Buying a business instead of starting one

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Sam was typical of many aspiring entrepreneurs. He had a paper route as a kid and worked for several companies as a young man, including J.C. Penney, where he discovered a passion for retail. After college and a stint in the armed services, he decided to pursue the path of business ownership. Rather than start a business from scratch, he borrowed $20,000 from his father-in-law, added it to $5,000 he had in savings and bought an existing franchise location, a Ben Franklin general merchandise store.

This purchase served as the platform for what became a successful business. Sam focused on providing a wide range of goods at discounted prices, kept the store open longer than his competitors, and was good at negotiating lower prices on orders from his suppliers. He quickly became the top seller in the franchise within a six-state region. Sam opened several other stores with the help of his brother and various in-laws. His sons also became actively involved in the family business over the years, which provided a good living for everyone.

Buying a going concern seems like such an obvious, common-sense approach to business ownership, and yet the thought doesn't even occur to many entrepreneurs. The dot-com era popularized the notion of businesses started by college students in garages, basements and dorm rooms and then sold for billions (often without having generated a penny of profit). Those stories are amazing, to be sure, but what about those of us with aspirations that lean more toward Main Street than Wall Street?

According to many, it's a buyer's market right now. The last year has produced countless stories of business owners with cash in the bank taking advantage of a "shopper's paradise," seizing the opportunity to grow through acquisition. If you've been planning to start your own venture — or expand your current operations — consider some of the advantages of buying an existing business:

Less risk

Some entrepreneurs think it's cheaper, and therefore less risky, to start from scratch. But risk is relative. Take the example of an established business with a $1 million asking price and consistent annual cash flow of $350,000. Compare that to taking out a $250,000 loan to finance a start-up, where projections may or may not be realized. Assuming you make a reasonable down payment, a bank may be more willing to finance the $1 million transaction with historical revenue and enough cash flow to service debt than the smaller loan for an unproved concept.

I've met plenty of bankers who have given me the cold shoulder because they assume I work with start-ups. When I clarify that I help people buy and sell existing businesses, their chilly exteriors begin to thaw (a little). Buying a business versus starting one definitely tips the risk/reward ratio in your favor.

Don't forget the opportunity cost associated with starting a business from scratch. What is the total cost if the start-up fails? In addition to your initial investment, you've spent one, two or possibly three years without income or the ability to save and invest. If purchasing an existing business seems pricey, make sure you're factoring in all of the costs associated with start-ups — both money spent and income forgone.

More cash flow

The purchase of an existing business is typically structured so the buyers can a) cover the debt service, b) pay themselves an owner's salary and c) have something left over to take the

business to the next level. This eliminates the entire “ramen” (a k a starvation) phase associated with start-ups. It’s not unusual for a start-up to take anywhere from one to three years to make a profit.

“Sales will be generated the day you take over,” explains Richard Parker, president and founder of Diomo and an expert on the business-buying process. “In fact, when done right, you can get the keys to your business on Monday and take a paycheck on Friday.”

Established infrastructure

When you buy a business, you can immediately focus your energy on running, improving and building the business. The sellers have already taken care of the heavy lifting associated with starting the business. They’ve built the infrastructure with operational necessities like computers, phone systems and furniture. They’ve developed policy and procedures, and they’ve forged relationships with suppliers. These are all things that take an enormous amount of time, money and energy and don’t always generate direct or immediate cash flow. And there maybe other less tangible benefits associated with buying an existing business, such as an established brand and customer base, a proven business model and a team of trained employees.

Of course, there is a right way and a wrong way to approach the process of buying a business, but that will be the topic of future posts. Buying an existing business certainly worked out for Sam. He bought the corner store back in 1945 and turned it into the largest retailer in the world.

New York Times, New York, Nov. 4th 2009, Small Business, online.