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Chapter **1**

Preparing to Buy a Business

Thinking or dreaming about owning your own business is easy and tempting to do. All it may take is knowing someone who is making decent money setting their own hours and perhaps even doing something they enjoy.

Starting a business from scratch of course is daunting and increases the obstacles and possibility for failure. Buying an existing business, possibly including a franchise, could be your ticket to small business ownership.

This chapter gives you the big picture of the acquisition process, what's involved, the pros you should consider having on your team, and how to budget for all this. But first, we help you assess — and if necessary, create a plan to improve — your financial fitness.

Figuring Your Financial Fitness

So you think you may want to buy a small business? We'd like to help you determine if that path makes sense for you; and if you can afford that, we'd like to help you turn that dream into reality.

You can't play if you can't pay. Buying a business requires solid financial fitness. Think of it as similar to buying a home if you've ever done that or considered that. You're going to need down-payment money and likely a loan to finance the bulk of the purchase price. And, in the early years of owning your business, you should be sure to have a decent financial cushion in place in case the business isn't performing at the level you expect it to.

If you're struggling to regularly save money, lack sufficient savings for a down payment, and are otherwise financially stressed, you may need to postpone setting the wheels in motion to buy a business.



REMEMBER

Having your personal finances in order is one of the most under-recognized keys to achieving success in your small business. Just one significant money oversight or mistake can derail your entrepreneurial dreams or venture.

The following sections describe the important financial tasks you need to undertake before buying a business.

Assess your financial position and goals

Where do you stand in terms of retirement planning? How much do you want to have saved to pay for your children's educational costs? What kind of a home do you want to buy?

These and other important questions can help shape your personal financial plans. Sound financial planning isn't about faithfully balancing your checkbook or investing in stocks based on a friend's tip. Rather, smart financial management is about taking a hard look at where you are, figuring out where you want to go, and making sure that you're prepared for occasional

adverse conditions along the way — a process, incidentally, that isn't unlike what you'll be doing when you run your own business.

Measuring your net worth

The first step in assessing your financial position is giving yourself a financial physical. Start with measuring your *net worth*, a term that defines the difference between your financial assets and your financial liabilities.

Begin by totaling up your financial assets (all your various bank accounts, stocks, mutual funds, and so on) and subtracting from that the sum total of all your liabilities (credit card debt, auto loans, student loans, and so on). *Note:* Because most people don't view their home as a retirement asset, we've left your home's value and mortgage out of your net worth calculations. (Personal property — furniture, cars, and so on — doesn't count as a financial asset.) However, you may include your home if you want, especially if you're willing to tap your home's equity to accomplish goals such as retiring.

Now, don't jump to conclusions based on the size of the resulting number. If you're young and still breaking into your working years, your net worth is bound to be relatively low — perhaps even negative. Relax. Sure, you have work to do, but you have plenty of time ahead of you.



REMEMBER

Ideally, as you approach the age of 40, your net worth should be greater than a year's worth of gross income; if your net worth equals more than a few years of income, you're well on the road toward meeting larger financial goals, such as retirement.

Of course, the key to increasing your net worth is making sure that more money comes in than goes out. To achieve typical financial goals such as retirement, you need to save about 10 percent of your gross (pretax) income. If you have big dreams or you're behind in the game, you may need to save 15 percent or more.

If you know you're already saving enough, or if you know it won't be that hard to start saving enough, then don't bother

tracking your spending. On the other hand, if you have no idea how you'll start saving that much, you need to determine where you're spending your money. (See the later section "Shrink your spending" for insight on how to start saving.)

Telling good debt from bad debt

After you calculate your net worth, categorize your liabilities as either good debt or bad debt:

- » *Good debt* refers to money borrowed for a long-term investment that appreciates over time, such as a home, an education that bolsters your career prospects, investment real estate, or a small business.
- » *Bad debt* (also called *consumer debt*) is money borrowed for a consumer purchase, such as a car, a designer suit, or a vacation to Cancun.

Why is bad debt bad? Because it's costly to carry, and if you carry too much, it becomes like a financial cancer. If the outstanding balance of all your credit cards and auto loans divided by your annual gross income exceeds 25 percent of your income, you've entered a danger zone, where your debt can start to snowball out of control.



