

FINANCING THE PURCHASE OF A BUSINESS

The financing of the purchase of a business can be accomplished in an astonishingly different number of ways. The manner of structuring the deal is only limited by the imaginations of the buyer, the seller, the brokers and the bankers.

In the seventies, large corporations were bought with junk bonds. Companies have even, on occasion, been purchased with their own money. Such high finance shenanigans, however, are more likely to occur on Bay Street or Wall Street and have very little or nothing in common with the purchase and sale of the average restaurant, gas station or bakery on the Fraser Highway.

For most ordinary business purchase transactions there are really only three basic sources for the purchase price - vendor financing, third party borrowing or equity financing.

If the vendor does not insist upon being paid the full price in cash on closing, vendor financing is often the most convenient way for a purchaser to buy the business. It not only allows the purchaser a form of holdback in the event there have been misrepresentations or undisclosed liabilities (it's like the vendor is giving a guarantee), it is often easier to negotiate. Because the vendor is intimately familiar with his own business there is no need to convince him of the value of the security.

Third party financing sources, such as banks or trust companies, can be somewhat more difficult to convince. For that matter, such things as interest rates and security may also be more advantageously negotiated with the vendor than with a third party lender. If, for example, the banks are paying 3 percent on a long-term deposit while charging 7 percent on loans, it is to the advantage of both buyer and seller to arrange a vendor loan back for 5 1/2 percent. Everyone makes money (except the bank, of course).

Borrowing from third parties usually means going to a bank or a credit union for a loan. The money can also come from private lenders or government agencies, such as the Federal Business Development Bank. Whatever the source of the loan, however, the lender is going to want some form of security beyond your heartfelt assurance that they will probably get their money back. This generally means pledging the assets and credits of both the business and the purchaser.

Equity financing means obtaining additional investors who are willing to put money into the business in return for a share of the ownership and, hopefully, the profits and the increased value of the business under your wise management. Equity financing is accomplished by offering shares for sale either privately or through public stock offerings, usually on a stock exchange. Of course, selling off pieces of the action usually also means selling off some of the control.

Except in the case of equity financing (where the investors are exposing their money to the same risks as the major purchaser), some form of security will normally be required by the lender to increase the likelihood of repayment. This can take the form of anything that the lender or the vendor will accept but it usually involves some sort of charge over the assets such as a land mortgage, pledged personal property or debenture security. In a share transaction the shares are often held in escrow - that is, they are held in a sort of limbo and delivered to the buyer upon full payment of the debt to the lender. They can also be delivered to the vendor upon default of payment.

Often, these forms of security are supplemented by personal guarantees or covenants of the principals. Guarantees are when one party (the share owner) agrees to pay the debt of another party (the company getting the loan) in return for the lender loaning money to that other party. Covenants are essentially promises to do or not to do certain things once the business is taken over. They are usually taken to insure that the business is managed in such a way as to be able to pay its debts.

When it comes to the wonderful world of high finance there are many different ways to skin the cat. For that reason alone it is wise to get professional assistance. If you aren't sure of your options or the best way to go about it, the cat that gets skinned might be you.