How to Buy a Business in 10 [not so] Easy Steps

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1. ASSEMBLE A TEAM. Buying a business can be a time consuming and confusing process, particularly for the uninitiated. Before proceeding, a wise buyer assembles a team of experienced advisers familiar with the process by which businesses are bought and sold. Team members ordinarily would include an accountant, tax adviser and attorney. Others could include a business valuation expert, environmental consultant and other professionals with particular expertise.

2. DETERMINE THE TYPE OF BUSINESS TO BUY. First, decide the general category of business. For example, service, manufacturing, internet, retail. Then consider the specific type of business, such as software developer, flower shop owner, shoe seller. Decide on the size of the business in terms of sales, profits, and the number of employees. Decide whether to seek a business that is profitable and stable or one that is losing money and in need of new management. The more profitable and stable a business, the more it will cost. If you plan to buy a business outside your area of expertise, you should make certain that key employees will stay on after the change in ownership or that similar expertise can be hired.

3. FIND A BUSINESS FOR SALE. Possible sources include business owners, business brokers, investment bankers, print advertising, trade sources and your attorney, accountant and other contacts in your network. Do not overlook any possibility in conducting your search. Business owners are often the best sources of industry information and may be willing to give free advice. Trade sources can be a viable source of information on businesses for sale. Key people within an industry, including suppliers, often know when businesses come up for sale or which owners might be willing to sell if the right offer were presented.

4. INVESTIGATE THE BUSINESS. Preliminary investigation may be conducted prior to making an offer or signing a letter of intent. More complete investigation is undertaken prior to the closing. The major areas to be investigated include the Seller’s financial statements; the status of pending or threatened litigation; business relationships with

suppliers and customers; tax matters; the competitive situation; employee relations and benefits plan matters; status of trademarks, patents, copyrights, trade secrets and other intellectual property; corporate, government and regulatory compliance; warranty and product liability issues; and potential environmental liabilities.

5. VALUE THE BUSINESS. Rules of thumb and valuation formulas are a starting point in determining the value of a business. The most useful of these may be the discounted cash flow method which is used to calculate the net present value of the future cash flows of a business based on certain assumptions. Remember that value is not the same as the price that is paid for a business. For many reasons, such as the relative bargaining positions of the parties and the skills of their negotiators, businesses are often purchased for more or less than their valuations. Nonetheless, having an accurate picture of the value of a business is essential in determining whether and how to proceed.

6. MAKE AN OFFER. This is ordinarily done by presenting the Seller with a letter of intent that serves to outline the agreement of the parties on fundamental issues and commits the parties to an exclusive period of negotiations. Price is the central bargaining issue in the transaction, but price cannot be understood without thinking about terms. Terms are often more important than price. It makes a big difference, for instance if a $10 million dollar offer is for stock or assets. The tax consequences for buyer and seller are significantly different depending on the choice. Better for the buyer because of a step up in basis, and worse for the Seller because of double taxation. Similar considerations apply to liability issues and the timing and type of payments to be made. For instance, asset deals leave the seller exposed to liabilities that are not assumed by the buyer. Stock deals require the buyer to assume the liabilities of the business. Installment payments are worth less than the same amount paid at closing. Payment in stock of the buyer brings its own set of valuation issues.

7. NEGOTIATE DEFINITIVE DOCUMENTATION. The Purchase and Sale Agreement can be a complex document. The major bargaining issues include: price; structure; seller's representations and warranties; the conduct of the parties pending the closing; and conditions to the closing. In a sense, the entire negotiation process

involves the apportionment of liabilities between buyer and seller. This process often is crystallized in a hotly contested negotiation of the agreement's indemnity provisions. The parties must agree on who is to bear the risk of post-closing liabilities, both those that have been disclosed and those which are contingent or unknown. The seller wants to sleep at night. The buyer counters that the buyer is paying good money for a business that exists as the Seller has described. The buyer wants protection if the business turns out not to be as advertised. Resolution usually involves agreement on time limits for making claims and limits on the seller's exposure for certain types of liabilities.

8. ARRANGE FINANCING. The buyer's sources of financing depend in part on the size of the business being purchased. The larger the business being acquired the more sources that are available. Not only does the willingness of a particular lender to participate in the transaction increase, the number of potential lenders increases. Banks, insurance companies, commercial finance companies and venture capital companies all may be interested in providing financing for a larger acquisition. Many smaller businesses are purchased with a significant portion of the purchase price financed by the seller. The buyer, however, usually is required to make a down payment and ensure that adequate working capital sources are available. If the funds needed for the down payment are not readily available, the buyer must look for financing from an outside source.

9. SATISFY CLOSING CONDITIONS. In addition to the buyer obtaining financing, there may be several other conditions to be met before the purchase is closed. Typical closing conditions include: satisfaction with the results of the due diligence investigation; receiving required opinions, approvals and consents; entry into ancillary contracts; and the absence of certain events such as threatening litigation. Typically, buyer and seller cooperate to satisfy the closing conditions in advance of an agreed upon closing date.

10. CLOSE THE TRANSACTION. When the closing date arrives, and all of the conditions to the closing have been met, save those that will be satisfied at the closing, the parties and their representatives ordinarily assemble and lay out the paperwork. In neat piles on tables are found bills of sale, required consents, officer's certificates,

opinions of counsel, and other transfer memorabilia. After dealing with the inevitable last minute snafus, documents are signed, wire transfers are completed and the business changes hands.