

PREFACE

The genesis of this book was the day I went to the library to find something I could recommend to my students. When I came home that night empty-handed, I felt discouraged, but I didn't give up. I kept searching the catalogues and stacks at other libraries and I managed to find a scant handful of excellent books. But the excellent ones were for sale prices well outside the realm of small business, or for topics like venture capital and appraising that were too specialized for my students, my buyers, or my sellers. Finally, I did give up. That's when I decided to write this thing myself. The small business marketplace was in sore need of a detailed, comprehensive manual on solving its many difficulties, and somebody had to do it.

That was in 1992.

Now, in 2007, as this book goes to press, I'm still searching the libraries, and things haven't changed much. I've reviewed a total of about 40 books in the how-to genre with no significant improvements to report.

I've also reviewed several university textbooks on entrepreneurship. I found their qualities of writing and informing their readers to be at the usual high levels of academia, but dealing almost exclusively in starting a business. They tend to brush over buying with a single chapter or less, and they cover selling mostly with advice (like launching an IPO) ill-suited for the owners of small businesses. What's more, their advice tends toward the management level, like a branch manager's outline to his staff, while *Buying and Selling a Small Business (BSSB)* tends toward the detail level, like an engineer's blueprint for shop workers.

So here's how this book can be useful: depending on the aim of your entrepreneurship program, *BSSB* can serve as the text for a new course in buying a business, or as a complement to the text in an existing course in starting a business. However, since university professors generally do not have all of the right experience to teach the variety of topics in this book, you may

have to supplement your staff with one or more instructors from outside your school. For example, you might hire a business broker to teach brokering (Chapter 5), a business owner for fact-finding (Chapter 6), and a mediator for negotiating (Chapter 8).

Of course, if you are simply a prospective buyer or seller of a small business, as opposed to a teacher or a student, this book will guide you through virtually every step in your deal.

To enhance your understanding of the text and add to your enjoyment, I've provided background and orientation below. Part 1 describes the small business marketplace including its meaning, its difficulties, and its history. Part 2 describes the benefits you should expect from reading this book. And Part 3 describes the organization and features of this book, its many examples, the disciplines and areas covered, and those not covered.

Whether you're a small business manager or a business school professor, I think you're in for a big surprise by the depth and complexity of what you are about to discover.

PART 1:

THE SMALL BUSINESS MARKETPLACE

The Meaning of a Small Business. In 1980, when I began my career as a business broker, I thought that buying a small business was just a way to invest, and that selling was merely an exit. I also thought that a small business was little more than a chattel or an offshoot of the job market.

I was so wrong about that.

The purchase and sale of a small business are major milestones in the lives of most entrepreneurs. For buyers, it is the beginning of a new, more fulfilling life. For sellers, it is often the end. In Maslow's Hierarchy of human needs, the buyer's purchase of a small business would score at the highest level, the one described by Maslow as self-actualization. That's when one becomes all that one can be. That's why the purchase and sale of a small business are on the same scale of life's most memorable events as graduations,

weddings, divorces, and funerals. And that's why they are just as emotional.

The Definition of a Small Business. In contrast to definitions based on annual sales, number of employees, or other quantitative measures, I define a small business conceptually as one with only one tier of management, namely, the owner. That definition is not perfect but it more or less sums up what most small businesses actually are. Its importance will be brought out in Part 4 of Chapter 7, "Appraising."

The Scope of the Marketplace. There are some five million corporations in America. About 98% of them have fewer than 100 employees, and 89% have fewer than 20. I would guess that most of those in the 89% would fit the above definition of a small business. I would also guess that from 10 to 15 percent of them are for sale at any given time. (See <http://app1.sba.gov/faqs/> for the latest information.)

How I Chose My Book Title. The title I really wanted was *Arcane World*. It summarized so perfectly the small business marketplace and all the difficulties of working in it. But that neat, nippy phrase, alas, was an alien in the world of search engines. Besides, for many folks, *arcane* itself was arcane. So that's how I came to the dull but practical title now on the cover. My gurus made me do it.

A Litany of Difficulties—Why the Small Business Marketplace Is Dysfunctional. When you consider that these are small businesses we are talking about, this marketplace is surprisingly complex. For example, the typical deal is not a relatively easy sale of corporate stock. Instead, it is an asset sale requiring around 20 documents to close (see Appendix A on page 474).

Adding to the difficulty is that the marketplace is mostly unregulated. In Missouri, for example, the state does not require testing and licensing for business brokers as it does for real estate agents, certified public accountants, and lawyers. That means that anyone may become a business broker by simply so declaring. It also means that people are not being trained whose skills

we can reasonably count on. The result is a marketplace where incompetence is much too common, and people are getting hurt. Details are provided in some of the real-life examples spread through the book. (The examples where people are getting hurt are summarized in Part 2 of Chapter 12, starting on page 448.)

In some states, regulation does exist but much of it is superficial, requiring only a real estate license or a simple registration with the state.

Because the market in most states is either unregulated or regulated superficially, with no licensed, well-trained advisors for guidance, buyers and sellers often turn to their accountants and lawyers for help. But these professional advisors lack the special training required to be effective in this marketplace. As a result, their good intentions notwithstanding, they often do more harm than good, and their clients are getting hurt. Those details too are provided in the above-mentioned real-life examples.

There are private organizations that train and certify business brokers and business appraisers, and they seem to be competent. But they are not widely recognized, so the help they provide is very limited.

