SUCCESSION MATCHING

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GUIDE TO BUYING AN EXISTING BUSINESS

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Introduction - Buying an Existing Business

"*A lot of young people are apprehensive about becoming an entrepreneur because of the financial risks associated with owning a company and the emotional toll it can have on them if they fail. Aspiring entrepreneurs can help mitigate these effects by having strong mentors and a sound financial plan. Finding the right business with good market share, proven cash flow and great staff in place can increase the odds of long term success. That said, entrepreneurs who buy an existing business statistically have a higher success rate after five years than people who start a new business.*

For the past eight years I have worked in economic development. I have met with hundreds of business owners, written countless business plans, conducted extensive market research and provided counsel throughout many startups. More recently over the past five years, I have focused on businesses looking to sell and people looking to buy an existing operation. After observing many pain points and successes, here is a step by step guide to buying an existing business"

Alison Anderson
CEO
SuccessionMatching.com

In technical terms, a business transition is when the business is passed from one owner to another. This can be a family member, employee share ownership program or third party sale at market value. Every plan can be unique because of the human factors involved, but all three types of business transitions have similar elements.

There can be several phases to business transitions: Getting the Business Ready to Sell; Actively Looking for a Buyer or Engaging the Family or Staff Member; Due Diligence and Financing & Transition. In combination, the process can take anywhere between two and seven years depending upon the needs of the sellers and buyers, market conditions and the type of industry.

From a buyer's perspective, there are often even more things to consider versus a person selling their business. We've identified some of the common phases buyers go through.

Phase One – Identifying an Industry or Field of Interest

- Process 1-3 months
- Identify personal and business skills sets
- Identify industry or fields of interest
- Research certifications or accreditations

There are thousands of different business opportunities for potential entrepreneurs to consider. The first step in phase one is to understand what environments that you as a business owner would work best in, set goals and find your personality strengths. Many first time entrepreneurs make a list of all of the jobs that they have had and write out the pros and cons to having that position. By identifying what areas you enjoyed most about past positions, you will be better able to narrow down your search. Asking close friends, colleagues and family members who know you best to validate this list can also be beneficial.

Next, you can identify types of industries or fields that would use your best talents and refine this search by what types of business would have the potential to meet your goals. After you have specific areas of interest, research the required certifications or accreditations you will require to own this type of business and what type of additional training you would require to meet the minimal requirement. For example, to own a dental office in Canada 100% of the shares in the company must be held by someone with a valid dental license from the provincial association.

Phase Two – Understanding Business Transition Basics

- Process 1-3 months
- Learn about the structure of purchase agreements

Before you start your search for financing or a business, it is important to understand business transition structures and how this will affect your timelines and expectations. In Phase One, you outlined your strengths and weaknesses. A major benefit to buying and existing business is that most current owners will agree to stay on for a period of time to mentor you.

It is also important to understand the difference between asset and share sales and other financing, legal and accounting considerations when purchasing a business. SuccessionMatching.com members can access a full checklist after they sign in to their profile. They also have the benefit of working one on one with an Economic Development Officer that will send them resources, contacts and details of programs available to them.

Phase Three – Pre Qualifying Finance Options

- Process 1-6 months
- Write a first draft business plan
- Research financing options
- Meet with potential financers

Depending upon the size of the company, tax implications, long-term agreements and ability to finance the acquisition, financing the purchase of an existing business can vary greatly.

Futurpreneur Canada offers financing to purchase a business through its Financing + Mentoring program. In partnership with the BDC, financing up to the amount of $45,000 is available plus entrepreneurs are matched with an expert business mentor for two years. This industry-leading mentoring offers expertise, resources and skill-building opportunities to aspiring business owners.

Futurpreneur Canada also provides free online access to multiple resources. Key within these are a suite of Crash Courses; a suite of Business Plan Examples; a comprehensive Cash Flow Template and the hugely popular interactive Business Plan Writer.

The Business Plan Writer has been designed to simplify the business planning process. Not only is the tool dynamic, allowing customization of a business plan, it also includes Tips & Tricks and Examples to assist in writing this key document.

According to CIBC World Markets, 310,000 Canadian businesses are currently considering transitioning their business. Due to the supply of businesses and the demand for buyers business owners have an increasing need to become more flexible with the third party's buyout or payment terms. Many businesses, especially those in the trades, actively look for a third party buyer and then implement their own employee share ownership scheme.

