Daniel M. Isard

Thinking About Acquiring a Business?

Critical things to evaluate before you make your decision.

Dear Dan,
I own a 115-call, one-location business that I took over from my parents in a small town with only one competitor. I have one full-time, licensed employee. I am making an okay living and have no long-term debt in my business.

Just yesterday, my quiet, simple world turned upside down when my "competitor" called and offered to sell me his business. His business is about the same size as mine. He has been associated as a Catholic firm and ours is known as a Protestant firm, though of late, we are both burying families from each church. He told me that if I didn't buy his business, he would look for another buyer. He even went so far as to give me a price and his terms for purchase.

Dan, in my mind, if I don't buy it, a new competitor will come in, start a big advertising campaign, and I'll risk losing my market share. If I do buy it, I will be taking on debt and working twice as hard.

Signed, Concerned About Change

Dear CAC,
Over the past three decades, I've helped hundreds of funeral directors and business owners make acquisitions. There have been about 50 times that I advised clients not to make an acquisition. Let me guide you through the steps of analysis you need to understand before you make the decision to attempt to acquire a business or choose to remain a one-location firm.

There are many reasons to make an acquisition and just as many to walk away from one. The difference is there are no bragging rights to be had for not having made a business acquisition. So, the buyers are loud and proud, and the humble souls who elect not to purchase are quiet and debt free.

You, CAC, demonstrate in your letter some reticence in making a purchase. As I lay my hands on my monitor viewing your email, I am able to learn a great deal about you. I get the sense that you are happy in your divided market. Families go to you or to your competitor. When your competitor started burying families from your church, you were not too worried because you were burying just as many from his. It's easy. There's no stress. I can tell you are not friends with the competitor, but you are not enemies. I also sense that you do not have an assertive preneed program or strong marketing plan and neither does your competitor. In fact, you are at peace. You are complacent with the way things are.

Now, one way or another, change is going to happen. My mood ring monitor indicates that your soul is stressed.

The problem with your "tomorrow" is that you did nothing during your "yesterday." You are satisfied. You make an "okay living." You do not feel you are a better alternative for families than your competitor. So you are very amiable. Now, all that will change. Concerned you should be.

There is a four-step process a business owner must follow before deciding to make an acquisition.

Step 1: Value
I have appraised more than 2,300 funeral homes. If you hire an appraiser, make certain he or she knows the world of funeral service. Values are different based on the location of the business and the size of the market. A 100-call firm in a major town is usually worth more than a comparable firm two hours from a major airport. The key to the valuation is to avoid overpaying for a business.

I have seen many who have overpaid, excusing it by saying, "The seller wanted that amount." I have seen funeral home owners walk away from a deal over a difference of a thousand dollars, yet, when buying a business, 10 percent overpayment is not uncommon.

Overpaying by 10 percent means:
- It will take you about four years longer to pay for the business.
- It will raise your chance of default in the first five years by 50 percent.
- It could risk your ability to get financing.
- It could prompt you to give more personal collateral than you should.

The concept of overpaying applies to the package of the business and the real estate. The real estate should be valued as a funeral home, not a commercial property. Too often, someone gets a local appraiser to value the real estate, but these local real estate appraisers are not assuming that the highest and best use of the building is that of a funeral home. Some don't even understand that a funeral home is a special-use property. This leads to many cases of overpaying, and you don't know you've overpaid until you're exhausted and realize you are not making any profit after paying your debt. Remember, the objective is to acquire profitably, not just acquire!

Step 2: Evaluate
The dynamics of the evaluation are many. First, is this a business you truly want to own? Don't assume you should buy it just to eliminate competition. Are there barriers to entry so that a new competitor will not move into your town? Know that ego induces a lot of people to buy a business, regardless of whether it's a good move for them or not.

Ask yourself honestly: Can you operate your competitor's business as well as he did or better? Will you keep both buildings open or just one? While there is a cost of operating out of two buildings, there is also protection from competition. The building is a sign of comfort to families. Often, that helps you retain market share.

Staffing is a key determinant of the success of operations. Since labor is the largest cost of running a funeral home, it is also the greatest source of synergies when blending multiple businesses. Even if you are keeping both buildings, you'll probably need just one bookkeeper. With today's software for accounting and management, this is a solid savings. If you could save some professional staffing costs, that might be an added benefit. Or, in the absence of trying to save staffing costs, giving more time off to the blended staff is a much appreciated benefit.

Step 3: Revalue

First, value the target to acquire in order to understand what profit exists in the business. Next, value your own business. Lastly, assume you have acquired the business and you merge them. Look at the synergies and how much that brings to the merged enterprise. It is very common for two businesses that are each worth \$1 to merge and be worth \$2.25!

So does that mean you can afford to offer more? Yes, but you shouldn't. This synergistic bump is the profit built in because of your continued ownership. You should offer what the target business is worth, and when you can implement the synergies, then that increased value comes to you.

Step 4: Finance

Your business is going to take on a large amount of debt. Based on the world today, this will probably be a blend of Small Business Administration financing and seller financing. The SBA financing can come through a local bank or a national lender/bank. Frankly, there are benefits to the local lender and there are benefits to the national specialist that markets to funeral homes. The local lender is your neighbor. The specialty lender knows funeral service. That becomes important in the loan structure and if there is ever a problem. The specialist will have more confidence in finding a solution.

What could happen? Death could slow down. Keep in mind, the mortality rate is 8.2 deaths per 1,000 in population a year. However, just when you get millions of dollars in debt, mortality takes a holiday. The specialty lender can be more flexible. The neighbor will probably be more afraid of having a default.

Owner financing is called a Covenant Not to Compete, a form of seller debt. This is how you negotiate with the former owner to promise not to interfere with the patronage you are buying.

CAC, if you don't buy out the competitor, figure out what is at risk. If a really sharp person buys it, can he or she hurt your business any more than the existing competitor? Do you have a solid marketing brand? What's that, CAC? It sounded like you whispered, "No."

So you need to figure out if you really want this. Will it be a benefit or a curse? Can you afford to make this purchase and what happens to your quiet market strategy if you do not acquire. Also think about how this will affect your personal life. With good staff, you might get more time off. If you are not a delegating person, this will run you into the ground.

Be careful what you wish for! ✶

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