Other sources of help are available, but the advice offered is usually aimed at business starters, only seldom at buyers and sellers, and it tends to be too basic to be helpful in this market. For example, the State of Missouri maintains a web site offering advice for entrepreneurs. That site is very informative and easy to read, and I recommend it to those newly interested in business. However, it doesn't begin to deal with the difficulties in this litany (see <http://www.ded.mo.gov/business/pdfs/startuppacket.pdf>). And the Small Business Administration (SBA), for another example, has a group known as SCORE (Service Corps of Retired Executives) providing volunteer advisors who are experienced in business and anxious to help. Yet, for all their good intentions, those volunteers seem to have little or no training for this marketplace.

What's worse is that the inadequate help we receive from otherwise trustable sources as the Missouri web site and SCORE obscures the need for advice that we can reliably count on. In other words, we can think we're being helped when we're really not.

Worse still, as if the marketplace were not difficult enough, the human condition, in all its diversity, exerts its dispiriting influence. Here are some of the problems that occasionally impede our deals: marital discord, idiosyncratic behavior (occasionally by in-house accountants, and by owners who do their own bookkeeping), dueling partners, hubris, myths (those with respect to financing are especially persistent), emotional blockages (like irrational resistance to hiring a lawyer), incivility, arrogance, autocracy (mainly by business owners), rudeness, skullduggery, and meanness of spirit. Of course, these are not the everyday stuff that deals are made of, but they appear often enough to remind us of our humanity, and to make an already tough market even tougher.

But worst of all is that for many, the biggest difficulty is when would-be buyers and would-be sellers attempt to find each other to simply get their deals started. That's because this marketplace, unlike the real estate marketplace, lacks a multiple listing service and because business brokers sometimes don't cooperate with one another. It is also because sellers tend to keep their businesses for sale a closely guarded secret. Because of this difficulty, the painstaking effort to find the right matchup—probably harder on buyers than on sellers—often amounts to months or even years of fruitless and frustrating searching, the kind of effort that some would describe as drudgery. One almost has to go through the experience to understand why each deal, once it gets started, should be thought of as precious to behold and worth fighting to preserve.

Amidst all the difficulties, however, there are two groups that stand tall. One is the SBA which does a great job working with the banking industry to finance the purchases of small businesses. The other is the banking industry itself which, despite imperfections, does an overall fine job financing those purchases.

The difficulties nevertheless prevail. Thus, working a deal successfully from start to finish requires technical skill, diplomacy, no end of patience, and a sensitivity to human emotions. It is something of an art, and it is always a challenge.

Continuing the Litany—A Difficulty of Another Kind. Based on my observations, most business owners do not report their true incomes. That makes business appraising a difficult and special art. Because cheating on taxes is rampant, and because it is done systematically in large amounts, I felt compelled to tell my readers, in exhaustive detail, how to deal with it. In fact, I've offered enough detail that my explanation may seem like an encouragement to cheat. You may even think of it as unethical. I will therefore remind you that a writer's first duty is to tell the truth, and that means the whole truth. It usually leads to a greater good. (See "Business Morality in America" on my web site: www.monnetpress.com.)

Why the Real Estate Marketplace Is Regulated, While the Small Business Marketplace Is Not. The marketplace's regulatory disparity—and some of the difficulties mentioned above—can best be understood by looking briefly at a special history of our culture.

The situation began more or less in 1215 when King John signed the Magna Carta and copies were distributed to some 20 boroughs around the kingdom. As a result of the distribution of that document, the laws introduced by it, and the judicial decisions arising from it, became common throughout the land. Thus, English common law was born and, through colonization, so was American law.

These early laws dealt more with ownership of land than with ownership of business because land was more important as a producer and store of wealth and as a badge of prestige. Businesses in those days consisted mainly of crafts connected to the land or to a fief (a feudal estate lived on and worked by vassals). Crafts rarely were marketed partly because they tended to be family affairs (although apprentices and journeymen sometimes were hired) but, more importantly, because the value of a craft mostly remains with the skill of the artisan and that skill cannot be sold. Further, many of the reasons we think of today for selling a business either did not commonly exist, did not exist at all, or were not socially acceptable or recognized. Such reasons included retirement in old age (most people died before reaching old age), divorce, moving to another city to be with family, burnout, and upward mobility.

Another factor explaining the disparity between real estate-marketing law and business-marketing law is that early advances in entrepreneurship were hampered by conservative laws tending to preserve the status quo. One English law passed in the 1500s, for example, limited the number of looms that could be maintained in the homes of country weavers. Gradually, however, such developments as specialization, technological improvements, marketing techniques, emerging social attitudes, and laws tolerating such changes came into being. Then the industrial revolution, beginning in the late 1700s, shifted emphasis from agriculture to production and from the skills of workers to the capabilities of machines. Even then, the vast majority of the people remained agrarian and rural and the need for laws dealing with the buying and selling of businesses remained slight.

Finally, the twentieth century unfolded, society became urbanized and complex, and businesses became numerous while the reasons for selling businesses became compelling and common. Thus, with a glimpse of history and the realization that the need for laws and regulations for the marketing of businesses developed suddenly and recently while the need for regulations governing the marketing of real estate developed centuries ago, the regulatory disparity between the two markets becomes understandable.

Still, there is another reason that significant regulatory control has not yet reached the small business marketplace. Most of the buy-sell transaction is so much more difficult than meets the eye that few individuals have been able to define it, especially in writing. That's why the small business marketplace is arcane. And that's why it will remain arcane unless it is subjected to intelligent regulation. The difficulty is partly because of the market's innate technicality and partly because whether one is a principal to the transaction or an advisor, the skills required are largely an art as well as a science. (See Chapter 12, Part 2 for my proposal to regulate.)

PART 2:

THE BENEFITS OF READING THIS BOOK

The Benefits for Buyers and Sellers. The primary benefit is that it will increase