

FAST FACTS 5: BUYING A BUSINESS

Buying an existing business can be less risky and lead to more profit in a shorter timeframe than starting your own business from scratch, but this strategy is not entirely risk free.

Advantages:

- good business history increases likelihood of success
- immediate income from sales to existing clientele
- easier to obtain finance for a business with a good track record
- lines of credit and supply are already developed
- staff are trained, experienced and can provide valuable assistance
- previous owner can provide hand-over training and assistance

Disadvantages:

- location, facilities, image and policies are hard to change
- clientele may have special relationship with current owner
- key personnel may leave company after change in ownership
- goodwill difficult to evaluate

The purchase decision

To decide if you should be purchasing a particular business you should be considering two key elements. Is the business worth the asking price and does the business have long term viability? It is recommended that you seek assistance from professionals such as accountants and solicitors to help you make a purchase decision.

Is the business worth the asking price?

Your success in buying an established business will depend on how wisely you choose and appraise each potential venture. Your accountant and business adviser can help you evaluate the potential of the business by considering the following items:

- profit and loss from past three to five years
- balance sheet from past three to five years
- tax returns from past three to five years
- analysis of sales by product line or service type (monthly for one to two years)
- stock on hand
- asset register listing all plant and equipment included in the sale
- list of debtors (receivables) and creditors (payables)
- key personnel.

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Checklist for long term business viability

There are many considerations to ensure you obtain value for money and that the previous business owners have given you a true picture of the business potential. If you get positive answers to the following questions you may decide to proceed with the purchase and more detailed planning for the business.

Sales

- What is the sales pattern? Are sales seasonal? What are the major customers?
- Is the business expanding, decreasing or remaining stable?
- Are you sure the sales figures shown were all generated by the business?
- Does documentary evidence support the figures (eg, bank statements)?
- Is the business in a good location (ie, visibility, access, parking)?
- Have you assessed the competition?
- Are any developments planned or commencing which may affect your trade (ie, increased competition from a new shopping centre)?

Costs

- Have you re-assessed the operating costs to reflect your way of running the business (ie, will you have the same level of expenses)?
- Is the business keeping up with its bills? Unpaid and overdue bills may indicate the owner is struggling with cash flow.
- Will you be able to continue buying from existing suppliers?
- Are you aware of the additional costs associated with the purchase (eg, stamp duty, legal fees, loan establishment costs).
- Allow for interest expense if you borrow money to buy the business.

Profits

- Can the business generate sufficient profits to provide you with a reasonable income as well as an attractive profit margin?
- Have you analysed the financial records for as many years as possible?
- Is the gross profit declining over time?
- Have you looked at other similar businesses, and how does this one compare?

Assets

- Do you know exactly what you will be buying? If there is an asset list, check each item.
- Have you checked the ownership and condition of plant and equipment included in the sale?
- Are the prices shown realistic or are they old values?
- Have you checked the value of stock included in the sale?
- Do you have to take all the stock if you buy the business?

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- Is the figure asked for goodwill reasonable?
- Will the site, building and lease be suitable for your future plans?

The seller and you

- Do you feel comfortable with the business, and can you afford it?
- Why do the existing owners wish to sell? Try to determine the real reason.
- How long has the business been owned by the seller?
- How long has the business been on the market?
- Will the seller train and assist you for an agreed time after the purchase?

Legal issues

- Do you understand the business structure you will be operating (ie, sole trader, partnership or company)?
- Is the seller willing to sign a restrictive clause?
- Have you discussed the terms of the lease with your solicitor?
- Do you require any special licences to operate this kind of business?
- Have you obtained a quote for insurance cover?

For more information refer to other Fast Facts in this series or contact:

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