SECTION 2

BE A SMART BIZ BUYER

We cover buying a business in this major section of the book. This targets A) the person who does not own a business but plans to buy one in the future and B) the person who already owns a business but plans to purchase another. As you know, selling a business and using the proceeds to purchase a next, larger one—the NLB—is central to the Quantum Stack Investing™ approach.

There are few investment avenues as profitable as buying a great, closely held business. History shows us that. However, making a wrong decision can be a problem. Thus, the goal of the upcoming chapters is to educate you about the process of becoming a smart buyer.

Remember the statistic in the last chapter: 95% of people who approach business brokers are inexperienced buyers who do not understand the process. The upcoming information will help you become one of the 5% who are smart buyers and improve the probability of buying the right business at the right price and succeed in business by implementing the QSI strategy.

STEPS FOR BUYING A BUSINESS

Buying a business is a process. We'll start you on the adventure of becoming a smart buyer by explaining each step and sharing more information. Some steps warrant their own chapter later in the book. Knowing these steps is a vital part of the QSI process.

Step 1: Gut Check: Do You Really Want to Own a Business?

Before we dive headfirst into teaching you how to buy a business, we want you to do a gut check. Nope, not a casual pass by the concept, but a real, hardcore look at the following question: ***Do you really want to own a business?***

The advantages of owning a business are well known. A quick survey of the world's richest people will show you one thing: nearly all own companies. Even most celebrities that rank on those lists in the billionaire category—like Oprah or Kylie Jenner, for instance—make most of their wealth not from being a celebrity, but because they own related businesses that capitalize on their fame.

Owning a business has been, and will continue to be, one of the best ways to generate wealth. It is true of the super-rich, but also of people who achieve significantly more wealth than the average person, though much less than the billionaires. In other words, there are varying levels of success, and the range is extremely wide. Chad has a great saying, "There will always be people wealthier than you, but there doesn't have to be so many of them."

Surveys of parents show that owning a business is often at the top of desired professions for their children, even eclipsing esteemed positions such as doctors and lawyers. Most doctors and lawyers will also tell you that they can earn a great income doing that profession, but they still get paid in exchange for their time (i.e., billing for hours or per surgery), meaning they must show up to perform the work needed, just like an employee. However, being a business owner, you can build it up so others do the work, and, for some, they can cash checks from their vacation home!

There are other advantages provided to business owners as well. Consider this: you require specific education or certificates to be an attorney, doctor, scientist, or even a plumber. A sign on the door says, "*You may not enter*" unless you take specific classes, take the proper exams, and have the right experience. This usually means they got on a particular path early in life. In many professions, it is a remarkably high bar.

To succeed in business, a great background helps but is not necessarily required. Rather than traditional schools and colleges owning the commodity of education required to become a doctor or lawyer, knowledge about business and how to run one is readily available to you on Google and in every library across the world, by authors such as us, who have carved a path that you can mimic and use to become wealthy, as well.

> *To succeed in business, you only need to succeed in business. It also helps to have an extremely deep level of want to.*

And don't forget what many see as the best bonus: you don't have a boss! You are the boss. You get to set the rules and choose which ones you will follow. It's no wonder that surveys say that as many as 96% of adults in the US said they would like to own their business someday. Obviously, that is a big gap from the approximately 4% of adults in the US who own a business with employees.

The benefits of self-employment are unquestionable. But there is another side. There is no real gut check needed if all you do is think about—or dream/fantasize about—*only* the positives. These dreamy thoughts are of a warm summer day at the beach, with a waiter who brings you a tropical drink and room service in the sun. Ah, how nice it would be to have your feet up and all the minions doing everything?

The gut check parts are when you think about the downsides. If you are going into business without considering these, you are missing the boat and are seriously underprepared. If over 90% of adults want to be a business owner but as few as 4% are owners with employees, a gap between the "wanting to" and the "actually doing" exists, and rightly so.

Most people who own a business will tell you that it is not easy. They will tell you it is a fantastic personal growth experience. Why? Because the business needs more out of them than they brought to the table at first. They had to expand. They had to grow because the business made them, whether they wanted to or not. They had to stretch their brain and have more courage than they thought they had. And they have confronted times when they looked in the mirror and said, "*What the hell have I gotten myself into?*"

It can be fun one day. And terrifying the next. It can be exhilarating one moment and draining the next. You can peer into your future and see unlimited wealth and, five minutes later, you fear losing it all. A friend of mine said his son asked him how his day was. He told him he experienced his highest high, then, within an hour, the lowest low. Many entrepreneurs describe the process as a roller coaster.

Many people will read this and say, "Yeah right. I would give my left arm to own a business. When I get my chance, I won't waste it or take it for granted."

What you are saying to yourself is that you are going to be the exception. Every other entrepreneur on the planet experiences immense joy and great pain from their business. But you are telling yourself that you are the only one who will be the exception.

> *Only one problem: you won't be an exception. That's a bullshit way of thinking. The business will put you to task—further than you think you can go. You will face some things that feel horrible.*

Let's consider a few statistics. Over 90% of small business startups fail. Yet only one out of 72 SBA guaranteed loans go into default. This statistic shows you that the odds are in your favor by purchasing a seasoned business but stacked against you on startup ventures. Startups take you to task more than an existing business, but both do the same. We think it is a good idea to consider the negatives, as well as the positives. Some questions to ask yourself include the following:

- Are you naturally good at solving problems?
- Can you weather through frustration?
- Can you risk losing all the money you will invest?

- Do you have an aversion to debt? Note: you can be an entrepreneur and avoid debt, but the biggest returns, including the Quantum Stack approach, are often greatly enhanced by debt.
- Do you panic when times get tough or can you keep a level mind?
- Can you show success in something in life? It does not have to be academics or business, but can you show some time when you fought through obstacles to succeed?
- Owning a business tends to be all-consuming; can you handle the personal ramifications of balancing owning a business and trying to maintain a life? Entrepreneurs will tell you that there is some tradeoff here.

In wrapping this up, we want you to consider a few things. First, speak to at least three people who own a business. Ask them about what they love about it and what they hate about it. Ask them to be 100% honest with you. We are not asking you to find someone to talk you out of it, but rather, we want you to have a broader, more comprehensive perspective on the matter.

Next, consider that many business owners coming to us to sell their companies are making $300,000 or more annually. Compared to even the best lawyers and even doctors, being self-employed eclipses the earnings of what used to be the highest esteemed careers in the country. On the contrary, many people in business are more average, and they don't have much to sell. They may be making $80,000 a year and they may be self-employed, but the business owns them, rather than them owning the business.

The point being is that not every business owner is rich. But on the flip side, however, most rich people own a business—or inherited it from someone who did. Our goal, of course, is to help you become immensely successful and blow away average numbers.

Our QSI program is powerful. But it is not for the meek.

Another crucial point: there are multiple ways to get into owning a business. Buying an existing one with existing Cashflow is a significantly *less* risky venture than starting a business from scratch! The concept we teach here leverages into this and "stacks" the odds in your favor.

Think long and hard about buying a business before you take this step. A gut check will be necessary. Not only prior to buying the business, but after as well.

Step 2: Researching Candidates

After deciding that you want to own a business, you need to prepare a list of companies to buy. There are many ways to do this and even more factors to consider.

One of the first ways is to assess how much cash you will have to invest in the business. As we have mentioned before, most businesses are bought with a down payment—buyer injection—as well as borrowing from a bank. This will help you understand the range of prices you may be able to afford.

> *A general guideline is that you will be able to buy a business that costs approximately ten times (10X) the amount of your down payment, or buyer injection.*

If you keep some money held for purposes of Cashflow or unexpected expenses, also called working capital, this number could be closer to 6X or 8X. When considering your appetite for buying, the bigger bite—down payment/buyer injection—the more Cashflow you can buy.

Unlike a house, where your down payment has a ratio to the level of debt you can take on through proven income from your job, banks underwrite businesses based on the Cashflow the business makes and the debt service it costs monthly to pay the note over a multi-year term, typically five to ten years. You must decide how much of your reserves you wish to play with when buying a business. Again, typically, a bigger injection equals more Cashflow.

Geography and industry can also have an impact. Do you want to work in a certain type of business? And are you limited to buying a business in the area where you live or are you willing to relocate? You can move some businesses, but we suggest giving that careful consideration; purchasing a business and making dramatic changes—disrupting a business—can have a negative impact on overall performance. As a rule, you want to do what the current owner does, as it obviously works! Then you make changes after a year of seasoning in the business.

What you can see with these points is you are starting to generate a profile of the type of business you are looking for. We suggest you put this profile down on a piece of paper. Make a list and organize it. That's more powerful than just thinking about or understanding it.

Price, geography, and industry are great starting points, but you will want to add other items to the list as well. The more detailed the profile, the better.

Some other things you may consider when developing your list include the following points/questions:

- How much money do you want to earn? (SDE/Cashflow)
- What is the Cashflow of the business?
- What is the asking multiple of Cashflow?
- Can the business grow?
- What does the business owner do in the business?
- What are your personal skills and what do you bring to the business? QSI works best with growth.

- How closely does your skillset line up with the existing owner, who will exit the business shortly after selling it?
- What characteristics of the business are you drawn to?
- What type of employees would you like to be in the business you buy?

Again, the more detailed your list, the better positioned you are to start to look for companies. However, as a brief side note, don't approach a business broker with a lengthy list of must-haves. You could be put in the category of high maintenance, put on an email list, and barely contacted. Think organized versus overly picky or insanely demanding. The right approach will get the broker wanting to help you; this is the goal.

Armed with this list, you can start to develop a list of possible companies to purchase. A great place to start is the website, www.BizBuySell.com. This site is similar for buying a business to what *Zillow.com* or *Realtor.com* is to purchasing a house. Multiple brokers come together in one spot to list multiple businesses which are available for sale. This website has great searching tools and gives you the ability to set up an account and save searches and listings. Consider the research you do on BizBuySell to be an invaluable part of constructing your list.

Another method is to connect with different business brokers in the area where you are looking for the business. They will have different listings and ideas for you. However, as a broker, we can tell you that the more organized you are when approaching brokers, the more help you will get from us.

A good broker is listening for intelligence and willingness to buy. A good broker is also paying attention to your attitude, as he should know the personalities of the sellers, and he is already figuring out if it is going to be a good fit from the time you answer the phone. This is true of our brokerage as well as others.

As mentioned previously, brokers will ask you to sign an NDA and supply personal financial information before sharing deep details about their listings. If you have $10K to invest in a business and are asking about a $4 million listing, we owe it to our sellers to weed you out, as you would not meet the qualifications to buy that business. It's not personal; it's simple math and a waste of time.

Again, let's use the real estate similarity. If you have $10K to put as a down payment for a house, you will be able to buy a house. You will not, however, find many agents willing to give you a personal tour of a $4M house. It is the same with a business. I can assure you showing the seller's documents is every bit as confidential for a business owner selling a $4M business. Just like the owner of a $4M house does not want you going through their closets if you are not qualified to buy that house.

Acting put off by our asking these questions is our number one red flag that you should not receive the detailed information on the listing.

Brokers and BizBuySell supply a lot of information about the listed companies in what we call the Blind Ad. For research and learning purposes, it is more than sufficient. When you are serious about looking at a listing, you will ask the broker for a document called a Confidential Business Review—or CBR. This will share the name of the company and supply detailed information on the company, including financial information. This is when the NDA and personal financial information become necessary.

Another way to find a business to purchase is what the "no money down" gurus promote, which is to reach out to companies directly. Can this work? Sometimes. But it's like catching lightning in a bottle. You must reach out to the right business and reach that owner at exactly the right time, as well as convince them that they should hand over their business for little or no money down at closing. You also better be a damn good salesperson!

As brokers, we don't discourage you from doing this, as it is a method of learning about companies and why people sell. We just don't think it is going to be as productive as coming to a person who has already shown they want to sell their business and has it listed. Not to mention, you must be an absolute pro at knowing all the ins and outs of buying a business to be successful with the "no money down" approach.

I, as the author of this book, would be the best candidate to be able to successfully pull off a "no money down" acquisition, and I give myself less than a 5% chance that I would be successful at it. QSI is based on using the money for leverage and taking Quantum Leaps in wealth. QSI removes any fairy tale dreams of owning something for nothing; it is not necessary to exhaust yourself down the "no money down" path.

Once again, a similarity in real estate. The comparison above would be to knock on doors to ask people who do not have their houses listed if they are interested in selling. As you might imagine, you could find a potential seller, but it is not likely. Additionally, the seller, not knowing what the market is for the business might just say, "Sure, you can buy it for twice what it is worth."

This happened recently in the neighborhood where I live. Houses were in high demand. So people would stop by the house and ask if we were interested in selling. In talking to neighbors, we all had the same comment. Sure, we would sell, but only at a premium. The fact is, buying and selling a business is exponentially more difficult than a real estate purchase, and going it alone is a recipe for failure.

However, call any business you wish and speak with as many business owners who will give you their time and ear, but if you really want to buy a business, you will find more utility from actual listings from the brokers working with actual sellers.

From there, start to narrow down your list. One business buyer mentioned to me that they looked at the basic listings, Blind Ads, for over 150 companies to narrow down their list to 15 companies they really wished to investigate in depth. You don't need to go into that much depth, but studying listings will help you define what you seek in a business so you can compare this to what is available in the market.

In most cases, this investigation will involve the process detailed above, contacting the broker, signing an NDA, and supplying some financial information that proves you will be qualified to purchase the business in question. After that, you need the details in the next step.

Step 3: Review of Key Documents

After going through those steps, you will have narrowed your search down to a concise number of companies to do a deep-dive study on. You will have completed some information for the broker, including the NDA and personal financial statement. The broker is now ready to send you the CBR if you meet the criteria of a qualified buyer for that business.

Here is where the smart buyer really starts to do their homework. The information sent should give you a clear picture of the business. Truthfully, at this point, most people will know whether they are interested in a business or not. Many businesses will not pass this test for you.

> *A note on confidentiality. The documents shared with you are extremely personal. In many cases, the business owner does not want others to know they are selling the business.*

Think about it: customers may become uncomfortable if they know a business is for sale and take their business elsewhere, vendors may ask a lot of questions, and employees may wonder if they should go to work somewhere else. All these things decrease the value of the business.

Keeping this information private is extremely important, and the sellers deserve that right and respect. Do not discuss the details with your friends or family. In most cases, the NDA will specify you can share the information only with advisors helping you with the business purchase, such as an attorney, accountant, or banker. But be cautious and confirm. The information shared with you is important and you need to take exceptional care of it. Honor the seller's wish and handle with kid gloves.

If you ask for a CBR and violate this trust, then you deserve what is coming to you. If you use the information to go start a competitive business, you are walking on thin legal ice. If you divulge the information to competitors or employees, and the business gets hurt through your negligence, the company may have legal recourse. This is another reason brokers are extremely cautious with seller CBRs.

In addition to a general description, the CBR will have financial information, such as an assets listing, tax returns, and financial statements. Information smart sellers do not want floating around, but information critical to smart buyers, legitimate buyer candidates, for the business.

If you do not know how to read financial statements, it is important that you either A) learn how to study a company by reviewing the financial statements or B) consult an accountant to help you wade through the information. Financial statements are a tool that business owners use to study their businesses.

If you are going to buy a business, you would be smart to know how to speak the language of a business owner. Understanding a profit and loss, also known as a P&L statement or income statement, is crucial. We strongly suggest you really study the numbers, as they tell an important story about the business you are considering buying. If you buy it, you will need to know the numbers anyway. Just as important—and many would say more important—a business owner should know their way around a balance sheet and a Cashflow statement.

There are several tools to learn how to read financial statements. If you get a package of information that makes your head spin, take the time to learn what it is you have been provided. There is a reason these documents are part of the CBR: it is the information a smart buyer will study when considering purchasing a company.

If you look at multiple companies at this level, you will have one or two or more businesses drop off your desired company levels. They will start to weed themselves out.

At this point in the process, the broker will request some feedback. Is it a hard pass? Are you looking at other businesses and this one is lower on the list? Or are you strongly considering the business? It is important to be direct with the broker. Tell them the truth. If you are interested, this will help them get more information. If you are going to pass, tell them. And let them know that you have deleted the files they have provided you.

If you are interested in learning more and have questions, commit these to paper with a comprehensive and organized list of questions. The broker will facilitate your inquiries, but to honor the time of the business owner/seller, and the broker, only ask questions when you have a genuine interest in buying the company.

Step 4: Valuation Estimates

At this point, you are starting to get a feel for the potential businesses. You have gone from a larger number of companies you studied at the basic listing level, and even reviewed the CBR for a few of them, which weeded even more out. Your list is starting to get smaller, which is what you want.

At this point, you will take a much closer look at the purchase price. You are going to have to answer the question, "Is the purchase price, right?" and if not, "What should it be?"

If the seller is working with a strong broker, they will have calculated and shown at least three years of history with the Owner's Cashflow in the CBR. You can find how to calculate this number in our sellers section of this book in the Cashflow section. Reading this chapter will help you understand how to determine this number.

You will want to calculate what the Asking Price is as a multiple of the Owner's Cashflow. Simply, if we sell a business for $1M, and the Owner's Cashflow is $350,000, we are asking for a multiple of just under 3X. If the Owner's Cashflow is $200,000, the owner is asking for a 5X multiple.

Consider the post-close Cashflow, which is how much Cashflow you can expect after the bank note. At the time of this book, interest rates on a 10-year SBA note were between 6% and 8% APR. A seasoned broker can show you what the post-close Cashflow number is. This tells you what lifestyle you will live after paying the debt service. The business will pay the note, and in 10 years or less you would not have debt service and it would all be yours to keep. Also, an important thing to keep in mind: the current seller is doing $XXX amount in Cashflow, and he or she is most likely burnt out and bored. With new vigor and energy, what could you do with the business?

Typically, small to medium-sized, closely held businesses will sell for a multiple between 2X to 5X of Owner's Cashflow, with 3X being quite common. For a business to sell for significantly more than this, there must be an extraordinary circumstance or the business needs to have highly unique characteristics. The seller's chapter on Valuation goes into more detail about the distinct factors that can affect Valuation.

However, if you find a business that is a normal, mom-and-pop business and the asking price is 5X of Cashflow, you likely have an overpriced business. To get the listing, the broker probably told the seller the business is worth more than it is. This broker contributes to the statistic where very few businesses listed actually sell. Frankly, this is incredibly sad for all involved!

Sometimes, you can negotiate in these situations. For instance, the broker may have listed the business high and told the seller she was going to do this, just to see if they can find a sucker. Many times, there can be no deal because the (bad) broker blew smoke up the seller's ass to get the listing, and disappointment is tied to expectations.

Importantly, this rarely works because the multiple has an impact on how the Cashflows from the business will be able to support a loan payment. Simply put, the higher the multiple, the harder it is to make a bank feel comfortable that the Cashflow can cover the payments. Even if you find a sucker buyer, the bank won't fund the deal, as the Cashflow cannot support the debt, and rightly so. Remember, the three most important things when considering the value of a business.

1. Cashflow
2. Cashflow
3. Last, but not least—CASHFLOW

Most often, the buck stops at the bank.

Study the later chapter on Valuation and Owner Cashflow, but for now, know that part of the process of buying a business is to calculate the multiple of seller's Cashflow and decide if this is appropriate.

There are a few factors that can alter the guidelines above.

The first is real estate. If a building is included, this can alter the multiple. In fact, we will usually isolate the part of the asking price which is equivalent to the building, then calculate the Cashflow multiple from the remainder.

Let's say a business's asking price is $1.5M. They have Cashflow of $400,000 and a building worth $300,000. We would deduct the $300,000 from the asking price (leaving $1.2M) and divide that by Owner's Cashflow (400,000) to produce a 3X multiple, which is more on track than if we had not considered the real estate.

This does not, however, apply to other assets such as vehicles and equipment. The valuation logic says that those are necessary to generate the Cashflow, thus those amounts are *not* deducted from or added to the selling price in calculating the Cashflow multiple.

Step 5: Factors to Consider

There are several other factors to consider as you are narrowing your choices down to a single business you may wish to move forward with. Here are some of those considerations.

Cashflow – In real estate, a buyer's focus is location. In business acquisitions, it is Cashflow. The industry typically prices small businesses using a multiple of Cashflow. We have talked about this and will talk about it further. It is *that* important! We find that the smart buyer focuses almost exclusively on Cashflow, while the inexperienced buyer will focus more on things like products, markets, and employees. These things are crucial and can be drivers of Cashflow, but the reason to consider buying an existing business is the existing Cashflow stream.

> *It is also important to look at the trend of the Owner Cashflow. This means if you look at three years, is the number increasing or decreasing, and how fast?*

Ideally, you would like to see strong Cashflow over time which is increasing. As you consider valuation and the multiple used, everything else being equal, a smart buyer will be willing to pay a little more for consistency and growth in Cashflow. You are looking for numbers that show a higher probability that the trend would move in the same direction in the future.

Customer Base and Supplier Base – "Don't put all your eggs in one basket" is good advice. Having one or two customers account for most of the business might make the business easier to run, but it represents a significant risk. As a rule, a company should not have any one customer being more than 15% of the company's total Cashflow. Under five percent is even better.

The same can be said for suppliers. This is especially true if you are single sourced on a given product. This shifts a lot of power to the supplier. You would prefer to have several supply options from which you can buy. This makes them compete for your business, an incredibly good thing.

Obviously, as you study the company's customers, you want to see what is going on with the Revenue (Sales) number. This is the "top-line" number. Ideally, as with Cashflow, you would like to see steady, consistent revenues, with an upward tick in the trend. Top-line sales are one of the drivers of Cashflow. Customer revenues, obviously, are particularly important for the company's overall financial performance. The revenues are the dollars that pay for all the costs of goods and expenses.

Another reason to buy an existing business is that the company has already established a revenue stream, and the supporting infrastructures—employees, advertising, products, distribution—necessary to generate that revenue stream. Most will tell you that growing an existing, steady stream of revenues is easier than beginning from nothing, as startups do. Insufficient revenues, customer purchases, are one of the biggest things that kill startup businesses. You reduce this risk when you purchase a business that is already running.

Years in Business – Buyers often equate longevity in the business to less risk. While it may not be true, all other things being equal, a 15-year-old firm may sell more quickly and for more money than a five-year-old firm with similar financials. As you dig deeper, you will want to get a feel for where the company is in its life cycle.

Don't underestimate the value of what the business has learned over time. While markets do shift and evolve, businesses tend to adapt and change along with them. Over the course of time, a business, and the people inside of it, can gain significant knowledge.

Length of Training – This leads us to the time the previous owner/seller is going to take to impart their knowledge to you, the buyer and new owner. It is standard procedure for a seller to train the new owner in the operation of the business. The training period will usually be a month or two, although the length of time will vary based on several factors. Be aware, though, that some buyers will want the seller out of the operation as soon as possible.

