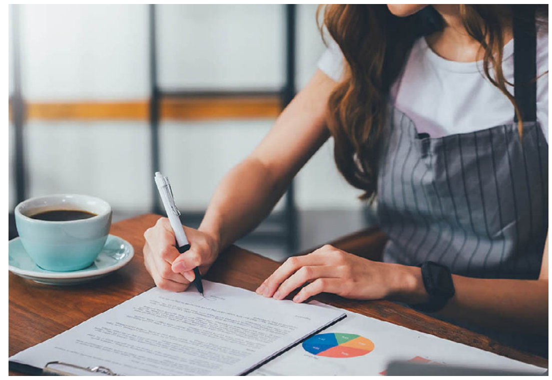
Buying an Existing Business

RESOURCE PACKET

The North Dakota Women's Business Center is the leading voice, resource, and partner for women business owners. We are dedicated to amplifying the economic voice of our clients through advocacy and access to critical resources.



NORTH DAKOTA
Women's Business
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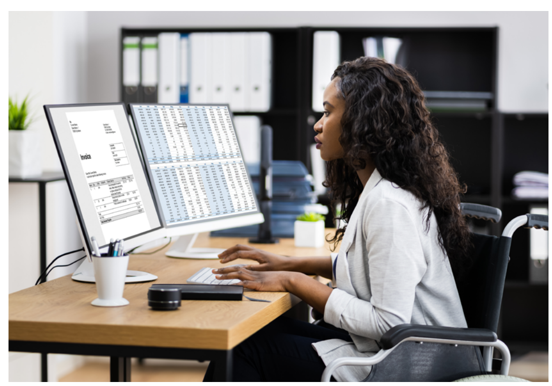
North Dakota Women's Business Center (NDWBC) partners with women business owners by walking them through different business aspects to understand their progress and knowledge. NDWBC is dedicated to providing women business owners with critical resources to equip them to make informed decisions about their business and guide them forward on their journey.



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You want to be a business owner, but you're not sure you want to start from scratch. NDWBC is here to help you through the process of buying and expanding an existing business. Use our free resources to help make smart choices as you get started.

Table of Contents

Pros and Cons of Buying an Existing Business 4
Selecting a Business to Buy 5
The Buying Process 5
- Searching for a Business on Sale 5
- Aligning Budget, Goals, and Resources 6
- Analyze - Your Due Diligence Period 6
- Evaluate - A Business Valuation 8
- Capital - Funding your Business 9
- Closing - A Checklist 10

Pros and Cons of Buying an Existing Business

Advantages

- Proven business concept and plan.
- Time, effort, and money already invested in testing products/services.
- Lower operating costs than startup.
- May negotiate for intellectual property, such as copyrights, patents, and trademarks.
- Inheriting customer base, vendor relations, experienced team, income stream, inventory, assets, and equipment, built-out brand, suppliers, market data, and refined operations.
- Potential for rental income and control of the property.
- Tax breaks for interest, depreciation, and non-mortgage expenses.
- Inherited assets and performance will help you secure financing.

Disadvantages

- Discrepancies between your and existing culture, vision, and goals.
- Dependence on key staff and their existing customer relationships.
- Higher upfront purchasing costs.
- Steep and time-intensive learning curve to understand inner workings.
- Difficulties integrating this business with your existing operations.
- Risk of hidden problems or that things are worse than they appeared.
- Potential for loss of liquidity or capital.
- Loans
  - » 10-20% upfront down payment.
  - » May have difficulty qualifying for financing.
  - » Repayment penalties on loans.
  - » Liability insurance required.

> A small business is an amazing way to serve and leave an impact on the world you live in.
>
> CEO Nicole Snow - Darn Good Yarn

Selecting a Business to Buy

Understand and narrow your passions, interests, talents, skills, and experience. Gain experience in and build your knowledge base. Understand and embrace the business's model, roducts or services, customers, industry, and trends. Ask yourself:

» What makes me come alive?

» What are my innate strengths?

» Where do I add the greatest value?

» How will I measure my life?

The Buying Process

Search for Businesses That Are on Sale

Once you have checked in with yourself and have examined your goals for business ownership, you can start your search for a business that would be a good fit for purchasing. Some places to start your search might include:

» Going to meetups

» Industry conferences

» Classified newspaper ads

» Online sites like bizbuysell.com

» Talking to small business owners

» Working with a business broker

Did you know...

Business brokers can help buyers understand the kind of business they want, pre-screen successful businesses options, keep negotiations civil and smart, and help with all the necessary paperwork. However, brokers legally represent the seller and are paid commission by the seller, so guard your budget.

As you narrow your search and begin talking to business owners to understand the possible business acquisition. You will want to know as much as you can about the successes, failures, challenges, and future. Interviewing existing customers, existing employees, locals in the area, and neighboring businesses will help you assess the business. Here are some questions you will want the answers to:

» What challenges have you encountered?

