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HOW TO BUY A BUSINESS

Buying a business is possibly the most important financial decision you will make. It may consume all your spare cash, cause you to borrow a significant sum of money, determine your income, your working life and possibly your home as well. It would not be surprising if you felt that you cannot afford to get it wrong.

Many people launch into the process of buying a business with no previous experience and little professional assistance. One of the difficulties is that most professionals are only able to advise on their area of competence. Where can you get more general advice? One answer is, of course, a business transfer agent (see below). You could buy a book. This article is an attempt to provide, rather briefly, some practical advice which arises from many years of experience in business transfer – seeing success stories, disasters, shrewd and competent buyers and those who muddle through but often do not do themselves any favours in the process.

An article of this length cannot be completely comprehensive and some items will be of more relevance to you than others but perhaps all are worth some consideration.

What type of business?

The following comments read like statements of the obvious – but experience teaches us both that many people do not think through the options and their pros and cons and also that many people are looking for suggestions and guidance.

The first question is perhaps, are you wanting a traditional lifestyle business or is this not an issue – you just want a good business which you can run successfully? Are you looking for something to make use of your previous experience, qualifications and skills or do you want a complete change? Do you want to 'live above the shop' or not? Would you prefer to buy freehold or leasehold? Do you want a business where you have constant customer contact (mainly consumer businesses)? Are you happy employing staff or would you prefer to work alone or with limited staff? Are businesses with considerable levels of stock acceptable or should you be looking at service businesses with limited stock?

There is not room here to debate these various questions but you should think about them in relation to your skills, lifestyle requirements, financial resources and personal objectives. Generally, it is better to remain flexible by ruling out certain types of business rather than ruling in your favourites. You are less likely to miss something you may not have considered. However, there are three principles which are generally true.

If you buy freehold you are investing partly in a business and partly in bricks and mortar. If you buy leasehold (or with no premises and work from home or a vehicle) you are investing everything in the business. If you buy a business and live on the premises you will probably need to compromise in your choice of location for business and for living. Separate living accommodation offers you more choice. Finally, the 'roses around the door' lifestyle businesses generally produce a lower rate of return on your investment than the industrial or service type businesses – certainly if account is taken of the hours being worked!

What can you afford?

The financing of a business purchase is very different from obtaining a mortgage for a house purchase. It is more complex and there is far greater opportunity to find a creative solution – either to borrow a little more or to reduce the cost of the finance. It is also much more likely to be affected by factors which are specific to the business being bought. For these reasons it is difficult to forecast how much you can borrow and therefore what price you can pay. **You need to look at each case on its merit with the advice of a good commercial finance broker.** One of the reasons for this is that there are a large number of different prospective lenders and they vary in their attitudes to different types of businesses and different types of lending – and their attitudes (policies!) can vary significantly over time. Only a good broker can keep up with this and be able to suggest the best current sources of finance for your purchase at that time.

As a general rule, you may be able to borrow up to around 70% of the price of a freehold business (excluding stock) and 50% in respect of a leasehold business.

Just as assets outside the business may be used as security for a loan, so other income may be taken into account in determining your ability to service a loan.

Which businesses to view?

Of course this is a matter for you but, for your own sake and that of the owners of the business, it makes sense to undertake some research in order to try to avoid time-wasting journeys. If the agent's sales details omit information which may be critical, speak to the agent and if necessary ask him to speak to the vendors. Depending on what is important to you, it may be appropriate for you personally to speak to the owners – *they will probably know more about the business and the local area than the agent!* This will normally be welcomed because it may rule out what would otherwise have been a non-productive visit from the owners' point of view. Alternatively, it may be the start of a productive relationship which will result in a sale for them.

Before deciding which businesses to visit, have you determined your criteria for your business search? Are you only going to look at serious prospects or are you going to use these visits as part of the process of deciding what type of business you want to buy?

Plan the inspection of the business

Viewing a business is different from viewing a house – even where there is property with living accommodation. Firstly, confidentiality may be of the utmost importance. The staff may not know that the business is on the market. The customers/guests/residents etc. will almost certainly not. You should assume that you must not disclose the purpose of your visit if this is during working hours unless the owners indicate that you may do so. Secondly, you must appreciate that it can be difficult for a business owner to see you at busy times. He may prefer an 'out of hours' visit but, failing this, there may be times when it is just not realistic to expect an owner to be available. A good example of this would be catering businesses or pubs at their busiest times.

To make the most effective use of your time and to avoid overlooking important matters, why not draw up your own agenda in advance? Under key headings such as location, staff, trading figures, lease, competitors, buying/suppliers etc., list the things you want to see or questions you need to ask.

