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Buying a Business – is it time?

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Buying a Business – is it time?

Buying a business is an exciting concept, but a process not to be taken lightly. It should be approached with due care and consideration, and will require time and input from a range of resources.

This guide will help you through this process, ensuring you have covered all the bases, and gained the information necessary to judge whether buying the target business is a sound decision.

The 7 Steps of Buying a Business

Step 1: Internal & External Analysis

Step 2: Searching for the Right Opportunity

Step 3: Pre-sale Analysis

Step 4: Sign a Conditional Agreement

Step 5: Undertake Due Dilligence

Step 6: Go Unconditional

Step 7: Possession & Handover

Internal & External Analysis

Before you begin evaluating a business to buy it is important to have a clear picture of what is going on in the surrounding commercial environment, as well as your own investment objectives. This knowledge will give context to your overall investigation of target businesses.

First, consider the external environment and identify potential threats to business, or indeed opportunities, in the following areas:

- Technological changes and trends
- Current and future economic trends
- Changes to legal, government or other regulations
- Societal trends, changing culture and demographics

Then, try to evaluate your own key strengths that could help a business succeed, as well as areas where your expertise is not as strong and support may be required from others. Ask yourself:

- What do you excel at and how can these skills and experience help you succeed in a new business?
- What gaps do you have that other key personnel may be able to balance?
- What is your capital situation? How much can you invest and how easily will you manage any associated debt?

At the Generator, we believe in the importance of external and internal information as a basis for a successful business. We search a range of sources to keep informed on national and international business and technology news, then utilise this knowledge to assist clients in identifying opportunities and threats to their businesses.

We have also found that in order for business ownership to be successful it is important for the owner to understand the link between their personal aspirations and business potential.

Step 2

Searching for the Right Opportunity

Once you have undertaken this analysis, you can formulate the criteria for your search.

This may include location, staffing levels, export vs import, industry, technical knowledge required or even operating hours. Do you want to work in the business as an Owner Manager, or do you want to work in a Board role and be less hands on?

At this point, enlisting the help of a business broker is highly recommended. Business brokers specialise in buying and selling businesses and will be able to help find businesses that fit your criteria. A broker may also be able to forewarn you of businesses coming up for sale before they hit the market, so be sure to form a good relationship with them.

You should also discuss your plans with a Chartered Accountant, like the Generator, who will give you an independent view of your targets against your personal goals and be ready to support you in the next stages of the process.

It may also be appropriate to engage a lawyer at this time, to be ready to review and prepare agreements.

Step 3

Pre-Sale Analysis

Once you have selected a business (or several) that fits the bill, you should undertake an initial period of research to "vet" the business before signing any formal documentation. Most likely you will be provided with an Information Memorandum, giving an overview of the business and some basic financial information.

After signing a confidentiality agreement (which means that you cannot disclose or act on the information), in most cases you will receive:

- Adjusted financial statements of the business
- Limited current performance analysis
- Details of fixed assets being sold with the business
- A guide purchase price
- Answers to questions put directly to the vendor and broker

At this stage your you need to gain enough information on the business in order to check for any major problems and factors that signal that you should walk away. However, this must be done quickly, so you are not "pipped at the post" by another potential buyer also wishing to sign an exclusive deal.

Keep in mind that the information memorandum is created by the broker and seller of the company and as such may be painted in the best possible light.

The Generator can help you analyse this information quickly and efficiently, taking the stress out of the situation. We have over 20 years' experience in buying & selling companies, and can provide insight into the key questions to verify the suitability of the business. A small investment at this stage could save you substantial time and cost at a later date.

Step 4

Sign a Conditional Agreement

If you are confident the target business may be right for you, the next step is to sign a conditional sale and purchase agreement with the vendor.

This contract will give you, exclusively, the right to delve deeper into the company's situation and ask more questions, known as "due diligence". Your lawyer will be able to advise on the appropriate conditions to include in the contract. These conditions may include turnover warranty, finance, due diligence, arrangements to transfer the lease, employment contracts. There will be an agreed timeframe in the contract to work towards the final purchase date.

We have seen too many buyers sign an agreement at this stage without consulting a professional advisor and, later, find they are stuck with a poorly performing business.

Vendors and their agents will always portray the business in the best possible way. Your failure to fully investigate the business at this stage may result in several months of painful decision making on how to minimise loss and possibly sell-on the business.