» In what ways have you tried to solve those problems?

» What kind of results did that yield?

» Do I have what it takes to meet these challenges with different or better solutions?

Red Flags to Note

- A poorly conceptualized business plan
- Inventory difficulties (the cost of production is too high, low quality is losing the business customers, storage is difficult, there's no supply and demand balance, etc.)
- Monopolistic competitors
- Existing business debts
- Location problems
- Brand issues
- Bad equipment (outdated/expensive upgrades
- Difficulty finding vendors

Aligning Budget, Goals, and Resources

Before moving forward identify your budget, goals, and resources when you think about what you can honestly invest into a business. What is your ideal when it comes to the size, location, sales, and staff? Consider how much time and energy you can invest to make the business. Next, ask is this business in line with what I can offer? Will I be satisfied if I have to sacrifice elements of my vision? If so, how will you solve those issues, and what is negotiable?

> I pick up details that drive the organization insane. But sweating the details is more important than anything else.
>
> CEO Indra Nooyi - PepsiCo

Analyze - Your Due Diligence Period

Now that a potential business has aligned with your values and passed the initial research period it is time to roll up your sleeves and dive deeper into the business. This is the time for doing your due diligence. This is the process of gathering as much information as you can before buying a business. Note, work with your accountant to understand how the business' financials and transaction structure. A lawyer will be a huge help with paperwork and negotiations.

Confidentiality

Before due diligence, the seller may ask for a signed confidentiality agreement or nondisclosure agreement. By signing, you agree not to disclose any confidential information during the due diligence process. This protects the seller in case you decide not to buy.

Initial Information to Screen

- Business licenses and permits - Review organizational paperwork and certificate of good standing to show that they are approved to operate in the state.
- Zoning laws - Check with your city hall to learn about your city or county's ordinances to see that the business is not violating any restrictions.
- Environmental regulations - Ensure this business is following the area's environmental regulations.

Letter of Intent (LOI)

You can expect the seller to issue a letter of intent, LOI, outlineing the price (including business, assets, and liabilities), terms, and conditions of the business sale. By signing this statement, the seller will know you are serious about buying this business. It will give them the confidence to show you the rest of their financials, so you can complete your due diligence.

Review Checklist

- ☐ **Lease**
  Ensure the landlord will transfer legal documents to your name. if not, you'll need to negotiate a new lease, which can significantly add to your expenses.
- ☐ **Outstanding Vendor & Customer Agreements**
  Does most of the business's revenue comes from a single client? This situation is risky for a new owner since they will no longer be around to manage that relationship.
- ☐ **Business Financials**
  Ensure they are audited by a CPA
- ☐ **Tax Returns**
- ☐ **Balance Sheets & Cash Flow Statements**
  Is there a clear path to profitability?
- ☐ **Sales Records, Customer Lists, & Accounts Receivable**
  Ensure old debts are paid off before purchasing. It can be difficult for new owners to collect 90+ days.
- ☐ **Accounts Payable**
- ☐ **Advertising Expenses**
- ☐ **Organizational Chart**
  Rank and Relationships. You'll want to know about compensation data, management practices and processes, benefit plans, insurance and vacation policies and contracts.
- ☐ **Inventory, Equipment, Furniture, & Building Lists**
  Ask what's on hand; how is its quality and condition; can it be sold, both in terms of market viability; how fast and for how much each type of inventory has sold in the past; how has been maintained and does it need repair; does it match my aesthetic; will the current building work in my vision?
- ☐ **Property Documents**
- ☐ **Brand Assets for Advertising**
- ☐ **Intellectual Property Assets**
- ☐ **Business Insurance Statements**
- ☐ **Legal Liabilities**
  (liens, lawsuits, and/or judgments)
- ☐ **Debt Disclosures**

Evaluate - A Business Valuation

A business valuation is a process of determining the economic value of a business, and a good valuation can save you thousands in the long run. Ultimately, you and the seller will most likely value different aspects to varying degrees. Urgency and negotiation skills will determine who gets a better deal. Below are outlines of three models that can be used to determine a business' value:

Earnings Approach

Values a business based on its historical, current, and projected profits, and include the capitalized earnings method and discounted cash flow method. Disadvantage: relies on a prediction of future earnings and may not be accurate. Best Use: Already profitable business or have a positive forecast of earnings.

Assets Approach

Values a business's tangible (equipment and real estate) and intangible assets (patents, trademarks, and software) minus debts and liabilities. This approach considers the current fair market value of the business's assets and the future return on investment that the owner could get from those assets. Best Use: Capital-intensive business, (i.e., manufacturing or transportation) or businesses that aren't profitable yet.

