
Buying a Business

WHY A SMALL BUSINESS

In our experience there are a number of reasons why people operate small businesses, and these reasons change with the changing environment. The pressure being exerted by the more market orientated theories currently in vogue are changing them again, but generally the New Zealand characteristic of INDEPENDENCE rates highly. Many New Zealanders prefer to be their own boss, to choose their own hours of work, or perhaps provide an outlet for their individual flair or skill, or simply they don't like being told by anyone else what to do or when.

Income is another dominating factor. There is a belief that the self employed have tended to earn more. That they have sometimes had access to more "perks" and in some instances were able to obtain capital gains. We would caution anyone entering small business solely on these grounds as the environment in which we now operate makes many of these commonly held views something of a myth. Not that a good income cannot be achieved from small business, but simply that it is not as easy as some commonly held theories would have you believe.

Personal satisfaction is probably one of the stronger valid reasons for operating your own business and of course is closely related to the independence factor which we have already covered. There is no doubt that many people who operate their own small business achieve a level of personal satisfaction which makes it all worthwhile. Many people giving a technical service find that they can do this better in the form of their own business where their personal relationship with the customer and their level of technical competence combine to provide a high level of personal satisfaction, both to the businessman and the customer.

If you are thinking of entering the world of the small businessman, or if in fact you are there, your reasons will undoubtedly be a combination of those mentioned above. The important thing to emphasise is that the successful small businessman will be there for the right reasons and often the alarmingly high number of unsuccessful small businessman were there for the wrong reasons in the first place.

CHECKLIST FOR BUSINESS PURCHASE

Evaluating the Opportunities

This investigation should cover:

- The reason the business is for sale
- Business profit, sales and operating figures both past and projected
- The assets and liabilities of the business
- Return on investment
- Other evaluation factors such as the history of the business, location and the legislative framework in which the business must operate i.e. The Resource Management Act

The following are some important guidelines in analysing a particular proposition. Proper investigation of these factors will take considerable time and effort. Purchasers are often tempted to act quickly so a "golden opportunity" won't be missed. We recommend caution and a thorough investigation into why the business is for sale.

1. Reasons for selling may include:

- Declining business
- Changes in the character of the neighbourhood
- Lack of competitive strength
- Impending loss of business due to new competition including competition from imports resulting from changes in government policy etc
- Obsolete product/facilities
- Poor selection of merchandise or materials
- An expiring lease or franchise
- Inability to collect accounts receivable or problems with creditors
- Owners bad reputation (which may stay with the business)
- Labour and supply problems
- New environmental constraints

The reason for selling may be a factor that would make it extremely difficult for a new operator to make a success of the business. Remember the seller is knowledgeable of the business and its market environment.

2. Profits, Sales, Expenses

- Obtain last 3 - 5 years results of the business
- Projected results for next two years
- Projected cash flows for the next two years on a month by month basis
- Does the business have enough working capital?
- Prepare a detailed breakdown of sales and operating ratios for the past 3 - 5 years.

This information should be analysed to indicate trends. Comparisons with Industry trends (if available) would also be useful.

A critical approach should always be taken when examining financial information provided by a prospective seller.

3. The Assets and Liabilities of the Business

Assets

- The assets should be closely investigated to determine their existence and value and to make sure they are transferable to the new owners
- Consider who is to carry out valuation (Independent valuer??)

Stock

- Is the basis of valuation realistic?
- Consider obsolete/damaged stocks
- Are the quantities realistic to projected sales levels?
- Are there any ownership issues to resolve?
- Does work in progress require review?
- Check on purchasing terms, and supply sources. Will they be appropriate?
- Is any stock held on consignment?

Plant and Fittings

- What is their market value?
- How modern, efficient and useable are they?
- Are they in good repair?
- Are they the type the buyer really wants in the business?
- What major changes will be necessary?
- Are they paid for or are there monies owing under a hire purchase or lease agreement?
- Are any assets located elsewhere, and if so are they subject to a lien?
- Has the depreciation policy been realistic?

Goodwill

- How has the figure been valued?
- Is goodwill sustainable and transferable?
- Is a non-competition clause necessary?
- Are there rules of thumb to check the goodwill figure against?

Debtors

- Check their age and collectability
- Is an excess amount of the business coming from credit customers with slow payment records?
- Would this necessitate excessive working capital?
- If a stricter credit policy were established would key customers be lost?
- Consider the current economic climate, how does it affect the customers ability to pay?

Where possible, customer lists, business and credit records, mailing lists and the like should be included in the sales agreement.

The Lease

- Is it transferable/assignable to a buyer?
- Is it included in the contract so that the legal obligation to purchase depends on availability of the lease?
- Do the covenants of the lease enable the activity envisaged to be carried on?
- What rent and other outgoings including a proportion of profits will the tenant be responsible for?
- Is there provision for adjustment of rent during the lease?
- Provision of tenants rights to sub-let
- What is the term of the lease and is there an option for renewal
- Are there any fixtures and fittings that belong to the landlord?
- At the termination of the lease can the tenant remove fixtures and fittings?

Franchise

- Are any exclusive franchises transferable to the buyer and are they included in the contract?
- What is their value to the purchaser?
- Any restrictions on transfer

Liabilities

Liabilities may be extensive and hidden. They may include:

- Unpaid bills or security arrangements
- Leases on equipment
- Outstanding payments due to employees including holiday pay, long service pay, sick pay, superannuation and redundancy payments
- General security agreement holders and specific charge holders

Trained Personnel

- Will key employees continue to work for the firm under new management?
- If key personnel are lost how adversely would this affect the business?
- Will the purchaser want to make changes and if so will there be liabilities for redundancy or loss of office?

Trademark, Patents, Copyrights, Registered Design

Marks and Other Licenses or Contracts

- Are they included in the agreement and are they transferable?
- Will they be as valuable in the future?

Business Reputation and Clientele

- Does the business have a good reputation and established satisfied clientele?
- Are there many customers who would leave with the vendor?
- Does this possible loss of clientele affect the value of the business?
- Are there firm contracts for key customers and are these transferable to the new owner?
- Is an adequate restraint of trade proposed?

Supply, Credit Relations

- How are business relations with these sources?
- Will supply continue on favourable terms?
- Is the business committed through contracts to suppliers?
- What future deliveries are scheduled (should they be increased or cancelled)?
- Are the estimated average stock turnover or the length of time on trade debt greater than the length of time on trade credit.

4. Return on Investments

- Is the return satisfactory when compared with the return of similar businesses and alternative investment opportunities?
- Remember to restate the figures to determine a return under your financing arrangements.

5. Other Evaluation Factors

- What is the history of the location over the past few years?
- How many businesses have been there, what types, and how successful were they?
- How long has the business been for sale?
- What will be the total amount of capital needed?

There must be enough for working capital, repairs, modernisation, new equipment, new inventory, cash to carry accounts receivable (if any), reserves for taxes, insurance and depreciation, opening expenses, legal fees and a contingency reserve.

- Does the condition of the business premises and equipment meet local legal, building and health code requirements and any other statutory requirements?
- Taxation - have all implications been considered?
 - Consider GST status of transaction!
 - Consider tax deductibility of any interest to be borrowed to complete the purchase
 - Is there an early or deferred settlement which might invoke the accrual rules?
 - Have you considered the proposed structure of the new business?
- Are all pertinent matters included in the agreement?
- Competition
 - Who are the major users of the business?
 - Consider risk from off-shore suppliers
 - Consider pricing strategies of competition

We are happy to provide a free, no obligation independent assessment of your personal and business taxation obligations.

For further details contact any of the partners or www.mcp.co.nz.

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