How to Avoid Making a Bad Business Investment

Caveat Entrepreneur Emptor - Let the Business Owner Beware

Whether you are buying an existing business, purchasing a franchise, or starting your own enterprise from scratch, it pays to go into the situation with both eyes open and one hand on your wallet. Perhaps you're interested in building a legacy for your children by leaving them a successful business. Maybe you're tired of the corporate rat race and the prospect of working for someone else the rest of your life. Or it's possible you are the descendent of a business owner and plan to take over in the near future. If you want to retain your financial and mental health throughout the process, there are a number of pitfalls to avoid.

Franchise No-Nos

By purchasing a franchise business you take advantage of a recognizable brand name, enjoy solid backing from a well-financed entity, and utilize time-tested methods that will make your efforts financially and emotionally rewarding. But not every franchise is created equal. Uppermost in your mind should be the type of business you plan to run. If you're uncomfortable with technology, don't buy a computer repair franchise, no matter how cool the logo-encrusted vehicle would look parked in your driveway. If you hate dealing with the public - and unless your plans include a totally behind-the-scenes approach - you probably don't want to own a fast food or daycare franchise. It's just as important, though, not to let your ego get in the way of a terrific franchising opportunity. If you're worried about what the neighbors might say if they happen to discover your ownership of a home cleaning franchise - even though it has the potential to make you a six-figure-a-year income - it might be time to rethink your motivation. A major consideration in choosing a franchise should be its potential for ROI (return on investment), not how embarrassed you might be to disclose what you do for a living. After all, most franchise owners run the business but have employees to do the basic stuff, like cleaning toilets or crawling under a car to replace the muffler.

Drawbacks in Buying an Existing Business

We have all daydreamed, at one time or another, about taking over a local business that has been a success over the years. In many cases, the owners are ready to retire and want to keep their legacy intact under new management. Maybe you have been a loyal customer down through the years and recognize the potential for your own success by picking up where the previous owners have left off. Don't let your emotions get the best of you. When taking over an existing business, you will want to closely examine the books - profit-and-loss statements, bank balances, and so on - along with existing lease arrangements and valuation. Don't take the owner's word that he or she had taken home X dollars over the past so many years. By hiring experts who know the industry to review your options, you will avoid buying a "pig in a poke."

So You Want to Start a Business From Scratch

Let's say you live in a town where a certain product or service is either absent or seriously underrepresented. Maybe the local liquor store doesn't carry any foreign brands of beer, or the closest chimney sweep lives 30 miles away. You may be tempted to close out that 401(k), liquidate your Roth IRA, and start your own business. Of course, many well-to-do entrepreneurs have done just that. After all, every business concept had to start somewhere. There was no Goodrich before good ol' B.F. sold his first tire, and no Stouffer's until that first cherry pie came out of the oven. But just because something seems like a good idea doesn't mean it is financially viable. One of the biggest mistakes anyone can make is to assume that people will beat a pathway to your door simply because you're selling something you think they want. Market research will pay for itself all day long, and properly recognizing where your competition lies and what motivates people to make this purchase but not that one is critical to your financial success. Do plenty of research, talk to people already involved in the business - especially if they are well removed from your prospective operational area - and take their advice to heart.

General Errors in Judgment

No matter which path you decide to take, another common error made by potential business owners involves making a decision without considering all the alternatives. You will not be a successful entrepreneur just because you recently lost your job and need the income. You will not preserve your nest egg by jumping into a situation you barely comprehend, especially if management experience is not part of your resume. This is not to say that no one can do well under such circumstances. But recognizing your weaknesses in advance will definitely help you to make the right decision. If you lack some of the skills necessary to run a business - maybe you're not very good at math, or you love working with customers but hate to deal with salespeople, such as suppliers - it might be the perfect opportunity to take in a partner who exhibits the traits you lack. The old saying, "Two minds are better than one," is hardly truer than when thinking about running your own business. Of course, the next step involves choosing someone whom you trust, whose personality will not clash with yours, and who would make an equal partner in the enterprise. Once again, it all boils down to taking your time and making the right decision.