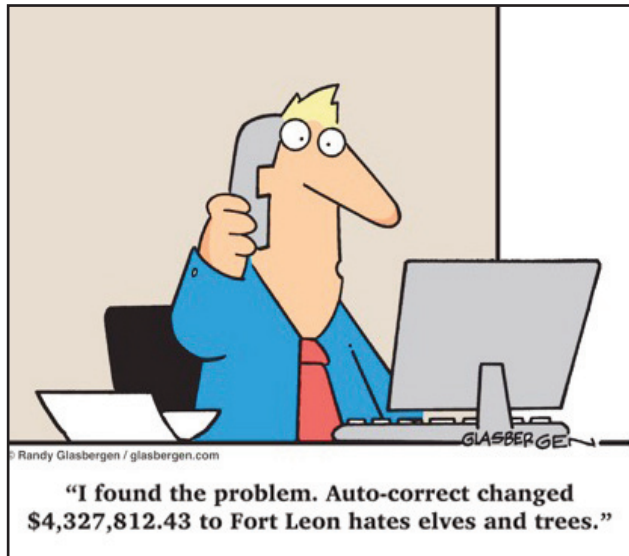


Purchase Process

If you are like me, buying something and getting it done with minimal effort is appealing. But that is when mistakes happen – we buy the wrong thing or we overpay. My last newsletter focused on determining the value of an asset separately from the decision of how to finance it. That rule brings up another important issue about following a disciplined process as a buyer.

What Does a Purchase Process Look Like?

A good purchase process maintains discipline from beginning to end. By discipline I mean careful analysis of our options and their costs / benefits. It is tempting to hone-in on one option and exclude other options early on. It saves time, so why not? In this case, though, time is not money – saving time can actually cost you money. But if the purchase process runs wild you can get bogged-down. So the right answer is somewhere between making a snap decision and grinding your mind into dust with overly-detailed analyses.



Here are a few steps to consider in a basic outline of a purchase process:

- 1. What utility or function do you need the asset to address?** Focus on the core need, not the available solution that got you thinking about it. If we start with the core need it allows us to more completely consider our options. As an example, if we want something to help us get from point A to point B, instead of thinking about cars only we might think about what is causing us to go from point A to B and what sort of options we have to accomplish the task.
- 2. What are your options to obtain such utility or function?** This is where the analysis gets its power. Often there is more than one option to satisfy a need. If we take our example to the next step, we could consider: car/truck/motorcycle, ride-share, cab, Uber, bus, other rapid transit, bicycle, walk or telecommute. I am sure that I am missing some other options.



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Corporate Finance Insights

3. Identify the strengths and weaknesses of each option. Any options we consider will have good points and bad points. Identify the strengths and weaknesses of each option. In our example cars and trucks offer great convenience, but they are expensive to purchase and maintain. Make sure to capture the costs of each option. For cars and trucks there are the purchase price, gas & oil, regular maintenance, insurance and repairs to name a few.

4. Rank your options in order of their ability to meet your needs. Then rank your options along different scales. Which is most convenient? Which is lowest cost? Which is most efficient? Which functions the best? The idea is to explicitly consider the costs/benefits of each

option. Some of the costs and benefits may be subject to estimation or pure judgment. Make sure to be as objective as possible.

5. Do any of the options meet your needs at a reasonable cost/benefit ratio? Select your best option based on all the facts. But have a few back-ups as well in case there are any snags in financing the purchase of your selected option.

6. What financing arrangements are available to purchase the asset? Similar to identifying the options above, there are often a number of different ways to finance a purchase. Cash on delivery, trade terms, financed over time, leased/rented or a financed purchase could be options. Select the financing option that best fits

your operating cash flows, and is priced competitively. If you need outside financing, the only way to know if the price and terms of the financing package are competitive is to talk with several financing sources. Make sure to work with reputable financing sources and make sure to carefully review their financing documents. It is often helpful to get a lawyer involved to see if the terms are commercially reasonable.

The purpose of following a process like this is to lessen the impact that emotions have on our decisions, since emotions are often unreliable from a financial perspective. So whether you follow a process similar to the one listed here or a different process, make sure to stay disciplined and work through your options.



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