How Not to Buy a Business – Unless You Like to Overpay for Risky Businesses with Cloudy Futures!

1. **Wow, this business is almost too good to be true – I should commit now, before someone else discovers this opportunity!**

   If it sounds too good to be true, it probably is! While it is true that many really good companies are snapped up quickly as soon as they are put on the market, any company you buy should withstand a rigorous process of due diligence. No company is perfect. Even the gems that sell quickly will have some flaws – any company that seems too perfect simply hasn't yet had its flaws exposed to you.

2. **The business is worth what? OK, I'll take your word for it.**

   Many small business owners have an inflated sense of what their businesses are worth. They've put their heart and soul into the business and truly believe in the value. A good broker will work a seller and help him/her adjust expectations to what is in line with market realities. Sometimes, however, managing those expectations will be entirely up to you. Armed with market knowledge, you can then approach any business opportunity and quickly decide whether you think it is undervalued, fairly priced, or over-priced.

3. **I don't like the broker – can't I just set up something with the seller directly?**

   Brokers and sellers typically have a contract that specifies that the broker is owed a commission on the sale regardless. Bypassing the broker because you don't care for him/her or because you hope to avoid having the seller pay the commission is not only unethical and unlawful, but it also keeps you from taking advantage of an important role the broker can play in the negotiations. The broker can be a valuable asset to both parties in getting the negotiations moving forward (or keeping them on track if they start to derail).

4. **Really, the business generates that much cash flow? Then I'll offer $X million for it.**

   Never just take someone's word for how much cash flow the business generates. It is common that the cash flow of the company is in reality somewhat lower than the numbers you were originally shown. This doesn't necessarily have anything to do with dishonesty on the part of the seller. It simply means that many owners of small businesses do not have the financial savvy to give you financial statements prepared according to Generally Accepted Accounting Principles (GAAP).

5. **If all the employees and managers are as amazing as the owner says, I won't have to replace anyone when I take over.**

   Wouldn't it be nice if you didn't have to fire or hire anyone, at least in the near future? Ideally, this will be true. The more consistency and continuity you can have in taking over a well-run business, the smoother the transition will be. In reality, you will want to talk with each of the key employees during your due diligence phase and make up your own mind. Not only should you evaluate how good they are at performing their jobs, you will also want to know how they fit into the company that you will be running.

6. **The business runs itself? Great, I can take a permanent vacation and get paid for it!**

   If you want to run your new business into the ground soon after you buy it, this is a great way to do it. Beware the absentee owner fantasy. Yes, some businesses run themselves – or rather, some are run by an outstanding employee other than the owner. Before committing, make sure you really understand what the seller's role is or is not. It may even be true that the current owner can get away with only coming in part-time. It is unrealistic to think that a new owner can do the same, at least in the beginning. How systematized is the business really?

7. The projected income for the rest of this year is $X million? Sure, since we're already into this fiscal year, we can make the purchase price a multiple of this year's projections.

If you have money to burn and don't mind over-paying for a business, this is an excellent approach. If you're like everyone else, don't! Projections are part of your calculations in deciding whether you want to buy the business – but making them happen is your responsibility as new owner. You should get the credit for that growth, not the current owner. If the owner wants to get paid more, then s/he should keep the business until the end of the year, prove the growth by generating the income, and then sell.

8. The laborers just voted in a labor union, but it sounds like no big deal. I don't expect any changes in how the business is operated.

This is an important transition. We advise getting professional input on the impact this transition will have on your financial modeling for the business. Similarly, you will want to address how you will transition your employees into the culture you plan to build and maintain for your new company. The employees will already be undergoing one transition; respecting the limit of how much change people can absorb at any one time will be critical to the success of your own plans for the business.

9. I don't like the seller at all, but that's OK. All I have to do is give him his cash. It doesn't matter what kind of a relationship I have with him – once the deal closes, he's out of the picture.

If you like adrenaline and fighting unnecessary fires, go ahead, take that point of view! A strong working relationship with the seller is key. S/he will be much more cooperative in pointing out issues to be aware of in advance of the closing and will also be more interested in sticking around during some transition period to help you with issues as they arise. Even if you don't care for the seller, you owe it to yourself to establish a good working relationship regardless.

10. Flat or declining revenues for the past 3 years are due to the economic conditions? I should be able to expect that to naturally start picking up again shortly, then.

We've seen this one come up a number of times recently. It is a tempting argument to make and one that is easy to believe. Some people specialize at turning around under-performing companies. If this is you, great! This might be your opportunity.

Most individuals who buy small businesses prefer to take companies that are doing fairly well and have them continue to do well or even better. If revenues have been flat or decreasing, it is well worth taking the time to understand why and then deciding whether you have a solid and realistic plan to make them start increasing, however slowly or quickly your investment criteria require. If you cannot do that, this is probably not the company for you.

Author: Karin Hollerbach brings financial and transaction expertise as well as real-world management experience to work with companies to complete successful financings, mergers & acquisitions, and strategic partnerships. To us, deals are not just financial and legal transactions; they are relationships among organizations powered by humans.

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