

BUSINESS VERSUS REAL ESTATE BROKERAGE

KEY DIFFERENCES SELLERS AND BUYERS NEED TO UNDERSTAND

When you want to sell or buy commercial real estate, you look for a commercial real estate broker. When you want to sell or buy a business, with or without real estate attached, you look for a business broker. They fulfill the same function, right? Well, the answer is: “Yes and no.”

While it is true that both real estate and business brokers assist in transferring assets between a willing seller and a willing buyer, the **differences in skill sets, techniques and time investment** are significant.

Ed Pendarvis, a legendary business broker, identified seven critical differences between the two types of transactions. They are: Confidentiality; Financing Availability; Buyer/Seller Relationships, Valuation Strategies; Agency; Negotiating Strategies; and Factors in Determining Value. A brief review here will help you, whether you are considering buying or selling a business, to understand the differences.

SOME ASPECTS OF BROKERAGE ARE THE SAME

First: the similarities! Unless you are very experienced in evaluating, buying and selling either businesses and properties, an experienced broker can help you get the best deal in the shortest amount of time – and save you from the distraction that focusing on something you do only occasionally. A successful transaction involves

- **knowing the market** for the business or property
- **understanding** recent transactions and trends
- having a **network** of prospects and marketing resources in place
- paying attention to **detail** and
- having the **objectivity** necessary to negotiate a deal that will hold together.

Some sellers and owners have successfully participated in transactions without benefit of an experienced broker; in most cases, the costs of doing so (both opportunity and time) are substantial.

VIVE LA DIFFERENCE!

When you get past the initial similarities: **both real estate and business brokers are trained professionals** whose role is to optimize your experience, the **differences** start to emerge.

Confidentiality: When you ask a real estate broker to list your property, you expect that he or she will shout it from the rooftops. Real estate agents use multiple forms of advertising from large signs in front of the property to individualized web pages to color displays in magazines and newspapers to get the word out. They host broker tours and open houses to invite the public to view the property—and tell their friends. Business brokers, on the other hand, recognize that **it can cause irreparable harm if word gets out that your business is for sale**. They use discrete teasers and cloaked business scenarios to get the word out via specialized business brokerage sites and well-developed business networks. They protect the seller's privacy by requiring an executed Non-disclosure Agreement (NDA) also called a Confidentiality Agreement (CA) and enough financial information to demonstrate that a prospective buyer is qualified to run and able to pay for the target business before revealing any particulars, including the name, of the business for sale.

Financing Availability: Buyers of businesses, like buyers of real estate, rarely have the means to make a cash purchase. Just about any bank has a mortgage department that provides loans for the purchase of real property, however, bank financing is difficult or impossible to get for many small business purchases. Bear in mind that to a bank, a “small business” is \$3 million to \$20 million in annual revenues, so most “Main Street” (under \$3 million in revenue) transactions don't qualify. Also, **banks consider business loans riskier for a variety of reasons, and security for a business loan can be tricky**. This is why most banks will not consider a small business loan without a Small Business Administration (SBA) guarantee of 90% of the principal amount of the loan. Most small businesses do not have enough physical assets to adequately secure a business loan, and most small business purchasers know better than to risk their homes as security for their businesses. A business broker needs to be much more creative than a real estate broker in identifying funding sources to make a deal come together.

Buyer/Seller Relationships: Purchasers of real estate, particularly residential real estate, rarely meet the buyers until closing—if even then. The real estate agents handle the entire transaction, and the purchase is the end of the relationship. Buying a business is a different animal. **The business seller and buyer will need to meet and get to know each other well during the contract negotiation and due diligence stages the negotiations**. A business is much more complex than a piece of real estate, and a broker needs to help both parties come to a satisfactory agreement on what the seller is selling and the buyer is buying prior to the transfer of funds and control. In addition, the buyer and seller need to be prepared to work together *after the purchase is complete* to effect a successful transition. If the buyer and seller can't get along or don't

see eye to eye on the package being offered, the chances of a successful transaction are nil.