Market Approach

Values a business based on how much comparable businesses have sold for. Best Use: Accounts for local factors and can confirm a price based on one of the other two approaches.

Sales Agreement Contract

Have your lawyer draft or review the sales agreement or bill of sale. This legally binding contract between the buyer and seller outlines the terms of the business sale, including tangible assets (e.g., inventory, equipment, furniture, building, etc.). intangible assets (e.g., goodwill, brand value, etc.), intellectual property (e.g., patents, copyrights, etc.), and customer lists. It will protect you from unclear expectations, fraud, or misunderstandings. Includes:

- Buyer and seller names and contact information
- Description of goods, services, or property being purchased
- Payment amount, dates, and method
- Liability of each party in the case of loss, damage, or delivery failure
- Ownership information, such as when ownership formally transfers to the buyer
- Notices, or clarification of how the parties will communicate regarding the transaction
- Dispute resolution outlining how to resolve disagreements
- Delivery details (if applicable)
- **More information**

Capital - Funding Your Business

Capital is critical to the success of acquiring and running a business. It is wise to **factor working capital into the purchase price** and to ensure you have funding after you buy your business. Many women start or purchase their businesses through personal savings, but consider that you have more options that can help you purchase your business, give you breathing room, and spend money post-purchase. Examine these options for funding your venture:

Family Money - Be sure you and your family know the tax implications for gifts and family loans. Document the exchange of money in writing and follow IRS rules for family loans.

Seller Financing - Some sellers will agree to holding a note, or accepting staggered payments. This may be preferable option for some as it may provide them with a guaranteed income. Understand seller financing rules, especially if you use another form of debt financing. For example, if you take out an additional SBA loan, the seller must agree that they won't be paid back until you pay off the SBA loan.

Partner Up - Partnerships allow you to divide the payments while still owning that company. Taking on a partner when buying a business isn't only useful to cut costs, it can be helpful to bring on a different skill set and spread the responsibilities. Remember to draw up a partnership agreement.

Sell Stock to Employees - By organizing your business as an S corporation or C corporation you can sell company stock to your employees. This method may allow you a big discount — making up 50% or even 90% of the business price. Tip, sell non-voting stock to retain ownership.

Leasing the Business - Instead of buying the business right away, you might be able to purchase it down the road. Not all sellers will be open to this option, but it's a lower-risk option that may allow you to save up more money and become more familiar with the operations. Leasing may also cost more money in the long run.

Debt Financing - With a financial history, cash flow analysis, and assets, your business is a less risky option than a startup, so small-business loans may be an option to consider.

Term Loan - A loan in which borrowers receive a lump sum upfront from their lender and repay the loan on a predetermined schedule.

SBA Loan - SBA loans work where other lending options do not. These loans are guaranteed by lenders like banks and credit unions. They may require smaller down payments, offer more favorable interest rates, and have specific qualifications.

Asset-Based Financing - A loan or line of credit issued to a business, secured by some form of collateral, including but not limited to inventory, equipment, accounts receivable, and other balance-sheet assets.

Close Checklist

It's time to transfer over the business. Review the checklist and be prepared.

- ☐ **Bill of Sale**
  This document, signed by you and the seller, proves the actual sale of the business and officially transfers ownership of the business's assets to you.
- ☐ **Adjusted Purchase Price**
  This is the final count of the cost of your purchase, including all prorated expenses—like rent, utilities, and inventory.
- ☐ **Lease**
  Leasing your location? Ensure your landlord knows. You may need to negotiate a new lease.
- ☐ **Vehicle Documentation**
  Buying any vehicles? If so, transfer ownership at the ND Department of Transportation. Complete these forms by the time of sale.
- ☐ **Patents, Trademarks, and Copyrights**
  Patents, trademarks, and copyrights may require forms to be transferred.
- ☐ **Franchise Paperwork**
  File any franchise documents. Review **SBA's Guidance for Buying a Franchise**.
- ☐ **Non-Compete Agreement**
  A standard practice is to ask for the former owner to sign a non-comete agreement.
- ☐ **Consultation/Employment Agreement**
  If the seller will become your employee after the sale, **file this agreement**.
- ☐ **Asset Acquisition Statement**
  The **IRS Form 8594** lists the assets and their values acquired for tax returns.

Best Practice: Ensure you get a new EIN although you are not required to. EINs help separate your personal and work finances. To simplify accounting and bookkeeping, and to limit liabilities, get a new one once you take ownership.

ENJOYING THIS CONTENT?

Ask your business coach about NDWBC's other resources for more information on:

- Business Model Canvas
- Closing a Business
- Writing a Business Plan
- Marketing Your Business
- Buying a Commercial Building
- Checklist for Starting a Business
- Understanding Business Credit
- And other topics...

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SBA U.S. Small Business Administration

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