Our advice is to soak up all the knowledge you can gain from the seller. It's typical for us to see an arrogant/inexperienced buyer in this case. Perhaps they were a vice president in a large company and had huge budgets, responsibilities, and employees. They look at the company they are buying and assume, because it is much smaller, that their experience will make owning that business easy. When they look at the seller, she has less education and all she has ever done is manage this *little* business. What does she have to teach me?

> *Don't make that mistake. In the same vein, don't be an asshole. The seller has insights about their business that you want to absorb.*

Respect the fact that they have poured their heart and soul into this business and built something good enough such that you want to pay them to buy it. Respect goes a long way. Approach confidently but respectfully, and keep your ego under control. Believe me, I have seen the corporate ego guys buy a little business and struggle in such an environment. Often, they reference their earlier career in a larger operation, and it simply isn't the same.

Often what works well is to have an intense overlap period where the seller stays on board for the transition of power—typically 60 to 90 days—but there is a longer period when the seller is available for questions and consultation. This tends to be the best arrangement. Not only do buyers need this, but banks may require it. Remember, the bank could be lending up to 90% of this deal, and they want 100% assurance that the new owner can operate the business.

Regardless, the seller training is important, and you will want to study what the seller does to be successful and mimic it for at least one year, minimum.

Reason for Selling – This is one of the first things you want to ascertain: why the owner wishes to sell the business. Common reasons are age, health, and burnout. Read the chapter in the seller section that helps owners understand why they want to sell. Burnout does not necessarily mean the business is bad.

A common suspicion of buyers is, "If the business is so great, why does the owner want to sell it?" It is a reasonable question on one hand and absurd on the other hand. To think of it another way, do you remember that job you had when you were eighteen? Why aren't you there anymore? Did you have to move on? Something in the human spirit needs to evolve and grow beyond current markers of success. This desire to evolve is the heartbeat of QSI methods.

We don't want to discourage you from doing your due diligence, and you certainly need to research this question. But we find it is not typically the case that the seller wants to move on because there is some fundamental, underlying problem, but that they have become bored or burnt out. We use the term "shelf life," and everything has one. We call this The Passion Cycle™ and discuss it more later in this book

For a lot of businesses, the owner has given the business what she has to give it and now wants to move on to the next adventure in life, whatever that may be. In most cases, we see the new owner take it to new heights. One thing about the United States is we have the chance of new and better leadership every four to eight years. It takes energy and vision to make a business successful. Burnout and boredom are natural, and the seller is ready to move on to new adventures. The buyer is usually outgrowing their situation as well and wishes to own a certain business for whatever reason that they need to change.

Study the reasons to sell to gain input but resist the urge to believe that something must be wrong with the business because someone listed it for sale. That is not typically the case, especially in stronger brokerage firms.

Owner Role – Another thing to consider is the role the owner plays in the business. Everything else being equal, you would be willing, and prefer, to pay more for a business where the owner is (mostly) removed from the day-to-day management. It is important, however, to learn what the owner does in the business, as, likely, someone else will need to fill that role moving forward. If the current owner is a salesperson and you hate sales, you can work around this, but you should at least be aware of the fact when purchasing the business.

We typically find the new owner brings something to the table the previous owner did not. And that when the seller moves on, there is, inevitably, a need to fill some holes. Overall, when this matter sorts out, the company is, ultimately, better off in the end. Just like the seller may need a change of scenery, the business, often, needs to have an injection of some fresh enthusiasm and ideas. This is especially the case with a smart buyer who is very self-aware and who puts some thought into this matter. Usually, the smart seller and smart buyer working together produces great ideas to ensure the transition is a big positive! This is *so* important!

Employees – The quality, quantity, and tenure of employees can have an influence on the value of a company. Most business owners will tell you that the most important asset in the business is their people. Learning about the employees is an important part of the consideration and an especially important part of the step listed below where you begin to integrate the new owner into the situation.

Asset Value – Many buyers want to know how much of the business price is determined by hard assets, so getting an equipment appraisal can help the valuation of the overall business. This can also have an impact on borrowing capabilities with the business. Therefore, you will want to study the balance sheet, one of the financial statements, and review the assets listing. Should there be a shortfall in assets within the business, the bank may ask for more collateralization from the buyer. It's workable, but knowing the assets is part of underwriting. A good broker would know how to approach the bank with this issue. This can also have an impact on taxation and depreciation. Generally, higher asset values are preferred from a taxation perspective.

Inventory – Inventory is essential to the operation of many businesses, but too much inventory can have a negative impact on the selling price. Look to acquire and maintain optimal inventory levels. Inventory management is a detailed science and there are many resources to learn about it, if, indeed, the business you are considering carries a lot of inventory.

A side note with inventory: if the business relies on inventory, it will likely require more inventory investments as the business grows. Build your growth plans taking this into account. Any aged or useless inventory will simply be a loss for the seller, thus it will not be included in the sale or sold at a significant discount.

Accounts Receivable and Accounts Payable – When we base a small business valuation on a multiple of Cashflow, we include hard assets, equipment, and inventory in the sale price—excluding real estate as mentioned above. If we include accounts receivable and accounts payable, we will adjust the price based on net values.

Asset vs. Stock Purchase – Basically, a stock purchase is best used for larger or publicly held corporations. For small businesses, asset purchases typically tend to be better for both the buyer and seller. In many situations, a buyer prefers an asset purchase as this limits the transfer of liabilities or exposure to risks from the company's past. Asset purchases allow the buyer to start with a larger number for depreciation, a tax strategy. A stock purchase can have its own perks, such as the buyer being able to purchase cash in the bank from the seller or other assets which must remain in the seller company, including key licenses or contracts. Any element discussing the tax ramifications of the transaction should involve consultation from a CPA or tax advisor.

Business Type – Some types of businesses are more attractive than others to prospective buyers. The primary types of businesses, listed in order of desirability, are internet/software, manufacturing, wholesale, retail, and service. We discuss more about industry impact on Valuation in the seller section of the book. Keep reading!

Additional Factors – Market strength, industry growth, appearance, and location can all influence the desire of a business to a prospective buyer.

Step 6: Financing

Unless you are wealthy or some rich relative or friend is going to give you the money to embark on this new venture of owning and operating your own business, chances are good you're going to need financing from a bank or financial institution. In the end, it's not just the buyer and seller who have to get on the same page. Usually, there is a financing element, which means there is a third party needed to make a deal work. Again, the buck really does stop with the bank.

Never fear! Though many people are very anxious about this step, like everything, it can be managed. Remember the gut check step above? You will need to be committed enough to the process to go through the steps necessary to qualify and obtain financing. For many, this is unpleasant. But if you know and follow the rules, it does not have to be.

We will share a little about this process now but will elaborate a lot more a few chapters down the line when we discuss financing. For now, here are some initial key points.

Form, forms, forms and more forms! Though every bank has their own list of documentation they request, all are similar and have most of the same requirements, especially if your loan is going to be through the Small Business Administration (SBA). This will be both information about *you*, as well as information about the business you wish to buy.

If the CBR is well prepared, most of the documents about the business the bank needs will already be provided, including at least three years of tax returns, financial statements—P&L and balance sheet—and a detailed asset listing with values. One of the broker's jobs is to ensure the seller has put together enough information in the CBR to answer most of the bank's questions. This makes your life much easier if you are the buyer. If records are incomplete, or it takes a long time to get documents upon request, this could red-flag the lender that something may be amiss about the business. It pays to have your shit together at this stage in the game.

Banks will often ask to see a business plan, and this can be the biggest difference between banks. Some banks want a standard business plan; others give you a questionnaire designed to show things a business plan would but in a less formal way. For instance, "Why are you interested in this business?" "How do you plan to increase revenues?" Still others want variations or combinations of the two. The bank will want to see some documentation that you have thought through how to make the business successful under your watch.

Next, the bank is going to want to know a lot about you.

This is the point in the book where most of you will start to squirm. But to play the game, you must know the rules, so don't hold it against us as we spell the truth out for you.

The primary thing the bank will want to see is your personal financial statement, also called the statement of net worth. On a single sheet of paper, you are going to list all your assets, which will include things like checking accounts, investments, real estate, vehicles, and life insurance policies. Next, it shows everything you owe: credit cards, mortgage, child support, alimony, everything. The process feels a bit like standing in front of the mirror naked. It can bring up issues and create anxiety.

Subtract the assets from the liabilities, and the remainder is your net worth. For instance, one way to judge if a person is a millionaire is if their net worth is larger than $1M. This means their assets exceed their liabilities by over $1M. There are more of these than you might imagine, and many got there by owning a business.

Whether you are a millionaire or not, looking at your personal financial statement is daunting. For many, it can be a source of pride, but at the same time, often a reminder that we have more potential than what we have achieved. Even billionaires get queasy looking at their personal financial statement; it's why they continue to press to grow. People rarely get there and have total confidence. There is something inherent in humans that feel we can always do better. This is both a blessing and a curse!

Okay, so let's get this out on the table. Your net worth is only a financial metric. The bank is not asking the question to decide if you are a good person, a great parent or spouse, if you are loved by your family, or if you are a great friend and person to be around. They are looking at it for one reason only: to figure out if they can safely give you the loan you need to buy this business and it—and you—can afford the payments.

Later in the book, we will discuss more about the format of the data and how to present this information to the bank.

> *The truth, whether you consider this good news or not, is: if you are going to get a business loan, you will need to prepare and present your personal financial information, and that can feel comparable to an anal probe aboard an alien spaceship.*

Want better news? If you are fortunate enough to get the loan, you will get to supply the bank an updated personal financial statement about every six months. It is the gift that keeps on giving! But don't take this personally, this isn't about your bank rep being nosy; laws require banks to stay on top of their loans, which means staying on top of their client's personal and business affairs. Yep, if you sell mutual funds, or buy a house or car, your banker must know about it.

It's not fun, but they are the rules that everyone else plays by, too.

As a broker, we routinely ask for personal financial information. In our case, we have banking experience, so we can judge what the bank is going to say—what they are likely to approve or reject. Rather than taking offense when we ask for information the bank needs anyway, work with us so we can best help you. We aren't asking to judge, be intrusive, or get in the way of making a deal; we are doing it to protect our clients, including you! This information helps us put projects together. A smart buyer wants our help.

While banking rules may be a pain and very frustrating, there is a reason they exist: to ensure you don't get upside-down in the loan or get a loan that will sink you in the end. Believe it or not, the bank covers its own ass not only to comply with the law, but for their benefit… *and for yours*.

Banks have been lending money to people since the invention of money. And guess what? Over the course of time, some very smart people have produced some good guidelines and statistics. They seek to set you up for success, not for failure. Interestingly, they know better than you whether you can afford a loan. Similarly, they can give you guidelines on how much of a business you can purchase.

Remember, banks only make money if they lend money. And the more money they lend, the more money they make. So, if they were assured you could handle it, they would lend you all the money in the world.

The hard truth, though, is you have a certain borrowing capacity, whether it is ten thousand dollars or ten million dollars, and the bank uses information about you and your business, and all the collective knowledge the banking industry has accumulated over the years, to guide you through buying a business that is right for you.

Financing is often the determinant of the deal. If you know the rules, you are better prepared to apply for and get the financing you need for your business. Please read forward to understand more of the details about financing, but for now, know it is important, and there are rules that are consistent by law and not about you personally.

> *To play in the game—and if you want to move forward, you will—you need to play by the rules.*

We share more about the SBA in later chapters, but to give you a quick overview, the SBA will often guarantee small business loans which meet certain criteria. These standards are typically higher than traditional loans. They never explain it like this, but basically, they act as the cosigner on a loan with you. With the SBA, banks can make loans they would never make without the SBA backing. Everything else being equal, it means you can borrow more money than you could without the SBA. That's extremely good news.

The unwelcome news, however, is that both felonies and bankruptcies are looked at very negatively by the SBA. And they have more rules than that, too. They also tend to avoid "sin" based businesses as well. Probably the optics for taxpayers. This does not mean you cannot succeed in business if you have a prior felony or a bankruptcy—in fact, many have and most people cheer when someone succeeds, despite past challenges. But, again, to play the game, you need to know the rules.

Lastly, with the SBA, the bank typically requires the business buyer to put 10% down. At times, however, they will require more, based on underwriting, assets, and how comfortable the bank feels about the deal. The requirement may be 20% down, but this can often be split between 10% from the buyer and a 10% "carry" from the seller. The seller finances the other 10% to get you to a 20% total down payment. While this varies from transaction to transaction, most smart sellers have learned that a willingness to loan the buyer 10% to make things work with the SBA ends up being a good move.

A good guideline is that you will need to bring 10% down to the transaction. And then, between the business assets, your assets, and creditworthiness, along with a guarantee from the SBA, the bank will consider doing the deal. Again, more to come in upcoming chapters.

Thinking through financing helps you find the range of price you can afford when purchasing a business, and any limits financing may present. It does you no good to run down a path which the bank will eventually shut down. This is a waste of your time—and everyone else's, as well! A smart buyer knows what level of financing they will be able to obtain and approaches the process of studying businesses with this in mind.

Step 7: Letter of Intent/Offer Letter

So, you have completed a lot of work so far, but the fun is just starting. Once you have done a deep dive and have some preliminary idea of your ability to finance a business, you will move to the offer and negotiation phase of the deal.

A good broker knows how to listen with four ears: two ears for what the buyer wants and two ears for what the seller wants. The old song goes, "You can't always get what you want, but … you get what you need," and it applies to deal making. Both parties must walk away in a win/win.

The first part of this is to make an offer on the business. This is typically completed through a letter of intent (LOI). Another approach we often use is "offer to purchase" forms to reduce the amount of pre-deal attorney costs which aren't necessary. No one will hold a gun to your head if we don't reach a deal.

Often, we see fearful and unconfident buyers spending money on attorneys when it is usually not necessary at this stage of the game. It is like a letter the buyer typically writes to the seller and indicates the terms of their offer. This will include things like the type of purchase—asset or stock—the price offered, and any revisions to the terms. As with most things, the more specific the better.

> *Assuming it is a serious offer, then the LOI is a signal to the seller, and the broker, that there is serious interest in the business, and the conversation goes to a different, deeper level.*

Importantly, the LOI puts the discussion onto paper. At this stage in the game, it is important to move the conversation from verbal communications to putting things into print. The reason: written communications reduce the possibility of misunderstanding. Two people can hear a few sentences in spoken word and walk away with different perceptions of what was said. However, while misunderstandings can still occur, the probability that the two parties are on the same page increases when the communications switch to written.

Additionally, while the LOI is not a formal contract, typically when the parties agree to terms, both sides will sign the document, signaling that, at least for the terms in the LOI, the parties agree. From a negotiation standpoint, addressing other details is good, but if the parties reach an agreement in the LOI and one of the parties tries to change those terms later in the discussion, there can be some breakdown in trust.

Step 8: Negotiation

Typically, there is some back and forth between the buyer and seller via the broker between the first LOI and a final agreement.

While you can do some of these things verbally, if the seller receives an LOI and wishes to formally counter, it should be done in writing, preferably in a similar format to the initial LOI. The goal is to help highlight exactly which terms the parties agree to and which terms the seller wants to revise from the offer.

Many people believe negotiation is a game of putting up false pretenses and gaming an opponent. In fact, many of the training programs on negotiation teach these strategies. Typically, they suggest acting uninterested so the other party will need to put forward concessions. Sometimes these suggestions are fine; other times, they just lead to delay and ill feelings. A good broker can help prevent too much of this and keep the antics at bay for the benefit of both parties.

Another strategy, and one we suggest, is to be respectful and transparent. Often in the negotiation, both parties have important needs to achieve. Some position negotiation as an "either/or" mindset, where usually it can be "both/and." Meaning, negotiation does not need to declare one party the winner and the other party the loser. If both parties are forthright about their desires, often you can strike a deal where both sides get exactly what they want and need.

If a broker is involved, they can help guide the negotiations. A strong broker will realize the best deal creates a win/win situation and will represent the transaction versus being for one party over the other. It is important for both the buyer and the seller to understand where the broker is coming from.

This is a little different than many arrangements, where each party has their own representation. Like in a court case, the plaintiff and defendant each have their own attorneys. While they will try to see the other side, the lawyer for the plaintiff is bound to represent the best interests of only the plaintiff. In real estate transactions, similarly, there is often a buyer's agent and a seller's agent. Both sides are represented.

Normally, it is a little different in a business transaction. Usually, the seller contracts and pays the broker from the transaction proceeds but has significant interaction with the buyer. In the best-case scenario, the broker can navigate the best interest of both parties to get to a good deal for each. This means the broker sits in a unique spot and must have the versatility to see the transaction through both the eyes of the seller, as well as the buyer. Brokers of this type are intermediators and have both parties' interest in mind. This approach can make or break the deal.

Similarly, everyone involved—the buyer, the seller, the broker, and the bank, as well as any other experts involved—should seek an agreement where both parties get what they want. If one party wins and the other loses, it tends to have negative consequences down the line. Handing off a business from one party to another typically needs some ongoing interaction, hence a decent relationship between those parties certainly helps.

As a buyer, you should negotiate not only to get the best deal that works for you, but to keep the seller on your side and wanting you to be successful in the transaction. Most sellers are predisposed to this, because they want to see the business succeed, the employees continue to grow and have opportunities, and that the buyer takes good care of customers. They want to see the business thrive as part of their legacy. A respectful approach to negotiation and a willingness to help the seller also get what they want can set the tone for the rest of the relationship. Confrontation during this part of the transaction can do the same, and rarely helps.

At the end of the negotiation phase, the parties will usually sign a revised LOI. In addition to the other terms, typically the LOI will agree to a targeted close date. This is typically between 30 and 60 days after the LOI is agreed to.

One of the terms of this agreement usually specifies that the transaction will be contingent upon the buyer being able to obtain financing. This is another reason both the seller and the broker are focused, from the very start, on the buyer's ability to obtain the financing necessary to complete the transaction. A smart buyer not only is transparent and takes part in these inquiries but will go out of their way to prove to the seller, and broker, that they can finance the deal.

Lastly, there is normally a small payment, or earnest money, the buyer will pay the seller at this point in the agreement. This, too, shows the seller the buyer is serious about the purchase. You can negotiate the terms of this earnest money, but often it is a smaller payment which is non-refundable. If the payment is refundable, the seller will typically negotiate that it is higher.

Step 9: Due Diligence

We describe the time between agreeing to an LOI and the close date as the due diligence period. There are several important things which to accomplish during this period.

First, the actual due diligence, which gives the buyer a chance to confirm that the representations the seller has made to date are, indeed, true.

Due diligence also takes time and effort. It involves a comprehensive appraisal of a business. You'll identify assets and liabilities. You'll evaluate its commercial potential. You and your advisors will review, confirm, and challenge when appropriate, every aspect of the business. This stage of the process is about managing your risk by knowing the facts. It's a major step.

It also allows the buyer and seller to start to work more closely together. Up until this point, the seller was not sure you were a serious buyer. When you present an LOI, negotiate terms, and reach an initial agreement, the seller begins to feel the transaction is real.

The due diligence period, because of the deeper level of commitment, allows the parties to have more in-depth conversations. All along the process, the buyer will have questions come to the surface. A smart buyer commits those questions to writing, so they can be extremely specific about getting those questions answered prior to the transaction.

In the best-case scenario, the smart buyer is highly organized and detailed about asking questions. Similarly, the smart seller is very transparent and trustworthy about answering those questions. During due diligence, smart buyers will be applying the smell test to the answers provided by the seller. A smart seller knows this is an important part of the process. Forming a productive relationship between the smart buyer and the smart seller will contribute positively to both parties.

A divorce is not a great analogy with selling a business, as the process is not necessarily that negative. However, we can draw this comparison: Imagine the situation where a couple is going to get a divorce and they have young children. Contrast the difference between the divorcing couple where the two parties can have a productive conversation and work together for the benefit of the children to another divorcing couple who constantly fight and cannot communicate. Consider how much more positive the situation is with the communicating couple. A buyer and seller that are working together during and after due diligence resembles the better situation.

One of the worst situations which can happen is if both parties hire an attorney and fight through the attorneys at a combined rate of $700+ an hour. A neutral third-party attorney can make a bank-approved purchase agreement and drastically reduce the cost, and headache, of lawyering. Consider this approach like getting married and it is easy to do! But if you both hire attorneys, it very much looks like a divorce, and that's costly and can lead to delays.

If the seller and broker have been organized preparing the needed documents for the CBR and documents for the buyer and their financing, then due diligence can go a lot more smoothly. If you, as the buyer, are asking questions and not getting answers or having to wait for documents, then you have the right to put up a red flag and ask questions. Due diligence is the time to give the smart buyer the confidence that they have made the right decision. Ideally, the buyer leaves due diligence more informed, and more confident about the transaction.

Step 10: Contract

Also, between the time when the parties agree to the LOI and closing date, they need to also prepare and execute a contract. Most transactions in the arena of closely held businesses are asset purchases. In this case, we refer to the contract as an Asset Purchase Agreement, or APA. In a stock transfer, is it called a Stock Purchase Agreement. We have included a sample APA in the book's online Appendix.

The contents of the APA are straightforward. First, all terms agreed to in the LOI will transfer to the APA. If you have been thorough at the LOI stage, this makes the contract easier to construct. Simply, you are negotiating fewer items, as the parties have already agreed to many of the key ones in the offer.

Typically, the Asset Purchase Agreement will include:

- An exact list of assets to be purchased
- A list of any company assets which will specifically be excluded, often including some personal items of the seller, i.e., personal vehicle and cell phone
- Typically, in an APA, there are no existing liabilities that will transfer from the seller to the buyer. However, if they are, they will be described.
- The price the buyer will pay for the assets
- The specifics on any seller financing/carry back, related notes, and collateralization
- Details on the seller training and availability to answer buyer questions
- A non-compete agreement, where the seller will agree to not compete against the buyer, in a specific geographic area, for a specific period

- A non-solicitation agreement, where the seller will agree to not solicit customers, employees, or vendors of the company for a period
- Any waivers of liability for either party
- A detailed asset listing is usually provided in an Appendix

Here is a strong word of advice. Don't get too creative here unless you have already been creative in the LOI.

Earlier, we explained how the banking industry has already walked the path of identifying how much loan a borrower can handle based on inputs from the buyer's personal financial situation and the business's financial performance. The industry established these rules over time and has formed a solid methodology, not based on you personally but the collective experience over the duration.

The same can be said for an Asset Purchase Agreement. Over the years, there have been millions of APAs executed. They have also become standardized. The contracts have evolved to fairly protect both the buyer and the seller. Trying to be too innovative here likely backfires. You want standard and fair.

The most common way that deals fall apart is this: the buyer, usually prompted by their attorney, tries to get cute and win in the contract phase. Don't get us wrong, you should read the contract. You should read the contract to ensure that the seller's attorney doesn't try to get cute—the second-most common reason a deal falls through—in the contract. You should be on your toes and protect your interests, but the more you try to keep the agreement within the normal, defined parameters, the more likely you are to get to a deal.