Feedback

If you have ever been a vendor of a property or business you will know how frustrating it is when you get no response as to why someone is not intending to take the matter further. It is only courteous to provide some feedback, perhaps via the agent. More importantly from your point of view, if the agent knows why the business did not suit you, this will help him to better understand what you do want – and this will also encourage him to take you more seriously.

Trading Accounts

The usual format used for the presentation of trading accounts is 'Abridged Profit & Loss Accounts'. These are not the same as the accounts produced for the Inland Revenue because those accounts will include expense items not relevant to you – e.g. personal benefits of the owners such as private motoring or finance charges and depreciation which reflect the way in which the business has been funded by the current owners and non-recurring expenditure such as a legal bill for an event now concluded. The accountant will normally note on the accounts the items which have been excluded. This may assist you to substitute your own figures for planning purposes (as well as any other adjustments such as perhaps the wages cost or an imminent or recent rent increase not shown in the accounts).

Unless you intend to buy the shares of a company, the balance sheet (if it exists) is not relevant to you because it not only reflects the way the business has been funded but also the effect of accounting practices and trading results going back probably over many years. The values of some of the assets shown may bear no relation to current values. It is a statement of the assets and liabilities of the business on that single date but the asset values can be seriously out of line with current actual values. What you need is a Profit and Loss statement over a period of time, usually 3 years.

You will probably need to supplement this with other supporting documentation and to establish the trading performance since the date of the most recent accounts. This may be in the form of Management Accounts which are usually produced quarterly or monthly from a computer system. They can be valuable in demonstrating the seasonality of a business and making comparisons between recent months and the same months in previous years. However, you must be careful to recognise that they are often produced on a slightly different basis than the financial accounts produced by the accountant. Comparisons should only be made between management accounts or between financial accounts.

The other document which can be useful and can be relied upon, is the quarterly V.A.T. return. If that says a certain amount of money was taken last quarter, you can bet that it was – or at least it was not less than that figure!

At a later stage, during the due diligence process, you may wish to examine the internal records of the business. These may show buying terms, the level of trade with key customers and other matters. However, you will appreciate that much of this may be very commercially sensitive, particularly a list of customers. You may be asked to sign a Confidentiality Agreement. Alternatively or in addition, it may be that you are denied access to some things until after either the payment of a non-refundable deposit or the exchange of contracts. If these matters are critical to you, the answer may be to exchange or to make the deposit conditional upon the subsequent satisfactory examination of those documents.

Making an offer

The first question is, should you make one? It will not enhance your credibility in the eyes of vendors or agents if you spray offers around like confetti. An offer should only be made with serious intent to buy the business. Before taking this step you should be certain that you want the business, be reasonably clear abut your ability to finance the purchase, know of any conditions on which your offer is conditional and have some idea of your plans for the business. All of this will reduce the chances of a sale being agreed but then having to be aborted or re-negotiated.

You will almost certainly need professional help when your offer is accepted and it is sensible if you obtain that help before you make it. Apart from more specialised advice which may later be required, for example a surveyor or a stocktaker, the following people will probably be needed.

A commercial finance broker, as previously indicated, even if you also wish to talk to your own bank. An accountant, who may have advice on the financial statements of the business and wish to recommend an appropriate method of purchase (see below). You may wish to involve him in the production of a business plan at an appropriate stage. A solicitor, who may identify issues at an early stage which it may be useful to deal with at the time of the negotiation.

Be careful if you ask any of these people about the value of a business. They may or may not express an opinion. Their qualifications for doing so will vary but none is working daily in the business of valuing and selling businesses. The advice may be better founded than that of 'the bloke in the pub' but it is often somewhat theoretical and formulaic. The market place determines values and business transfer agents are in the best position to have an opinion about the value of a business.

Because business transfer agents have a lot of experience of different types of businesses and trades, have a reasonable understanding of the area in which they operate, are used to looking at business accounts and can sometimes 'see beyond the figures' to get a feel of trends or methods of management, have examples of similar businesses in their files with which comparisons can be made (not just on price but also profit margins, stock turn ratios, labour costs etc.) and of course have an opinion of business values, you should consider whether it is worthwhile consulting an agent (not the agent selling the business). In relation to the cost of the business, the cost of this is small but can sometimes produce valuable results. This may be to rule out a business and prevent what would have been a purchase you would have regretted or it may simply produce a better deal for you.

A large number of businesses have been 'incorporated' in recent years, that is the ownership is in the form of a limited company, usually owned by one or two 'owners' but key personnel can sometimes be minority shareholders. You need to establish whether you wish to buy the limited company or to buy the assets and goodwill but not the shares of the company. There are pros and cons for both buyers and sellers and individual cases can vary. You should take professional advice.

You may also have the option of buying on a leasehold or freehold basis. Again, you should discuss the pros and cons with someone before making your offer (though you may be able to change your mind at a later stage and re-negotiate).

