A YOUNG ENTREPRENEUR'S GUIDE TO BUYING A SMALL BUSINESS

by

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Abstract

Each year, over 500,000 businesses with less than $5 million in sales are sold. This total doubtlessly includes purchases by thousands of young professionals who decide to realize their career aspiration of managing a small enterprise. In the academic literature, there is a wealth of information to support young entrepreneurs starting-up a company, but little to aid in the process of purchasing a firm.

This thesis utilizes my recent experience in trying to buy a small business to provide a resource for others taking on this challenge. The thesis is divided into two main sections, general advice to the young buyer and information on channels through which a young buyer might locate and purchase a small firm. The general advice section includes information on areas such as the challenges of locating a small company to purchase, methods of structuring a search, and financing the purchase a small company. The section on the channels available for locating a small business to purchase identifies the channels through which buyers and sellers of a business are often linked, and analyzes each of these channels. This analysis includes suggested approach strategies to each channel, strengths and weaknesses of each channel, my particular experience with each channel, and the probability that each channel might eventually lead the buyer to a transaction.

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The Young Entrepreneur's Guide to Buying a Small Business

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SECTION 1

INTRODUCTION/RESEARCH METHODOLOGY

SECTION I - CHAPTER 1
INTRODUCTION

Approximately 500,000 businesses with under five million dollars in sales change hands each year.[1] Buying and building a business can lead to substantial returns on investment that any Wall Street arbitrageur would envy. According to a recent report on the Public Broadcasting Service's Nightly Business Report, activity in sales of small businesses is skyrocketing[2]. In a 1986 survey of small businesses conducted by Arthur Andersen, 53% of all companies surveyed were approached about selling their businesses in the past year.[3] The competition for businesses which are for sale is often fierce. The Arthur Andersen survey also indicated that 33% of all business hoped to grow through acquisition.[4]

This thesis is intended to provide a realistic depiction of the young entrepreneur's process of locating and purchasing a small business. Unfortunately, I will be quoting few eminent sources on the subject, as few apppear to exist in this area. Instead, I will focus upon a four month intensive search that I performed in early 1987 to locate and purchase a small business, and upon the benefit of extensive research and numerous interviews performed while undertaking this search process (See Research Design/Methodology Chapter - Chapter 2).

While the title of this thesis refers generally to a young person's search to buy a small business, the target audience of the paper is actually a subset of this group. This thesis specifically addresses investigations by buyers with a professional background, who seek to purchase a non-retail company. The concept of a search is also primary in this thesis. My focus is on young entrepreneurs who make a conscious decision to try to buy a business, and then set out to realize this goal. Buyers fortunate enough to have come upon an opportunity prior to deciding to make a purchase (such as family members in a family-run business), may be better served by consulting one of the many books on operating rather than locating a small business. Finally, my experience and base of interviews is essentially limited to the Boston area. While this thesis is geared toward buyers in that area, studies of similar urban centers would likely duplicate its conclusions.

This thesis consists of three sections. The first includes this brief introduction, as well as a description of the research methodology employed in creating this thesis. The second section consists of general advice which is useful to a young entrepreneur and is unavailable from other sources. This section specifically allows the potential buyer to gain a better understanding of the activities and difficulties involved in the buying of a small business and in its operation. The caveats highlighted in this section will help other intrepid entrepreneurs avoid the many pitfalls of the purchase process. In addition to offering necessary warnings, this section details means to streamline and maximize the effectiveness of the purchase process, finance the purchase, and practical advice on the logistical side of conducting a search.

The third section of the thesis will consist of a directory of the channels through which a young entrepreneur might locate and purchase a business. Two of these areas, business brokers and direct contacts with company owners, were found to be significantly more promising than the others that I pursued. I have accordingly devoted significant space and effort to analyzing these channels.

SECTION I - CHAPTER 2
RESEARCH DESIGN/METHODOLOGY

This chapter describes the research methodology employed in producing this thesis. Most important to note is that my research was performed while I was actually seeking to purchase a small business. This search was performed between January and May of 1987. In January, I attempted to locate published information sources which could assist my efforts in locating a company. In part, this thesis is a product of my frustration at having been unable to locate suitable sources. My goal is that the thesis might support the efforts of other young buyers, hopefully providing a resource which will reduce the time they find necessary to locate an attractive acquisition candidate.

My initial research methodology was relatively simple. I interviewed any person that I encountered who I felt could provide insight on the process of buying a small business. Interviews broadly discussed the idea of a young entrepreneur purchasing a business, and the interviewee's particular area of expertise. Wherever possible I obtained estimates from interviewees on industry norms.

Initial interviewees fell into two primary groups: Individuals familiar with the purchase of small businesses from personal experience or through making purchases as representative of a corporation; and professionals serving as intermediaries to small business sales, such as business brokers and bank commercial lending officers. These initial interviews allowed me to gain a basic understanding of the small business purchase process, and led me to additional sources of information and assistance.

The search took on a more formalized structure as it progressed. Throughout the process my goal was to locate and concentrate upon those channels of assistance which held the greatest potential for providing an attractive acquisition candidate. I focussed iteratively on particular channels, concentrating upon a channel until it no longer appeared efficient to spend time increasing my contacts within it. The treatment of each channel is consequently not equal. Some areas, such as business brokers, led to roughly thirty interviews and a chapter in this thesis. In other areas, such as small investment banks, I felt it advisable only to invest the time required to perform two interviews and to write a few pages of text. My experience in approaching each of these channels constitutes chapters eight through ten of the thesis.

To summarize the activity of my four month search, I interviewed four former buyers - three of whom are now presidents of small firms, six retail business brokers, eighteen corporate business brokers, three venture capitalists, two directors of acquisitions at diversified corporations, seven bankers, nineteen small business owners, four accountants, two small company investment bankers, one small company lawyer, one director of the 'work-out' loan area of a commercial bank and staff at the SBA and Federal Bankruptcy court. The majority of these sixty-eight interviews took place over the phone. In addition to these interviews, I sent approximately two hundred letters to potential sources of either information or acquisition targets. During my search, I analyzed seven serious purchase candidates and entered detailed acquisition discussions with one company.

My initial goal was to limit the thesis to a discussion of the channels available for locating small businesses. But, in interviewing the sources mentioned above, I felt that the general information which I was accumulating contained sufficient value that it would be a disservice to withold it from a prospective buyer. This general information comprises the first seven chapters of the theis.

While my activities of the past few months were generally motivated by my desire to purchase a company, at each stage of the search process I was diligent in accumulating information which would be useful to include in this thesis. The dual motivations of my search, to locate a company to purchase and to write a thesis on the purchase process, prevent me from disclosing the names of the individuals whom I contacted during the process. Many of these individuals were unaware that I was writing a thesis, and I did not disclose this fact because I feared of compromising my position as a prospective buyer. Releasing interviewee's names would therefore represent an invasion of these individual's privacy. Instead, in footnotes where I have referred to or quoted these individuals, I will give a general description of the interviewee as well as the date of the conversation.

One of the great difficulties in assembling a guide to aid purchasers of small businesses is that no data or formalized standards exist in this area. In many cases, my research was sufficient only to allow me to make my own conclusion on an issue, rather than to make a statement of fact. I have disclosed these personal conclusions in this thesis (often supported by a quote from a market participant), if only to be used as a starting point for the prospective buyer. While I would have ideally tested each of these conclusions on a broad level, the nature of the small business market and the broad scope of the thesis precluded me from performing this analysis.

SECTION II

GENERAL INFORMATION ON BUYING A SMALL BUSINESS

SECTION II - Chapter 3
Challenges Involved in Buying a Small Business

The Process of Buying a Business

Purchasing a company can be divided into four stages. The first stage invoves goal definition. Here, the would-be purchaser resolves that buying a business is the correct career decision, decides upon the type of company to acquire, determines a desired geographic location, and calculates a range of purchase prices and terms. In the second stage, the buyer attempts to locate companies which satisfy the requirements determined earlier. The third stage includes the courting of sellers - interesting them in selling their business to you. Finally, the fourth stage consists of negotiating a purchase price and closing the deal.

As stated earlier, this thesis is designed to provide information on those aspects of purchasing a small business which are not covered elsewhere in the literature. Consequently, I have not allocated equal time to the four stages of the process. The first stage, for instance, is very much an individual decision, akin to the traditional job/career decision. This topic is covered in depth in several books on job selection, most notably the perennial best-seller What Color is Your Parachute.[1] Aside from providing possible insight on those facets of the search process which are not generally available (see next section), I have not addressed this stage in depth. The second and third stages of the acquisition process make up much of the content of this thesis. I will discuss the channels through which one might locate a company, and suggest ways to approach these channels. Very little space, however, will be allocated to the fourth stage of the process. This is a function of my only having been peripherally involved at this stage, as well as the abundance of material available on negotiation.

Challenges Faced By a Young Entrepreneur In Acquiring a Small Company

A tremendous amount of analysis and introspection typically occurs before a young entrepreneur begins the process of buying a small company. The commitment of time and financial resources required in performing a search justifies this analysis. Like me, the first step of many young entrereneurs is to consult the existing literature to learn as much as possible about the purchase process. Unfortunately, the literature appears to consist of single chapters within general books about entrepreneurship. These chapters contain only general information on buying a company (as opposed to starting a firm) and on financing a purchase.[2] Nowhere is there a realistic description of the process involved in locating a small company to acquire or information on the less glamorous aspects of a search. To fill this void, I have assembled in the following pages my perceptions of the challenges involved in buying a company. A prospective buyer should weigh these issues heavily prior to entering a search. In discussing these issues, my intent is not to discourage the young entrepreneur, but merely to shed light on the difficulty of completing an acquisition.

There are five paramount concerns that make the process of buying a small business potentially disheartening for a young entrepreneur:

a) The tremendous competition for businesses which are for sale.
b) The constant questioning of young buyers by market participants.
c) Difficulties experienced by young buyers in

obtaining financing.

d) The time involved in completing a transaction.

e) The low likelihood of success for a young buyer.

f) Issues related to working in a small business environment

Competition for Available Businesses

Many of the business intermediaries that I interviewed observed that for every potential seller of a marketable business, over twenty potential buyers existed. When working with sellers, this oversupply of buyers allows business brokers and other intermediaries to 'cherry-pick' the buyers which they believe will be most attractive to a seller. This intra-buyer competition is played out upon the dual criteria axes of buyer financial resources and buyer credibility. Buyer financial resources considers the magnitude of funds to which a buyer has access, the content of those resources (cash vs. borrowing against assets vs. commitments from investors), and the financing terms which the buyer would require (in terms of owner financing). Buyer credibility includes the factors of general experience, experience in the seller's industry, and age.

The general level of financial resources and credibility typifying buyers in today's market astounds me. When speaking to the head of the troubled loan department at a large Boston bank, the lender pointed to a pile of solicitations on his credenza which consisted of corresondence from individuals and firm's searching for businesses to acquire.[3] The lender stated that most of those buyers had at least fifteen years of experience in a particular industry and over one half million dollars of investable personal funds.

Prospective young entrepreneurs also face stiff competition from large corporations in the acquisition of small businesses. According to a 1986 survey conducted by Arthur Andersen, a third of firms questioned had attempted or were attempting to grow through acquisition.[4] Needless to say, these well-established corporations enjoy considerably more initial credibility than an untried, if eager, individual. And these well-financed operations often offer to pay the entire purchase price for a company in cash, rendering the competition for an under-financed young entrepreneur more formidable.

With 'high calibre' individuals and corporations competing to purchase the attractive companies which come to the attention of market intermediaries, young entrepreneurs must work very hard to convince an intermediary to even show him or her a deal. In fact, many young buyers have difficulty even locating some types of intermediary, such as corporate business brokers. (This problem will be discussed in depth in the business broker section of the thesis. Section III - Chapter 8)

Adding to the young buyer's difficulty in attracting the services of intermediaries are the factors that young entrepreneurs traditionally pursue smaller transactions than other acquirers (leading to lower commissions for the intermediary), and that young entrepreneurs usually require higher levels of owner financing than other buyers. Facing the combined weight of these disadvantages is one of the most challenging aspects of buying a company. One must either surmount these apparent deficiencies or avoid them, perhaps by seeking acquisitions through channels not employed by corporations or high-calibre individuals.

Many young entrepreneurs might wonder whether intra-buyer competition is really important. After-all aren't sellers really just concerned with the price that a buyer will pay for a company? One of the flaws in this reasoning (other faults will be discussed in the description of sellers in the next chapter) is that sellers usually only want to interact with one buyer at a time. If a buyer is not high on an intermediary's priority list, his or her chance to evaluate an attractive company may never come.

Constant Questioning of Young Entrepreneurs

Even outside the realm of potential intermediaries, young entrepreneurs are constantly being analyzed on the financial and credibility dimensions listed above. When contacted by a young buyer, one of the first things to go through the mind of a small company owner-president is 'Who is this young guy?', 'What is his experience?', and 'How does he think he can get together the funds required to purchase my business?'. This situation where the seller regards the young buyer as highly aggressive often leads to an uncomfortable initial meeting with a seller.

Difficulties in Obtaining Financing

Having youth and limited work experience makes it very difficult for a young entrepreneur to obtain bank lending facilities or investments from institutional sources such as venture capitalists (see Chapter 5 - Financing the Purchase). An experienced buyer can often examine a deal without the comfort of pre-arranged financing, knowing that funding can be arranged if an acquisition opportunity is sufficiently attractive. This luxury is not available to a young buyer. Regardless of experience, business acumen or holdings in non-liquid assets, the young buyer has a far greater need to assure a seller up-front that funding is obtainable should it be necessary, as there exists a high perceived risk that the young buyer will not find financial support from any source.

Time Involved in Completing a Transaction

There are three reasons why a young buyer should expect that it will take him or her longer to buy a company than it would an older counterpart: First, a young buyer often needs to exploit non-traditional channels to avoid his or her competitive disadvantage versus other buyers. Second, the young entrepreneur typically relies on owner financing, which is often difficult to obtain. Finally, young buyers are generally less well accepted than more established buyers by sellers, brokers, and bankers.

Although numerous anecdotes testify to the existence of young buyers who enter the business purchase market and within six weeks are operating a company, most young entrepreneurs undrgo a far more testing initiation. Finding the 'right' business to buy appears to be close to a random process, with a mean finding time for a non-retail company of considerably over a year.[5]

Indeed, my interviews with business school graduates who had undertaken a search to purchase a company confirmed this harsh reality.[6] Despite their attention to time-saving strategies such as limiting their search to particular industries, the average full-time search period for these buyers stretched over two years. Of the three individuals whom I spoke with, one is expecting to close on a deal in the next six months after almost two years of intensive activity. The other two potential buyers never bought a company; one started her own consulting firm while the other became the chief executive of a small service company.

Each of the individuals that I interviewed believes that, unless a buyer is particularly lucky or indiscriminate, it is critical to work full-time on a company search. Each felt that the loss of focus suffered by a buyer not devoting his or her complete attention to the process reduces the probability of completing a transaction to almost zero. Given the length of time one might expect that a search would take, this full-time approach involves huge opportunity costs. Clearly, a buyer should not begin this process before fully analyzing his or her complete devotion to the task of operating a small company.

Low Likelihood of Success

The timeframe involved for a young entrepreneur in locating an attractive, affordable and available business, coupled with the difficulty of closing a deal makes it fairly unlikely that the a young entrepreneur beginning the process of buying a business will emerge from that process as a small company owner (no statistics are available). This uncertain outcome, which occurs despite the opportunity cost expended by the buyer, must weigh heavily on an individual considering the challenge of buying a business.

Issues Associated With Working in a Small Company Environment

Perhaps more important than understanding the process involved in buying a small company is understanding the functions of a small company owner-manager and making sure that they are consistent with the buyer's goals and sensibilities. Numerous books exist which allow potential entrepreneurs to screen their outlook with the reality of operating a small business.[7] Nevertheless, one point which I had not encountered in the literature became clear to me as I pursued my search: Owning a very small business can be a very lonely experience.

A young entrepreneur can often only afford to purchase a company which has revenues of less than one million dollars. In most of these companies, the overhead structure of the business supports a single owner/general manager, rather than multiple 'professional' employees. In speaking with two current presidents of larger companies who formerly worked in very small companies, both commented on the loneliness of not having a work associate with whom to discuss issues, share business interests, or merely to joke with.[8] Another issue to consider is that unless a small business is able to grow, the challenge of its management can quickly wear thin. One of the presidents that I interviewed was fortunate enough to grow the revenues of his company to the point where its management remained sufficiently challenging. The other president, however, addressed these drawbacks by leaving small business for the camaraderie and learning of business school.

SECTION II - CHAPTER 4
SUGGESTIONS FOR EASING THE PURCHASE PROCESS

"Breaking into the leveraged buyout market for small businesses is almost impossible. There are thousands of people in their 40's and 50's out looking to buy. Unless you have a million dollars, no one really pays attention to you."