Remember, the bank underwrites the purchase agreement. Sometimes people get egotistical about having an attorney. Simply put, the bank has attorneys as well. You wouldn't change your own tire before going to the mechanics shop and have them change it, would you? Would you wash your car before taking it to the car wash?

The SBA and the banks have legal teams, and the broker has connections to the attorneys who draft purchase agreements. Thinking this through in advance can guide you through this process.

In our brokerage, we supply a standard contract for the transaction, approved by both banks and attorneys. We also include a copy of it in the Appendix! It is not buyer friendly, or seller friendly, it is *transaction* friendly. We also have an attorney available who will make modifications to the contract, but we strongly encourage the parties to negotiate towards agreement, not towards one-upmanship. A *win/lose* approach to the contract rarely succeeds. Victory happens when the parties work together for a successful business transition, where both parties get what they want.

Many attorneys, especially younger, more aggressive attorneys, aren't wired this way. They seek to help their clients win at the other party's expense. They do not feel like they are doing their job unless they accomplish this. We call it "over-lawyering." If the buyer brings an attorney to the contract phase with this mentality, the seller usually responds by bringing an opposing attorney to their side with the same win/lose mindset. In this situation, the deal often crumbles.

Who loses? The buyer and the seller. And the broker.

Who wins? *Only the attorneys.*

Both the smart buyer and the smart seller will realize that the goal of the whole exercise is to complete a successful transaction. The seller wants to sell. The buyer wants to buy. Both sides have a lot vested in seeing that through. Both sides, and the broker, have invested a lot of time, energy, passion, and expense to get to this part of the process. It is tragic when an overly aggressive attorney blows that whole thing up, especially given the APA is a typical, straightforward document.

A smart buyer knows what is in the APA. Between this chapter and the sample APA in the Appendix, you can get a grasp of its contents and the purpose of the document. While most contracts do have some legalese, most of the document, and the most important parts of the contract, are written in plain English. The inexperienced buyer says, "I am not a lawyer," and questions their ability to read and understand the terms of the contract. At some levels, how can you commit to an agreement and agree to be bound by the terms of that agreement if you do not even read and understand it?

Take some of the power into your own control by being familiar with the terms of an APA. Don't just turn over control to your attorney. And certainly, do not try to pull the wool over the eyes of the seller. Play defense, not offense. Avoid being tricked, but do not try to trick. Look to the standard terms that have governed thousands upon thousands of contracts. A good broker can help you with this process.

Note: this advice is not a substitute for legal advice. The authors of the book are not lawyers. But we have seen hundreds of transactions, including many where the bad lawyers blew up good deals. The best advice is to be informed and surround yourself with whatever support team you need to get you to the goals you have.

Step 11: Closing Prep

Get the champagne ready. We are getting close. Coming up to the closing date, you have several things to put into place.

First is the financing. Then there is the due diligence and the contract. We covered those in the prior steps.

In addition to these items, you also need to plan for taking over the business. On closing date, the business is yours. Consider it a hard cutoff date. Before closing, you are a potential buyer; after the close, you are the full owner!

Some things you will need to consider.

Legal Entity – if you are acquiring assets, you will bring those assets into a new legal entity. You will need to have this entity in place and legally registered with the government—both federal and state registrations. Typically, this is with the IRS at the federal level, and the Secretary of State at the state level. This is, of course, in the US. It will be similar but slightly different in other countries.

Included with this step is the decision of which type of legal entity you will form. The most common forms of small business entities are Limited Liability Corporations (LLCs), Sub S Corporations, C Corporations, Partnerships, and Sole Proprietorships. There are multiple educational tools on these. See the online Appendix in the "Business Resources" section.

Part of registering these entities will be to obtain ID numbers, such as a Federal ID Number (IRS) and Sales Tax (state), if applicable. You will need the Federal ID Number to pay employees. This number ends up being to your business what a Social Security Number is to you personally.

License, Permits, and Inspections – These vary by industry and location. So, you will need to research these requirements at the state and local level, primarily, and the federal level, secondarily, for your specific type of business. You need to ensure these items are in place on the close date so you are prepared to conduct business the day you close.

Insurance – The day you close, the assets are your responsibility, so you need to ensure that all insurance is in place before you take possession of the assets. If you have employees, you will need to have workers' compensation insurance in place. Your insurance contact or broker ends up being an important member of your team.

Banking/Merchant Services – The day you close, you will start transactions both collecting and distributing money. You will need to have your banking accounts in place, checks printed, and merchant account services set up, if you are going to accept credit card payments. Similarly, you may need credit or debit cards to take care of expenses right from the start. These, too, need to be in place.

Payroll Processing – Are you set up to make payroll? This often means hiring a service to help. You need to have banking for direct deposit and checks if you are going to provide physical checks. Certainly, one of the most important parts of keeping the team in place with the new company and new owner/you is to make sure you pay them correctly, seamlessly, and on time. This also includes payroll deductions and having the processes in place to do the proper withholdings. As part of this, you will need to have all employees complete the normal, new employee paperwork to get them set up appropriately in your systems and to ensure that any payroll deductions are correct. A significant point of emphasis here: make this easy for the employees. You want to get off to a *great* start with them. Make this as hassle-free as possible!

Inventory – You need something to sell on the first day. This may involve some coordination with the seller around existing inventories in the company, which are changing each day. It also, likely, involves ordering some new inventories. This means setting up accounts with vendors and having the inventory onsite the day that you close. You need to ensure you are prepared to take part in transactions.

Real Estate – Are you renting property? If yes, you will need to have a lease in place that allows you to take possession of the property in coordination with the closing.

Getting through everything can be a challenge. You'll be dealing with different parties—banks, landlords, inspectors—who move at their own pace. It can be frustrating, so it's important to keep a positive attitude and stay on good terms with everyone. Just keep in mind that, at the end of the closing, you will own your own business. Then you can pop that champagne!

Step 12: Smart Transitions

The transition of ownership from the prior owner/seller and you, the buyer, is an important one. You will have invested a lot of time and money into this process, thus the handoff, or passing of the baton, is crucial. As you just saw, the amount of work for the buyer between acceptance of the LOI and the close date is immense.

Be organized and thorough. You should also realize that the transition starts well before the close date and extends well beyond. It may take well over a year before you and the other stakeholders—customers, vendors, employees—view you as the actual owner versus the new guy. Planning is important here. There are too many things to do, so do not fly by the seat of your pants. Be strategic and generate lots of lists. We hope this book will help with this.

While the to-do items are important, there is something else that is even more important: the relationships.

A big part of a smart transition is to move the relationships from the seller to you, the new owner. Assets and accounts are easy to move. Personal relationships are a bit more complicated. The result of this step is to ensure that vendors, customers, and employees get on board with the transition and, in the end, are happier that you have bought the business. You want to avoid displeasure here and certainly want to avoid abandonment.

We have talked extensively about Cashflow and will continue to do so. We generate Cashflow by buying things from vendors, then having employees facilitate sales transactions with customers. Revenues come in, expenses go out, profits and Cashflows hopefully remain. This means aligning those relationships to continue the same path and keeping the relationships such that the money continues to flow.

Customer and vendor relationships are a bit easier to handle. These can be as simple as sending out a letter indicating there is a new owner—and a new entity—and making the switch. Where those relationships are more personal, the seller and buyer go out together and meet with the key people who drive those relationships. The overriding message is that things are going to be the same and everything is going to be okay. Retaining the customer and vendor relationships, such that they produce as much value for the new company, as they did for the old one, is what we are seeking.

The goal is the same with employees, but this can be a trickier, more complex transition. Obviously, the timing on when to share this with employees is unique to each situation, but often during the due diligence period, the buyer is onsite in the company more regularly. They may be set up in the conference room and reviewing lots of documents.

To get answers to the many questions, the seller will have employees answer many of those questions. It is common for the buyer to interview—not a job interview, rather an inquiry meeting—employees to obtain due diligence information. As you begin to be more present, employees start to figure out that something is afoot.

For some employees, this will be a welcomed change. They may feel that the former owner had lost passion and the business had been stale for a while, or that the owner had started to become more interested in other things. It could also be that they had conflict with the prior owner or did not believe they could take the business to the next level. These employees will still be evaluating you as much as you are evaluating them, but they may be open to the change and excited to see that new blood and enthusiasm could be coming into the company.

Other employees could be exactly the opposite. They worry that things will not be as good for the employees and that their job, and its rewards, will not be as good as before. They may feel betrayed that the prior owner is being disloyal or abandoning them. Employees often feel that they have poured their hearts and souls into something, and now the former owner is giving up. They may start to wonder why the seller wants to move on and suspect they know something bad that the employees don't yet. They may consider if they want to change jobs. Some employees may even believe the previous owner should have sold or given the business to them and now someone else is taking that away.

What is even more likely is that some people will feel one way and others will feel the opposite. Many employees will be torn, feeling things from both the positive view and the negative view. The point being, the employees will change their relationship status to "it's complicated."

We go into a lot more detail about how to transition in a later chapter, but for now, as you are learning the steps, it is important to realize that a successful transition is key to preserving the value of the company you are buying.

Yes, Cashflow is king. But the relationships in the business drive Cashflow, so a smart buyer will be very deliberate about approaching the transitions to keep and grow the relationships to maintain and grow the company's performance.

Whew! That's a lot of stuff. Get used to it.

If you are a first-time business owner, you have heard people talk about this, but truthfully, you still probably underestimate the number of details you will need to manage. Fortunately, you are looking at buying an existing business, which means many of the important aspects of the company are already in place. You just keep the train on the track at first, then move the business into its next phase.

This is easier than a startup, where many of these things are *not* yet established and your statistical odds of success with an existing business are improved.

Master your knowledge of this process. This chapter is a wonderful place to start, and the upcoming smart buyer chapters will help fill in other details. But you want to become familiar with, and comfortable with, this process. You can benefit from book learning during this process.

As mentioned earlier, we also suggest you study the smart seller parts of the book. If you know what a seller is going through, you will be more informed as a buyer and can use that knowledge to your advantage when buying a business.

Then, if you are successful—and we want you to be!—at some time, you will also be a business seller. If you engage in the QSI method, you will be a seller earlier than if you are a traditional buy and hold business owner.

But either way, if you know what is involved with selling a business, you will make decisions differently through the process. One of the best ways to run a business is with the mindset of an eventual seller. This is extremely important. Please do not just read the buyer sections of this book and skip the seller parts. You will be doing yourself a tremendous disservice.

Keep going, you are on your way to reaching your goals!

Summary of Smart Buyer Steps

Step 1: Gut Check: Do You Really Want to Own a Business?
Step 2: Researching Candidates
Step 3: Key Documents
Step 4: Valuation Estimates
Step 5: Factors to Consider
Step 6: Financing
Step 7: Letter of Intent/Offer Letter
Step 8: Negotiation
Step 9: Due Diligence
Step 10: Contract
Step 11: Closing Prep
Step 12: Smart Transitions

BIZ SHOPPING – RESEARCHING & COMPARING OPPORTUNITIES

Let's take a deeper look at the research stage and how to compare business opportunities.

Many reading this chapter will know exactly what type of business they are looking for, while others may be unsure. Both views are fine. But for the moment, let's assume you believe you want to purchase a business but have no idea where to start. Even if this is not your current perspective, the process will help you learn about companies and how to do this research.

A suitable place to start is to look in your local area. There are thousands of businesses for sale listed in a massive database. You can go to www.BizBuySell.com, which we mentioned earlier is a website where brokers from around the country provide their listings. This is an excellent place to start to familiarize yourself with companies.

Search 1: Local Market City or State with No Restriction on Industry or Asking Price

We suggest that you look at all the businesses sold in your markets. As you look at the listings, you can learn a great deal even from the Blind Ads information you find on BizBuySell. In many instances, you are going to see the following information:

- Industry
- Asking Price
- Why Selling
- Competition
- Future/Growth Prospects
- Cashflow
- Sales Revenue
- Net Income
- Real Estate Included
- Employee Count
- Broker Name & Contact

Reading 10-20 of these Blind Ad listings will give you a feel for the type of information you can gain from these profiles. At this point, it doesn't matter that you are looking at businesses in an industry you might or might not consider. The goal is for you to learn how to study and evaluate these listings. As you go into these listings, we suggest you get a feel for a few things.

Sales Price Divided by Cashflow – As you read through this book, you are going to see us repeatedly refer to this concept. When you divide the Sales Price by the stated Cashflow, if the listing includes it—and it should—then you will produce the Valuation Multiple.

Remember, the higher this number, the more the bank will be concerned about whether the Cashflow generated within the company can support the debt payments. This is something both you and the bank will want to make sure you get right.

Compare this over different businesses. Do you notice any trends? Based on this, do some companies seem like they are a better or a worse deal? Are there a few businesses where the multiple is exceptionally high—or uncharacteristically low?

Cashflow Divided by Sales – Another number you can calculate is the percentage that Cashflow comprises of Sales Revenue. Let's think about this one for a minute. We know that a business generates Sales Revenue by selling products and services to customers. We also know that it costs money to generate those sales and take care of those customers.

In the end, when we own the business, especially with debt service payments, we aim to generate positive Cashflow from those revenues. Big picture, you need to pay income taxes out of Cashflow, make the payments to the bank, pay yourself, and make future investments in the business. In other words, Cashflow is—say it with us—king!

The goal of generating sales, then, is to create Cashflow. Within each business, we can look at what percentage of sales revenue turned into Cashflow in this business. Financial people use the term *efficiency* for this. In other words, how efficient were we at generating Cashflow from Sales Revenue?

Let's use a hypothetical example. Company A generates $1 million in revenue and has a Cashflow of $50,000 per year. Company B also generates $1 million in sales revenue but has a Cashflow of $350,000. In this example, Company A generates 5% Cashflow for every dollar of revenue. From every dollar in sales, 5 cents will be Cashflow. Company B generates 35% Cashflow, or for every dollar in revenue, they generate 35 cents in Cashflow.

Holding the ratios consistent, Company A would need to generate $7M in revenue to generate the same amount of Cashflow that Company B generates on $1M. That's an enormous difference, right? Many would argue that Company A must work seven times harder to generate the same Cashflow as Company B.

Everything else being equal, we would prefer to buy a company with a higher number when we calculate Cashflow as a percentage of sales. As you might imagine, this can impact the Valuation Multiple. To use this example, we might find that Company B has a valuation multiple of 3.5X, whereas Company A has a multiple of 2.5X. This also gives us a way to compare companies.

What we tend to find is there are trends in this number based on industry. Construction companies, for example, will tend to have high revenues, but a lower percentage of that revenue translates into Cashflow. Service industries tend to be the opposite.

Industry impacts this metric, but if a company is generating between 10% and 15% Cashflow as a percent of sales, we typically consider this average. Lower is under average, higher is above.

When buying a business, you will want to know what this number is and what it can/should be.

Real Estate Impact on Sales Price – As we have discussed before, we usually exclude real estate from the calculation of Cashflow times the Valuation Multiple. The goal of this broad search within your local market is to study many of these Blind Ads from different views to help educate yourself. This research costs you nothing, but the knowledge gained can be significant. You are digging into the data provided to you on this highly informative and wide-reaching website.

Find a company or two in these listings that discusses the treatment of real estate. This also helps you learn.

Qualitative Information – The things we have listed above are a few financial metrics that you can use to study a variety of companies from their BizBuySell listing. While we want you to get a good feel for these numbers, we also want you to look at the words in the listings and the ideas they convey.

Some things you will want to look for include the following questions:

- Does the business sound attractive to own and operate?
- Does the business sound like it is growing?
- How is the industry coping with trends—either positive or negative ones?
- Why does the owner want to sell? How do you feel about their description?
- Besides the number count, what can you glean about employees based on the description?

As you study these listings, you will start to find other things that stand out, ways to differentiate between companies.

Another thing about BizBuySell is you can set up an account and save listings to a "like" list. As you are doing this research, it makes sense. If you read 20 listings, find the ones that stand out to you and start understanding what captures your eye. This will help you know your criteria for selecting a business you like.

Search 2: Industry Search Across Geography

A second excellent learning opportunity is to search in a specific industry throughout the country. Let's say you have an interest in buying a digital marketing agency. As you did the previous search in your local area, you were particularly drawn to two companies for sale in your local area in this industry, both of them involved in digital marketing.

That's great! Now let's study several companies in that industry but throughout the country. Ideally, you will do this and find another 20-50+ companies in that industry that are for sale throughout the country. BizBuySell is fantastic at modifying the search criteria to do just this.

Again, do not worry if you live in California and have no interest in moving to Florida. That's not what the exercise is designed to do. We are walking you through how to become a much smarter buyer by studying Blind Ads in BizBuySell listings. If we use a real estate term, by looking at similar businesses in separate locations, we consider these comparable companies or "comps."

When you look at different companies in the same industry, you can compare some of the same things we looked at before: asking price, Valuation Multiple, Cashflow as a % of sales, and qualitative information. See what insights you gain.

A few questions we would suggest you look for:

- As you narrow the search within the industry, do you find the Valuation Multiple range becomes smaller?
- What else do you notice about the Valuation Multiple?
- Did you find some listings where the Asking Price just seemed off? If yes, why?
- What things do you observe are common in the industry listings?
- Do you notice anything different about listings in this industry compared to others?

Ok, you should start to get your feet underneath you and should be learning *lots* from BizBuySell. This is exactly what we want you to do. Again, this costs you nothing but your time, and the knowledge you gain can be indispensable if you are seriously considering buying a business. We have one last suggested search at this phase.

Search 3: Common Price Range

There is a third search we would suggest you spend some time with in BizBuySell. This one will narrow in on a price range. Select the range for asking price which corresponds to the approximate amount you will have to spend on a business.

Sorry to get preachy again, but we need to do it. Previously, we have discussed that most businesses need a down payment of approximately 10% from the buyer. Thus, if you know the amount you have to invest in the down payment, you can approximate a range of business prices you may be able to buy.

We suggest you keep the industry open and limit the search to the surrounding area where you are looking to purchase if geography is a limitation. To increase the number of results, you might want to expand the geography to include a radius slightly larger than where you intend to buy a business; this will give you some feel for companies in the closest geographic area.

Again, you will be able to look at these businesses the same way as others. The key to this search is you are focusing exclusively on a price that is feasible for you. By keeping the industry and geography broad, in this search, you will get a better feel for the type of business you will be able to buy. This supplies some great insights.

Some questions you may ask yourself:

- Do you notice any trends relating to the businesses you see?
- What are the various Cashflow numbers for the businesses within the price range?
- Can you gain insights based on the different industries included in this price range?
- Upon looking at the listings, does this impact the types of businesses/industries you may be interested in?

- With the Cashflows, it is wise to calculate the annual payments. The rest will be what you can pay yourself and live on. Does this meet your income requirements? You can Google the term "payments calculator" to figure out your monthly/annual debt service commitments.

These different analyses will help you get a list of companies you may wish to research further. Additionally, as you find a listing you like, you may want to visit the broker's website to see if they have other listings that interest you. It is common for people to find other listings here.

Start narrowing the list to a few companies you want to take the next step with.

Older Listings - Before we move to a new section, there is another item we suggest you start to look at: the length of time listed. If you are looking for a house on Zillow, the listing shows how long the house has been on the market. The theory is that the longer the listing has been out there, the more anxious the seller may be, which may change the sales price.

BizBuySell does not list the number of days/months listed, but if you regularly check the site, you will get a feel for the listings you have been following that have not moved.

There can be several reasons for this, but very few will affect the price in most cases. The goal with a house is to sell within thirty days of listing. But with a business, it is often a year. We coach smart sellers to be ready for a longer process.

And, contrary to what many people assume, most businesses are not listed under urgent conditions. As we have highlighted quite a few times, our experience shows that most sellers consider exiting because they are bored or burnt out. Many are making great money.

They want to sell, but if not, they will prefer to hold onto the business as a cash-generating asset rather than "fire sale" it.

So don't necessarily get your hopes up that you will find a motivated seller who will give their company away. Keep in mind that good companies are generating Cashflow equal to 1/3 the asking price each year, which is often a lot of money!

Similarly, you may have a situation where the broker has listed the business for too much money. In that instance, they may be looking for a business buyer with more money than sense. Or the broker has misled the business owner into thinking the company is worth significantly more than it is. We find this usually results in an upset and frustrated seller.

Regardless, it is an interesting piece of information to know if a business has been listed for a long time, like over nine months, and there may be a story behind that. It may or may not be an opportunity, but it is certainly something you can inquire about.

Studying the CBR

Until now, we have suggested you use BizBuySell and individual broker websites to study their Blind Ads on a more substantial number of companies. If you are serious about making a purchase and have access to the cash for the required down payment, the next step is to request deeper information.

Forgive our repeated emphasis on this point, but only request a Confidential Business Review (CBR) if you are serious about purchasing the business, are prepared to make an offer on the company, and could finance the project, including the down payment. The information included in this deeper level is simply too proprietary for the seller to casually share or simply hand out indiscriminately.

Frankly, if you request this information under any other circumstances than those listed above, you are making the seller take an unnecessary risk.

And you waste a lot of the broker's time. Similarly, you assume some risk of liability yourself. When you sign an NDA, you are signing a contract specifying the exact use of the information you receive. While it is uncommon for this to result in litigation, you certainly are committing yourself to legal obligations that can have some teeth.

We have said this before, but it also applies to NDAs. They are standard legal documents. As a broker, we will only have you sign one if we believe it is a fair contract for both you and the seller. Getting attorneys involved at this point shows you are not familiar with the process. Certainly, we will speak with you and your attorney, but if you make a big stink about the NDA, it tells us that you will make a big stink about everything legal along the way and that a deal will not come together.

The seller has significantly more to lose regarding the NDA than the prospective buyer does. So, if you come as a prospective buyer with an extensive list of changes to the NDA, it is a big red flag. In our experience, we cannot recall any client—buyer or seller—who significantly helped themselves by over-lawyering. But we see, every week, deals that could come together if the parties took a more realistic, common-sense approach to it. Over-lawyering can kill deals.

Okay, we will step down from that soapbox and switch gears. Let's assume you are a serious buyer, have looked at several companies, and have a genuine interest in a few. You are willing to sign an NDA and provide a personal financial statement, and you would like to see the CBR.

The CBR will come to you as a series of PDFs and spreadsheets files. Each business will have different materials. We suggest you create a file labeled "From Broker" for the business and organize them this way. In many cases, how thorough the broker has prepared their client to sell impacts the quality of the presentation.

For us, if the information is complete, easy to follow, and well organized, then you are dealing with a stronger broker and an organized seller, which is good for both the buyer, the seller, and the transaction overall.

Typically, a PDF file will supply a deeper narrative about the business. In the CBR, we disclose the company's name, so you should find the seller detailed and forthright. This is their opportunity to convince you, the prospective buyer, that the business is strong and an excellent opportunity for the new owner.