WARNING

Don't even consider buying a small business until you've paid off all your consumer debt. Not only are the interest rates on consumer debt relatively high, but the things you buy with consumer debt also lose their value over time. A financially healthy amount of bad debt — like a healthy amount of cigarette smoking — is none.

Reducing debt

If you have outstanding consumer debt, pay it off sooner rather than later. If you must tap into savings to pay down your consumer debts, then do it. Many people resist digging into savings, feeling as if they're losing hard-earned money. Remember that your net worth — the difference between your assets and liabilities — determines the growth of your money. Paying off an outstanding credit card balance with an interest rate of

18 percent is like finding an investment with a guaranteed return of 18 percent — tax-free. (*Note:* We recognize that some small-business owners finance their small businesses via credit cards, and in some cases, because this debt would be investment debt and investment debt is “good debt,” we feel this situation may be acceptable. We discuss business financing options in Chapter 7.)

If you don’t have any available savings with which to pay off your high-interest-rate debts, you’ll have to climb out of debt gradually over time. The fact that you’re in hock and without savings is likely a sign that you’ve been living beyond your means. Devote 10 to 15 percent of your income toward paying down your consumer loans. If you have no idea where you’ll get this money, detail your spending by expense category, such as rent, eating out, clothing, and so on. You’ll probably find that your spending doesn’t reflect what’s important to you, and you’ll see fat to trim. (This process is similar to budgeting and expense management in business; not being able to manage your personal expenses may be a telltale sign of your inability to manage a business.)

While paying down your debt, always look for ways to lower your interest rate. Apply for low-interest-rate cards to which you can transfer balances from your highest-interest-rate cards. Haggling with your current credit card company for a lower interest rate sometimes works. Also, think about borrowing against the equity in your home, against your employer-sponsored retirement account, or from family — all options that should lower your interest rate significantly.



TIP

If you’re having a hard time kicking the credit card habit, get out your scissors and cut up your cards. You can still enjoy the convenience of purchasing with plastic by using a Visa or MasterCard debit card, which is linked directly to your checking account. The major benefit of using a debit card rather than a credit card is that you can’t spend beyond your means. Merchants who take Visa or MasterCard credit cards also accept these companies’ debit cards.

Buying insurance

Before you address your longer-term financial goals, you need to make sure that you're properly covered by insurance. Without proper insurance coverage, an illness or an accident can quickly turn into a devastating financial storm.

Buy long-term disability insurance if you lack it. This most overlooked form of insurance protects against a disability that curtails your greatest income-generating asset: your ability to earn money. If anyone depends on your employment income, buy term life insurance, which, in the event of your death, leaves money to those financially dependent on you. Make sure that your health insurance policy is a comprehensive one. Ideally, your lifetime benefits should be unlimited; if the policy has a maximum, it should be at least a few million dollars. (We provide more details on these important coverages later in this chapter in the section “Assessing and Replacing Benefits.”)

Also check your auto and home policies' liability coverage, which protects you in the event of a lawsuit; you should have at least enough to cover twice your assets.



TIP

For all your insurance policies, take the highest deductible you can afford to pay out of pocket should you have a claim. Of course, if you have a claim, you'll have to pay more of the initial expense out of your own pocket, but you'll save significantly on premiums. Buy insurance to cover the potentially catastrophic losses, not the small stuff.

Planning for the long term

In coauthor Eric's experience as a financial counselor, he has seen many examples prove that earning a high income doesn't guarantee a high rate of savings. The best savers he knows tend to be goal oriented; in other words, they earmark their savings for specific purposes.

If you know that you're an undisciplined saver, you may consider adopting the technique of designating certain savings or investment accounts toward specific goals. After all, if you're feeling tempted to buy a luxury car, it's a lot harder to take

money out of an account earmarked for Timmy's college education or your retirement than from a general savings account.

Perhaps because it's the farthest away, retirement is the most difficult long-term goal to bring into focus. Retirement is also much tougher to plan for than most goals because of all the difficult-to-make assumptions — inflation, life expectancy, Social Security benefits, taxes, rate of return, and so on — that go into the calculations.



