

The Small Business Market: Reading Between the "Negative" Lines

Experienced buyers of large businesses have tended to spurn the smaller business, citing traditional "negatives" involved in this type of transaction. Now big-time buyers are throwing away the don't-buy-small book; or at least, they are beginning to read between the lines. The so-called shortcomings of the small business acquisition can actually be opportunities in disguise.

Let's take a look at these small-business negatives and see the possibilities or (improvements) inherent in each:

A Good Small Business Is Hard To Find

Experienced buyers often complain about the difficulty of locating a viable smaller business. Furthermore, when a business of possible interest is found, the owner/seller is often trying to manage the transaction single handedly, foregoing the advice of professionals. This negative issue can be resolved instantly by the use of a business broker. For the seller, the business broker will offer the support and expertise needed to launch and consummate the sale. For the buyer, the business broker will pinpoint appropriate businesses for sale, using a knowledge of the marketplace and extensive databases to shortcut the search process.

Business brokers will also be able to present the buyer with small businesses that are not "shopworn," as can be the case when a business sale has floundered--again and again--in the inexperienced hands of the seller. The bigger-time buyers will especially appreciate this, since they are always on the lookout for the unusual and first-time seller.

One Person Is Key

When the owner is also the key employee, what happens after the business is sold? How can the new owners/investors hope to replace the one person who has essentially been the business? This traditional concern paints a far too gloomy--and, in fact, inaccurate--picture. Too many small business owners only think that they are irreplaceable. In most cases, they are not. In fact, new management can bring with it the fresh enthusiasm and energy essential for significant growth. For example, viewed from the outside, the quaint gift shop that is an extension of the personality of its owners might have become just that--too quaint, a clutter of Aunt Susie's jams, somebody else's painted beach rocks, aged potpourri. The new management clears out a space to serve gourmet coffees, stocks gift items from an endangered rainforest made by third-world peoples, and the business takes on a whole new life.

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Casual Company Structure

Lines of responsibility often blur in the small-business management structure. This problem is compounded when, as in many cases with the small to mid-sized business, the owner is also the manager. Daily concerns override long-term planning, and decisions tend to be driven by instinct rather than by in-depth analysis. The typical informality of small business management is not an insoluble problem by any means. The use of expert, highly specialized consultants and the instituting of an enthusiastic board of directors are two possible initial steps to take. Both groups--consultants and board members--will be invaluable resources to support the existing management and to help formalize the company's structure. With the burden of managing the business more clearly defined and more equably distributed, a small business will have better opportunities for rapid change and growth.

An additional tip for those owner-managers considering selling their business: Experienced buyers will be more impressed with your business, no matter what the size, if you prepare an operating manual that details the current operation scheme and charts the responsibilities of each employee.

The Owner Keeps the Books

With many small businesses, the owner keeps track of operations and financial reporting procedures--off the cuff or in the head. Even when careful records are kept on paper or computer, the systems may not have kept up with the business and the times. (The operating manual mentioned above will help owners as they plan to sell their business.) The good news for buyers is that the changes needed to update most small business systems will not call for major overhauls. Simple systems improvements can effect dramatic results.

Goodwill Is What's (Mostly) for Sale

A small business is not typically rich in assets. The investment in capital equipment is minor, and, in the case of S corporations, the majority of earnings go to the owner or owners. What is left to attract the experienced buyer? Mostly goodwill--just what most buyers don't want to hear. There are, however, two positive sides to the low-assets "negative." First, it is possible for the new owner to increase assets by the purchase of equipment and by frugal management decisions. Second, the business with a small asset base might receive a lower valuation, which will naturally appeal to any buyer; the experienced buyer will see the further benefit of using the resulting higher cash flow as a means to grow the business.

Leaving the issue of assets aside, most small businesses, in general, are going to sell for much lower multiples than the larger business. A buyer must "buy into" an exit strategy wherein the business will be re-sold on the basis of a higher multiple of earnings as well as simply higher earnings. This strategy has appeal for those buyers who want to buy small businesses at reasonable valuations.

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Small Customer/Supplier Base

It is not atypical for a small business to rely on just one customer for 50 percent of its trade, or on a handful of customers for as much as 90 percent. Businesses with such small customer bases (and similarly small supplier bases) survive by cultivating strong relationships and loyalties. This one-on-one way of doing business poses a potential problem for buyers who are doubtful about maintaining these customer-supplier ties.

The seller can alleviate the buyer's concerns by agreeing to stay on board, as needed, to help maintain key relationships with customers and suppliers. The smaller the customer base--with a few major customers forming the bulk--the more important the seller's ongoing participation will be. In addition, sellers can use paperwork to their advantage, creating detailed listings of current customers and suppliers, as well as leads to those used in the past or with future potential.

The Uncertain Seller

Is the business really for sale? This is a vital question that any buyer wants answered. In the case of a small business, the decision to sell will involve many emotional factors, including the reluctance on the part of the seller to part with what has been such a large chunk of his life. If the need to sell is caused by family difficulties or by personal burnout, these are fluctuating issues that may leave the seller running hot and cold.

When the seller's decision-making powers have become skewed, it is wise to enlist the help of a professional. The business broker can assess the seriousness of the seller--as well as that of the buyer. Once it has been determined that both parties are serious, the business broker will keep an eye on the chemistry of each player, fostering patience on the part of the buyer and guiding the seller on a steady path toward a successful sale.