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Decide if You Should Buy and Existing Business
by Stuart Adams

There are three primary ways to get into business for yourself. You can create one from scratch. You can enter into a contract to become a franchisee of a larger company that is already established. You can also look around for an existing non-franchise business and purchase it. In this chapter, we'll look at the last two choices.

In terms of difficulty, creating a business is the hardest, but it could be the cheapest. You can do it on your own timetable and, up to the point of incurring ongoing expenses, such as rent, utilities, and other such costs, you can finance it as you are able to. You can do it right, providing you know how to do so, rather than buying someone else's mistakes. You can start small, out of your home, and save on most costs, until the business is ready for the "street." Best of all, if you make any money, you get to keep everything after the government gets its share for taxes.

Next easiest is the purchase of someone else's existing business. Like every other decision you make, this has both advantages and disadvantages, which may not become clear until well after you have committed to purchase the company. Also, like every other part of your business path, planning and detail can be the key to your success or failure on this route.

In looking at the purchase of an existing business, you must realize that cost becomes one of the two primary factors. It is much more significant a factor than a business built from scratch, where the incubation may be spread out over time and availability of funds. First, in buying someone else's property, you must determine if you can afford the business. This is relatively simple, since you will be dealing with a fixed price. Second, you must also try to determine, however, if the business will produce enough net profit to allow you to do better economically, in the final analysis, than if you had not "quit your day job."

"Doing better" is a complex issue, of course, as we've discussed in earlier chapters. It involves direct compensation, or money taken out of the business. This, of course, equates with what you get paid at your day job. It also involves benefits, such as insurance, pension, company perks and other measurable economic factors. It also involves subjective factors, such as the typically family isolating schedule of early mornings, late nights and work crammed weekends. For many, this is simply buying a job which is less profitable than the one they left.

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Many people look at a financial statement for a business they intend to buy and simply compare the apparent profit margin to what they are making at their present job. It is far from uncommon, however, for owners to find that they are the last to have adequate life or disability insurance or the ability to put some money from their business into some form of retirement account for the future.

Advantages of Buying Someone Else's Business

One advantage of buying an existing business is that you can shop around, in a variety of places, for all the different factors that are important to you. First, of course, is choosing the right type of business. It must be right for you, meaning one for which you have an affinity. It must also be a business that will remain viable and profitable in the future. Many businesses look good on paper at first, but their performance numbers are based in the past. Things do change.

If your prospective purchase come with a storefront or other land based factors, you can assess the suitability and convenience of the business. Additionally, you can assess the equipment, its age, condition and suitability for continued use.

You can assess the employees, although getting a handle on the chemistry is nearly impossible. You can, however, look at their qualifications for the job, turnover and unemployment history, workers compensation claims, rates of pay and benefits, etc. You can also review personnel manuals and policies, management structure, use of independent contractors, outsourcing and other aspects of the people part of the business.

On the other side of the table, you should be able to assess the customer base of the business, or at least determine that the current owners does or does not have some demographic information on it. If there is no such information, that certainly gives you a clue about the work you may have to do if you buy the business.

Disadvantages of Buying Someone Else's Business

Existing businesses get on the market for many reasons. Sometimes an owner simply has gotten to retirement age and wants to cash out. Sometimes two or more owners find themselves in a deadlock and come to the decision, voluntarily or involuntarily, to get out. Sometimes owner burnout turns into a sale. Often, the economics have simply not worked out, and owners cannot afford to go forward. Sometimes lenders or others having a financial stake in the company have seen diminished return on investment, impairment of collateral or other financial "handwriting on the wall" and decided to force the owner to sell. There are also, of course, distress sales, in bankruptcy, to pay taxes, to pay judgments, because of divorce or death of the owner, because a better opportunity has come up, and for innumerable other reasons.

Regardless of what you think of the value when you first see it, if you buy it, you will soon discover the previous owner's mistakes and problems. It may be equipment that passed the "in working condition" clause in the purchase agreement, that finally gives up the ghost after you take over. It could be a new exit on the expressway will divert your traffic or that road "improvements" in your area will prevent customers from getting to your business. I've had more than one client get in financial trouble because extended sewer work or road construction caused their customer base to dissipate and their cash flow to evaporate.

You may also find that the former owner did not pay bills on time, so you have trouble getting inventory on favorable terms. There may be a concentration of sales to a small number of customers. This may be marginally acceptable to start with, but if a major customer pulls out, perhaps because they don't like you and your business methods as much as your predecessor, then you could be in financial trouble immediately because their business represents such a large portion of your total sales. The economy of scale may simply be gone.

