

BizBuySell Insight Report

Small Business Acquisitions Slightly Higher, Seller Confidence Remains Low Amid High Interest Rates and Inflationary Costs

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- Median sale prices up 10%, buoyed by manufacturing and restaurants
- Retail and service sectors report weaker financials as rising costs eat into profits
- Savvy buyers scoop up bargains as retail business prices drop 18%

Small business acquisitions grew a modest 2% year-over-year in Q3 2023, continuing steady gains following a 13% drop in Q4 2022 according to BizBuySell's Insight Report, which tracks and analyzes U.S. business-for-sale transactions and sentiment from surveys of business owners, buyers, and brokers. In total, 2,281 businesses were reported as sold on BizBuySell, representing an enterprise value of nearly \$1.65 billion, 4% higher than the \$1.59 billion at the same time last year.

This activity is a positive sign that buyers and sellers are coming together and finding ways to hammer out deals in a higher interest rate environment. As prime based fixed SBA loans become more costly, funding methods and deal structures are evolving. With cash flow to repay debt getting further squeezed, lenders are asking sellers to carry higher levels of financing.

Lisa Riley, CEO and M&A Advisor at Delta Business Advisors (<https://www.bizbuysell.com/business-broker/lisa-riley/delta-business-advisors/17084/>) explains how buyers and sellers are getting creative in today's market. "Beyond traditional secured notes, a plethora

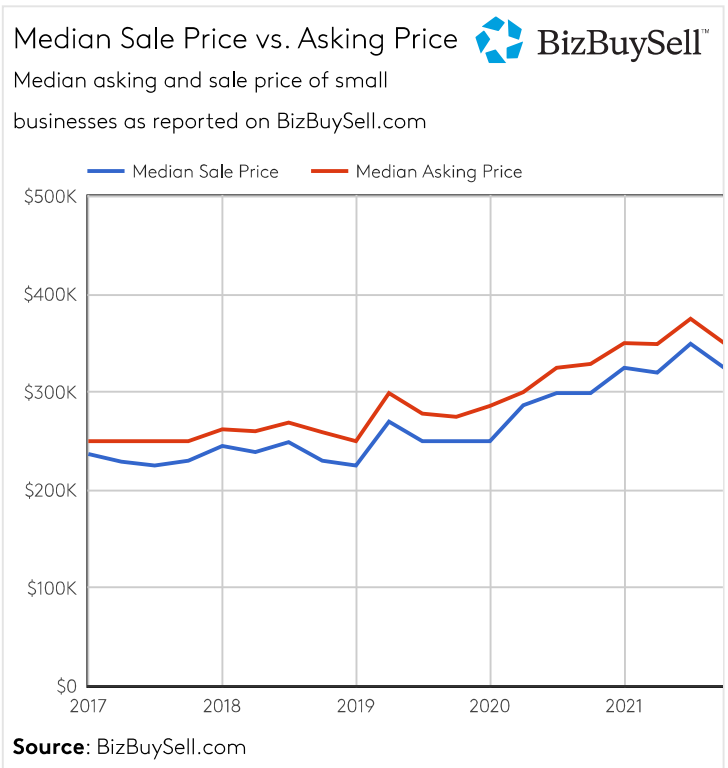


of seller carry and value bridging instruments exist, from earnouts and insurance agreements to consulting contracts, lifestyle arrangements, and more. The possibilities are diverse, ensuring a myriad of avenues to secure a successful sale," said Riley who also leads the International Business Brokers Association Market Pulse (<https://www.ibba.org/resource-center/industry-research/>) report.

"I think changes in the debt service coverage (DSC) ratios now being required by smaller banks have had almost as much of a negative impact as rising rates. When DSC increases, owners are often being required to provide a higher level of seller financing," adds Robert Flynn, Managing Member of United Brokers Group LLC (<https://www.bizbuysell.com/business-broker/robert-flynn/united-brokers-group-llc/6365/>).