You are now ready to make an offer – you have an opinion about the value of the business and you have decided your maximum price. How do you pitch your offer?

You will want to buy as cheaply as possible but recognise that unless it is acceptable on the part of the vendors, no agreement can be reached. If it is too low you run the risk of being dismissed as a 'time-waster' – a frequently heard phrase from the lips of vendors, quite often when it is not true. You therefore need to enhance your offer in the eyes of the vendor while minimising the cost to you. Think about it from the vendors' angle. Can you find ways of making the offer more attractive to them, perhaps with offers of employment, even for a short period or consultancy for one or more members of the family? Is there an offer in respect of the property, plant & machinery, vehicles, stock etc. which would be beneficial to the current owners? Timing, particularly in a seasonal business, can be extremely important. An offer to complete the purchase in October may be far more valuable to the owner than one to complete in June. Ditto January rather than early November.

You also need to enhance your credibility in the eyes of the vendors. Taking professional advice, doing research, establishing 'in principle' funding demonstrates seriousness – as does putting it in writing and listing any conditions along with any pertinent personal factors in terms of your qualifications and experience. If a purchase is subject to the sale of other property or a business, state what you have done to expedite this, perhaps quote an estate agent's opinion of the likelihood of a sale and provide the opportunity for the vendors or their agent to check this. If it is not subject to the sale of anything or borrowing, say so.

While you need to be careful not to insult the owners with too low an offer, if two offers at the same level are received, the one from the person who appears to be more serious will be taken more seriously and if that person is more likely to proceed quickly to an exchange of contracts, it is that offer which is likely to be accepted (assuming it is acceptable). More than that, owners of businesses often have emotional ties to the business. They want it to prosper in new hands. They want staff and customers to feel happy with the change of ownership. They will consider seriously anything which appears to enhance your claims in this respect and many even decide to take a lower offer against someone whose credentials are not as strong in this regard.

If you are buying a leasehold business you will need to provide references to the landlord for him to agree to assign the lease to you. If you will be able to provide excellent trade, banking or personal references and do so quickly because you have already agreed in advance with your referees that they will do this, mention it when making your offer. It builds confidence in you on the part of the vendors.

How can you avoid being gazumped?

If there is competitive interest in a business, one way to enhance your offer is to also offer to put down a non-refundable deposit (lodged in the agent's or the vendors' solicitor's client account). This would be conditional on you having time to exchange contracts during which no other offer will be taken (probably also no advertising of the business for sale being done). There may need to be a condition(s) under which you could get back your deposit – basically if there was discovered to be a material difference from the statements made about the business or if there is an issue which you specifically wish to investigate which may be critical to your decision to purchase or the price. This does enable you to reach an agreement to buy a business ahead of any competition while providing time to carry out your due diligence.

It must be said that this is a commercial decision. Solicitors tend not to like them – when acting for purchasers.

What if my offer is accepted?

Move quickly. Delays put deals at risk. If you are buying through the vendors' agent, furnish him with all the necessary information to enable him to issue the "Memorandum or Confirmation of Sale" – which is issued to both parties and their solicitors. In whose name(s) is the purchase being made (is it to be a limited company?)? Agree a realistic timescale for the exchange of contracts and completion (check with all relevant authorities e.g. your solicitor, your lender, your referees before agreeing this with the vendor who should have done likewise). If your solicitor does not keep regularly in touch with you, keep in touch with him and also with the vendor. This enables problems to be nipped in the bud rather than become major issues. It also helps to avoid misunderstandings – it is quite common to discover that both sides thought the other side were dragging their heels!

The next task is to agree an agenda with the vendors to discuss the various matters which must be agreed, either before exchange of contracts or before completion. These could be to do with staff, customers, suppliers, buying (for next season?), advertising (Yellow Pages, directories etc.) or stocktaking on completion (who is to do it, on what basis etc.).

A written Action Plan, so that items can be marked when completed, is a good idea.

What if my offer is not accepted?

Your response will probably depend on two factors. Why has it not been accepted and what is the vendors' position? Have you decided your maximum price?

You really need to establish as clearly as you can what deal is available. If there is a gap which cannot be bridged, you have no option but to walk away. However, before withdrawing you should review your maximum price and whether you can be a little more innovative in making your offer more attractive to the vendor.

All of this is a simpler and quicker process if you have previously done your homework in order to make your first offer as attractive as possible.

…. and finally

On completion of your purchase you may (or may not) wish to announce that you are the new owner. The issue of a press release (possibly by the selling agent) offers the opportunity of free publicity and also gives you the chance to announce any plans which you may have for the business.

The last point to be made is that almost certainly you will wish to sell the business at some time. Day one of your ownership is not too soon to be thinking about this and planning its development in order to enhance its saleability and value – but that is a whole new subject, called **How to sell a business.**