The Steps to Buying a Business

Are you considering buying a business? It's a commitment that involves a lot of time and money. Make sure you're prepared and become familiar with the legal steps involved before making the jump.

A vital component of any successful business is ensuring you follow the correct processes before getting started. Here are five steps you should follow when you're in the market to buy a business.

1. Do Your Research

The first step is to research each prospective business properly. Find out their strengths and weaknesses, as you want to get a clear sense of what you'll be buying. For example, you should request the company's:

- Financial statements
- Lists of customers and suppliers
- List of employees, including a breakdown of salaries and years of service
- Details of any major contracts necessary for the operation of the business, including the lease of any premises
- List of all equipment and assets of the business
- Any related debts, licenses and liabilities (Gift Cards, Account Credits, Alarm Contracts are frequently overlooked)

The seller may insist you sign a non-disclosure agreement before sharing this information. They want to prevent you from using it for anything other than buying the business. Remember that any documents you're asked to sign should be shown to a lawyer to ensure you're not making unwise legal commitments.

Use available government databases to verify that the information provided is correct. These searches will show, for example, whether there are any liens on the business assets, unpaid taxes, ongoing lawsuits, human rights complaints, and whether the seller owns certain buildings or vehicles.

2. Decide on a Structure for the Purchase

The structure of the purchase is the most basic aspect of the deal. This includes who will be buying and selling, if shares or assets will be bought, the price, and when and how that amount will be given to the seller.

Who is Buying and Selling?

Private companies operate most businesses. So, in most cases, all important items associated with the business – like the inventory, the trademark, and so on – will be owned by a company. As a result, when you buy a business, you will first need to decide:

Who will buy the business?

Will it be you personally or through your company?

What will be bought?

Will you buy the shares of the company that owns the business or the business assets directly?

In nearly every case, it makes sense for a buyer to make the purchase through a company. It limits the risk to other things owned by the company and puts your personal assets out of reach of creditors. There are also tax benefits to operating a business through a company.

Will Assets or Shares be Bought?

Buying the assets means that you'll be in a contract with the company that owns the business. Buying shares means you'll be in a contract with the person or people who own the company. This requires a high level of trust in the information the seller offers.

A main advantage of buying the assets of a business is that it gives you a better sense of the specific assets and liabilities you'll have when the transaction is complete. This means you won't be surprised by unknown or undisclosed liabilities. It also gives you more flexibility and control over what you're buying. For example, you can decide that only certain employees or assets will be transferred to you.

The downside of buying the assets is that certain one-time transaction costs connected to the purchase may be more expensive. There's also a risk that if the business goes sideways, the seller, as a private company, may have no other assets. But you'll still need to be compensated. One way to deal with this risk is to insist on ongoing commitments or responsibilities, called indemnities, from the person or people who own the company.

What Price will be Paid? When and How will that Amount be Given to the Seller?

Deciding on a dollar amount for the value of a business is only one element of the price. It's more complex than deciding on a price and paying the seller on a particular sale date.

The business will likely be active around the sale date, which means inventory, accounts receivable, and other items will be in flux. A cautious buyer may insist that a portion of the price be held back for some time to ensure that the information offered by the seller is correct and that profit expectations are met. If you cannot pay in a lump sum, set out a payment plan in annual or monthly installments.

3. Negotiate Other Terms

Contract terms are not just about the structure of the purchase, sale date, or if there's a personal indemnity if the seller is a company. The number and type of terms to be negotiated can vary depending on the risks associated with the business.

For example, in an asset sale of a business with many employees, the seller may insist that you take on all the employees, while you may want only a few. The seller may also refuse to fire employees on the eve of the purchase. Even if you intend to re-hire employees after making the purchase, this is an essential process as it can influence the amount of severance you might have to pay should things not work out after the change in ownership.

To prevent the seller or the seller's owner (if the seller is a company) from creating a competitor business after the sale, you should insist they sign a Non-Competition Agreement.

4. Have the Legal Documents Prepared

The buyer is generally responsible for preparing the legal documents, which are often complex and lengthy. These documents must be sent to the seller's lawyer for review before being finalized.

Letter of Intent, or Term Sheet

This first legal document is used to record the basic aspects of the deal early on. It helps prevent misunderstandings and avoids having to renegotiate any key terms close to the sale date.

Purchase Agreement

This main legal document covers everything connected to the purchase. It builds on the content of the Letter of Intent, speaks to significant details of what both parties are agreeing to, and anticipates situations where things may not go as planned.

The seller's representations and warranties are one of the most important parts of this agreement for you. This puts the seller on the hook for the information they gave about the business and aims to ensure you're getting what you paid for.

The description of the assets and liabilities related to the business that you'll assume is another crucial part of this document. They're usually included in the schedules section attached to the main agreement.

Consent of the Landlord or Franchisor

Many purchases will also involve a document showing the consent of the landlord or franchisor, each of which might be necessary for the deal to move forward. Depending on the type of sale and individual situation, there may be other documents your lawyer must prepare, including the Non-Competition Agreement mentioned above.

5. Final Tips to Keep in Mind

Buying a business is a complicated process. Here are some final tips to ensure you're starting with your best foot forward:

Know what to focus on

Take one thing at a time. Do the proper research before committing to the purchase. Once you understand the risks involved, come to an agreement with the seller on basic terms and spend time on the details. Write a list of priorities and concerns you can refer to as the sale date nears. And don't let the seller control the process or keep you in the dark on any issue that's important to you.

Get the right advisors and rely on them

Good advice can be worth more than it costs. Don't make this commitment without having someone help and direct you toward success.

Know when to walk away

Buying a business costs time and money. If the information from the seller doesn't add up, or the risks are too great, it may be more advantageous just to walk away. Trusting your instincts could save you a lot of money and frustration.