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New Ownership Can Save Some Recession-Stressed Businesses

By John E. Barraclough, Jr., CPA, Managing Principal, Barraclough and Associates, P.C.

Recessions tend to stress-test many businesses. When financing is tight and customers are pinching pennies, a business that was treading water despite poor management, chaotic cash flow or short-term planning might find itself going under. In some cases, the problems are insurmountable, and the owner is forced to sell or close a business.

As long as the failure wasn't due to industry-wide crises, such as depletion of raw materials or a massive turn away from a product or service, one businessman's failure can be another's success. In fact, an entrepreneur with a sharp head for business can find many opportunities in a sluggish economy to turn a poorly run company into a profitable venture.

Check for a pulse

Due diligence is especially critical when buying an existing business that has ceased to make money for its owner. A potential new owner must be confident that the business can be viable and profitable given the right leadership, and that requires a close inspection of the business and the industry in which it operates.

The first documents to review are balance sheets, income statements and cash flow statements for at least five years back. Papers to review are tax returns (including income, payroll and gross receipts tax), accounts receivable and payable, property or equipment leases, labor and supply contracts and warranties. These documents can reveal not only the money going in and out of a business, but they also tell a story of business decisions — some good, some fatally unwise.

It might be that the business was doomed no matter who was in charge. It might have been based on an industry that's on its way out or very sensitive to global economies. But if the industry is vital and growth is possible, the buyer should analyze where it stands and what can be done to grab a larger share of its market.

Assets to look for

Clients, employees, equipment and inventory are among the assets that warrant close inspection when buying a failing business.

If the company has a small client list, it could be that little effort was made to build it through marketing or competitive efforts. If the client base is diversified and extensive, the potential buyer will want to know how the business failed in spite of this. A survey of clients would yield critical information about the long-term prospects for a business under new ownership.

A prospective new owner should assess the skills and ambitions of the business's workforce and decide who to keep and on what terms. Many who work for a failing business will be demoralized and understandably anxious about their job security, but face-to-face meetings with some or all employees can reveal much about past management of a company and could identify leaders and problem solvers who might blossom under new management.

The more tangible assets of a business — the equipment, building and inventory — should be inspected before a purchase. The prospective buyer will want inventory that is marketable, equipment that works and a building that is well maintained. If the business is leasing its headquarters, the prospective owner should discuss with the property owner a new lease or sublease that allows the business to stay put under stable and favorable terms.

Another set of eyes

Before buying a faltering business, an entrepreneur should hire a qualified CPA and lawyer to review all terms of the purchase and all financial records, contracts, leases and other agreements. The closing attorney should search tax liens for possible encumbrances against the business's assets.

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