

BUYING A BUSINESS



“Opportunity is missed by most people because it is dressed in overalls and looks like work.”

- Thomas Edison

MOTIVATION

Owning a business can be both more rewarding and more demanding than permanent employment. Freedom and independence come with risks and responsibilities, and financial success is ultimately driven by personal performance. The motivation for owning a business may come about by a change in personal or professional circumstances, dissatisfaction in the workplace, or the fulfilment of a long term plan. Whatever your reasons for buying a business, it's important to recognise that successful entrepreneurs share a common trait – they're highly motivated individuals.



BUY OR BUILD?

The first 3 years of a new business venture are the riskiest. Key contributors to failure include embarking on an unproven business concept, a lack of working capital, and poor management skills. Alternatively, acquiring an established business, with a proven business model and demonstrable cash flow, can increase the probability of success. Listed below are some of the advantages and

disadvantages of buying an existing business versus a startup venture:

ADVANTAGES:

- Immediate income through established relationships with customers and suppliers
- Stock, equipment and facilities in place
- Staff hired, trained and experienced in business operation
- Previous owner can provide insights on running the business
- Financing facilities more readily available

DISADVANTAGES:

- Buying a business can be a challenging, time consuming process

- Assessing the true worth of a target business can be difficult
- Loss of previous owner's rapport with customers may affect trading performance
- Existing location, facilities, and equipment may not be adequate for future needs

THE COMPATIBILITY QUESTION

Business owners require a broad range of skills to run a business successfully, from sales and marketing, to finance and administration. You should consider what relevant experience you will be bringing to the business, how much time you will be able to devote, and your appetite for risk. The more confident you are that a particular type of business is right for you, the easier your search will be. If you are interested in a business that operates in a market outside of your area of expertise, then you should make certain that key employees will stay on after the change of ownership or that similar expertise can be recruited.

CREATE AN ACQUISITION PLAN

Without an acquisition plan, the search for a business can be frustrating. Investing resources in the formulation of a plan at the beginning of the process saves time and effort later on, and increases the probability of a successful outcome. It is important to establish clear acquisition criteria to focus your search and to measure potential targets against. The acquisition criteria should include:

- Business type – service, retail, distribution, manufacturing
- Industry type
- Size – sales, employees
- Location
- Maturity
- Performance – profitable, loss making, operating margins

The acquisition plan should also address the amount of capital available to fund the acquisition along with the sources of external financing, the required level of income from the business, the business search methodology, the role of external advisors, the legal structure of the business, and a proposed timetable to completion.

SEARCHING FOR BUSINESSES

The number and quality of the deals available is directly related to the intensity of your search. The more committed you are, the greater the commitment of business owners and intermediaries to invest time with you. Deal flow can be facilitated either by searching

through businesses listed for sale, or by approaching businesses that are not officially for sale. Business owners looking to sell, often via intermediaries, may advertise in the business or classified section of newspapers, trade journals and business publications, or on the Internet. Approaching suppliers, distributors and other trade sources can also lead to potential opportunities. Intermediaries, including business brokers, accountants, and lawyers, play an important role in facilitating a

marketplace for the buying and selling of businesses. Business brokers can be an excellent source of deal flow, as they typically advise business owners looking to sell, and maintain a database of opportunities. Intermediaries can also be retained to perform a business search, and make approaches to potential targets on your behalf.

EVALUATING OPPORTUNITIES

Once a list of potential targets has been compiled and the relevant confidentiality agreements are in place, you can begin the process of further researching each opportunity. The checklist of items to review should include:

- *Owner's reason for selling*
- *Market dynamics – trends, position in market, market share, competition*
- *Financial profile – trends, seasonality, volatility, margins, fixed and variable costs, future investment requirements*
- *Business history – longevity, ownership structure, significant events*
- *Business reputation – relationships with customers and suppliers*
- *Management controls – finance, HR, legal, supply chain*
- *Business strengths, weaknesses, opportunities for growth, threats*
- *Personnel – management, employees, and part time staff*
- *Assets and Liabilities that are being transferred – stock, equipment, debtors, creditors*
- *Trademarks, patents, copyrights and other intellectual property*
- *Location – lease agreement, permits, rates, scope for expansion*
- *Taxation matters*

The quality and presentation of the information provided can be a useful indicator of the commitment and professionalism of the seller. In some cases, however, certain information may be withheld until an offer, contingent upon various conditions being satisfied, has been made.

ESTABLISHING THE PRICE AND NEGOTIATING THE TERMS

The financial viability of a business opportunity depends on three factors:

- *the required salary level of the owner*
- *sufficient debt coverage from operating income*
- *a return on investment commensurate with the level of risk assumed*

Various techniques can be applied to achieve a range of



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intrinsic values for a business, including income based methodologies, comparables approach, and asset based valuations. It may be pertinent to retain the services of a professional business appraiser for this important exercise. The actual selling price is driven by market factors and timing considerations, in conjunction with the terms, tax implications and structure of the deal. One factor that can influence the selling price is whether the seller is willing to finance part of the purchase price with a loan note.

After fully appraising the business, make any offer in conjunction with your lawyer, who should be experienced in business acquisitions. The offer should be dependent upon the satisfactory conclusion of due diligence, and any other contingencies that are deemed necessary. Both parties should maintain an honest and open attitude to discussions. As a potential buyer, you should acknowledge the fact that the seller may have an emotional attachment to the business, having the welfare of employees and customers in mind. A well structured deal is a 'win-win' for both parties.

CLOSING THE DEAL

After an agreement on the price and terms of sale has been reached, preparation of the relevant completion

documents can begin. As a buyer, you should insist on a period of exclusivity, giving you and your advisors sufficient time to perform due diligence on the business. The due diligence process includes the verification of financial statements, a review of the legal status of the relationships of the business, and any necessary commercial analysis. Other conditions will need

satisfying prior to completion, including the transfer of lease agreements, supplier and customer contracts, and the obtaining of finance for the deal. The final Sale and Purchase Agreement usually contains various representations, warranties, and covenants designed to protect the interests of the buyer.

POST COMPLETION

The business handover should be conducted as smoothly as possible. The seller may agree to stay on for a period of time after completion, and should agree not to compete with the business after leaving. Employees, customers and suppliers will need to be informed of the change of ownership. Your initial concern should be that of gaining their confidence.

Be cautious about making changes too quickly, and make allowances for a period of learning. Finally, ensure that you have sufficient working capital to fulfil the short term needs of the business.



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