We can help you check for any black holes or skeletons in the closet!

Undertake Due Dilligence

Due diligence is an opportunity for a prospective buyer to take enough time to gain an accurate picture of a target business, decide whether or not they are willing to purchase it, and at what value. This period may take several weeks, a timeframe that is generally negotiable with the seller and broker.

During due diligence there are six main areas to consider:

Commercial

It is important to find out why the business is being sold, its history and any future plans that may have been laid out. Next look to analyse the business in its commercial context, some areas you may want to investigate are:

Customers:

- Who are they and how does the business deal with them?
- Are they loyal to the business or loyal to the business owner?
- What is the chance they may switch to a competitor if you take over the business?
- How dependent is the business on a small number of customers?

Industry:

- What are the key past industry issues and what are commentators saying about the future developments?
- What regulations, environmental or technological issues are currently affecting the industry?

Competition:

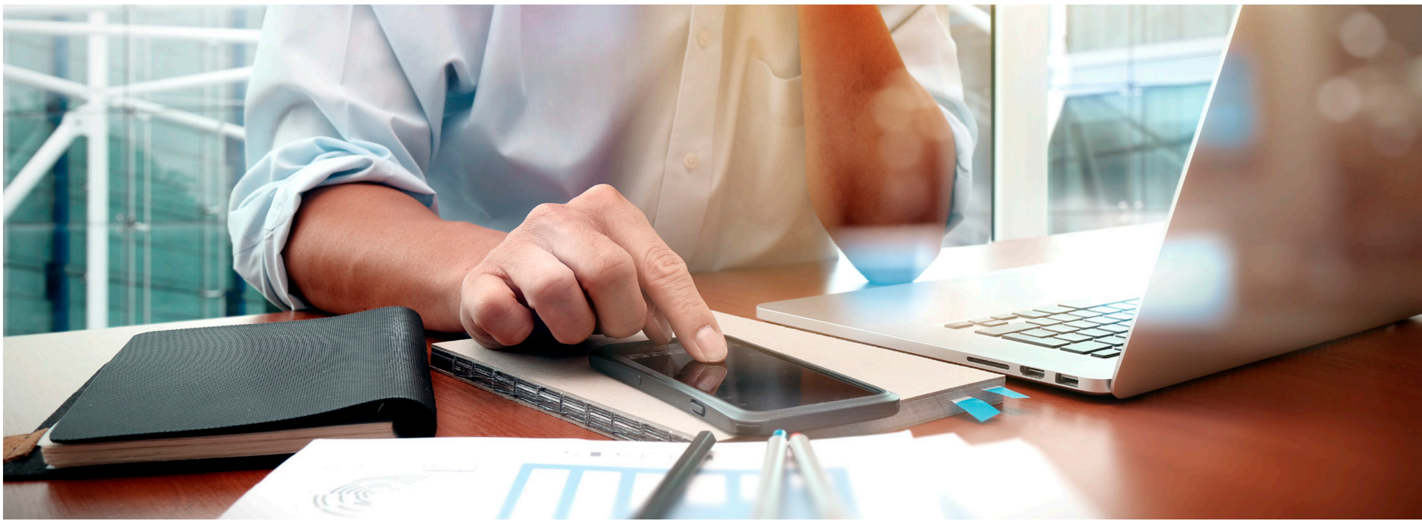
- Who are the major players in the industry and who are the main rivals?
- What is the chance of competitor action if you take over the business?
- Are they competing on price, quality, service or a mix?

Relative Market Position:

- How does the target compare to others in the industry and the performance of the industry itself?
- What scope do you have to improve the relative market position of the target?

Capabilities:

- What is the competitive advantage or point of difference the target offers its customers?
- Does it have any key capabilities that drive this? Can these be better exploited?



Financial

A detailed analysis of the business's finances will ensure you haven't missed any black holes lurking in their books. Look to investigate:

- Current performance: sales, turnover, gross and net profit margin
- Financial situation: cashflow, debts, expenses, assets
- Key drivers of income and costs
- Analysis of revenue streams, by product or customer mix

It may be appropriate to spend time on the premises to validate sales and the existence of assets included in the purchase.

Legal

This should consist of a review of all contracts that exist with the business, including leases, employment contracts, licences, franchise agreements or contracts with customers and suppliers. The non-existence of contracts may itself be an issue to consider.