- Former buyer[1]

"What, exactly, are you looking for? How much money do you have?"

- Business Broker[2]

Having shown the adversity faced in purchasing a small business, I should now emphasize that there is hope for the young entrepreneur. At least some small portion of the 500,000 small businesses that are sold each year are bought by young entrepreneurs. Furthermore, a buyer can take definite steps take to maximize the likelihood of his or her success. From my interviews with experienced buyers, sellers, and market intermediaries, I developed the following list of 'critical success factors' for the young buyer:

a) Focus your search on an industry, market segment or geographic area
b) Find advisors who hold the expertise to help you with your search and lean heavily upon them.
c) Solidify your finances and financial backing before you begin the search (to whatever extent possible).
d) Work very hard to understand the seller's position in any transaction. What motivates him or her? How can you increase the attractiveness of your offer in his or her mind?
e) Understand that as a young entrepreneur, your function

is more to sell yourself than to buy.

f) Keep a high profile.

Each of these critical success factors will now be discussed.

<u>Focussing a Search</u>

A buyer who can determine in advance the exact composition of both the perfect acquisition target and the optimal (realistic) purchase arrangement will be miles ahead of the game in all aspects of the business search. This definition of purpose is a critical result of the first stage of the acquisition process. Focus allows several advantages. Most importantly, it allows the buyer to know where to look for a company.

My initial purpose in looking to purchase a company was to take an existing operation and to rationalize its operations and expand its markets. This goal could be accomplished with almost any company. Nevertheless, each time that I contacted a business broker or other intermediary, they would all enquire as to kind of company Iwas looking for, to which I would reply "almost any company that contains potential". In a market with few buyers and many sellers, my approach would have been appropriate. But, in the market in which I was competing with other buyers for deals, my lack of focus was interpreted as a lack of interest. Also, intermediaries are always looking for evidence of fit between buyers and sellers. A buyer's stated industry preference provides an opportunity to create perceived fit.

Focus is particularly important to young buyers. Having focus on an area implies that the buyer has expertise in a field. Because young buyers often lack credibility with intermediaries, any potential source of credibility is valuable. Focus is also useful because it allows the buyer to obtain value from time spent working unsuccessfully on previous acquisition candidates. This process of 'getting smart' in an area also makes one's contact with intermediaries more efficient. Within a few moments, a buyer with a structured search knows whether or not a candidate will be a good match.

Focus becomes even more critical when a buyer contacts a seller in the third stage of the purchase process (contact with sellers). As will be seen later in this section, small business owners typically regard the sale of their business as more akin to a handoff than a punt. The first questions that a seller often asks a buyer is "how did you locate my company?", and "why are you contacting us?". To these questions, the focussed buyer can respond that (s)he is knowledgeable with the industry, or that (s)he was referred to the company by of his or her industry contacts, who felt that it might be mutually profitable to approach the seller. This response is radically different than that of the unfocussed seller: "I was looking through a directory, and I thought that your company and your industry looked very interesting." By showing knowledge of the seller's industry, a buyer legitimizes the process used to locate the seller.

I have had suggested to me a final Theory-X-oriented potential benefit of focus. If a buyer approaches a seller stating that he or she is soon going to perform an acquisition in the seller's industry, the seller may become quite concerned that there will be a new, aggressive competitor entering his field. This concern may provide sufficient impetus to convince an otherwise unwilling owner to sell his business before one of his competitors does. The effectiveness of this tactic obviously depends on the buyer's ability to convey a sufficiently Machiavellian persona.

One drawback to the idea of a focussed search could be that a buyer might unneccesarily limit the scope of deals to which (s)he is exposed. This was a concern that I felt at the beginning of my search. While this may be a valid arguement, I believe that the competitive nature of the local market for small businesses creates a situation where the unfocussed buyer will not see <u>any</u> deals, rather than seeing a broader base of deals than the focussed buyer.

<u>Locating Advisors</u>

When launching an undertaking as large and important as buying a small business, anyone can use good advice. Young entrepreneurs, who are less experienced in both buying companies and business in general, can benefit tremendously from affiliations with individuals whose capabilities complement their own.

There are three primary roles that I have identified for advisors to buyers. Advisors assist the acquisition process by providing insight from their experience, and can direct the buyer to sources of information with which they are familiar. Advisors also can serve as an impartial judge. This role becomes critical as the buyer becomes more involved with a search or with a target company. A good advisor is impartial, and will tell the buyer when a deal is not really attractive, or when it is time to 'pull the plug' altogether on a search. Once the entrepreneur is well into the process of searching for a company, it is very difficult for the individual to retain the perspective needed to make these decisions.

Another role for an advisor is to provide the emotional support and uplift required for the buyer to retain enthusiasm. When the search process has gone on for some time and the buyer is getting discouraged, it is the role of the advisor to encourage the young entrepreneur that a perfect deal may just be a phone call away. Finally, advisors help the buyer retain the focus which is so important in a search. Having been frustrated in one area, it is easy for a young entrepreneur to not 'stick to the knitting' and search for deals in supposedly greener pastures. It is the presence of an advisor figure, to whom the buyer feels he or she reports, that keeps the buyer from looking into areas which were not originally a part of the search charter.

Locating advisors is easy, locating good advisors is quite difficult. For a young entrepreneur, at least one of the advisors should have a great deal of work experience in either a field related to the buyer's search focus, or in the field of buying companies. This advisor can provide the buyer with a network of connections with whom (s)he can speak, can make suggestions based upon past experiences which may prevent the buyer from unwisely allocating time, and can help prevent the young entrepreneur from making a fatal mistake (from a business standpoint).

Other advisors, such as friends or relatives, can serve as sounding boards. This function is of great value in testing the attractiveness of an opportunity, in reading and making suggestions on letters that the buyer is sending, or in providing emotional support. Often the buyer just needs someone to talk to, because in discussing an opportunity the buyer often becomes aware of an aspect of the transaction which (s)he had not previously recognized.

Solidify Financial Backing

Many business brokers and owners have had a horrible experience where an entire transaction was structured and about to close when the deal was cancelled because the buyer could not obtain the required financing package. Also, intermediaries often see situations where potential 'friendly investors', such as relatives and friends, agree before a search process begins to invest in a buyer's acquisition, but get 'cold feet' when the transaction arises. (As a rule, individual investors tend to underestimate the risk involved in taking on any new operation.)

Because brokers and other intermediaries have been 'burned' so often by 'certain' financings which did not materialize, they tend to give credence to only the money that a buyer has in the bank or committed in writing by investors (or at least specific amounts verbally agreed upon). Further, intermediaries always ask for a financial statement from the buyer very early in the acquisition process. Consequently, the extent to which a young buyer can pre-arrange financing could be a critical factor in convincing intermediaries to show the buyer attractive deals.

Understand the Seller's Outlook

A buyer should recognize that the decision to sell a company is far more difficult and emotional than the decision to buy a business. Depending on the company owner's motive in selling, the decision to sell can be anything from an admittance of unfitness to the recognition of the limitations of age. Selling a business often marks the end of a twenty or thirty year period of the owner's life - not a decision to be entered into lightly. The buyer must also remember that most small business owners take tremendous pride in their organizations. One must appeal to this sense of pride in approaching the owner, or risk having the owner reject the buyer merely on the basis of 'not understanding my business'.

A buyer must also remember that for a small business owner the decision to accept an offer is not based entirely on price. The attitude of many young buyers comes across to small businessmen as 'I'm giving you a good price for the business, what do you care about what I do with it once you are gone?'. A small business often represents two things in the owner's mind, a family and an institution. The owner of the business does not want to feel that he has abandoned the employees with whom he has worked (often for decades) to someone who will mistreat or fire them. Also, the seller has strong feelings that the conduct of a subsequent owner will directly reflect on him or her. Except in sales resulting from financial distress, the owner wants to see his creation embellished, not restructured. In summary, an owner cares very much about liking and respecting the person to whom (s)he sells a business, and about the new owner's plans for the business subsequent to the acquisition.

A technique that one former buyer found useful in speaking with owners was to speak of continuing the company in its current state, but accomplishing growth sufficient to perhaps bring the company public. Thinking about a potential buyer as the vehicle for bringing his company to such lofty heights can dramatically increase a seller's regard for a buyer.

Another issue for a buyer to keep in mind is the possible existence of benefits from owning a company which the seller perceives to be of tremendous value, but which are actually of low cost to the company. In one interview, a former buyer told me that a seller was willing to take a large drop in selling price to be able to keep his company gas credit card. Other buyers are worried about how they will spend their time if they sell their business. In these situations, retaining the seller as a paid part-time consultant might make that seller far more open to a transaction. It is these non-price sources of value which the buyer must search out and use to make the seller more responsive to the buyer.

As a result of the emotional ties listed above, many company owners involved in the sale process develop strong reservations about selling their companies. A buyer should be very aware of this danger, and take steps to ease the seller's anxiety. If the anxiety appears insurmountable, the buyer should discontinue the purchase process before his or her time investment outweighs the potential for a successful transaction.

Methods exist which the buyer can employ to pre-screen sellers to assess whether the sale process will dissolve prior to completion. One former buyer told me: "If you directly contact a seller and he says that he 'might consider' selling his business, hang up the phone. He'll never go through with it."[3] Another danger in dealing with small company owners is that they often use potential buyers simply to value their companies. This allows the owner to brag of its value to his or her friends. Small business owners often have no idea of their company's worth, so they use a buyer to determine a value and then stop the sale. One of my interviewees stated that one of his friends actually got to within a month of closing before the seller admitted to him that he was really just attempting to value his business.[4] Beware!

One way to avoid the danger of the appraisal-seeking seller is to work through a business broker. The business broker values the seller's company by putting a market price on it, so the seller does not need the buyer to perform this function. Also, the business broker's contract with the seller states that if the broker creates a deal at the listed price and the business owner decides not to sell, the owner must still pay the broker's comission. This financial disincentive usually prevents sellers from abandoning a transaction employing a business broker.

Understand the Buyer's Role as a Seller

Taking into account the information above on the typical seller mindset, as well as the competitive disadvantage faced by young buyers in purchasing a company, it is important for the young buyer to think in terms of being a seller rather than a buyer. The young entrepreneur needs to sell all parties of the transaction (and the buyer's adsvisors) on the idea that (s)he is capable of completing the transaction and sucessfully managing the firm. Two of the former buyers that I interviewed strongly emphasized this selling function. "Always prepare for meetings as if you were selling yourself to the owner, don't wait for it to happen the other way around", was a piece of advice that I received which proved very useful.[5]

Keep a High Profile

Many, many buyers and sellers are brought together because one individual knew both the buyer and the seller and arranged for them to meet. It is critical for the buyer, therefore, to tell as many people as possible that (s)he is in the market to purchase a company. This allows the buyer to maximize the amount of information and number of potential leads received in the search process.

SECTION II - CHAPTER 5
FINANCING THE PURCHASE

Financing is typically one of the most difficult areas of the purchase to achieve for a young entrepreneur. Their are six ways that I have encountered for obtaining the equity necessary to complete a leveraged purchase:

a) Prior savings
b) Equity in a home or in other assets
c) Money from close relatives
d) Investments from friends and more distant relatives
e) Investments from wealthy individuals such as 'angels'
f) Investments from institutions such as venture capital firms or banks.

I will discuss below each of these methods, and also include a small section on the non-equity portion of the purchase.

Prior Savings

If one already has the equity necessary to complete a purchase, no need exists to read the remainder of this segment. If not, financing will in many ways provide the 'acid-test' of whether a young entrepreneur is perceived as being ready to begin the purchase process. Whatever source of funds the buyer utilizes, it is safe to say that some direct investment on his or her part will be required, if only as an indication that (s)he is comitted to a sucessful outcome. As one would expect, the more cash that the buyer has directly available for investment, the better. In the company-buying business, absolutely nothing opens the doors to financing sources like the presence of ready cash.

Home Equity or Other Assets

Home equity financing is much more difficult to obtain than a buyer might think. If one is not employed while attempting to obtain a home equity loan, it is almost impossible to obtain financing. Almost every bank offering this type of equity-based loan has a policy which requires the loan amount to be calculated as a function of both the homeowner's equity in the property, and the homeowner's income. Typically, the income requirement is that a homeowner's monthly payments on the total equity line plus the interest payments on all other debt cannot exceed 38% of the homeowner's gross monthly income.[1]

For many business buyers who hope to purchase a company and then have the company pay them a salary, the income standards on home equity loans represent a Catch-22. One cannot obtain the loan to buy the company because one does not have any income. But, in order to obtain income, one must obtain the home-equity loan to buy the company. Thus, the buyer cannot get either the loan or the income (or the company, for that matter).

If a buyer is not hampered by the income constraint of the home equity loan, (s)he can expect to obtain loan availability up to a level where the outstanding balance of the first mortgage on the home plus the home equity line equal 75-80% of the home value. Usually, these loans are performed on a floating rate basis at an interest rate of about prime plus one percent.[2] The situation for borrowing against other assets of the buyer is probably analogous to the home equity loan.

Money from Relatives and Friends

Many venture capitalists strongly recommend against obtaining money from relatives and friends. The belief is that: 1) there are always 'strings' attatched to these funds, 2) this type of unsophisticated investor expects returns unrealistically quickly and will not be understanding if a second round of financing is required, and 3) these investors can hinder a firm's ability to obtain future funds because a large group of shareholders with different interests will need to be appeased.

This advice should be put in the context in which it was given, for the funding of a start-up firm. Still, some of the same issues arise when purchasing a company. At the very least, a potential buyer should always stress that investors are making a long-term investment, and that they should neither invest funds that they cannot afford to lose nor should they expect to see any returns in the short term.

<u>Investments From Wealthy Individuals</u>

Wealthy individuals not known to an entrepreneur who are willing to fund exciting ventures, otherwise known as 'angels', are becoming increasingly common on the entrepreneurial front. These individuals are often succesful entrepreneurs who are interested in advising and sharing in the rewards of companies which resemble their own organizations of many years before. While I have never heard of an angel (in the sense of an unrelated individual) funding a young entrepreneur that was interested in buying a company, it seems logical that some angels could be interested in this kind of investment. For instance, I am familiar with two recent business school graduates who were able to assemble both a 'search fund' and a pool of equity capital from individuals with whom they were only moderately familiar.[3]

Locating individuals who might serve as angels is extremely difficult, because they tend not to advertise their presence. There have, however been recent attempts on both coasts[4] to create listings of these investors and of the entrepreneurs interested in receiving their investment funds. I have also heard that the 'individual' practices at major accounting firms tend to be aware of individuals who might fill this role.

Financing From Institutions

Institutional financing from a bank or venture capital firm is very rarely an option for the young entrepreneur. An acquaintance of mine employed by a large, Boston-based venture capital firm stated: "I can categorically state that someone right out of business school will not get institutional financing."[5] While I know that some venture capital firms are willing to invest the cash required for an experienced manager to make an acquisition, I was told by several sources that this type of arrangement would not take place with a young entrepreneur.

The Non-Equity Portion of the Purchase Price

Although it is critical for a buyer to raise the funds necessary for the equity portion of the purchase price, it is also essential to pay close attention to the leverage which can be taken on by the company once it is purchased (LBO potential), and to the amount of owner financing which might be included in a transaction. While standards do not exist for levels of owner financing or bank debt (see the chapter on business brokers for a view of the contradictions present in the market), an owner can reasonably expect to require an equity payment of only 25-35% of the purchase price.[6]

Three aspects of the non-equity portion of the purchase price which the buyer should understand are the income-advantaged and tax-advantaged status of owner financing to the seller and the asset richness of the firm. To the seller, the income advantage of owner financing arises because the interest rate which a seller receives through financing a purchase is typically well above the rates obtainable on bank CD's or money market funds. In fact, owner financing often presents a win/win situation for the seller and buyer, in that the interest rate is usually set at a level between the seller's investment interest rate and the buyer's loan interest rate.

The tax-advantaged status (to the seller) of owner financing is a fairly complex issue to explain, and a buyer might want to consult an accountant before approaching a seller. The tax advantage arises from the seller's ability to accrue interest on the total pre-tax purchase proceeds which are financed, rather than the after-tax amount.

An owner who receives all of the purchase proceeds at the time of the sale first pays taxes on the entire amount, and then places the remaining funds in, say, a bank CD. Interest at the bank is earned on only the after-tax sale proceeds. For seller financed loans, the owner receives interest on the total outstanding balance from the buyer, rather than just the after-tax amount. Thus, the amount that the owner saves can be stated arithmatically as a total of (the seller's personal tax rate * the amount yet to be paid to the seller * the interest rate) in each year of the contract.

