FROM VETERAN INDUSTRY EXPERT ANDREW HOFFMAN

10 TOP TIPS WHEN BUYING A BUSINESS

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MY FRANCHISE PARTNERS

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Congratulations if you are thinking of becoming your own boss, through the purchase of an existing business, starting a business from scratch or a buying a franchise. This guide is for you.

The goal of this guide is to:

• Educate you on the business buying process and give you the information you need to make a fact-based decision on whether buying an existing business, an existing franchise, or new franchise is the right decision for you.

• Help you become more comfortable with the buying process. We believe the more you know, the more comfortable you will be in the process.

• Help you become your own boss faster, which will give you greater control of your life.

We sincerely hope you will make the decision to invest in yourself and become a business owner through the purchase of an existing business or franchise. With the decision to become your own boss, you accomplish three very important things:

• Job security. You have a job for life

• The opportunity to make more money

• You are building equity in something that you own and can sell later

With the help of this guide, we want to help you find, value, negotiate, buy and own your own business.

There are basically two ways for you to provide an income for you and your family:

1- Work for someone else
2- Work for yourself

Both approaches have rewards and both have risks. In the first case you are building someone else's business and legacy while in the second case you are building your own business and legacy.

I strongly believe that you are much better off using your skills and talents to build your own business and legacy..

1-Due Diligence

Probably one of the single most important factors when purchasing a business is due diligence.

When investing in a house we always ask for a home inspection. The same should apply when buying a business. You need to inspect the business.

Next to your home, a business may be the largest single investment you ever make. Reviewing all aspects of the business is a must. It's unfortunate but all too often people so excited about the thought of getting an amazing deal that they go ahead and purchase the business without conducting the correct due diligence.

Too often they take possession of the business and find out very quickly that what they bought does not exactly match their expectations. The seller may have misrepresented the potential or the buyer's expectations were artificially elevated by inexperienced excitement. Unless there is proven fraudulent misrepresentation. the buyer has little or no recourse.

Key Factors To Consider When Doing Your Due Diligence:

- Thorough review of all the business financials, tax returns, HST returns, invoices, payroll information, all financial statements etc. This should always be done by a charted accountant who has the knowledge and expertise to explain what the numbers mean and what questions to ask.
- Lease Agreements (if you don't own the premises). Review these documents carefully and also sit down with the potential landlord to clarify any issues or questions you may have. Your commercial realtor and lawyer can assist you with this process.
- Review of management and staff. Have you heard of the old saying: "you're only as strong as your weakest link?" You need to know whether the management and staff you are inheriting are competent people you can work with. This may be done by interviewing the staff, examining employment contracts, or looking at past employment reviews.

Focus on the top line, gross sales, not the bottom line of the financials. Remember, the financials have been prepared by the business owner's accountant with the primary objective of minimizing taxes. You pay your accountant to do everything that he or she possibly can to legally minimize the taxes that you have to pay. You should not be surprised if the financials show a loss for tax purposes.

A small business could make from 10% to 20% of gross sales (10% of sales on a business doing over $1million). Of course, we will ask the owner, "How much are you making?" at the right time in the relationship.

Offers should be contingent on the following due diligence:

- Buyer review and approval of the business financials
- Buyer review and approval of the terms and conditions of an acceptable lease
- Buyer/Seller agreement on an acceptable training and transition period for new management

- Buyer/Seller agreement on an acceptable non-compete agreement for this industry
- Buyer being able to obtain financing at acceptable terms to the buyer
- All equipment to be in good working order at the time of closing
- The normal level of sellable inventory will be in the business at closing

Due diligence, by its very nature, is designed to both verify information and to look for problems.

First, focus on the actual gross sales of the business over the last three years. Apply the 10% to 20% rule of thumb for possible owner's benefit. What is the sales trend? Normally, the best indication of future events is what has happened in the most recent past and what is happening now.

Next, go over the cost of goods sold to look for any changes or possible changes in products, services, or vendors that may be positive or negative.

Then review the expenses, line by line and have the seller explain any recast adjustments to give you an explanation of discretionary expenses.

Review the depreciation line to see if all of the depreciation can be added back or if some FFE (furniture, fixtures and equipment) has to be replaced in the near future; causing a major capital expense.

Make sure that you "normalize" the income and expenses to adjust for any unusual, or one-time, income and expense. Also, take out any non-business-related income and expenses that will not be a part of the business that you are buying.

Allow at two to four weeks for the due diligence process. Be sure to write down any questions for the seller. Document your questions and the answers.

2-Capitalization

Starting a business with insufficient funds, or capital, to support on-going operations is called under capitalization.

Although under capitalization can affect any business, it is particularly common and problematic for small business start-ups. These owners are often overly and unrealistically optimistic about their potential success in the early days.