One of the outcomes of this analysis is generating a list of questions. This is good, as if you continue the process of buying the business, you will undoubtedly want to get your questions answered. We would, however, suggest you make a list of questions but divide it into two categories: one is "Before Offer," and the other is "Due Diligence."

The fact is this: you could draft a list of 1,000 questions to ask the seller. However, it is not necessary to address every detail if you are not able to first reach an agreement in the offer stage. So, having a list of questions to cover later in due diligence is fine. In the first part of the list, "Before Offer," focus only on questions you must have answered before you feel comfortable making an offer. Those first questions should be a shorter list that will create enough comfort for you to make an offer.

Remember, you will have 30 and 60 days to address those other questions. This is the due diligence period, and if you discover something during this process that changes your mind or has been previously misrepresented, you can back out. Some questions you have, particularly getting into the weeds about the company, employees, and customers, can and should get addressed in due diligence.

Part of the analysis of the CBR, then, is to take the seller at their word, as you get to confirm all this in due diligence, and then to see, based on this information and a more preliminary discussion, if you would like to make an offer.

Financial Analysis

The deeper insights you receive in the CBR will be related to financial information. There are several ways you can start to study this.

First, as suggested before, if you are unfamiliar with basic financial statements, it makes sense to do some basic studying—again, Google is *great*! You do not need an accounting degree to study financial statements and tax returns. Many people who are initially intimidated by this concept are often surprised that the process is simple after learning a bit.

The primary financial statement is the income statement, also called a profit and loss statement or P&L, and is used for calculating income taxes. The profits found on the income statement are what the government taxes business owners on.

We can boil down an income statement to a basic explanation. Customer sales are the top line of the statement and display as "Sales," "Gross Sales," or "Sales Revenue,"—all those mean the same thing. The company generates revenues by selling goods or services to a customer.

The next part is "Cost of Goods Sold," where the costs tie directly to the product or service sold. This leaves "Gross Margin" or the "Middle Line." We often express margins as a percent of sales. For example, 50% margins say that the cost of goods sold equates to 50% of the sales price, and the remaining gross margin also equates to 50%. This is similar to but slightly different than markup, but if you are doing financial analysis, you will be discussing margins.

From there, Operating Expenses, those expenses of the company not directly tied to the cost of the product or service, are then subtracted. These expenses are referred to as overheads and not as directly connected to sales as the cost of goods sold are.

What's left are the profits. The income statement is:

Sales - Cost of Goods Sold = Gross Margins.

Gross Margins - Operating Costs = Net Profit.

Or Sales - Cost - Expenses = Profits.

Armed with this five-minute explanation of accounting, you can begin to study the story in the financials. As you review financial statements, look for the following:

Trends – Are specific numbers going up or down? How rapidly? Trends start to tell a story about certain things in the business.

Ratios – Ratios are simply numbers calculated from other numbers. When we look at an income statement, we often look at "percent of sales" type analyses. We look at gross margins, as shown above, as a percentage of sales. When we talk about changes in margin, we often talk about changes in percentages.

Outliers – If you look at a sequence of numbers, are there some unusually large or small numbers that seem out of place? This can be an essential part of understanding the financial performance.

Consistency – You will have both an income statement and tax returns. Is the same information shown in both places? Or is it different? If it is different, it is often because the CPA did some work to save on taxes. This can be okay, but it is essential to understand the rationale behind it, particularly if it has a meaningful impact on

Cashflow and thus the company's valuation. Banks also pay careful attention to this matter, so you need to be out in front of this.

Addbacks – We explain this more in our seller's chapter about calculating Cashflow. When valuing a business, the seller can add several expenses to net income/profits to determine the owners' actual cash flow. You want to understand which addbacks were included, confirm they are valid addbacks, and locate them in the financials. Owner's perks are a legitimate addback to calculate owner's Cashflow, also called seller's discretionary earnings, or SDE. This is a significant part of calculating the value of the business. Addbacks are fine, but you should study and understand them. Unscrupulous sellers will sometimes get overly aggressive with the types of addbacks they include, which could inflate the business's selling price.

Asset Value – Part of the CBR usually includes an asset listing report. We typically detail this down to the type of equipment and its value. This is something often studied. With the internet, getting a feel for the actual value of such assets is fairly easy. You can check the listing to see if it is on track.

Note: It is typical for sellers to inflate the asset list slightly. In some methods of calculating business valuation, this does not necessarily hurt you, the buyer. In fact, it can even be a slight positive with the bank—more assets to guarantee the loan—and even help with your taxes through depreciation. Of course, consult a tax professional! Regardless, you must understand the assets the seller will transfer to you and the value the seller places on them.

Another financial analysis item will be the balance sheet. Again, studying how to read a balance sheet is an important thing to learn—Google/YouTube can help—because it lists the company's assets, liabilities, and equity. The statement balances because assets will always equal liabilities plus equity. Your house is the same, and it is a straightforward way to analyze this. If you have a $300K house (asset) and a $200K mortgage (liability), then you have $100K in equity (equity).

It works the same way in a business.

Critical assets typically include the following: cash, accounts receivables—monies owed to the company by the customer—inventory, equipment, vehicles, and real estate.

Typical liabilities on the balance sheet include accounts payables, credit cards, and long-term debt.

By looking at these numbers, you can see how much value they have in each of these categories. Often, we will look at the ratio between assets, like ARs and inventory, and compare that to sales, which is on the income statements.

In other words, how much inventory is needed to support a certain level of sales? This is a term called "inventory turn." If the company has inventory, you will want to know how inventory turns work. We can ask a similar question about the accounts receivable. Looking at the books, you can see how many receivables the company carries. This can show, overall, how long it takes for customers to pay their bills.

All essential information.

Qualitative Information

Not everything you will study in the CBR will relate to numbers. There are several non-financial things you will want to start to understand.

Importantly, when you receive the CBR, you now know the company's actual name. This will enable you to visit their website or retail location, if they have it, as a customer. In many cases, this will allow you to secretly shop as if you were a customer and learn much more about the business.

You can visit online review sites to see what customers say about the company. You can obtain the address of the company and drive by. You can call the office, pretend to be a customer, and see how well the person handles your call.

You also start to gain insights about customers and employees. For example, if it is a restaurant, you can buy a meal for yourself and observe the employees and customers in the business. This is possible in other types of companies, as well.

Learning the name of the company will expose you to a different level of understanding. If you do any of these things, it is important to reinforce that you *must* maintain confidentiality. It should be obvious, but don't go into the business and say, "Your company is for sale, and I am thinking about buying it." Not only would this violate the NDA, but it could cause unnecessary damage to the seller and potentially expose you to liability.

This added exposure will raise other questions you can add to your list of things to discuss with the seller. It will also supply some information to see if the business meets the profile of a company you want to buy. As in previous steps, some companies rise to the top of your desired list and others drop towards the bottom.

As much as possible, try to think of the reasons *why*.

For instance, if you drive by the company location and get a terrible feeling in the pit of your stomach, this is good but it does not help you refine your list. If you drive by the location and the building was in a state of disrepair, which was the cause of your discomfort and is essential to you, you can add that to your list.

In other words, define what feels good or bad about the companies you evaluate. Even if this business does not end up being one you buy, these steps can help you better define the type of company you wish to purchase. It enables you to become a smart buyer.

Pre-Offer Conversations

If you get through this information and feel you are likely to make an offer, it may make sense for you to have a few conversations.

Broker - The first one is with the broker. A good broker will have gotten to know the seller and their business through listing the business. An important part of the broker's role is to read companies and people. Thus, the broker can be a tremendous source of information about the seller. Our advice is not to call the broker 20 times per day; instead, pull together a list of questions to review with the broker in an organized, time-efficient manner.

A good broker will answer the questions and do everything possible to help you with the process. In some ways, the information you get from the broker will be less biased than the seller's information.

As you speak with sellers, you will notice that they tend to discuss their business as if it were a child of theirs and selling the business is a huge deal to them. This is normal, as business owners usually end up being emotionally connected to their companies. A broker does not typically have this emotional attachment, so they can share information with you more objectively, both positive and negative, without all the emotional baggage.

One last comment about speaking with the broker is that a good broker will evaluate you as a smart buyer and a good fit for the seller. They know the seller, and their job now is to find a qualified person who could buy the business and be successful with it.

Remember, the seller will have invested a lot of time and money into the business. Thus, the seller is likely to be picky about who they sell to. They want to see that the buyer has the personality to take care of customer and employee relationships they cultivated over time. Brokers always assess the buyer as it relates to fit with the business and the seller.

After speaking with the broker, they may suggest you—or you may request permission to—talk with the seller. Please be respectful of both the seller and the broker and go through this channel, particularly for the first time you connect.

Appreciating the process is a good indicator of a smart buyer. Reaching out to the seller directly without coordination will typically cause both the seller and broker to be defensive and potentially outright angry.

It always works better if the buyer and the broker speak and then go through the items the buyer would like to discuss with the seller first. Often, the broker will have the answers; in those instances, the broker will know when it is wise for the buyer and seller to speak and make the proper introductions. Going around this is a violation of good business conduct.

We have seen it both ways: buyers speaking directly to the seller before an offer, as well as not. Frankly, sellers tend to be very guarded when speaking with potential buyers before an offer is in place. When they see that the buyer is serious and there is a real offer on the table, the seller tends to take it much more seriously.

Similarly, if a seller has already had several inexperienced buyers contact them, they may be more skeptical and guarded before an offer is on the table.

A good broker's role ensures that only strong proposals reach the seller. Sellers can discourage quickly, which does not help anyone, including the ultimate buyer. If the broker parades a group of bad buyers in front of them, it can lead to a jaded, fatigued seller. Thus, the broker tends to protect the seller in this way.

Conversation with Seller Pre-Offer – It often makes sense for a discussion to occur between the buyer and the seller before the offer. For the reasons mentioned above, you should coordinate this through the broker, with the knowledge that the broker may take some steps to protect the seller from the frustrations associated with working with many unqualified buyers.

If the broker coordinates this meeting, the buyer and seller need to connect in confidence. This conversation can occur over the telephone or in person. The seller can host the meeting onsite if they believe the meeting's purpose can be kept private from employees. However, to decrease this risk, the seller may prefer to meet offsite with the potential buyer. The potential buyer must consider both the broker's and the seller's concerns regarding these matters.

In this meeting, there are a few things to keep in mind.

First, be respectful of the seller's time.

Running a business takes a lot of time. Both the buyer and the seller want to ensure the buyer has the information they need to put forward an offer without wasting time. Pay close attention to things the seller may be doing that indicate they are feeling time constraints, like looking at their phone or watch.

Next, one of the most critical parts of this meeting is that the buyer and the seller like each other. Consider this like a blind date. Both parties will be evaluating the other. Both parties will decide if there is an interest in pursuing the relationship further.

We suggest both parties also treat the meeting like a job interview– with that level of professionalism. This means being on time for the meeting, dressing appropriately, and interacting in a manner that shows mutual respect for the buyer, the seller, and the seller's business. A poor first impression, on either part, can be harmful to the relationship. Professionalism counts.

A side note to potential buyers: this is not a smart time to come across arrogantly. Some buyers cop a significant attitude towards sellers because the buyer is considering, potentially, spending a considerable amount of money with the seller. We find this is a dumb move. Yes, if you buy the business from the seller, you will be spending a lot of money with them, but this does not give you the right to take an "I am the customer; therefore I can treat you however I want to" attitude. Be confident but also respectful.

Like most professional meetings, it makes sense to be cordial at the start of the conversation and ask questions about how the owner started in the business and some personal things relating to the company and the owner. In other words, you want to get to know the seller better, and you want them to get to know you and your story. Without wasting time, engage in professional small talk.

Next is to ask intelligent, relevant questions during the conversation. Ideally, you want the owner to feel that you know what you are doing by asking questions. Some of the questions in this process are more for due diligence, for instance, information that basically says "prove it" for the things the seller and the broker have already put forward. We suggest you save these questions for *after* the offer, as they come across as questioning the seller's integrity. We ask these questions later in the process. Asked too early, the seller will feel like they are on trial.

You don't really want this. Not at this stage. You want the seller to feel like you are asking smart questions about the business to fill in your knowledge.

Lastly, we don't suggest negotiating the price in these early interactions. We recommend it is better to send those in writing with a formal offer. Doing this in person can feel awkward. You want the owner to feel very positively about these first conversations as a smart buyer. These are the things we want the seller to walk away with from these first conversations.

- The buyer seemed smart; they asked good questions.
- I like the potential buyer; they came across strongly.

- I think they would do an excellent job running my business; my employees and customers would like to work with them.
- That buyer would bring things to the company that I am not currently.
- This buyer has the potential to buy my business, including getting financing.
- The buyer was respectful of my company and me.

A guideline on some questions you might ask the seller in these first conversations include:

- How did you get involved with the company?
- What do you love most about owning it?
- What do you like least about it?
- Would you say your employees like their jobs? Tell me more.
- What happens with customers when you do a fantastic job?
- What are some of the challenges you encounter with customers?
- I don't need names, but who are your most important employees, and what do they do in the business?
- If you were to sell the business, do you think any key employees would not be inclined to stay on board?
- Describe a typical day for you in the company. What are the things you spend most of your time doing?
- What are the things you are good at that help the business?
- What items do you think you could do better in running the company?
- What does the business most need over the next three years to succeed?

- What are a few mistakes you think you have made running the business?
- What are the company's top three opportunities in the next five years?
- What are your desires for your time with the business after the sale?

You do not have to ask all these questions, and we don't necessarily think it is a good idea to have a huge list you pull out to discuss. However, the best-case approach is to have a good discussion with the seller and have these types of questions come up in the conversation. This creates a more favorable impression than if it comes across as you are reading them from a list.

You will notice many of the questions above relate to relationships. You already have financial information from the reports included with the CBR. You need to understand the company's significant relationships, including employees, customers, and vendors. In all cases, you will be looking for A) how did these relationships form, B) which are the most critical relationships going forward and what can you learn about them, and C) what must the business do going forward to continue, improve, and attract more and better relationships?

You do not need to get into transition planning at this point. Think in terms of big picture understanding. If you have a deal in place, you can discuss which customers or vendors you will need to meet with after the close. Discuss employee relationships but at a macro level. In transition planning, you will drill down into the specifics on key employees. However, you want to uncover any issues with key employees that may prevent them from staying on after you sell.

As you wrap up the conversation with the seller, you must do two things with them. The first is to express your appreciation for the seller taking the time to speak with you. Even if you feel the seller owes you the thanks, given you are thinking about buying the company, resist coming across this way. Arrogance can be highly toxic to getting deals done. If you are polite and respectful, like a true professional, this will go a long way for you.

The second thing is to discuss your next step with the seller. If you think you will put forward an offer, you are okay to say this is your intention. If you are meeting with another business, it is also fair to indicate this. Ideally, however, you are providing them with some input so they leave the meeting with some idea of your intentions.

An excellent protocol is also to send the broker a note when you meet with the seller or have a phone conversation; this keeps the broker in the loop. A good broker at this point will be looking for you to supply some input on how you are leaning. If you do not think you will be making an offer, that is fine, but tell the broker this and why.

It is extremely common for a potential buyer to be working with a broker on Deal A that does not come together. But two weeks later, Deal B comes across the broker's desk. You want the broker to consider you the perfect buyer for that business. You would be surprised at *how often* this happens!

But it will only happen by respecting the broker, keeping them posted about your thoughts, and not playing any games. It does not help you, the broker, or the seller if you keep your planned next steps close to your vest.

This transparency is especially true if it is a "hard no." A good broker will want to collect your honest feedback. It is good karma for you to be honest with the broker, as they will have invested time and energy in helping you to this stage in the game. If the deal is not for you, give the broker proper consideration and give them helpful feedback. This really can come back to you positively.

If you make an offer, this is the time to put it together. We have supplied some other information on LOIs and offer worksheets in other chapters and the online Appendix.

Shop. Research. Study. Learn. Communicate. Be a pro!

THE MINDSET OF A SMART BUYER

Earlier, we mentioned that buying and operating a business will be one of the most remarkable personal growth experiences in your life because the company will place demands on you that force you to grow. These demands are often not particularly pleasant but come in the form of a stream of obstacles and challenges. Addressing them forces you and the business to grow. Because of this, the business owner's mindset significantly impacts results. Part of becoming a smart buyer, then, is to begin to analyze these mindsets shifts.

Many books address these topics in several different areas, but we will supply some summary points here. These are insights you can immediately put into action without having to study extensively.

Additionally, we hope you will study how your mind works. Not only will you need to get familiar with this during the process of acquiring a company, we think you will need to get quite committed to this concept and reach out to resources, again, not just for today but on an ongoing basis.

Many business owners and managers, even remarkably successful and seasoned professionals, have a performance coach. There is a reason for this. Consider this chapter a quick primer on some related concepts.

It Takes Time

We have often highlighted that owning a closely held business is one of the most significant and common wealth-builders known to man. This is not our statistic. It is a proven fact. There are no guarantees, but the process you are embarking on can, indeed, be a "get rich" endeavor.

However, many unscrupulous marketers have promoted it as a "get rich quick" deal. It sounds great, and people will line up to attend the workshop and pay for the book. The problem, however, is with the word *quick*. Most business owners will tell you they never feel like they are getting wealthy quickly.

They may tell you their mind is working quickly. They may have so much to do that everything feels like they are running quickly—all the time. They may feel they must be quick on their feet when responding to challenges. But wealth acquisition typically does *not* ever feel quick.

It doesn't feel quick because it isn't.

A great comparison is fitness. You go to the gym and eat right, and you will eventually see progress. The progress may be encouraging early, but you rapidly get into a zone where it hardly feels like you are making or noticing any gains—even though you may be making them. It is easy to get frustrated here. And it is easy to lose your dedication and discipline. You, of course, know what happens next. The gains you made go in reverse.

When it feels like things are not working, success in fitness is to stay resolute and even increase your commitment. Showing up day in and day out is part of the game. If you stick with it, you make fantastic gains in the long term. But it will never feel like the changes are fast. No, to the contrary, they feel like they are terribly slow.

Getting in great shape can happen in a couple years. Wealth in a business can take a couple decades. So, you can imagine how it rarely feels like you are getting rich quickly. Even if they are growing their wealth, most entrepreneurs will tell you that many days it does not even feel like they are making progress.

This often creates nervous energy and unease. It can prompt decisive action and commitment to progress, serving a great purpose. Other times it generates lots of stress. A small business owner will need to bring an important level of urgency to the way they manage things. The goal is to get something done—and get it done quickly!

It sets the stage for one of the most interesting paradoxes of business management. There is the need to bring an elevated level of urgency to management processes but to simultaneously have a high level of patience. As much as we would like progress to be unbelievably fast, it usually isn't.

The paradox goes counter to our desire to get rich quickly and against our increasing world of instant food, fast-cooking microwaves, and instant gratification. All under the influence of insta-posts on social media. All things prefer to seek success instantly, without pain or patience.

Sorry, it just doesn't happen that way.

Success takes patience, and along that path is pain. I wish there were a way around it, but it is what it is. As the old saying goes, "Rome wasn't built in a day." It speaks to the truth. As much as things have changed, there really are no new ways to succeed. Old sayings about success are as true today as they were back then.

Building a solid business takes patience, grit, and the highs and lows to get you there. There will also be doses of pain along the path. Most business owners who want to sell fully appreciate the pain it took to build that business. If you asked the business owner to look back and describe where they could have created a shortcut, they almost always have a challenging time doing so, as they had to figure out their path as it unfolded; nothing about it was instant to get where they got.

As mentioned, usually, it is not just waiting for success to come along but also includes overcoming challenges. Many, at the time, felt completely insurmountable. Very often, you can look at someone who presents themselves as a confident business leader, but inside they are saying things like, "Shit, I have no idea of what to fucking do," or the ever-popular, "Crap, I cannot imagine if my employees ever found out how little I know!"

That also means a required success ingredient is persistence. A toughness and grit that fights through adversity, even when it feels like the challenge is King Kong and you are one of those pesky little airplanes.

It's a willingness to try and try and try again.

So, when success does come around, it can be a fantastic payday for the business seller, and for a good reason. The time and patience it took to build that business is worth it in the end, but they will have earned every penny of it.

A smart buyer knows this is what they are in for, even if they have incredible intelligence and experience. They must appreciate it, even if the amount they invest is a comfortable bet for them. Similarly, in an ideal situation, they recognize that this business they are considering buying has required *a lot* of the seller to get it to this point.

Frankly, sellers will always tell you the asking price for the business does not even begin to compensate them for what they have been through. And, just as frankly, there is an element of truth to this.

You are embarking on a fascinating journey, but one that will require patience and persistence. Respect the road ahead of you and the path the seller has already walked down.

Excellent Communication Skills

The ability to communicate is essential. A small business owner must communicate regularly with many distinct groups: employees, customers, suppliers, competitors, and the public. In most cases, this includes both in writing and in person.

Effective use of these available tools will help:

- Word choices
- Tone of voice
- Eye contact
- Smiles
- Handshakes
- Listening

Being a good listener means caring about what others have to say. Pay attention and ask questions. Make sure you understand. Speak in positive terms with tact and authentic caring. Others will respond in a way that will help make your business successful, but you must listen carefully.

There are a considerable number of resources available to improve your ability to communicate. There are multiple training programs on active listening, which is an invaluable skill in managing a business.

Most business owners feel like they must have the last word. In some ways, this is true; people bring their problems and challenges to the business owner, and the owner is supposed to have a solution. However, thinking about what you will say while the other person is talking is one of the biggest obstacles to great listening.

Active listening starts with being highly present and very deliberate about the process. It also combines a respect for the person talking: you need to genuinely care about what they are telling you. Think about the complaining customer or the frustrated employee—they often want someone just to care enough to listen. Customers will teach you how to sell to them. Employees will tell you everything you need to do in the company. But only if you are really listening!

You can use several tactics to tell the person you are listening. The first is to stop talking and stop searching for what to say next. Focus on them intently. This includes looking at them and making excellent eye contact. Multitasking and listening do not go together well. Nothing says "you are not important" more to someone when they are talking to you and you are looking at your phone or typing on your computer. If you catch yourself doing this, stop it at once; it harms your relationships more than you know.

You can also make statements that show you are listening. Little cues like "interesting," "wow," or "no kidding" can make the person feel like you are paying attention and care. Asking good questions to draw out more from people is an excellent communication skill.

This also works exceptionally well when interacting with the seller of the business you are considering purchasing. Don't just act interested in what they are saying, but genuinely *be* interested. When they are talking, they are telling you valuable information learned from running the business; they might say something meaningful or something they only say once. Do not miss out on these nuggets!

If you act aloof or cool, chances are good the seller will only answer your questions and stop elaborating on things. This is not good. If the seller senses you are interested, they will tell you more and may give you information that ends up helping significantly when you buy the business. If you act like you already know everything, the seller won't even try to teach you things. You are paying for their knowledge, so open your eyes and ears!

