Buying a Business?

Humans are complex animals. The study of human behavior and motivation is fascinating. Why do people do what they do?

Why might a person want to own a business? Buy a business? Certainly, the reasons are unique to each person. Motives range from the material (i.e., money, possessions) to the spiritual; may originate from within (i.e., reside within oneself) or outside us (i.e., be socially or relationship-motivated); may be substantially selfish (i.e., greed, power) or altruistic; may be healthy and rational (i.e., strategic or self-actualizing*) or unhealthy and irrational (i.e., an inappropriate and unwise response to pressure, fear or deficiency).

Buying a business is a big decision. It’s not for the timid, tired or tethered. Before you buy, ask yourself a few questions.

Question 1: Is This Right for Me?

From a personal standpoint, this is a tough one. This is the stuff of philosophers, psychologists, spiritual advisors, career counselors and maybe mothers. This subject goes well beyond the scope of this publication, but I do believe that to find happiness and fulfillment every person must spend time navel gazing getting to know who you are: what are your talents, abilities, strengths and weaknesses; at what are you most well suited; and what endeavors give you the most satisfaction.

At times, I’ve found the work of Abraham Maslow helpful – the 20th Century psychologist spent his life studying and writing on such issues. For a brief introduction, read the article herein titled “Maslow’s Hierarchy.”

It also might be helpful to consider that successful business owners tend to be:

- Energetic and motivated
- Comfortable being in charge
- Confident
- Decisive
- Calm under pressure
- Competitive
- People-friendly

Question 2: Is This Business a Good Fit for Me? For my Business?

This question deals more with strategy. Is the business a good fit for you as an individual? How well does it fit with your skills, abilities, experiences, contacts and financial resources? Are you fully prepared for the challenge? If you were accused of being “out of your league,” would a jury convict?

If it'll be an add-on to your existing business, is it a good fit? Do others readily see the fit? Is the fit real and practical and in the here and now or is it more intellectual or emotional?

Will you enjoy real and immediate synergies? If the purchase goes bad, can you survive? Could it sink your whole ship and, if so, are you really sure you want to risk that?

Question 3: Will The Right People be on Board and Committed?

Ownership ... that's committed and clearly in control?

Leadership ... that's clear and passionate?

Management ... that's proven, committed and has "bought in?"

Employees ... that are experienced, committed and dependable?

Question 4: Am I Gambling or Investing?

The most successful business buyer of the past 100 years is Warren Buffett. He explains, "Investing is not gambling. Know the difference." Said another way, when you buy a business, risk return ON investment, if you wish (i.e., rate of return), but don't risk return OF investment (i.e., whether or not you eventually get back what you invested). Gambling is for entertainment. Investing is for making money. Before you agree to a purchase, make sure it's a winner.

Question 5: Will I Earn a Fair Rate of Return?

You must not buy until you have a very good handle on what will be your minimum after-tax, cash-on-cash, rate of return. That's after (i.e., over and above) fair compensation for the time and talent of all laborers – both owner and nonowner. That includes YOU.

More particularly, you should require a return on equity that fully compensates you for the burdens and risks inherent in a private-company investment. Private companies are incredibly illiquid, undiversified, and require a tremendous amount of management/oversight time. Compare this to investment alternatives such as high quality, publicly traded stocks and bonds. They consistently provide annual rates of return of 6% – 18% and they're liquid, require almost none of your time, are easily diversified, and there's almost no chance you'll lose your equity (as long as you DO diversify).

So what should your equity return be on investment in a private company? Well, 25% per year or more.

To conclude, buying a business is a serious matter. It requires substantial financial outlay and obligation, plus considerable time, energy and responsibility. Fail, and although you no longer risk being stoned to death, you could lose all your material possessions and more. It's not for the uncommitted, unprepared or undercapitalized.