TIP

Use a good retirement planning program. Check out the resources online from T. Rowe Price (www.troweprice.com) or Vanguard (investor.vanguard.com). These retirement planners can help you transform a fuzzy dream into a concrete action plan, forcing you to get specific about retirement issues you may not have thought about and opening your eyes to the power of compounding interest and the importance of saving now.

Goal-specific saving is challenging for most people given their many competing goals. Even a respectable 10 to 15 percent of your income may not be enough to accomplish such goals as saving for retirement, accumulating a down payment for a home, saving for children's college expenses, and tucking away some money for starting or buying a small business.

So you have to make some tough choices and prioritize your goals. Only you know what's important to you, which means that you're the most qualified person to make these decisions. But we want to stress the importance of contributing to retirement accounts, whether you use a 401(k), SEP-IRA, or IRA. Not only do retirement accounts shelter your investment earnings from taxation, but contributions to these accounts are also generally tax deductible.

As for the money you're socking away, be sure to invest it wisely. Doing so isn't as difficult as most financial advisors and investment publications make it out to be. (Some make it sound complicated in order to gain your confidence, business, and fees.)



REMEMBER

What's your reward for whipping your finances into shape and staying the course? Although it's true that money can't buy happiness, managing your personal finances efficiently can open up your future life options, such as switching into a lower-paying

but more fulfilling career, starting your own business, or perhaps working part time at a home-based business when your kids are young so that you can be an involved parent. Work at achieving financial success and then be sure to make the most of it.

Shrink your spending

Do all you can to reduce your expenses and lifestyle to a level that fits with the entrepreneurial life you want to lead. Now is the time to make your budget lean and entrepreneurially friendly.



INVESTIGATE

Determine what you spend each month on rent, mortgage, groceries, eating out, insurance, and so on. Your banking records, your credit card transactions, and your memory of cash purchases should help you piece together what you spend on various things in a typical month. The best way to track your expenses is to pay either by credit card, debit card, or check. Cash doesn't provide you a paper trail to reconcile your expenses at the end of the month.

Beyond the bare essentials of food, shelter, healthcare, and clothing, most of what you spend money on is discretionary — in other words, luxuries. Even the dollars you spend on the so-called necessities, such as food and shelter, are usually only part necessity, with the balance being luxury.

If you refuse to question your current spending or if you view all your current spending as necessary, you'll probably have no option but to continue your career as an employee. You'll never be able to pursue your dream! Overspending won't make you happy; you'll be miserable over the years if your excess spending makes you feel chained to a job you don't like. Life is too short to work at a full-time job that doesn't make you happy.

Build up your cash reserves

Shrinking your spending is a means to an end — that end being the ability to save for a rainy day. In the world of small business, you're going to see your fair share of rainy days; you may even

experience years predominated by rain. Ask someone who bought a restaurant in 2019 only to be smacked in the face in 2020 (and beyond) by pandemic-related shutdowns and restrictions.

Your wherewithal to stick with an entrepreneurial endeavor depends, in part, on your current war chest of cash. At a minimum, you should have three to six months of living expenses invested in an accessible account, such as a money market fund with low operating expenses. If you have consumer debt, after you finish paying off your debt, your top financial priority should be building this account. The bigger the stash, the better; if you can accumulate a year's worth of living expenses, great!

Stabilize income with part time work

One way to pursue your entrepreneurial dreams — and not starve while doing so — is to continue working part time in a regular job at the same time you're working part time in your own business. If you have a job that allows you to work part time, seize the opportunity. Some employers even allow you to maintain your benefits.

When coauthor Eric was planning to start his financial counseling business, he was able to cut back his full-time job to half-time for four months, using his time away from his regular job to start his financial counseling, teaching, and writing business. Similarly, in the first year of coauthor Jim's initial entrepreneurial venture, he continued his full-time job working for a wood-products business.

In addition to the monetary security you get from a regular job, splitting your time allows you to adjust gradually to a completely new way of making a living. Some people have a difficult time if they quit their regular full-time job outright and start working full time as an entrepreneur.

