

What Is Seller Financing for a Business?

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5 minute read



Seller-financed business sales are more common than not these days and can prove to be beneficial for sellers and buyers alike. Financing may allow sellers to benefit from a greater number of potential buyers and a quicker sale while providing buyers with an additional incentive to buy. So just what is seller financing for a business?

1. A portion of the business can be paid off over time with interest.

Sellers financing for a business is when the seller allows the buyer to pay off a portion of the price of the business over time with interest. A promissory note is drawn up outlining the Terms of Use of the sale including a schedule of payments and interest to be paid.

2. It's similar to a bank loan, but with the seller acting as the bank.

When buying a seller financed business, the interest rate is usually the same or lower than bank prime rates, while the term tends to be about the same. Small business sellers typically finance a third or more of their sale price. The buyer typically makes monthly payments to

the seller starting a month from the sale date, unless seasonal sales fluctuations affect the business to the extent that they would be reflected in the payment schedule.

3. The seller has a vested interest in the long term success of the business.

Seller financing demonstrates that the seller is confident that his or her business has the potential for long-term profit, which will enable the buyer to pay off their loan. Additionally, banks view seller financing as buyer equity and may be willing to lend more money in a seller-financed business for sale transaction.

What Are the Benefits of Seller Financing a Business?

1. Businesses offering seller financing are more likely to sell.

In BizBuySell's 2015 nationwide survey of business brokers, 82 percent calling seller financing either "important" or "essential" to completing transactions in today's market.. That in itself is an incentive for sellers to consider financing in order to stay competitive in the market. Many small business sellers offer seller financing in order to widen their scope of potential buyers, which may in turn reduce the time that their business is on the market, but there are additional benefits to financing your business sale.

2. Seller financing increases the likelihood of getting a higher selling price.

Financing a business for sale allows sellers to set a higher sales price than with a cash sale. This is partly due to a greater demand for seller-financed businesses for sale, but also because the seller can set a slightly higher asking price to help offset the risk of financing.

3. Sellers financing brings in profit from interest.

In addition to setting a higher initial selling price, seller financing brings in profit from collected interest, and allows sellers to spread out the taxable income from the sale over time. It also takes less time to clear than commercial financing, and since banks can require quite a bit of time to approve a loan, this may contribute to a quicker sale.

What to Consider Before Seller Financing a Business

- Include seller financing in the business for sale listing
- Ask for a sizeable down payment of at least a third up front
- Enlist the assistance of a financial advisor or business broker
- Ensure your collateral is secure and your contract is airtight
- Be prepared for your capital to be tied up until the loan is paid off
- Be prepared to stay involved in the business to some degree

If a seller decides to seller finance a business for sale, it's important to make that apparent in the business-for-sale ad. This will attract a greater range of potential buyers, since many buyers may be filtering their search results to show only seller-financed businesses for sale.

Of course, there is some degree of risk involved with financing a business for sale. Requiring a sizeable down payment of at least a third of the purchase price, and enlisting the assistance of a financial advisor or business broker to establish a contract with clearly defined loan-security measures can help to reduce the risk.

Loan security used for financing the purchase of a business can range anywhere from a personal guaranty from the buyer and his or her spouse that if payments are not made according to the promissory note the seller may foreclose on the business, to specific collateral in the form of mortgages and security agreements on personal property.

Loan security can also come in the form of stock pledges in which a corporation is formed giving the seller voting rights within the company so he or she can act in his or her own interest should the buyer default on payments. Sellers should consult with a professional to ensure that collateral is secure and the contract is airtight.

Another thing sellers should consider is that if they finance the sale, they will be connected to their company after it's sold up until the time that it's paid off. The seller's future opportunities may be limited if their capital is tied up in their old business when a new venture presents itself.

On the other hand, providing financing may be beneficial if the seller wants to stay involved in the business to some degree in order to ensure that it fairs well in the future. Seller-financed business sales require that the seller and buyer work together to some extent, potentially creating a positive relationship to help smooth the business transition.

Seller financing is not something to be entered into lightly. You should consider all the Do's and Don'ts of Seller Financing a Business for Sale before making a decision. Yet, after carefully consider all the risks and rewards, as well as consulting with legal and/or business professionals, you may well find it to be the best choice for you.

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