

Things to consider when buying a business

Income

How much is the total income to owners, including any company profit?

- Ask for five years' accounts.
- Have these accounts been prepared by a qualified accountant? If not, how do you know how the figures have been put together?
- If not supplied, insist on having the balance sheets. They provide a wealth of information such as:-
 1. Has the owner tried to manipulate the figures?
 2. Could bad debts be high and not written off?
 3. Is the business in financial difficulty?

Profit arises only after a fair wage has been paid to the owners. Many businesses for sale do not make a profit. The income they generate is barely sufficient to cover the owners' wages. This ought to mean there is no goodwill. However, many people buy businesses and pay goodwill even though the wages they will earn are low. Sometimes they see opportunities to make a greater profit but often they are merely buying a job.

When buying a business, look at what you are going to get out of it and deduct a fair wage. Is what is left over a sufficient return for the risk you are taking with your money? In my view, you ought to get at least 25% back on the money you outlay. This takes care of the interest you would have got and also the risk you are taking. Never overlook the very real possibility of losing your money.

Sales

What is the trend of sales over last five years? Are sales steady or fluctuating? How does the future look?

Check the sales over the last three months. Compare this with the same time last year. Are sales going up? Go by money banked rather than vendor's records. Remember bankings could include non sales income.

GST returns can be useful for additional evidence of income. They contain all sales including equipment so are not 100% reliable. Use the IRD assessments as well as the copy of the GST returns to ensure figures have not been altered.

Owner runs a second business

Ensure the owners do not run a second business. If they do, they can inflate the income of the business they are selling with sales from the other business.

How to minimise risks

Take a security (like a mortgage) over the business assets. If the business goes broke you will have a prior claim over ordinary creditors. This is very useful if you still owe money to the bank. Alternatively, the security can be in the favour of the bank.

Avoid guarantees like the plague. Negotiate where ever possible. Try and limit your guarantee. Refuse to allow your spouse to be a guarantor. Renegotiate previous guarantees whenever you have the chance.

Agencies such as Lotto

Beware of dependence on one source of income and the ease with which it could be removed. Also look out for expensive demands by the firm granting the agency.

Make comparisons

Shop around and make comparisons with similar businesses for sale.

The following may be signs of a good buy

- Retirement - outgoing owner may have been undercharging and you can put up the prices
- Trouble with the landlord. You may be able to negotiate a good lease.
- Owners fighting amongst themselves including matrimonial
- Vendor prepared to leave substantial money in at a favourable interest rate
- Business is making a loss but assets being sold at less than their break up value.
- Business has excessive owner overheads which can be trimmed.
- Ratio of staff wages to sales out of kilter compared with normal for industry - may indicate inefficient use of labour or under pricing.
- Illness
- Dependent on key employee who has left

Set up yourself

Look at the option of setting up a business, instead of buying.

Opportunities

Make allowance for the opportunity to make the business grow.

Competition

What is competition or possible competition in the area like? Could someone set up in opposition to you?

Hours of work

Number of hours of work, including family.

Interest

Remember you pay interest on borrowed money. This will reduce your profit. If you use your own money to buy the business, you will no longer get interest. Allow for this. You need a higher return to compensate for the risk of being in business.

Health requirements

For food businesses check to see health requirements are up to date.

Lease

Check the terms of the lease. Will the rent be going up shortly? When does the lease expire? If leasing premises you should check the lease with your solicitor. Be sure there are substantial rights of renewal. You do not want the landlord able to take over the premises when you have paid goodwill to be there. If necessary, make it a condition of purchase that you obtain a fresh lease acceptable to you.

ACC

If you take over someone else's business either by "buying the business or by taking over the shares in the business" you may be given the experience rating of the previous owners. This can mean you could face a loading on your ACC. It's worth checking with ACC.

Equipment

Does money need to be spent on it?

Product life cycle

Is this a growing, mature or dying industry. Do you really want to own a business in a dying industry?

Sale and purchase agreement

Most assets (but not goodwill), can be depreciated for tax purposes. Therefore, if buying a business be sure to list the assets and state the price paid for each. Negotiate for goodwill to be as small a share of the total price as possible.

Vendor warranties

Anything a vendor has said can be put into your sale and purchase agreement. If promises have been made, be sure to include them.

Be sure to include a warranty by the seller concerning the level of sales. Also insist on seeing the final accounts so you can confirm the sales were as warranted.

Include in your agreement figures for liquidated damages. This means the agreement states how much the selling price will be reduced if certain conditions have not been met. This will save you any arguments later.

Skills

If special skills needed, the market for the business is limited to those who have the skills.

Stock

Is some obsolete? Don't buy the other person's purchasing mistakes.

Finance

Will vendor leave money in? If the seller misrepresents information to you, you can withhold payments.

There are several ways of financing a business. We can help you.

Staff

Any risk of staff leaving and competing with you?

If manufacturing, would it be better to use subcontractors and out-workers?

Make yourself familiar with the basics of the Employment Relations Act.

Threats

Consider possible threats from:-

Customers - E.G. Do it yourself market

Competitors

Economic changes

Government regulation - eg changes to parking or one way systems

Law Changes

Technology change
Social changes

Hidden benefits

- Costs shared between business and private. e.g. car registration, insurance etc.
- Opportunity to purchase stock at wholesale prices
- Sometimes cheap accommodation
- Better way of life being your own boss
- No fear of redundancy

When you have bought

Take over as quickly as possible. A person who has sold a business loses interest rapidly and their service to the customers deteriorates.

Require the owner to assist you fully, as you require. This should be a condition of purchase. EG to be available to work for the new owner without charge for up to 20 hours a week for the first month after purchase. You may find you only need a few hours of instruction and it is better to get rid of the old owner as quickly as you can. Some people can be reluctant to give up the reins and they get in the way.

When to use your accountant

Finally, before signing any contract, contact your accountant who will be able to check the business for you and help with financing.

Important business advice

When you have bought your business you should also make enquiries about:-

- How to make your business grow and become more profitable
- Keeping Books and Records
- Income Tax, GST, Fringe Benefit Tax etc

Cash under the table

You may be told, as the business takes a lot of cash, we do, of course, take money out of the till. These statements are not always true. There are ways of determining whether this may be true and perhaps getting an idea of the degree of dishonesty. You can never be sure of these statements and it is best to disregard them.

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