Credit card cash advances and excessively investing in lottery tickets are not good capitalization strategies.

Although more than 50% of small business failures can be attributed to under capitalization, it is important for businesses to not only raise enough money but also to use that money wisely. During your due diligence period your accountant will be able to give you a better understanding of the current and future potential cash flow of the business. This is important because debt service is an important factor to consider when purchasing a business. It is imperative that your business can sustain the payments required to service the debt. Do not overextend yourself, make sure what ever you borrow has favourable rates and terms and is manageable for the business to repay.

How long will you have to “burn” through your start-up cash before you become cash flow positive? That means taking in more income through sales of your products and/or services than it cost you in cost of goods sold and expenses to produce those sales and operate the business.

How many weeks or months can you and your family go without a reliable income? As a business owner, you are paid after all of the other expenses have been paid.

Let’s consider buying an existing business. The same statistics that apply to the failure rate of small businesses show that if you buy an existing successful business (with trained employees, an existing customer base with existing sales and established cash flow, there is a 90% - 95% chance the business will still be in business after 5 years.

Third, you should consider buying a successful franchise. The 90%+ success rate applies to buying a successful franchise, provided that the franchise has already proven the market’s acceptance of that franchise concept. This may be true even though the franchise that you buy may be a start-up in that location.

Each of these business opportunities have some advantages and some disadvantages

Your business plan should be based on conservative, well supported estimates that present a reasonable and realistic financial view of your business.

3-Ask For Expert Advice

There are many people with experience that is broader and deeper than your own. These experts can help you make the most informed decision possible.

I consistently advise clients to work with a commercial realtor to help them find commercial space for their business.

Hiring an experienced certified accountant is a good investment. They will provide invaluable insights when evaluating the businesses during your due diligence period. They will give you a snapshot of the financial health of the business and be able to assist you in setting up the best corporate structure to maximize your net profits and minimize your tax implications.

An experienced lawyer will help you set up your corporate structure correctly and guide you through closing the deal. Lawyers specialize in various aspects of commercial law; so choose the one with the experience most closely related to your needs. For example, hire a franchise lawyer for a franchise deal.

My suggestion is that you take advantage of the market knowledge and professionalism of the business broker and seek their help in locating a good business for you. As a franchise broker, I work with over 3000 franchise brands, including emerging and mature brands as well as off-market deals.

4-Prepare a Business Plan

Thorough business plans may seem expensive. The more thorough the business plan, the greater the probability of success.

A business plan is a living document that provides a road map for a business. A well prepared business plan defines the strategic course for your business; it defines where you are heading and assists in making the correct business decisions along the way.

Many people try to forgo a business plan with the logic they will think and adapt as they go. However, what happens when times get tough, you begin to scramble and find yourself far off the original path.

Personally, I find business plans to be an invaluable tool that will help you for years to come. If you have partners and managers, it helps them fully understand your business goals and will be a prerequisite if you are trying to raise capital for your business.

Investors will want to know about, and understand, your business and your financial strength. Commercial lenders will not lend money to a business without a comprehensive business plan.

A well executed business plan will stop you from making poor or emotional business decisions, it will assist you in being laser focused on your goals.

What To Include In Your Business Plan:

5-Choose a Business That Matches Your Skills and Experience

This is much too common! Clients want to purchase a business because it’s making a lot of money right now or they believe it will be on the edge of the next big trend.

Too often they lack experience or skills that are relevant to this type of business or this industry. This is a disaster in the making! It is only a matter of time before things fall apart.

You have to feel a passion for your business. But it is equally important to understand the business matches your personality and skillset.

In order to magnify their possibility of success, many franchisors now use personality profiles. I have a link to a personality profile on my website. I encourage you to invest a few minutes to complete the study and review it in detail.

Shy, introverted personalities tend not to fare well with a business that demands a strong hunter and closer persona. Do your research, understand the businesses that interest you and understand yourself in order to find the business that is right for you.

The seller may find an owner who will allow the potential buyer to observe the business operations for a short period of time to get a better understanding of the business before making a final commitment.

Take advantage of this when presented with the opportunity. Hands-on exposure is invaluable, particularly if you are inexperienced in this business sector.

FOCUS on the business, not just on the financial statements. If you don't like the business - the numbers will not matter. I believe the most important thing is to find a business that you like and feel that you can manage and grow. Remember, any business that has been around for three years or longer and is currently making someone a living could make a living for you too.

Think about what you will do with the business after the sale; not just on what the present owner/seller is doing or may have done. This is most important to you.

How many times have you seen a business such as restaurant, go out of business and then six months later someone comes into that same location - same type of business, opens back up, and kicks the doors down with the business. Same business, better management.

