Business saleREPORT

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10 Biggest Buyer Mistakes

Buying a business is no mean feat. The process to do so can be long, complicated, unexpected and, most crucially of all, expensive.

On the other hand, securing your own successful enterprise can be one of the greatest decisions you ever make. Getting to that stage requires an awful lot of hard work and homework; whether researching the options available to you, evaluating your own capabilities or finding out about the many necessary legal steps along the way.

In order to guide you on your business-buying journey, we have identified 10 of the most costly mistakes that you could make along the way. These range from quick tips to whole new ways of thinking about your search for the perfect business opportunity.

So, without further ado, let's run down the biggest business buyer mistakes that you need to avoid...

1

LACKING FOCUS

Many potential buyers are concerned about deal flow, leaving no stone unturned to find the next potential transaction and getting as many completed as possible.

The real issue is the quality of the deal – not the quantity – and focusing on that requires narrow criteria.

For example, a typical target business for buyers could be a manufacturing or distribution business with sales from between £2 million and £10 million, with no retail component, located in the nearby metropolitan area. That's it. It is not unreasonable to assume at least 1,000 buyers are actively looking for a business with the above criteria. If one assumes that 100 businesses will be sold then any buyer's odds of success are 10 to 1 against.

Reducing those odds is a simple matter of narrowing your criteria. In the above example, one might look for manufacturers of fluorescent lighting fixtures that sell only to schools – that's narrowing down the product offering and focusing on a more specific market.

Once this has been identified, it's a case of doing your homework:

- Target a narrow vertical market and manufacturing niche.
- Find out all the players in that niche and contact them.
- Study the manufacturing processes, the markets and the competition.
- Go to every trade show where the targets are exhibiting or attending.

With narrower criteria, you can become an expert in the market, the manufacturing processes and the competition. From the seller's standpoint, too, you can come across as a person who knows the business and knows where they are going.
There is rarely a seller who does not want their business to continue and prosper. Your focus will be to communicate to them that you are the ideal candidate to take over their business and make it grow and prosper.

2

AN UNMOTIVATED BUYER

All buyers soon come to realise that the most important criteria for a selling situation is a motivated seller.

To successfully buy a business, you have to be passionately committed and prepared for trials and challenges along the way. The average successful buyer will look at 100 deals; of those, maybe 12 are considered seriously; of those, they may make offers on three and buy one.

There are a number of questions you can ask youself:

- Am I willing to start this process, knowing it can take a year to complete a deal?
- Will my family support me, or am I willing to live off my savings, while it completes?
- Can I afford to continue pursuing a deal if it takes longer to complete than expected?
- Am I passionate enough to see this through to completion?
- Can I put up with the negatives of owning a business? The risk of losing my investment, the long hours, the menial jobs that need doing, the red tape and regulation, dealing with employees, evenings away from my family?

Before even starting the process of buying a company, review your personal mission statement, do a motivation check, and assure yourself of the support of your friends and family.

3

NOT ESTABLISHING THE SELLER'S MOTIVATION EARLY ON

In most cases, a seller's motivation will extend above and beyond purely financial matters. As someone buying their former project, it's up to you to find out more about what this motivation is and to determine whether it could have a material effect on the business.

Reasons vary wildly from the more pragmatic to the personal – is the seller retiring? Have they moved too far away from their family to justify the commute? Maybe they have a burning desire to be a missionary in Columbia? Perhaps the seller has more money than they could ever reasonably spend? Either way, it is necessary to ask more subtle questions to work out what they are.

Often this can take a while because the seller has not yet crystallised their own thinking and is merely "testing the water" with the sale, or may have a partner keen on buying out the seller's stake and so is using you to get a read on its market value. The unintroduced partner – or desire of the seller to have offers and promises in writing – is something to be wary of.

Motivated sellers are identifiable through a few key criteria:

- They have a strong vision or plan of what they are doing after they sell up
- They have already paid an intermediary an up-front fee
- They are nearing retirement age and have no family members in the business
- They may have family or health-related reasons for selling

The best course of action is, after establishing a rapport in an initial meeting, to ask the potential seller in clear terms about what made them decide to sell. If the answer is "anything is for sale at the right price", or similar, then move on to the next deal.You've landed a money-motivated seller and are wasting your time.

4

NOT DOING DUE DILLIGENCE

Not just a fancy legal phrase, but a vital phrase to bear in mind when assessing a new business: 'due diligence' refers to taking a top-to-bottom view of the company you are about to buy.

