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Small Businesses Tempting More Buyers

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Small businesses are hot prospects for buyers these days.

Financiers with money to spend are turning more frequently to the mini-mart or small trucking company as a good investment. Among the most avid buyers are private equity funds flush with cash.

"There's no question that small businesses are becoming more frequent takeover targets," said Joe Astrachan, director of the Cox Family Enterprise Center at Kennesaw State University and editor of the Family Business Review. "Ten years ago, this didn't happen at all."

Buyers have gotten far more sophisticated about gauging the risks of taking over a small business, and as a result are going after those "all the way down into the area of 100 employees or fewer," Astrachan said.

But new buyers pose some challenges as well as opportunities for small business owners looking to sell. Along with capital, they may bring performance contracts that require owners to stay in the business and keep it growing. Moreover, buyers may suddenly swoop in with an offer unexpectedly - which may require a more rigorous approach to keeping the business ship-shape.

Proof that the buying spree has heated up is partly in the growing ranks of business owners and executives seeking out advisers for a review of their personal finances, according to M. Holly Isdale, managing director and head of wealth advisory services at Lehman Brothers Inc.

"There are bids being made that may tip family or closely held companies into selling because the price is right," said Isdale. "Executives are coming to us and for a look at how their finances are structured."

How small is small? Mom-and-Pop outfits continue to fly under the radar of the acquisition-hungry - these are the tiny corner grocery or liquor stores whose owners struggle to make ends meet. As ever, such businesses are more likely to fall victim to the local superstore than become the object of buyer desire.

Prime targets are well-oiled businesses with an annual profit of at least \$150,000.

Manufacturing, trucking and garbage collecting concerns are popular targets.

"It really depends on the industry, but most deals are being done with businesses with around \$250,000 or up in annual profits," said Grafton "Cap" Willey, a shareholder and managing partner of the Rhode Island offices of Tofias PC, a regional accounting firm, and chairman of the National Small Business Association.

Common sense comes into play. If an owner is working more than 60 hours a week and the business is bringing in only a modest profit, there's probably not a queue around the block to take it off his hands.

"If it's more like a job than a business, why would someone want to buy it?" said Paul Hense, president of Hense & Associates, a small accounting firm in Grand Rapids, Mich.

Still, there seem to be more people now looking for profitable small businesses than are available, according to Hense, who has seen many of his good clients bought out.

"That's the awful part of being a small CPA firm," said Hense. "We're good at taking other small firms and making them work. Then they go away when they get bought."

Private-equity funds are the biggest driver of small business takeovers these days, though retired executives looking to get back into action with companies to call their own are also buyers.

"Buyout firms are raising huge pools of capital," said Isdale. "There's just so much money going into buyouts."

A common modus operandi for a private-equity fund: Take a minority stake in a business through a performance-based contract that grants representation on the board of directors. A bigger share of ownership results if the company doesn't perform well, and a buyout can follow.

Small business owners who get into a deal with private equity should remember that these arrangements may exert uncomfortable pressure. Often, a partner is looking to turn around the investment in two to five years.

"We like to say that small business owners are looking for patient capital," said Willey. "Venture capitalists, by their nature, aren't patient."

So it's important for business owners to make sure they have a good exit strategy should things go wrong, said Colin C. Blaydon, director of the Center for Private Equity and Entrepreneurship at the Tuck School of Business at Dartmouth College in Hanover, N.H. "Owners have to make sure they're in control of their own destiny."

Ira Bryck, director of the University of Massachusetts Amherst Family Business Center in Hadley, Mass., said he sees numerous people with small family businesses who want to sell.

People in that position should consider a number of things, said Bryck. Among them is making sure the business isn't bloated with vacation homes and other "toys." These can make it hard to tell the true value of the business.

"When it comes time to sell your company, which often comes unexpectedly, you have to throw all of that stuff overboard and clean house fast," said Bryck. "You have to get rid of anything in the business that's not a value-added part of it."

Indeed, the element of surprise is more often in play these days, as private equity funds get more aggressive.

"We're starting to see more hostile takeovers," said Isdale. "It used to be that as a senior vice president, I would have a say, but now takeovers are coming out of the woodwork."

Understanding the real value of the business is also key. Small business owners are "notoriously bad at judging the value of their own business," said Astrachan. Often, an owner thinks it's worth a lot more or less than it really is, he said.

"They also need to figure out what value they derive from the business that isn't financial," said Astrachan. "What's the thing they get out of it that would be hardest to purchase? Lots of times, the financial offer might be great, but it just wouldn't make up for what the business adds to your life."