For instance, in a case involving a one million dollar purchase price, a thirty percent tax rate, a ten percent interest rate, and owner financing of fifty percent of the sale price to be paid in five equal payments, the seller saves over forty-five thousand dollars.[7] If the payments can be sufficiently extended to allow the seller to lower his or her tax rate in any year below the maximum thirty percent assumed here, the savings would increase.

The asset intensity of a business predicts the seller's ability to borrow against the unencumbered assets of the firm to fund the purchase. When looking at a business, I often used a ratio of asset value to purchase price to predict the possible leverage available for a given company. Rules of thumb are that a healthy buyer can usually borrow up to 75% of the value of real estate, up to 80% of the value of receivables, 20-40% of the value of inventory, and 20-60% of the value of equipment[8]. These collateral advance rates may not be available to a young buyer, but (s)he should be able to obtain at least some portion of these advances.

Young buyers on the verge of a purchase should become familiar with the loan programs sponsored by the US Small Business Administration. Under these programs, the SBA guarantees the loans of small businesses which would otherwise be unfinanceable at commercial banks. If one wants to pursue this program, it is best to begin the process well before funds are truly needed. Among other things, the requirements for an SBA-guaranteed loan include having been turned down for traditional financing by at least two local banks.

SECTION II - CHAPTER 6
LOGISTICAL SUGGESTIONS TO AID THE SEARCH PROCESS

In this chapter, I will discuss some of the 'nuts and bolts' of the company search process, with the hopes of saving the potential entrepreneur the time which I spent before assembling these suggestions.

General Approach

My approach when starting my search was to attempt to build a 'paper fortress' of credibility, which I hoped would give me the appearance of an established firm with owners and intermediaries. I created the name of a company, obtained stationery, referred to myself as general partner, and spoke of "we" and "our firm" in all of my letters. This technique was fairly succesful in getting a letter read by the addressee.

My first mass mailing was to bankers. Each banker that I called to follow-up the letter wanted to know more about my firm. After a minute or so of questions, the banker would realize that my company consisted of myself and a limited partner and did not have a huge capital base. Quickly, the banker would lose interest in my situation. No matter what I did at that point, I was unable to regain my credibility. (Credibility is an extremely valuable commodity in the company purchasing business.) The negative reaction that I received from having been 'caught' at self-aggrandizement was thus not worth the increased value received from getting a foot in the door.

I now realize that everyone that a buyer contacts will discover the buyer's exact circumstances in short order if a relationship is formed, so it is best to be as forthright as possible from the outset. In fact, an unpretentious young buyer often catches the imagination and paternal spirit in a seller or intermediary, obtaining greater cooperation than would be received by a seasoned professional.

In order to increase credibility, a young buyer needs to consider every aspect of his or her communication with an intermediary or seller. For instance, one should probably say 'hello', rather than 'hi'. A buyer also needs to think about such mundane matters as how to sign one's name on a letter, and what message to leave on one's telephone answering machine. (I recommend a message which includes both the buyer's name and the company name. This approach won't scare away either a business caller or your friends). While the advice above might appear to be advocating extreme behavior, I believe that the young entrepreneur should take every possible step to overcome the many disadvantages facing his or her search.

Adopt a Company Name

While one should not misrepresent one's position, I found it to be logistically helpful at times to have a corporate-sounding name to refer to as my company. This was particularly useful when sending out a mailing or in speaking with support staff at companies. A letter going out on personal or untitled paper just does not make the impression created by heavy weight, professionally laid-out corporate stationery. To avoid conflict with the advice above, I usually included in my letter an explanation that my firm consisted of merely myself and a limited partner.

When calling a company owner, the secretary almost always asks what company the caller represents. When the caller says "no company", the secretary usually tries to divert the call or find out the nature of the contact. It is very important to company owners that their employees not be aware of the impending sale of their company. To tell the secretary that you are calling to inquire about the seller's potential sale of the company is out of the question. To say that the call regards a personal matter is awkward. Having a company name to use in this situation often saves the day, because once the secretary is given a company name (s)he usually presumes that the owner will know the subject of the call.

Another useful tip to employ with inquiring secretaries is to merely tell them that you are calling to follow up on a letter that you sent. While this does not satisfy the assistant's desire to know the nature of the call, it is still usually enough to get even the most inquisitive secretary to pass you on to an owner.

Letter-Writing

Writing a satisfactory letter often takes many hours, do not commit to it lightly. When writing a letter to a seller or an intermediary, always consider how the letter will be interpreted by the addressee. Have as many people as possible read your letters before you send them, providing feedback on the letter's content and tenor. Typos, unclear meanings, and inappropriate tones can transform an effective letter into an affront. In exhibits related to the third section of the thesis (Methods For Locating A Small Business To Purchase), I have included a number of the letters that I wrote during my search. While these letters in no way represent perfection, they may provide a useful starting point for the reader.

Time Requirements to Close a Purchase

Once a target company has been located, it typically takes at least nine months to close a deal. Always keep this lead time in mind while performing a search. The following chronology of an actual deal was given to me by one of the potential buyers that I interviewed:[1]

September - Became aware of company

October/November - Received information about the company from our broker, anayzed opportunity and industry, and met with seller. Decided that the opportunity met with our purchase objectives. Began business plan.

December - 'Got serious about buying the company'. Signed a preliminary purchase and sale agreement, which served two purposes. First, it placed a price on the business, subject to adjustment after close scrutiny of the company's financial records. Second, the agreement prevented the buyer and seller from pursuing purchase or sale options with other parties. Received tentative bank and SBA approval for the loans sought to leverage the company's assets. Received and analyzed two years of detailed financial statements.

January - Completed the formal business plan for the company.

February - Our lawyers and the seller's lawyers completed most of a 60-80 page tentative agreement.

March - Signed a formal purchase agreement, subject to an actual inspection of the property and other details.

Early May - Targeted closing date.

The process shown above might be interpreted by the reader as overly time consuming, and not representative of a typical transaction. But, from my interviews with former buyers and intermediaries, the timing in this case appears to be only slightly longer than average. I spoke with the head of a venture capital firm on the subject of timing, and he stressed the value of the time spent in creating a deal. "Don't trade meeting time deadlines for information", he said, "because you will regret for many years the omissions of a few months".[2]

On that note, I will disclose that the transaction chronicalled above never closed. At the physical inspection of assets and inventory occurring in mid-April, the buyers discovered that only about half of the seller's stated assets were present. Of the inventory on hand, the majority was valueless. It was also disclosed that the seller's law firm specialized in bankruptcy cases. The sale never occurred, and the buyer had to sue the seller to recover the initial sale deposit. Message: Always take the time to fully understand every aspect of the seller's operation before buying a company.

SECTION III - Methods For Locating A Small Business to Purchase

SECTION III - CHAPTER 7
INTRODUCTION/FRAMEWORK

Let us assume that a young entrepreneur has confirmed that purchasing a small business represents his or her optimal career choice. The entrepreneur has, to date, developed a focus for the search, located advisors whose strengths complement his or her own, and identified potential financing sources for a purchase. The next issue to address is to develp a methodology to locate and contact potential acquisition candidates.

Every young entrepreneur that I have talked to seemed to be searching for the same company. This company is very well established, and has an owner that desperately wants to retire. The business is profitable, but has not been aggressively managed in years. The company's industry is growing, but is not large enough to justify the entry of Fortune 500 calibre firms. Unfortunately, this ideal company is seldom available in the market. As a partner at a 'Big-8' accounting firm told me: "Everyone is looking for that same company, and if I were to ever come across it, I'd buy it!"[1]

There are several channels available for locating companies. In my mind, there is a continuum along which these channels can be placed. On this continuum, the varying factor is the amount of assistance granted to the buyer and seller throughout the purchase process. I have identified nine potential channels, which I have categorized into the following groups:

- High Level of Assistance
    - Business Brokers
    - Smaller Scale Investment Banks
- Moderate Level of Assistance

- 'Efficient Outreach Channels'
  - Accountants
  - Bank Lending Officers
  - Lawyers
  - Acquisition Directors at Large Corporations
  - Bank 'Work-Out' Customers or Troubled SBA Loan Customers
- Low Level of Assistance
  - Direct Approach of Company Owners
  - Bankruptcy Court
  - Classified Advertisements by Owners
  - Networking by Buyers

There will be great variation in the depth of analysis performed on each of these channels. As you will see, I have concentrated my efforts on separate chapters on two channels: business brokers and the direct approach of companies. These areas were emphasized because I believe that they contain the greatest potential for leading a young buyer to a purchase, and also because these areas contain significantly more issues to discuss than, say, contacting accountants. I felt that it was particularly important to fully discuss business brokers, as they are typically the first channel contacted by a prospective buyer when beginning a search.

Following the chapters on business brokers and directly approaching companies, I will analyze the other deal location channels identified in my search within the framework shown above. In my search, I fully examined only those channels which appeared to offer an acceptable probability of leading to a purchase. Therefore, I may have little insight to offer the reader concerning some channels. In these areas, I will attempt to offer whatever guidance I can, as well as suggesting the 'next steps' which I would have taken were I to have pursued this channel further.

As stated earlier in the thesis, I will not be disclosing the names of individuals that I contacted during my search. This policy is not intended to slow the prospective buyer's search, but to protect the confidentiality of parties who may not have been aware that my search was in part performed to research this thesis.

SECTION III - CHAPTER 8
BUSINESS BROKERS

Overview

For the purpose of this thesis, a business broker will be defined as a person of some professional standards who obtains his or her livelihood from bringing together buyers and sellers of businesses.

In my search, I have located two distinct varieties of brokers. The first group I will refer to as 'retail' brokers, because they specialize in smaller transactions most often involving retail businesses or franchises. These brokers are short-term and transaction oriented, attempting to compensate for the small size of the purchases undertaken with a high volume of transactions. One needs only to look at the 'Business Opportunities' section of a local newspaper to see results of the proliferation in local retail brokers which has occurred in recent years. In the Boston area alone, there are now over 50 organizations fitting my description of a retail broker advertising themeselves as general business brokers.

I refer to the second set of business brokers which I have encountered as 'corporate' brokers. These are individuals or firms performing transactions involving companies with, generally, at least one million dollars in sales. These brokers keep very low profiles, and tend to work very quietly within a long-established network of buyers and sellers. Corporate brokers are often difficult for potential buyers to locate, as most of their customers come via word of mouth.

Using a business broker can be tremendously valuable to both a buyer and seller. To a buyer, a broker is the most efficient channel for locating companies for sale. To complete the purchase of a company, the qualified buyer need only to look at the broker's listings, find an attractive candidate, negotiate a purchase price, and perform due diligence. The buyer also gets access to the broker's expertise on the process of buying a business, advice on negotiating strategy, and access to a network of support professionals such as lawyers and accountants.

Sellers benefit in several ways from using a business broker. On a logistical level, the seller does not have to take on the time-consuming process of listing the company for sale, screening and qualifying buyers, and explaining to each potential buyer the basic attributes of the company. The seller also obtains advice from the broker as to what the market will bear for the company with regard to purchase price and selling terms. Additionally, a seller is able to maintain until the last moment the confidentiality of the sale process when a broker is employed. This is critical in avoiding the customer and employee anxiety which often occurs when a business is known to be for sale. Finally, using a broker in some ways separates the seller from the reality of the emotional decision to sell the business. For most owners of small businesses, the decision to sell the company which has been most of their life for many years contains supercharged emotions. To them, being involved in the smallest details of arranging the sale is often a very disagreeable prospect. (Note: The importance of a buyer understanding the emotions involved in selling a business cannot be overstated. A discussion of this topic is included in Chapter 4, the 'Suggestions for Easing the Purchase Process' chapter of the thesis.)

In the following section, I will examine the operations of the two types of brokers that I have identified, examining issues such as:

a) The typical set-up of the operations and motivations of individuals working in each type of firm
b) The process followed by a broker in each type of firm when trying to locate a business for the buyer.
c) The classes of buyer preferred by each type of broker.
d) Arrangements the broker will atempt to create to increase the chances of receiving a comission from the buyer.
e) The financing structures most commonly resulting from dealing with each type of broker.
f) A subjective assessment of the probability that each type of broker will be able to provide a buyer with an attractive stream of potential acquisition targets.

To summarize the conclusions which will result from my analysis of the factors above: Retail business brokers do not seem to have many attractive non-retail deals, but they also tend to greatly undervalue non-retail companies (relative to the prices asked by other intermediaries). Consequently, if a buyer can locate a retail business broker with an attractive company, he or she should seize the opportunity. Corporate brokers appear to have access to much better acquisition candidates than retail brokers, but have a large pool of potential buyers to select from once an available business is located. Young buyers with modest experience and capital rarely get access to these opportunities.

8.1 Retail Business Brokers

Organization/Personnel

Retail business brokers, meaning paid intermediaries between buyers and sellers of very small businesses, have existed for almost as long as traditional real estate brokers. Nevertheless, the evolution of the industry toward dedicated staffs working out of a single-purpose office is fairly recent. According to Tom West, Director of the International Institute of Business Brokers (Concord, MA), there are currently over 6000 retail business brokers in over 3000 offices nationwide. Growth in the number of brokers has increased by over 20% in each of the last eight years. Further, these brokers are now involved in an estimated twenty-five percent of the 500,000 sales of small businesses which occur annually in the United States.[1] This market share is significantly higher than any other form of intermediary.

As one might expect, a typical retail brokerage is operated very similarly to an upscale real estate brokerage. The office is usually located in an office building or the second floor of a 'strip' shopping center or mall. Inside, the brokerage consists of 'bull-pens' where multiple brokers share a small space, and conference rooms reserved for client meetings.

Retail brokers almost always have college or at least associate degrees, and many brokers have fairly extensive exprience as a lower or middle corporate managers. Often, business brokerages are staffed by individuals who first approached their firm as a prospective buyer. Exhibit I is a listing of the personnel at Trudeau & Trudeau, a business brokerage south of Boston. I am uncertain as to whether this is a representative sample of retail business brokers - this group seems to have better credentials than some that I have encountered, and I do not believe that all of the firm's brokers are listed here (I spoke with someone there who was not listed) - but I have included this listing as a guide as to what a buyer might expect in dealing with a retail broker.

Like many intermediaries, retail business brokers are paid entirely by comissions from sellers. Brokers are accorded procedural expertise, office space, documentation, and support services by their companies, in exchange for about half of the comission from any transaction. Most retail brokerages are either franchisees or affiliates of large chains such as VR Business Brokers, Business Brokers International, and ProVenture, or are spin-offs of sections of residential real estate brokerages.

Commision levels at retail business brokerages are extremely high, ostensibly a result of the time-consuming nature and specialized expertise required in completing a transaction. At one national chain for which commision level data was received, the commision was 11% of the first million dollars in sale price, 5% of the second million, 4% of the third milllion, and etc. with a 1% commision on all purchase proceeds above six million dollars in sale price.

The high comparative commision rate received by retail brokers causes them to be willing to take the time to speak with almost any prospective business seller or buyer. These broad contacts are greatly encouraged by brokerages to enhance the probability of creating a buyer/seller match, and thus a comission. This causes the broker to take on a 'listing' mentality, where multiple contacts are received daily, and buyers approaching the firm are hopefully matched almost immediately with listed sellers.

If the firm does not have any current listings of the type desired by a buyer, financial information to measure the buyer's resources is placed in an active file. The buyer is then contacted whenever a listing matching his or her specifications is received. My sense is that this follow-up rarely occurs, at least in an area like Boston where potential buyers greatly exceed potential sellers. It is the buyer contacting the brokerage shortly before or after a listing is received that usually gets access to the firm's latest list of prospects.

For example, I called six business brokerages in the Greater Boston area. Almost without exception the broker with whom I first spoke asked me if I was interested in a particular deal currently listed by the firm. In most cases, I was not interested in any of the brokerage's current listings. In each case, I registered with the firm to be contacted if any manufacturing or product-oriented companies became listed. I have not received a single call in response. Yet I have seen listings from these same firms in the newspaper which roughly fit with my description of a desirable company.

It may be useful to note here that many people in Boston who are close to the market for small company acquisitions are frustrated with the quality of personnel at retail brokerages. When I asked the head of a Big-8 accounting firm's small business practice for the name of a good retail business broker, he said "I don't know any that I would recommend to a client, and I know many of them".[2] The perception is the broker's comission structure creates a hard drive towards any transaction, not necessarily a good transaction. Also, in what is a very sensitive situation for the seller, retail business brokers sometimes exhibit the level of tact associated with used car salesmen.

Process

Retail brokers operate very much like real estate brokers not connected with a multiple listing service. Exclusive sales contracts are entered with a seller, and the broker uses its access to potential buyers to create a transaction. Buyers are located either from a pool of individuals who contact the firm without a specific purchase in mind, previous contacts who have left a description of their interests, or from responses to a specific newspaper advertisement placed by the broker.