Getting hold of financial information like a firm's balance sheets, customer lists, accounts receivable, accounts payable, and projections is a great place to start. Some buyers, it seems, are reluctant to ask about a company's money matters. It is impossible to evaluate a prospect without the finances, however, and the sooner you see them, the better.

In an ideal world you should have three to five years' worth of accounts, plus a current interim statement, by the end of your first meeting – earlier if possible. The sooner you obtain this information, the sooner you can evaluate the seller's valuation of their firm; if the gap is unreasonable, it is easy to gracefully terminate discussions and move on to your next prospect.

Sellers are often unwilling to give this confidential information out before meeting in person, though involving an intermediary can mean seeing these details earlier. Intermediaries can also arrange for buyers to see other important documents such as tax returns, business plans, product and market information and an in-depth report on the business.

Some extra considerations include:

- Obtaining complete information about a business' liabilities, debts and suppliers
- Any existing debts that might be on the business that require paying
- Regulatory sanctions or lawsuits the business might be involved in, as well as litigation holds

5

FAILING TO ASSESS YOUR OWN FIANCIAL CAPABILITY

That familiar phrase 'due diligence' can apply to you, too. Having a firm grasp of your own financial situation is advisable to avoid going into serious debt when buying a business. You are far better off waiting until you have sufficient funds before purchasing, or putting together a team of backers if you require a larger cash injection.

You can buy a business for "no money down" if you're lucky, but definitely cannot if you have no money to start with. As per the classic banking paradox, a seller is not going to lend you money if there's no collateral - whether debt, property or otherwise - to offer. Furthermore, unless the seller or the business is in dire straits they are unlikely to hand over any assets without financial commitment on your part.

Before starting the process of looking at businesses, decide how much money, cash and collateral you are willing to put on the line. Imagine closing the deal, after your down-payment has disappeared and your assets are at risk. Are you comfortable with the feeling?

Make sure you create a cash reserve for future borrowing capacity or working capital infusion, if possible, especially in case of a loss of cash flow of the business. Remember: this can happen at any time, even when the business is doing well.

6

FAILING TO PACKAGE YOURSELF

When your name appears in their inbox or on their doormat, the target seller will not know you. Anything you can prepare for them in advance will help this. The basics include an up-to-date CV, any online business profiles (eg. LinkedIn or website),and any useful publicity information. For example, any articles you have authored or conferences you have spoken at. A brochure stating your acquisition objectives can also be a nice touch.

Getting this into the seller's hands before your first meeting can make a great first impression. Save handing over your financial statements and credit report until you exchange monetary information with the seller once appropriate legal commitments to confidentiality have been made.

This information can extend to the online world, too, so make sure anything that comes up under your or your current enterprises' names is up-to-date, truthful and useful - including on social media. A personal website can be a nice addition to the information above, particularly with links to your social media accounts and other resources that can give a seller a more rounded view of you. If these do not come up top of a Google search, spend some time ensuring your sites' SEO - or search engine optimisation - is up to scratch. There are plenty of guides online about doing this efficiently, and service providers who will give your only presence a spring clean.

There are three characteristics that every seller looks for in their buyer candidates: financial capability, technical knowledge, and personal chemistry. Anything you do to demonstrate these will help enormously with establishing a rapport.

7

BEING WEB UNAWARE

Things have moved on a bit in the online sphere over the past decade or so. Where once the advice would have been to make sure you're familiar with spreadsheets, search engines and word processing, these are universally taken as read in the business world.

There are some very useful – and powerful – online tools that can help you in your search for the right business. Simple steps include digging into the history of a website's ownership and hosting history to see whether they have been consistent, checking past directorships or stock ownership if relevant, or even just checking social media for customer reviews or industry comment.

Beyond that, there are market and industry aggregation tools that will give you a much better picture of not only the company being bought, but your potential competition, too. There are a range of sources for this information and each will have different strengths - and costs, to match - but gaining a better picture of the landscape in front of your business is crucial to its success.

Otherwise, brushing up on your basic coding and design could be useful. Most companies have an online presence and being able to tackle any teething problems without turning to expensive web development could be useful. Ask to see information about social media followings, website traffic and the like for any websites and accounts that belong to the company to get a good feel for how they are doing in the online marketplace.