Still, businesses with healthy cash flow and good management remain in high demand, with cash buyers having the clear advantage. Deals in Q3 moved faster, with the median days a business is on the market dropping to 164 days from 182 days in Q1, compared to a high of 200 days in 2020. Rather than hinder deals, high interest rates have motivated buyers and sellers to look for other solutions.

Despite rising material and employee costs, sale prices continue trending upward. The median sale price rose 10% to \$329,000, while the median asking price rose 8% to \$350,000. However, small business valuations remained flat. The average cash flow multiple of sold businesses declined 1.4% while the average revenue multiple inched up 1%.



Small Business Owner Confidence Remains Low as Inflation and High Costs Squeeze Business Values

Confidence among small business owners again hit a score of 46 in 2023, unchanged from 2022, according to BizBuySell's Business for Sale Confidence Index, which measures the sentiments of over business owners and buyers with 50 representing neutral confidence on a 0 – 100 scale. Again, this score falls within a point of 2020s record low of 45, when owners were grappling with uncertainty over the pandemic.

Most owners feel market conditions have remained relatively the same as the previous year, with the majority (49%) saying it would be difficult if they were to sell their business today. Owners cite economic uncertainty as the top factor (37%) followed by high interest rates impacting buyer purchasing power (29%). Yet, most owners (45%) don't feel next year will bring them a higher price.

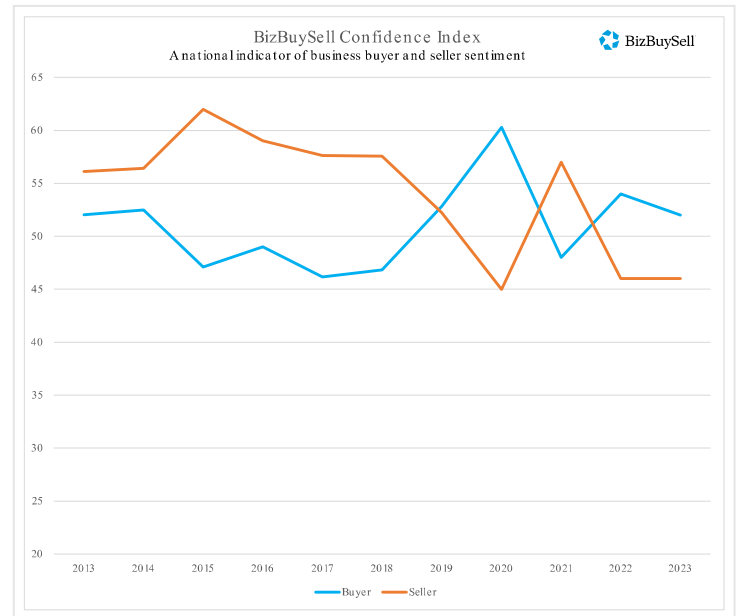
"Regardless of the buyer type, rates are up and so seller financing is still a prominent part of these transactions. Sellers can expect to be asked to carry 10-20% on a seller note.

We have seen terms of seller notes being reduced. Typically, they would be 10 years and now we are seeing 5 year notes or a 5 year balloon," says Katrina Loftin, Co-Founder of M&A Business Advisors (<https://www.bizbuysell.com/business-broker/katrina-loftin-cbi-mami/mandabusiness-advisors/36761/>).

Inflation is a major concern among business owners, with a majority (74%) saying their costs have gone up over the previous year. Most blame an increase in the cost of goods, plus overhead such as rent and fuel. One owner states, "The same vehicles we bought in 2018 and 2019 cost twice as much just 4-5 years later, gas is more expensive, oil changes, the cost of everything associated with the industry has increased."

The labor market, specifically the ability to hire or retain employees at a reasonable rate, is also affecting small businesses, with 47% say the market is not improving. In addition, 48% saying recent increases in state minimum wage have hurt their business. One owner explains how new state minimum wages have impacted his bottom line, "Even though I've raised my prices, I can't keep my wages in line with previous amounts. Now I am at the new minimum wage, which is \$5.25 higher than it was 3 years ago and I can only offer just at or slightly above minimum wage. Plus, all the other costs have gone up, so we're barely getting by."