Intangible Assets

Give consideration to intangible aspects of the business that may impact its value. These may include:

- The company's reputation
- The value of goodwill
- The value of licences
- Patents or intellectual property
- Reliance on key people in the business – the owner, employees

Once you've gathered this information you have the tools to evaluate the desirability of the business.

This is also the time to construct a projected business plan and financial forecast.

Business Potential

The potential of the business may be what attracted you to it in the first place. Now you have more detailed information on the business you are able to take a more informed look at what growth opportunities may be available. Think about not only improving the business as it is currently, but also what other revenue streams you may be able to add or cost savings you may implement.

In saying this, when it comes to the sale, remember you are primarily evaluating the business in terms of what it is now, the stand-alone value of the company. Thus, think about what you are willing to pay for it in its current state, not what value you might be able to create in the future.

Prices & Costs

Be aware of all the costs involved in the sale and potential development of the business. In addition to the advertised sale price for the target business you should also now be fully aware of its financial situation, its operating cash flow requirements and have a more accurate idea of how much development may cost.

In the turbulent economic environment we are currently experiencing it is important to plan for both the expected reality of the investment and also a worst case scenario. So, ensure you can answer the following questions:

- How much debt and working capital will be involved and how will it be financed?
- What happens if the economy turns sour and our development plans do not work out as expected?

Also think about your financial goals with the investment; how long you intend to be involved in the business and what you want to gain from it? Your attitude towards the business will be markedly different depending on whether you want to improve it and sell it off quickly, or build it up to be an integral part of your investments in the longer term.

Whichever you intend, draw up appropriate financial goals and ensure you have a clear exit strategy in case the investment does not go to plan.

Our experience is that successful due diligence occurs where there is a team who work together and communicate regularly. The team would, of course, include the purchaser, but also external advisors with experience of due diligence and the particular areas being focussed on. Good communication is essential when engaging advisors from different backgrounds in order to ensure all areas are covered and that the knowledge gained creates a comprehensive picture of the target business

Step 6

Searching for the Right Opportunity

Once your advisors have completed their work, they will give you assurances that the conditions in the contract can be met. For example, if you are financing the purchase with a bank loan, your bank will provide an unconditional offer letter of finance.
When you are happy with the outcome of all the investigations, enquiries and due diligence undertaken by you and your advisors, you (or your legal advisor) will need to formally confirm to the vendor that all the conditions of the contract have been satisfied. This is known as declaring the contract "unconditional". At this point there is no going back!

You should ensure that there is sufficient time in the contract between going unconditional and the hand over date. There is still much to do to, including finalising matters such as selecting and implementing the most appropriate structure to purchase the business assets, finalising bank documentation and setting up bank accounts, negotiating and finalising new contracts with employees, suppliers, the landlord and customers as well as setting up new accounting and business management systems, EFTPOS or other payment gateways and registering with authorities including the IRD, local government.
To ensure a smooth transition into your ownership it is critical that you keep in contact with the vendor and the business. You will need to monitor what is going on with the business in this period so there are no surprises when you take over.

At the Generator we work with our clients at this phase to ensure the purchaser has peace of mind that the financial operations of the business are properly established ready for possession. Our expertise with accounting and management systems such as Xero and its Add-ons, means that the purchaser will be using the most current technology to track business performance.

Step 7

Possession & Hand over

The legal term for the date of hand over is Possession. We like to think of this stage as "Where the Rubber Meets the Road". The business now belongs to you and you are in charge. This is important to remember when you have negotiated an assistance period. This is where the previous owner or other employees, who will not remain with the business, assist you for an agreed period of time (usually four to six weeks) to understand the day to day operations of the business.

You should plan for the first 90 days of owning the business. This is a critical time to build relationships and set new ground rules, if necessary, about the way you plan to operate and manage the business. You will need to meet key customers and suppliers, engage and settle new and continuing employees. You also need to confirm warranties that the vendor may have signed in the contract about aspects of the business, for example turnover levels

Purchasing a business is a big commitment, both in time and money. It is important to undertake this with your eyes wide open and to educate yourself about the benefits and pitfalls of business acquisitions and ownership prior to making this decision. We particularly recommend that first-time business owners read "The E-Myth" by Michael Gerber.

We welcome your enquiries prior to, or during your business acquisition.

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