Vendors who make the deal seem too good to be true. If something appears too good to be true, it's usually because it's not true.

Prospective purchasers noticing any of the above warning signs should walk away from the deal. If they are still keen to pursue the opportunity, they should negotiate to lower the selling price of the business and seek more information from the vendor or other parties.

Conclusion

A successful business will generate sufficient profit to provide for a fair income for the proprietor, a reasonable return on capital invested in the business, the recovery of invested capital and repayment of borrowed capital. Prospective business purchasers should establish a realistic value of a business and ensure not only that they will make money, but also that they will recover their invested capital. Prospective purchasers should be warned that there are always risks. Although an existing business may be successful for the current owner, that success may not transfer to another owner. Consultation with a legal adviser and accountant before signing any binding document is strongly recommended.

Kelly & Chapman will help you

It is a comprehensive legal advice that you need to obtain well before you engage yourself in any negotiations of starting a new business by any of the above methods, particularly if you are buying an existing business or franchise.

If you are intending to buy or sell your business – contact Mr. Vujnovic of our office today on (03) 9557 2915 or by email mv@kellyandchapman.com.au or visit our website www.kellyandchapman.com.au.

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KELLY & CHAPMAN

LAWYERS

ARE YOU BUYING A BUSINESS?

Owning and operating a business usually involves greater risk and responsibility than employment. However, it can also be highly rewarding – professionally, personally and financially. With good planning and preparation, the risks involved in buying a business can be greatly reduced.

One of the biggest mistakes potential business purchasers can make is to allow their dream of owning and operating their own business to cloud their judgment when deciding whether a particular business is truly capable of satisfying their needs, abilities and ambitions.

Small business owners may require a broad range of skills to operate their business successfully. Depending on the business, the owner may require skill and acumen in a number of areas such as sales and marketing, research and development, management, human resources, communications, financial management and bookkeeping amongst others. It is critical that intending business owners buy businesses that suit their personality and which demand skills consistent with the work they want to do.

The process of buying a business requires a careful investigation into all aspects of its operation and a verification of material facts such as trading figures. Professional advisers such as accountants and solicitors should be consulted at all times throughout the process.

THE ESSENTIALS OF BUYING A BUSINESS

Buying an existing business

The three main ways that people get into small business ownership are by
- Starting a business from scratch;
- Buying an existing business (or part of a business);
- Buying a franchise.

The immediate benefit of buying an existing business is that it is already operating and should, if the figures are correct, provide an immediate cash flow. Of course, purchasers have to recognize the possibility that the departure of the previous owner may adversely affect the short-term performance of business in ways, which may include a reduction in goodwill. Buying an existing franchise or an existing business has both advantages and disadvantages over starting a business from scratch.

Due Diligence

Failing to take the time to examine all key aspects of a business prior to purchase may result in a costly mistake. Prospective purchasers should only buy a business after a thorough due diligence process. Due diligence is the process of acquiring and analysing information to help a prospective purchaser decide whether or not to go ahead with a proposed purchase. The information obtained and analyzed should extend to all facets of the business, i.e. financial and non-financial information. Financial information includes records of sales and expenses and, ideally, should include tax returns (if supplied by the vendor). Other matters, which may require investigation, include an assessment of the existing products or services, location, existing licenses and the market demand and growth prospects. Are the products and services meeting the needs of the local market? Is there any legal impediment to the continuing and operation of the business? Are there any other factors, which may restrict its growth prospects?

Assignment of lease

If the business is operated from leased premises, the sale of a business will require the leased to be assigned (i.e. legally transferred) from the vendor to the purchaser. In most cases, this requires the landlord's consent – something which should be obtained as soon as possible. Where the value of a business depends on factors such as its good location, a high cost of relocation, a good passing trade, a rapport with local customers etc, the lease will be one of the most valuable assets of the business. Prospective purchasers should ensure that the contract to purchaser is strictly conditional on a proper Assignment of Lease being secured before settlement.
Before you commit yourself to buy any business you should obtain legal advice as to all the terms and provisions contained in the Lease. How would you feel if, two months after buying a business, you learned that you were obliged to paint the landlord's premises in their entirety? How would it affect your cash flow?

Statutory requirements

Section 52 of the Estate Agents Act 1980 requires a vendor of a business or part of a business (or the estate agent acting on his/her behalf) to provide a prospective purchaser with a Vendor's disclosure statement (known as a Section 52 Statement) where the business is being sold for a price of $350,000 or less (excluding stock). If a vendor fails to provide this statement, the effect can be substantial. Apart from the fact that the vendor commits a criminal offence, the purchaser is entitled to avoid the Contract of Sale at any point up until the time he/she takes possession of the business or on the expiration of three months after signing the contract (whichever takes place first).

Warning signs

There are a number of warning signs, which should sound alarm bells for prospective buyers. Prospective buyers should be wary of:
- Vendors who are overly keen to sign them up and close the deal – that is, applying pressure to close the deal quickly
- Vendors who won't provide a reason why they are selling
- Vendors who give in too easily at an offer
- Vendors who fail to disclose important information such as details of the lease, outgoings and any necessary licences
- Businesses or proprietors that are subject to pending litigation
- Businesses with poor records of customer complaints or product returns.
- Business that own rights over copyright or other intellectual property and which are due to expire
- Vendors who won't allow a trial period before the contract is signed
- Vendors who won't agree to a transition period (stay on and help out the purchaser) after the business is sold
- Vendors who refuse to disclose information under the guise of 'confidentiality' especially if the prospective buyer has signed a confidentiality agreement
- Vendors who won't agree to a restraint of trade clause in the contract of sale
- Vendors who won't introduce the prospective purchaser to suppliers
- Vendors who won't disclose information about existing staff and management (prospective purchasers are liable for staff entitlements when they take over the business)
- Vendors who wont introduce the prospective purchaser to the agent or landlord to discuss lease issues
- Landlords that will only grant short leases
- Vendors who talk up the cash trading figures and diminish the value of the tax return figures of the business
- Vendors who drop the sale price of their products or services in an attempt to bump up gross sales (trading profit is more important than an artificially inflated sales volume)
- Vendors operating a business from leased premises who offer the business for sale at a reduced price, but offer to assign the lease to the prospective purchaser only at a premium; and