Financing the Business Sale

Understanding the Engagement from the Buyer and Seller

Whether you're looking to buy or sell a business, the biggest challenge comes from how the financing is going to take place. Many factors influence the selection of the right avenue for both the buyer and seller. Regardless of the side you're on, you must be aware of the options available and methods employed when financing a business. Both sides have to know how this part will be accomplished in order to have a successful transaction.

From the Seller's End

If the seller wants all cash, he or she is making it clear they don't want to be involved in any kind of seller financing. The buyer will either have to use the liquid capital they have available or seek to obtain a loan. In the latter case, the business must qualify for a loan through an approved lender. The seller will have to produce a list of items from the approved lender in order for the business to be approved – ie. Tax returns, financial statements, pro forma operating statement for next three years, procuring a lease to allow for a sufficient occupancy window to match the loan term.

From the Buyer's End

If a buyer does not have the capital to make the purchase, they can qualify for a SBA guaranteed loan. Most states follow similar requirements for obtaining a SBA loan.

Cash Equity

Depending upon the buyer's experience with the kind of business being purchased, the approved lender will require cash equity – at least 20% with experience, at least 40% without it.

Credit and Life Insurance

With most approved lenders, the buyer must have a solid credit record as well as carry decreased life insurance in equal amount to the loan.

Property and Investments

Approved lenders may ask you to pledge non-residential real property and investments as collateral for the loan – IRAs, 401Ks and Keogh investments are exempt from this.

With any SBA loan, you will have to wait the 30 to 45 day processing period before obtaining approval and funding. You also have to be willing to hold the business for half of the note term before selling by assumption or refinancing.

Option for Seller Financing

In many cases, the seller may be willing to finance the sale. If so, a few areas have to be addressed.

Financial Statements and Credit Checks

The seller should perform a credit check on the buyer. They can also require them to send copies of the business' financial statements once ownership has changed hands. However, the buyer doesn't have to encumber his other assets in the agreement.

Payment and Liens

Unlike the cash equity of a loan where the buyer has to pay anywhere from 30% to 50%, in the case of seller financing, the buyer will have to pay anywhere from 50% to 70%. In addition, the buyer holds the right to prepay the note in full or in part without penalty. The seller should also have a recorded first lien on all assets of the business.