Likewise, if your employees had stayed on because of loyalty to the former owner, you may find an attrition of key employees. Those employees may have been paid at below market rates, and you may find that replacing them may be impossible. Even if it is possible to replace them, you may find short term problems with the gaps in your personnel. You may also find that the recruiting, training, and compensation package costs for replacements may cause your bottom line to look quite different than the one the prior owner showed you.

On closer inspection, you may find that much of the inventory is obsolete, dated or damaged. You may simply find that a newer product is coming out, which will make your product or service less attractive to the customers, harder to sell, and worth less in the market place. Equipment may be running during the inspection, but you may find that it soon breaks down, perhaps being so old that you cannot find replacement parts. Accounts receivable may be harder to collect than anticipated, perhaps even having a claim against your business for inferior workmanship, warranty work or other reversal of fortune for you.

Computer hardware and software, for instance, is especially susceptible to early retirement. You may find that the business is dependent on a legacy computer software program which is no longer supported. If there was one lesson to be learned by the "Y2K Crisis," it should have been to know your computer system and those who service it. Many old software programs, which had been favorites of the companies using them, simply were no longer supported. Partially because so many computer companies are always being bought, sold or merged, it may be difficult or impossible to get a replacement, upgrade or technical advice. Typically warranties, if any, have expired when you discover problems, so you are probably looking at funding a total replacement.

Buying into a Franchise

The good news about franchises is that they should be more likely to succeed, with even modest research, than either a pure start-up or a take-over of another's business. The reputation of a franchise is built upon nearly instant success for the franchisees. Granted, it may take quite some time to pay off that franchise fee and other start-up expenses. The thought which should have gone into the business plan of the franchisor, however, should make success of the franchisee much more likely.

Most franchise operations involve what is sometimes called a "turn key" business. In some situations, after the franchise agreement is signed and other preliminaries are out of the way, the franchisor’s expert real estate operative will come to town to eyeball the area and help you determine optimal sites for location of the new franchise. You, on the other hand, may find you either may or must attend some form of franchise college, where you are trained to make or sell the goods, operate and maintain all the equipment, do the accounting, manage the employees, and take care of virtually every other aspect of the business.

Some franchisors require the franchisee to work full time at the franchise, as a condition of granting the franchise. Some do not. Some have extensive training and some do not. Some have perfected a business method which will always make money, while others may more likely ensure you will be bankrupt within a year.

Because so many have been taken by bogus franchises over the years, the federal government and essentially every state have enacted legislation regulating the offering of franchise opportunities. The Federal Trade Commission has a great deal of good material available free online at http://www.ftc.gov related to franchises and business opportunities.

Keep in mind, when evaluating a franchise, that the franchise agreement probably will require you to pay a relatively large franchise fee when you sign up. Additionally, you will likely have to pay a monthly royalty to the franchisor, which may be based on gross income. You may be required to update and remodel your store, buy new equipment, or contribute to advertising expenses. Additionally, you may find your franchise agreement requires you to turn over essential functions, such as accounting. Your ability to innovate may also be non-existent, since the conformity to the franchisor business methods largely mandated.

Another factor which is often overlooked, is that all franchises do not come with an exclusive territory in which to operate. Worse yet, the franchise agreement may not prevent other franchisees or even the franchisor from coming into your area and starting up themselves, in direct competition with you.

How to Find a Business to Buy

It’s fairly easy to come across franchise opportunities. Simply look around you. Go into them and pick up a copy of their franchise brochures. Observe there personnel and their customers. There are also lots of magazines which exist primarily to create a database of franchise opportunities. There are also web sites which post such opportunities.

Getting Help and Good Advice

Buying a business is definitely something best handled by a team of experts and you. The lawyer to conduct due diligence, the accountant to crunch the numbers, the valuation expert to get you a price, and the insurance agent to help cover the risk with insurance.

Determining the Value of the Business

Most of us would not buy a car we knew we couldn't afford. It might get repossessed. Likewise, we would not intentionally buy a vehicle we knew would not take us where we wanted to go or carry the number of passengers we wanted to take along for the trip. Few of us want to be stranded in the wasteland. There is always a more luxurious vehicle we could buy, or one that looks prettier. In the end, however, we make a business judgment on the basic features of price, comfort, capacity, durability, and the like.

Some of us, of course, just have to have the car. I'm often faced with clients in my practice who are as fixated on buying a business as a kid is on candy at the grocery checkout counter, where merchants intentionally place impulse items. Although I too succumb to some of these items, buying one of these baubles for a buck or two is a little different than investing nearly everything you've been able to acquire in the past on a bet that it will provide you with nearly everything you will ever have in the future.

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