



Complete the deal with the right financing

You've identified an attractive acquisition target. Now you need the financing to complete the deal. With many different sources of funding out there, how do you select the type that's best for your situation?

There's no one-size-fits-all solution. Depending on such factors as the business history, management structure and financial strength, you may benefit from certain types of financing but not others. What's more, some of your available options may prove overly restrictive, while others that may be wrong for your rivals may be entirely appropriate for you.

Before you make such an important decision, thoroughly examine your choices.

Bank financing

Traditional bank financing is the typical funding approach for companies with a very solid balance sheet and a history of strong cash flows.

If you qualify, bank loans may be advantageous because they tend to be less expensive when compared to other alternatives. But in difficult economic environments, bank loans can be hard to come by.

Although conditions have improved recently as the economy has picked up, applicants for cash-flow-based loans may still find themselves with relatively high hurdles to clear. If, for example, your company has any credit problems likely to raise red flags with a lender, you may need to look elsewhere for financing.

Asset-based financing

With bank financing difficult to obtain in recent years, an increasing number of companies have turned instead to asset-based loans.

Rather than depending on cash flows and credit quality, asset-based loans are based on the tangible value of a company's assets, which serve as collateral. The most commonly used assets are accounts receivable and inventory. Some lenders, however, will accept almost any asset with determinable value — including machinery and real estate, and even patents or other intangible assets.

Asset lenders are more likely to be critical of *qualitative* factors such as the strength of a company's management team and business plan, as well as its ability to articulate how an acquisition will make the company stronger and add to future value.

Asset-based loans are popular with companies experiencing weakness in their business as a result of poor economic trends or a challenging competitive environment. Young companies with promising growth potential but a limited earnings history may be good candidates for asset-based loans.

One significant disadvantage of asset-based loans is that lenders will impose strict reporting requirements to keep them current on asset values. These reports can mean a steady and burdensome stream of paperwork. Also, asset-based loans tend to be more expensive than traditional bank financing.

Sale-leasebacks

By relying on the value of a company's real estate, sale-leaseback financing enables businesses to obtain needed cash without increasing debt or — contrary to some competing types of financing — diluting valuable equity.

With this approach, an owner sells a property to a buyer, and the buyer simultaneously leases the property back to the seller. Commonly used by retailers, sale-leasebacks have become more widespread in recent years as low interest rates have pushed up real estate values.

One drawback to this approach: lost flexibility associated with giving up ownership of a valuable property. Forgoing ownership could even result in a lower credit rating for the company, as lenders place a high value on property ownership.

Venture capital

Particularly prevalent in fueling the technology sector's growth during the late-1990s stock boom, venture capital may also be a source of funding for a merger or acquisition deal. Venture capitalists are most interested in opportunities that can generate a substantial near-term return on an investment, after which they may decide to cash out.

The main advantage of venture capital is a ready source of funds for qualifying candidates. The biggest disadvantage is cost: Venture capitalists usually demand a significant ownership stake in exchange for their investment.

Smaller, service-based businesses may want to look to small business investment corporations (SBICs) for funding. Sponsored by the federal government, SBICs are often more flexible in the terms of their investment arrangements and offer an attractive alternative for companies making a deal worth less than \$5 million.

Seller financing

If it proves difficult to identify prospective lenders, requesting seller financing may be a good way to go. With seller financing, sellers facilitate a deal by agreeing to accept a note for part of the acquisition price.

Nontraditional forms of compensation, such as consulting agreements, royalties or sales commissions, also can be used to finance the sale over a period of time. These approaches can be attractive to a buyer because of their flexibility.

In most cases of fully seller financed acquisitions, buyers make a down payment and give the seller a note for the rest of the purchase price, with the business and its assets serving as collateral. Occasionally, the seller may demand extra security and require a buyer to put up additional collateral, such as a home or other personal investments.

With this approach, the seller assumes some risk in letting the buyer pay part of the purchase price over time. Why? The seller is on the hook for some of the business's risks, even as day-to-day management control is relinquished.

Also, if buyers mismanage the business or encounter a rough market environment, they may have trouble paying back the note — potentially requiring sellers to foreclose, reassume control over the business and restart the selling process from scratch.

From the buyer's perspective, seller financing can be great if you can get it. Lending criteria often are more flexible than you can obtain through bank financing. Terms, such as payment schedule, interest rates and loan length can be varied based on the requirements of the buyer and seller.

The best match

While searching for financing, remember there may be no single perfect approach. The one you choose should be the best match for your company's financial situation and business characteristics.