When a buyer contacts a retail broker, the first thing that a broker will usually want to do is determine whether the type of company desired by the buyer matches a current listing at the brokerage. Next, the broker will often try to get a buyer to come to his or her office to create some sort of bond between the two parties. This bond is designed to attempt to gain some form of exclusivity with the buyer, therefore increasing the likelihood that the broker will have quick access to buyers when a seller lists a business with the broker's firm. The next step pursued by the broker will be to qualify the buyer for certain sized transactions. The brokers all seem to have a common financial statement to be completed by the buyer (Exhibit 2).

The subsequent steps in a buying a business through a retail business broker include the buyer's receipt of basic information on the target company (excluding its name or exact financial circumstances - see Exhibit 3 for a typical "Confidential Business Profile"), a qualification of the buyer with the seller, and an external tour of the selling company's facility and community. After much screening for financial capability and intent, the buyer is finally allowed to meet the seller. (The exact process steps observed at one business broker are detailed in Exhibit 4.)

The process detailed above is highly skewed toward the interests of a seller, in terms of confidentiality, buyer qualification, and in how the buyer is forced to make significant commitments before the seller is identified. The skewed situation toward the buyer applies to all apects of the deal except pricing and terms (see Valuation section), and is a function of the reality that the seller pays the broker's comission.

Because irritating a seller in any way can endanger a commission, the broker will do almost anything to placate a seller. For example, at some retail brokerages a letter of intent to purchase a company and an "earnest money" deposit is required before the buyer is given a chance to examine in detail a company's financial books and records. (Notably, the buyer is allowed to make an offer contingent upon the satisfactory examination of books and records.) This system where the offer is made even prior to determining exact profit and cash flow results seemed incredible to me. In another brokerage, I was told of the practice of compensating the seller on an hourly payment basis for time spent if the transaction was not completed.[3]

Buyer Customer Base and Profile

Almost all buyers approach retail business broker as individuals. Most of these individuals have extensive work experience, and are either planning a career change or have recently left their jobs. In many cases, these people's motivation for buying a business is to stop having to work for someone else. This sentiment is highly encouraged by retail brokers, who I have heard say: "You are not buying a business, you are buying a job."[4] A common scenario in the Boston area is for individuals who could not otherwise afford the down payment for a company to fund the payment through borrowing broker are detailed in Exhibit 4.)

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Buying a Business Through a Retail Broker

Product Mix - As one would expect, retail brokers specialize in selling retail operations. In total, retail businesses usually represent 90-95% of the companies sold through retail brokers.[5] This is confirmed by the advertisements placed by brokers in the Boston Globe Business Opportunities section. On a recent Sunday (April 5), retail opportunities represented 97% of the 201 listings from brokers and business broker arms of realtors and 95% of all listings. Within these listings, restaurants (67), convenience stores (27), beauty shops (22), and franchises of regional or national service chains (15) were the most prevalent sellers.[6]

The orientation of retail brokers toward sellers and the statistics above should not discourage a buyer with a non-retail focus from approaching this channel. In the past two years, there has been a definate trend toward retail business brokers becoming involved in larger, non-retail transactions (a transaction is considered large to a retail broker if the purchase price exceeds $300,000). This trend is a result of the emerging viewpoint in retail brokerages that structuring large and small deals requires the same investment of a broker's time, yet the payoff on the larger deal is significantly higher. Numerous seminars and educational materials have been produced in the industry to teach brokers how to support a larger sale.

Benefits of using a retail broker for a non-retail transaction accrue to the buyer as well as the seller. In fact, as will be shown in the valuation section below, the retail broker's previous orientation toward small transactions involving retail firms can be highly advantageous to a non-retail buyer.

Valuation Method and Financial Structures Employed - The type of buyer most often attracted to retail operations has significant experience but limited resources relative to the transaction involved. In order for retail brokers to complete the large volume of transactions necessary to remain profitable, deals must include pricing and terms which are affordable to this primary customer base. This demand-pressure has forced the market for retail businesses to adopt low valuations relative to earnings and include significant levels of seller financing.

On the dimensions of pricing and seller financing, the contrast between retail brokers and corporate brokers is significant. I attended a seminar on buying a business that was hosted by a retail brokerage. At the seminar, the lecturer stated that the price paid for businesses in his firm ranged from one to three times the business's adjusted cash flow. (In this case, adjusted cash flow represented earnings before depreciation, interest, taxes and the principal's salary.) The speaker went on to say that the average price to cash flow ratio was 2.4:1.[7]

For a retail operation, where the principal's salary is a significant portion of revenues this method of valuation leads to a company value which is consistent with those observed in other channels. But, for a larger manufacturing or service company, where the principal's salary is often less than five percent of revenues, this valuation method becomes extremely advantageous to the buyer relative to the valuation ratios employed by other channels.

For instance, my interviews suggest that corporate business brokers employ an average valuation rate of five times a company's adjusted cash flow after principal's salary.[8] Given this valuation approach, I have prepared a chart comparing the value placed on a manufacturing company by retail versus corporate brokers. In this example, the selling company has two hundred thousand dollars in cash flow and a principal's salary of fifty thousand dollars.

	Retail Broker	Corporate Broker
Cash Flow Before Prin. Salary, Interest, Depreciation and Taxes	200	200
Less: Principal's Salary	Not Subtracted	50
Total Adj. Cash Flow	200	200
Purchase Price Multiple of Cash Flow	2.4 X	5.0 X
Purchase Price	480	1000

As can be seen above, where the principal's salary is not a substantial portion of cash flow, the price charged by a retail business broker will be substantially below the price charged by other channels for the same company. For those who are interested, the breakeven rate between the two channels comes at a point where the principal's salary is equal to approximately fifty percent of the total of the post-salary cash flow. This level is typical for a retail operation, but rare in a manufacturing environment.

The issue that retail brokers underprice non-retail companies when employing their standard valuation formula would become moot if the pricing method employed by retail business brokers for non-retail companies was different from that which was used for retail operations. This is definitely not the case at one large broker that I have contacted, and does not appear to be the case in directories I have obtained of companies for sale by brokers.[9] Consequently, I believe that there are tremendous opportunities available to an entrepreneur that purchases a non-retail company from a retail broker.

Another advantage for the non-retail entrepreneur in dealing with retail brokers is the extent to which retail brokers encourage a seller to finance the purchase of a company. In most other channels, a seller would only be willing to accept buyer paper on the 'gravy' portion of the sale, such as the proceeds exceeding book value.[10] For retail brokers, seller financing appears to be a way of life. At the seminar that I attended, the broker went so far as to state "We tell our buyers to stay away from any seller that won't finance a purchase. We think that it means that the seller doesn't believe in the business."[11]

The combination of low purchase price and aggressive seller financing allows a buyer dealing with a retail broker to purchase a substantial operation for a fairly modest investment. The following example was given to me for the purchase of a company with a one million dollar sale price:[12]

Annual Cash Flow:	420K
Purchase Price:	1000K
Financed Through:	
Down Payment:	350K
Seller Financing:	300K

Borrowing on Assets:	
- Real Estate	300K
- Inventory	50K
	1000

To me, paying $350,000 in exchange for an annual cash flow of $420,000 represents an extremely attractive opportunity. Unfortunately, many of these companies are not in industries which tend to excite professional managers. The businesses that I was referred to when contacting retail business brokers included machine shops, a structural steel company, a maker of plastic novelty items and a commercial laundry.

A logical question arising from the previous section is: "How can retail brokers get sellers to agree to terms which are so advantageous to the buyer". While I unsure of the answer, my sense is that sellers suffer from a lack of information, and a lack of alternatives. An owner of a manufacturing company has limited options when deciding to sell his or her firm. In most cases, the seller is not familiar with commercial brokers, who in any event perform most of their work for buyers. The size of most small firms also precludes them from working with investment banks, the smallest of which often have informal lower limits on purchse price of about five milion dollars.[13] Retail brokers are perceived by many buyers as the only option to selling a business on their own (see the discussion earlier in this chapter for information on the attractiveness of brokers to sellers). Because retail brokers have developed industry standards as to the fair price for a business, the seller has little choice but to accept these norms. One retail broker that I contacted stated that it usually took six months to a year for a prospective seller to acclimatize himself or herself to the conditions of sale recommended by the broker.

Approaching Retail Business Brokers

When contacting a retail broker, a buyer need not worry greatly about approach method or style. It is important, however, to make sure that the broker believes that the buyer is sincerely searching for an acquisition, to avoid being discarded as a long-shot for producing a comission. Also, it is important for a buyer to assure the broker that he or she has the capability to complete any transaction pursued, even if this requires speaking about as-yet-unknown investors in fairly strong terms. The last thing that a broker wants is to have a deal get to the altar only to be cancelled for lack of financing. This situation not only ruins a payday for the broker, but also alienates the seller, endangering a future comission.

Summary Assessment of Retail Brokers as a Channel

If a buyer is willing to purchase a company in a basic industry, or if the buyer is fortunate enough to locate a retail broker with an exciting opportunity, I believe that the low valuations and favorable terms obtainable through retail brokers make them a very attractive channel for buying a company. The first thing to remember is that the broker is really working for the seller. The second caveat is that working with a broker requires constant pressure from the buyer to keep the broker working on his or her behalf. Otherwise, the broker may presume that you have discontinued your search for a company and offer an attractive new listing to the most recent caller.

8.2 Corporate Business Brokers

Organization/Personnel

There are many distinctions between retail and corporate brokers, but two of these distinctions are most important. First, corporate brokers deal in low volumes of relatively high value transactions (companies with over one million and usually less than ten million dollars in sales), whereas retail brokers perform a large volume of small transactions. Second, corporate brokers usually work for a particular client, and proactively search for an appropriate match for the other side of the transaction. This contrasts with the traditional retail business broker, which serves only as an intermediary between sellers approaching the firm as listers, and individuals approaching the retail broker as buyers.

Corporate business brokers are usually individuals or very small companies. The organizations are significantly smaller than retail brokerages, and cultivate long-term relationships with a limited number of clients. Corporate brokers are much less publicly known than retail brokers, and the existence of their services usually travels by word of mouth. In fact, it would be easy for a business buyer to not know that the entire channel of corporate brokers existed. Most buyers learn of the channel by hearing about it through contacts with acquisition departments of larger companies or from other buyers searching for an opportunity. Personnel at corporate brokerages are usually highly skilled in some managerial or technical aspect of business, and often have graduate degrees.

Corporate brokerages appear to take on two forms. The first and most common form consists of a sole proprieter who is highly respected in a certain field (often technical) and at some point circuitously winds up in the brokerage business. This often occurs when an individual serves as an intermediary between a buyer and seller with whom he or she is familiar. Arranging deals then becomes a part-time job, where the broker levers off of existing relationships to locate appropriate buyers and sellers for clients. As the broker becomes involved in more transactions, his or her network expands, and brokering becomes a full-time position. In many cases, brokering eventually becomes a comfortable form of semi-retirement.

The second type of corporate broker is usually a small professional firm which has a distinct orientation towards buyers. These firms specialize in performing searches for companies or individuals which are looking to acquire firms in a particular industry or location. Once these 'search' firms establish themselves, sellers within their network know to contact them when deciding to make their company available for sale. In this way, a corporate brokerage builds up a file of 'active' sellers, to be matched with its buyer clients. Recently, these firms have received significant revenues from foreign firms interested in either entering the US market or in learning more about a particular technology.

Corporate business brokers are compensated by a comission paid by whichever party hired the broker to perform a search. Fees are calculated according to the so-called Lehman formula, whereby the broker receives a comission of five percent of the first million dollars in purchase price, four percent of the next million, three percent of the third million, two percent of the fourth million, and one percent of the remainder of the purchase price.[14] When a corporate broker performs a proactive search for a buyer, it is sometimes paid a retainer by the client, which is refunded if a deal takes place. Retainers usually include an upfront fee ranging from $500 to $7500, and a monthly fee of between $250 and $2500.[15]

My own feelings about paying a retainer are mixed. I have been told by some buyers that the quality of potential deals that they saw increased dramatically after formally retaining a broker. Brokers that request retainers say that in a world with many buyers and few sellers the only real way to guarantee a broker's attention is to show a willingness to pay fees to the broker up front. For a young entrepreneur with significant time resources and limited cash, I am unsure whether this investment is sound use of scarce resources. After all, as we will see in the process section of this sub-chapter, if a corporate broker is not locating a company for a buyer using its own network, it is probably performing a search and screening process that the buyer might be able to more cost-effectively perform alone.

Process

While I have not gone far enough into a transaction with a corporate broker to have first-hand experience as to the process employed, in my contacts with twenty or so corporate brokers I feel that I have gotten a sense for the general approach which they employ.

Buyer Qualification - When a buyer contacts a corporate broker, the broker first attempts to qualify the buyer to determine whether he or she has the financial resources and experience to serve as an acceptable buyer. This approach reflects the corporate broker's close relationship with sellers, who are often a part of an established and ongoing network. Unless the prospective buyer appears to present a good opportunity for a seller, the broker wishes the buyer luck and advises the buyer to consult a retail broker. This approach is very different from the retail broker's immediate attempt to make a match with a listed company, and to subsequently build a relationship with the buyer, almost regardless of the buyer's resources or experience.

Nowhere is the shortage of sellers of non-retail small businesses more visible than in the market for the services of corporate brokers. There appear to be two primary criteria used by corporate brokers in determining the attractiveness of a buyer. The first is financial, that being the probability that a given buyer could smoothly complete a transaction. The second is credibility. Given that the market contains many buyers and few sellers, a broker wants to present the seller with the most credible buyer possible, in terms of reputation, experience and wherewithal. Also, credibility in a buyer is desirable because it increases the buyer's prospects for obtaining whatever institutional financing is required.

In the pecking order above, corporations attempting to acquire a business almost always are given priority over individuals, given their high level of credibility and their ability to purchase a company completely for cash. There are also a large number of individuals of very substantial means and significant credibility currently searching for a business in the Boston market. These potential buyers also place high on the corporate broker pecking order. When a young entrepreneur with less than $300,000 in ready cash approaches a corporate broker, the response is almost always 'I would love to help you, but you are really not our target market'.[16]

<u>Search Process</u>

A corporate broker begins a search for a client by examining the type of business desired by the buyer and comparing this to its files of potentially available companies. In addition, the broker approaches contacts in its network which fit the description and might either be for sale or know of another company that is for sale. For the sole proprieter corporate broker, this is often the entire process undertaken to create a transaction.

For the professional firm corporate broker, the next step in the search is usually proactive. Contacts are made with companies fitting the buyer's requirements and enquiries are placed as to these companies' desire to sell. This process, while time consuming, often leads to a buyer and seller match. One broker indicated to me that when retained to perform a proactive search, he found that he could successfully arrange a purchase within one year for roughly eighty percent of the buyers with whom he had worked.[17] Nevertheless, a buyer with sufficient time resources could probably internally replicate this process of directly contacting companies without tremendous difficulty.

While I know little about the services offered to sellers by corporate brokers, my sense is that the broker is usually looking to sell the firm to a corporation. In these cases the broker's value-added is in performing a search for potential buyers and in advising the client as to the optimal price for the business and the optimal time to sell.

Importantly, corporate brokers appear to be very concerned that any transaction which they facilitate be 'right' for both the buyer and seller. This is in sharp contrast to the reputation of retail business brokers, who often appear more concerned about comission schedules and closings than about interpersonal and intercorporate fit.

Buyer Customer Base

As stated previously, corporate business business brokers work most often with corporations, and to a lesser extent wealthy individuals. Demand appears to be both steady and extremely heavy. Recently, the pressure on the industry's capacity has increased, partly due to a dramatic growth in clients from abroad. These non-domestic clients are often pursuing a modest acquisition in this country in order to better understand the US market or a US-based technology. Nevertheless, this segment appears to be very small portion of the overall corporate broker activity.

In my contacts with twenty corporate brokers whose names I obtained from the acquisition department of a Route-128 conglomerate, five were no longer in the business, three were in Florida for the winter, and eleven of the remaining twelve either immediately stated that they could not help me (three were blunt enough to tell me that I honestly was not worth their time), or did not return my repeated calls, or promised to check their files for potential matches.[19] I have not received any additional information from any of these contacts. Although only one of the brokers was of assistance to me in my search, referring me to an attractive acquisition cnaddate, several were willing to take the time to advise me as to the best method for me to employ in locating a company. This information has been of great assistance in my acquisition process.

<u>Buying a Business Through a Corporate Broker</u>

Product Mix - Corporate brokers do not appear to have a specialty in terms of the types of sellers that they deal with, although proprietership corporate brokers usually work with sellers in industries which are at least remotely related to their former areas of expertise. Transactions completed by corporate brokers appear to have an average purchase price of approximately two million dollars, with a range of from five hundred thousand to five million dollars.

