



ASSESSING RISK WHEN BUYING A BUSINESS

By JoAnn Lombardi, President VR Business Sales / Mergers & Acquisitions

When evaluating a business for acquisition, understanding the risk profile is critical. Risk influences not only the purchase price and financing terms but also the long-term viability of the investment. For business buyers and brokers, a thorough risk assessment can mean the difference between a profitable acquisition and a costly misstep.

KEY RISK INDICATORS TO EVALUATE

The best way to find a strategic buyer for your company is to consult with a VR M&A intermediary. We will assist you in finding qualified candidates through identifying possible synergies such as:

1. Stage of the Business
 - Startups: High risk due to limited track record and unproven models.
 - Established Businesses: Lower risk, especially if they show consistent revenue, customer retention, and operational stability.
2. Competitive Advantage
 - Look for businesses with strong brand equity, customer loyalty, or unique offerings that differentiate them from competitors.
3. Proprietary Assets
 - Intellectual property, exclusive supplier agreements, or patented technology can significantly reduce competitive threats.
4. Management Team
 - A seasoned, capable leadership team adds value. If the current owner is key to operations, consider how their exit will impact performance.
5. Industry and Market Trends
 - Analyze the sector's growth potential, regulatory environment, and susceptibility to economic cycles.
6. Financial Performance
 - Review historical financials, cash flow statements, and debt obligations. A business with healthy, predictable cash flow is more attractive to lenders and investors.

HOW LENDERS VIEW RISK

Understanding how different lenders assess risk is crucial for buyers aiming to structure deals effectively. Traditional banks tend to favor businesses with strong and predictable cash flow, as this ensures reliable loan repayment. They typically require collaterals such as real estate or equipment—and often insist on personal guarantees from the borrower. Their approach is generally conservative, prioritizing financial stability and security. In contrast, asset-based lenders are more flexible when it comes to cash flow. They are willing to extend credit even to businesses with weaker cash flow, provided there are valuable assets to secure the loan. However, this flexibility comes with tighter oversight, as these lenders often require frequent monitoring and may impose stricter operational controls to protect their investment.

VALUED REPRESENTATION

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FINANCIAL INSTRUMENTS RANKED BY RISK (LOW TO HIGH)

This hierarchy helps buyers and brokers understand how different funding sources align with risk tolerance and control preferences:

Instrument	Description	Ideal For
Senior Loans (All Assets)	Secured by all business assets. Lowest risk for lenders.	Banks, SBA lenders
Senior Loans (Specific Assets)	Secured by named assets like equipment or inventory.	Equipment vendors, asset-based lenders
Subordinated Loans	Repaid after senior debt. Higher risk, but flexible.	Community lenders, Mezzanine funds
Unsecured Loans	No collateral. Based on trust and relationship.	Friends, family, informal investors
Preferred Stock	Equity with priority over common stock. Often includes control rights.	Sophisticated investors, strategic partners
Common Stock	High risk, high potential return. Last in line during liquidation.	Angel investors, friends and family

PRACTICAL TIPS FOR BUYERS AND BROKERS

When preparing to buy a business, it's essential to take a strategic and thorough approach. Start by conducting comprehensive due diligence that goes beyond just reviewing financial statements. Evaluate key operational areas such as customer contracts, supplier relationships, employee turnover, and any potential legal liabilities. This deeper insight helps uncover hidden risks and opportunities. Next, have a clear understanding of the exit strategy, know when and how you or your client might want to exit the investment, and consider how different risk factors could impact that timeline. Finally, ensure that the financing structure aligns with the business's risk profile. Choose funding sources that match your tolerance for risk and your desired level of control and return, which can significantly influence the long-term success of the acquisition.