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Avoid these Five Mistakes in Buying a Business

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1. **Failure to verify all data**. Most buyers accept all the information and data given to them by the seller at face value, without verification. Thorough due diligence is **critical**.

2. **Buying on price**. Buyers don't typically take into account return on investment (ROI). If you are going to invest $200,000 in a business that returns a five-percent net, you may be better off investing in stocks and commodities or putting your money in municipal bonds or your local bank.

3. **Cash shortage**. Some buyers use all their cash for the down payment on the business, though cash management in the startup phase of any business, new or existing, is fundamental to short-term success. They fail to predict future cash flow and possible contingencies that might require more capital. Further, there has to be some revenue set aside for building the business via marketing and public relations efforts. If you have $500,000 to invest, make sure you don't invest the entire amount. Although figures vary from industry to industry, a common contingency amount is 10%. You should also set funds aside for working capital –typically enough to cover three months' of expenses.

4. **Heavy payment schedules**. Buyers often overestimate their revenue during the first year and take on unduly large payments to finance the purchase. Generally, however, revenue rarely pans out. During the first year of any operation, the owner experiences numerous non-recurring costs such as equipment failures, employee turnover, etc. It makes sense to have a payment schedule that begins fairly light, then gets progressively heavier.

5. **Buying all the receivables**. Although it generally makes good sense to buy the seller's receivables, receivables that are 90+ days are frequently uncollectible at par, if at all. Preferable alternatives include:

- Not buying 90+ accounts receivable and paying the seller any amounts that are collected, if and as they are collected
- Severely discounting 90+ accounts receivable
- Offsetting uncollected accounts receivables against the deferred purchase price

If you spend time reviewing the deal, performing independent due diligence and making sure that you have enough cash reserves to finance the purchase and the first year's operations, you will avoid potential pitfalls position your business for success.

About the author: Susan E. Wells is a partner at the Phoenix law firm of Jaburg Wilk. Her corporate and business practice encompasses all aspects of business transactions and commercial relationships in numerous industries, including franchising. She has extensive experience representing both buyers and sellers. Susan can be reached at 602.248.1034 or sew@jaburgwilk.com.

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