If you're not interested in keeping your current job, you can completely leave that job and line up a different form of work that will provide a decent income for at least some of your weekly work hours. Consulting for your former employer is a

time-tested first “entrepreneurial” option with low risk — just one of many reasons why you should endeavor to leave your current job without burning bridges in the process.

Another option to working part time is to depend on your spouse’s income while you work on building up your own. Obviously, this option involves sacrifice from the love of your life, so be sure to talk things through with your partner to minimize misunderstandings and resentments. Perhaps someday you’ll be in a position to return the favor — that’s what Eric did. His wife, Judy, was working in education when Eric started an entrepreneurial venture after business school. They lived a Spartan lifestyle on her income. Several years later, when Eric’s business was on solid footing, Judy left her job to start her own business.

Assessing and Replacing Benefits

For some aspiring entrepreneurs, the thought of losing their employee benefits is even scarier than cutting off their paychecks. Insurance coverages in particular — especially health insurance — seem daunting to replicate outside of the friendly umbrella of a corporation or nonprofit institution.

You may be surprised at how quickly and cost effectively you can replicate your employer’s benefits in your own business. As a small-business owner, you may have access to some valuable benefits that your employer doesn’t or can’t offer you. So if you’re dreaming of starting your own business, don’t view your employer’s benefits package as a ball and chain tying you to your current job.

Retirement savings plans and pensions

If your employer offers retirement savings programs, such as a 401(k) plan or a pension plan, don’t despair about not having these benefits in the future if you should start your own business. Of course, what you’ve already earned and accumulated (or *vested*) as an employee is yours.

Some of the best benefits of self-employment are the available retirement savings plans — specifically and most notably SEP-IRAs (Simplified Employee Pension Individual Retirement Accounts). SEP-IRAs allow you to shelter far more money than most corporate retirement plans do. With SEP-IRA plans, you can plow away up to 20 percent of your net income on a tax-deductible basis. Those with more employees may want to consider a 401(k) or SIMPLE plan, both of which allow employees to contribute money from their own paychecks.

Retirement plans are a terrific way for you, as a business owner, and your employees to shelter a healthy portion of earnings from taxes. Especially if you don't have employees, making regular contributions to one of these plans is usually a no-brainer. If you do have employees, the decision is a bit more complicated but still often a great idea.

Health insurance

If you're in good health and you've decided to start your own business, start investigating what will happen to your health insurance coverage when you leave your job. The first option to explore is whether you can convert your existing coverage through your employer's group plan into individual coverage. If you can, great; just don't act on this option until you've explored other health plans, which may offer similar benefits at a lower cost.

Also get proposals for individual coverage from major health plans in your area. Be sure to select a high deductible, if available, to keep costs down. The Affordable Care Act (also known as Obamacare), which was passed in 2010, is still the law of the land and has greatly affected health insurance options and pricing throughout the country.

Also, health savings accounts (HSAs) have become far more attractive and increasingly available. Like the best retirement accounts, HSAs offer an upfront tax deduction on contributions as well as tax-free compounding of investment earnings over time. HSAs also offer tax-free withdrawals so long as the money is used for eligible expenses. So, unlike any retirement account, HSAs are so-called triple-tax-free accounts. For all the details

on these terrific tax-saving vehicles for small-business owners and their employees, turn to Chapter 12.

Disability insurance

Well in advance of leaving your job, be sure that you secure long-term disability insurance. *Long-term disability insurance* protects your income in the event of a disability. If you're like most people, your greatest financial asset is your ability to earn employment income. If you suffer a disability and are unable to work, how will you and your family manage financially? Most people, of course, couldn't come close to maintaining their current lifestyle if their employment income disappeared.



WARNING

Don't wait until you leave your job to shop for disability coverage. After you quit your job and no longer have steady employment income, you won't be able to qualify for a long-term disability policy. Most insurers will then want to see at least six months of self-employment income before they're willing to write a policy for you. The risk is that, if you become disabled during this time, you'll be completely without insurance.

