

Do you have what it takes to buy a business?

[Brad Cherniak](#) | Dec 10, 2012 10:09 AM ET



Nam Y. Huh/AP Photo files Increasingly, companies are coming up for sale and the average buyer's will is being tested by a chronically weak economy and outlook.

Prospective entrepreneurs have three main options for getting into business: set up a startup; buy a franchise; or buy an existing business. This column will focus on the third option and the two critical decisions that must be made: whether or not to buy a business; and if so, what type and size.

Increasingly, companies are coming up for sale and the average buyer's will is being tested by a chronically weak economy and outlook. That doesn't mean it's easy to buy a company. The key is to be systematic, patient ... and self-aware, says Barry Wood, a serial entrepreneur who has bought, run and sold several private companies. (Disclosure: I have served on the board of one.)

His suggestions won't guarantee success, but they can raise the probability of making good decisions in a challenging business environment:

Reality check The first step, Wood says, is to ask yourself if you are prepared to invest the time, effort and money to search for a business, and then have the passion to buy it and turn it into a great one. Hard work, perseverance and dedication are required, which means long hours, below-average cash income and significant pressure from all quarters — customers, suppliers, employees, service-providers.

Consider whether you have the requisite skills and aptitudes to be successful. Exceptional people skills are required, especially stepping into the shoes of the former owner-manager.

Narrowing the field Next figure out what type of business you want to run. This is more than an investment, Wood says, it will be your life. Whether you choose manufacturing, services, distribution, software, or something else, in this challenging economy and with the tumult caused by the social web and technological convergence, you will want to be thorough about understanding the short- to long-term fundamentals of the business. You should also consider location. Are you prepared to move? If not, how far are you prepared to commute?

Getting out on the dance floor The search for a business prospect involves extensive networking, Wood says. This would include accounting and law firms, banks, merger and acquisition advisory firms, private equity, venture capitalists and angel investors, and industry and government contacts. There is also the direct approach — equally challenging and painstaking — involving basic online research, business directories, and input from business associates, followed by cold-calling the owners.

Size matters Choosing a smaller business may mean you can finance the purchase on your own. If you want to run a larger business, you may require equity co-investors.

Once you identify a prospect, an initial size-up is required: Can the business take on additional debt to reduce the equity investment required, and increase the return on investment? Are there tangible assets that might be attractive to lenders as security? How much risk are you willing to take on? A sensitivity analysis using spreadsheets is required to come up with a robust deal structure.

Consider who might be an equity co-investor — relatives (not always a great choice), outside investors (angels), or institutional investors (VCs and private equity funds).

Know your co-investor and business partner before you make a move, including whether their investment horizon fits with yours, what the investment structure will be and what level of detail and decision-making they will want to participate in. (Post-investment, Wood recommends a weekly phone call to discuss bigger issues and opportunities so co-investors share the risk on strategic decisions.) The basic elements of the strategic plan post-acquisition should be agreed on before getting too far into due diligence, or problems can arise later, Wood warns.

You should also know what your co-investors' key governance principles are — board size and composition, quorum, and matters requiring board approval, for example. Will there be a shareholders' agreement to cover key areas including selling some or all of one's shares, and the valuation. If you are investing hundreds of thousands of dollars, make sure you have reasonable rights, and as the operator also ask for an employment agreement with the company.

Assuming the answers are satisfactory, you can proceed to a detailed due diligence review of the business. As part of that process, Wood says, you will want to meet and interview the key people you will be working with. It is generally best to put in place a new chief financial officer or controller at the time of purchase.

Of course, in all but very small business purchases, experienced advisors should be used to assist with the due diligence process.

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