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ELEVEN STEPS IN BUYING A BUSINESS

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The Eleven Steps in Buying a Business

When third party financing is involved

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Purchasing an established business can be a daunting and complicated process for many individuals. Understanding the steps involved in the acquisition and doing the necessary planning and preparation will enable the buyer to increase their chances for a successful transaction.

Following an established and proven process will not only reduce the stress that often comes with chartering new territory but also eliminate many of the risks and unknowns that often derail a business acquisition.

1. PERSONAL ASSESSMENT

The first step in buying a business starts with introspection. This process should be a thoughtful and honest examination of the candidates' strengths and weaknesses, skill set, as well as their likes and dislikes. This analysis will assist in narrowing the selection for the logical and best choice of business enterprise to pursue.

What talents, skills, and experience do you bring to the table and what are the types of businesses that can excel with these attributes behind the helm. Here are a number of questions that the introspection phase should involve:

1. What type of business do you want to operate? Is it one where you are the owner/manager or do you prefer to have a management team in place?
2. What hours are you available to dedicate to the business? Obviously, owning a small business will never be a 9 to 5 endeavor. Having said that, it will be important to determine the time available to manage the business. Do you prefer a B2B business that operates M-F 8-6pm or are you more flexible and would consider a consumer oriented business that is open late or often over the weekends?
3. Are you successful at sales, meeting with clients, and being the face of the business or are you better suited to a managerial role and running the business from behind the scenes with an established sales force in place?
4. Are you able to travel and be away from home for several days or do you require a business that keeps you close to the family each day of the week?
5. Do you have a background and expertise in the manufacturing of products or is it the service industry or distribution model that is more your forte?
6. Do you have any licenses or certifications that qualify you for a certain business? If not, are you prepared to obtain the necessary credentials required for successful ownership if the targeted business requires such certifications?
7. What are the things that you really enjoy doing? What are the things that you prefer not to do? The best advice is to start considering businesses in industries that the buyer is passionate about.
8. Do you have business categories that you know you are not interested in such as franchises, retail or food service?

These are a few of the questions that will help an individual assess the types of businesses that they are best suited for and assist in narrowing the range of enterprises where the buyer's skill set, experience, capabilities and passions can be leveraged.

2. DEVELOP INVESTMENT CRITERIA

Now that you have established the type of business that is a 'good fit' the next step is to put pen to paper and concisely define your investment criteria. If you will be seeking bank financing it will be important that the investment criteria match your resume or the transferrable skills that you are bringing to the table. The investment criteria will state the following:

1. What is the price range of the business that you can afford to buy?
2. What is the geographic location for the business you seek to buy?
3. What type of business are you looking for?
    a. Manufacturing
    b. Wholesale/Distribution
    c. Service
    d. Retail
    e. Web-based
4. What industry should the business be in?
5. Management structure (owner managed or management team in place)?
6. Size of business. In terms of:
    a. Revenues
    b. Profits/Earnings
    c. Number of employees
    d. Number of locations
7. Recurring revenue model vs. project based

3. LENDER PREQUALIFICATION

If you plan to use bank financing to acquire a business it is important that you obtain a prequalification at the beginning of your search process. Not only will this the 'prequal' provide you with the data as to how large of a business you qualify to purchase, but it will also demonstrate to the business broker and seller that you are a serious buyer. If you are serious about buying a business and will need to obtain financing, receiving a bank prequalification is going to be a required step at some point in time. Therefore, what would be the reason for procrastinating and not having this in place at the outset? There is zero downside and only considerable benefits. Contact your business broker as they will be able to recommend a financial institution that does business acquisition lending for the type of business you are interested in purchasing. This is an area where having the right lender is critical.