Proven sources for securing long-term disability insurance include:

- » **Professional associations:** Thanks to the purchasing power of the group, associations that you may be a member of — or can become a member of — often offer less costly disability coverage than what you can buy on your own.
- » **Insurance agents:** Consider shopping for an individual disability policy through agents who specialize in such coverage.

Life insurance

If you have life-insurance coverage through your employer, odds are you can replicate it on your own. If you have dependents (children, a spouse, or others) who rely on your income, you need life insurance.

The amount of life insurance you carry depends on how much annual income you're trying to protect and over how many years. For example, to replace your income over the next decade, multiply your annual after-tax income by 8.5. So if you annually make \$60,000 after taxes, you should buy about \$500,000 of life insurance. You only need to replace your after-tax income because the death benefits on a life-insurance policy are free of income tax.



REMEMBER

Term life insurance, which is pure life-insurance protection, offers the best way to buy needed coverage at the lowest cost. Other policies, such as universal, whole, and variable life, which are collectively referred to as *cash-value policies*, combine life-insurance coverage with an investment account. For an equivalent amount of coverage, a cash-value policy typically costs about eight times what a term policy costs. Furthermore, in the early years of a cash-value policy, the bulk of that cost difference builds little in the way of cash value and instead goes mostly to pay insurance agent commissions and administrative costs.



TIP

In the long run, you would do best to separate your life insurance from your investments. Buy term insurance and invest your savings through your employer's retirement savings plan or your self-employed plan like an SEP-IRA. Contributions to 401(k) plans and the like typically offer an upfront tax deduction at the federal and state levels. Money put into a cash-value life-insurance plan offers no such deduction.

The good news is that if you need life insurance, you can probably purchase an individual life-insurance policy at a lower cost than you can purchase such coverage through your employer.

Insurance agency quotation services send you a handful of relatively user-friendly proposals from the highest-rated, lowest-cost companies available. Like other agencies, the services receive a commission if you buy a policy from them, which you're under no obligation to do. They'll ask you for your date of birth, whether you smoke, and how much coverage you'd like. Reputable firms in this line of work include AccuQuote (www.accuquote.com), ReliaQuote (www.reliaquote.com), and Term4Sale (www.term4sale.com).

Dental, vision, and other insurance

You may have other insurance programs besides the traditional health, life, and disability. Some employers offer insurance plans for dental and vision care, and occasionally some other unusual benefits, such as prepaid legal plans.



REMEMBER

As an aspiring or new entrepreneur, you can't afford to waste money. Insurance programs such as these that cover small potential out-of-pocket losses aren't worth purchasing. Don't waste your money buying such policies. Remember that insurance companies are in business to make money. On average, insurers pay out no more than about 60 cents in claims per dollar paid to them in policyholder premiums. The other 40-plus percent goes to administration and profits.

Social Security taxes

Another “benefit” of working for an employer is that the employer pays for half (7.65 percent of your income) of your Social Security and Medicare taxes. Don't despair of the extra cost of having to pay both halves of this tax when operating your own business. Although you do have to pay the entire tax (15.3 percent of your income up to a certain threshold amount) when you're self-employed, the IRS allows you to take half of this amount as a tax deduction on your Form 1040.

The value of your Social Security tax deduction as a self-employed person depends on your marginal tax rate; if you're in, say, the 24 percent federal income tax bracket, then the actual cost of your self-employment tax is 5.97 percent: $7.65 - (7.65 \times 0.24) = 5.81$. Thus, the tax isn't as painful as you think. (State tax deductions decrease the effective costs of self-employment taxes even further.)



TIP

When pricing your products or services, you can build the cost of this tax, as well as other benefits you'll pay for out of pocket, into your calculations. (After all, this is what your current employer does.) We explain pricing strategies in Chapter 13.

Time off

All work and no play make Mary and John dull and probably overstressed entrepreneurs. When you work for a company, we trust that it provides you with certain holidays and at least a couple of weeks of vacation each year. You may never have considered that your paycheck covers the cost of these normal workdays when you're allowed time off.

Again, when you price your products and services, you need to factor in that, given holidays and 2 to 3 weeks of annual vacation, you probably won't be working about 5 weeks out of the 52 weeks in a year. Although some new entrepreneurs don't take much vacation time or many holidays off, we certainly don't want you to plan for that; if you do, you might burn yourself out and not be much fun to be around!

