

Buying a Business: A Process Overview

Knowledge is power, and this article will give you a high level overview of the business buying process so you can proceed with confidence. The exact process you go through may vary depending on whether you are dealing with a broker, or directly with an owner. The process can also vary from broker to broker, or owner to owner, but the concepts will remain largely the same. Be sure to talk with your attorney regarding the specific requirements in your state, as these can vary substantially.

At the highest level, there are seven basic steps in the process:

1. Find a business
2. Initial review of financial information and the general operations of the business
3. Determine the price at which you want to make an offer based on initial information
4. Prepare a Letter of Intent (see the BizByOwner “Critical Documents Package”)
5. Prepare the Purchase Agreement (see the “Critical Documents Package”)
6. Conduct due diligence and finalize negotiations and agreements
7. Proceed to closing

Process Details

After you have followed the steps outlined in the BizByOwner *Search Techniques* article and identified a business that meets your criteria, the steps that follow will help you understand the process in detail and get the deal to closing.

- 1. Inform your Attorney and CPA that you are actively searching for a business to buy.**
 - A good transaction attorney and a CPA will be valuable resources for you throughout the process of buying a business. If you have not yet established these relationships, now is the time to do so.
 - Buyer Representation: A quality business intermediary (business broker) may be of value to you in your search. You may want to consider retaining one to help you find a business and negotiate the deal.
 - If bank financing applies to your situation, contact a bank early on to learn about the process and requirements for obtaining bank based financing. Consider choosing a bank with Preferred Lender status with the Small Business Administration (SBA).
- 2. Arrange for a meeting with the buyer to tour the business and review information.**
 - Before calling, review the BizByOwner *Questions to Ask the Seller* article, included in the BizByOwner **Buyer’s Tool Kit**.

- Review preliminary information about the business prior to committing to an onsite visit—there's no reason to waste your time or the seller's if the basic finances and market position of the company don't meet your needs. A quality seller will have prepared a comprehensive package like the BizByOwner Business Offering Package to present the information on his or her business. If they have not prepared a comprehensive, professional presentation, refer them to bizbyowner.com.
- Review and take with you the BizByOwner **Site Visit/Inspection Checklist**, included in the Buyer's Tool Kit.
- At some point, the Seller may request that you sign a Confidentiality Agreement and an Investor Profile—these are standard, but review their terms carefully, particularly as it relates to damages for breach of confidentiality. *Have an attorney review any agreements about which you are unsure or have questions.*

3. Review all information provided to you about the business.

- Be prepared for your first meeting to get the most value possible out of it, but multiple meetings may be necessary with the business owner to address all of your questions or new questions that come up.
- Be detail oriented when reviewing financial information, looking for inconsistencies in the information itself, and between the information and verbal representations that have been made about the business.
- Ask your CPA to *briefly* assess any financial information (your CPA will do a more thorough analysis and verify all financial information during the due diligence phase described below).
- Ask your attorney to briefly assess any significant contractual relationships that the business may have and on which the value/ongoing success of the business is dependent (again a more thorough review will be necessary during the due diligence phase).
- Your advisors are critical to your success, but manage your use of them in a way that maximizes their value for their fees—there is a role for them early on, but the final stages of due diligence and purchase contracts is where their greatest value lies. **DO NOT BUY A BUSINESS WITHOUT HAVING YOUR ATTORNEY REVIEW THE PURCHASE CONTRACT AND A CPA REVIEW THE FINANCIAL STATEMENTS.**

4. If your initial reviews of the financial information, the facilities and other aspects of the business are satisfactory, it may be time to make an offer.

5. Formulate the offer.

- Determine key components of the Deal Structure (all of these will be included in your offer)
 - Asset Purchase vs. Stock Purchase
 - Setting the offer price and terms

- Allocation of the Purchase Price
- Identify your due diligence requirements
- Consulting terms (Seller training period)
- Terms of the seller's Covenant Not to Compete
- Will you require employment agreements with employees?
- Closing time frame
- Have your attorney and accountant review key components, particularly the implications of a stock versus asset purchase agreement and the purchase price allocation.

