Financing your Purchase?

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"I am a cash buyer!" How many times have I heard that? More often than is true. Once you ask the buyer to explain if he is bringing a bag of cash or if he is ready to do an EFT today from his saving account do you find out a different reality. Understand one thing please, if you don't HAVE THE CASH ready, now, here and today you not a cash buyer. If you have to get it from your bond to pay the buyer cash, you still need to arrange financing. If I don't write that in you contract with a financing clause and the bank don't release the funds for any reason you more that likely will loose your deposit to the seller.

> *"Cash means you have it ready in a bag or ready to be transferred!"*

The truth is very few people have the cash ready to make a purchase, and why would they have it lying around? So be honest to the seller, and the broker or they can also sue you for misrepresentation.

1. What financing options do I have?

There are many ways to finance a business from obtaining money from friends and family, a bond on your house, to special funding relating to BEE (Black Economic Empowerment) and from various institutions to name a few. These are all options, including in some cases even financing from the seller, although this is very rare. Your specific best option of financing a purchase will also depend largely on the business you buy. A business with a lot of goodwill will be very hard to finance, that with a lot of assets easier. SME's notoriously keep a set of accounting records that does not favour any form of financing.

2. Banks

> *"The big myth of small deposit, no surety and you ready to do it!"*

One of the biggest problems is that your account manager at the bank said sure, we will look at it, no problem. Yes they will look at it no problem, its their job and you are a client that must be pleased, but you are in for a big surprise! Once your application meets the credit comittee who actually decides on your loan application, the reality sets in.

The most important aspect to understand in getting finance from a bank regardless of the type of loan is that they are NOT going to finance the whole transaction. This is the most common mistake prospective new business owners make. They have no or a very small deposit, hardly any collateral (security of their own) and then think they can get a loan to buy a business. It is not happening, sorry.

> *"Marketing department will give you a green light and the credit committee a red light!"*

Although these by no means are the criteria of any specific bank or institution, you can use these as a rule of thumb. If you don't meet these basic criteria you will not get that loan, despite what anybody tells you out there. Every transaction differs so this is only a general guideline.

As a rule of thumb the following can be used:

- The bank will finance 50% at most of the transaction
- You have to give the other 50% in CASH
- You have to have trading capital available as well in CASH
- The 50% that the bank finances needs to have security presented by you for it
- Stock in the business you buy is not security (A truck can remove it overnight)
- Tangible Assets is security. This is not the value to replace them, but the value on a auction if your business doesn't make it...so 1/3 of the actual value.
- Using your house as security will work, BUT remember the value minus the bond amount is security, and then only 70% of that value.

- The business must be able to pay as proven through a proper set of accounts, your salary, and over and above that the loan, and they will build a 30% safety margin in as well.

With the new Credit Act and the current market conditions this is the reality. So as example, if you want to buy a business of R1million rand, you must have R600,000 in cash. You also will need security of R350,000 for the loan you are making. No security, no loan, no cash, no loan. Right now to the business, this business will have to make enough money to cover your expenses and repay the loan. So let say you need R20,000pm as salary. The loan in the example is for R500,000 over 4 years with a 10% interest rate. That means paying it back at R12,700pm. So the business needs to make R32,700pm in the example, but with a 30% safety margin the financial institution will want the business to make al least R46,000 pm profit to feel comfortable. That means your profit can drop with 30% and you can still survive.

Normal credit criteria still apply, are you without judgements, can you afford the payments (yes the business income is added) and all other criteria.

Therefore you will look for a business that fits these criteria as the deciding factor. **What you can buy is what drives things and not what you want to buy**.

3. Seller Financing

"Seller financing is an option but beware"

Can the seller not finance a portion to me direct? The answer is yes they might be willing to, and do indeed is some cases. That is a fantastic way to buy a business if you don't have all the money. It also means the seller believes in the business and that it can actually afford the payments. Seller finance is an option but beware. You must be aware that the payment terms are normally very short. The cashflow drain will thus be on you and the business for a period. They will ask in most cases that you pay a higher interest than a bank. They will require collateral as well, in most cases the business will do, but you slip on a single payment, they will take the business back and you loose everything paid to date. They normally ask for 70% or more of the purchase price as deposit. You will not be able to negotiate a lower price for the business like a cash buyer can sometimes.

Most buyers aim way above their maximum reach. So when we ask questions as brokers about your finances it is because we will be able to assess if you even stand a chance to buy the business financially.

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