Title:
5 Key Components Of A Small Business Acquisition Loan

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Summary:
In order to secure a business acquisition loan, you need to understand and manage the key components of the purchase the lender will be interested in. Here you will learn about the 5 key components of a business purchase and some insight as to how to effectively manage them to secure financing.

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Article Body:
Major Challenges To Securing A Business Acquisition Loan

Qualifying for a small business acquisition loan can be quite an ordeal to say the least.

If the business being sold is very profitable, the selling price will likely reflect a significant amount of goodwill which can be very difficult to finance.

If the business being sold is not making money, lenders can be difficult to find even if the underlying assets being acquired are worth substantially more than the purchase price.

Business acquisition loans, or change of control financing situations, can be extremely varied from case to case.

That being said, here are the major challenges you'll typically have to overcome to secure a small business acquisition loan.

>>> Financing Goodwill

The definition of goodwill is the sale price minus the resale or liquidation value of business assets after any debts owing on the assets are paid off. It represents the future profit the business is expected to generate beyond the current value of the assets.

Most lenders have no interest in financing goodwill.

This effectively increases the amount of the down payment required to complete the sale and/or the acquisition of some financing from the vendor in the form of a vendor loan.

Vendor support and Vendor loans are a very common elements in the sale of a small business.

If they are not initially present in the conditions of sale, you may want to ask the vendor if they would consider providing support and financing.

There are some excellent reasons why asking the question could be well worth your time.

In order to receive the maximum possible sale price, which likely involves some amount of goodwill, the vendor will agree to finance part of the sale by allowing the buyer to pay a portion of the sale price over a defined period of time within a structured payment schedule.

The vendor may also offer transition assistance for a period of time to make sure the transition period is seamless.

The combination of support and financing by the vendor creates a positive vested interest whereby it is in the vendor's best interest to help the buyer successfully transition all aspects of ownership and operations.

Failure to do so could result in the vendor not getting all the proceeds of sale in the future in the event the business were to suffer or fail under new ownership.

This is usually a very appealing aspect to potential lenders as the risk of loss due to transition is greatly reduced.

This speaks directly to the next financing challenge.

>>> Business Transition Risk

Will the new owner be able to run the business as well as the previous owner? Will the customers still do business with the new owner? Did the previous owner possess a specific skill set that will be difficult to replicate or replace? Will the key employees remain with the company after the sale?

A lender must be confident that the business can successfully continue at no worse than the current level of performance. There usually needs to be a buffer built into the financial projections for changeover lags that can occur.

At the same time, many buyers will purchase a business because they believe there is substantial growth available which they think they can take advantage of.

The key is convincing the lender of the growth potential and your ability to achieve superior results.

>>> Asset Sale Versus Share Sale

For tax purposes, many sellers want to sell the shares of their business.

However, by doing so, any outstanding and potential future liability related to the going concern business will fall at the feet of the buyer unless othewise indicated in the purchase and sale agreement.

Because potential business liability is a difficult thing to evaluate, there can be a higher perceived risk when considering a small business acquisition loan application related to a share purchase.

>>> Market Risk

Is the business in a growing, mature, or declining market segment? How does the business fit into the competitive dynamics of the market and will a change in control strengthen or weaken its competitive position?

A lender needs to be confident that the business can be successful for at least the period the business acquisition loan will be outstanding.

This is important for two reasons. First, a sustained cash flow will obviously allow a smoother process of repayment. Second, a strong going concern business has a higher probability of resale.

If an unforeseen event causes the owner to no longer be able to carry on the business, the lender will have confidence that the business can still generate enough profit from resale to retire the outstanding debt.

Localized markets are much easier for a lender or investor to assess than a business selling to a broader geographic reach. Area based lenders may also have some working knowledge of the particular business and how prominent it is in the local market.

>>> Personal Net Worth

Most business acquisition loans require the buyer to be able to invest at least a third of the total purchase price in cash with a remaining tangible net worth at least equal to the remaining value of the loan.

Statistics show that over leveraged companies are more prone to suffer financial duress and default on their business acquisition loan commitments.

The larger the amount of the business acquisition loan required, the more likely the probability of default.