Understanding Your Time and Financial Commitments to Buy

Successfully buying a business is a process that is best done over a number of months, not days or weeks. There's plenty of research, due diligence and soul searching to be done so please don't try to rush into this.

We would argue that this is an even bigger commitment and purchase than a home, which is more easily salable. Yes, you live in your home but buying a small business is a major financial commitment and will involve your full-time, year-round engagement, especially in the earliest years. And your acquired small business may well come with the responsibility of managing employees.

While research and due diligence can be worthwhile to perform, you can get too much of a good thing. You can easily spend 6 to 12 months or more trying to locate the right business to buy and then completing the steps necessary to complete the purchase.

But we've seen some folks search for years and be unable to consummate a deal. Sometimes the lack of action can be for the

best but in other cases, analysis–paralysis sets in and prevents a purchase. You can always do more research and investigation — the goal should be to strike a balance between being reasonably well informed and moving forward with a decision and purchase.



REMEMBER

There's no such thing as the perfect business to buy and all deals have risks and pros and cons. Accept and embrace those facts and gray areas. Some folks get further into the process of looking at businesses to possibly buy and then decide that buying a business isn't for them. That can be a good and smart decision. But, if you spend years debating and worrying about making the ideal purchase, you may need some help making a decision and moving forward.

Stepping Toward Buying a Business

It's time to get organized! To help in your quest to buy a business, walk through these steps involved in making a wise purchase:

- 1. Pick a business.** The types of businesses you could buy are quite varied and some will be more appealing and a better fit for you than others. Check out Chapters 3 and 4 for details.
- 2. Inspect the business and run the numbers.** When you've found a potentially appealing business you might buy, you should conduct due diligence and do some number crunching to evaluate and value the business. We walk you through doing just that in Chapters 5 and 6.
- 3. Negotiate and seal the deal.** As with buying a house, once you've found a business you'd like to buy, you'll assemble an offer and negotiate the price and terms of the deal. Chapters 7 and 8 explain what contingencies and strategies to use to close the deal at a favorable price.
- 4. Transition into your business.** Once your purchase is complete you face the big task of taking over the reins of the business, getting up to speed on all facets of the

business, and beginning to make your mark and improvements. Peruse Chapters 9 to 11.

- 5. Plan a growth trajectory.** If you expect to grow your business, you're going to need to hire and retain top-notch employees and know how to attract and satisfy customers. Chapters 12 and 13 covers those vital details.

Enlisting Help from Top-Notch Professionals

Running your own business can be a lonely endeavor. But that doesn't mean you have to go it alone — doing so can be foolish and undermine your chances for long-term success. You should tap into the expertise and knowledge of those who can assist you with important decisions leading up to your potential purchase.

Some of these pros or veterans cost decent money to hire, but there are also plenty of free or low-cost resources that you can learn a great deal from.

Start with free/low-cost industry resources

Consider this example. Suppose you're interested in buying a restaurant — could either be an existing restaurant with ongoing operations or perhaps a new franchise location.

Start by checking in with the industry association(s) which for the restaurant industry includes the National Restaurant Association and state-based restaurant associations. Look for magazines (for example, Restaurant Business Magazine, Nation's Restaurant News), websites/blogs (for example, Eater, Grub Street), and business news coverage of the industry that may further your knowledge and understanding.

Of course, you should be skeptical regarding the accuracy and objectivity of what you're reading and listening to, especially when it's coming from a source with a reasonably obvious bias.

But realize there's tremendous value in immersing yourself in learning about an industry and small business overall when you're considering committing serious money toward buying and operating a small business in that sector. Count this book among the numerous highly affordable resources that can assist you in making great small business purchase decisions!

Finding and interviewing reputable professionals

As you get further into the process of potentially buying a business, selectively hiring particular advisors and professionals to provide specific counsel and insights can be money well spent. But you've got to do your homework to ensure that you engage professionals who provide a return on the money you spend on them.

