<u>Small Business Acquisition: Report from the Front-Line</u>

Admitted to the N.Y. bar in 1993 and having defended hundreds of clients against electronic piracy claims, your author is a recognized expert on electronic piracy defense issues in the federal courts.

Of greater relevance to this treatise however, is his direct small business experience, together with years of professional small business analysis and legal representation. He is a 30 year veteran of the coin-laundry industry, having owned six coin laundries. Since 2001 he has maintained a coin laundry consultation and financial evaluation practice which is utilized by clients throughout North America and Europe and in the course of which he has performed over a thousand coin-laundry related consultations and evaluations, together with legal representation of laundry industry clients. His practice of law, although extensive, is currently focused primarily upon legal representation for both buyers and sellers of various types of small business (including, of course, coin laundries).

______

Although essentially every thought I express here regarding the purchase of a business is also relevant to business "start-ups", one should note that "start-ups" generally require a more difficult analysis as to marketing and potential goodwill than does the purchase of an established business– a subject I will greet later on.

When considering the purchase of a business, newcomers to an industry typically place too high a value upon it. **This is due to varying degrees of self delusion on their behalf** – the most common of which are a **preoccupation with top-line (gross) revenues**, together with **insufficient attention to expense projections, current and potential challenges to the business, and half-sighted risk analysis**. In fact, top-line infatuation can be so severe that I am frequently hard pressed to get many of my clients to listen to reason; although, subsequent to my input, they always reduce what they are willing to offer for a business, many remain prepared to make an offer which still exceeds what its approximate value to the purchaser would appear (at least in my judgment) to be.

Permit me to define my meaning as to several terms:

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

- **Value**: **Solely what a business is worth to the <u>purchaser</u>**. For example: if the business involves a certain complex technology, it is worth considerably more to one who understands that technology than to one who does not; a business is generally more valuable to one who lives next door to it than one who has an extended drive to get there. A complete list of appropriate examples as to personal adjustments to the value of a business would extend to infinity.

- **Challenges**: identified and potential problems, including the identification and resolution of adaptation issues. For example: Believing that the "Horseless Carriage" was a novelty, many "buggy whip" manufacturers and others in the animal power industry failed to recognize the opportunity and declined to adapt their business models to include automobile accessories; recently, some newspaper publishers failed to timely adapt to online rather than in print publication; currently, in the mobile computer/phone industry there is a whirlwind of innovation which to date has had significant adverse impact upon both the hotel and taxi industries and which continues to excite a constant need for adaptation amongst a wide variety of businesses.

- **Industry**: the multitude of separate businesses found under a commonly accepted class or category such as construction, graphic arts, laundry, etc.

- **Business**: the thin slice or subset of an industry which you are considering purchasing or establishing.

Adequate funding aside, success in business is primarily about successfully perceiving and resolving challenges. Unfortunately, most people shy away from challenges – especially if they present as problems. Really, it's too bad – because, as my Dad used to say "**problems are typically opportunities in masquerade".** Actually, I prefer to state it with greater specificity: "**In business, identified challenges are always opportunities (even if it's merely the opportunity to disengage or get out of the way) – but a challenge must first be identified!**

In my professional practice, I find that those of my clients who seem to me as possessing a **genuine enthusiasm to be challenged** are far more

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

inclined to be successful in business. **Their enthusiasm enhances their perception – and accurate perception is the antidote for delusion.**

As it is the challenges presented by the steady need for adaptation which not only creates new industries and extinguishes old ones, but also determines if a standing business will survive or fold, I am comfortable offering the following advice to the prospective purchaser of a business with which they are unfamiliar: unless you have a real enthusiasm for being challenged, which as explained, includes a similar passion for problem resolution – don't do it!

Still in, you say? Well, if you are new to the industry in which you seek to invest, and before you look for a particular business within the industry, here's your first challenge: significantly **improve your understanding** of the industry – and the **best gateway to understanding is to identify and increase your knowledge of the challenges which affect the industry**.

Assuming that someone whose opinion you can trust (their objectivity not clouded by self-interest) can be found for a reasonable fee, the absolute best way is to engage a specialized consultant. The internet is also a great source of info for those with superior search skills. So are industry conventions.

- Every industry has conventions – magicians, morticians – you name it. Identify yours on the internet and attend. Then, instead of focusing exclusively on the exhibitors, **talk with your fellow attendees** (many of them will own, or have a roll in, a business within the industry). Given the right circumstances, people are frequently willing to be candid with others:
    - Anonymity: As convention attendees, most of you are just faces in a crowd, not readily associated with a particular business within the industry, and presumably more inclined to be forthcoming.
    - Given a sympathetic listener and a safe environment, people are more likely talk about their problems. It is cathartic (makes them feel better) and some people also like to teach – especially to those who appear to be in need of instruction.

