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Determining Risk When Buying a Business

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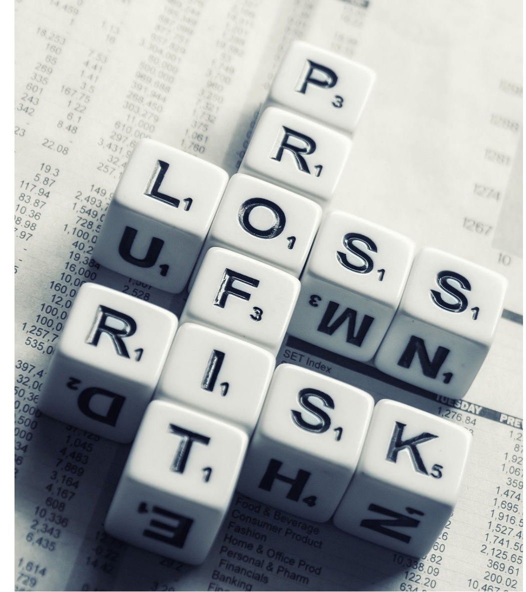

Risk can be influenced by the stage of the venture, the competitive advantage, proprietary technology, the expertise and experience of management and many other factors that can determine whether a venture succeeds or fails.

It is possible for a venture to fail and lenders to get their money back. This is the strategy used by asset-based lenders. Banks want businesses to have sufficient cash flow to be able to repay their loan and interest. They also insist on a secondary source of repayment, whether in the form of collateral that they can liquidate or guarantees from sources who could repay.

Asset-based lenders may lend money to a business even when it does not have cash flow. They rely on their security in the form of collateral, and closely monitor the loan.

Below is a list of some financial instruments that are sorted by ascending order of risk:

Senior Loans Across All Assets

Good for banks because they prefer the least risk.

Senior Loans with Specifically-Named Assets

Good for vendors of equipment or asset-based lenders who have very specific needs.

Subordinated Loans across All Assets

This can be advantageous for smaller and community development venture capitalists, who often have lower appetite for risk than the venture capital limited partnerships.

Unsecured Loans

For those who trust you such as friends and family that are not seeking a high return.

Preferred Stock

For sophisticated investors who know that it adds equity to the venture while giving them the control they want.

Common Stock

This is generally for friends, family and relatively unsophisticated angels who invest small amounts of money in high risk ventures.