Valuation Method and Financial Structures Employed - One widely respected corporate business broker with whom I spoke stated that the industry average price to cash flow ratio for corporate brokers was approximately five (after the owner's salary and before interest depreciation and taxes).[19] Most corporate business brokers have a strong distaste for seller financing, stating that when their sellers want to leave a business, they want to make a clean cut. In one case, a broker stated that his sellers would generally consider seller financing only for the amount that the buyer was willing to pay above a fair base value for the company (often book value).[20] Another broker stated that he would only advise a seller to accept owner financing to a level equal to ten percent of the buyer's net worth. Obviously, this preclusion of seller financing creates a tremendous barrier to a young entrepreneur enlisting the aid of a corporate broker in performing a leveraged buy-out.

It is interesting to again examine the differences in valuation and term policies between corporate and retail brokers. Retail brokers primarily work for the seller and are anxious to complete a transaction in a most timely fashion. As a result, businesses in the retail market are on average undervalued and offer generous purchase terms. These terms are necessary to attract buyers in a timely manner. In the corporate broker market, an excess supply of buyers has created a situation where sellers are induced to sell by high price/cash flow multiples and favorable purchase terms. In each market, it therefore seems that the party which the broker concentrates on serving is left with the least advantageous position in the transaction. This may say something about the service levels provided by brokers, and about the potential advantages available to a buyer in circumventing the use of a broker.

Approaching a Corporate Business Broker

If a buyer feels that he or she fits into the target customer segment of a corporate business broker, I would suggest gathering information from one's network to identify the corporate brokers in the buyer's area. With some brokers, a young entrepreneur might also possibly catch the imagination of the former young entrpreneur lurking inside an older corporate broker. In this case, the broker might provide the young buyer with assistance, even though the transaction may not be financially optimal for the broker. For example, my enthusiasm and connection with MIT was essential in one of my corporate broker contacts, a Sloan Undergrad from the 1940's. While this broker has provided me with only one active lead, I attracted his curiousity to the extent that he has offered significant assistance during my search.

A final note on approaching corporate business brokers: When calling a broker, I often tried to efficiently address in my initial comments the questions that I knew that the broker was going to ask me about my background, interests and financial resources. According to feedback that I received, giving away unrequested information in this manner was regarded by some brokers as the sure sign of a 'green' buyer. Consequently, other buyers may want to take a more gradual approach to disclosing information, in order to maximize the the buyer's perceived credibility in the eyes of the broker.

Summary Assessment of Corporate Brokers as a Channel

Corporate brokers are, as the saying goes, 'great work if you can get them'. As a group, they appear to have access to quality companies of approprite size to the young entrepreneur. Nevertheless, the abundance of buyers in the corporate segment creates a difficult competitive situation for young entrepreneurs, as do the higher valuation methods and the lack of owner financing available through this channel. These negative factors and the ability of a buyer to replicate the process undertaken by this channel make it disadvantageous in my opinion for a buyer to hire a corporate broker on a retainer basis. This may be a corporate broker's typical request in response to a statement of interest by a young entrepreneur, but should probably be avoided.

SECTION III - CHAPTER 9
DIRECTLY APPROACHING COMPANY OWNERS

Introduction

Directly approaching company owners provides the young entrepreneur with the best chance of ending a search with an attractive acquisition candidate.

The primary advantage of this approach is that the young buyer is often able to locate companies which are not officially for sale, thus giving the young buyer an exclusive relationship with the seller. Under these circumstances, the underfinanced and less experienced young buyer need not worry about uncomplimentary comparisons with other buyers.

The primary disadvantage of directly soliciting small business owners is the young entrepreneur expends significant resources knowing that only a small portion of the owners contacted will be interested in selling. Unlike other channels (such as business brokers), the company owner in a directly solicited company has not given any indication that the company is for sale.

Nevertheless, there is a surprising degree of receptivity on the part of small company owners to direct approaches to sell. A recent survey by American Express indicated that roughly ten percent of all small business owners surveyed were planning to sell their companies in the near future[1]. This is appproximately the response rate that I - and other young entrepreneurs that I contacted[2] - received from direct solicitations of owners. Because this ten percent rate exceeds the probability that an intermediary in another channel will provide the young buyer with a promising lead, my opinion is the young buyer's time will be better spent directly approaching company owners.

This chapter will describe all aspects of directly approach companies concerning their availability for sale. The process will be broken down into its components, with each segment containing information on useful resources and optimal approach strategies. At the chapter's conclusion, I will present a general assessment of the direct solicitation approach. The chapter is divided as follows:

a) Locating companies to contact
b) Structuring the correspondence
c) The first meeting
d) Advantages and disadvantages of contacting companies directly
e) The probability of succeeding in purchasing a company using this Method

<u>Locating Companies to Contact</u>

The first step in directly approaching company owners about selling their companies is locating a list of companies in which the buyer is interested. There are numerous resources which a buyer might use for this purpose. A partial listing might include:

- General corporate directories
    - <u>Dun & Bradstreet Corporate Directory/Million Dollar Directory</u>
    - <u>Standard & Poors Resource Books</u>
- State directories of manufacturers or service companies
- Trade association membership listings
- Local chamber of commerce membership listings
- Yellow page advertisements

- Interviews with suppliers or customers of an industry
- Custom listings from services, such as Dun's Marketing Service
- Product catalogs, such as Thomas' Register

Depending on a young buyer's industry or geographic focus, all of these sources could prove useful. There are several pieces of information that the buyer will need to obtain from these lists before a company can be contacted. At a minimum, the buyer needs to know a company's name, address, phone number, and SIC code. Directories of higher quality offer details such as a short description of a company's product line, the president's name, and the number of employees. At an even higher level of quality, marketing services such as Dun's Marketing can provide a buyer with customized listings, but usually at a minimum cost of $2000. These listings can include variables which serve as indicators of a willingness to sell, such as the ages of a company's principals (many people who sell their businesses do so in order to retire).

Exhibit 4 shows examples of listings from some of the directories that I have encountered, showing the depth of infomation that each directory contains. Not shown here is the ordering scheme used by each directory. This is a key factor in deciding which directory best suits the needs of the buyer. For instance, the Thomas' Register[3] lists companies by product classes, with companies within a product type listed alphabetically. This directory is well-suited to a focussed search of a particular industry where geography is not a constraining factor. The George D. Hall Directory of New England Manufacturers[4] lists manufacturers by city, with the companies in each city listed alphabetically. This directory was particularly approriate for my search, because I was quite concerned about company location, and not particularly concerned with industry boundries. The D&B Million Dollar Directory[5] and the S&P Source Books[6] are organized alphabetically by company name on a nationwide basis, with an index containing a listing of companies by SIC code. This type of directory appears useful only if a buyer already knows the names of the companies under consideration.

Another factor to consider when choosing a directory is the coverage of the listings. By coverage, I mean the portion of companies existing in an industry or locale which actually appear in the directory. While one might think that 'a directory is a directory', there are actually great differeces in the coverage achieved by directories. For instance, the company directory available from the Gloucester Chamber of Commerce[7] includes over 50 manufacturers in Gloucester. The Massachusetts Directory of Manufacturers includes only 19 listings for that same city.

A final critical differentiating factor among directories is the accuracy of its data. A buyer needs only to call one company and ask for a president who has been deceased for three years to appreciate this factor's importance. Directories which are published annually, and those listings for which the company pays a fee usually contain the most up-to-date information. The New England Directory of Manuacturers fits into this category. Listings from information services such as Dun & Bradstreet are notorious for not having been recently updated.

Structuring the Correspondence

Contact with a company typically comes in three forms: letters, telephone calls, and in-person visits to the company. In this segment, I will follow the course of correspondance from initial contact to the first in-person meeting with a company. While I will concentrate on the approach strategy which I used in my search, I will also try to examine alternate strategies.

There are three objectives to be met by the correspondence which occurs before the first meeting with a company. The first objective is to make a company owner aware of the buyer's presence and of his or her interest in discussing a purchase. The second objective is to determine the receptivity of the owner to the buyer's proposition. The third objective is to position all correspondence in a manner which maximizes the probability of an owner responding positively to the buyer. This third objective should take up most of the buyer's energy and requires that the buyer be particularly sensitive to the biases and needs of the owner. By sensitively approaching a company owner, a buyer can often convert a non-seller to a seller, thus obtaining an exclusive relationship with a legitimate acquisition prospect.

The Initial Contact - Initial contact with an owner generally occurs either through a letter or a phone call. The advantages and disadvantages of each approach can be considered within the context of two parameters: the efficiency to the buyer, and the impression made on the seller. I will discuss each contact method in depth below; but, to summarize, phone contacts are usually more efficient, while a letter usually makes a better impression.

If the initial contact is a phone call, the buyer is able to screen for seller interest with a very small investment of time. After calling a large number of seller prospects, the buyer needs only to send time-consuming follow-up letters to those companies expressing an interest in selling. These follow-up letters can benefit from the initial phone call by addressing those issues that the buyer recognized as being of particular concern to the seller. Also, the buyer can make his or her approach to a seller more personal in a phone call than would be possible with a word-processed letter.

The major disadvantage of initally contacting an owner by phone is the conversation might not allow the buyer to convey his or her intended messages verbatim to the seller. In my experience, when owners are contacted by telephine about selling their businesses, their first response is to evaluate the potential buyer. "Why my business? Where did you hear about us? How old are you? What do you think my company is worth? How much money do you have?" It is very difficult to effectively answer these questions spontaneously on the telephone. I would prefer to answer them in a letter, where I can carefully word my message.

A second disadvantage of initially approaching an owner by phone is some owners may regard this type of approach as disrespectful. According to a discussion that I had with an executive at a small business trade association[8], buyers with MBA degrees are often viewed by small business owners as 'punks in pinstripes', with no appreciation for the challenges involved in operating a small company. Simply calling a company and asking to buy it could be perceived as arrogance by some small business owners. In small businesses, where so many decisions are based on 'gut feel', making an unfavorable initial impression on a seller may prove disastrous to a buyer.

There is a third disadvantage to 'cold-calling' a seller which is logistical rather than functional. When a buyer calls a seller with whom (s)he has never spoken, the seller's secretary usually inquires as to the nature of the call. The typical question is: "Will (the owner) know what this is about?". The buyer can't tell the secretary the true nature of the call, and can't resort to the aforementioned "I'm following up on a letter" approach. This can make reaching the company owner fairly difficult. Also, one never knows what the uninformed secretary might say when transferring a call to the owner, perhaps something to the effect of: "there's some young guy on the phone and I have no idea what he wants and he won't tell me". This is not an optimal entry for the buyer.

A primary advantage of using a letter to initially contact an owner is it allows the buyer an uninterruptable forum in which to state his or her case for buying the company. It is critical that a young buyer maximally exploit this opportunityby making the letter interesting to the owner yet sympathetic to the owner's concerns. There are company owners who would never consider selling their business, those who are already in the process of selling, and those who might consider selling if approached in the correct fashion. The quality of the letter will have little impact on the first two types of readers - the non-sellers will throw the letter away, and the sellers will immediately call the buyer. The buyer is really targeting the third type of owner - the one on the margin, who hasn't thought about selling but who's curiosity will be piqued by the letter. Positioning a letter to spark this owner's interest is challenging, and requires more psychology than letter-writing excellence. Multiple issues must be addressed, without leaving the impression of having simply covered points.

There are three other general advantages of using a letter for an initial contact. First, it is perceived by sellers as formal and polite. The first time that I called a company owner to inquire about selling a company, the owner replied: " I can't talk to you about this on the phone, write me a letter and then we can talk about this".[9] Second, the buyer can use a well-written letter to make an articulate first impression on the owner. Finally, writing a letter allows the buyer a base of information to fall back on when calling the seller.

The two major disadvantages of using a letter for an initial contact are that the letter may come across as impersonal, stiff, or standardized and that a letter requires a tremendous amount of time to write and produce. As one of my advisors once told me: "Never give away equity when you can pay someone, and never write a letter when you can make a phone call."[10] There is no question that writing my letter was a time consuming process. Especially if one does not have access to a laser-printing word processor, the incremental success obtained by writing a letter rather than phoning may not justify the extra time investment.

The letter which I wrote to owners took tens of hours to produce. By the time that it was mailed, the letter had been pared such that every sentence remaining was serving some purpose designed to induce the owner to sell. My particular effort was hampered by a search which focussed on locating a leading company in a small market, rather than a company within a certain industry or geographic locale. I have placed the result of my work in Exhibit 5.

In designing my letter I tried very hard to avoid the style of a form letter. Instead, I wanted to give the impression to the recipient that the letter was sent only to a select group of companies. In my letter's opening statement and much of its first paragraph I attempted to show the company that I recognized their industry leadership position. My first paragraph also explained my purpose in writing and the terms under which I would make an acquisition.

My second paragraph was intended to counter anticipated owner responses after having read the first paragraph: "Who is this young guy, what are his skills, and why does he think that he can buy my company?" This section also described TCHayles, my company. Finally, this paragraph assured the seller that I had the wherewithal to buy his or her company.

In the third paragraph, I reiterate the attractive financial returns available to the owner from selling his or her company. I also attempted to take advantage of the small business owner's natural mistrust for paid intermediaries. Finally, I stated my intention to build upon any owner's business, rather than change it. I included this remark because Lewis Shattuck, the Director of the New England Smaller Business Association, told me in an interview that small business owners often fear that MBA's entering a small business will instantly attempt to change those factors which made the business successful[15]. My goal was to differentiate myself from this stereotypical MBA.

The final part of the letter was intended to show that I recognized the small business owner's busy schedule and that I was open to questions or seller input.

The response received from this letter was extremely favorable. In my follow-up calls, owners generally stated that the letter made them think very hard about selling, and that they wouldn't change any part of it. In all, I sent twenty-one letters to small company presidents. From this group, I received four bona fide leads. While none of these leads has prompted a purchase in the short-term, I remain in active discussions with three of the companies.

I did, however, receive some negative feedback on my letter. I reviewed the letter with a former small and large company entrepreneur who was enrolled at an executive education program at the Sloan School. This individual believed that the letter was far too detailed and complimentary, and that it would cause an owner to overvalue his or her company. When a buyer tells an owner that (s)he has an exceptional company, he reasoned, the seller will expect that exceptional-ness to be translated into cash. I believe that this criticism is accurate, but believe that if one does not court an owner, the owner may not consider selling his or her company. There is, therefore, a tradeoff between getting owners to consider selling and enhancing the buyer's price negotiating position.

Following Up the Initial Contact - It is my sense that in most cases a buyer will maximize his or her effectiveness by alternating between written and verbal contact with the owner. For example, I found it very useful in my search to follow up an initial solicitation letter with a telephone call. In this call, I guaged the owner's interest, and, if the situation looked promising, comitted to sending the owner a resume and a tailored letter which detailed my interest in the firm and addressed the owner's concerns about selling. In fact, I have found alternating between communication forms remained useful even up to the fifth and sixth contacts with an owner. In written communication, I take advantage of the opportunity for clarity and precision to address nebulous issues arising from earlier phone conversations. In oral communication, I maintain my personal relationship with the seller and obtain feedback on my letters.

In corresponding with companies, a buyer should constantly consider whether (s)he has reached a point of time overinvestment in a company. For instance, a buyer should never take the time to write a customized letter to an owner who has not given a clear indication that (s)he is interested in selling. I again refer to my interview[12] where a former young buyer advised that if a seller says only that (s)he might consider selling a company, hang up the phone, a deal will never occur. While I initially regarded this statement with septicism, it has been confirmed during my search. Each owner who initially gave me a lukewarm response has since taken steps to delay the discussionn process.

While it is critical not to overinvest time in owners with low potential for selling, I am convinced that a well-positioned approach from a buyer can convert a non-seller into a seller. Time is the critical factor. If the buyer is looking for an acquisition in the very short run, the advice given above is accurate, and swaying the owner holds little promise. If, on the other hand, the buyer is less time sensitive, customized contacts can represent the first stage of an extended process which ultimately leads to a transaction. One of the company owners that I contacted[13] stated that he had bought five companies using this 'extended courtship' approach. In his opinion, this approach constituted by far themost effective purchase method that he had encountered. Notably, one of his transactions required a four year gestation period between the initial contact and the closing.

<u>The First Meeting</u>

The four primary objectives of an initial meeting with a seller are to analyze whether the company represents an attractive acquisition, to determine the owner's true willingness to sell, to get some sense of the selling terms which would be required by the seller, and to create a positive interpersonal relationship betweeen the buyer and seller.