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

- Generally speaking, an understanding of the unsung downside of an industry is far more valuable to you than easy to come by hype – it gives you a window into the industry and helps guard against your overvaluing of a particular business within the industry.

Once you are well familiar with the industry, but before you purchase a particular business, **game-up your "due diligence",** with this basic thought: **Trust the opinion of no-one who has even the slightest interest (or potential interest) in the outcome of your business purchase transaction.** And remember:

- Sellers tend to overstate revenues and understate expenses – sometimes by deferring expenses for past due maintenance or repairs.

- Sellers generally pass over or fail to mention the problem details which attend their particular business – and details can be quite important. Sometimes they are critical!

- The only mission of a business broker is to sell the business. The more he or she sells it for, the more commission earned from the seller. Loyalty in business follows the same path as money. See "Dealing with Business Brokers".

- If relying upon trade publications to improve your knowledge, be attentive to the presence of advertising. A publication which routinely publishes cautionary or problem identifying articles may be avoided by many advertisers (Simply put: they don't publish articles which might displease their advertisers.)

Establish and maintain good lines of personal communication with the seller. It may enable you to sort things out for yourselves when misunderstandings or disputes arise in the course of the transaction. But always remember: the seller is your **counterparty** in the transaction.

- **If using an accountant or other analyst, always select one with significant experience in the type of business involved.** Ideally, it is best to find an accountant or financial analyst who possesses actual "hands on" experience in the same type of business, rather than someone who has merely played an advisory role as to tax issues.

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

Never be dismissive of risk! As it is present in everything we do, you must be eager to both identify and evaluate it*. To be dismissive of risk in a business deal is to invite disaster.

***Note: In my considerable experience, well seasoned business people have a far greater interest in risk than people who strike me as less seasoned. For example: I'll make an observation as to a risk element regarding a transaction and my seasoned clients immediately want a detailed explanation; the less seasoned generally display less interest - even indifference.**

Here's the primary initiative as to reducing risk: **Don't go "all in"** (invest all of your available capital) **– and especially don't go "all in plus**" (incur legal obligations which place you in a situation wherein you stand to lose considerably more [sometimes multiples] of your net assets).

- **Avoid signing personal guarantees for payment of notes, loans, or rent to a landlord**. It significantly adds to your risk in the deal and is one of the best ways available to get into deep financial trouble. Depending on the sum involved, your other assets, and the state in which you reside, it can result in the loss of your home!
- Business involves too many things which are beyond your control for you to place your personal assets on the line without limit.
- There are alternatives to full personal guarantees, including a wide variety of "good guy" guarantees, which can be utilized instead.

Recognize that **professional services are expensive**, and deserve more attention than the average newcomer gives them. Moreover, the smaller the transaction, the greater the professional fee percentage of the purchase price will be. In any event, here are some steps the purchaser of a small business can take to minimize professional fees, and especially legal fees:

- Discuss fee arrangements before engaging an attorney – and understand that attorneys typically charge for the professional time they spend on your deal – if you can minimize professional time, you can minimize your legal bill.
- Note that the assignment and/or negotiation of a commercial lease can be very consumptive of lawyer time. Frequently fifty or so pages of legalese which endeavors to minimize the landlord's obligations to the

tenant and maximize the landlords rights against the tenant is fairly common, and it needs to be dealt with as economically as possible.

  - Perhaps you can negotiate some changes or even a brand new lease in exchange for a little more rent or additional security escrow. “Form” leases which are more favorable to the tenant are generally available, and it may well be less consumptive of professional time to negotiate from that basis.

  - In my view it is better to pay a little more rent than to be placed at an even more severe legal disadvantage as to the landlord than the law normally provides.

- Economize on lawyer time by resolving as many of the significant details of the transaction before you engage a lawyer to represent you on the purchase. For example: If on a purchase I am representing a laundromat industry insider, my client has usually negotiated a price for the business that reasonably matches its value, together with other significant details of the prospective deal before he hands it all over to me - and therefore it will take me just a fraction of the time to close his deal than the time required for me to close a deal for a newbie who presents me with a deal that includes the agreed purchase price (typically considerably more than the value of the place appears to be) together with financing terms, but little else. This requires me to explain the oversights to my client and frequently initiate an effort to renegotiate the deal - if that is even possible.

- Be aware of **forbidden communications**. As soon as the seller engages a lawyer for representation on the sale, the buyers lawyer is forbidden to deal with the seller personally (he must deal with the seller’s lawyer instead) and visa versa. So if you had developed the recommended direct working relationship with the seller, you will not be compelled to an expensive (consumptive of professional time) and inefficient “relay” system which demands communication solely through the lawyers. Provided you can handle it, you will be able to negotiate directly with the seller while seeking guidance directly from your lawyer, thus leaving the lawyers only to the task of reducing the final deal to a written agreement.

