



Do's and Don'ts of Buying a Business

Buying a business can be an intimidating experience. There are many issues which must be considered in order to make an educated purchase decision. It is important to objectively evaluate all aspects of the business as well as to consider your goals, objectives, and strategic plans for the business. Included below are suggested do's and don'ts of buying a business.

Do consider why the business is for sale. Evaluate possible reasons why the business is for sale. If sales are declining, consider the causes and explanations.

Do ask the seller lots of questions. Information can be obtained by interviewing the seller and asking questions. Communication between buyer and seller is important. The seller provides invaluable experience and knowledge that he may transfer to you upon purchase.

Do request access to the business's past financial records. Other information can be learned by obtaining important business documents such as financial statements, tax returns, leases, etc. A buyer should request access to all financial business records. These financial details paint a picture of the business's past profitability as well as projected future success. If the seller lacks adequate information, the buyer must make the decision to either terminate efforts or make an offer contingent upon obtaining additional information.

Do evaluate changes needed to continue business operations. In many instances, business operations and strategies will change considerably upon the transfer of ownership. Evaluate changes you expect under your ownership and plan accordingly.

Do research the product/service and market of the business. It is important to fully understand the operations of the business. Ideally, you should have experience within the industry. If not, make an effort to learn all you can before you purchase the business. Another option is to make certain that key employees will stay on after the change in ownership.

Do consider whether the business is a fit with your personal objectives. When considering a business purchase, it is important to not only determine whether it is a good business but also whether or not it is a good business for you. Determine whether the business fits within your personal objectives and consider issues such as required time commitment and financial expectations.

Do consider the realities of obtaining financing to purchase a business. Lenders typically aren't interested in financing 100% of a business purchase. They expect the buyer to contribute cash to the deal. Also, keep in mind that if the purchase price includes significant amounts of goodwill or "blue sky", financing may be more challenging. Lenders are often reluctant to finance large amounts of goodwill.

Do realize the purchase price of the business is often negotiable. Purchasing a business is not like purchasing a loaf of bread. The purchase price for a business is often negotiable. It is important for the buyer to feel comfortable with the price paid for the business.

Do consider historical cash flow of the business. It is important to consider whether or not the historical cash flow of the business is adequate to pay future loan payments and provide the desired return to the owner.

Do consider that updates to the business may be necessary. It is important to determine whether or not updates or repairs to inventory, equipment, or the facility will be needed after the business purchase. If so, the costs of such updates should be carefully evaluated.

Don't purchase the business without "doing your homework". A buyer must be prepared to carefully assess all business records and risks while searching for the business's weaknesses. Do not purchase the business simply because "it's a good deal." Be certain you can operate the business successfully.

Don't purchase the business with too little capital; verify other sources of funding. You do not want to purchase the business and be "strapped for cash" soon after. It is a good idea to project maximum expenses you might reasonably pay and plan for adequate working capital.

Don't skip the process of writing a business plan. Even though the business is existing and fully operational, a business plan is a good way to organize your research and ideas for the business. It can serve as an operational guide in addition to facilitating the search for financing.

Don't be overly anxious or rush into making the purchase decision. Doing the proper research is time intensive. Do not rush through the process and overlook key problems. If the seller is pressuring you to hurry up and make a decision, it is probably not the business for you.

Don't forget to discuss the purchase with advisors such as your accountant and attorney. Key advisors can provide insight and suggestions concerning the business purchase. Additionally, they can introduce and discuss issues you may not have previously considered. There are important tax and legal issues related to the structure of a business purchase which should be considered.

Don't rely on claims of "unreported cash sales" by the seller. When considering a business to purchase, be cautious if the seller claims there are unreported cash sales, and do not rely on these claims to make a purchase decision. Keep in mind that lenders will use documented financial information (tax returns) when evaluating a loan deal. These claims of unreported and unsubstantiated cash sales are sometimes viewed as a red flag.

Don't assume current relationships will continue after the business is sold. The seller may have established relationships with vendors, customers, or employees which have been beneficial to the business. Some of these may not continue after a new owner takes over. It is important to discuss these relationships with the seller and make contingency plans for those relationships that may not continue.

Don't forget to develop financial projections. Developing financial projections (a budget) for the business under your ownership will help you evaluate the feasibility of purchasing the business. It will also help in applying for financing and planning for the future.