Another popular trend in financing a business buyout, if traditional financing will not cover the full amount, is the use of full or part vendor financing or Venture Capital (VC) funding. It is important for both sides to engage legal advice for any type of contract or agreement. Most VC funders like to be engaged in the Due Diligence process and that is why some companies that offer services to find a buyer also integrate introductions to VC funding into their systems.

Phase Four – Finding a Business

- Process 1-6 months
- Identify an organization which matches your aptitude and interests

In many provinces there are now more people over the age of 65 than under the age of 15 years old. With a large baby boomer population, a lot of small and medium sized businesses are looking for buyers[i].

According to the Canadian Federation of Independent Business, the number one barrier to selling a business is finding a buyer. This business climate gives aspiring entrepreneurs a lot of options when looking for a business to buy. The SuccessionMatching.com online platform offers a place for business buyers and sellers to meet whilst providing additional resources and introductions to industry professionals. However, buyers can also use other online posting boards, brokers or word of mouth to find a business.

Commercial Real Estate Agents

- Commission base
- Privacy is low
- High level of service in a local market

Online Posting Boards

- Price, privacy and type of service provided varies greatly depending upon the provider
- International geographic reach

Important: read the Terms & Conditions before signing up for any online posting board. Look for percentage of commission on the sale price, whom they share your information with, other services you are obligated to sign up for and length of contract with the provider

Brokers

- High commission on the sale of the business
- High privacy
- Geographic range varies greatly with individual consultants

Personal Network

- Low cost
- Low privacy
- Limited service and geographic range

Compatibility with the business is important. The hiring manager in a company should not hire everyone who is just like them – it is the exact opposite when a business owner finds a buyer. The business owner has successfully run the company for the past few decades. By finding an individual or group with similar soft skills required to run the company will increase the chance of both parties having an increased level of trust in the Due Diligence process, a higher level of corporate knowledge transfer and the long term sustainability of the company.

Phase Five – Due Diligence

- Process 1-12 months
- Confirm exactly what you are agreeing to buy

Depending on the size of the company, timelines and expectations of the seller and buyer the Due Diligence period can vary greatly. To achieve efficacy professionals such as accountants, lawyers and business services should be engaged early on.

Confidentiality agreements or down payments can be used early on to establish trust. Often both the sellers and buyers are entertaining multiple parties at once and in the interest of time and resources, both parties should individually establish a Best Alternative to a Negotiated Agreement (BATNA).

Throughout this phase 'good paper makes good friends'. All timelines and expectations should be well documented. By the end of the Due Diligence stage, both parties should have a crystallized sell price and understand timelines and expectations.

Phase Six – Valuation

- 1-2 months
- Understand the value of what you are buying

Having a business valuation done is important as it provides the buyer with additional due diligence and an understanding of the business' current cash flow and transferable value. This information can be used in negotiations and after the purchase to turn around areas of the business that are underperforming. Business Valuations can be undertaken by Certified Business Valuators, Accountants and with some business consultants who are able to produce these analytics.

Phase Seven – Transition

- 0-60 months
- Bring it all together

An individual buying a business has a higher success rate than an individual starting a new business. This is primarily due to the competent mentorship that is often available to buyers. The majority of owners agree to stay on under a key employee contract for 6-12 months, giving the opportunity for a corporate knowledge transfer. In some cases, the seller is unable or unwilling to stay on for the mentorship period. In these instances it is strongly recommended that the buyer finds an alternative business mentor. This can be achieved through their own personal networks or through formal mentorship programs (such as Futurpreneur Canada's Financing + Mentoring program)

During this phase it is important to outline the expectations not only for the period of time the seller will stay on for, but also how a change of ownership will internally affect operations. The human resources of a company are often greatly affected by a transition. The new owner may want to make changes to the staff, policy and procedures. Having agreements in pace to outline who has final say on any hiring changes or discipline can mitigate the escalations of any issues that may arise.

Owners must also recognize that this is a major life event for them. Often a lot of their identity is connected to owning the business and it is the largest asset sale they will make in their lifetime. Therefore it is important to reflect internally about what they would like to do to find purpose in the next phase of their life.

Conclusion

While there are no guarantees in any business venture, buying an existing business and building on proven results can offer reduced risk regarding the uncertainty of a start-up. Looking for existing business also provides the luxury of seeing what works in the marketplace. It allows you to discover an organizational culture that best mirrors your own attributes and ambitions.

[i] 'Baby boomers retirement glut poses risk, CIBC says' CBC News, November 2015