BUYING A BUSINESS
OVERVIEW & CHECKLIST

There are two common options when buying a business, purchasing an established business or purchasing a franchise.

Franchise

Franchises come with a set of operating rules, the franchisor has developed their business template, which is then replicated. There is a consistency of quality, product, design and operations. Because of this, franchises are typically quicker to establish a customer base.

PROS	CONS
Benefit of a big business network	Entering a formal agreement
Don't necessarily need business experience	Limited opportunity for business decisions
Typically have a higher rate of success than start-ups	Restrictions on where you can operate
Financing may be easier than a start up	Franchise performance affects other franchises
Established reputation	Franchisors to don't have to renew the agreement

Established, Independent Business

Buying an established business allows you complete control over your business decisions.

PROS	CONS
Product / service is already market tested	You get what you pay for
Established customer base	Significant improvements may be required
Reduction in startup time	It can be challenging to make it 'yours'
Financing may be easier than a start up	Might have a bad reputation
Established brand	

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Items to Consider When Purchasing a Business:

☐ GENERAL ITEMS

- Intangibles included
  - Business name, mailing lists, exclusive right, leases, etc.
- Licenses
- Legal advice
- Accounting advice

☐ SALES

- Location
- Monthly and Annual Sales (patterns and fluctuations)
- Bad Debts
- Current Inventory
- Current Staff
- Seller’s Reputation
- Supplier Relationships

☐ SALES

- Expenses
  - Is everything included in the sale? What isn’t?
  - Are there any delayed expenses?
  - When are annual expenses due?
  - Any new expenses or prepaid expenses?
  - Look at what similar businesses have for expenses.
  - Wage structure
- Inventory costs
- Cost allocations per project
- Equipment depreciation
- Take into account GST on the purchase of assets

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☐ PROFITS

- Profits
  - Impact of sales fluctuations
  - Sales trends
  - Impact of inflation
- Risk mitigation
  - Record keeping
  - Accurate and detailed
  - Balance sheets
  - Tax returns
  - Bank statements
  - Projected cashflow

☐ LIABILITIES

- Assets
  - Any debts or liens
  - Value
- Are there contingencies such as warranties or guaranteed debts or accounts?
- Risk of Liability for seller's previous actions
- Be aware of any Advances or Prepayments
- Business rating with supplier
- Ownership structure
- Cashflow covering debts
- Information being freely given
- Non-compete from seller
- Training and assistance from seller

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☐ PURCHASE AGREEMENT

- Contract
  - Assets, liabilities, timelines, price
  - Escape clauses in the proposed contract covering:
- Obtaining financing, inspecting records, receiving licenses, rights and other transfers?
- Legal advice

☐ THE PRICE OR VALUE OF THE BUSINESS

Pricing a business is not an exact science and several methods are commonly used. You should use several the methods to arrive at a range of prices use in your negotiations.

Assets Value Method

1. Book Value
Lists the business net balance sheet value of its assets minus the value of its liabilities. This method usually understates the value as listed assets are often depreciated more than their true market value.

2. Modified Book Value
Book value adjusted to reflect current market value assets.

3. Replacement Value
Lists the replacement cost of the assets less liabilities. Since few assets in a business are usually new, this method will overrate the value.

4. Liquidation Value
Net Cash that would be received if all assets were sold and liabilities paid off. This would be the net cash result if the firm was going out of business and as such is probably the lowest value acceptable to the seller.

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5. Market Value
Evaluates a business by comparing it with similar properties that have recently sold. This method is very difficult to use as similar businesses differ widely in size, reputation, market and management.

Earning Value Method

You should be interested in business performance not only its asset value. Therefore, earning potential is a factor that should be considered.

1. Capitalizing Past Earning
Profits for a selected period of past years is adjusted for unusual items and an appropriate rate of return is divided into the average profit level derived. The rate of return (capitalization rate) is what return an investor would require on his money given the risk he sees in the business relative to other more secure investments such as bonds, GIC's, etc.

2. Discounted Future Earning
Instead of using an average of past earnings, an average of the trend of predicted future earnings is used and divided by the capitalization rate.

Rules of Thumb

Rules of thumb can serve as a guide in business valuation. Examples:

'X' times sales; or
'X' times net profit; or some
Combination of asset value and percentage of sales.

Be cautious when using rules of thumb as they are based on averages and often may not reflect the current business situation. Rules of thumb should only be used to support other valuations, not be the deciding factor.

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Goodwill

Goodwill is the value of intangibles, such as location, reputation, customer lists, franchises, supplier arrangements, quality of personnel, etc. Goodwill can be though of as the difference between an established, successful business and one that has yet to establish itself. A profitable business has a value over and above its asset value. Be aware, many sellers try to increase the value of goodwill by adding the potential they see for future growth. This should only be used to help decide whether to buy, not how much to pay.

☐ WHAT TO BUY - ASSETS OR SHARES?

If the business is incorporated you may have the choice of buying the seller's shares or you can purchase part or all of the assets. If the shares are purchased you should be very aware of all possible liabilities (debts, liens, lawsuits, etc.) before you take over the shares. Also, if shares are purchased, the assets on the books may have been fully depreciated to zero so there may be no further depreciation allowance available for tax purposes. There may be some advantage to purchasing shares if the company has previous tax losses that you can use against future profits. Due to the complexity of tax laws, you should seek competent tax advice from an accountant or lawyer.

☐ FINANCING THE BUSINESS

Banks may be more receptive to financing a business that has a past track record of profitability as opposed to a new business start. If goodwill is part of the purchase, the bank usually will not be interested in financing this portion of the purchase. Many businesses change hands with the seller providing some of the financing in the form of an agreement for sales. This is especially true if the seller is retiring and does not need all the cash up front. Banks will generally require a set of recently audited financial statements before they can proceed with financing.

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☐ THE PURCHASE / SALES AGREEMENT

This agreement should be made up by a lawyer and will include terms and conditions to protect both the buyer and seller. Conditions regarding help of the seller is training the new owner and conditions not to compete with the new owner for a period of time, are some of the points often included in a good agreement.

☐ FINAL CONSIDERATIONS

- Take your time and verify all the information.
- Don’t fall in love with the business before your research.
- Don’t to pay too much for goodwill.
- Be familiar with the industry you are buying in.
- Buy based on the return on investment.
- Have a contingency plan – don’t use all your money to buy the business. Finance.