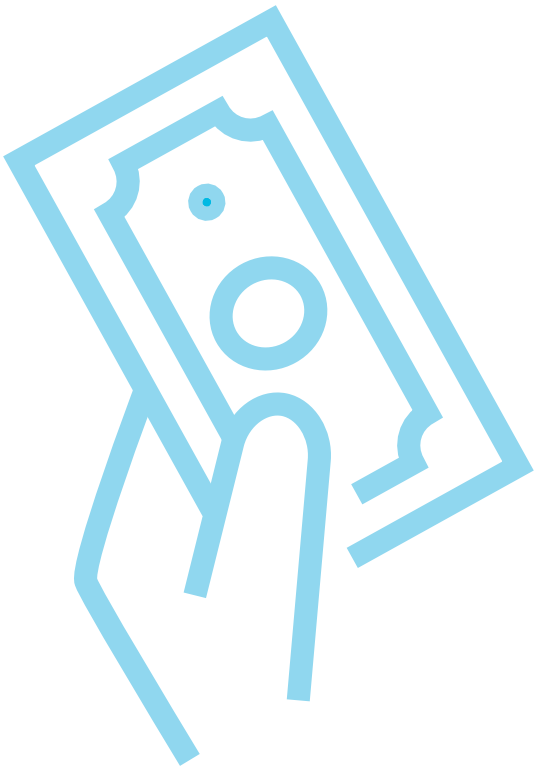
Building your knowledge

Buying a business
a practical guide



GOVERNMENT OF WESTERN AUSTRALIA

Small Business Development Corporation

133 140

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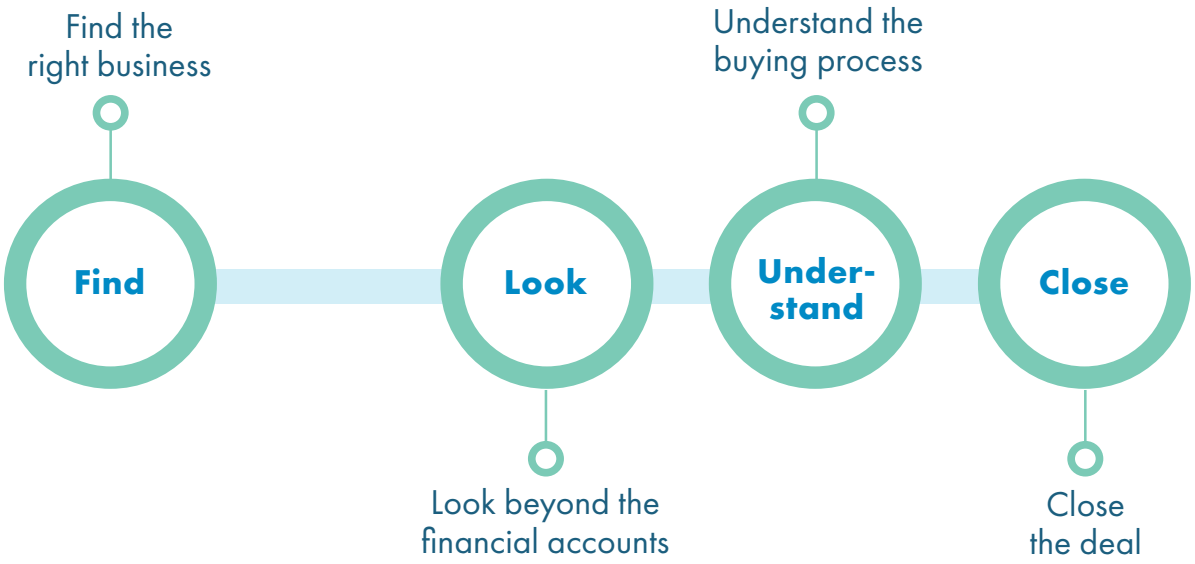
A practical guide to **buying a business**

The option to buy an existing business can be appealing to many potential small business owners, however, it comes with advantages and disadvantages. The key is finding the right type of business for you.



Find the right business

Once you've decided to venture into self-employment, you need to choose whether to start your enterprise from scratch or buy an existing business.

