Lambert Chapman
Chartered Accountants

Buying a business

Buying an established business provides a path that many follow to fulfil their desire to enter into business or expand existing operations.

Like buying a second-hand car or house the need for care and due diligence is essential as this could represent the opportunity to achieve ambitions, but could also be the route to financial disaster.

Advantages of buying a business

One of the main reasons for buying an existing business is the partial elimination of the time and stress in establishing and growing a business.

While the initial outlay may be greater this is almost certain to be represented by underlying assets. Any deficiency in asset value is normally represented by what is known as 'goodwill' - the difference between the price of the business and the underlying value of the net assets.

That is the price of being able to operate an existing business and generate cash flow and profits. It may also be easier to secure financing for an existing business, provided there is a positive track record and the purchaser is considered a suitable person or company for running the business successfully.

A new business may be acquired through a franchise. Other business types include internet or mail order businesses.

Disadvantages of buying a business

Often the biggest hurdle to buying a small business outright is the initial purchasing cost.

As the business concept, customer base, brands and other fundamental work are already established the financial costs of acquiring an existing business are usually greater than starting one from nothing.

Other possible disadvantages include hidden problems associated with the debtors or stock that may not be worth what they are valued at. Good research and professional advice are essential ingredients on the path to acquiring a business.

Other disadvantages of buying an existing business include:

1. Customers may associate the goodwill to the previous owner and leave when a new owner takes over the business.
2. Staffing problems/issues
    - Some staff may leave when the new owner takes over
    - Some staff may be unsuitable for the job they are doing
    - Some staff may not approve of the new owner
    - You will inherit statutory obligations with regard to their employment
3. Plant, equipment, technology may be obsolete or faulty
4. The business may not have a good image or reputation
5. The cost of acquiring goodwill may be unrealistically high

Choosing a business

Finding profitable businesses for sale at reasonable prices can be difficult, as business owners are often overly optimistic with regard to the market value of their business.

There are many resources for finding a business including business sale agents (e.g. Daltons), advertising sections of trade magazines or papers such as *The Times* or *Guardian*, or more commonly today online agencies.

Some of the best search terms include 'business for sale'; 'buy business'; 'sell business' or 'buy sell business'. You may need to further refine the results by entering criteria that restrict the geographic area and also the type of business you are seeking to acquire.

Before registering with any agency it is essential to establish any costs that you may incur - not all agencies are free to use, even for the purchaser. Other opportunities for finding out about businesses for sale include word of mouth - although this is often the most unreliable relative to conducting a specific search.

The first questions you should ask yourself

- What professional advice is required?
- What due diligence should be undertaken?
- Do you know what type of business you wish to acquire?
- What are your qualifications for running the business successfully?
- Do you have the temperament to deal with all types of customers, demanding creditors, and difficult employees?
- Do you have the necessary business acumen?
- Can you deal with all the administrative demands of the business including book keeping and the demands of business regulation?
- Are you prepared for the business to take greater prominence in your life than when you were previously employed?
- Can you address problems without losing your cool?
- Can you deal with uncertainty without losing sleep?
- Are you satisfied that your relationships will not be too adversely affected by the acquisition of a business?
- Can you accept the potential significant financial loss that investing in the business exposes you to?

Common mistakes

- Buying a business that doesn't fit with your capabilities or your existing business
- Buying without proper due diligence
- Buying without proper preparedness
- Buying without a proper contract in place
- Not knowing the seller's intentions
- Buying a business and then finding there is a lack of working capital
- Being unduly optimistic about your ability to do something that the existing owner is missing or doing wrong.

Business acquisition checklist (partial)

- Find out why the business is for sale
- Are profits falling? What forecasts are available?
- What is the likely market potential over the next one to five years?
- Decide whether the type and size of the business fits with your needs, skills and experience, financial capacity and future plans
- Check the operations of the business, including sales, costs, profits and assets. It is important to seek our advice when reviewing the financial records
- Discuss with us our due diligence services - the larger the business the more essential this becomes. Larger businesses will normally require a due diligence service which may include specialist due diligence services such as legal, patent, technology reports.
- How will the cost of acquisition be funded?
- How will external funding be structured?
- What restrictive covenants may apply?
- If staff are being taken on from the existing business owner, be aware of their redundancy rights.
- What are the working capital requirements?
- What might the spend be that is more of a capital nature?

Checking the operations of the business (partial)

- Sales
- Costs
- Profits
- Taxation
- Assets
- Staff
- Technology.

The purchase agreement

It is possible that before both parties proceed to a purchase agreement the intention to proceed and contract together may be evidenced in a draft agreement sometimes referred to as an MOU (Memorandum of Understanding) or HOT (Heads of Terms). This normally precedes the work on due diligence.

Closely review the draft purchase agreement with us and your lawyers in particular the non-compete, warranty and guarantee clauses. This agreement will detail:

- Details of the assets to be acquired
- States when the business is to be taken over
- Details any warranties
- Covenants
- Representations
- Guarantees
- Obligations
- Non-compete clauses.

How we can help

There are many decisions to take along the path to acquiring a business regardless of whether this is your first business or the decision to expand existing business operations.

We welcome the opportunity of advising you while you are acquiring your business, in particular we can advise with regard to the areas we have set out above.