8

NOT DIGGING DEEP FOR THE BEST OPPORTUNITIES

There are all sorts of people who are aware of businesses for sale - lawyers, bankers, accountants, brokers, even friends and family - and to contact all of them personally is quite a task. How can you be effective in finding companies for sale? Who should you contact?

There are four broad areas you can focus on:

- **Direct advertisements -** A great way to find sure-fire leads but, these business owners will be inundated with interest so, unless your enquiry really stands out, you're unlikely to hear back. It is worth following up on any ads that fit your criteria.

- **Online marketplaces and auctions -** Potentially the most open and easy option for buyers and sellers, these listings are provide an accessible way to view potential businesses. There is some variation between different sites so do a little research beforehand - some may charge commission or specialise in certain areas. A good option is business-sale.com, which does not charge commission, has verified businesses listed by private vendors, brokers and accountants alike, and provides alerts when new listings that meet your criteria are made.

- **Intermediaries -** Both online and in person, intermediaries often specialise in a given industry, sector or region. In return for a percentage commission on both businesses bought and sold, they can offer a significant amount of expertise, data and contacts to aid your search. However, be aware that any leads they give you will be seen by many buyers' eyes and that an intermediary's top aim is to get a good deal for the seller (and their commission packet).

- **Your friends and professional associates -** Let them know you are looking, give them your criteria and see what comes back. It is possible - but not likely - that a deal will come back this way, but it's not worth spending an inordinate amount of time over.

WORKING ON DEALS YOU CANNOT MAKE

En route to buying your perfect business there will be a number of false dawns, red herrings and poor decisions that you can waste a lot of time on. In an ideal world, you would avoid these un-doable deals.

How? There is no 100% accurate method but here are some red flags to keep your eyes peeled for:

- **A seller who says "anything is for sale...at a price" -** As pointed out above, a seller will make more money by not selling, so hearing something along these lines means you are not going to be able to afford to match their lofty valuation.
- **A seller who lacks motivation to sell -** Either through age, family situation or other reasons, some sellers will lack conviction to sell. Sniff this out and be sure of their motivation before spending time on the deal.
- **A seller with unreasonable terms -** Explore their expectations early and query any sticking points early, too. Any last-minute changes - or constantly moving goalposts - should ring alarm bells.
- **An invisible partner or family member -** Insist on meeting any owners particularly if there is a mysterious, unseen partner. Evaluate their motivation to sell and take the opportunity to ask the same questions twice; you may catch out a discrepancy the second time through.
- **A lack of information -** Those who procrastinate or refuse to deliver critical financial documents put business buyers at huge risk. You cannot skip these crucial steps.

10

OVERPAYING

This is one of the most crucial mistake that you can make, and one that can remain undetected for years.

We can all imagine a situation where you might fall in love with a business and offer up its cash flow for five years without blinking - this is a classic case of over-leveraging and is a recipe for disaster. Sensible buyers, however, base their valuation on a business' return on investment (ROI), before projecting cash flows, estimating financing structures and seeing how it will fare realistically in the future.

The ROI percentage you use should be based on the risk level of the business. New ventures are more risky than established businesses - venture capitalists target a 50% return on investment, for example, while most privately held businesses sell for between 25% and 40% ROI, pre-tax. While a manufacturing business in a growth market with proprietary products might sell for 25% ROI, a job shop or machine shop might go for 40%.

For most businesses, future cash flow is most reliably predicted based on historical cash flow. Do not be misled by the glowing potential picture the seller predicts. By and large the future success of a company comes down to what the buyer does, and the potential rewards that brings should remain with the buyer. There are situations where the seller has a right to future earnings or similar, but this should be established early on and is often written into any contract you make.

An over-leveraged business is as bad for a buyer as one that is overpriced. The two often go hand-in-hand, too. Any debt will accrue interest and the higher the fixed cost, the more likely that a drop in cash flow could jeopardise the business. If you find yourself in a high-leverage situation, do your homework to make sure you can stand the fluctuations in the business cycles of the business, providing capital from other sources if necessary. If you can't, move to considering a smaller undertaking.

So, in summary, the best work you can do to ensure your business-buying journey ends in success is all done before you've even picked up the phone.

Clarifying your own aims and capabilities is a good place to start. After that, fully researching the best place to find your new business, as well as the industry it will operate in, is paramount. From there, learning the ins and outs of each opportunity, as well as its owners and detailed financial information, is important, before checking over all the details of the deal. From there, with all the hard work done, you're then free to enjoy your new business and all the potential benefits it brings.

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