LEARNING MADE EASY

Buying a Business

for dummies®
A Wiley Brand

Pick the business that fits your situation

Review the numbers and make an offer

Manage a smooth change in owners

Eric Tyson, MBA
Jim Schell

Buying a Business

by Eric Tyson, MBA and
Jim Schell

for dummies®
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Buying a Business For Dummies®

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Introduction

Many folks dream of being their own boss and running their own business. Plenty of those dreamers envision starting their business from scratch. Fewer think about buying an existing business but that route may indeed be a better fit for your skill set and situation.

Buying a Business For Dummies can help you to understand what's involved in buying a small business rather than starting one from scratch. We walk you through all the important considerations to help you decide if buying a small business is right for you and how to find one in the best niche.

As with buying a home or other real estate, making an offer on and closing on a small business purchase involves plenty of research and due diligence. We detail what to do and what to avoid throughout the entire process. And, once you buy a business, we highlight how to improve your business and make the most of it.

About This Book

The following backgrounds and philosophies serve as a guide to the advice we provide — advice from the field that makes this small-business book stand out from the rest:

- **We're small-business experienced, and we share the benefits of that experience with you.** Between us, we have seven-plus decades of experience in starting, buying, and running seven successful small businesses. In addition, we've worked with thousands of small-business owners. Jim has led numerous small-business peer-networking groups and has provided volunteer counseling services to small-business owners. Eric has conducted financial counseling for small-business owners, taught financial-management courses, and worked as a management consultant.

Throughout this book, we share the experience we've gained, in the hopes that you'll use our advice to eliminate trial and error from your inventory of management tools. We also share an ample collection of straight-from-the-horse's-mouth anecdotes, each one based on a true story.

- **We take an objective view of small-business ownership.** Although we firmly believe in the creative power of small business, we're not here to be its pitchmen.

  Sadly, too many small-business books are written by folks with an agenda: a franchise to sell, a multilevel marketing scheme to promote, or a high-priced seminar to foist on the reader. Free of conflicts of interest, we're here to pass on the truth and let you decide. If you're the type of person who wants to get into this competitive career field, we'd like you to enter the race informed as well as inspired.
- **We take a holistic approach.** Because small business can at times be both demanding and intoxicating, buying and running your own shop can threaten to consume your life. Although everyone knows that life is more than just business, striking a balance and staying in control can represent a colossal challenge. With that in mind, we take care to present the realities of buying and running a small business within the larger (and more important) framework of maintaining a happy personal and financial life.
- **We look to the future.** As this book is published in 2024, the concept of Artificial Intelligence (AI) is going mainstream. Both AI and ChatGPT (just one of AI's many tools) increasingly should be considered by small business buyers and operators. However, just as with any other technology or innovation, we help you to weigh the costs against potential benefits in deciding which tools and strategies may make sense for your specific small business.

Foolish Assumptions

Too often, books about buying a small business assume that their readers are ready to make the leap into small business and are cognizant of the risks and pitfalls. We don't make that assumption here, and neither should you. That's why we include sections designed to help you decide whether buying and running a business is really for you. We spell out the business and finance terms, break down the tasks, and point out the dangers. We don't think that you're incapable of making the decision yourself; we just know that time is your most precious resource, and we think we can help you save it. You'll lose too many years of your career and commit valuable financial resources if you make the wrong choice.

Much of this book is targeted to buying a small business and running it intelligently. Even if you have a business in mind, buying and then operating a small business is much harder than it appears, so we show you the best ways to purchase, manage and grow your enterprise.

We've organized this book to satisfy different reading and personal styles. Some of you may read it from cover to cover, while others may refer to it to answer a specific question or address an immediate concern. For this reason, each chapter of the book is designed to stand on its own. We're flexible — read it as an all-in-one project or use it as a reference guide.

Icons Used in This Book

To help you find the information you need to assist you on your entrepreneurial path, we've placed icons throughout the text to highlight important points.

INVESTIGATE

This icon asks you to do some thinking and checking before you take the plunge. You have a lot of important choices to make when buying and running a business, so don't rush in.

REMEMBER

This icon points out stuff too good (and too important) to forget.

TECHNICAL STUFF

If you like to sweat the dull stuff, this icon points out the inner workings of the business world that you're likely to ignore as you get down to the real work.

TIP

This symbol indicates time-tested tips to make your small-business journey more profitable and easier. Often straight from the heart of experience, we clue you in on what works for us as we navigate the oft-troubled waters of small-business life.

TRUE STORY

We present tales from our own experiences to save you some trial and error. Enjoy the company of your fellow entrepreneurs and benefit from the lessons we've learned.

WARNING

The path of small-business ownership can be fraught with peril. Some deals may be too good to be true, and some people may have their own interests at heart, not yours. This icon points out the dangers and helps you steer clear of them.

Beyond the Book

To access this book's Cheat Sheet, go to `www.dummies.com` and enter "Buying a Business For Dummies Cheat Sheet" in the Search box. There you will find the key themes that we emphasize throughout this book.

Where to Go from Here

Where you go from here is up to you, but if you're just beginning to think about buying small business, we recommend that you read straight through, cover to cover, to maximize your knowledge regarding buying and operating a small business. But the A-to-Z approach isn't necessary. If you feel confident in your knowledge of certain areas, pick the topics that you're most interested in by skimming the table of contents or by relying on the well-crafted index at the back of the book.

1

Deciding to Buy a Business

IN THIS PART . . .

Get to know the acquisition process and the professionals you can hire to help.

Assess whether you have the knowledge, time, and financial resources to purchase and be successful with an existing business.

IN THIS CHAPTER

- Assessing your financial fitness
- Replicating employer benefits in your own business
- Making the time and financial commitment
- Understanding the acquisition process and hiring professionals
- Calculating a down payment amount and search expenses

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.