Furthermore, interest rate hikes are making it increasingly difficult for owners to attract customers while covering costs, with 64% saying higher rates have had a negative impact. As capital has become more expensive, nearly half of owners (46%) say they have responded by



raising prices, another 40% have had to delay expansion plans. Just 18% are pausing hiring and only 7% are resorting to layoffs.

Most Business Buyers Remain Optimistic Amid High Rates

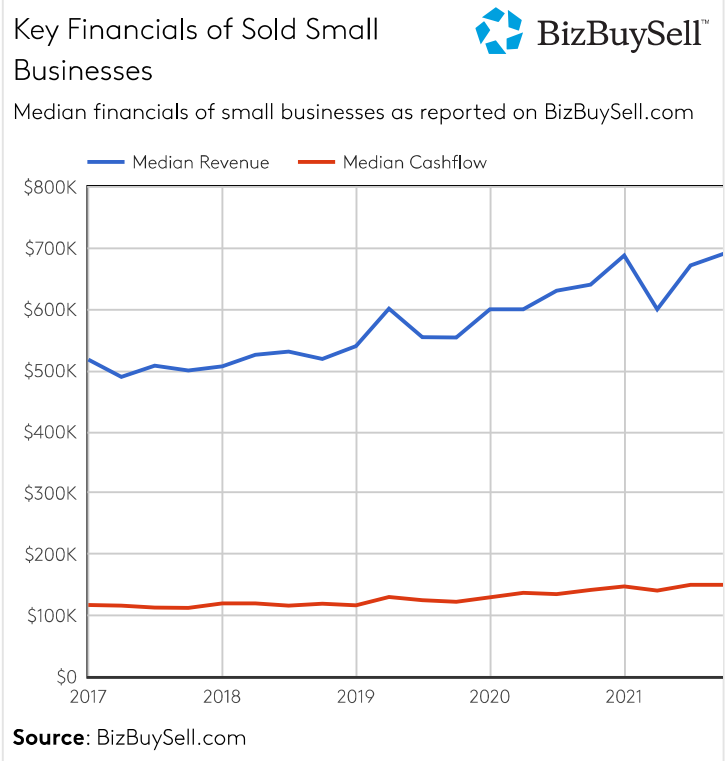
Facing the highest interest rates in over 20 years, business buyer confidence is higher than sellers and generally positive, but dropped to a score of 52 in 2023, down from 54 in 2022 after a high of 60 in 2020 when many opportunities emerge during the pandemic. Similar to last year's Business for Sale Confidence Index, 73% are confident they can buy a business at an acceptable price.

In terms of value, 53% of buyers believe businesses are overvalued, yet 40% believe values are similar to last year. Over 34% of buyers attribute economic uncertainty as the top reason they would receive an acceptable price, while 41% attribute high interest rates as the top reason they would not receive a favorable price.

Regarding motivation to seek business ownership, 44% said they are corporate refugees seeking to leave their current job with another 16% newly unemployed and seeking independence. Interestingly, 50% of those surveyed have owned a business before, which highlights the serial nature of entrepreneurs.

"I owned a brick-and-mortar business for 11 years and sold to an employee. We would like to get back into business but want to find something that is already successful," said one buyer.

Thirty-nine percent (39%) of buyers see today's environment as an opportunity to take on a variety of great businesses as more and more Baby Boomers retire each day. "A large number of boomers are retiring and selling good, reliable businesses that have been proven to be resistant to economic downturns such as 2008," said Whitney Richter, a small business buyer in California. However not all Boomers are ready to close shop and some are instead looking to open one, with one in five buyers identifying as belonging to the older generation.