Understanding the attractiveness of purchasing a company is primarily a strategic exercise. Nevertheless, if a young buyer's general goal in purchasing a company is to rationalize its operations or to expand its markets there will be clear indications from the company owner as to the opportunities existing in these areas. For instance, I was speaking with a small company owner who stated that he was too busy to worry about computerizing his operations even though he was sure that it would save him thousands of dollars.[14] Another owner stated that while he almost never contacted his customer base, they were always approaching him with as much business as he could handle.[15] These were sure signs of opportunities for rationalization.

Determining the owner's true willingness to sell requires very carefully watching and listening to the owner. The owner's responses to questions asked by the buyer can very quickly provide the buyer with much of the information required to make a decision. A revealing question to ask is: "What will you spend your time on if you sell the business?". If the answer to this question doesn't appear genuine or to be very well thought out, the owner is probably not seriously considering selling. The buyer can also ask questions about the seller's vision of the sale price or terms. If the owner has no opinion on this issue, and only wants to hear the buyer's bid for the company, the owner is probably just valueing the business and not ready to sell.

A willingness to sell can also be interpreted from the openness displayed by the seller regarding the disclosure of financial or customer information, and from the general warmth accorded to the buyer. Finally, a buyer can interpret an owner's willingness to sell by watching how the owner interacts with the company surroundings. If it looks like the owner would never be happy anywhere else, (s)he probably isn't considering selling. If the owner seems tired with the surroundings, the likelihood of a sale is higher.

There is little to be said regarding the buyer's final objective from a first meeting of creating a positive relationship with the seller. The buyer should be open, honest, enthusiastic, and sincere. If a sale is to occur, this will be the first meeting of many between the two parties, they should get along.

Advantages and Disadvantages of Contacting Companies Directly

There are two distinct advantages of contacting companies directly as opposed to using other search methods. The first advantage is the young buyer is not usually competing with a multitude of more credible buyers. There are benefits from this lack of competition. First, the young buyer does not need to pre-arrange financing. This allows great flexibility in achieving financing tailored to the purchase of a specific company. Second, the young buyer need not worry about compensating an intermediary to provide the buyer with leads.

The second advantage of directly contacting companies is the buyer is able to pre-screen the companies contacted. Using this approach, the buyer will only pursue companies which are appropriate to his or her search focus. When dealing with intermediaries, the buyer may work very hard to make a contact with an intermediary, only to find that the sole lead that the intermediary has is in an industry far removed from the buyer's interests.

There are several other advantages to directly contacting a company owner. A partial list would include:

- The buyer, not an intermediary, controls the communication flow with the seller.
- The buyer is able to gather external information on the

target company at all stages of the process. When working with an intermediary, the identitiy of the seller often remains confidential for much of the process, making this sort of 'due diligence impossible.

- The high response rate on direct mail approaches allows the buyer to constantly have a large pool of potential purchases.

There are three disadvantages to directly approaching companies. The first is that there is no way of pre-screening for interest on the part of an owner. Given that all contact is initiated by the buyer, the seller can participate in discussions with a low level of commitment, and discontinue discussions at any time, regardless of the buyer's accumulated time investment. Notably, this situation contrasts to those in other channels for acquiring a firm, such as business brokers. In htese areas, if the intermediary provides the owner with an acceptable buyer, the selleris financially bound to complete the sale. No such control exists in this case.

The second disadvantage of dealing directly with owners is the purchase timeframe is usually significantly longer than one would expect when dealing through an intermediary. To complete a transaction after a direct approach, the buyer must both convince the owner to sell and agree to purchase terms. The owner's decision to sell can be compared to a seed planted in the owner's mind. Some seeds germinate overnight, others take months or years. If a buyer needs to complete a transaction in the short run, counting on a rapid owner 'germination' may not be advisable. Also, when a young buyer and seller are negotiating without an intermediary, each side feels a need to progress slowly in order to avoid having advantage taken of them. This factor can further delay the purchase process.

The third disadvantage of directly contacting an owner is the negotiating power in the relationship usually lies with the owner. The buyer initiated contact, so the seller justifiably expects to be treated as though his or her company is 'special'. As noted earlier, this perception is usually manifested in an owner's unrealistic expectation of a company's value. Consequently, the buyer must attempt at all stages of the discussion process to encourage the adoption of specific criteria on which price will be based, such as cash flow or assets.

There are two other disadvantages which I associate with directly contacting owners:

- The lack of an intermediary makes determining a price or purchase terms difficult. Neither side is aware of industry standards, so a great deal of negotiating takes place. During these negotiations, the fees of professional advisors such as lawyers are constantly rising.
- The amount of effort required of the buyer is significantly higher than is necessary when using an intermediary. In the process of contacting and negotiating with a company directly, a buyer is taking on many of the roles which are typically played by an intermediary. These activities are tremendously time consuming.

Summary of Opportunity

I believe I would now own a company had I begun my search by concentrating on directly approaching small businesses. Despite the disadvantages associated with this channel, the favorable response of small business owners to direct solicitations and the young buyer's ability to create an exclusive relationship with a seller make this the most attractive channel available to the young buyer. The buyer's individual probability of successfully completing a search is a function of two variables. The first is the amount of time the buyer can devote to the search. In this case, the longer the buyer can spend, the better. The second is the circumstances in the market upon which the buyer has focussed. If the market largely consists of older, stable companies, there is good chance that one of the existing owners might wish to sell. If a market is new and growing rapidly, it may be difficult to locate a willing seller.

SECTION III - CHAPTER 10
OTHER CHANNELS FOR LOCATING ACQUISITION OPPORTUNITIES

Introduction

To this point, I have discussed in depth those channels which I believe offer the young buyer the greatest likelihood of consumating a transaction. Nevertheless, buying a business is above all things a random process, almost any channel could be the one which leads the buyer to an attractive seller. In the following pages, I will explore several alternate approaches which the buyer might employ to locate a company. As stated earlier, I have not fully analyzed these channels because of my concern with overinvesting time in areas with low expected returns. I will, however, include as much information as I have gathered on each approach, as well as my explanation as to why I viewed each channel as having low potential. As discussed earlier, this chapter will be organized according to the amount of support provided to the buyer by an intermediary.

High Level of Buyer Support

- Business Brokers - See Earlier Chapter
- Small Scale Investment Banks

10.1 Small Scale Investment Banks

There exist numerous investment banks which facilitate transactions involving the sale of small to medium sized businesses. In recent years, the number of firms offering these services has greatly increased. In the banking sector alone, at least three middle market Boston banks, Bank of New England, Shawmut Bank and USTrust, have created investment banking divisions in the past two years.

I spoke with a few of these intermediaries, but soon realized that the market which they were targeting was for much larger transactions than I was seeking. One investment banker told me that his firm had an informal minimum sale price of five million dollars.[1] His feeling was that this lower bound was fairly common in the industry. "It takes just as long to do a small deal as a large deal, and using the Lehman formula it just isn't worth it to take on anything smaller than that." (As noted earlier, the Lehman formula is used for determining commisions for investment bankers and corporate business brokers. The formula is: 5% fee on the first milion in purchase price, 4% on the second million, 3% on the third million, 2% on the fourth million, and 1% on the remainder of the purchase price.)

A second drawback of investment bankers is they tend to greatly overprice small companies. As was shown earlier, the average price earnings ratios on deals from retail and corporate brokers ranges from 2.4 to 5 times earnings. In my opinion, investment bankers' focus on larger deals makes them expect prices equal to 7.5 to 15 times earnings. These premiums are more akin to Wall Street than Main Street.

Advantages do exist in working with small-scale investment banks. Working with small company investment bankers may offer the young buyer advantages not available elsewhere in the market. First, investment banks often have the capability to assist a buyer in financing a purchase by locating funding sources or taking equity positions in a purchased company. Second, many of the new entrants to the investment banking field do not seem to be tremendously busy at this time, so there may be a short-run oportunity to utilize the services of these firms for smaller transactions. For example, each of the start-up investment banks that I called suggested a same-day meeting when I asked whether we might meet to discuss my search.

When dealing with investment banks, one must be very careful to pre-arrange which party will be paying the banker's fee. For the sale of small companies, it is typically the party that first approaches the bank which pays the fee. In other words, if the investment bank is doing a search for a buyer and locates a company, the buyer pays the fee. If the bank has been approached by an owner to sell his company and the buyer subsequently contacts the bank, the seller pays the fee. Nonetheless, in one case that I recently encountered, a small investment bank was so eager to create transactions that it worked with a business owner without a fee, with the understanding that the fee would be absorbed by the buyer. This fact had not been made clear to me when first approaching the banker.

Moderate Level of Buyer Support - The 'Efficient Outreach' Channels

- Accountants
- Bank Lending Officers
- Lawyers
- Corporate Acquisition Directors
- Bank Work-Out Loan Areas or Troubled SBA Loan Customers

The participants in the moderate buyer support channels fall into two catergories. First, there are intermediaries who serve as advisors to small businessmen as a normal course of business, and who would tend to know when an owner is considering selling. In this category fall accountants, bankers, and lawyers. Second, there are intermediaries who tend to encounter companies which are currently in a state of flux, where selling a company is an option which is constantly under consideration. Into this category fall the 'work-out' loan departments at commercial banks, the U. S. Bankrupcy Court and directors of strategic planning at diversified corporations. I refer to these intermediaries as efficient outreach sources because with one contact the young buyer can gain access to information on the selling intentions of a whole base of clients or companies.

In each of these channels, the intermediary benefits by assisting the young entrepreneur. For practitioners of services, the ability to assist a company owner in selling reinforces the intermediary's desired position as confidant to the owner. Providing this level of service can solidify an intermediary's relationship with an owner to a point where the owner would never consider using one of the intermediary's competitors. Also, the intermediary will often receive some sort of professional fees (such as accountanting or legal fees) while representing the seller in discussions with a buyer. Similarly, when a business is referred to a young entrepreneur from a workout officer, bankruptcy trustee or corporate strategic planning officer, that intermediary is usually attempting to rid itself of a difficult situation. Thus, the moderate level of support channel provides an example of mutual self-interest between all parties to the transaction.

When I began my search, I felt that efficient outreach sources held the highest potential for my finding a company. In speaking with other young buyers that I interviewed, two of them said that they too had started their search with this belief, but soon realized that these channels would not lead them to any attractive situations.[2] They both said, 'go talk to them, you need to do it, but it still won't get you any deals'. I didn't really believe them then, but now I understand. For each channel, I found at least one drawback which made that channel less than satisfactory. Hopefully, this next section might save the young buyer from spending as much time as I did in this channel before arriving at a similar conclusion.

One general message of caution: With as many potential buyers as there currently are in the Boston market, none of the channels below has been ignored. Each intermediary that I interviewed referred to a file or a pile on a credenza that was full of letters from potential buyers. Thus, a young buyer must fear the same sort of intra-buyer competition when approaching these channels as in the business broker market. Emphasis should be placed on the young buyer's focus or unique approach, or the young buyer risks being relegated to the bottom of the pile.

10.2 Accountants

According to a survey of small business owners, over fifty percent said that their accountant was their most important advisor[3]. Accountants are often the 'grass-roots' business owner's only contact with sophisticated financial matters. As such, if a small company president is considering selling his or her business, the accountant is informed very early in the process. In fact, one of the accountants that I interviewed indicated that he was often the first to bring up the idea of selling with an owner[4].

For a young entrepreneur, contacting accountants would seem to be a clear first step in making use of efficient outreach sources. The primary difficulty of such an effort is that as a group accountants are tremendously decentralized. There are literally hundreds of accounting firms in the Boston area. When attempting to locate accountants to contact, my first step was to consult the local yellow pages. Unfortunately, there were over five pages of listings, with no way of distinguishing large firms from small firms, and firms focussing on small businesses from firms concentrating on individuals. The 'efficient outreach' was looking less than efficient.

There exists a second major difficulty in using accountants as an outreach source. When becoming aware that one of their clients is thinking of selling, accountants often refer a lead to one of their existing clients, rather than to an "outsider". Most accountants have a large enough client network that, at any given time, at least one of their clients is looking to grow by acquisition. (I again refer to the Arthur Andersen survey, which stated that at any time an average of 33% of all small businesses are looking to grow by acquisition.) An accountant would much rather refer a company to a known revenue-paying client than to a unknown young entrpreneur.

I interviewed the partner in charge of the small business practice at two of the 'Big-8' accounting firms. My hope was that by talking to the largest of the accounting firms, I would be maximizing my chances of learning of an attractive opportunity. Generally, what I learned was that the large accounting firms only concentrate on small businesses which they hope will soon grow into large businesses. For businesses which are not growing rapidly, the high fees associated with a Big-8 firm make using these firms uneconomic. In fact, one of the Big-8 firms that I interviewed placed an informal lower limit on company size of two million dollars in sales. For me, this was toward the high end of the companies that I was looking to buy.

Late in my search, I became aware of two potential methods for locating the accounting firms which tend to serve the small company market. One of the Big-8 partners with whom I spoke recommended that I obtain the ranking of accounting firms by size which appears in the Boston Business Journal, and focus on contacting the firms which were the fifteenth to twenty-fifth largest in the area. A second source which I located was a membership listing of the Smaller Business Association of New England (SBANE)[5]. In this directory are advertisements for about fifty accounting firms which specialize in serving small businesses. Were I to start my search again, I would begin my contact with accountants by approaching these firms. To contact an accounting firm, I would recommend writing a letter to the managing partner of a small firm, or to the partner in charge of the small business practice at a large firm (Exhibit 5 contains my letter to the head of a small business practice at a big-8 firm).

To summarize, the very close relationship that accountants often have with small business owners could make them an extremely valuable lead source to the young buyer. But, the lack of concentrated sources to approach in the small business accounting field as well as the motivation for an accountant to refer a lead to an existing client rather than an unknown buyer may make approaching this channel an inefficient use of a buyer's time.

10.3 Commercial Bank Lenders

Like an accountant, a banker to a small company often provides support to the owner as a financial confidant. In addition, every commercial loan agreement contains a provision against selling a company without the lending bank's pre-approval. For this reason alone, the owner often involves the banker at a very early stage of the selling process.

Unfortunately, after conducting a direct mail campaign to over 125 bankers, I realized that this channel holds a relatively low probability of leading to success for a young entrepreneur. The fundamental problem with bankers as intermediaries is usually only bankers to middle market and large companies interact with a company frequently enough to serve as true advisors. These company's sales usually range from ten to one hundred million dollars - far larger than anything that I would consider purchasing. The economics of lending to small companies, which typically have loans of well under one million dollars, only justify the time investment of a 'small company' lender. According to my interviews with bankers, these lenders typically have between fifty and one hundred fifty accounts. The lender, therefore, can not spend a great deal of time with each of his or her customers, so it is only very rarely that the subject of selling a company could arise. If the responses to my letter are any indication, bankers are a very poor channel from which to obtain leads for acquisitions (130 letters sent, zero responses - see Exhibit 6 for the letter).

10.4 Lawyers

Lawyers are the final group of advisors whom the small business owner might consult when deciding to sell a company. In my search, I had very little contact with lawyers, simply because this group appeared to be even more decentralized than accountants. Knowing which attorney to approach when contacting a law firm is difficult, as is locating a firm in the first place. Also, the sporadic nature with which most small businesses retain an attorney makes it unlikely that a lawyer would casually learn of an owner's intention to sell.

If a young buyer is interested in contacting lawyers, my two suggestions for reaching them would be to either consult a small business directory similar to that of SBANE, or to learn about popular small business lawyers from other contacts developed during the search process. Specifically, it might be fruitful to ask small business accountants which lawyers they encounter most frequently when dealing with small businesses.

One note of caution: Several people that I have interviewed have cautioned me to be wary of the involvement of lawyers in the purchase process. By the nature of their profession, attorneys are extremely risk averse. When dealing in an inherently risky transaction, such as the purchase of a company, it seems that an attorney's quest for a perfectly tight deal structure can often cause fatal delays to an acquisiion, lead a seller to require terms which are unsatisfactory to the buyer, or send the legal fees on the purchase into orbit. By willingly according the seller's lawyer the central role of intermediary in an acquisition may be inviting a frustrating experience for the buyer.

10.5 Acquisition Directors of Diversified Corporations

The staff officer at a corporation charged with performing acquisitions is often approached by representatives of owners who would like to sell their companies. In many cases, the corporation is not interested in buying the approaching company due to that company's size, industry focus or market position. This creates a situation where at any time the acquisition director may be aware of a virtual inventory of companies which are for sale but which do not fit with the director's own corporate needs. The acquisition director might also be aware of small subsidiaries of the corporation which are candidates for divestiture. These subsidiaries represent an attractive opportunity for a buyer, because the corporation's imperative is often to get the subsidiary off the books as quickly as possible rather than to obtain the highest possible price.

