What's It Worth?
Business Valuations, Mergers, Acquisitions, and Consulting
NEWSLETTER ARTICLE ARCHIVE

Seller Financing: Risk vs. Reward – You make the decision.

There is an old saying: "The Seller determines the price and the Buyer determines the terms". There is a lot of truth to this. Let me explain.

Strong vs Weak

If your company is in a strong growth stage, has a proven track record, has strong profits and a realistic purchase price, then the market will cash you out. This is the only guaranteed truth in selling a business. Other combinations can also lead to a cash price, but if you choose an unrealistic purchase price with little or no growth and average profits, then you will be forced to accept seller financing.

One of the key ingredients to the whole process is a realistic purchase price. The purchase price is based on your company's proven track record, its growth (or no growth), and its bottom line. Of course, this formula is assuming that the business is transferable (this topic is discussed in the following article on page 2).

If you have a transferable business and a realistic price, then you can receive a cash purchase price. There is no such thing as an unsellable business, it all depends on the purchase price and the assets being sold. The assumed premise here is that liabilities are not being transferred. If liabilities must be transferred, then the business may be unsellable.

Fifty Percent Cash/ Fifty Percent Stock

I wish I could give a favorite charity $1000 every time I have heard about someone taking 50% cash and 50% stock in the Buyer's company. The majority of these stories end with the same result….the Seller is never able to cash in the 50% stock! Let me restate that in another fashion. Many years ago, my wife pointed out that the stock I owned in various companies was only "Magical Numbers" until I cashed out and put it in the bank. She does not have a business background, but she was absolutely correct!

Why is it that these deals generally do not work out? The general reason is that the Buyer is paying more that what the company is worth. They are luring in the Seller by offering to give them a portion of the growth in the new company's equity. They are making their offer based on the assumption that the new merged company will exceed projections and therefore, every one will win and the Buyer is not at risk of having to guarantee the purchase price.

So here is the moral of the story. If you get greedy and are enticed by an offer you know is more than your business is worth, you can be ecstatic if it pays off, but do not be disappointed if you get half of the total purchase price!

When to take a Seller's Note

I personally have taken a seller's note on a business that I owned, then sold and have a glowing report! Why did my deal work when so many fail? Here are the key ingredients for a win-win situation: 1.) You must TRUST your Buyer. If you do not trust your Buyer and feel they will meet your customer's needs and your needs, walk away; 2.) Your Buyer must have proven themselves competent in managing a company; 3.) Your Buyer must have a proven history of financial prudence; 4.) If your business is tanking, and your know it, you will probably never see the Seller financial??? portion of the purchase price- though you may get to see the interior of the local court room; 5.) Your Buyer must have the necessary capital to grow the business and keep it afloat during difficult time; 6.) According to Paul Baron, a veteran business broker (Paul B. Baron, *When You Buy or Sell a Company*, rev. ed.: Meriden, conn.: The Center for Business Information, Inc., 1986). Walter Jurek advocates allocating 50 percent of the net cash flow to the servicing of the acquisition debt: " The entire income stream that is available should not be used for debt service. Any company needs a cushion between its debt service retirement schedule and its net available income for debt service. Normally, only 50 percent of the net available cash flow after taxes and reasonable capital expenditures should be used for debt service or debt retirement. (Walter Jurek, *How to Determine the Value of a Business* :Stow, Oh.: Quality Service, Inc., 1977, p. 29)

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