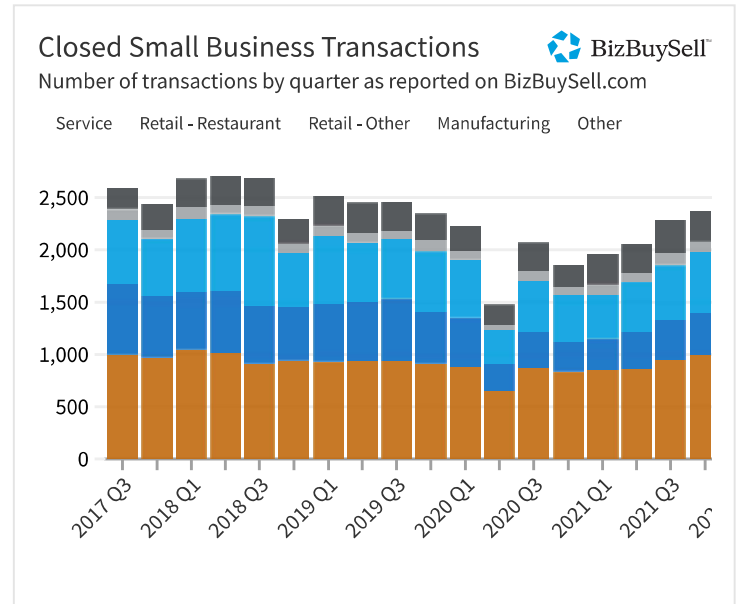
In terms of top business qualities, the majority of buyers (43%) are seeking service businesses. Fifty-five percent (55%) prefer thriving businesses while 40% are considering poorly performing business they can purchase at a discount.

Manufacturing Businesses in High Demand as Prices Surge 28%

The manufacturing sector led the market with the highest annual growth. Acquisitions grew 13% year-over-year in Q3 after growing 45% in Q2. Buyers also paid more, with the median sale price up 28% over the previous year and 36% over the previous quarter. Businesses ranging from lumber and wood products to medical devices remain in high demand.

This is further reflected in the sector's strong financial performance, with median revenue up 9.5% and median cash flow up 10% over the previous year. As more U.S. companies

shift away from offshore to domestic production where quality and inventory can be better managed, the manufacturing sector should continue to grow.



Entrepreneurs Scoop Up Bargains in Retail Sector as Prices Drop 18%

Retail business acquisitions grew 6% in Q3 yet median sale prices declined 18% to \$225,000, with sold retail businesses showing weaker financial performance. Median revenue in Q3 declined 15% over the previous year, while median cash flow declined 5.4%. Similarly, the average cash flow multiple declined 6% and the average revenue multiple declined 3%. The uptick in transactions suggests entrepreneurs are 'buying into the retail dip' as owners struggle with higher costs and weaker sales.

Discretionary spending has shifted as consumers face tighter credit conditions, dwindling personal savings, and the restart of student-debt payments. According to the Bureau of Labor Statistics, the personal saving rate (<https://www.bea.gov/data/income-saving/personal->

saving-rate) was 3.9% in August, well below a decade-long average of 8.9%. Consumers are still spending, yet more prudently, in order to have money for the things they enjoy, such as restaurants and entertainment.

Restaurant Revenue Grows as More Dine Out, However Rising Costs Eat Profits

While buyer demand remained relatively unchanged, with 1% annual growth in transactions, the median sale price of restaurants grew 7.4% in Q3 over the previous year. Furthermore, median revenue jumped 20%, showing strong sales as more consumers opt to dine out. Yet, median cash flow declined 3.6%, likely due to the high cost of food and labor cutting into profitability and putting pressure on restaurant values. The average revenue multiple declined 5%, while the average cash flow multiple inched up 2%.

Growth in the restaurant sector is also apparent through its expanding labor force. The Bureau of Labor Statistics' September jobs report (<https://www.bls.gov/news.release/empsit.nr0.htm>) showed that the leisure and hospitality sector added 96,000 jobs in September, the highest number of jobs of any sector. A large portion of these jobs are in restaurants, showing a gradual return toward its pre-pandemic February 2020 level.

Demand for Service Businesses Declines as It Diversifies to Other Sectors

The past year has shown a dip in both transactions and financial performance for the service sector, reflecting a slowdown in the demand. The number of closed transactions in Q3 declined 4% over the previous year, while the median sale price declined 6.4%. Median revenue declined 6% and median cash flow remained flat, with a 1% gain over the same time in 2022.