Here are the pros you might consider hiring to assist and advise you on your small business purchase:

- » **Appraiser:** Once you're interested in making an offer on a business that appeals to you, an appraiser with small-business experience and expertise can assist you with valuing the business.
- » **Attorney:** Legal advisors can help you with crafting a purchase contract including contingency terms and conditions to protect your interests. Contingencies might include things such as being able to inspect the business and its financial records and the ability to obtain a loan for a particular portion of the purchase price and for a competitive interest rate.
- » **Business broker:** Some folks looking for an existing small business to buy look at businesses for sale through business brokers. Like real estate agents, a business broker is a salesperson who gets paid on commission (from the seller's proceeds) when they sell a listed business, so keep that conflict of interest in mind when working with them.
- » **Small business consultant or advisor:** There are a modest number of consultants that specialize in working as advisors to small businesses.

» **Tax advisor:** CPAs and other tax advisors can help you with analyzing and understanding a company's financial statements and potentially valuing a business. Often, small business owners' claims of profitability may not be corroborated by their tax returns where the business owner seeks to minimize their reported net income and hence their income taxes.

Estimating the Cost of Your Search and Business Acquisition

The simplest way for most people to understand what's involved financially in buying a business is comparing it to buying a home or investing in real estate you intend to rent out. Unless you have enough cash to buy the property outright without a loan, you typically have two things to consider — the purchase price of the property itself and the amount you need to make a down payment so that you can finance the rest of the purchase price (unless you have enough cash to buy the property outright without a loan).

When buying real estate, some of the due diligence such as having the property professionally inspected costs money and leads to contingencies in the purchase contract. Applying for a loan generally involves some upfront fees and qualifying for affordable financing is another typical contract contingency.

Calculating a down payment amount

Generally speaking, you should seek to make a down payment of at least 20 to 25 percent of the expected purchase price of a business in order to obtain decent financing terms. Lenders and business sellers will typically balk at low down payment amounts such as 10 percent, and be concerned that you don't have enough skin in the game in the event that the business fails and you default on your loan(s).

Historically, borrowers who make lower down payments are far more likely to walk away from and default on their loans compared with borrowers who make more substantial down payments. That's why lenders will charge much higher interest rates and upfront loan fees with small down payment amounts (under 20 percent).

Suppose you're examining some businesses that you estimate would sell for around \$300,000. Thus, a 20 to 25 percent down payment would require about \$60,000 to \$75,000 for your down payment. As you save and accumulate money you'd like to use toward a down payment, the 20 to 25 percent down payment amount can help you fine-tune the approximate target amount for the purchase price of a business.

Tallying search expenses

By far, the biggest expense in your search will be your time, which doesn't have an explicit out-of-pocket price tag attached to it. Of course, if you have other ways of selling your time and your business search impinges on your ability to work for pay, you could quantify the value of your time spent on the business search process as part of the cost of your search.

We explain earlier in the chapter in the section, "Enlisting Help from Top-Notch Professionals," that you may wish to engage several pros you during the search process to assist with evaluating prospective small businesses for sale. These may include experts such as an appraiser, attorney, small business consultant, and tax advisor among others. Such professionals typically charge around \$250 to \$300 per hour for their time. Hourly billing rates may be lower outside of metropolitan areas that have a higher cost of living.

Most often you are likely to hire such a person for an hour or so of their time to review and opine regarding a specific business you're considering buying, problem, or financial situation. Appraisals typically take several hours of time and hence cost more.

If you're going to involve a consultant, attorney, or some other expert for more intensive and extended input, they may have a

contract for you to review. Be sure to thoroughly read it and question anything you don't understand or agree with. Contracts can of course be modified to address your concerns.

Finding funding

One of the obstacles standing in the way of turning your dreams of small business ownership into reality is being able to finance or pay the purchase price of a small business you wish to buy. Most buyers have to finance the majority of the purchase price.

So, after making a down payment toward the purchase, where is your financing likely to come from to pay the full sales price you've negotiated with the small business seller? You'll probably obtain a loan from a bank, the Small Business Administration, or the seller of the business.

Lending terms vary greatly among different sources, so it's imperative to shop around to find the best deal. See Chapter 7 for more on financing.