Buying a business	Starting a business from scratch
Pros • initial establishment and ground work has been done • client base is established • systems, stock levels and equipment are in place • staff are trained • there is an existing market for the product/service • having existing proven financial records could make it easier to access finance	**Pros** • flexibility and freedom to make your own decisions • choose your location, premises, equipment and suppliers • develop your own operating systems • choose your own staff and train them according to your needs • create the business image you want
Cons • may suffer from previous owner's bad reputation • there could be bad debtors, unknown creditors or other financial or legal liabilities • business goodwill can be over-valued • you may need to honour or renegotiate existing contracts • current staff may not welcome new owners • you may need to invest additional money to make the business successful	**Cons** • researching a business idea and assessing risk takes time and money • sourcing start-up finance can be difficult • building goodwill takes time • suppliers may not initially extend credit • may take some time to become profitable

Key questions to ask before choosing a business	Yes	No	Unsure
Are you physically, financially and emotionally suited to the business?	☐	☐	☐
Do you have the necessary skills, experience, time, resources and commitment to make this business a success?	☐	☐	☐
Will the business provide what you want in relation to working hours, the income you need, and the impact on your family and career?	☐	☐	☐
Do you think you will enjoy operating this type of business on a day-to-day basis?	☐	☐	☐
Do you like to have people around you at work?	☐	☐	☐
Are you comfortable negotiating with suppliers and customers?	☐	☐	☐
Do you like to manage people?	☐	☐	☐
Are you happy to work outside normal working hours (including weekends or evenings)?	☐	☐	☐

Three key steps to prepare for self-employment

1. **Be honest**
   Running your own business can be very demanding, so be sure of your reasons for self-employment.

2. **Be realistic**
   While being your own boss may provide self-satisfaction, independence and the potential to earn more money, it can also mean:
   - long and irregular hours
   - foregoing a regular income
   - possible business failure and loss of your personal assets
   - an impact on your lifestyle and personal relationships
   - feelings of isolation and frustration

3. **Be self-critical**
   Running a successful business means you need to be:
   - organised and able to plan ahead
   - able to use your initiative and be ready for hard work
   - confident in the product/service offered by your business
   - confident in your own abilities

Find the right business (continued)

Rating business characteristics

Review the following key aspects of a business and tick those that matter most to you.

	Essential	Desirable	Unimportant
Can be operated from home	☐	☐	☐
Close proximity to home	☐	☐	☐
Long-term leasing option	☐	☐	☐
Low staff levels	☐	☐	☐
Mainly a cash-based business	☐	☐	☐
Office-based	☐	☐	☐
Online business	☐	☐	☐
Outdoor-based	☐	☐	☐
Product-based			
Service-based			
Retail environment			
Solid customer base			
Strong growth potential			
Well established brand			

Can you afford it?

It's important to crunch the numbers before you commit to buying a business. How much money do you have to invest? Will this business support your current lifestyle? Seek advice from your accountant in the early stages of planning to avoid the disappointment of not being able to afford your chosen business.

Finding a business – where to look

Once you've determined the best type of business for your needs, it's time to start researching one to buy. Businesses for sale are usually advertised in newspapers (under business opportunities or businesses for sale), industry magazines, and the internet. Your accountant may also be able to assist. While business brokers and commercial real estate agents are excellent resources, be aware that they often represent the interest of the business seller and will be receiving a commission on the sale.

The Business Brokers Association (WA) can assist you in finding a broker.

bbawa.com.au

If you're thinking about buying a franchise, start with the Franchise Council of Australia. Also consider completing the online courses through Griffith University, some are free while others will cost a few hundred dollars.

franchise.edu.au

Buying checklist

- **Take your time**; buying a business is a major commitment, don't rush the decision.
- **Undertake research**; look at industry trends, determine who are the main suppliers and customers. The more you know, the better you can analyse the viability of a business.
- **Improve your skills**; if you need extra knowledge consider doing a short course or workshop.
- **Don't buy the first business you see**; look at as many as possible before putting in an offer. This way you'll get a feel for the industry standards in relation to turnover, profitability, staffing levels etc.
- **Get a second opinion**; once you find a suitable business, talk with someone who is independent of the transaction and understands the industry – perhaps your accountant.

Analysing the chosen business

Not all businesses for sale are a good investment. Before buying you need to understand exactly what you are paying for.

You need to:

- conduct due diligence and evaluate the risk
- have the business independently valued
- assess existing employees against your business needs
- investigate taxation requirements

Speak to an accountant or tax professional to understand your tax obligations or visit the Australian Taxation Office.

ato.gov.au

Due diligence and evaluating risk

'Due diligence' involves undertaking a thorough review of the business to determine the likelihood of its future success. It usually takes place after you submit an offer and before you sign the final contact. Be sure to include the term 'subject to due diligence' in your offer.

You will need:

- certified financial statements for the previous three years
- a balance sheet to identify assets and liabilities
- a list of the plant, equipment, fixtures and fittings the vendor intends to sell, along with the current valuation and associated warranties and guarantees. Before buying, confirm they can prove ownership
- a copy of the lease agreement (if the premises are leased)
- a copy of the franchisor's agreement and disclosure statement (if the business is a franchise)

Don't sign any offers or pay any money until you have been provided with all of the above, you have assessed the business and obtained independent professional advice.