Effective communication is a significant contributor to good relationships. If a marriage is in trouble, often the couple will visit a marriage counselor. Usually, the most crucial goal of these meetings is simply to reestablish effective communications. Usually before this, each side feels the other side is not listening and may be close to giving up on communicating.

You may think that business is only about trading money. But the reality is that business is about many relationships that interact with each other. Relationships that people choose to be in. Your employees may feel forced to have a job to make money and pay the bills. However, they are not necessarily forced to work for you. How much you pay them, the type of work they complete, and how you communicate with them influences the quality of the relationship.

Each year, several lists highlight the top companies to work for. Inevitably, these lists feature employers who have excellent relationships with employees. Not because they must, but because they have seen that positive relationships lead to positive results, including financial. The foundation of these relationships will always be excellent communications.

The same can be said for customers. They choose to do business with you. They have money in their pocket and pick who they wish to have a relationship with, who to give their cash in exchange for goods and services. These choices are based on relationships and communications, drive the money coming into the company through customer revenues, and are the starting point for the company's financial health.

The more you study the business, the more you realize that the company is just a series of relationships. All are enhanced through excellent communication skills.

Part of being a smart buyer is being a great communicator.

Financial Literacy

In earlier chapters, we talked about the importance of being able to read financial statements. Part of your evaluation of a company to purchase includes reviewing the financial performance. We discussed being able to read an income statement, or P&L, and a balance sheet.

So there are the mechanics of being able to read financial statements. If you struggle or are concerned, we think you will find several resources.

As you venture into the role of a business owner, you will not only need to be able to understand financial statements but also to be able to set the tone for how your company invests money. This is also an essential aspect of mindset.

Your employees will judge you for being frugal or more open with money. Based on the circumstances that face your business, you may need to be more economical at times and more spendy at others.

As discussed in the Quantum Stack Investing™ section, we suggest you spend an entire year observing the business before making significant changes. Remember, you have bought a functioning business with Cashflow. We recommend a more cautious approach based on continuance rather than a more disruptive, "turn over the apple cart" approach. Part of this is to gain a better feel for the company's financial performance. Is it doing better than with the prior owner, the same, or worse? And, importantly, why? The premise of our suggestion here is early on, you won't really know the answer.

Studying the financial statements will help you stay on the "continue" path. Input from employees will provide a similar approach. You will also want to break down yearly numbers into monthly numbers. And even into weekly and daily numbers.

Early on, you will want to set up performance monitoring systems/reports to keep you posted. Again, tapping into the former owner can help you with this financial literacy.

A great series of questions to ask the seller include the following:

- Does seasonality impact the business? If yes, which months are up, and which are down? How consistent is the pattern?
- Outside of the financial statements, what numbers do you look at monthly? Often numbers here can relate to things that lead to sales, i.e., leads or quotes, or matters related to headcount, i.e., how many people do we need to support specific revenue numbers?
- What numbers do you look at weekly?
- What numbers do you look at daily?
- What things tell you in advance if you are on track, ahead of schedule, or behind?
- What are the things you watch that give advance warning that things need to change in the business?

As you ask these questions, please be aware of a bias. That bias is that people tend to look down on the intelligence of others while boosting their own. Try to become a humble student. Ideally, with these questions, you are looking for algorithms for success. What the heck are algorithms?

Great question. They are not as intimidating as they sound. They are just if/then statements and directions. As simple as they are, they are essential keys to developing systems.

So how do algorithms relate to financial literacy? They can translate into financial guidelines.

For instance, in talking with the seller, you have learned that the business dips 15% during winter months. The seller tells you that you usually do not have to do any layoffs, but during those dip months, you should not aggressively replace team members lost to attrition.

The algorithms would look something like this:

- If the month equals December, then expect that customer revenues will drop 15%
- If the month equals December, then do not aggressively replace team members lost to attrition.

Seems simple enough, right?

Well, if you can gain this insight, you can start putting together a series of items like this. You want to begin to understand the essential financial relationships that happen within the company.

You can then set up monitoring to see if those things hold. And if not, why?

Believe it or not, simple algorithms like this are what form complex computer programs. The whole science of artificial intelligence (AI) is based on these things. Some of the most brilliant business people on the planet are focused on developing these fields based on their immense possibilities related to business management and other disciplines.

Okay, we digressed a bit. To get back on track, some financial relationships and algorithms exist in the business. You want to learn everything the seller knows and take on the role of the student, especially early in the company; you want to learn how the relationships work. Frankly, you need the seller to teach you things they may not even know they know—or notice are important. This means being a brilliant student and asking the seller excellent questions.

You will need to set up tools to monitor key indicators to confirm they are on track and if the assumptions you are making in the business are holding true, and if not, what to do about it.

This is a mindset. It challenges you to move out of guessing about the business's financial performance and start to look at it like a computer program would. While it sounds complicated, it helps make running the company a lot easier. It gives you rules to follow and metrics to achieve. From there, you watch, and when things are on track, good; keep doing what you are doing. When things are not on track, find out why, and seek solutions to get things back on track.

Please note that this level of financial literacy and learning will not happen overnight. If you approach it right, you will do an outstanding job of learning the things the seller knows. Frankly, they know more than they can articulate to you. They are intuitively doing many things like this without even noticing it. They have developed, even involuntary, habits over the years of which they are not even aware. Asking good questions may be the only thing to pull that information out.

From there, you use the first year of the business to observe and learn. Replicate the former owner's results by doing your best to duplicate how they managed the business. Trust us, you will learn a great deal!

> *As a business owner, you need to have the mindset of an investor, scientist, psychologist, and computer programmer!*

Financial literacy also extends to knowing the impact of critical financial actions such as borrowing money, how you are taxed, and how your actions will impact taxation.

There is a tremendous amount to learn, even if you have extensive business experience.

Knowledge and Passion for the Product

This is an interesting concept and one you can look at from multiple angles.

You will buy a business with an existing product or service expertise and a passion. What the company does for customers is integral to developing and keeping the right mindset.

As the new guy or gal, you may be looking at a business where *you* bring a great deal of product or service knowledge and passion. Or you could enter the company with vast business knowledge but little understanding of the product. Both approaches can work, but you must be aware of them and know how to adjust to the needs of the business and the market.

To generate substantial sales revenues from customers, the company will need to be good at the product aspect of the business. As the new owner, that expertise—and passion—will need to be in the company. That could be with you—as the new owner—with employees in the business, or from remnants of the prior owner, through the impact on the company and the training provided.

If the primary product expertise in the company is with the seller, you will either need to pick up that baton yourself or identify people in the company who will do this. But the company will need to move forward maintaining and hopefully growing this expertise.

Walt Disney said, "Do what you do so well that others will want to see it again and bring their friends." Following that advice will go a long way in helping you be successful, but you can't do that without a deep understanding of the product or service you're offering.

Suppose you are bringing significant product knowledge to the transaction. In that case, you must compare your knowledge with the exiting seller and develop a sound approach that capitalizes on both your knowledge and the seller's. If you are coming in very green, you need to be a sponge with the existing owner/seller so that the company does not skip a beat when they exit. Obviously, in this situation, the longer you have access to the seller through training or consulting access, the better.

In some instances, sellers will agree to stay on to only sell for the company. This can provide an interesting transition time. In this case, the seller is using their contacts and skill to continue to bring business to the table but without the more consuming task of running the business. This, of course, is entirely determined by the mutual goals of the seller and the new owner—you.

However, it is crucial to understand the specific product knowledge and passion in the business and where it will come from in the future as the seller transitions out and as you transition in as the buyer and new owner.

The larger the company, the more this product knowledge will be within the company itself and the employees rather than exclusively with the owner, as can be the case in smaller businesses.

Additionally, it is essential to gauge which employees bring this product knowledge and other abilities and how those factor in. Retaining them and giving them an opportunity to stay and grow in the new business will be paramount.

You most certainly will want to account for the product knowledge and passion necessary to continue and grow the company's Cashflows.

Leadership Skills

Leadership is a broad field of study; thousands of books exist on the topic, including profiles of leaders in business, politics, sports, and entertainment. Many colleges are now even offering advanced degrees in leadership.

Recently, I saw that one of the primary roles of a leader is to create at least one other leader. By title, the company's owner, especially in closely held companies, must bring the leadership element to the table. Not only to be a leader themselves but also to be a developer of other leaders.

Many buyers already have career experience that cultivated leadership skills. In others, they may be drawn to owning a closely held company because they wish to cultivate their leadership skills. Others may be interested in the business or its products, and leadership is another responsibility that comes with being the boss.

Regardless of your disposition in the earlier paragraph, leadership plays an integral part in your new adventure in owning a business. While we will cover a vast topic in just a few paragraphs, the following leadership insights can be vital in developing the right, smart buyer mindsets.

> *Leaders are problem solvers. As we have discussed, the path of owning a closely held business can be an extremely rewarding one but is rarely quick or easy. It means that problems come up.*

A lot of them. Big ones, little ones, and everything in between. And there seems to be a steady stream of them, even when things are going well. Leaders develop a mindset of being able to tackle problems. Often this means being able to identify issues at their root, brainstorm multiple solutions, select organized plans of action, and implement solutions that get the desired result.

Part of being a problem solver is being highly responsible. In many jobs, you can say, "not on me," or "that's not in my job description," or even just "I do not know." As the leader of a smaller company, you must take responsibility for solving problems, including ones that are not of your making. You will need to adopt a buck-stops-here attitude.

A good leader is strong at looking at the situation and deciding if someone else should solve the problem, including if it is a good training opportunity or to solve the problem themselves. However, this does not mean that you solve problems that others could learn from solving themselves.

That means there will be instances where you, as the owner, could solve the problem but you may have an employee who would learn a great deal from taking on the problem themselves, either on their own or with your guidance. Regardless, when showing strong leadership, the owner will take responsibility for the results—good or bad.

One of the primary roles of the leader is to be the visionary for the company. They have a plan for where the business is going. In the best-case scenario, they are excellent at communicating that vision and getting others excited about it.

Since you are buying a business, this vision may take some time to formulate. Remember, you purchased an existing business because that company was already doing something right. We prefer the learning owner for the first year or so compared to the new owner who comes in and makes immediate, significant changes that may or may not be proper.

This is where we suggest you start. That is in studying what the business does right. What are they doing to satisfy customers today? Why do people come back time after time again? What motivates the employees? When the company is at its best, what is it doing? The goal here, of course, is to bottle up the magic to maintain and eventually multiply it.

One of the ways this vision can come forward is to look at the elements that make up the company's purpose. There is a lot of literature about mission statements. Still, the advice is that a company tends to do better when the people in the company, including the owner, are motivated by more than just money. There is some greater good that the company and its employees are working towards.

When the company is good at this, not only does it keep customers happy, but it attracts and keeps better employees. Many studies have shown that mission-driven companies tend to financially outperform average companies. It is not just an altruistic goal.

We consider four parts to describe a company's purpose. Those four things are as follows:

- Mission Statement: What we do
- Vision Statement: Why we do it
- Values: How we do it
- Competitive Advantage: Why customers choose us over competitors

If you are considering buying a strong and well-developed company, they may already have these things well organized and articulated. You can review these as part of your process of purchasing the company. If their purpose aligns with you personally, then you should find a good fit. Another word used here is culture. If the company's culture, through defining its purpose, is well established but goes against your norms, it may not be the best fit.

> *Going back to an important key, you are buying something that works. Don't try to be a disruptive force at first.*

Identify and quantify those things that are working. If the purpose elements are poorly defined in the company, study what you feel is the magic the company makes when it is operating at its best self. Suppose the culture/vision/purpose elements are there but are poorly articulated. In that case, you can serve the business immensely by putting those items to paper, getting input from your team, and then working to replicate the positive results.

Coaching - Professional and Personal

Good leaders are great coaches. They help guide the team to more robust performance. They are adept at defining the goals, allowing team members to define their own goals, and then watching performance to identify areas where the progress is strong and duplicating that. They also help find shortfalls or gaps in performance to help the team close those gaps. Good coaches also tend to be coachable themselves.

Another way to look at coaching is to imagine the company at its best. Break down the elements that made that positive result happen. Then make the goal to have your former best be your new average performance.

Another way is to look at your prior average and find ways to make your previous average your performance floor. By doing this, you raise both your floor and ceiling.

You help your team—and yourself—study what is working already and focus on doing more of that. This is not turning over the apple cart in the company. It acknowledges that good things are going on, and we just want to make that result happen more often.

Similarly, there are books and whole courses on coaching skills. We suggest you consider ways you are a coach and can become a coach. Some of the everyday things that coaches use to improve the performance of those around them include:

- Strong, active listening
- Helping set effective goals
- Monitoring performance
- Naming strengths and replicating
- Identifying weaknesses and shoring up
- Asking awesome questions

- Brainstorming solutions
- Holding people accountable to higher standards
- Providing encouragement
- Pulling more out of people than they do on their own
- Monitoring attitude and effectively labeling it—good or bad
- Problem solving/brainstorming solutions
- Helping people believe in themselves
- Helping people persist through challenges

You can see how a leader with these coaching skills could contribute positively to a company. Think in the past of some leaders you have seen who had excellent coaching skills, as well as others who had poor coaching skills. Part of evolving as a leader is modeling strong leadership behavior in others and avoiding poor characteristics. No leader is 100% original. We all learn from others.

This segues into another vital leadership characteristic: being a lifelong learner. A leader should be confident but not arrogant. A great leader recognizes and has a lot of gratitude for all they have learned to date but readily admits that they don't know it all and will gain from further learning.

Leaders are always open to learning. This is one of the reasons you see an explosion of information and training materials available. Over the past 30 years, the internet has exponentially increased our ability to share knowledge. Things we are doing with this content today were not even around just a few decades ago.

For many, that means reading or listening to learning materials. Podcasts and audiobooks can turn commutes into an opportunity to gain a Ph.D. in any topic you wish. Most of these resources are low-cost or free, so cost is not the barrier. Discipline and dedication are.

We applaud you for reading this book and expanding your knowledge about buying and selling businesses and our groundbreaking approach with Quantum Stack Investing™. But don't stop here. Commit to continuing to learn now, and from here forward.

Just a few more comments on leadership before we wrap up this chapter. Organizations need energy inputs. It takes hard work and passion. The best organizations have built up a momentum—and an enthusiasm. You can almost feel the energy when you encounter an organization like this. It wakes you up, shakes you, and gets your attention.

The same for a business that lacks energy. This is easy to see as well. Employees are bored, tired, or downright angry. People are touchy and want to gripe at each other. No one wants to do anything and often sit back waiting for others to take over. The contrast between low-energy and high-energy organizations is dramatic.

Leaders affect this energy. If they are not directly the energy giver, which they usually are, they are at least setting the tone and holding a high standard. They also have a good radar for evaluating if the organizational energy is up or down and then ensuring it is on track.

> *Energy up. Good energy tends to lead to upward spirals or momentum. Simply, good things lead to more good things, which leads to the expectation of more good things.*

The same for negative momentum. Great leaders can sense when energy is low and find strategies to bring it back up.

Part of your smart buyer mindset will be around giving your organization energy. If you can do this, the other leadership skills tend to fall in line.

Lastly, we will only briefly mention it here, as there is a chapter on this later, leaders have courage. We are sure you have heard this before, but courage isn't about *not* feeling fear; it is about feeling fear but taking the right actions anyway.

The business will give you things to fear. We can guarantee that. It is one thing to talk about a concept like this but another when facing downright scary things. You will in business. Every person who has successfully bought a company has.

And in most cases, the business owner is victorious… or at least lives to fight another day. Leaders are courageous. So are business owners.

IT'S ALL ABOUT THE FINANCING

Let's go back to a number we mentioned before: in most small business transactions, the buyer puts down a deposit of approximately 10% and finances the rest. Most often, this is through a bank. And in a fair number of cases, this means a bank, along with the help of the government/SBA, will put up the remaining 90%.

So, you put in $100,000. The bank puts in $900,000.

Guess what? That means the bank is putting in 9X what you are. And as we mentioned before, the banks have guidelines and rules. So does the SBA.

You may be looking at this process for the first time, or you are a pro and have done this dozens of times. But over the years, the banks have done this millions of times.

If you hope to fully leverage the power of QSI, you will need to achieve mastery of financing. Acquiring a business means you will need to be good at playing the bank's games and abiding by their rules. Presumably, the most significant thing standing between you being successful at buying the business or not is getting the financing.

This fact forces many would-be business owners to abort the mission: going to the bank. Even if they are qualified to do so, it is so intimidating to them that they punt. For many, it is downright terrifying.

We don't want you to be scared. But we do want you to respect the process. So, as we get to this part of the process, it is the *no bullshit, stop fucking around* part of the conversation. Smart buyers and sellers simply must recognize the importance of the impact banks have on the transaction.

Navigating Small Business Lending

It is common to hear about a former IRS agent who now teaches people how to save money on taxes. The inference is they saw the IRS from the inside. They know the IRS rules and behavior. They will teach you how to work those rules and behaviors to your advantage. Sometimes these suggestions are great and occasionally risky.

We are doing the same with you in this book. But rather than highlighting fringe strategies, we will tell you the lay of the land from the bank's viewpoint.

We mentioned in the introduction that two of the authors of this book are former bankers. Early in his career, Chad owned and operated several locations of a mortgage company. He had his own warehouse line and was a bank. He saw banking from the eyes of an owner and learned how banks make their money, especially how they hedge their bets so that they never, or rarely, lose. It's like a casino: set up so the house always wins.

Don't just take our word on this. Look up the banking sector in financial investments and tell us how well that industry does. I'll save you the time: they kill it!

Or, when driving tomorrow, go down a block where there are retail establishments. Tell me which industry has the newest buildings. Tell me if you see a bank on every corner. Tell me if you see new banks going up everywhere. Tell me if you drive through the parking lot at the banks if the employees are driving nice cars. You get my point: it is banking for the win!

Make no mistake; this happens for a reason. The banks win because they created the rules this way.

> *You can win too. But you must understand how to work with the banks.*

This is not the area to go rogue or get cute. Banks have a process and things they *love* to see from small business owners. They watch how you approach the transaction, your psychology, your behavior, your reactions, and how cool-tempered you are under pressure. They observe how fast you get things to them and how responsive you are. They risk 90% of the transaction and bet on your aptitude for repayment. Work with their rules instead of against them.

Similarly, Lee also came to business brokering from the banking industry. He worked for multiple banks giving loans to businesses. He and Chad met because Lee was financing deals for Chad's brokerage clients. Lee has built SBA divisions for some of the biggest banks, including Wall Street banks, and is the authority and subject matter expert on SBA lending.

Casinos win by knowing exactly how to place bets. Banks do the same thing. Part of knowing how to place bets is how to reduce or eradicate risk from the equation. The SBA, part of the US federal government, can take bank risk down to an extremely low level.

If you know how the SBA works with small business lending and how the banks manage the process, you put yourself in a significant position to win as a small business borrower. If you plan to buy businesses, it's almost guaranteed that you will venture into these waters.

Given that Chad and Lee combine business brokerage experience with significant banking backgrounds, we feel the information we share here is vital.

How Banks Eliminate Risk

As we discuss how to secure a business loan to help you buy a business, it helps to evaluate a primary guiding rule that all investors use: risk and reward.

If you Google the term "stock market returns over the past 20 years," you will find some differing numbers based on different methodologies, but here are some numbers provided by the Motley Fool investing website. *Note: these numbers are from 2021.*

- 10-Year Return - 2011 through 2020: 13.9%
- 20-Year Return - 1991 through 2020: 10.7%

The stock market has done well over that time, but for ease, let's just say that over the past 20 years, the stock market has returned about 11% per year to investors. So, for the risk associated with investing in stocks, historically, you could expect to receive an 11% average return on that investment.

Bonds tend to be less risky. They are like loaning money to large companies and governments. The return is not as high, but the variability of the risk is much less. A similar Google search shows that bonds have return rates of between 5% and 6%. Split the difference, and the return is about 5.5% or *half* the return of stocks—less risk/less reward.

While some disagree, many investment advisors teach that the return on owning a small business should be much higher, approaching more like annualized returns of 15% to 20% because the risk is higher. The theory is that publicly traded stocks are bigger companies that can go up and down with the tides of business trends and economic cycles.

Also, if you invest in stocks, you will typically spread around the risk to many different stocks or mutual funds. Small businesses usually have all their eggs in one basket and come into and go out of business more regularly. More risk requires a greater return.

If you seek wealth from small businesses, you are happy about this arrangement. If people perceived the risk as lower, more money would move into that avenue, and the return would drop. The higher returns from closely held businesses have generated a lot of wealth!

Angel investors, often private individuals or funds which invest in smaller companies or startups, will typically seek between 20% and 25% return on their investment. Again, this is due to the added risk in smaller companies and startups due to more significant risk.

Similarly, credit cards will lend people money and charge anywhere between 8% and 26% interest. Often the difference is the person's credit rating and income. The more the credit risk of the individual, the greater the return needed.

Banks on business loans typically charge between 6% and 8% interest. Huh? Wait a minute.

Bonds are 5.5%.

Stocks are 11%.

Small Biz are 18%.

Angel investors seek up to 25%.

But banks get a 6% return on small business loans? And truthfully, banks often borrow the money they lend to small businesses. If they pay 3% (ballpark) and lend at 6%, then the profit spread is only 3%. How do banks make all that money? And we said that investing in small businesses was riskier. What gives?

Please understand this: the banks are *not* investors in your business.

They do not make, nor are they asking you for, investor returns. And thus, correspondingly, they do *not* take investor risks. Banks lend money and receive a modest return, for example, the 3% spread cited above, for the time value of that money. They do not receive a high enough return to take a risk on your business.

This is important: banks only lend to small businesses where they are practically guaranteed the return. They are not paid to do more than that.

So how does that happen?

It happens through several things. Other training materials will go into a lot of detail on this, and you can Google this concept and receive a master's degree worth of information, but we are going to give you an abbreviated explanation and then tell you what you can do about it.

Our focus is on giving you the step-by-step.

But first, the theory on how banks reduce or eliminate their risk on small business loans:

First, many get a guarantee from the SBA. Just like the government puts subsidies in place to ensure farmers can function in business, the government has a stake in making sure that small businesses succeed. They employ people, which generates taxable income both for the employees and owners of the company.

So, through the SBA, they make it so that banks can make loans at reasonable rates—i.e., compare the bank rates of 6% to 8% to angel investor return requirements of 20% to 25% for small businesses—so they can succeed and contribute to the overall functioning of the economy.

> *So, banks often use the SBA to ensure its risks are reduced or eliminated.*

Next, banks will go into a standard analysis of how creditworthy or *bankable* the business—and its owner—is. Again, there is a lot of information on the web on this point.

To condense this topic, banks will consider the "4 Cs of Credit:" Credit (or Character), Capital, Capacity, and Collateral. When you show up for the first day of "banker class," they drill this stuff into you and start with these "C words."

Here is a quick overview of how they relate to borrowing in the small business setting.

