

Financing The Deal

If you're thinking about buying a business, you'll be pleased to learn that financing the purchase is generally quite easy. In fact, it's far simpler to get the money you need to buy an existing business than it is for a start up. Most people simply don't realize how to do it. Don't get the wrong idea: you're not going to buy a business, at least a good one, with no money down; that only happens in the infomercials.

Many prospective business buyers mistakenly believe that traditional lenders will welcome them with open arms when they present them with a business they're looking to acquire. Unfortunately, nothing can be farther from the truth. It still amazes me how the banks have got most people fooled. They run these great ad campaigns promoting themselves as "business/client friendly" but try to get them to lend you money to buy a business. It won't happen.

It doesn't matter how experienced you are, or what your relationship is with them,. Unless you're prepared to collateralize the loan 100% with non-business and personal liquid assets, they aren't going to give you a penny. So don't waste your time seeing them. With the terms they offer, it's just not worth it.

The landscape is pretty lopsided when it comes to how people buy small businesses. 90% of all transactions involve some financing. Only 10% are all cash deals. Even if you're inclined to pay all cash, my advice is not to do so, unless you get a very hefty price reduction: at least 20%.

Seller Financing

The vast majority of small business acquisitions involve seller financing. In fact, it's estimated that over 80% include some form of financial aid from the former owner. While the percentages vary, it's generally 30% to 50% of the total purchase price. When you think about the situation, it makes perfect sense. First of all, by providing financing, the seller validates the viability of the business itself. Also, the seller is able to get the highest price possible by funding part of the acquisition.

From a buyer's perspective, it serves to reinforce that the seller is also at risk in the transaction. It's a perfect mechanism to help ensure that what you've been told by the seller is true and accurate. It also serves as a mechanism to deal with situations that may arise later on that come about as a result of their actions where you may need the ability to offset their financing.

- While the terms vary for seller financing, you can expect to pay about 6-8% over four to five years. Plus, you have the ability to get far more creative with seller financing than any other:
- Negotiate a holiday from any payments for three-six months after closing
- Allow for the first year to be all principal

- Have the right to make lump sum payments several times a year towards the principal
- No prepayment penalty
- You can arrange for lower payments throughout the loan with a balloon payment down the road
- While you will have to sign personally, you will not have to personally collateralize the loan. The seller's lien is against the assets of the business.

SBA Financing

The Small Business Administration does NOT lend money for people to buy businesses. The SBA guarantees loans made by lenders (up to a certain amount) for small business acquisitions. There are both good and bad points to an SBA loan.

- The good news is that there is money available; up to \$1,300,000 plus additional funding should it include real estate.
- The terms for repayment are favorable-up to 10 years and greater when real estate is involved
- When a business passes the SBA qualifications, you can be fairly confident that it is a solid business
- If you do not have at least 25% equity in your home, you may not have to fully collateralize the loan.
- Typically, they will finance 70-80% of the deal.

You may be thinking, if you can make the acquisition with 20% down, why would you even think about anything else? Here's why:

- Most small businesses won't pass the SBA requirements
- The financial review is based upon the weakest of the past two or three year's tax returns
- You must have demonstrative experience in a business that is similar to the one you are considering
- They will want your house, life insurance policy (possibly) and your first-born as collateral.
- It can take up to 90 days to complete the entire process.

Having said this, it is nevertheless advisable for you to explore the SBA option. You'll want to approach a "preferred SBA lender". Most banks have this status. What it allows for is the banks to approve the loan on their own without having to submit everything to the SBA. If you choose this route be VERY specific in asking the lender for timelines to complete the transaction.

So What's Your Best Bet?

Unless you're buying a business for under \$100,000 or getting an enormous price concession, don't pay cash. As for SBA approval, while their rigid guidelines will help to confirm the viability of a business, unless you're making an acquisition where you cannot finance the down payment, I tend to place this as my second choice.

I am a huge believer in seller financing. It's like buying a used car with an extended warranty paid for by the prior owner. There's no substitute for the flexibility you can achieve, or the favorable terms, plus, more than anything else, it really forces the seller to share in the risk. If I'm going to buy someone else's business, I want to be darn sure that they've got a stake (or risk) in my success as well.