

# Illawarra Small Business Assistance

## HELPFUL HINT – CHECKLIST FOR BUYING A BUSINESS

There are many advantages in buying a business, but equally many disadvantages. If you thoroughly check the operations of the business and ensure the purchase agreement contains safeguard clauses, many of the disadvantages can be minimized.

With an existing business there will always be surprises. You may never know the real reason why the business is up for sale, but you can reduce the potential for surprises by insisting on working in the business for a time prior to sale to see how staff and clients really view the business.

### Advantages of Buying a Business

If you buy a business you start with:

- an existing customer base and existing contracts;
- existing suppliers;
- existing staff and management;
- existing plant, equipment, stock and material;
- knowledge of the business from the current owner;
- premises that are set up;
- goodwill associated with the name and location of the business;
- financiers lending more readily to an existing business with a trading record.

### Disadvantages of Buying a Business

The disadvantages of buying an existing business can include:

- Customers may link the goodwill to the previous owner and leave when a new operator takes over the business.
- Staffing problems:
  - i. Some staff may leave when the new owner takes over.
  - ii. Some staff may be unsuitable for the job they are doing.
  - iii. Some staff may resent the change to a new owner.
  - iv. You may inherit staff entitlements, such as impending long-service leave payments.
- Plant and equipment may be obsolete or faulty.
- The business may have no real intellectual property that is transferable.
- The business may have a bad image which is difficult to change.
- The cost of acquiring goodwill may be too high.

## **Checklist for Buying a Business**

- Find out why the business is for sale.
- Decide whether the type and size of the business fits with your needs, skills and experience, financial capacity and future plans.
- Check the operations of the business, including sales, costs, profits and assets. It is advisable to take independent financial advice from your accountant when reviewing the financial records of the business being considered.
- Investigate the Work Cover claim record of the business.
- Research current and potential competitors. It may be prudent to consider placing restrictions in the sale contract on the future trading activities of the vendor where this is in direct competition with the business you are intending to purchase.
- Inspect contracts for current and future work with customers.
- Arrange for the business to be appropriately valued
- Review the draft purchase agreement with your solicitor and advise them to carry out all required searches.
- The level of co-operation you receive from the current business owner is one indicator of whether you should go ahead or not.

## **Checking the Operations of the Business**

### **Sales**

- Check monthly and yearly sales patterns.
- Compare sales trends with industry trends.
- Determine if the business is expanding, losing sales or remaining static.
- Value existing stock - ensure that it is not old or unsalable and that there is sufficient stock.
- Identify the business customer base and percentage of sales from different customers. Check to see if the customers will stay with the business if you purchase it.
- Determine where each of the business products is on their respective life cycles.
- Determine whether you'll be able to increase sales with current resources.
- Find out if you are able to continue to buy from existing suppliers.
- Find out if there are any local developments that may affect trade.

### **Costs**

- Identify all fixed and variable costs and include interest expenses on your borrowings for the business.
- Examine the costs recorded for the business and ensure costs are reasonable.
- Determine whether recorded depreciation costs are reasonable.
- Determine whether you will incur similar costs to the current business owner.

## **Profits**

- Analyze financial records, including balance sheets, profit and loss statements, Business Activity Statements and sales records.
- Determine whether the business generates sufficient profit for a reasonable income.
- Look at effects of increased or decreased sales on your profit.
- Compare gross profits and financial performance ratios with industry trends.

## **Assets**

- Identify all asset items that you are buying. Refer to an asset register/list, if available.
- Check depreciation schedule for equipment, fixtures, fittings, etc.
- Determine book value, market value and replacement value of fixed assets.
- Identify any current leases for fixed assets.
- Ensure equipment is in good working condition.
- Determine if any equipment is unnecessary for the business or obsolete.

## **Premises/Location**

- Arrange for your solicitor to undertake a title search on the premises
- Identify whether the vendor has the right to assign the existing lease or is it necessary to negotiate a new lease with the landlord.
- Check with Council regarding any rezoning or proposed planning changes which may affect the business.
- Clarify all existing insurance coverage and evaluate adequacy and transferability.

## **Staff**

- Determine whether existing staff will continue employment.
- Identify key staff and review salaries, employment packages and FBT implications.
- Assess any outstanding holiday pay and/or long-service leave liabilities.

## **Sale of Business and the GST**

The supply of a business as a going concern is GST free if the following requirements are met:

- i. The purchaser and the vendor must both be registered for GST.
- ii. The business is actually for sale with money changing hands.
- iii. The vendor must carry on the business until the day of sale.
- iv. All things required for continued operation of the business must be supplied.
- v. Both parties must agree in writing that the business is a going concern.

## Arrange for an appropriate Business Valuation

Due to the complexity required to reach an appropriate valuation, it is advisable to seek the assistance of a professional person such as your accountant, business advisor or business valuation specialist. It is important to bear-in-mind that there are no hard and fast rules – valuation methods are a combination of art and science, involve many assumptions and hence subjectivity is involved. For further information please refer to our related paper entitled “**Business Valuation Methods**”

## The Purchase Agreement

- Decide whether, on the basis of the due diligence conducted and the risks involved, you are comfortable with the purchase price.
- Closely review the draft purchase agreement, as well as all the clauses in the agreement. Ensure the purchase agreement:
  - details all assets and liabilities to be assumed;
  - states when the business is to be taken over; and
  - states whether the offer is conditional on:
    - i. obtaining finance;
    - ii. inspecting all records;
    - iii. receiving necessary licences and rights;
    - iv. minimum trading levels being met during a trial period.

### DISCLAIMER

This information is provided on the understanding that it is intended as a guide only and on the basis that the recipient will seek the advice and counsel of an appropriately qualified accountant and/or business valuation specialist to address and meet the specific needs and situations that apply to the recipient. Any representation, statement, opinion, term, condition or advice, expressed or implied in this documents is not made by or on behalf of, nor supported by Regional development Australia, Illawarra its agents and employees and none are liable (whether by reason of negligence, lack of care or otherwise) to any person or persons for any damage or loss whatsoever which has occurred or may occur in relation to that person taking or not taking (as the case may be) action in respect of anything contained, implied and/or represented, or as referred to above.

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