Credit (Character) – Basically, this is your personal credit report. In the past, have you paid your bills? Have you ever declared bankruptcy? It's a 100% guarantee this stuff will come up. So, it is best to address any issues as early as possible.

Capital – This is how much capital you are injecting into the project. Banks want to see that you have some of your own *skin in the game* or money at stake. Again, the norm is usually 10%. But the banks will be evaluating all your resources. This also includes partners and even investors, if you have them in the business.

Capacity – This looks at the borrower's (your) ability to pay back the loan. In personal situations, this is your income. For instance, the bank will look at your income and other monthly financial commitments if you apply for a mortgage. They are assessing if you will be able to make the loan payments. If you are paying attention, this is the part we have emphasized relating to Cashflow. This analysis is critical to the bank because they want to see that the Cashflow the business generates will be able to cover the monthly payment.

Collateral – Another aspect of lending is to see what collateral is available to pay for the debt if the business defaults on the loan. Again, in a personal mortgage, the primary collateral asset will be the home itself. You make the payment or the bank, in theory, has the right to repossess the home.

The business is similar in that the assets are the primary forms of collateral. However, often in a business setting, the business's assets are insufficient to cover the total value of the loan as there is usually some blue sky premium to the company. The price paid for the business exceeds the value of the assets bought. This is especially true if the business is generating robust and positive Cashflow. This means the bank will evaluate your business and personal assets and always require a personal guarantee.

It is imperative to point out that banks often rely on the SBA to address the situation above, where the assets of the business and the borrower's personal assets/liquidity are insufficient to supply enough collateral to ensure the bank's safety. This means part of the value of the business is intangible, which is fine and normal, but it increases the bank's risk. An SBA guarantee mitigates that risk.

This discussion about borrowing money might make you feel a bit uncomfortable. We understand. But know that many people have already successfully walked this same path. Throughout the discussion about small business as an investment tool, we have explained that it can be the most lucrative investment vehicle available. This is especially true in the context of QSI! But it requires the intestinal fortitude to learn about these banking rules, collaborate with them, and take properly calculated risks.

But to reinforce, banks do not take a risk on your business. They will ensure they are covered not only once but often multiple times. Don't hold that against them, as they are not charging you to take that risk. Additionally, working with bank debt can be one of the most significant multipliers of personal wealth, *but only if you do it right*—what this book is all about!

We touched on this in an earlier chapter, but all this means the bank will ask you for a lot of information. Form after form and schedule after schedule. And you can't get all pissy about it and act offended or put out.

Not only do they do this to protect themselves, but a gazillion lending laws require banks to collect this information and ensure that they are only making loans that people genuinely can pay back. Those laws protect lesser-informed consumers and businesses from predatory lending practices.

This approach also protects you, too. It is *not* a good thing for the bank to give you a loan you cannot afford. In the immediate term, you may feel that the bank needs to provide you with a loan just because you want it. In the long term, however, the rules and practices of the banking industry will try to ensure that you get a loan that works for you—a loan you can safely repay.

So, get accustomed to having to supply information, not just when applying for the loan, but even after the loan. Fight this and it will be painful. Acknowledge this as the way of the world and you can make the good things work for you while making the unpleasant things much more tolerable. They are what they are; you are not going to change them, and they are not going to change for you.

As mentioned above, members of our firm have lending experience. Most brokers will not have this level of banking experience, but the good ones will still ask you for information to help you prequalify.

Every day in our firm, people get upset when we ask detailed questions about their bankability. It's as if they are saying, "How dare you!" or, "You don't really need that information!" They act offended as if our goal is to get in their way.

The reality is that we *do* have the right to ask. And frankly, you need us to know it, too. Here's the deal. You can come to us completely broke and not bankable, and while the hill is steeper for you to climb, we can provide you with some guidance on how to get to a better destination. But not if you are lying or being evasive.

Seriously, we can give at least some direction to anyone. Maybe you are reading this book because we suggested it like that!

But what doesn't work is when people come to us trying to trick us—or even crazier, trying to trick the bank into believing they are something or someone they are not. They see a business on a listing site and want to learn more about it even if they cannot finance the deal.

If you are a pigeon, we can help you as a pigeon. However, if you are a pigeon but insist that you are an eagle, then not only do we run into a nasty wall, but so do you. We want to help you avoid that.

The same is true with the bank. Let's say you buy the most expensive suit at the mall. And get a high-dollar haircut. Then you go to the tanning booth and get a manicure. You can even rent an expensive sports car to drive into the bank. Perhaps the staff at the drive-through will be impressed, but you will eventually talk to someone who needs to complete paperwork to support the loan for the business you want to buy. That is when the rubber meets the road. Welcome to reality.

> *Regardless of where you fit on the continuum of financial security, the best thing to do is be honest. In the end, you will not fool the bank.*

So all the energy and effort put towards false pretenses could have been invested in things that make you more bankable or increase your probability of success. Dream boards and audacious goals are cool, but being delusional is not—and leads to failure.

If you are a pigeon, not an eagle, don't invest in haircuts and cars to make you look like an eagle. Invest in things that help you go from where you are and provide you with steps to get where you want to be. Educate yourself and act.

At the end of this chapter, we will provide some suggestions for playing the game described in this book, even if you are not currently bankable to a level you want.

But before that, we will discuss how to approach a lender when you are bankable.

Your Ticket to Admission

The banking process is detailed. The more you know going in, the more you can have everything in place to provide the bank.

Want to reduce the time and stress associated with lending? Then get your act together and get organized. If you walk in with a complete presentation for the bank, they will have the information they need and will be impressed and grateful, as you are making their job easier.

While it won't move the needle massively, how much the bank likes you can have an impact. There are a few ways to make a bank like you.

First is to come to the table highly organized with all the materials they need to do a review. And second, be respectful of the process. Banks understand there is a lot of information requested. They know you are uncomfortable sharing it. They know it is a pain in your ass. If you act put off with them, they won't like it. If you act like you know they have a lot of paperwork to organize and are respectful of that process, they will notice.

They also tend to get a bit disgruntled if you come in requesting a loan that is not even on the same planet as you should be. Want the bank to like you? Be respectful enough of their time not to waste it.

One of the essential documents for the bank is the personal financial statement (PFS). We mentioned this earlier in the book. This document is requested by every bank you interact with. No, this is *not* Mayberry, where Andy Griffith walks down the road to see Harlan Fagus, the friendly town banker. Nope, those days are over.

Today, Andy will get 20 forms to fill out. If Barney were with him, he would make those googly eyes! The first form will be the PFS.

Every bank is going to ask for the PFS. Every. Bank.

Next, if you are working with professional brokers, they will ask you for the same information before showing you higher-quality listings. Want to know a broker's secret? If the business is good, they will be *much more* protective of it. This means they will make you prove you are a solid buyer before sending you more information than you can see in the Blind Ad.

If a business sucks, they may be more desperate for a buyer, so they may let their guard down a little bit. They won't ask you those tough questions. Are you picking up our drift?

So, if you want to see the best listings, you will need to prove you are a legitimate buyer. And that means that if the broker does her job, she will require a personal financial statement. The good news is this document is the same one other brokers will want to see and the one that all bankers will also require. One form used by everyone is quite a positive.

It does not take a rocket scientist to figure out our suggestion. If you want to buy a business, you need to have a PFS ready and be willing to share it with those who need it. In buying a business, the broker and the bank are legitimate people who need to see this document.

Hey, do you want to know a secret?

It is a standard form. While banks may have you fill out their form, the information is the same. The SBA, another entity that will need to see this information, has a standard format. It even has a number. It is SBA Form #413. Don't believe me? Google "SBA Form 413 – Personal Financial Statement." Boom! There it is.

On the SBA website, this is currently a six-page document. Pages 1, 5, and 6 are explanations. It's like the tax forms. You can read the explanations; it is valuable information. But pages 2, 3, and 4 are the real heart of the matter. Combined, they are a personal financial statement.

So here is a tip. You may or may not need to apply for SBA lending. But if you fill out the SBA form, it is more detailed than other forms. If you spend an extra few minutes doing this, you can complete the SBA form to meet their requirements. The SBA has the most rules. If you fill out the SBA form and meet their needs, you will meet everyone else's needs.

Here is another thought.

Filling out a PDF form can be a pain. Working in Excel is significantly easier. There are tables and calculations in the PFS, and a spreadsheet works perfectly for tables and calculations. But the SBA only supplies the document as a PDF.

We have you covered. We have converted the SBA 413 form into an Excel spreadsheet. And you can download that spreadsheet and view an explanatory video on how to fill it out. So, download the spreadsheet and save it onto your computer, and you will be able to update this going forward. The link is in the online Appendix.

And update it you most certainly will.

When you get your business loan, depending on the loan size, the bank will ask you to update this document either once per year, every six months, or even once per quarter. So periodically, they will contact you during the entire duration of the loan and ask for an update. If you have a 10-year loan and they are asking for a quarterly update, that is 40 updates. Yippee!

It sucks. But this is another one of those things the bank needs to do *by law*! It's not an option for them. There are people who audit bank records. If they find the bank has not collected this required information from you, regulators can assess fines or even revoke their banking license.

So, we get it. This is a pain. But it is no big deal if you know the rules and play by them.

Okay, so when you make your personal financial statement, you want to provide good notes on how to update this—and where to find the information in the future, like email contacts or websites. Make it so it is easy to update. If you start from scratch each time, you will drive yourself crazy. But if you set it up so you do an easy modification every so often, it is easier.

Here's a tip. Put the date in the document name: "Joe Dough – Personal Financial Statement – Jan2022.xls." This way, when you update, you simply "save as" and modify the date in the file name.

We are being a little overkill here, but our intent is to make this easier on you. If you play this game, you will prepare, update, and share this document a lot! If you call our firm and make a big stink about our asking for this information, it screams that you are a pigeon trying to fool us that you are an eagle.

Reporting on the Biz

So, the personal financial statement is a comprehensive document that summarizes your financial situation. While the bank will pull your credit, the PFS is the primary thing you must supply them about your individual financial situation. This detailed document covers all the ground.

A business is a little more complex. There is a set of information the bank will need to approve the loan and a set of similar documents, the primary financial statements, they will require you to provide on an ongoing basis.

Here is the information the banks will want to see on the business:

- Confidential Business Review (CBR)

- Tax Returns for three years, preferably for the business and the seller, personally
- Income statements for three years
- Balance sheets for three years
- List of business assets/equipment
- List of key employees
- Business plan
- Cashflow projections

The seller will provide much of this information to you—the prospective buyer—after you have reviewed the broker's Blind Ad and have A) signed an NDA and B) submitted a PFS.

If the seller is working with a strong broker, they will either already have all this information organized or are well on their way to having all the information. A smart seller will supply a very complete set of information.

You, the buyer, can often organize your presentation to the bank. But if the broker or seller blows it and does not get you and the bank the information listed above, then the deal is in trouble. This isn't good.

A few things to consider. Please understand the information above is highly confidential information to the seller. The seller, through their broker, goes to a lot of lengths to qualify you because the seller does not want this information floating around, and understandably so. Be respectful of receiving this information, honor the commitment of the NDA, and don't create bad karma by using this information for anything other than the intended purpose.

Next, if the broker is careless with this information and sends it to you with little qualification or fails to ask for an NDA and PFS, then *run* in the other direction from this deal! If the broker knows what they are doing, then it's a shit deal that they are desperate to unload or they would have been more discerning and cautious. Or the other possibility is they don't know what they are doing, which can be just as dangerous. Be careful.

> *Believe us, how much the broker scrutinizes you is related to the quality of the deal.*

So, in most cases, you will receive this detailed, confidential information only after you provide the NDA and PFS. You will analyze this information, so make sure you understand it and discuss it with the seller and be prepared to discuss it with the bank, including answering questions they have. But primarily, this is you taking the information given to you from the seller and then providing it to the bank.

If the seller or broker has not pulled this information together for you at the point of presenting the CBR, then you will need to ask for the missing information. This can get frustrating; unfortunately, it means you are doing the work the broker should have already done. There are some moron brokers out there! It is much better to get the information together *before* you bring it to the bank.

But it says a lot to the bank if you come in underprepared with key documents missing. The bank also notes if they ask for information and it takes you or the seller an excessive amount of time to get them the information. They are thinking, "Does this seller have good financial statements and know what they are doing?" or, "What are they hiding?"

The notable exception to the statement above is the business plan and cashflow projections. In other words, the seller will very often *not* be the one putting this information together. You have an extremely organized seller if you get a business plan or planning documents with the CBR.

Banks, however, will want to ensure that the plan for moving the business forward after the loan is *your* plan, not the seller's. The business plan helps show them you know and understand the company you wish to purchase and that you have a plan.

And while the business plan needs to be *yours*, you will want to get the seller's input. They should be extremely helpful in putting this together. Frankly, there is information they would be much better to answer than you are. This is another instance where smart buyers and sellers collaborate for the transaction's benefit and the company's customers, vendors, and employees going forward. Work productively with the seller.

We will provide you with similar guidance on business plans. There are 1,000 separate ways to do it, but the SBA also has a template. It's not as formal as the PFS form, but they have multiple sample documents. You can download Word documents for a standard-format business plan and a short-form business plan at the time of this writing.

An essential part of the business plan is to complete a Cashflow analysis. This can be as simple or as complex as you choose, but it should show estimated revenues coming into the business, costs and expenses, and the debt service payment.

> *Remember, the most essential thing the bank is considering is "Does the business appear to be able to pay back the loan?"*

It makes sense to complete a monthly Cashflow analysis for the first year. Typically, we suggest you do this in a spreadsheet.

There are resources in the book's online Appendix, but you can Google "SBA Business Plan," which will direct you to a page with these downloads. Similarly, there is an associated resource where the SBA can direct you to help in your local area to create a business plan. Both the SBDC and SCORE are programs related to the SBA. In most instances, these are community resources available free of charge. Early in his career, one of the authors of this book worked extensively with the SBDC network and believes it is an excellent tool.

Is it starting to feel like a lot of work?

Yes, it is! And you haven't even bought the business yet.

Therefore, you must go down the path of purchasing a business and applying for a loan only once you have a high degree of probability of obtaining the financing.

A great broker will ensure you only go to this effort when the odds are stacked in your favor. If the broker knows you won't get the loan but sends you down this path and all the work related to it, well, they absolutely suck and have done you a tremendous disservice. Not to mention you both look bad to the bank. Put more than one lousy project in front of the bank and they will not take your calls in the future. This happens often; a good broker is valuable and not easy to find.

Dotting I's and Crossing T's

You might never see it, but both the bank and the SBA have a checklist of items they need before they can approve the loan.

Similarly, they have a set of standard analyses they will complete before giving the loan.

That means they will go through the documents you provide to ensure you have presented them with a complete application. In other words, all the documents discussed above are already on the required list.

Of course, the bank is accustomed to asking for more records, but you will get brownie points if you bring them all, or mostly all, of the documents right from the start.

When they have all the documents, they will go through a series of analyses and specific questions about the loan. This can be either the bank or the SBA. Even if SBA is not the route you are going, the bank will still follow SBA protocol. Here are some of those questions:

- ***After pulling the applicant's credit, does it check out?*** – The bank will verify the things you include in the personal financial statements and will evaluate your credit score. If you have a bankruptcy, it will show up. First, be honest here. Trying to pull a fast one with the bank is 100% ridiculous. If something is there, they will find it. Don't waste your time, the bank's, or the broker's if getting your loan relies on fooling the bank. Grow the fuck up! If there are blemishes, that happens. Be upfront about them and explain. The key here is you do not want any surprises. If they catch you in a lie, they will assume you have lied throughout. No business loan for you! Also, be aware that banks and brokers talk. Be smart: you don't want banks or brokers blackballing you, which ***does*** happen.
- ***Does the business look legit?*** – The bank will go to the website. They will drive by if they are close to the physical location. If it is a restaurant, they will do lunch there. The point is that the bank will do a smell test on the business. You should as well. Again, if there are obvious problems, address them upfront.
- ***Can the business support the loan payment?*** There are ratios that banks look at, and frankly, they relate very closely to the Valuation Multiple guidelines we provided you. We put so much emphasis on Cashflow multiples because the banks do! If the business meets those guidelines and Cashflow checks out, the

bank will view the loan positively. If the multiples are out of whack, it will raise concerns that the business cannot afford to service the debt with existing Cashflows. Assume the bank is wise—because they are—and that there are reasons they stick with these calculations. Put forward a request in their approval zone and you can own a business. Try to buy a company that is not within their formulas, and you are just wasting time and creating unnecessary frustration in your life and the lives of others.

- ***What are the debt service coverage ratios?*** – This question relates very closely to the one above. Banks will assume that you will only be happy with making bank payments with a certain percentage of the Cashflow generated by the business. The rule is that the bank would like to see the yearly Cashflow be at least 2X times the annual debt service payment. This says that half of the Cashflow can be allocated to debt service. If the Cashflow number is not as positive as projected, this affords some wiggle room, so you can still make the payments. Banks also know that if all the Cashflow goes to the bank, the owner will eventually get tired of this. They have seen the business owner who accuses them of being a slave wage trader. "All I do is work for the bank" is a statement the bank does not want to hear. Because of this, they use the debt service coverage ratios (DSCR) discussed here. Generally, the SBA will not fund a loan unless the DSCR exceeds 1.15. That means if the annual debt service is 100K, then the Cashflow must exceed 115K. Think about it. At that level, there is not a lot of meat on the bone left for the owner after paying the bank.

- ***How is the loan collateralized?*** Again, please remember that banks are not in the risk game. They lend you money, you pay it back. They do not receive investment-level returns. This means they cover their asses, and understandably so. Yes, the real question is, "How am I going to get my money back even if the worst case happens?" The first goal is that the business makes the payment, Cashflow grows, and the owner succeeds and needs to borrow more. This is how banks make money.

After that, they would like to see they could liquidate the business assets to cover the loan balance. Unfortunately, typically business assets have a much lower liquidation value, but the bank will look favorably on the loan if the business assets cover a substantial part of the debt. Next, they move to your personal assets. Again, you will personally guarantee the loan. The goal here is to see that, if the business cannot make the payment and the business assets won't cover the loan, a combination of your assets and your income will cover the nut. Often, they don't. This is where your favorite uncle comes into play: that is Uncle Sam and the SBA.

So yes, the bank may have its ass covered not just once but multiple times. Yes, if the collateralization is way out of whack, you can negotiate some of those points, but this, too, is part of the banking game. A smart buyer understands the concept of bank collateralization and how to discuss the matter with the bank.

Repeat after me: banks do not take risks on business loans.

As you can see, this is a detailed process. And the banks did not just make this up yesterday. No, those rules have evolved over decades, even centuries. Some involve legislation/laws and others are best industry practices. But the individual banks are not out there making up their own rules. They play by well-defined, well-orchestrated rules. It is a well-oiled profit machine.

You can succeed in business without debt. Just not as quickly or with as much scale as you can with bank debt. Putting bank debt to work in your favor is a central suggestion of the QSI investment method. This is where dramatic incremental growth can happen. Bank debt has created *a lot* of wealth in this country. Yes, many people are self-made, but rarely are they fully self-financed. Study these rules.

Walking Before You Run – How to Move Forward if You are NOT Bankable

For some of you, this is the part of the book where you are feeling low. You may be 23-years old and were not born with a silver spoon in your mouth. You have the desire and the energy, but you are not sitting on a wheelbarrow full of cash to invest in this concept.

The 55-year olds reading this book are now saying, "Wow, if only I had learned this stuff when I was 23!"

Or you may be a 60-year old who just had a bankruptcy—no judgment from the authors. Everyone knows successful business people who met obstacles. Most defaults are not because people overspend or are reckless. Illness and medical challenges happen. Or, at times, a business goes south.

Or you may be someone else not described by our two friends above but similarly feel some discouragement. We want to provide you with some encouragement.

First, let's be 100% clear. There is a shit ton of money in this world.

If you talk to private equity firms, they will tell you they rarely have trouble raising money to invest. The problem is there are not enough good deals to invest in. Now, we are not suggesting you go down to the local private equity company and see if they want to loan you $100K to buy a restaurant because the high probability is that they do not. We make this point to let you know that disciplined work and ingenuity are valuable in this world, and there are people with money to help you in several ways.

We have made a significant point in this book to highlight that nothing we are sharing with you describes a get-rich-quick scenario or anything that does not involve work, sacrifice, investment, or risk. No, to the contrary, we are suggesting this is a lot of work and requires many different elements to make it work.

> *But hustle, grit, and creativity are free. They don't look at your personal financial statement.*

Frankly, they don't care about where you have been but where you are determined to go. Go to www.ChadPeterson.com and read Chad's full bio. There were no silver spoons, and he created the concept you are reading about now!

Education is not your barrier, either. The information at your fingertips for free or little money is unmatched in the history of the world. The internet and digitization of the world's collective knowledge have made its distribution nearly free. It is a concept that was unfathomable just a few decades ago. If the authors of this book look at the world today and compare it to the world of their youth, it is almost unrecognizable.

While we want to encourage you, we also don't want you to be a dumbass.

We talk to dumbasses every day. Here is how the conversation goes:

"I was looking at your website, and you have a great business for sale for $3M. Can you send me more information?"

We are in the business of selling businesses, so when a buyer inquires, nothing will make us happier than to have a live buyer on the phone. So, we ask for an NDA and indicate that a business that size will require a $300K down payment. And we say we will happily send the information on the company, but first, we need some information supporting that a $300K down payment is possible.

Many unqualified people are cool. They are truthful. They know they are fishing with no bait. Some even apologize. They are embarrassed. Understand, we get no ego satisfaction from this. Zero.

The dumbass, however, gets evasive and defensive. We roll our eyes, knowing the person cannot buy the business they inquired about, and now they are pissed because we did our job. And we are frustrated because not only were they a dumbass, but they were also an asshole. *A dumbasshole*! We know we can't get to the closing table and get a bank behind a tire kicker with an attitude problem.

Here is a better way to go about this: *learn!*

Yes, you can access the collective knowledge of the universe with Google. But somehow, some way, with the choice of looking at millions of business book titles, you happened upon this book. Don't overlook this!

We may be arrogant in saying this, but what you have in your hands is enormously powerful. There are *many* people who have all the money in the world to implement this strategy but do not have the knowledge, energy, or fortitude to do it. Many people will be highly interested in the concept when they learn this stuff.

And you could bring a lot to that party.

So here is what we suggest: don't go it alone.

The slow way to do this is to learn the process and then spend time saving money or cleaning up your credit. This may be the wisest approach. Particularly, if you are the 23-year old, you may find a few years of saving can put you in the game. QSI does not need you to bring $200K to the table to start. Your individual circumstances will dictate how you look at the save-up concept.

A faster way may be to partner up with someone. That could be a true investor. Even more probable, you could go to work for someone who has the financial savvy to put this process in place. For many, it could change the way they look at their business. This is that different. Someone with an enthusiasm to make this happen (you!) could be extremely valuable for those people.

