

Buying a Business

Some points to consider before you begin...

Sales

- Is the product or service currently sold likely to maintain or improve its marketability, or is it in danger of becoming over-sold, out of style or obsolete?
- Is the business in a good location or is this the reason why it is for sale?
- Are prices competitive? Are competitors gaining strength?
- Are all sales in reliable records? Are the total sales broken down by product line, if applicable?
- Are bad debts deducted from sales, or are they still shown as receivables?
- What is the sales pattern year by year and month by month? Is the pattern seasonal or related to some business cycle (such as home construction or other uncontrollable variable)?
- Are some goods just on consignment, with the right of being returned for full credit?
- Are some goods on warranty? If so, will a financial allowance be made for possible warranty commitments?
- Are some fluctuations in sales due to lucky one-shot sales?
- Is a particular salesperson critical to success?
- Is the seller's personal role critical to success?
- Are you sure all sales are for this business, and the seller hasn't added sales from another business? Are you sure that the rate of stock turnover is in line with the industry practice? Are you sure that the existing stock does not include slow-moving items from another business?
- Will you be able to continue buying the products from existing suppliers?
- Can you increase sales with current resources?

Costs

- Are all expenses shown? Will you, as the new owner, have the same level of expenses?
- Has the owner delayed some expenses such as equipment maintenance?
- Are there annual expenses coming due soon?
- Are there new or increased expenses you should anticipate?
- Is an adequate salary allowed for work done by the owner and family in addition to profit margin?
- Is interest paid for money loaned to the business by the owner?
- Is depreciation claimed for the equipment?
- Are the staff adequately paid, or do they expect wage increases soon?
- Have you checked the terms and conditions of the lease and discussed these with your solicitor?
- What effect would decreased or increased sales have on your costs?
- What expenses do similar businesses have?
- Do you know what costs are allocated to which product, and how a change in product mix would affect costs?
- Are some expenses prepaid by the seller? Will you have to reimburse the seller for your share?
- Has inventory been accurately shown at true current value, for calculating actual cost of goods sold?

Profits

- Have you looked at the effect of increased or decreased sales on profit?
- Do you know the minimum likely sales? The maximum likely sales?
- Have you considered what effect inflation will have on sales or costs, over the years to come?
- Are profits adequate to warrant taking the risk?
- Have you analysed the financial records for the last three years including balance sheets, profit & loss statements, tax returns, purchases and sales records and bank statements? Have the records been well kept?

Based on past financial results, have you projected the future cash flow and profitability of the business? What is the break-even point for sales?

Assets

- Do you know exactly what you are buying and not buying? Are there lists and have you checked them?
- What is the book value, the market and replacement value of the fixed assets?
- If inventory or work in progress is to be included has a value been agreed upon at the time of offer? Have you agreed on how it will be adjusted at time of settlement, and within what limits?
- Has any inventory been sold but not shipped?
- Have you decided what intangibles you want – mailing lists, business name, exclusive rights, leases, etc? Can they be transferred?
- If you need new licences, do you know how to get them?
- Are you buying the accounts receivable? Do you have a listing of these accounts by age?
- Is the equipment in good repair? Is it efficient? Is it in danger of becoming obsolete or difficult to service? Could it be sold easily?
- Is any equipment leased? Do you know the terms and the cost of each lease? Will you get ownership on maturity?
- Will you have to build up your own accounts receivable? Have you figured out how this will affect your cash flow?
- If the business is a limited company, are you buying the shares or the assets? Be sure to consult a lawyer or an accountant on this point.
- Have you consulted an accountant on how to value the various assets?

Liabilities

- Are the assets you're buying free of debts and liens? If you are assuming some debts, do you know the exact terms of repayment? Is this in writing?
- Are there any contingencies, such as warranties or guaranteed debts or accounts? Are you assuming any risk of being liable for the previous owner's actions (as might happen when buying a limited company)? Will you be expected by customers to make refunds on warranties, even though you may not be legally obligated to do so, or risk losing their goodwill?
- Has the previous owner received any payments in advance – deposits etc – that should be turned over for you?
- Have you checked the business' credit rating with suppliers? Will you receive an established rating (or be treated as a new account)?
- If buying part of a company or entering a partnership, do you know what limits there are on one person making a commitment on behalf of the business?
- Will your cash flow from operations be enough to pay your debts?

The Seller and You

- Do you know the real reason why the business is for sale?
- Is the seller being cooperative in supplying information?
- Is the seller willing to sign a non-compete agreement?
- Will the seller train you and assist you after the purchase?
- Is this the type of business you were actually looking for?
- Is the type and size of business compatible with your interests, experience, personality and capital?

The Purchase Agreement

- Does the draft agreement cover what assets are to be purchased, what liabilities are to be assumed and when the business is to be taken over?
- Are you ready to negotiate? Remember a business is worth no more than the highest price someone will pay, no less than the lowest price the seller will accept.
- In drafting your offer, have you included escape clauses covering obtaining finance, inspecting all records, receiving necessary licences and rights, other transfers?