4. BUSINESS SEARCH (Individual or Retained)

What is the process that you are following to locate and qualify businesses for purchase? Will you be conducting the search on your own or will you utilize the services of a professional business intermediary or broker. There are literally thousands of business for sale at any given moment. A process needs to be established for conducting the search and qualifying businesses. Few of these businesses are of the quality, caliber, and profit level that distinguish them as being best in breed. What have you done to ensure that you will stand out and be given the proper consideration when engaging a broker regarding a business for sale? The business-for-sale marketplace is plagued by unprepared and non-serious buyers inquiring about any enterprise listed for sale. It takes the right preparation, message, and professional team to establish contact and quickly get to the point where the business can be qualified as a legitimate candidate or one that should be dismissed. Too many prospective buyers fall prey to the late business internet search process and clicking on any business that catches their interest. Unfortunately, serious buyers get lost in the field. This is where the prior steps come in handy - having a personal bio, an established investment criteria, as well as a lender preapproval.

5. QUALIFICATION:

A business that is professionally represented for sale will have a number of documents available for review by prospective buyers (e.g. Financials, Asset list, Business Summary, etc). Buyers will need to execute an NDA (Non-Disclosure Agreement) in addition to demonstrating that they are qualified both from a financial standpoint as well as an experience standpoint to be considered a serious candidate.

At this stage the buyer should already have completed individual research or have first-hand knowledge on the industry. For those without direct industry experience there are trade magazines for just about any business sector not to mention the wealth of data available online.

The buyer should have a list of questions already prepared, designed for one purpose – determining if the business meets the majority of the investment criteria. The buyer should understand the value of the business. If the business is priced outside of their financial ability they should not be evaluating the business and wasting anyone's time, most importantly their own. It will be important for a serious buyer to recognize that there is no such thing as a perfect business and each will have different strengths and weaknesses. Most buyers are seeking businesses with growing revenue, a stable customer base, excellent staff, established policy & procedures, and increasing profits. What are the most important qualities that you are seeking? Ranking the criteria is often helpful when qualifying businesses. Finding a business which meets some but not all of the criteria is more the norm than the exception. In many cases, the buyer may be positioned and experienced to improve certain business aspects that are deficient. Following this approach will also enable the buyer to quickly and efficiently eliminate those businesses which will not be a suitable fit, an endeavor that will save all parties considerable time. A quick no is far better than a slow no for everyone's sake. Lastly, the buyer should recognize that the better the business is, the more they will be expected to pay.

After the initial information exchange the buyer should prepare a second set of questions based upon the particulars of the specific business. After receiving this information, the time has been reached where the buyer knows whether their basic criteria has been met. The buyer is clear on the business valuation, the financials, and the business operations and the seller (through the broker) should be clear on how the candidate will be financing the transaction.

A teleconference should be arranged by the business broker to fill in any gaps of information and to allow specific business questions to be asked by the buyer and answered directly by the seller. Should this interaction satisfy the requirements of all parties a personal meeting and site visit is often arranged. During this meeting the buyer, seller, and broker can discuss the framework for a transaction that will satisfy the needs of each party. Only serious contenders should be involved at this point. Now is not the time to waste anyone's time as a tire-kicker if the goal is not to proceed. Buyers should be clear that regardless of signing the NDA, data such as names of specific clients will not be divulged, not just at this point, but until the transaction closes.

6. LETTER OF INTENT (LOI) – TERMS SHEET

A Letter of Intent (LOI) and Terms Sheet are typically non-binding documents which are used for one fundamental purpose…to determine if there is a meeting of the minds between the buyer and seller on the price and high level terms of the sale. The LOI will outline the strategic points of the agreement. Investing time at this stage and preparing a more detailed document will avoid misunderstandings and prevent key terms from being renegotiated later.

These documents should be prepared by an experienced transaction attorney (not a "business" attorney). Some of the broad points that should be addressed include:

1. Who is buying the business?
2. What is being acquired (Assets, Stock)
3. Transaction price and how that money is being paid
4. Loan commitment letter date.
5. Proposed closing date.
6. Is there a consulting agreement and if so, what are the terms?
7. What are the contingencies for the transaction to close?
8. Included Assets
9. Excluded Assets
10. Allocation of transaction proceeds
11. Seller non-compete terms
12. Details of any seller financing, earn-out and/or consignment inventory
13. Assigned liabilities transferring to buyer

7. LOAN COMMITMENT LETTER

With an executed (signed) LOI in hand the buyer will now need to obtain a 'Loan Commitment Letter' from the lender. A loan commitment letter is produced by the bank and will confirm that the buyer is approved for financing to acquire the business. The Loan Commitment Letter is generated after a thorough review of both the buyer's data as well as the target business' data.