There are a thousand ways to make money in this world and even more ways to be happy. If wealth through self-employment appeals to you, then dig in. You can get a significant amount of valuable information much faster than most people believe. Fifteen years ago, most people didn't even know what a podcast was!

Our company has a lot of information in this area available for a low price. Make sure to scour our websites. Good people are hard to find; if you are amazingly persistent, hard-working, and resourceful, your current financial situation does not need to be permanent.

WORKING CAPITAL – A POTENTIAL ADJUSTMENT TO THE PLAN

One of the challenges of authoring a book like this is to boil complex topics down into simple concepts so the readers, regardless of their background, can get up to speed. In our case, we are trying to describe the processes of buying a business, selling a business, and using an advanced wealth-building tool. We can summarize QSI in a simple paragraph, but working through every detail can become overly complex. To keep it digestible, sometimes we simplify.

We can explain a business purchase and the financing around the business in simple terms. The last chapter covered a whole lot of ground. It's imperative. One thing it did not address, however, is the concept of working capital, which we will do here.

The topic does not come up in many acquisitions because it is a non-factor. And frankly, in many circumstances where it is a factor, the bank will willingly loan you the money for the working capital padding. So it can be a non-factor even if it is relevant.

However, other situations require more research and a deeper consideration of financing for your specific situation. We will use this chapter to explain a bit about working capital and some ways you might consider this during QSI.

So What is Working Capital?

In accounting terms, working capital is the difference between current assets and current liabilities. Technically, current assets minus current liabilities.

What it really means is the cash the business may eat in its day-to-day operations. Any dollars in working capital or *growth* in working capital require a cash investment in the company. Suppose you are buying a business from scratch. In that case, it may require a cash infusion, which may mean you may need to either allocate some of your investment cash to working capital in addition to the down payment or put in borrowing capacities to address it.

> *You do not want to enter the business without enough operating funds to get the company a strong start.*

You do not need the extra stress or pressure. This could even mean buying a business slightly under your total budget, just to give yourself a little extra cushion.

Let's look at a few simple examples of working capital.

Let's assume your business purchase requires a new entity, and that entity has not one penny on the balance sheet.

In that case, you have $0 in cash in the business. You know you need to have some operating cash, and you believe you need to put $20,000 into the bank account.

The impact of this transaction on working capital is +$20,000. You need a $20K infusion of working capital. Where does that come from? Either A) you put it in the business, which raises the cash requirement for your entry, or B) you borrow it.

Other primary aspects of working capital include the following:

Current Assets = Cash, Accounts Receivable, Inventory, and Prepaid Expenses.

Current Liabilities = Accounts Payable, Current Portion of Long-Term Debt.

Let's look at another example.

You need to buy $80,000 in inventory, but your vendors will give you extended terms on those inventories. Inventory goes up by $80,000, and accounts payable goes up by $80,000. Thus, $80,000 - $80,000 = 0. There is no change in working capital. In this example, your vendors financed your inventory.

Since working capital varies by company, we suggest you study the business you purchase with this aspect in mind. You can glean this information from the prior balance sheets. You will see how much working capital the owner maintained in the business historically. Importantly, you will also be able to see how much working capital was required to support certain sales levels. Typically, there is a correlation.

Working Capital Situations

To help sort through working capital, we will highlight some situations where it is likely to be a bigger deal and some situations where it tends to be less concerning.

The following are situations where working capital will tend to be less of a critical issue:

- When the customer pays immediately for the purchase or places an early pay deposit.
- When low (or no) levels of inventory are required to support sales revenue.
- If vendors have incredibly long terms, including if they offer some extended terms on initial purchases—you can always ask for these!
- If you are acquiring ARs as part of the business purchase. This means you are receiving the monies owed from customers and will use those early cash collections to fund some of the cash outflows. This is related to the structure of the transaction.
- If there is an overlapping payroll with the seller. In other words, they make a payroll payment to cover periods before the transaction but are paid after the purchase. This is a timing issue, but if there is a period where you are collecting customer payments and are *not* required to make a payroll payment, this can reduce the challenge on the payroll.

Study the following situations closely where working capital is likely to create a more significant challenge:

- Where you must maintain significant amounts of inventory well before customer purchases.
- Where AR collection periods are significantly longer than AP terms, for instance, if you collect from customers after 45 days but must pay vendors in 15.
- Seasonal businesses where one "good" part of the year makes up for "bad" times of the year, especially if you are starting in the latter.

We have one final comment on working capital as it relates to the ongoing nature of QSI. As you will see in the other chapters, QSI suggests steady, healthy progress and maintaining/improving the consistency of Cashflow. It places less emphasis on rapid growth.

Rapid growth, the primary goal in other companies, is not only challenging and risky, but it can tax working capital. Thus, everything else being equal, QSI places a lower requirement/burden on working capital.

Don't forget about working capital as you consider buying a company!

CONFRONTING FEAR – HOW TO NOT TALK YOURSELF OUT OF BUYING A BUSINESS

Crash!

You hear a noise down the street. You flinch, your eyes widening. You sit up straight, heart racing, and start to sweat a bit. You are in an immediate and dramatic state of alertness.

The human mind is wired for survival. In addition to those physical reactions, you immediately and passionately ask yourself, "What happened?" You may even physically move towards the noise to satisfy your curiosity. Even though it didn't affect your life and was not an immediate danger to you, your senses went into a vigilant state to protect yourself.

Fear and *fight-or-flight* reactions like this are not voluntary thoughts. You didn't think to yourself you needed to do all those things. They just happened; it was an automatic reaction.

Where did those reactions come from? Millions of years of programming go back to when man encountered more direct physical threats from things in nature: volcanoes, trees falling, or even dinosaurs. Talk to a psychologist and they will tell you this programming is in our genes—even imprinted in our DNA, and it runs deep.

For many, these boogeymen can paralyze their lives. This tendency to fear and look for excessive negative possibilities moves us out of being prudent with caution and into the realm of being downright anxious and debilitated.

> *The stoic philosopher Seneca once said, "We suffer more from imagination than from reality."*

Yes, dreadful things can happen, but we often spend more time worrying about them than addressing them. This impacts business, personal relationships, and every aspect of life. For many, money issues are some of the deepest triggers for our insecurities.

Here is a fact that we often see in buying a business: you will try to talk yourself out of it.

People, by their nature, start to believe the situation is worse than it appears; they worry they have overlooked something. They worry someone is trying to trick them or that people will think they are stupid because they did not uncover the "Achilles' heel." In our mind, everyone else sees the blemishes and warts; we are the only dumb ones who see the positives. We trick ourselves into believing this rubbish.

It's human nature. And buying a business is a big decision. As you started your search, the optimism and enthusiasm about creating a better future for yourself and your family was coursing through your veins. You walked into the brokerage to inquire about that business with the confidence of Connor McGregor with his billionaire strut. At this stage, the company is not only a vehicle but the primary agent of change.

But then doubt creeps in, both for the business and in yourself. In your brain, you tell the confident part of you to be more serious.

Optimism steps aside and allows fear to take over. You will want to tell yourself it is prudence, but it's fear. Now, in your brain, the goal is to find the terrible things about the business. You convince yourself that doom-and-gloom is better for your situation than falling victim to a con job. It becomes more about seeing what is *not* right with the business than what is.

That job, which five minutes ago was the thing that was holding you back, your own personal version of hell, now starts to look safe, even comfortable. You work to convince yourself that the things you tolerate at work are not really *that* bad. For many, it is at this point that complacency wins over taking the leap of owning a business.

This is one of the many paradoxes people find when they own a closely held business. In this case, they must be cautious and skeptical but keep their optimism and courage to win. For many, in evaluating a company, they let the fear win. They simply cannot bring themselves to act where there are risks involved. They look for and run back to safety, even if security is worse than the probable outcome of acting. This concept is what keeps people tied to abusive relationships.

> *Due diligence is essential, but it can also be just a place where you let your fears overcome your ambitions.*

There are risks to owning a business, risks you should research. Be prudent. But you should also be aware of what you are doing or—more correctly described—that your brain is catering to the fear reactions and fight-or-flight impulses that are showing up. And they are bringing a lot of things that have nothing to do with the business you are evaluating. You—and all your baggage—are now in charge.

So, in this battle for your mind, you will have to sort some things out. Every successful business owner is courageous. The definition of courage, of course, is feeling fear but acting anyway. Everyone feels fear. Everyone doubts. However, people who win in life study the lay of the land and then make courageous decisions, each with a potential downside. Do not fool yourself into thinking that successful people do not have fears. They most certainly do, as bad or worse than yours. But they face them.

Businesses meet challenges. They ask the owners to step up. We were incredibly detailed in describing this earlier in the book and hope you were listening. But most business owners will tell you that for every one challenge they encounter, they worry about 10 more. The things which do come up were often unpredictable. But they were able to respond to the surprise. Still, many of the things they worried about never happened.

> *Successful businesspeople will often say that the most important evolutions of their companies happened in the face of challenge—sometimes even flat-out terror.*

The things that pushed them to the limits also drew opportunities and ideas out of them that they had never seen before. The successes could not have happened without the struggles. A closing door reveals one which opens. This element surfaces in every aspect of the human experience.

Every business has pluses and minuses—every one. There is no perfect business. You will not find it. There are no shortages of "what ifs" you can dream up as you evaluate the company. If you must find a perfect business before buying it, you will be shopping for a long time and will never own a business.

Every person who bought a business and succeeded had fears about the company. If they purchased it, they had concerns, both before and during the time they owned it. However, they stood up and faced them. To buy a business, you will need to get here and overcome and act.

Chances Are…

This book is about an investment strategy incorporating buying and selling closely held companies. We help people buy, operate, and sell a business—even more than once.

One thing that can help overcome the concerns of purchasing a business is to look at statistics and odds. Odds and statistics can help us navigate every decision we make. Frankly, anyone taking any risk to earn any reward should be good at studying and playing the odds. It's as true for buying a business as it is for selecting things to do recreationally or even how you eat and exercise.

Owning a business has risks and rewards. However, we can confidently say that the risk of buying an existing business is less than starting a business from scratch. This is especially true of long-standing companies with a current, solid financial history. In this case, the business shows it has already survived doing what it proposes.

A startup, even within a franchise model, poses more risk. Startups rely on a hypothesis that a particular business can start and find its way.

Existing businesses have already found their way. There is no hypothesis involved; it exists. That is a fact.

We will be as bold as to say there is no safer or more probable way to own a business than the approach we propose here.

Purchasing an existing business can be recharacterized as buying a current flow of cash. Do past results guarantee future performance? Nope. But that is the case in every investment mechanism. Think playing the odds.

Remember our discussion earlier about how banks do not take risks in financing the acquisition of your business? It's true. Banks will vet the business purchase. Not just the company, but the viability of *you* in the business. At first, this feels uncomfortable and frustrating. Why do they have to be so invasive? Why so many forms and schedules? Couldn't this process be more straightforward?

However, you can turn those frustrations into a significant positive at this point in the process. When fear and doubts creep in, you can rest assured that the bank put you through their rigors and, if they have approved your loan, they are essentially putting their stamp of approval on you and the business. That is a powerful reinforcement, about the best you will find.

Another statistic about lending happens when you involve the SBA. This, too, was an added hurdle you might have had to clear. Even more requirements. More hassles to get approved. Over time, only about 1 in 72 businesses that get SBA underwriting go bad or fail. Yet 100% of buyers entertain themselves with every "what if" scenario and worrisome thought they can muster up.

Could you be 1 in 72? Certainly. Someone is. But it shows the odds and helps you see that many more people win than lose. A lot more.

This number happens because both the bank and the SBA held higher standards and would not just approve anyone—and the success rates for existing businesses are significantly higher than other ways to get into business, i.e., startups. Place some value in the fact that you and the company passed the sniff test with the bank and the government.

Another thing we are especially pleased about is that the principles found in QSI are significant risk reducers as well. There are several ways this shows up. First, when buying a business, we challenge the buyer/new owner to focus on maintaining and steadily/safely growing Cashflow. The QSI model wins by using the current, existing Cashflow to pay down debt. Many other business ownership models require significant business growth to satisfy the investment part of owning the company.

For instance, most private equity companies are looking for businesses that either can grow more than 20% per year or have the *unicorn* characteristics of growing 10X over time. Even more risky are ventures which try to *disrupt* the market. This is starting with the intention of breaking people out of their habits. Not easy!

The more growth needed to make the investment work, the riskier the business. Thus, the model reduces risk because QSI focuses on steady Cashflow and maintaining the good things already in the business. It's much easier to keep a train on the tracks than to build trains or tracks.

QSI also reduces risk by suggesting you sell one business and then purchase a larger business (NLB). Generally, the larger the company, the safer the investment. Overall, a $5M revenue business can withstand dips in the market better than one with $500K in revenue. Similarly, the larger company will also be more likely to have more employees and a management team. Thus, the business's success is less related to one or two people/rockstars and more likely related to a larger group of people. If one leaves, you can usually replace them easier than in smaller settings. This, too, reduces risk. Overall, if you approach running the business with the QSI approach, you will be taking dramatic steps to minimize risk and pull the odds in your favor. All this, and you can boost your returns!

Lastly, study the broker representing the company. Do they have a track record? Have they been in business for a long time? Do they have processes to evaluate the companies they list? With a strong broker, they will pass on many more seller opportunities than they accept and list. We kiss a lot of seller frogs but only present the princes.

For us, we know that if we were to sell a bad business, this would eventually come back and negatively affect our business. Good brokers know they cannot set up buyers to fail and expect to keep an excellent reputation and business model going forward. When the sleazy sellers approach us, our radar alarms go off, and we pass. This is a benefit of working with thousands of buyers and sellers over the past few decades. You can tap into this by buying a business represented by a stellar brokerage.

> *A healthy acquisition requires a strong buyer, a strong seller, and a good relationship between them.*

Sellers will answer questions and want to ensure you have the information you need to make your decision. However, they will tire if you ask for assurances that no business owner can ever make. They will have been down the path many times and know the business had risks and stressors for them—and that the company will also give you stressors and irritants in addition to opportunities and rewards.

Excessive questioning could eventually make the seller believe you are a worry-wort or overly negative. They know the strength they needed to muster to run a business successfully. Be cautious about exposing the seller to too many of your fears. Have productive conversations, but if it turns into business therapy, know that most sellers will not have much tolerance for this. They are judging you on your resolve and character, as well.

Owning a business is about facing challenges and overcoming them. We would all like the business equivalent of eating chocolate cake all day and gaining no weight. Unfortunately, there is no business process to do that. QSI requires a healthy tolerance for risk and the courage to confront fears. What we are proposing has engineered out about as much risk while growing returns as we feel investing in a small business can. Fear is a part of the process—not just in buying the business but also in going forward. The company will present many things to be fearful about in the future. Those who are courageous and can step up to the challenge often are highly rewarded for it.

A person who sees the cup half full will never go thirsty. The one who sees the glass half empty may not be so fortunate.

TRANSITIONS – HOW TO TAKE OVER THE BUSINESS EFFECTIVELY

We have touched on several items relating to the transition from the previous owner/seller to you as the new owner/buyer. We could easily compare this to the handoff in a football game. Quarterbacks and running backs carefully practice this move so the ball ends up securely in the hands of the running back and not on the ground. We suggest you think carefully about the transition and how you want it to go.

To recap: When you buy a business, what are you purchasing?

As we have explained, much of the return of QSI is because you can purchase a business using bank debt. This and the asset purchased—the company—will generate the Cashflow to make the debt payments or debt service. Like most buyers, you are counting on that Cashflow to remain steady to compensate you for your time and, importantly, to make the loan payment. When you buy a business, you purchase a stream of Cashflow.

We have also talked about the need to *not* turn over the apple cart, especially during the first year. Smart buyers buy great businesses which are already generating solid and steady Cashflows. Do not be arrogant—or a *not-so-smart* buyer—and think that it will automatically be better just because you own the business. Be humble and acknowledge you were wise to buy a strong company; you want to honor and preserve that performance.

This means you need to be smart with the transition.

You can sum this step up in the following way. Your goals are to:

- Reassure and retain employees.
- Reassure and retain customers.
- Reassure and retain vendors.
- Collaborate with the seller to present a unified, positive front.
- Preserve the health, stability, and Cashflow of the company.

Don't Be An Asshole

It's advice we have shared previously in the book, and it has relevance in this part of the process as well!

> *Be confident you will succeed in the business but do everything you can to never cross the line into arrogance. This starts with your interactions with the seller.*

When you go into the transition, the more you are on the same page as the seller, the better. If the seller acts like they don't like you or even talks negatively behind your back—and yes, it can happen—it decreases the probability of success.

At many points in this process, we have emphasized the value and importance of developing a collaborative attitude towards the seller.

Frankly, this is where any relationship building comes into play and is the most significant factor impacting your success. Going into this transaction on the same team as the former owner works in your favor.

The best place to start here is with respect. Demonstrate and communicate to the seller that you respect them and what they have built. Let them know you value the relationships they have built in the business to form their success.

There is no value in trying to one-up the previous owner. If you have more education, don't cram that down their throat. If you have more money than they do, don't lord that over them. If you have more experience and a background working in larger companies, use that to impress them but never make them feel bad about themselves.

We shouldn't have to explain this. It should be logical. Though, if people let their egos take over, it can be a bad move!

Once you move past the negotiation and due diligence phases, it is time to come together. Sometimes that is hard because negotiations and due diligence can be uncomfortable. As a smart buyer, it is valuable at this stage to express that there is a reason you are buying the business: it is a good company and the seller did a wonderful job building it.

Make the seller feel good that they grew something worth buying. If it sucked, you wouldn't purchase it, right? Thus, the fact that you are buying the business should convey to the owner that you have a lot of appreciation for what they have accomplished—to the point you are willing to pay to acquire it.

Go into this stage on the same page. If you need to clear the air, do so. If the seller acts offended with the process or like they don't care for you, then invest some energy into repairing that relationship. If you had to be tough with them in negotiations or due diligence, they might be harboring some resentment. Frankly, it is natural.

Think of it like this. You have something the seller wants. It might be youth. They may be jealous that you get to take the business over and capitalize on their efforts. They might be miffed that you are *rich enough* to buy the company. As an aside, most sellers—and certainly sellers' employees—assume that the new person buying the business is affluent. This is a factor to contend with, and we discuss more below. They may not come out and say it, but they may feel weird about turning their baby over to someone else.

This can be a time when you and the seller come together. Realizing they may have natural, conflicted feelings about this is wise. Acknowledge this with respect and appreciation.

When all shakes out, here is the deal. You want to come together with the seller to construct the best plan for the transition. Take in their input about how to best approach the topics. Don't ask them to do the work for you, but place value on their opinion and input. You 100% want them to think that you value them. A few questions like, "Hey, how do you think we should do this?" may go a long way to make the seller feel *valuable* as part of the transition effort.

> *Buyer and seller working together can produce a great plan.*

This plan gets formalized in the Asset Purchase Agreement (APA) which lays out some contractual parameters. The most typical agreement usually involves some time working side-by-side, followed by some time when the seller agrees to be available by phone to answer questions, explain, or help troubleshoot a situation.

If the business relies on the seller for day-to-day operations as opposed to a strong team, you may want the seller to stay around longer.

A successful transition comes down to the buyer and seller working together.

Transitions with Vendors and Customers

You can manage vendors and customers similarly. Notify customers and vendors when you buy the company and the transition happens. In many cases, you can do this in a written letter or an email.

In other situations, you may need the communications to be more personal. These would be in cases where the relationship between the customer or vendor is very personal between the former owner and that person/company. If there is a concern that Customer X or Vendor Y will be stressed out by the seller moving on, then a more personal form of communication may make sense.

This could be a phone call. It means that the seller calls their contact to tell them personally. First, the vendor/customer will appreciate that you gave such care—and that you went to the effort to speak to them personally versus an impersonal email. This conversation also provides the seller with a chance to let the vendor or customer know they are enthusiastic about the change and happy to move on to the next venture. It also allows them to sell the virtues of the new owner/buyer and what the company looks like going forward.

If the seller feels these calls should be in private, honor that. Remember, these could be business relationships that have formed over decades. In many cases, these relationships could have developed into personal ones, and it may be more appropriate to conduct the discussions in private.

Sometimes, it makes sense to have the meetings face-to-face. This increases the level of personalization and would be for larger clients or vendors and ones where the seller believes there may be some level of concern.

In those personal situations, whether by phone or in person, it makes sense for the seller to make a formal introduction. Based on how the seller feels about this, those introductions could happen on that first call or visit or in a second interaction.

As a smart buyer, you are wise to plan this out and to take the seller's input into close consideration. The seller knows these people and will have intelligent input on approaching the matter.

When you introduce yourself to the customers/vendors, try to have the following things come across:

- Enthusiasm for the new situation
- Confidence that the business will do well
- Appreciation to the seller and their team
- Appreciation for the customer or vendor and their contribution to the success of the business in the past
- Excitement about continuing the relationships in the future and a willingness to listen to the vendor/customer about how to work together to improve those relationships
- Reassurances that your goal is a continuance of the relationships and not to come in with significant disruptions
- Optimism that the future can create win/win opportunities for all parties
- Convey confidence, enthusiasm, and honesty, but never cross over into arrogance or condescension

Through the transitions, the main goal is to communicate how things will be *business as usual*. Often there will be a new company if it is an asset transaction, so you should have all the necessary paperwork to make the process easy.

If it is a vendor, it is smart to assume you will need to supply new credit information, as it is a new company. While many vendors will honor prior credit arrangements, it is considerate to be willing to provide a traditional credit application or prepared credit references.

To the extent possible, honor existing pricing and terms if possible with customers. Even if you know a price increase is coming, it is best, if possible, to keep things as consistent as possible during those first transitions. The last thing you want to do is say, "Hi, I am the new owner—and here is your price increase!"

Remember, you are forming new relationships. Treat them like you are going on a job interview or even a blind date. You want them to judge you positively and keep the relationships intact to protect the Cashflow stream you are buying. In most cases, getting these relationships off to a positive start can lead to expansions of the relationships in short order.

While you should assume the relationships are currently favorable, as you begin to interact with vendors and customers, you will, in short order, start to hear about things they would like to see improved. This can create a significant opportunity for you. So express a strong interest in continuing the conversation but try to avoid being too disruptive during the first transition steps. If people push you right out of the gate, ask that they give you a few weeks to get your feet underneath you but express a strong interest in continuing the conversation.

Vendors and customers will sometimes use these situations as an opportunity to improve their position or renegotiate. This can be to the detriment of the company and its Cashflow. The better the relationship between the buyer and seller, the closer they can work together to address these issues as they arise. Some of these discussions can lead to a significant information transfer from the seller to the buyer that may not have come up otherwise.

The buyer and seller working together is the best-case scenario!

