Steps to Buying a Business – Part II

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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 second of a two-part series of how to buy a business.

Step Three: Assemble Your Purchase Team, Negotiate Price and Terms, Perform Due Diligence

Once you've identified a viable business (or multiple businesses, as will be the usual case) you should identify the members of your advisory team. This is most often an experienced transaction attorney, a qualified accountant with transaction and valuation experience, and a strategic management consultant, which is typically an accountant or marketing specialist.

"Price" and "Terms" are inextricably linked. There's an old saying in the profession, "Your price, my terms". As a matter of fact, the terms of a deal are so important that sometimes the price itself is irrelevant. Major items to consider here are the deal structure (will this be an asset purchase or a stock purchase?), the operational terms (will the owner continue to work for / advise the new owner for some period of time?), the insurance (if the company can't perform as in the past, is there a purchase price adjustment?) and many others. This is where it is critical to have experienced advisors on your team, as they have seen where good deals have gone bad and can advise you regarding the risks accordingly. It's vitally important that your advisor team has experience in business transactions. You may have a great CPA that prepares your individual income tax return, but if he or she doesn't have specific transaction experience, you're no better off. The same is true of your attorney.

While both CPAs and attorneys have a basic level of competency, it's important to select professionals that have specific expertise in business transactions. By their nature, CPA and attorney transaction specialists understand that they are only providing services to you during the purchase transaction, so there is generally no pressure to have you switch to them for all future services. As a matter of fact, most transaction services are referred by current service providers, so there is no issue of competition.

Due Diligence is the process of verifying the seller's claims regarding the business, and its capacity of future earnings, as well as standard legal checkups to ensure that you're not purchasing an unknown liability. There are typically two types of due diligence that are performed simultaneously.

First, legal due diligence is performed to ensure that the business is operating legally, and under your ownership would continue to operate legally (licensing, etc.) Next, accounting due diligence helps to ensure that the business you are purchasing "is what it seems". An experienced due diligence team will design the engagement such that the most critical items are checked first, so that if a deal should not happen because of legal or financial reasons, it will be discovered as soon as possible to minimize professional fees. This is also called "hunting the big deal killers first", and is critical to an efficient due-diligence engagement.

Step Four: Financing

After price / term negotiations and due diligence has been completed, the next step is arranging financing. There has been a sea-change in financing business purchases over the last few years. Only five years ago, it was possible to purchase a business with a 20% purchaser investment and 80% bank financing.

Now it's not uncommon for a bank to provide less than 20% of the purchase price, whether it's secured or not. That means that the buyer must provide the majority of financing up front, or the seller must take back a purchase-price note. This isn't necessarily a bad thing, because if the seller is willing to finance the sale, the more he/she is involved in the future success of the business, which may make negotiations easier.

There are also government-subsidized financing options. The most common options are available from the SBA (Small Business Administration). Contrary to popular thought, the SBA does not itself make any loans; it only provides default insurance to banks that provide loans under its programs. The most common SBA-guaranteed loan is the 7A program. Under this program, a bank can make a secured loan (secured by the SBA) at a slightly higher-than-market interest rate that would otherwise not be obtainable.

The disadvantage to the SBA loan programs is that they typically lock-in the purchaser for 10 years or more, and pre-payment isn't allowed. This means that the buyer cannot re-sell the business or pay off the loan during the 10+ year lock-out period without paying substantial penalties.

Non-conventional financing includes *Venture Capital* firms and *Private Equity* firms. Venture capital firms invest in businesses with the idea of selling them to a publicly-traded business within 10 years for a large profit. Private Equity firms come in two flavors – Buy & Hold, or Flip. The Buy & Hold variety looks for investment returns and has no intention of selling. The Flip variety is more like a Venture Capital firm and looks to make their profit on the subsequent sale of the business, although they usually have a longer time horizon to sell than a venture capital firm.

In the current market, the most common financing is seller-financing. This is where the seller finances the majority of the purchase price, with the buyer paying the seller on a monthly basis over 5 to 20 years.

The last step, commonly referred to as *post-due diligence* is to make sure that post-transaction terms are followed. Usually, this involves receipt of accounts receivables that are purchased and payment of accounts payable debts. There are usually several post-closing calculations to be made, and an adjustment of the final purchase price is obtained. This may extend up to a year beyond the purchase price date, and is usually negotiated up-front. Typically, a reserve against the purchase price is held by the attorney in their trust account to fund these adjustments and released to the seller after the "wind-down" procedures are completed.

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.