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

- When deciding upon or forming a personally protective legal entity such as a sub. S corporation or limited liability company, consider utilizing a CPA rather than an attorney (state law permitting):
    - Generally speaking, accountants charge considerably less than attorneys.
    - The primary differences between a Sub. S Corp and an LLC are based upon tax considerations which is a topic best left to accountants anyway.

Understand that personal protection from liability as offered by a Corporation or LLC is only a partial shield from personal liability from your actions - generally limited to contractual liabilities.

- **You will <u>not</u> be protected from liability for tortious acts such as negligence or conversion.**
- It is possible to shatter the shield completely if you write checks for personal expenses from Corp. or LLC funds.
- If you wish to enjoy the personal protection provided, be careful when executing a legal document. **First, the name of the corp. or LLC, then your name and title**; as in: ABCD LLC, by John Doe, Member. (Otherwise, you may place legal obligations upon yourself rather than, or in addition to, the entity.)

Reduce the possibility of incurring expensive legal problems somewhere down the road. In consultation (including getting your questions answered) with your attorney develop your own understanding of:

- Lease terms (especially if the business involved is location sensitive).
- Government regulations and other legal issues associated with the business.

Dealing with business brokers: Ideally, a broker should function as a facilitator. Some do. Others use tactics that deliberately obstruct the flow of information from seller to buyer, often by demanding “offers” or financial or legal commitments before “full” information on the business will be released, thus encouraging buyer action based upon incomplete information. Experienced brokers know the chances are good that there are problems with the business (frequently, that's why it is for sale), and the more

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

information available to the buyer, the greater the opportunity for the buyer to identify problem issues. Problem identification tends to suppress buyer enthusiasm, which leads to lower or no offers. Accordingly, many brokers attempt to frustrate buyer drill-downs.

As to purchasing a business with identified problems: It depends upon both the nature of the identified problem(s) and the mindset and abilities of the prospective buyer. For example: Are you to be an investor, a speculator, or somewhere between the two? Generally speaking, speculators buy into an identified problem, and investors buy a ready-made significant return on investment. **The key is to purchase something that is in harmony with both your mindset and your abilities.** Unfortunately, it is very common for an erstwhile investor to belatedly discover that he or she has purchased a problem situation - thus inadvertently becoming both a speculator and a victim who overpaid for what they got.

Investors and speculators: Common traits of the successful: Successful speculators seem always to know two things: a very good idea of what they are going to do to improve the business, together with a reasonably accurate approximation of what it will cost. Successful investors, on the other hand, seem never to wear rose colored glasses. However, the successful of either category always take a thorough and well informed look before they leap - that is to say: they are not dismissive of risk; they **apply "risk analysis" to the proposal**.

"Risk analysis"? Yes, I mean discovering and evaluating where you might stand to lose - and for that an experienced guide is best.

Should you overpay for what you got there's not going to be too much for it legally unless significant fraud was involved – and even then, legal action is expensive to take and outcomes are uncertain.

Bear in mind that the price for mistakes can be high. Moreover, if you wish to sell it again, you'll have to go through a process similar to that which you used to buy it, but in reverse (except that you will be paying any business broker you elect to use).

As to establishing a new business, and assuming sufficient capital:

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com

- A common recurring mistake is misjudging a potential market or level of public interest in the product. This mistake is frequently associated with the rental and fitting-out of a storefront. For example: someone with a keen interest in fly-tying (presumably projecting his interest to the general public) opens a fly-tying supply shop many miles from a trout stream. No! Others in your area are not likely to share that interest and there will be insufficient customers. (Author's note: I did not dream this example up – I actually witnessed it!)

- Establishing a business in order to enter an established market which is being underserved is somewhat less risky, especially for those with experience in that particular industry. Moreover, such an initiative also offers the opportunity to study real time market demand before proceeding, instead of relying upon projections.

- In any event, when establishing a new business in a yet to be tested venue, it is best if you can:

    - Start in your garage – many of the extremely successful have.

    - Try to find some venture capital that does not leave you personally liable for the monies advanced to your business.

____

Gary is a licensed attorney and a professional coin laundry analyst and appraiser with over 30 years of experience in the coin laundry industry. His appraisal and consultation services are available throughout the U.S., Canada, and Europe for a flat fee.

Gary also offers discounted legal representation to buyers and sellers of both laundromats and other small businesses which are located in the State of New York, and he is affiliated with like minded attorneys in other states. Contact him for more information.

See also: www.laundromatadvisor.com

If you elect to watch some of **Gary's video tips** just click here.

(Tip #1 and Tip #4 are applicable to any type of business venture)

Law Office of Gary Ruff 21 Pulaski Road, Ste 154 Kings Park NY 11754
garyruff@gmail.com Tel 631.210.7058 www.laundromatadvisor.com