



September 10th, 2009 at 5:02 am

How to Buy a Small Business Using Creative Financing as the U.S. Economy Recovers

September 10th, 2009 at 5:02 am

How to Buy a Small Business Using Creative Financing as the U.S. Economy Recovers

» by [Guest Blogger](#) in: [Entrepreneurs](#), [Finance](#)



The U.S. economy's worst recession in the post-war era has begun to turn for the better. Yet, despite the fact that the doom and gloom of the past 20-plus months may be behind us, entrepreneurs seeking to buy businesses still find it difficult to get banks to finance their purchases.

Fortunately, there are a multitude of other options available to business buyers and they center on an entrepreneur's ability to use creative financing for his or her purchase.

Using Other People's Money

The vast majority of small business entrepreneurs do not have enough capital to buy a business outright, and banks can present insurmountable barriers. Thus, leveraging other people's money, capital from investors to whom business buyers pay interest rate fees and/or a percentage of profits, is one of the best ways to finance the purchase of a business. Unlike banks and other institutional lenders, investors do not expect short-term payments. As a result, business buyers can spend more time on their business and less time worrying about making loan payments.

With a volatile stock market, declining real estate values and a growing amount of unemployed executives with substantial savings, investing in a small business has become a very attractive option. To that point, the U.S. government has positioned the small business community as the growth engine for the U.S. economy. In addition, many investors are still willing to take risks with their money despite the rough economic conditions, in return for greater profits than otherwise available through other investments.

Undoubtedly, a business buyer's ability to convince investors about the strength of the business and its potential for success are major factors in determining the amount that gets invested. Another issue playing a part in this includes the total capital needs for the purchase of the business and initial, ongoing operations. Fortunately, finding the investors is easy. Convincing them is the hard part.

Finding Other People's Money

There are several strategic methods businesses buyers can use to find other people's money. While personal contacts may be helpful, financing a business can require resources that most likely will go beyond what close acquaintances can provide. The following are some of the creative ways for business buyers to finance their investments using other people's money in today's economy.

Seller Financing

The best businesses on the market today are mature, profitable and fairly priced. While finding a business with these qualities may seem hard to find, working with an experienced business buying advocate can often times result in the discovery of this prime investment opportunity.

One of the main benefits of finding a mature, profitable and fairly priced business is that its seller is extremely interested in seeing the business survive and thrive. In many cases when a seller pairs with a buyer who shares similar beliefs and values about the business, sellers will be willing to finance the business buyer's purchase.

Seller financing provides the original owner of the business regular interest rate payments from the new buyer, and given the returns from today's investment vehicles, sellers are showing themselves to be more than willing to finance the sale.

Money Finders

One of the ways to go about finding other people's money is to use a professional money finder. The best money finders have close ties to individuals with investment dollars, and they have a knack for showing investors the benefit of supporting their clients.

When choosing between money finders, it is important to ask them about the channels from which they seek money. Those who have contacts with private individuals, rather than venture capital firms or institutional lenders, are more likely to be successful when trying to find funds for a small business. Capital requirements may also call for using more than one money finder if each has separate resources from which to draw.

Another important step in evaluating a money finder is to interview their past clients. Business buyers will want to ask: “What specifically have been the purposes, amounts, and costs of the financing?”

Even though the majority of money finders are legitimate, the buyers of businesses should be aware that rogue money finders occasionally have scammed individuals. Therefore, the importance of using quality legal and business advisors, such as a CPA, are highly recommended. Agreements with money finders should include a contract, defining compensation, the capital they will raise and the timeline for getting the work done.

Matchmakers

Matchmakers are another resource for business buyers to use when looking for investors. They are services which maintain national or regional databases of investors and routinely send database members information on behalf of the small businesses looking for financing.

Matchmakers differ from money finders in that they do not have personal contact with the potential investors.

Investment Forums and Clubs

Investment forums and clubs are increasingly popular places to pitch businesses. In most large markets, there are weekly or monthly meetings where potential investors listen to presentations about business buying ventures.

Investment forums often do not fund most offers, but their members do provide quality feedback and advice about how to make the investment idea more attractive.

Investment clubs are made up of individuals who contribute set amounts of money towards one or more common investments. In some cases, they will hire business advisors to review business plans and funding proposals.

Finding these groups can be difficult, but once discovered, they can be a rich source of funds.

Borrow from Your Business Broker

Business buyers whose deal includes a broker can ask the selling or buying agent for a loan, with the capital coming from the commission the broker earns in the deal. Brokers are willing to do this when they are concerned about losing the deal...and their commission.

Earn Out

An earn-out is another creative way to generate investment dollars for the purchase of a business. Earn-outs occur when business buyers make payments to sellers with the basis of the payout being the future earnings of the company. Here, additional payments are paid to the seller as a percentage of increase in the gross revenue or net profit over what the buyer and seller agree to be the purchase price.

This method works best when buyers believe the company is positioned to drastically increase its profit. In most cases, these agreements call for the buyer to make an initial down payment, and later payments based on the company's performance. Given that sellers will be earning more for their business if the company becomes increasingly profitable, he or she will often stay with the company for a pre-determined length of time.

With several layers to this business agreement, an earn-out is a relatively complicated business deal and should receive considerable oversight from legal counsel.

Advertise for Dollars

Major newspapers and their associated websites, along with trade magazines and other online sources, feature capital wanted advertising sections. These affordable media outlets can be utilized to advertise for capital.

The downside of advertising for investment dollars is the amount of time business buyers spend screening calls. Given the public nature of the media, using the ads can draw in unqualified investors.

Form a Partnership

Buyers can bring an investment partner into their deal when they need additional financing, but feel confident in their own ability to manage the day to day operations of the business. With this model, the investment partner owns a certain percentage of the business and receives his or her due profits.

From the operating partner's perspective, a good use of the investment partner's dollars is for the down-payment of the business. As a result, the operating partner has capital for the purchase and can start repaying any other loan payments and take a salary with the business' income.

The Cost of Creative Financing

Creative financing offers benefits to both the buyer and seller of small businesses. Nonetheless, for the buyer, there are costs associated with the tactics described in this piece. For example, creative financing increases the business' post-purchase price with expenses such as interest and fees; it can weaken financial stability; and it may require the buyer to pay the seller a higher price in return for the seller financing a large part of the purchase.

Even so, the costs are justified if the business turns a profit. Financing will come if the business plan shows promise for the future. Finding that business before others discover it is the most difficult part of the process.



About The Guest Author: Ted Leverette is president of [“Partner” On-Call Network](#) and author of *How to Get All the Money You Want For Your Business Without Stealing It*, read by more than 100,000 people since its first printing in 1997. With “Partner” On-Call Network, Leverette is at the hub of a global network of consultants who specialize in business financing, improvement, sales, acquisition and appraisal. These consultants furnish clients with impartial information to make informed decisions.