8. DUE DILIGENCE (DD)

Most business acquisition transactions will require bank funding. The bank will have a proven, structured, and very detailed due diligence process and it is this methodology that the buyer should rely upon when acquiring a business. Why attempt to recreate the wheel? The bank works solely on behalf of the buyer and their fundamental interest is in ensuring that the buyer is acquiring a business that has the required financial framework for the new owner to be successful and positioned to repay the principal and interest on the acquisition loan. The bank will provide a DD checklist that covers a wide variety of documents, including but not limited to the following areas:

1. Financial Statements & Tax Returns
2. Asset & Inventory List
3. AP & AR
4. Corporate Books & Records
5. Contingent Liabilities
6. Sales & Marketing Materials

7. Employee Agreements & Benefit Plans
8. Equipment, Vehicle, & Property Leases
9. Customer and Supplier Contracts or other Agreements
10. Insurance Policies

9. PURCHASE CONTRACT

The business for sale contract aka Definitive Purchase Agreement (DPA) is typically drafted by the Buyer's 'Transaction Attorney' after the LOI is in place. If the proper care was taken in developing the LOI, the DPA should be a much easier document to produce. In circumstances where the major deal components were not properly negotiated or addressed in the LOI, the DPA becomes much for complicated and a higher risk level is associated with the transaction closing.

Upon execution of the LOI, the DD period commences and the DPA should begin being drafted. The DPA is the binding contract covering all aspects of the transaction. The DPA will cover all assets that are connected to the purchase, including but not limited to:

1. Assets/Stock being acquired
2. Price, Terms, & Payment
3. Representations & Warranties
4. Covenants
5. Indemnification
6. Non-Competition Agreements
7. Lease Assignments
8. Landlord Consents
9. Consulting Agreements
10. Asset Allocation
11. Confidentiality

In most transactions the DPA is executed at the closing table but this is not a requirement. In certain circumstances, the buyer and seller will elect to execute this Agreement prior to the actual close (when the transaction is funded).

The DPA is the actual contract that consummates the sale of the business. It will include a number of Schedules and Exhibits detailing all of the terms of the sale. This is a custom Agreement and the level of detail, length, and companion schedules and attachments is predicated on the particular business.

During this stage the buyer should already have their new business entity established (assuming it is not a stock sale), business bank accounts created, insurance policies prepared, merchant credit card accounts (if applicable) in place, etc.

10. THE CLOSING

The closing should be the easiest part of the process. Why? Because all of the above steps have been followed diligently by both parties. For business-for-sale transactions the "closing" is simply the process by which both the buyer and seller execute (sign) all of the documents that have already been discussed and agreed to, if not done in advance, and the transaction is funded with buyer down payment and in most circumstances commercial lenders funds. Having the right transaction team in place from the start (transaction attorney, business broker, and lender/loan packager) will make this a smooth process. Each of the advisors has their role and when done properly the closing becomes an uneventful (final) step.

11. TRANSITION

The terms and conditions of the business transition will vary based upon the type and complexity of the individual business. Obviously, the specifics will have already been spelled out and agreed to in the DPA. For some businesses, a customary 80 hour transition period is all that is required. For others, the Seller will assist for an extended period of time, often under an employment or consulting agreement. When bank financing is involved, especially if an SBA guarantee is attached, the Seller is restricted to a consulting or employment contract that does not extend beyond 12 months. The transition period is the stage where the seller and new owner implement the change of ownership and how that is communicated to employees, customers, suppliers, etc. The transition of ownership represents a big change and the goal is (often) to make it as seamless as possible. To be effective, this process must be planned in advance with all stakeholders in agreement.

For many individuals the acquisition of a business will be one of the largest commitments they will make in life. Following a structured process will be one of the key components to ensuring a successful outcome.

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