FINANCING THE ACQUISITION OF A PHARMACY©

The issues that surround the financing of the acquisition of a pharmacy, while often somewhat complex, can be distilled down to two core premises:

- Sellers want to be sure that they will receive all the proceeds of any sale that is made, and;

- Buyers, particularly first time buyers, rarely if ever have the money required to pay for their proposed acquisition in cash.

These two premises lead to the more complex issue of how pharmacy acquisitions, and small business acquisitions in general, are financed. To begin with, let's assume that the buyer will probably not have the full purchase price in hand and therefore will have to borrow, from somewhere or someone, to finance the acquisition of his or her pharmacy. There are three more or less "traditional" sources of this financing, including:

- Banks and other financial/lending institutions
- Personal funds of relatives or friends
- The seller of the business

Traditional bank financing, whereby the borrower posts some sort of collateral for the loan, then receives the funding required to buy a business, is not the norm in the world of small business acquisitions. Since the collateral available in a retail pharmacy acquisition rarely, if ever, equals the value of the required loan, most commercial banks and other lending institutions are not comfortable lending a significant portion of the purchase price. This is particularly true in the case of pharmacy acquisitions, where so much of the value is in the goodwill attached to the reputation of the pharmacy and the customer relationships that reside, in actuality, in the prescription files.

The most notable exception to this rule is a government guaranteed SBA (for Small Business Administration) loan. In this scenario, an authorized SBA lender, of which there are many, provides the funding required for the acquisition, up to as much as 85-90%, a significant portion of which is guaranteed by the Federal Government, thereby reducing the risk of loss to the bank should the new owner fail in business. This process is not as mysterious as many would make it out to be, is done every day in the United States, subject to a number of terms and conditions for both the buyer and the seller, all of which can be met. These include:

- A "reasonable" equity contribution by the buyer, somewhere between ten and twenty percent of the total deal. If there is real estate involved in the transaction, whereby the buyer is also purchasing a building from the seller, this can lower the equity contribution required.
- A professional evaluation of the business, to support the value and price being paid.
- Complete financial documentation from both the buyer and the seller, and a reasonably complex set of forms that must be completed.
- The posting of additional collateral other than the assets of the business, usually in the form of a lien on the buyer's home, assuming he or she owns one.
- The personal guarantee of the purchaser(s).

While this may sound somewhat complex to a first time buyer it is, in fact, a process that can be accomplished, usually with the assistance of a qualified professional who is experienced in guiding people through the process and has the necessary banking relationships to make it happen.

The second financing method, borrowing money from family or friends, is often fraught with complications, as personal relationships can and do cloud good business judgment and may lead to difficult situations. With that said, there are young pharmacists who have the good fortune to have family or friends with capital available who will support them in the acquisition of a business. My counsel here is to treat these loans as formally as possible, clearly documenting the responsibilities of the borrower to pay back the money, under specific terms and within a specific time frame. In this way, misunderstandings about the term of payback, interest rates payable and default provisions can be avoided.

The third method, probably the most widely used since this activity first began, is for the seller of the business to hold the note from the buyer, "take back a purchase money mortgage, to use the popular vernacular for this activity. In this scenario, not dissimilar to bank borrowing, the buyer puts up a down payment, as much as the parties agree is required (but rarely less than the value of the inventory in the pharmacy) and the seller holds a note for some agreed upon period of time, at an agreed upon rate of interest and payment intervals, which the buyer proceeds to pay once the transaction is closed.

The benefits of this type of borrowing for the buyer are the lack of paperwork and professional fees required for a bank loan (though the sellers usually require documentation of the buyer's personal financial situation and a formal credit check). If the parties are in agreement on all points, the loan is a done deal without the need for government guarantees, bank credit officers' approvals and other requirements which can slow down, impede or kill a deal. From the seller's perspective, these loans pay interest at market rates, providing a reasonable return on investment for them and regular monthly payments. This provides a steady income, assuming they don't need or want to receive all the proceeds of the sale at the time of closing, and often provides some tax benefits since they are not receiving the entire proceeds within one tax year.

There are many ramifications to the various methods of financing a transaction, all of which should/must be explored by both buyers and sellers prior to negotiating and closing a deal. It is important to seek the advice of qualified professionals who are familiar with these types of transactions, attorneys, accountants, financial counselors and others who can explore the various financing methods and help guide both buyers and sellers in the proper direction.