionals above is the *transaction intermediary*. This type of professional doesn't represent the buyer or the seller, but assists in the completion of the transaction. Ethically, the intermediary doesn't advocate for either side but makes sure both sides have the same information to make their decisions. The advantage is that the fee is typically lower than the other types of professionals and is split between the buyer and seller. The disadvantage is that the intermediary is not looking out for either party's interests.

B. Dane Byers, CPA, ABV, CFF is a partner in Bassett & Associates, P.A., a full-service CPA firm in Raleigh, NC focused on entrepreneurs and investors. Dane has prepared professional valuations on over 120 companies over the last 20 years, and has represented buyers and sellers ranging from small businesses under $100,000 to public companies over $1.6 billion. Feel free to contact Dane at (919) 303-1049 to discuss any questions you may have in your search to purchase a business.