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The importance of management in small business ventures

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Was it a coincidence that 2 years after the Red Sox hired Theo Epstein as general manager (GM), they won their first “World Series” since 1918. Many of us are not fans of George Steinbrenner, but I envy a man that hires the proper management team to reach six “World Series” in the last ten years (so what if they have the highest payroll, it is still impressive). The successful candidates on Donald Trump’s reality show “The Apprentice” are usually not the smartest candidates, but rest assured they are always the best leaders/managers. The management team of any organization, regardless of its size, is one of the most crucial components to success.

Many quality small business ventures (\$1M to \$10M acquisition price) such as a gas station, hotel/motel, self-storage facility or similar types of business venture that include the underlying commercial real estate, often fail because of the management team or lack thereof.

Pre-Acquisition Phase

One may forget that the management team, especially for a small business venture, may include outside services such as legal counsel and accounting services. These in-

dividuals are crucial in the pre-acquisition phase. Please make sure that your accountant is a certified public accountant (CPA) or equivalent. I often find it amazing that small business owners are rarely concerned about the qualifications and services of their accounting professional. After one audit they usually change their tone, but this can be a costly lesson. Even though I am a CPA by trade, I “make my money” in the real estate property management/ownership and mortgage business. Therefore, I make sure that I have a solid affiliation with a tax professional to assist me with complex issues. Regarding pre-acquisition, make sure that you and your accounting professional perform a thorough financial/operational due diligence on the business acquisition. You want to be assured that the seller is not inflating the monthly Net Operating Income that the business generates thereby over stating the “cap rate” (assumed rate of return on an investment in real estate) and “debt service coverage” (the amount of cash flow available to meet annual principal and interest payments on the debt obligation associated with the commercial business venture). Reductions in these figures can be a great bargaining tool or a warning to put a brake on the acquisition process.

Attorneys on the other hand will make sure that the contract you are signing doesn’t include provisions that are disadvantageous to you. Don’t get me wrong here, I am not implying that you shouldn’t read the contract, but your attorney must

be able to answer any of your questions or questions from the seller’s attorney in a timely manner. In addition, your attorney will help properly set up the structure of your new organization (LLC, partnership, S-Corp) including the Article of Incorporation and the Operating Agreement.

Many costs associated with this phase are considered start-up or organization costs and can generally be amortized (expensed) as a deduction on your tax return over a period of 15 years.

Owner’s Experience

Plain and simple – as an owner, make sure to get involved in an industry in which you have significant knowledge or experience. I can’t stress this point enough. My father and I went into a gas station venture a few years ago and though we had a wealth of business and operational knowledge, we had a difficult first year with the business because the industry learning curve was so steep and our staff took advantage of this flaw.

Hiring a Manager

After you have completed a thorough due diligence you must decide on a competent manager(s) for your venture. Reference, credit and background checks are a no-brainer. Please also take into the consideration the following:

- If you are not going to be present at the business on a daily basis, make sure that the individual has experience in the industry at the manager level. I’m all about giving somebody a chance that has a solid amount of experience in their re-

spective industry, but there is no substitute for managerial skills especially if the owner is not present on a daily basis. Even if the manager has a limited number of staff, such managerial skills are important in dealing with the customers. I am a big fan of Isaiah Thomas as a basketball player. He led the Indiana Hoosiers to the college national title and the Detroit Pistons to an National Basketball Association (NBA) championship. However, as an owner and GM no one can argue that he led the Continental Basketball Association (CBA) to bankruptcy, and the New York Knicks are a complete failure during his tenure.

- On the flip-side, do not hire somebody that is over qualified. The qualifications may seem like a blessing, but I guarantee they will second guess many of your decisions and they will always be unhappy with their compensation package.

- Never hire somebody you can’t fire. This is my father’s favorite motto. Even if you are hiring a family member or good friend, you must be able to separate business from pleasure. If you have a difficulty with this concept, avoid arrangements with these individuals.

If you are in the market to acquire a business of any size, do not ignore the importance of the management team at your new venture.

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