Analysing the chosen business (continued)

When you've found a business you would potentially like to purchase there are several aspects to evaluate, particularly the financial viability. You may wish to engage an accountant; however you should still conduct an analysis yourself.

This includes asking:

- Why is the business for sale?
- Will the business still operate successfully without the previous owner? How many customers will disappear once the owner leaves?
- Does the business have growth potential?
- Do sales rely on a small group of customers? What would be the impact if they took their business elsewhere?

Educate yourself

Our free 'Starting a Business' workshop will take you through the essentials of starting a business, and the 'Understanding Business Financials' workshop will help you understand key financial information.

Visit **smallbusiness.wa.gov.au** to book your place.

Undertake a financial evaluation

Your first step is to obtain and review:

- **Contracts already in place:** They could be with suppliers, clients, landlords or employees. If you are unhappy, how easily can you break the contract and what are the potential penalties?
- **Existing lease and conditions:** Under what terms are the current premises leased? Are you able to renegotiate in relation to potential renovations or an extension of the lease?
- **Financial records:** Review at least three years of financial data, including balance sheets, profit and loss statements and asset registers.

Business benchmarks

Use benchmarking reports to compare the sales and expenses of the proposed business against industry averages. Full reports are available from the SBDC or search for 'small business benchmarks' at ato.gov.au

Industry ROI%

To find the ROI (return on investment) for your industry ask a business broker or accountant.

Valuing a business

An independent valuation will confirm whether you are paying a fair price. There are three main methods of valuing a business.

- Return on investment = net profit x 100 ÷ price
- Asset value = assets of the business + goodwill
- Market value = turnover x industry multiple (this is rarely used for retail businesses)

Important points to check

- Is it reasonable to assume that profits will continue at the current levels?
- Will the profits cover loan repayments, the cost of maintaining and replacing business assets, and allow you to progressively recover your investment over the commercial life of the business?
- What is the condition and current market value of the plant, equipment and other assets?
- Is the goodwill of the business a realistic figure?
- Is the profit percentage higher or lower than industry standards?

Look beyond the financial accounts

There's more to a business than financial data. A savvy buyer will look at aspects of a business that contribute to its earning potential and reputation and ask the right questions. Bear in mind there's always a reason why the business is up for sale.

Employees

In most industries, employee costs account for one of the largest expenses. If staff will be transferring with the business you need to be aware of your responsibilities. Specific requirements regarding the transfer of a business and employee entitlements will vary according to which industrial relations system covers the business. For state system employees visit commerce.wa.gov.au and for those covered by the national system visit fairwork.gov.au

Also consider how many employees are involved, the length of time they've been with the business, their rates of pay, and whether they're due to take extended periods of leave.

Industry

Learn about the industry in which the business operates. Consult with business associations, other business owners, trade journals, and the IBISWorld database at our office.

Marketing

Meeting your customers' needs means understanding the products, methods of distribution, pricing and promotion.

- Will you be selling to many customers or just a few?
- Is the customer base expanding or contracting and where is it located?
- How much time and money has been spent on promotion and advertising? Would you need or want to change this?
- Is the advertising reaching your target market? How is this being measured?

See our *Building your knowledge: 'Marketing and branding'* guide and attend our marketing workshops. Visit smallbusiness.com.au to find out more and book your place.

Competition

To differentiate your business you need to understand who your competition will be and what they are doing.

- What is the unique selling proposition (USP) of your business – how does it stand out from the competition? Does this USP already exist or is there opportunity to develop one?
- What recent movements have there been in the market? Have competitors closed down or started up?

Location

The nature of your business will determine the characteristics you should seek in a building and a location.

- Are there local council plans for rezoning, developments or street changes that would impact on the premises or access to it?
- Are the local demographics changing, for example shifting from young families to retirees?
- Are there restrictions on trading hours?
- Is there adequate parking for customers, staff and delivery vehicles?
- For retail shops, is there adequate floor space to display a full range of products? Does the lease allow you to sell the business and re-assign the lease, or sub-let a space?
- Will an expensive fit-out be required?

Look beyond the financial accounts (continued)

Stock

Before you purchase a business, a physical count of existing stock should be undertaken by an independent stocktaking firm. Its value, quality and levels will affect the purchase price of the business.

- Does the stock reflect the type of product you would like to sell?
- Are you paying for a large proportion of obsolete stock?
- Is there sufficient stock or will you need to buy large quantities immediately after purchasing the business?
- How long does it take to restock?
- Is there an efficient stock control system in place?
- Will you be responsible for any guarantees or warranties associated with the stock?

Buildings, equipment, furniture and fixtures

The physical fit-out of business premises needs to be taken into consideration when planning for long-term growth.

