Buying a Business

PENNSYLVANIA SBDC Small Business Development Center The University of Scranton
Helping businesses start, grow, and prosper.

Offering quality training and confidential small business consulting at no cost.

Before You Begin

- **Be prepared for a steep learning curve.** Buying a business is a complex process that requires extensive research, due diligence, and a strong personal commitment. Expect to ask many questions and think through all aspects thoroughly.
- **Every sale process is different,** with different timing and expectations for both buyer and seller.
- **Many deals don't end up happening!** For various reasons like finances, timing or other factors, many potential business purchases don't reach the finish line. This is normal, not a failure.
- **Don't let yourself be rushed**. If the seller or their representative seems overly anxious to push the deal through quickly, take a step back. Their motivations likely differ from yours as the buyer.
- **The SBDC is here to help!** You can rely on us to help you through the buying process.

Starting Points

Meet with the seller.

- Gauge their interest, commitment to, timeline, and expectations of the selling process and the asking price. Let them know you're in the research stage, and you'll have questions.
- Understand why they are selling and what is included in the price. A sale can include stock or assets.
  - Asset sale can vary, but generally transfer individual assets and liabilities at fair market values. This may include real estate, equipment, contents, goodwill, contract accounts, inventory, etc.
  - In a stock sale, the buyer purchases shares from the company's shareholders, avoiding the need to renegotiate contracts.
- Request a breakout of the value of these elements.
- Get a list of all equipment, brand, and age.
- A certified business valuation is often part of seller preparation and is completed by a certified professional in business valuation.
- Ask for seller tax returns and profit and loss reports so you can take a deeper look at the health of the business. *Tip: Ask for three years of business tax returns and one year of profit and loss reports by month to get started.*

Start considering who your resource team will be.

- Depending on your needs, this may include an accountant, attorney, business advisor, lender, real estate agent, or colleague/friend with business skills.
- Engaging your own attorney and accountant in an advisory capacity early-on is critical.
  - Your attorney can review any legal ask, guide you on types of sale, and even assist in sale negotiation, should a more formal approach be needed between you and the seller.
  - Your accountant may be willing to review or complete a valuation of the seller's business, review the deal from your own taxation standpoint, and give advisement on current business financials, including questions to inquire about.

Begin researching the industry.

- Learn how much demand there is for those products or services, who the other major businesses are that you'll be competing against, and if that type of business is growing or shrinking overall. Knowing these details ahead of time helps you make a smart choice about whether buying that particular business is a good idea or not.

Action Items

Next Steps

After addressing the starting points on the previous page, focus on:

- Assess the health of the business with historical analysis, market evaluation, and future trends.
- Determine if the asking price is fair and in line with industry standards based on the business's revenue, profits, and growth prospects.
- Start developing your business plan and assembling projections using tax returns, income statements, industry research, and anything else gathered. Use the list below to make sure all items have been considered and included.
- Continue to communicate with the seller.
- Start to think about how you will fund the purchase and early operating expenses and keep in touch with your lender or other funding contact throughout the process.

Be sure to review the following before you purchase a business:

- Incorporation documents, any business licenses
- Business tax returns (three years)
- Income statement, balance sheet, cash flow statement
- Large customer accounts, list of customers
- Information about existing debt (Amounts, due dates, collateral used, etc.)
- Any lease or rent documents
- Existing contracts with vendors
- Employee information
- Any legal records
- Marketing materials
- Business plan
- Projections
- Zoning requirements

If you're not sure how to do some of this, don't worry – the SBDC can help!

If the sale is moving forward, finalize your business plan and projections in preparation for financing or sales transaction.

Funding Considerations

Acquiring a business requires significant financial resources beyond the purchase price. Thoroughly calculating the total financing need is a critical step. Once you determine the cost from start to finish, you need to think about where you will obtain this funding. Options include:

- **Traditional Lending:** Secure financing through banks or other lenders; typically requires a business plan, solid projections, downpayment, and collateral.
- **SBA-Backed Loans:** The Small Business Administration (SBA) provides loan guarantees to lenders so lenders can make loans to eligible small businesses. SBA loans are applied for through lending institutions like banks or credit unions.
- **Seller Financing:** Negotiate with the seller to finance part of the purchase price; may require a downpayment and agreed-upon terms. This may also include a lease-to-own structure.
- **Investors:** Attract investors to provide capital in exchange for equity; requires a solid business plan and pitch.

Get prepared! Most funders will require:

- **Credit Score:** Ensure you have a good credit score, as this affects your ability to secure favorable loan terms.
- **Cash Savings:** Have sufficient cash savings for a downpayment and early operating expenses.
- **Collateral:** Determine if you have any equity or assets to use as collateral for a business loan.
- **Business Plan and Projections:** Having a solid business plan outlining strategies for financing, operations, and generating cash flow to service debt or provide investor returns is critical.

An appraisal will be completed as part of the funding process and is considered in determining the amount you may be offered (this can be different than asking price).

Action Items

Things to Consider

Consider the timing.

- Is this the right time in your life to take on a business? Owning a business requires a major time commitment - in many cases, you'll be working long hours, evenings, and weekends. Make sure your personal circumstances allow for this dramatic shift. If you have young kids at home or other big responsibilities, consider what this means for you and your family. Can you fully dedicate yourself to running the business without being pulled in too many directions?

Consider your skills.

- Owning a business requires a broad set of skills beyond just expertise in the products or services. Take an honest look at yours. Can you effectively lead and motivate employees? Are you comfortable making tough decisions under pressure? Do you have financial management skills to properly handle cash flow, budgeting, and money matters?

Consider your commitment.

- Buying and running a successful business requires an immense personal and financial commitment. Realistically assess if you have the stamina, risk tolerance, and support system to make the sacrifices necessary for entrepreneurship.

Red Flags

In addition to the tips provided, here are some critical warning signs to be aware of that could significantly impact your success after acquiring a business.

- **Unreported Cash Claims**
  Sellers may claim unreported cash flow boosts the business's value, but undocumented finances cannot be considered. Buyers must stick to analyzing only verified, reported financial records to avoid risky speculation.
- **Declining Revenues/Profits**
  If the business's revenues and profits have been declining year-over-year with no turnaround plan, it could signal deeper issues.
- **Heavy Customer Concentration**
  An over-dependence on one or two major customers is risky if you lose those accounts, and this may happen with the sale of the business to new ownership.
- **Outdated Equipment/Technology**
  Expensive equipment/tech upgrades may be needed soon if the business is using obsolete assets.
- **Disorganized Records**
  Sloppy or incomplete financial records and legal documentation can make it hard to see issues.
- **Key Employee/Owner Dependence**
  If the business relies heavily on the current owner or a few key employees, their departure could severely disrupt or derail operations.
- **Pending Lawsuits/Liabilities**
  Unresolved legal issues like lawsuits or regulatory actions raise liability concerns that you don't want to inherit.
- **Poor Company Culture**
  Signs of low morale, high turnover, or toxic culture should give you pause.

Action Items

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