# Buying A Business

Many find the idea of running a small business appealing, but lose their motivation after dealing with business plans, investors, and legal issues associated with new startups. For those disheartened by such risky undertakings, buying an existing business is often a simpler and safer alternative.

**Advantages:** The main reason to buy an existing business is the drastic reduction in startup costs of time, money, and energy. In addition, cash flow may start immediately thanks to existing inventory and receivables. Other benefits include preexisting customer goodwill and easier financing opportunities, if the business has a positive track record.

**Disadvantages:** The biggest block to buying a small business outright is the initial purchasing cost. As the business concept, customer base, brands, and other fundamental work have already been done, the financial costs of acquiring an existing business is usually greater then starting one from nothing. Other possible disadvantages include hidden problems associated with the business and receivables that are valued at the time of purchase, but later turn out to be noncollectable. Good research is the key to avoiding these problems.

## Purchase Research

Once you've found a business that you would like to buy, it's important to conduct a hard, objective investigation. Look into every aspect of the business, verifying whether the owner's stated reasons for selling are legitimate; double check every detail for accuracy.

**Professional help:** A qualified attorney should be enlisted to help review the legal and organizational documents of the business you are planning to purchase. An accountant can help do a proper evaluation of the financial condition of the business.

**Letter of intent:** A letter of intent usually creates a non-binding offer to purchase the business and is usually needed in order for the seller to provide sensitive information about the business. It should spell out the proposed price, terms, and conditions for the sale of the business. The letter should also state that either side may revise or quit for any reason.

**Confidentiality agreement:** Often required by the seller, a confidentiality agreement indicates that you won't use the information about the seller's business for any purpose other than making the decision to buy.

**Contracts and leases:** It's important to discover all the obligations that the business is subject to. Also be aware that you may have to work with the current landlord to assume any existing lease on the business premises or negotiate a new lease. If you acquire an existing lease from another lessee, you may have to pay the previous lessee for the privilege. The cost of acquiring your lease may be amortized over the remaining term of the lease.

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**Financial statements:** Examine the financial statements from the business for at least the past three to five years. Also make sure that the statements are accompanied by an audit letter from a reputable CPA firm. Don't accept a simple financial review by the business itself.

**Tax returns:** Review the business' tax returns from the past three to five years. This will help you determine the profitability of the business as well as whether any tax liability is outstanding.

**Important documents:** Numerous documents should be checked during an investigation. They include:

- real and personal property documents
- bank accounts
- customer lists
- sales records
- supplier/purchaser list
- contracts
- advertisement materials
- inventory receipts/lists
- organization charts
- payroll, benefits, and employee pension/profit sharing info
- list of employees
- certification by federal, state or local
- list of owners

## Determining Value

A realistic business valuation requires more then merely looking at last year's financial statement; it requires a thorough analysis of several years of the business operation and an opinion about the future outlook of the industry, the economy, and how the subject company will compete.

Most people believe that a business should be sold for Fair Market Value. The term Fair Market Value is defined by the IRS at Rev. Ruling 59-60 as follows:

> "the price at which the property would change hands between a willing buyer and willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts."

There are a number of different methods to determine a fair and equitable price for the sale of the business. The following lists a few methods to determine the price:

- **Capitalized earning approach:** This method refers to the return on the investment that is expected by an investor.
- **Excess earning method:** This method is similar to the capitalized earning method, except that it splits off return on assets from other earnings.

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- **Cash flow method:** This method is usually used when attempting to determine how much of a loan the cash flow of the business will support. The adjusted cash flow is used as a benchmark to measure the firm's ability to service debt.
- **Tangible assets (balance sheet) method:** This method values the business by the tangible assets.
- **Value of specific intangible assets method:** This method is based upon the buyer's buying a wanted intangible asset versus creating it. This method also takes into consideration valuing the goodwill of the business.

Sales Agreement

The sales agreement is the key document in buying the business assets or stock of a corporation. It is important to make sure the agreement is accurate and contains all the terms of the purchase. It would be a good idea to have an attorney review this document. It is in this agreement that you should define everything that you intent to purchase of the business—its assets, customer lists, intellectual property, and goodwill.

The following is a checklist of items that should be addressed in the agreement:

- Names of seller, buyer, and business
- Background information
- Assets being sold
- Purchase price and allocation of assets
- Covenant not to compete
- Any adjustments to be made
- The terms of the agreement and payment terms
- List of inventory included in the sale
- Compliance with the bulk sales laws of the state
- Any representation and warranties of the seller
- Any representation and warranties of the buyer
- Determination as to the access to any business information
- Determination as to the running of the business prior to closing
- Contingencies
- Possibilities of having the seller continue as a consultant
- Fees, including brokers fees
- Date of closing

Due Diligence

**Licenses and permits:** Most businesses need licenses and permits to operate. The type of license or permit you need depends on your industry and the state in which you are located. License and permit requirements also affect where you locate your business, how much you'll have to spend for remodeling, and whether or not you'll have to provide off-street parking.

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**Zoning requirements:** It is important to check the zoning requirements for the area where you are acquiring your business. The zoning requirements may affect the type of business that you are intending to operate in a particular area.

**Environmental concerns:** If you are acquiring real property along with the acquisition of the business, it is important to check the environmental regulations in the area.

Closing Checklist

It is important during the closing to make sure that you have legal counsel available to review all documentation necessary for the transfer of the business.

The following items should be addressed in a closing:

- **Adjust purchase price:** This would take care of prorated items such as rent, utilities, and inventory up to the time of closing.
- **Review documents required to be provided by the seller:** These would be a corporate resolution approving the sale, evidence that a corporation is in good standing, or any tax releases that may be been promised by the seller. Check with your local department of corporations or secretary of state.
- **Signing promissory note:** In some cases, the seller will carry back financing, so have an attorney review any note documentation.
- **Security agreements:** These documents may be necessary if you are going to finance your purchase. A security agreement lists the assets that will be used for security as a promise for payment of the loan.
- **UCC financing statements:** These documents are recorded with the Secretary of State in the state you have purchased your business. Again, these documents are necessary if you are going to finance your business.
- **Lease:** If you have agreed to assume an existing lease, you will be required to execute the assumption. Make sure that you have the landlord's concurrence to assumption of the lease. You may have negotiated a new lease with the landlord instead of assuming the existing lease.
- **Vehicles:** If the purchase includes vehicles, you may have to execute the transfer documents for the vehicles. You can check with your local Department of Motor Vehicles to determine the correct procedure and necessary forms.
- **Bill of sale:** The bill of sale will be proof of the sale of the business and will transfer the ownership of the other tangible business assets not specifically transferred on their own.
- **Patents, trademarks, and copyrights:** May need to execute the necessary forms if part of the transaction.
- **Franchise:** May have to execute franchise documents if the purchase of the business was a franchise.

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- **Closing or settlement sheet:** The closing or settlement sheet will list all financial aspects of the transaction. Everything listed on the settlement should have been negotiated prior to the closing, so there should be no surprises.
- **Covenant not to compete:** It is a good idea to have the seller execute this agreement. This will help add to the success of your operation of the business without any interference from the previous owner.
- **Consultation/employment agreement:** If the seller has agreed to remain on for an amount of time, this documentation would be necessary.
- **Complete IRS Form 8594, asset acquisition statement:** This document will indicate how the purchase was allocated amount the various assets. Important for your tax return.
- **Bulk sale laws:** Make sure that all bulk sale laws have been complied with in the transfer of the business assets.

Taken from **http://www.sba.gov/smallbusinessplanner/start/buyabusiness/index.html**