6-Learn About The Business and The Competition

Buying a business isn't all about how much money you think it might make. You have to know all about the business including its major competitors and how the business fits into the market segment.

Get to know the industry that the business is in; ask specialists and industry experts their opinions on the business's strengths and weaknesses. You can learn a lot by talking with your suppliers. It is important to review the industry as a whole, not just the performance of a single location over the last few years.

Learn where and how this business fits in the sector. Is it a market leader? Is it well regarded with a strong reputation? Is it losing market share? Is this an emerging or mature industry? What are the short term and perceived long-term prospects for the industry and this location? Conduct a thorough SWOT analysis – Strengths Weaknesses Opportunities Threats.

If necessary, hire a professional to perform a SWOT analysis on your behalf. It will be worth the investment.

The three most important inputs to value in a small-small business are usually:

1- Location (depending on the type of business)
2- Track record of the business, including recent sales trend
3- Management of the business

Assuming that the location is good, and you feel you could manage the business, provided the seller trains and transitions you properly. We will focus our approach to value on the track record - especially the financial track record.

The formula to answer the question, "How much can I make?" starts with:

1- How much is the seller currently earning
2- Less the debt service created by the acquisition
3- What will the buyer do to grow the business going forward

You should be intimately familiar with details of the business before you consummate the purchase.

7-Understand the Pros and Cons of Franchises

Many people do not put enough thought into this decision. The difference between a franchise and non-franchise business is considerable.

I recommend a franchised business for many reasons whether you have significant experience in an industry or very little experience.

Franchises offer many opportunities to manage a business as a semi-passive investment, buy a job or build an empire.

FRANCHISED BUSINESS:

PROS

- Training and On-Going Support
- Proven business model and operating systems
- Peer group support from fellow franchisees
- Brand recognition
- Quick start program
- Local and national advertising
- Marketing collateral
- Large buying power
- Easier to sell a brand name business than an independent business
- Better success rate than independent businesses
- Brand invests in product development

CONS

- A % of sales goes to head office in Royalty and Ad fund payments
- Strict operating guidelines
- Controlled products or services
- Restrictions on selling the business

NON-FRANCHISED BUSINESS:

PROS

- Owner makes all the important decisions
- Latitude with regards to expansion and new products
- No restrictions when selling the business
- Make your own hours

- 100% of sales are kept for discretionary expenditures

CONS

- No support and training
- No peer group support
- No buying power
- No marketing collateral to tie into
- The cost of support and marketing may cost much more than the royalties
- Lack of brand name recognition
- No product research and development

8-Prepare an Exit Strategy

At some point, you are going to consider selling or retiring from your business. Having gone through this exercise is a good step.

Proactive thinking allows you to plan for things such as tax strategies and who will run the day to day operations when you retire.

Trained professionals can assist with answers to all your questions and structuring the business for the correct and most profitable exit strategy.

9-Don't Buy On Price Alone

"You get what you pay for" is a universal axiom. The truth is that buying a business based on price alone is a mistake.

You may feel constrained by a fixed budget when purchasing a business but there are many ways to adjust your budget that will maximize your investment. VTB's (Vendor Take Back), an operating line of credit and extended loan payment terms are all ways to open up your options.

A bad deal is a bad deal regardless of price.

When purchasing a business, it is important to consider all factors, not just price.

The down payment has to be an amount of cash that you could put down on the business at closing and still have a little working capital available. In small business that is usually 20% to 50% of the purchase price. Normally, the balance is financed over five to ten years at an interest rate of 6% –7%. When you make an offer, keep the deal as simple as possible to start with.

Never start off with a full price offer, you can always increase your offer.

Don't spend all of your cash with your down payment; you will need some working capital plus personal expenses such as a house payment and possibly a car payment.

Remember, after the monthly payments on the debt service you still need enough money to provide your minimum family lifestyle.

Allow for a little “what if” money to allow for a no-surprises training and transition of the business. If you do end up with an all cash deal, I suggest that you place from $10,000 to $20,000 in the closing attorney’s escrow account for 60 – 90 days to ensure a smooth transition. This provides some ability to offset any surprises - otherwise the hold back amount is released to the seller after the hold back period.

10-Learn The Business Before Making Changes

Over the years I worked for a few firms in the turnaround phase of their business life.

One piece of advice I applied when walking into a new business is to invest your effort in listening and observing for the first three months and don’t make any major business decisions during that time.

People inherently believe they can make the business better than the previous owner. Rash decisions can come back to haunt you.

Take your time to get to know the ins and outs of the business and the players in the business. Then and only then can you make informed, calculated business decisions affecting the direction of the company.

Stepping in as a new owner takes time and if you enthusiastically rush in with lots of changes, you may make the mistake of not knowing enough about the business to make informed, calculated decisions that can and will be the improvements it actually needs.