Valuation Strategies: Comparable sales information is readily available in real estate and with large public companies. However, with Main Street and most small businesses the sales price is confidential and not disclosed to the general public. A real estate broker can choose comparable properties, make adjustments based on number of rooms, age, lot size or other criteria and recommend a price range that will be generally accepted by all parties. Business brokers have access to certain data base information for comparable sales, however, even with that data, **identifying a “comparable business” is not so simple.**

Management styles, processes and procedures, established relationships and marketing and sales strategies are only some of the many factors that can make two businesses in the same market in the same size buildings sitting next to each other vary widely in value.

Add to that, a business can have a different value based on the needs and perception of the buyer. For example, the owner of an established business that sees the offered business as an opportunity to expand because of the synergy of the product lines will use a different set of criteria from a prospective buyer who wants to replace his current job by running the company on his own. In the end, the deal boils down to what a buyer can and will pay and what a seller is willing to accept under mutually agreeable terms with no ready financing market. A business broker has to be skilled in helping the buyer and the seller move to that point.

Agency: While Pendarvis uses the term “agency” to point to the difference between the responsibilities real estate brokers and business brokers have to those who hire them, I prefer the term “advocacy.” . In many (but not all) states, there is implied agency (fiduciary responsibility) by the simple act of engaging with a client, whether in writing or verbally. In most real estate transactions, different brokers will represent the buyer and seller even if both brokers are members of the same firm because the relationship is somewhat adversarial – the seller’s agent is looking to get the best deal for the property being sold while the buyer’s agent is looking for concessions that benefit the buyer. Traditionally, **a business broker, while engaged by the seller, acts as an intermediary, negotiating with both the seller and the buyer to create a solid win/win;** in other words, **the broker advocates for “the deal.”** It won’t come together unless both parties are satisfied with the terms and there are many more moving parts in creating a win/win business sale than in a property sale.

Negotiation Strategies: By now you have probably figured out that the negotiations for buying a business are much more complex than those for buying a house or commercial property. (Remember those moving parts!) Business brokers need to be creative in identifying ways that buyers and sellers can both have their needs met. They also perform a calming role as intermediary when frustrations flare or disagreements

threaten a successful deal. Most real estate transactions can be handled with a standard contract. **There are no standard contracts for business purchases, and the final agreement almost always looks very different from both the seller's original sale package and the buyer's initial offer.**

Factors in Determining Value: "Location, location, location" is the mantra of the real estate agent. Location is by far the most important component in determining the value of real property. For the business broker, the formula is more complex: location is still important, but the remaining two components of the business value mantra are track record and management. **Seller's discretionary cash flow replaces the location mantra for the sale of a business.** Knowing how to evaluate the seller's representations and cash flow is a skill required of business brokers and is very different than for real estate.

AND THEN THERE'S DUE DILIGENCE . . .

At Business Acquisitions, we have added an 8th differentiation and that has to do with due diligence. In real estate transactions, due diligence typically boils down to a series of inspections by experts, which take place over a relatively short period of time. When purchasing a business, it behooves the buyer to dig more deeply. Buyers typically engage a group of experts including CPAs, attorneys and other business professionals to examine the business in depth. As observed in "Factors in Determining Value," due diligence is not as cut and dried as examining the roof or the plumbing and electrical circuits. Management practices, whether or not are one or more unions represented, retirement and pension plans, accounting practices and lease terms are only a few of the items that need to be considered before signing on the bottom line. Business due diligence can take months rather than weeks to complete and the broker often needs to work with the buyer and seller and their consultants to determine acceptable levels of risk, since there is no business equivalent of a homeowner's warranty.

In effect, real estate brokers have established routes to travel, with most of the routes being paved and navigation tools available; business brokers typically have tested tools at their disposal, but each successful transaction will have characteristics similar to those of blazing a trail in the wilderness: a good guide is valuable.