With the proper approach, the young buyer might be able to access this network. One problem is that these individuals may not be accustomed to being contacted by young buyers, or they may not want to take the time to speak with the buyer. Consequently, I have found it useful to solicit acquisition directors through a networking approach, using contacts that I made earlier to facilitate discussions. This is a somewhat difficult situation to arrange. Nevertheless, once a discussion has been arranged, I have found these individuals to be tremendously suppportive of the young entrepreneur. Unfortunately, it seemed in my discussions that the smallest deal evaluated by an acquisition director and the smallest contemplated spin-off were considerably larger than the deals that I was interested in performing.

In the case of a corporate spin-off, there are advantages and disadvantages of buying a company from a corporation rather than an individual. One distinct advantage is that the emotional side of selling the company usually doesn't exist. A corporate acquisition director doesn't feel any emotional attachment when selling a company. Also, the timeframe necessary to complete a sale is usually shorter with a professional corporate staffer than it would be with a relatively unsophisticated seller. The two primary disadvantages of purchasing an operation from a corporation are that the corporation has strong barriers against selling a company at a loss, and that corporations are usually extremely hesitant to provide seller financing. In many cases, these disadvantages can make buying a company from a larger corporation unattractive to the young buyer.

10.6 Bank 'Work-Out' Areas or Troubled SBA Loan Customers

Within most large banks and the SBA is a group of lending officers that works with companies which are in trouble, but which usually have not reached the point of bankruptcy. Loans within these areas are generally referred to as 'work-outs'. The poor condition of these companies is often a function of poor management, and occasionally both the customer and lender agree that the sale of the company would be appropriate. Hence, I felt that this area might serve as a fruitful channel for locating companies whose depressed condition would warrant a modest purchase price.

As it turns out, many potential buyers have come to this same conclusion. I spoke with the director of the work-out area at a large regional bank who pointed to a six inch pile on a credenza which entirely consisted of buyers seeking companies for sale. A second problem with purchasing a company in distress is that the young buyer will face a tremendous adjustment period when first purchasing a company. To obtain this learning in a troubled company may not allow the owner time to clear the decks before the ship sinks. This creates an extremely risky situation for the young entrepreneur. Finally, I was completely unable to gain access to SBA loan officers, who refuse to discuss any matters related to a loan program customer. This lack of access eliminated my chances of exploiting this portion of the channel.

<u>Low Level of Buyer Support</u>

- Direct Approach of Company Owners (See Section III - Chapter 9)
- Companies in Bankruptcy
- Classified Advertisements by Owners
- Networking by Buyers

The process involved in locating an acquisition target is very similar across all channels providing a low level of buyer support. In these channels, the majority of contact is between the buyer and the seller, rather than the buyer and an intermediary. Consequently, I will only briefly discuss the existance of each channel in this section, and will refer the reader to the chapter on directly approaching companies for additional insight into the process of working with a seller.

10.7 Companies in Bankruptcy

Bankruptcies are a matter of public record. Every company which files for bankruptcy has created for it a folder which is available for public examination at a local federal building. In this file is a wealth of information about the company - its line of business, financial statements, creditor lists, etc. - all of the information that a buyer needs to judge whether the company presents an attractive opportunity.

A firm in bankruptcy is either operated by the firm's pre-bankruptcy management or placed under the supervision of a court-appointed trustee. The individual managing the company is responsible to a comittee of the firm's creditors, and, ultimately, to a bankruptcy court judge. The trustee or previous company president (if a trustee has not been appointed) serves as the buyer's point of contact. Firms in bankruptcy are often anxious to be sold, because weak or uninvolved management is often the root cause of the company's downfall. Two of the company owners that I interviewed had bought bankrupt companies.

Buying a company out of bankruptcy is equivelent to buying a company which is in the work-out area of a bank. In these transactions, the prices are low, but the risk of never bringing the firm to profitability is high. Unless the buyer is very comfortable with the bankrupt firm's industry, I would recommend against utilizing this channel.

10.8 Classified Advertisements By Owners

Each Sunday, the 'Business Opportunities' section of the newspaper contains classified ads placed by owners seeking to sell their companies. Also, there exist several listing services which produce monthly listings of owners anxious to sell their companies. These listings are distributed monthly to potential buyers. Both parties, the owner and the potential buyer, pay the listing service a moderate fee (typical buyer's fee: twenty dollars per list per month). Listing agencies providing these services include: ADMAX (Ft. Lauderdale, FL), The North East Business Opportunity Report (Nashua, NH), and Leval, Inc. (Boston, MA).

The demographics of the companies advertized in owner listings parallel those of companies listed by retail business brokers. Hence, the same difficulty applies in terms of finding an interesting non-retail purchase opportunity. During my search, I did not identify any advertisements placed by owners, either in a newspaper or through a listing service, which led me to approach an owner. Should I have made an aproach, I presume that the process would have mirrored that involved in the directly contacting a company owner which was detailed in the previous chapter.

10.9 Networking

This segment is included more as a reminder than a resource. As was stated earlier in this thesis, networking can be a critical source of leads for a young buyer. The young buyer should tell almost every person (s)he encounters about his or her search. There is a good chance that the young buyer knows someone who is aware of a company owner anxious to sell a business. It is also important to cultivate contacts for informational interviews, as these interviews often lead to an even larger number of leads for the young buyer.

SECTION IV - CONCLUSION

SECTION IV - CHAPTER 11
CONCLUSIONS/AREAS FOR FUTURE RESEARCH

This thesis has attempted to ease the young entrepreneur's search to purchase a small business by informing the entrepreneur as to the challenges involved in purchasing a company, providing information to ease the search process, and identifying and evaluating the channels through which a young buyer might purchase a company.

In terms of general search guidelines, the thesis stressed the young entrepreneur's need to focus on a particular area, obtain advisors whose skills complement the young buyer's, pre-arrange the financing required to perform a purchase and understand the psychological profile of the small business owner. If the young buyer addresses each of these needs, my opinion is the likelihood of completing a purchase is dramatically increased.

In thinking about the channels for locating a company to purchase, it is critical that the young buyer remember that finding a company is almost a random event, the lead can come from any source. There are, however, channels which provide a higher probability of success for the young buyer. For example, retail business brokers can provide the young entrepreneur with a company at an extremely attractive price if the young buyer is willing to accept a company in a traditional industry. Directly contacting small company presidents can also provide an extremely attractive channel for locating companies, if the buyer has a time frame which permits a moderately long gestation period before the purchase is completed.

Further research is required in almost every area addressed by this thesis. As the scope of the thesis has been broad, my ability to fully cover any aspect of its content has been limited. A particularly interesting area of research might be to gain a better understanding of the methods employed by succesful purchasers in locating and communicating with sellers and in negotiating purchase transactions.

As detailed in one of the first chapters of this thesis, the challenges involved in buying a small business are great. The young entrepreneur must successfully compete against other buyers who often have more credibility and financial support than is typical for a young buyer. Nevertheless, if the young buyer is persistent, structures a search in a way which maximizes the chances for success, and utilizes channels for purchasing a company which are less well understood by other buyers, there is a very good chance of succeeding in a search. The search may be time consuming, but by all reports the benefits of fulfilling one's goal are tremendous.

EXHIBITS

EXHIBIT 1

TRUDEAU TRUDEAU

& associates

WILLIAM R. TRUDEAU (Age 39) – *President and Chief Executive Officer of Trudeau & Trudeau. William brings over 15 years experience in finance and marketing. He held positions with the Honeywell Corporation and New England financial institutions. William has a BA from St. Michael's College, and is a member of the institute of Business Appraisers and a graduate of the Venture Resource Group Mergers & Acquisitions Program. He is also the past President of the New England Council of Business Brokers.*

William, his wife, Nancy, and son reside in Hull, MA.

MICHAEL C. TRUDEAU (Age 33) – *Vice President and Chief of Operations at Trudeau & Trudeau. Business ownership experience and industrial education coupled with a B.S. in Industrial Technology has well prepared Michael for his partnership role in the firm. Mike is a certified I.B.A. business appraiser, a graduate of the Venture Resource Group Mergers & Acquisitions Program, presently serving as President of the New England Council of Business Brokers and a member of Braintree Rotary Club.*

Michael and his wife, Cathy, reside in Boston, MA.

COMPANY *Profile*. . .

MARK S. BARTLETT (Age 34) *has been with the firm since July 1984. A former management consultant with Camp Dresser & McKee, Inc. responsible for conducting management and financial evaluations for public works entities in New England and Florida, Mark received his Bachelor of Science and Masters degree in engineering from Tufts University. He is a registered professional engineer and has received his MBA in finance with honors from Boston University's Graduate School. Mark is experienced in all aspects of business ownership transfer.*

Mark, his wife, Patti, and two children reside in Easton, MA.

GEORGE J. BENDER, Esq. (Age 45) *an attorney and graduate of the Wharton School, has concentrated his career development in operational and financial areas. He has over 15 years of experience in the service industry with specific emphasis on the acquisition and divestiture of various business entities.*

George's law background has presented a great opportunity for him to customize programs that provide comprehensive services for professional organizations.

The additional benefit of an association with the most successful firm in the Venture Resource Group has provided the stability and guidance necessary for program maturation.

George and his 4 children reside in Weston, MA.

D.C. and for 6 years with a major accounting firm in Boston.

Goldie, her husband and two children reside in Weymouth, MA.

WILLIAM C. HARRIS (Age 59) *comes to Trudeau & Trudeau with 25 years of proven success in business ownership and personnel management.*

Bill's professional career as a major oil company franchise consultant and high volume fuel distributor has earned him enviable experience.

Bill has an AB and MS degree from Boston University, is an overseas veteran of World War II, and is fluent in Greek.

Bill and his wife, Barbara, reside in Weymouth, MA.

ANNE B. JOLLES (Age 32) *comes to Trudeau & Trudeau after years as a health professional in a multitude of roles, including owning her own business. In 1984, she received her MBA from Simmons College Graduate School of Management. Following this, she worked in management capacities in the medical information technology industry. Anne specializes in selling and marketing franchise licenses for the Franchise Division.*

Anne and her husband, Jon, reside in Hanover, MA.

Jay has completed many sizable transactions including several multi-million dollar sales in which he was instrumental in securing financing and structure. A graduate of Central Connecticut University in marketing and finance, has recently earned a degree in Mergers & Acquisitions.

Jay resides in Scituate, MA.

JOHN C. REALE (Age 49) *brings a broad base of professional experience in executive management positions with several major companies during acquisition years. John held various executive positions with Ocean Spray Cranberries.*

John has an MBA from Southeastern Massachusetts University and has recently retired from the Marine Corps reserve as a Lieutenant Colonel.

John and his wife, Lynne, reside in Shrewsbury, MA.

JON A. SCARAMELLA (Age 43) *is the director of the franchise division responsible for marketing, development and sales of franchise licenses. He has earned a business degree from Laffeyette School of Business in Chicago, Ill.*

Jon's professional experience includes 25 years in retail clothing management stores and directorship of multiple stores for a New England retail chain.

Jon has become a leading expert in franchise ownership, transfer and education.

Jon and his wife, Sarah, reside in Reading, MA.

EXHIBIT 1 (Cont.)

RUDOLF G. BRAUTIGAM (Age 56) *is Dutch born with over 20 years of management and new business development expertise from the U.S. and Europe with Union Carbide Corporation and Emhart Corporation (Bostik Chemical Division).*

A graduate of New York University (pre-med), Rudy also studied international economics and political science and holds a Master of Science degree from Rutgers University. Rudy has 6 patents and is fluent in German, Dutch and French.

Rudy resides in Boston, MA.

ROBERT L. CAGGIANO, CPA (Age 45) *Chief Financial Officer for 11 years with American International Chemical where he was responsible for overall operations to include tax planning. Formerly with Coopers & Lybrand of Boston for 6 years, Bob formerly sat on the board of directors of the Massachusetts Society of CPAs.*

Bob, his wife, Brenda, and 4 children reside in Westwood, MA.

RICHARD N. CURTIN, Esq. (Age 42) *is a Vice President and General Counsel for the firm. He presently is a partner with Parker, Coulter, Daley & White. Richard's undergraduate work was done at Fairfield University and he obtained a law degree at Boston University.*

Richard and his wife, Anne, reside in Medfield, MA.

GOLDIE M. ECKL (Age 45), *Assistant to the President, graduated from Eastern Illinois University and served for 17 years on the staff of a United States Congressman in Washington,*

WILLIAM W. MARTIN (Age 54) *has served in an executive role with Newman-Crosby Steel, Inc. of Pawtucket, R.I. for the past fifteen years. He was President and Treasurer during the last 6 years. He was also employed by Bevis Industries, Blackstone Industries, Raytheon and Rodney Metals. Bill has an MBA from Suffolk University and a BS degree from Bryant College.*

Bill is a member of the Pawtucket Rotary Club, the National Association of Accountants, as well as many other clubs. He is a trustee of the Pawtucket Boys Club and a director of the Pawtucket Boys Club Group.

Bill and his wife Carol, reside in Seekonk, MA.

BRUCE E. MARQUIS (Age 42) *has over 20 years experience in sales management and business ownership. President of Results Service Co., formerly General Manager of the Sani-Tech Company and Executive Director of the National Spinal Cord Injury Foundation, he is also on the faculty of Northeastern University. Bruce holds a BA, and a Masters from Boston University. In 1979 Bruce was recognized by the Boston Jaycees as one of the area's Ten Young Outstanding Leaders.*

Bruce, his wife, Lucy, and 2 children reside in Newton, MA.

JAMES F. MORAN (Age 31) *is an accomplished business intermediary with 4 successful years of experience in the business brokerage division of Trudeau & Trudeau Associates. Prior to joining the firm, Jay was in the marketing group of a major Western resort.*

DR. ANDRÉ E. ST. GERMAIN (Age 48) *attended Brown University for pre-dental studies and graduated (DMD) from Tufts University School of Dental Medicine in 1963. Following a 2 year military tour with the U.S. Army Dental Corp. in France, he attended Boston University School Graduate Dentistry for specialty training is Pedodontics (children's dentistry) earning a MScD. Dr. St. Germain had maintained both a part time private practice and served on the staff of Tufts University School of Dental Medicine. He is full Colonel in the U.S. Army Reserves.*

Dr. St. Germain, his wife, Barbara and children reside in Medfield, MA and summer on Martha's Vineyard Island.

ELAINE ST. MARTIN (Age 38), *Executive Secretary, brings over 15 years administrative experience with major corporations. Her last position was with the Cellier Corporation, Paris, France. Elaine has attended Northeastern University.*

Elaine and her children reside in Wayland, MA.

FRANK X. LANG (Age 46) *has been a Chief Financial and Administrative Officer for a major development program offshore. He has held positions with the Arthur Young Company, Rockwell International, Crown Zellerbach Corporation and United Brands Company.*

Frank holds an undergraduate degree from Yale University and a masters in finance from Columbia University.

Frank resides in Scituate, MA.

EXHIBIT 2

BUSINESS BROKERS™

FINANCIAL STATEMENT STRICTLY CONFIDENTIAL

Name ______________________________

Street Address ______________________________

City ____________________ State ____________ Zip code ____________

Assets

Cash on Hand and in Banks	$
U.S. Government Securities	
Accounts, Loans and Notes Receivable	
Cash Surrender Value Life Insurance	
Value of Businesses Owned	
Other Stocks and Bonds	
Real Estate	
Automobiles-Number ( )	
Household Furnishings and Personal Effects	
Other Assets (Itemize)	

TOTAL ASSETS $

Liabilities and Net Worth

Notes Payable	$
Liens on Real Estate	
Other Liabilities (Itemize)	

TOTAL LIABILITIES $

NET WORTH $

Source of Income

Salary	$
Dividends and Interest	
Bonus and Commissions	
Real Estate Income	
Other Income	
TOTAL INCOME	$

The undersigned certifies that this information was provided by him and is true and correct.

Date: ______________________________

Signature ______________________________ Home Phone ____________________

EXHIBIT 3

CONFIDENTIAL
BUSINESS PROFILE

PIP NUMBER : 568AR

BUSINESS TYPE: Steel fabrication servicing the construction industry and manufacturing firms.

LOCATION : East Coast

PRICE : $1,200,000 with real estate Down Payment: $600,000

ESTABLISHED : 50+ years, operates 5 days, single shift

REAL ESTATE : Includes approximately 20,000 sq. ft. production and office facility.

REMARKS : The company is located on the fringe of one of the fastest growing industrial areas in the East. Growth potential without substantial additional capital is excellent. This is a stable, well established firm with a reputation for quality products and excellent service.

OPERATING PERFORMANCE

	Pretax Income	Owner's Compensation	*Cash Flow
F.Y. '86 (9 mths.)	$172	$75	$263 9 mths.
'85	101	84	350
'84	56	67	179
'83	(107)	51	8
'82	15	56	119

Assets included in purchase: (Fair market value)

Real Estate	$210,000
Machinery & Equipment	$171,000
Net Accounts Rec.	$212,000
Inventory	$ 70,000
	$663,000

*Adjusted pretax cash flow before debt service & non-recurring income & expenses.