- Does the building suit the needs of the business? Does it require major renovations?
- Is the equipment in good working order? If it needs maintenance, how much will this cost?
- Is the equipment free of debt?
- Are the equipment and fixtures valued at market value or book value?
- Does the building, equipment, furniture and fixtures conform to relevant legislation and regulations?
- Does the building have adequate security?
- If the business is a shop or factory, are local council zoning laws and health regulations being met? Are there any outstanding orders against the business? When were the premises last inspected?

Reduce the risks of buying a business by making sure all plant and equipment is in good working order, checking the vehicles are licenced, and that there are no interests on the property being sold. Check the Personal Property and Securities Register at **ppsr.gov.au**

Administration

It's important to obtain complete records before taking over the business.

- Has the business maintained good records? If not, how would you improve them?
- Does the record keeping system use particular software? How easy will it be to learn?
- Do you know how to use financial and managerial data to help you plan?
- Do you know how to interpret cash flow statements, balance sheets and profit and loss statements?

Licences and insurance

Business insurance and licence requirements depend on the type of business, the industry in which it operates and its physical location.

Refer to our *Building your knowledge: 'Business Insurance'* guide for more information.

- Does the business have adequate insurance against loss, fire, theft, and public liability?
- Do you have your own personal cover against sickness and death?

Understand the buying process

Buying a business can be a complicated process, so we recommend you seek professional assistance. Build a trusted support team including an accountant and lawyer. Refer to our *Building your support team* guides for advice.

Making an offer

There is no standard documentation when buying a business. If you are not using a real estate agent or business broker you are likely to need a lawyer to draw up a legally binding offer and acceptance.

Negotiating a fair price involves understanding what's included in the sale of the business and any additional costs you may be responsible for, such as:

- stocktaking fee (you and the seller pay half each)
- settlement fee
- stamp duty
- business registration
- fees associated with premises (eg. re-assignment of legal costs, agent's commissions council rates, water rates, land tax, rent in advance, merchants association fee)
- licences
- accountant's fees
- solicitor's fees
- bank fees
- stock (this can be substantial depending on the type of business)

For your own protection make sure all promises and undertakings given by the vendor are confirmed in writing.

Your lawyer should include appropriate conditions in the offer. This will allow you to withdraw your offer, without penalty, if the vendor doesn't meet these conditions.

Key parties involved in selling a business

- **Purchaser**; the buyer of the business
- **Vendor**; the seller of the business
- **Settlement agent**; the seller and vendor each have their own settlement agent. They handle the legal transfer of the business/property. This includes filing paperwork on your behalf and notifying relevant authorities regarding change of ownership.
- **Business broker**; works on behalf of the seller. They market the business and act as the go-between for the seller and buyer.
- **Lawyer**; reviews contracts and makes sure everything is legal.

Close the deal

Protect yourself by following proper procedures.

The sale of business contract

It's generally up to the vendor to draft the contract. Ensure your lawyer reviews all the paperwork before you sign anything. These are some of the clauses and additions that should be included:

- The contract should be subject to finance approval (if required), inspection of records, receiving the required licences, transfer of the lease of premises, re-assignment or grant of the franchise, and any other transfers.
- All assets related to the business must be itemised in the agreement including a 'proof of sale' clause, with any titles signed into your name.
- You should be aware of any current or future liabilities you will be taking on. The contract should state that liabilities not detailed will be met by the seller.
- If required, the contract should stipulate that the seller is prohibited from starting up a similar business within a certain time and distance from the business you have purchased.
- The contract should specify on which day you will be taking over the business and who will be paying the various fees.

Before you move in

Between the contract being finalised and the settlement date (when you officially take over the business), it's recommended you have the following in place:

- Ensure all licences and permits relating to the operation of the business will be transferred to you at settlement date.
- Arrange business bank accounts.
- Take out appropriate insurance cover.
- Contact suppliers and advise them of the imminent change of ownership. Discuss existing credit terms and re-negotiate if required.
- Advise existing customers of the change of ownership – take this as an opportunity to do some early marketing.
- Advise service companies (water, power, phone etc.) of the change in ownership.
- Apply to the Australian Taxation office (ATO) for an Australian Business Number (ABN) and GST, if appropriate.
- Undertake any training you need to successfully run your business.
- If needed, make arrangements with staff.
- Undertake any training you need to successfully run your business.

If your business is changing name:

- Register the new business name and trademarks.
- Arrange new signage.
- Order stationery, business cards, invoices, etc.
- Prepare promotional material, for example press releases, brochures, advertisements.

Once you have undertaken all the necessary steps, it's time to enjoy the rewards of being a small business owner!

Visit smallbusiness.wa.gov.au for more information or contact one of our business advisers on 133 140.

Sign up for our monthly e-news and follow us on facebook.com/smallbusinesswa to receive handy hints and tips on running your business.

Note: This information is not a substitute for legal advice.

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