# Business guide

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Solutions For Your Business

## Buying a business – how much should you invest?

It can be easy for your heart to rule your head when you find a business you want to buy. However, if you don't do thorough research before signing on the dotted line, you may regret it. Before buying a business, you need to establish its worth and whether the returns are going to be worth your time and money.

There isn't a generally accepted formula to use when deciding what a business is worth. It depends on a number of factors, including current market conditions, how many similar businesses are selling and how many buyers are in the market.

### What is the business worth?

Before you part with your hard-earned cash, you'll want to know how much the business you're considering buying is worth. Arriving at a market value for a business can be quite subjective, and the amount you're prepared to pay will be based on what the business is worth to you (you might only want the land or access to the customer database, and have no interest in the business as a going concern) as well as the market value.

It's not as simple as reaching a sum of the amount the current owner has invested. They might have over-capitalized in some areas or invested in refurbishments that aren't to your taste. In addition, they might have intangible assets such as an exclusive license to sell certain products in a particular area, or have secured future orders that reduce the risks associated with buying the business.

You obviously don't want to pay more for the business than it is worth. To avoid this:

- Chat to your advisers about the business.
- Find out more about the industry and future trends.
- Investigate the location of the business and any future developments and plans for the area.

### How much can you afford?

Once you've arrived at a value for the business, you also need to be sure you can afford to make the purchase.

You'll probably already have a financial limit in mind based on:

- The cash you have available.
- The amount you've been able to secure as a loan.
- The amount partners, investors and venture capitalists are prepared to put in.
- Or any combination of these.

It's a mistake to think this means you can spend the full amount you have available on the business purchase. You'll need to work out how much additional money you'll need:

- To cover additional purchase, transfer and set-up costs.
- To tide you over during any unexpected delays and teething problems.
- To keep the business running until it reaches break-even.
- To cover the finance charges and interest payments (if applicable).
- As a contingency reserve.

The total amount of capital available, less the money you need to keep the business running until it breaks even (including interest payments and loan repayments), defines the top purchase price you can afford to pay.

Work out how much money you will need to set aside to cover operational costs by using an annual cash flow chart.

### Is the return on investment attractive?

Another critical factor to consider is whether you'll earn a reasonable return on your investment. Work out how much profit you expect to make each year for the next five or 10 years. Is the annual net profit you anticipate earning a worthwhile return on the amount of money you'll need to invest in the business?

A surprising number of small business owners would be better off financially if they put their money into an attractive fixed-term, high-interest-bearing deposit and headed off with their fishing rods, rather than toiling long hours in their low-profit business.

Unless this is a lifestyle purchase, you'll want to make sure your investment is likely to earn you a significantly better return than your money could earn sitting in a bank or medium-risk investment, earning interest.

### What is the risk?

The amount you're prepared to invest buying a business will also depend on the level of risk involved. If you've done a thorough investigation and the business is in good shape, and in a growing market, you'll be prepared to pay a higher price. On the other hand, if it's a new business or a new product, in a low-growth or untested market, the risk involved means you'll only be prepared to buy the business at a lower price.

One other point to consider is: how easy would it be to get your money out if your situation changes? Would you be able to sell the business easily if you needed to? If you can answer yes, you'll be prepared to pay more for the business. But if your answer is no, you'll probably only be prepared to buy the business at a lower price.

### Other factors to consider

There are a number of other factors you might want to consider when deciding how much to spend. If the business is a lifestyle purchase or a way for you to make money while also contributing to your favourite cause, this could increase the value of the business to you – and the amount you'd be prepared to pay.

If you need financing to buy the business, you'll need to consider whether it's still a worthwhile investment. You might have to give over control of the business to an investment partner or provide security for the finance, possibly risking your family home if the venture fails. The business will also have to generate enough additional revenue to cover the related finance costs. In some cases, this additional financial burden can make the purchase a far less lucrative option.