These declining numbers could also be attributed to a correction in the service sector after being in high demand during the pandemic, when many of these businesses performed exceedingly well. Whereas other businesses, such as restaurants and retail shops which relied heavily on foot traffic and once considered high risk, are now becoming more attractive to buyers.

Market Expected to Continue Adapting to High Interest Rate

Environment

As the market moves through the holiday season and into 2024, the prevailing high interest rate environment is expected to continue. The labor market remains strong as the Federal Reserve continues their quest to slow the economy and bring inflation down to 2%. As of September, the Consumer Price Index (<https://www.cnbc.com/2023/10/12/cpi-september-2023.html>) holds steady at 3.7%.

Yet under these conditions, the economy has been resilient. While the cost of doing business remains high, demand is strong for profitable businesses as well as other value drivers, such as prime real estate. For example, recently sold manufacturing businesses show strong performers are in high demand while restaurant businesses are showing a strong uptick in sales volume.

Seller Financing Increasingly Important, SBA Loans Remain Top Source of Financing

The high cost of obtaining capital has become a major sticking point in business for sale transactions over the past year. Seller financing helps overcome this in a number of ways. First, it offers buyers and lenders extra assurance for the risk they are taking on when sellers have some skin in the game. It also helps bridge the gap between price issues. As high rates and inflation continue to put pressure on cash flow, buyers will ask sellers to carry a higher level of financing.

"In the realm of business sales, the seller carry proves to be an invaluable asset. It opens doors to maximizing the amount one retains, creates a path for non-SBA enterprises, and may shorten the timeline to closing," adds Lisa Riley.

SBA financing remains the top lending source when it comes to business for sale transactions, even as rates are being pushed up to the 10% range. Top SBA lenders are now taking steps to streamline the closing process. However, many regional lenders are taking longer. "Due to some recent SBA rule changes, transactions are taking longer to close than they ever have. A normal SBA financed transaction, without issues, is taking 60-90 days to close," says Katrina Loftin, Co-Founder of M&A Business Advisors.

Seller financing is one area where dealmaking still needs to adapt to current market conditions. The gulf between buyers and sellers remains wide, with 24% of sellers say they are planning to offer seller financing compared to 55% of buyers who are expecting to ask for it.

More Retiring Baby Boomers Expected to Sell their Businesses in the Coming Years

Regardless of market conditions, sellers with profitable businesses and strong financials have an advantage, as buyers are always on the lookout for these opportunities. Yet, many owners who find themselves in a position where they're unprepared and forced to sell end up accepting

reduced prices. This is often the case with aging Baby Boomers who are suddenly faced with health or financial issues.

In fact, 38% of all business owners surveyed identify as Baby Boomers and nearly half (46%) of all owners looking to sell their business say they are retiring. "We're looking to either bring in equity investors or sell the business and increased interest rates are one of the major factors behind this. Interest rates, especially on our SBA loans are killing us," said Stephen Gould of Golden Moon Distillery in Colorado.

Yet, many are still not prepared, with 27% saying they do not have their financials in order or a transition plan in place. The best advice for business owners is to start planning now for when the unexpected occurs. This is essential to achieving a more favorable outcome at the negotiating table.

About the BizBuySell Insight Report

The BizBuySell Insight Report is a nationally-recognized economic indicator that tracks the health of the U.S. small business economy. Each quarter, BizBuySell analyzes sales and listing prices of small businesses across the United States based on approximately 50,000 businesses for sale and those recently sold, reporting changes in closed transaction rates, valuation multiples and other economic indicators for the small business transaction market. Closed transactions are reported to BizBuySell.com on a voluntary basis by business brokers nationwide. Each report includes real small business data on over 70 major U.S. markets and across 65 small business industries.

BizBuySell is the largest business for sale marketplace online, receiving over a million visitors a month. Since 1996, BizBuySell has offered tools that make it easy for business owners and brokers to sell a business, and potential buyers to find the business of their dreams. The website also features an extensive franchise directory as well as an easy-to-use business valuation tool.

Media Contact:

Adam Debussy

BizBuySell

Email: adebussy@bizbuysell.com (mailto:adebussy@bizbuysell.com)

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