The People Transition – Employees are the Hardest Part

The most important part of the handoff between the seller and you pertain to the employees. Each employee will have their reaction to the change, and you should expect that the responses will run the whole gamut, from being incredibly excited to downright angry.

Dealing with any potential concerns when you get to this stage can be annoying as the new buyer. By this time, you will have invested much time and money into the process. You are already emotionally invested. You will want people to respect this more than they may initially let on.

Interestingly, you will have been thinking about this for some time and have gotten very accustomed to the thought of taking over the business. However, for many employees, this will be news, which may take some time. Parts of this transition may expose you to all aspects of this process, and frankly, you should be prepared, at some level, that it will hurt your feelings.

People vary on this point. Honestly, it is not a male/female thing, nor is it a strong leader versus a weak one. It is human nature for people to A) want others to like them and B) want others to like their plans.

When it comes time to speak about a business transition, you are likely to meet some resistance to one or both of those things, including resistance based on reasons that have little or nothing to do with you.

Consider some of these things:

- Someone may have just started working for the company and made a career decision based on things said by the seller, who is now the former owner; they are worried you may not honor those commitments.

- Someone may have worked with the former owner/seller for many years and looks up to them as a mentor; they fear they will now lose that relationship.
- Someone may love their current job because they get away with many things, including things detrimental to the company; they fear you may not be as gullible.
- Someone may have thought that the former seller viewed them as a partner or a surrogate child and hoped they would transition the business to them—even give it to them; they may feel hurt on multiple levels.
- Some people may wonder if their jobs are safe after the transition, and some may have a legitimate reason to worry about this even if you don't know it yet.

We have personally witnessed these and many other things. You can go into those situations with the best intentions and have the outward appearance of the perfect new owner for the business, and those issues will still surface.

> *The more you prepare for this, the better off you will be.*

Some advice, of course, is not to take this personally. It may have been your dream to own a business for two decades, and you have saved up for years to earn the opportunity to own a business. It feels like you climbed a mountain to get there, and people will hold these little personality-based things against you?

It would be natural to feel like this is not fair. But it is your reality. Smart buyers will acknowledge that people have a right to feel the way they do but will also take responsibility for communicating a vision for the employees. How you come across in those first interactions will go a long way to determining the success of keeping the right employees.

Start with some careful planning with the seller before making any announcements. And, as mentioned above, commit many of these plans to paper. The following questions are the things you should discuss with the seller.

- Which employees are the most important to keep moving forward? And how does the seller believe the key people will react?
- Which employees will be the most resistant to a transition? And how is it best to manage communications with those people?
- Which employees are the key opinion leaders in the group, meaning those who can spread their views to the entire group? These are the key influencers, both positive and negative. What are the best strategies?

In most cases, it will be best to have an employee meeting. People tend to receive face-to-face communications better than an email or text. Likely, this starts with the seller initiating the discussion and then introducing you. It is essential to discuss and plan this meeting with the seller in advance and perfectly sync with each other.

Ideally, the seller will convey all or most of the following points in this presentation.

- The seller has decided to sell the business after concluding it is best for herself, her family, and the company.
- She is grateful for the team members' contribution to the business; without those contributions, the company would not be what it is today.
- She is proud of the company and the team.
- She is optimistic about the future of the company.
- She has worked closely with the buyer and believes you bring some significant value to the company.

- She will be cheering for the company and employees.
- She is grateful and appreciative!

When you have an opportunity to speak, try to have many of the following points come across.

- Speak positively about the seller and the business's accomplishments during her tenure. Talk positively about contribution.
- Share how you admire the company. You have decided to join the company because there are many things about it you appreciate and strengths which draw you to it.
- Convey that you and the seller have discussed the team members and their value to the company, now and in the future.
- Explain that your goal early on is not to make any significant changes—in fact, you hope to take several months to study the company to understand precisely what is working well in it.
- Express that you are excited to learn from the employees. Explain that you are certain they have great insights that you need to learn. Share that input from employees will impact changes in the business.
- Do not peacock in this meeting! Share a little about your background to show that you are bringing something to the table. Do this without bragging or being condescending to anyone in the business, especially the employees or the seller.
- Ask for their patience as you learn the ropes.
- Express that you see a bright future for the company and that you can see the company growing, which will create new jobs and opportunities for advancement with the people in the company.

Now, of course, anything you share with employees should be truthful. And you should make promises, but don't overpromise.

You want the following to come across… "Things are going to be all right. Even though there will be some changes, your jobs are safe, and we are optimistic about the future."

During the first week, take some time to observe and interview employees. We suggest you do *not* rush in with a lengthy list of changes. Some questions you might ask employees in these first sessions include the following:

- What do you love about your job?
- What do you hate about it?
- What are your three most significant challenges to doing your job well?
- What are the things about this company that makes people want to work here?
- What are the things that make the company great to customers?
- How would you describe to others what we do in this company?
- Do you feel respected within the company? Where is this strong and weak?
- Do you have the resources you need to complete your job successfully? What other ones do you need?
- Are there any steps in the company's processes that you feel are wasteful?
- What are the most significant things in your job that waste your time?
- If you could add one thing to the company, what would it be?
- If you could get rid of one thing in the company, what would it be?

Use questions like these to learn. And take good notes! You will be amazed at how much information will be shared.

As you ask these questions, one important thing to convey: do not promise immediate changes. In fact, it is better to say that you will be taking a bit of time to accumulate these ideas and that you will step back and study them all before acting.

Sometimes employees get very prideful about making these kinds of suggestions. This is what you want. It means they are thinking about them and telling you the truth. People tend to be most protective of these ideas when they are proud of the insights. You want people to share their best thoughts and ideas.

But the early learning process holds back on making too many changes too fast. Resist the temptation! They will present many things as emergencies… but most will not be. They will be urgent for the presenter but will have been around in the company for weeks, months, and even years. The point is that their solutions are not required today.

Some things may be emergencies that require immediate action. But taking a slower, more deliberate approach will communicate stability to the employees, which is a critical first message.

Asking their opinion shows that you value them and their ideas. Telling them you will collect a lot of input before acting sets the expectation that you will be deliberate about taking actions and that you value managing the business with a focus on continuity in the preliminary stages.

Transition: You

Another significant transition is yours.

You may have leadership experience, you may not. You may have small business management experience, you may not. You may have bought fifteen companies, or this may be your first.

Each company is different. Each seller is different. Each set of teams is different. Regardless, you are still going to learn something in the transition with the company.

Given this, we suggest that you approach the process as a confident student.

On day one of the transition, you will be the leader, typically with *the-buck-stops-here* decision-making power. And for most, you will not be fully prepared for that on day one. We have a few suggestions.

First is to come in with the perspective of being a leader but with a commitment to understand those you lead. This means you ask a lot of questions. We highlighted some above, but others include asking people about process steps, how they make decisions, and the resources they use.

> *One of the leader's most important roles is to set the company's strategic direction.*

This sets the tone for how the business will approach growth, customers, product development, marketing, and employees. Sticking with our suggestion of continuity, you should try, as much as possible in the early stages, to stay on the path of the previous owner. This is true, even if you know there will be significant changes down the line.

The prior owner may have been tired and only looking to exit. They may have let things get a little stale; this is common. So one of the best immediate infusions is of new blood or a new perspective. By simply bringing enthusiasm and interest, you can start to shift this. While this is not a disruptive change, it is an easy one that team members should accept widely.

This, of course, does not permit you to run around with an attitude. "We are going to change this place around here. For the past few years, you have been coasting. With me, we will get aggressive and grow this company." You don't even have to speak these words to come across this way. Bring energy and enthusiasm while respecting what the organization is and what it has done.

Leaders set the tone and direction. Hopefully, before the transition, the buyer and seller will have spent a fair amount of time discussing the company's vision. Even better, the two have worked together to merge the current picture into a future vision. With this, you, as the new owner, can come in with an appreciation and understanding of the path and a vision for the future.

Rather than start with changes, we suggest you highlight the positive things that will not change. Our best suggestion is to seek out the things that are working and well ingrained in the company. If they have not yet been labeled, just doing this can help. We suggest an attitude that follows this kind of statement:

"I've noticed XYZ a lot in the business lately. That is great, and I believe our customers must love it and that our employees like doing business that way. Am I on track with this thought?"

If you can have these kinds of conversations, you will start to hear the employee having a reaction that goes something like this:

"Wow, the new guy really gets it. He understands us and the way we do business. I am going to like this change."

> *Leadership, thus, sets the tone and the vision, but with an approach to maintain the Cashflow. It can be a situation that acknowledges the past without overturning the apple cart and simultaneously starts to identify improvements the team most seeks.*

If you are quiet and listen enough—instead of talking too much—the team will tell you precisely what they liked about the past and want to keep. As well, they will tell you what they think should change going forward. We believe this approach to leadership during the transition will serve you and the company best.

On a related point, you will find that people will bring the new boss decisions to make. Your first response might be simply to answer the question, establish your authority, and even *wow* them with your intelligence. We suggest you not. There are several reasons for this.

First, employees may be testing you. They may want to see how you approach things. If you answer quickly, without requesting input, it paints you as a more authoritative type of leader, even more *manager* than *leader*.

You are also setting the tone for the decisions you want to make. As time goes by, you want employees to become more capable of making decisions themselves. In fact, the issues employees are bringing to you may be issues they would typically address themselves. They are assessing the situation to see if they should answer the question themselves or if you want to.

Seek opportunities to take a coaching approach instead of a managerial one. A manager answers the question so the employee does not have to. All the burden of the decision moves from the employee to the manager/you. So they bring you a challenging issue. If you decide and it ends up being a mistake, then it is on you. This is a standard accountability deferment technique that tests a new owner.

A coach noodles around with questions about the situation. Let's say Mary comes to you with a decision about changing the monthly budget for Facebook advertising in the business. In our little fictional scenario, let's assume Larry was the previous owner, and your name is Bill.

Mary: Hey Bill, how are you today? A question came up. The agency is suggesting we increase our Facebook ad spend from $2K per week to $3K per week. What do you think?

Remember, Mary expects you to answer the question and wants to defer the question to you. And many new business owners will jump right in to answer the question.

Here is an alternate approach, one more modeled after coaching:

Mary: Hey Bill, how are you today? A question came up. The agency is suggesting we increase our Facebook ad spend from $2K per week to $3K per week. What do you think?

You: Hi Mary. Thanks for bringing that question to me. It's an important one and something we really should discuss. But rather than answering the question directly, let me ask you a few questions. Is that okay?

Mary: Absolutely. What are your questions?

You: First, in the past, is this a decision that you made, Larry made, or the two of you discussed together?

Mary: Actually, Larry always deferred those questions to me. I kept him posted on the decisions, but largely he trusted my judgment.

You: Hey, that's great. Larry is wise to trust his people. Let me ask you this: when issues like this came up in the past, did you feel comfortable answering them?

Mary: Yes. Some decisions are easy, but others not so much. Larry really didn't like talking about advertising and didn't even like talking about anything that was newer technology.

You: So, if I could restate this, there are many decisions you feel good about making on your own. But on more complex issues, you would like to have a little more participation from me than Larry provided. Is that a correct summation?

Mary: Yes, that covers it. Yes, I think so.

You: That's great. So, first, I need to stay out of your way and let you do your job. With your experience, I will be like Larry and trust your judgment. But in those instances where you would like someone to bounce around ideas with, I want you to feel like you can come in and we can discuss. Does that sound fair?

Mary: Yes, in fact, that sounds awesome.

You: Super. I want you to spearhead your projects but never feel like you are on an island on your own. So, going back to your question about the agency suggesting we increase our Facebook budget, is this one of those decisions you feel you can make on your own or one you would like to discuss?

Mary: Truthfully, it is an easy one for me. Let's leave the budget exactly as it is.

You: Well, then that's easy. Let's leave it as you have suggested. In fact, let's use that as a guiding principle for other related questions. If it isn't broken, let's not try to fix it. At least until I get my feet under me a bit better, and then you and I can have a more intelligent conversation. But for now, you are the expert, and I trust you. Sound good?

Mary: For sure.

You: I think our approach should be to keep our current strategies, especially those we feel are working. In fact, we should be on the lookout for advertising and other vendors trying to upsell us on several things just because there is a new guy around. Do you agree?

Mary: That sounds really good to me, Bill.

You: And I bet as we move along, you may have some suggestions on things we are currently doing that we shouldn't be, as well as some things that we are not doing today but you believe we should. Is that right?

Mary: Yes, that is the case, as well.

You: Okay, we can have that conversation. But can we agree that, unless there is a big problem, we stay the course with our marketing strategies to support the success we have built to date, and then, a bit further down the line, you can present your ideas to me for how we might improve things?

Mary: I would like that very much.

You: Great! Give me a bit to get my bearings. I will eventually bring some ideas to the table, and we can compare notes to improve things even more. Are you up for that?

Mary: Of course, you are the boss.

You: Well, I am the new boss for the time being, and my goal is to reassure you that I'm not going to come in here and turn everything upside down.

Mary: Good. Pleased to hear that. We have a good team and a successful approach.

You: That's exactly what I want to hear. And I also want the team to feel my support. If it comes up, you can reinforce to them that this is the approach we will be using here out of the gate. I don't want people worrying that the new guy will come in and make a ton of unnecessary changes. Can you do that for me?

Mary: Certainly. I think a few people would appreciate hearing that.

You: Fantastic! Great talk. Feel free to bring those items forward at any time.

It would have been much faster for Bill/you just to say, "No, let's keep our Facebook budget the same." But look at how much different the conversation would have been. Mary could have taken many steps back as a manager and sucked you into the muck of day-to-day decisions when she is completely capable of making decisions on her own. Not to mention, the organization would be in fear of how you might want to micromanage things.

Can you see the value of asking many questions versus being a know-it-all with every answer? And the bottleneck of being the guy who must make all the decisions in the company?

Smart transitions can increase the return you gain from the QSI model.

THE RIGHT BROKER – HOW THEY HELP BIZ BUYERS

In the current world of acquisitions with closely held businesses, brokers play as critical a role as they do in real estate transactions. Though, we would strongly point out that what makes a great real estate broker—even a commercial real estate broker—has little, if anything, to do with being a good business broker. A business is not a physical piece of property and vice versa.

We will reiterate the earlier caveat: business brokers authored this book. We think our experience brings a lot to the table and believe we are pretty damn good at what we do, but you are hearing about brokers from brokers. Our hope is, by sharing our experience and opinions, you will be a more informed buyer and hold any brokers you are working with to an extremely high standard.

Unlike real estate, where there is typically a buyer's agent and a seller's agent who work together in business transactions, the broker is hired by and paid by the seller. In most situations, the buyer will have significant interactions with the broker but does not hire them directly.

For some, that raises concerns about whether the broker works for the seller at the buyer's expense. From our view, while the seller technically pays the broker, the buyer's money makes the transaction happen. So, rather than being on the side of the seller or the buyer, a strong broker represents the transaction.

In some ways, the business seller chooses the broker you work with. If you wish to buy Business A and they are working with Broker B, then they have selected the broker you work with on that deal, regardless of whether Broker B knows what the hell they are talking about or not.

You take a bit more control when you review their listings for a business to purchase if you like a specific broker. In that case, you select the company and the broker you wish to work with. You should, however, only buy a business that matches your criteria.

Have we seen circumstances where clients have asked us to help them, as the buyer, with purchasing a business that we did not represent? Yes. And we have done so for a fixed fee. Normally, the seller hires and pays the broker from the proceeds of the transaction.

As a buyer, you need to know the process yourself. If you have read this far in the book, you are well on your way to that.

But you must also hold the broker to task and make them accountable to you as the buyer in the transaction. You need them to perform.

Before we move forward, however, we want to remind you that for every successful transaction, there is one seller, one actual buyer, and 25-50 other prospective buyers. That means the broker's job is to screen through 50 potential buyers to find just one.

> *Chad has a saying in our brokerage. "A seller lead is worth gold. A buyer lead before the screening is worth a penny. But once the buyer is qualified and is the actual buyer, they are also worth gold!"*

Do you see how this works? If you can understand this part of the process, you increase your odds of success.

At the screening stage, brokers are typically going to ask you for two things: an NDA and a PFS. These are the primary screening tools. Have them ready and be willing to share this information; the process requires these documents.

Being demanding at this earliest stage of the game is usually a red flag to brokers. Refusing to supply the required information, and very often the related ego statements, is a dead giveaway that you should be screened out.

Well-qualified buyer = "Here is my NDA and personal financial statement."

They are confident they meet the criteria of a great buyer.

Unqualified buyer = "Why do I have to provide that information; do you know who I am? I am interested in buying this business. You need to do what I ask, as I am the customer here."

They know they are not qualified and are trying to fool us.

As brokers, we can tell you with 100% certainty that a well-qualified buyer stands out in the crowd. If you want us to treat you like gold rather than pennies, understand the process and make it easy for the broker to put you into the *qualified buyer* bucket instead of the *yet another tire-kicker* one. You can change how the broker works for you by working *with* their process instead of against it.

Before we move on, here is an additional reinforcement of this point. The real numbers are like this: less than 1 in 20 buyer prospects come to the process prepared with the NDA and PFS already prepared and willing to sign it/provide it. In the other 19 situations, we must explain why we need the information and usually meet resistance. Often in those 19 situations, we must follow up and chase the information.

Think of the impression you make if you are the one person in 20 who comes to the transaction well prepared and willing to engage the broker in the process that they will insist upon anyway. Just by doing this, you separate yourself from the crowd and immediately get better service.

From that, you can ascertain how brokers spend over 50% of their time with bullshit that never amounts to anything and less than 50% of their time working on real stuff, like putting a transaction together. If you come to the process respecting the broker's time and not being like the others who have no problem with wasting the time of other people, then you should get the higher level of service you rightly deserve.

This is an excellent, unbelievably simple, and free way to get a lot more support from the broker. Come prepared to sign an NDA and share your personal financial information.

What Brokers Do for Buyers

If the broker represents the transaction, then a good broker works on behalf of the seller and the buyer with the recognition that both need to be successful for the transaction to work. Don't think because the seller hires and pays the broker that the broker does not work for the buyer. They do.

Even if you just think of it from the sales perspective, the broker wants you, as the buyer, to be happy for selfish reasons. When you sell the business, which you will, the broker wants you to think of them. They know you may buy another company and want to cultivate the relationship.

Finally, they know you will interact with other business buyers and sellers and want to earn your referral. A good broker knows you will only refer if the transaction is successful for you. That means the business transfers well and succeeds.

Knowing the process is a crucial element of the value the broker can bring forward. If you read this whole book and study it, you will know the process well. You may even know it better than some inexperienced brokers! However, a good broker will understand the process and work with you to navigate it successfully.

As a broker resource for buyers, one of our goals is to be an outstanding ally to our clients. Many people who are business buyers have never done this before. Having trained many people through this process is one of the reasons we feel confident writing this book! Knowing the process, we know the questions people have at each step of the way and know some of the resources our clients will need.

The broker's contact list (Rolodex, for you old timers!) should include many business resources. Things like banks—not just the name of a bank, but actual individuals they suggest you speak with—business insurance agents, accountants, and website resources for business registrations. We even suggest business coaches and marketing agencies as resources for the client. A strong broker should guide a buyer through the process.

Another key element from the broker is this: things come up in transactions to derail the process, and you want the broker to jump in to resolve these things. This can be things relating to the seller or financing. But when problems come up, you want a broker who can help put the deal together.

In many instances, the strong broker saves the deals because she gets people back on track and keeps them there. A good broker can be firm when they need to be; this also helps you.

Taking charge of the transaction helps you keep elements on track and can go a long way to assure you of things. As we discussed, it is natural to get cold feet about deals. You can look to the broker for reassurance. Yes, if they work for the transaction, they will do what they can to keep the transaction together, including keeping the seller focused on productive deal completion.

But remember that both you and the seller came into the process with the hopes of completing a deal. A good broker will go to bat for the transaction and help you with the process. If they do not, ask them to. It's their job.

Even if Things Don't Initially Work Out

Buyers can gain much from broker relationships, even if things don't immediately come together. Here are a few example situations where the ongoing nature of the relationship produces value.

Imagine you find the listing information on Company Z and contact the broker. You learn that this company already has an offer on it. But the broker speaks with you and understands what you are looking for, only to find out they have another listing that is even better suited to you.

You speak with the broker about a listing but decide it is not suitable for you. In two weeks, that broker has a deal fall through because the other buyer had qualified with the bank but did not qualify with the SBA. Thus, a listing that was previously not available is now back on the market. The broker sends an email stating that this deal is prepared, including bank approval, for a buyer who can qualify for SBA.

Have you ever heard of a residential neighborhood in your area where the homes are exclusive? Often listings for these homes never hit *Zillow* or *Realtor.com*. You must know the listing broker to see the listing. And they usually have five offers before even hitting the MLS listing! In that case, it pays to know the realtor!

Something similar can happen with businesses. Strong brokers will cultivate an extensive database of prospective buyers. Our database has thousands of buyer prospects. When we have a new listing, we will broadcast that to those buyers, many of whom are institutional buyers who buy businesses for a living. Yes, the strongest ones often get early interest.

This does not mean that a business listed for a long time is not a good business. The average listing takes six to nine months to sell. So, the timeline is significantly longer than the average personal home, which usually sells within four weeks. But it pays to be on these lists and see businesses before others do.

Study the Broker for Clues

The way brokers behave will give you some clues about the listing.

Earlier, we mentioned that if the broker does not require an NDA or PFS before sending you the CBR, this might indicate the broker is not being as discriminating about the buyer, potentially saying the listing is not as strong or that the broker does not know what they are doing—both are possible.

Similarly, how thorough the broker is with the intake process—application, NDA, PFS—and the overall process will tell you some things. First, understand that brokers interview sellers just as much as they do buyers, and often in a comparable manner. A good broker will not list a bad business; they know that the short-term win quickly results in a long-term loss. Brokers do not want to gain a reputation for listing any company that comes along.

If the broker is thorough with you and follows a more organized process, you can assume they have a similar approach with sellers. If you feel like the broker made you jump through a few hoops to prove you are a good buyer, you can assume they do the same with sellers.

> *Great brokers bring together great sellers with great buyers. Others may just be scrambling for commissions.*

Another element that can provide some tipoff is how creative the broker is. Can they tell you things they would do if they owned the business? Can they brainstorm with you about growth strategies? Can they offer suggestions about financing? Do they have marketing ideas? Are they sincere about opportunities within the business to correct current weaknesses? Are they an incredible resource?

The broker who can do these things shows they are more on the ball than the broker who just collects CBR information, designs a blind ad, and lists the business. You want to engage with a broker who comes across like a businessperson. Better sellers gravitate towards stronger brokers and are repelled by mediocre ones. As you look at a broker, think to yourself, "Why did a seller choose this person?" If the answer is strong, that tells you something about the listing and the broker.

Think about this as you consider how you shop for a business.

The right broker can make or break the deal. If you buy the business, some of your money, upwards of 10%, will go to the broker. So, challenge yourself to get what you are paying for.