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business brokerage • business searches • valuations

EXHIBIT 4

ACQUISITION PROCEDURES

Confidentiality is one of the most important elements to both owner and investor. The following procedures provide the potential investor the greatest protection from violation of confidentiality, which is critical in a smooth transfer of business ownership.

1. Investor meets Trudeau Associate for orientation and focus of objectives. Financial capabilities (financial statements) and acquisition team members are identified at this time.

2. Investor reviews generic company profiles supplied by Trudeau & Trudeau office.

3. Trudeau Associate presents investor with confidential Business Package detailing target company facts and financials.

4. Trudeau Associate accompanies investor on presentation of target community and company facility (exterior only).

5. Trudeau Associate arranges a brief investor interview with present company owner.

6. Company owner selects a limited number of qualified investors for an internal review of the target operation.

7. Investor and advisors structure Letter of Intent with input of parameters from Trudeau Associate.

8. Trudeau Associate presents Letter of Intent/Offer to Purchase to owner. This letter must include an earnest money deposit.

9. The investor's attorney is responsible for preparing the definitive acquisition agreement and supporting documentation.

10. Trudeau office is responsible for coordinating with all principals and their advisors the execution and completion of all events by their milestone dates, thus leading to an efficient and expedient close.

EXHIBIT 5

Examples of listings in Company Directories

The George D. Hall Directory of New England Manufacturers

MEDFORD Cont'd

● **WILLMAN COMPANY**
58 SWAN ST MEDFORD MA 02155
TEL-(617) 395-0069
SIC-3599 **EMPLOYS**-20
COMPUTER - NO
GROSS SALES - BETWEEN 1 AND 10 MILLION
PRES & TREAS ADAM J BOLAND
PRODUCT — MACHINERY FOR CUTTING RUBBER SOLES, MACHINE PARTS

MEDWAY

● **ALL TUBE CORP**
7 INDUSTRIAL PARK RD P O BOX 429 MEDWAY MA 02053
TEL-(617) 528-5611
SIC-3599 **EMPLOYS**-10
COMPUTER - NOT GIVEN
GROSS SALES - BETWEEN 1 AND 10 MILLION
PRES & TREAS WILLIAM F HULBIG
PRODUCT — TUBING

The Dun & Bradstreet Million Dollar Directory

4082 **RICH PLAN OF UTICA INC**

D-U-N-S 01-332-9347
RICH PLAN OF UTICA INC (NY)
4891 Commercial Dr, Yorkville, NY
Zip 13495 *Tel* (315) 736-9308
Sales 12MM *Emp* 60
SIC 5422 5722 Ret Frozen Foods & Home Appliances
Robert A Evans *Pr Tr*
Dorothy Evans *VP*
R Bruce Evans *Sec*
Harold Broadhurst *Asst Sec*

RICH TOYOTA
See RICH MOTOR MART INC

D-U-N-S 00-880-3967
RICH UNITED CORP (FL)
RICH PLAN OF FLORIDA
203 E 3rd St, Sanford, FL
Zip 32772 *Tel* (305) 322-3663
Sales NA *Emp* 77
SIC 5422 7399 5722 Ret Food Plan & Meats Sells Membership Warranty & Appliances Food Freezers
Bk Flagship Bk Of Seminole
William E Adamson *Ch Bd Pr Tr*
Tom Sheibenberger *VP Sec*

The Thomas Register

RELAYS: INDUSTRIAL CONTROL & POWER

RELAYS: INDUSTRIAL CONTROL & POWER (Contd)

MA: BOSTON
HOAGLAND INSTRUMENT DIV. 560-T Harrison Ave. (ZIP 02118) (Time Delay Relays & Motor Overload Protectors) (617—542-3123) .... **1M+**

MI: TROY
United Industrial Trading Corp. 256-T Executive Dr. (Professional Offshore Parts Importing To Customer Specs.) .... **NR**

MN: WINONA
Watlow Winona, Inc. 1265-T E. Sanborn St. .... **NR**

EXHIBIT 6

T C Hayles & Company 60 WADSWORTH STREET - 27E, CAMBRIDGE, MASS. 02142 TELEPHONE 617-494-1354

March 17, 1987

Mr.
President
Cmpany, Inc.
14 Central Street
Massachusetts

Dear Mr.

I am looking for a great company.

More to the point, I am pursuing a search to locate and purchase a small business in the Greater Boston area. In this search, my concentration is on identifying what I refer to as 'special-niche companies'. These companies have filled a market need with a unique product and are recognized as market leaders by their customers. While only a small portion of firms fit this description, I am fascinated with your firm's activities in the convention badge market. Consequently, I would like to investigate your potential interest in selling your firm, either through an immediate sale or through some alternate arrangement. This arrangement might consist of my joining your firm's management team now with the hopes of gradually purchasing and assuming control of the firm.

Over the past five years, I have purposefully accumulated experience in several areas which have prepared me to assume the challenge of buying a company. My work experience consists of positions in manufacturing at Hewlett-Packard, management consulting at Bain & Company, banking at Bank of New England, and venture capital at Schooner Capital Corporation. I am currently finishing an MBA degree at the Sloan School of Management at MIT. At Sloan, I have headed the school's Volunteer Consulting Group, providing strategic and operational advice to undercapitalized small businesses. While I may still be early in my career, I feel that I would bring to your firm the marketing, management and strategic skills necessary to be an effective small company manager. TCHayles, my company, consists of myself as general partner and of a former business associate as limited partner. I am confident that we have access to whatever funds are necessary to complete a transaction.

I very much look forward to speaking with you. I think that I can provide a business owner with an attractive financial opportunity. Notably, my goal is not to change the way that the company does business, but to further lever the strengths which originally made it attractive to me. Any transaction undertaken would avoid the involvement of expensive intermediaries such as business brokers or investment bankers.

I know that you are probably extremely busy, but I hope that we still might be able to briefly discuss this matter. If you have any questions about my background or about this opportunity, please call me at 494-1354 or write to me at the above address. Otherwise, I will contact you within the next few days. Thank you for your time and consideration.

Sincerely,

Tom Cronin

FOOTNOTES

FOOTNOTES

Section I - Chapter 1

1) *Wall Street Journal,* March 24, 1987, Pg. 1. Dow Jones & Company, Inc., New York, N.Y.

2) A story on the *Nightly Business Report* on March 12 focussed on the tremendous growth being seen in the market for purchasing small businesses. In particular, the story concentrated on the growth of firm's serving as business brokers, and on the relative shortage of business sellers in the market. *Nightly Business Report* is a program of the Corporation for Public Broadcasting.

3) Arthur Andersen & Company. *1986 Small Business Survey.* Arthur Andersen & Company, Chicago, Illinois

4) Ibid.

Section I - Chapter 3

1) Bolles, Richard N., *What Color Is Your Parachute,* Ten Speed Press, Berkeley, California, 1980.

2) Numerous books exist which generally cover the subject of entrepreneurship. Two which I was able to analyze in depth were:

Baumback, Clifford M., *Baumback's Guide to Entrepreneurship*, Prentice-Hall Inc., Englewood Cliffs, New Jersey, 1981.

Comiskey, James C., *How to Start, Expand, and Sell Your Own Business,* Venture Persectives Press, San Jose, California, 1985.

As stated in the text, these sources provide only a cursory analysis of the process involved in purchsing a small business.

3) This interview was conducted on February 27, 1987,

with the director of the work-out loan department of a one of the four largest Boston banks.

4) Op. Cit. Arthur Andersen

5) This estimate of the mean time to complete a purchase was developed by aggregating all of the information compiled through my interviews. In particular, I can point to my discusions with retail and corporate business brokers, who all emphasized the length of time required to purchase a company.

6) The search periods of the four individuals that I interviewed who had pursued formal searches were approximately: 30 months, 20 months, 18 months and 8 months. These figures average to 19 months. (more information about these buyers will be provided in a subsequent notes)

7) Books on owning a small business which I have encountered include:

Lowry, Albert J., *How to Become Financially Successful Owning Your Own Business*, Simon ad Schuster, New York, New York, 1981.

8) One of these interviews was performed on February 20 with the president of a small holding company, which had grown its revenues by over fifty percent in the last three years. This president warned me about purchasing a small company without growth prospects and being 'trapped' operating a small firm. The other interviewee (interview date: April 3) is also the president of a growing concern, but told of his experience prior to attending business school as at first fascinating, but later stifling, as he realized that operating a stagnant company with three million dollars in revenues did not provide him with a challenge.

Section II - Chapter 4

1) This quote was received in a March 17 interview with a former buyer who attempted to purchase a business with her

husband in 1984. Her search lasted aproximately 20 months, and did not lead to a succesful transaction.

2) While I received this comment from several corporate business brokers, this is a direct quote that I received on February 23, from a corporate broker from Andover, Massachusetts.

3) I received this quote from a young buyer interviewed on March 15, which was toward the end of his 18 month search. This is the buyer who, along with a partner, was able to raise $140,000 in money from investors to complete a search. These buyers also obtained a commitment from these investors to provide the equity required for any purchase resulting from the search.

4) This quote was received during my afore-noted 2/27 interview with the director of a bank workout loan area.

5) This qoute was received from the same young buyer as was listed in note 3 above.

Section II - Chapter 5

1) This figure is derived from telephone conversations that I had with several Boston commercial and savings banks in the last week of January. Each of these banks had almost identical requirements for income as a percent of the home equity loan total. Banks contacted included BayBanks, The Mutual Bank for Savings, Bank of New England, NeWorld Savings Bank, The Boston Five Cent Savings Bank, Cambridge Trust Company, and Security Pacific Finance Company.

2) See Note 1 Above.

3) As was explained in Note 3 from Chapter 5, two graduating business school students were able to form a group of investors, mostly from loose acquaintances, who funded the young entrepreneurs's eighteen month search, and were expecting to fund the equity portion of an acquisition when

necessary. These investors contributed a total of $140,000, in three rounds of financing (the first two rounds of funding were depleted midway through the search). The minimum contribution to the search fund was $5000.

4) On the East Coast, Professor Bill Wetzell of the University of New Hampshire has attempted to provide a cross listing of 'angels' and entrepreneurs. On the West Coast a silicon valley firm is making a similar effort, which was noted in *Fortune* magazine in April of 1987.

5) This quote came on March 3, during a discussion with a former college classmate of mine who is employed at one of the largest Boston-based venture capital firms.

6) My estimate of the required equity to perform a purchase is again the result of a sense that I developed after numerous interviews. I first came to believe this after attending a buyer's seminar at Trudeau & Trudeau, a Braintree business broker. (This seminar took place one evening at a cost of $20. The seminar covered the process of buying a business through a business broker, and included a discussion of general industry norms.) I later confirmed this estimate with an internal venture capitalist at a Route 128 conglomerate.

7) The tax savings to a seller from owner financing are as follows (Using the formula and assumptions detailed in the text):

Year 1: (.30 X $500,000 X .1) = $15,000
Year 2: (.30 X $400,000 X .1) = $12,000
Year 3: (.30 X $300,000 X .1) = $ 9,000
Year 4: (.30 X $200,000 X .1) = $ 6,000
Year 5: (.30 X $100,000 X .1) = $ 3,000

Total Savings = $45,000

The actual savings are slightly higher than this figure as the earlier year savings (the $15,000 in Year 1, for instance) can be re-invested in interest bearing accounts.

8) These typical advances against assets were those which were prevelent while I was employed as a lending trainee at a major Boston bank, I believe that they have remained accurate.

Section II - Chapter 6

1) This was the buyer time profile of the woman mentioned in Note 1, Chapter 4. The interview took place on March 17.

2) This interview took place with the director of a Route 128 conglomerate's venture capital arm. This individual had over thirty years of experience as an entrepreneur, a small business buyer (and seller) and as a venture capitalist. The interview took place on April 7.

Section III - Chapter 7

1) This interview with the head of the Boston small business practice at one of the largest of the Big-8 accounting firms took place on April 6.

Section III - Chapter 8

1) Tom West is both Director of the International Institute of Business Brokers and of the Business Brokerage Press. These organizations are located at 118 Siver Hill Road, Concord, MA. The Business Brokerage Press publishes *The Business Broker*, a monthly journal. Data was obtained during my interview of Mr. West on March 29.

2) See Note 1, Chapter 7

3) The concept of an 'earnest money deposit' was raised to me when discussing the purchase of a very small laboratory. The owners of the lab brought up this subject, saying that they had made a similar payment when attempting to purchase a company one year before. The confidentiality afforded a buyer

can be noted in Exhibit 3 and was also made clear at the seminar which I attended at Trudeau & Trudeau in Braintree (see Note 6, Chapter 5).

4) A comment by the speaker at the Trudeau & Trudeau seminar mentioned in the preceeding note.

5) Ibid.

6) *The Boston Globe,* April 5, 1987, pgs. A92-93, Globe Newspaper Company, Boston, Massachusetts.

7) This information was first received at the Trudeau & Trudeau seminar listed above. I confirmed this information with Tom West (see Note 1 above), and by observing listings by brokers in publications such as the North East Business Opportunity Report (NEBOR Publishing, Nashua, NH), a monthly listing service.

8) This rule of thumb was first provided to me by a Boston-based corporate broker on March 2. This broker appeared to have a very good sense of the activities in the market. His results were confirmed in several other interviews with corporate brokers.

9) See the Classified Advertising services listed in Chapter 10.8.

10) This information was obtained in the same March 2 interview listed in Note 8 of this chapter.

11) A quote from the seminar listed in Note 3 above.

12) Ibid.

13) I received this information in a February 19 meeting with an investment banker from a regional Boston bank. This investment banker's belief was that many other Boston-based institutions required the same lower limit.

14) The Lehman Formula appeared to be used by every corporate broker that I encountered. It was revealed to me in my first interview with a corporate broker on February 25.

15) The lower ranges of fees for a search by a business

broker were stated to me by a former buyer (see Note 1, Chapter 4, above). The Andover-based corporate broker mentioned above asked me to pay a fee at the higher extreme on February 27.

16) This was a common statment in my approaches to corporate brokers. See Section III - Chapter 8.2 for the results of my discussions with corporate brokers.

17) This was the success-rate professed by the Andover-based broker listed in Note 15 above.

18) These solicitations/interviews were conducted between February 25 and mid-March. As was noted in the text, I did not receive a single attractive acquisition opportunity from approaching these intermediaries.

19) This figure was obtianed from the individual quoted in Note 8 above (the Boston-based corporate broker interviewed on March 2).

20) Ibid. This information was confirmed in several subsequent interviews.

Section III - Chapter 9

1) American Express Corporation, *Small Business Survey,* as quoted in *The Boston Herald,* February 4, 1987, pg. 29.

2) The young entrepreneur mentioned in Note 3, Chapter 5 stated in our March 15 interview that he had performed one direct mailing to companies, and had been surprised at the 10% response rate, which he felt was very high.

3) *The Thomas Register,* Thomas Publishing Company, New York, New York, annual.

4) *The Directory of New England Manufacturers,* George B. Hall Corporation, Boston, Massachusetts, annual.

5) *The Dun & Bradstreet Million Dollar Directory,* Dun & Bradstreet Corporation, New York, New York, annual.

6) *The Standard & Poor's Corporate Source Book,* Standard

& Poor's, New York, New York, annual.

7) *Directory of Employers,* Gloucester Chamber of Commerce, Gloucester, Massachusetts, 1982.

8) This comment was taken from a March 30 conversation with the director of a New England small business trade association.

9) This was a comment from the first company that I attempted to make an offer on in early January. I later re-interviewed the company president, who told me that he was taken aback by my direct approach.

10) This valuable quote was provided by my thesis advisor on March 5.

11) This quote was obtained in the same interview with the small business trade association leader mentioned in Note 8 above.

12) See Note 3, Chapter 4

13) This quote was obtained from a company owner that I approached as a buyer, but who had himself been a buyer earlier in his career. The interview occurred in late January.

14) This statement was made in a purchase discussion that I had with a South Shore manufacturer of recreational equipment.

15) This statement was made by the president of a testing laboratory that I was negotiating to purchase.

Section III - Chapter 10

1) See Note 8, Chapter 8

2) This surprising sentiment was shared by two young buyers that I interviewed, one who was mentioned in Note 3, Chapter 4, and the other who is now a small company president, but who completed a thirty month search to purchase a small business three years ago.

3) *The Wall Street Journal,* May 20, 1985, pg. 34C, Dow Jones Corporation, Inc., New York, New York.

4) From a 2/27 interview with a small business oriented accountant based in suburban Boston.

5) *Directory of Members,* Smaller Business Association of New England, Waltham, Massachusetts, 1986.