6. Make the offer.

- Letter of Intent (LOI) and/or Purchase Agreement (PA)
 - The Letter of Intent can be more or less comprehensive, but primarily gets a number “on the table” for negotiation purposes, as well as outlining the general terms of a potential deal. Sample/template LOI's are available in the BizByOwner ***Critical Documents Package***.
 - The LOI can be binding or non-binding. Clearly a binding LOI has more serious implications for a buyer and may require that earnest money accompany it.
 - Some processes may try to move directly to a final and binding Purchase Agreement and skip the LOI altogether. It is definitely in the Buyer's interest to start out with a LOI, and then proceed to the final Purchase Agreement after agreement is reached on the more general terms in the LOI. It is also far more desirable to have a non-binding LOI. A non-binding LOI still requires that you proceed in good faith with regard to the contemplated transaction.
 - Always have your attorney review the LOI prior to submission. Attorneys are a critical and valuable part of your process, but remember that while your attorney is there to protect and advise you, it is always up to you to determine whether the protection afforded is worth losing a deal over what may be minor details from a business perspective.

PROCESS NOTE: Understanding Due Diligence. During your initial review, you are taking much of the information at “face value.” Due diligence is that phase at which you validate the information you previously took at face value. For example, the financial statements say sales are \$1 million per year, but during due diligence you may want to review bank statements, cash register record tapes, sales tax reports, sales receipts, bookkeeping ledgers, etc. to validate the \$1 million number. Depending on the seller or applicable laws, due diligence may take place under the LOI or under the PA.

7. Negotiating and accepting the deal.

- There are two primary points when you are involved with negotiations: general parameters at the time of the LOI; and all the final details of the deal at the time of the final Purchase Agreement.

- The seller or the seller's attorney will always counter your offer. Not necessarily on price, but at least on terms or specific wordage. Again, listen to your attorney but also rely on your own independent business judgment.
- Once all negotiations are agreed upon, the final LOI will then be drafted and executed.

8. Perform due diligence.

- See PROCESS NOTE, above
- Review the BizByOwner ***Due Diligence Checklist***, included in the Buyer's Tool Kit.
- These items should be verified before proceeding to the next steps in the process. Your CPA will be instrumental in this process. Your Attorney will also be important in this process, especially if the business has contractual relationships, patents, trade marks, etc.
- If you have not done so already, now is the time to get your bank involved if you need to finance a portion of the purchase price through a financial institution.

9. Finalize the purchase agreement (PA).

- The LOI usually calls for the execution of the PA upon the satisfaction of due diligence. If earnest money was not tendered with the LOI, it will be now. Earnest money should never be paid to the Seller—it should be paid into the escrow account of the closing attorney, or another attorney acceptable to both parties (if a broker is involved, it can go to the broker's escrow account). Verify with state licensing authorities that the broker is in good standing.
- The PA will identify the targeted closing date.
- The PA is always binding and will identify all of the details of the deal.
- Depending on how extensive the LOI was, the final Purchase Agreement may be executed at Closing. While it can be in a buyer's interest to bind themselves with a PA later rather than sooner, executing it at closing can introduce significant last minute obstacles, and it may be in your best interests to have the PA executed a week or two before closing so that all parties can "have their ducks in a row" at closing.
- During the Purchase Agreement process (possibly beginning during due diligence), final negotiations on the details of the deal will be completed. The various other documents and agreements needed to consummate the deal (which should have been referenced in one form or another in the LOI) must now be agreed to by the parties, i.e. – Purchase Agreement, Consulting Agreement, Covenant Not to Compete, Lease Agreement/Assignment, Promissory Notes, Security Agreements, Assignment Agreements, etc. *Your Attorney must be involved in this process to either prepare the documents/agreements or review the documents/agreements prepared by yourself or other parties.*

10. Prepare escrow and closing documents.

- If not finalized in prior phases, you should instruct your attorney and the seller's attorney to prepare the closing documents in accordance with your negotiations. The attorney handling the closing will need a copy of the Purchase Agreement.
- Any "Conditions to Closing" identified in the Purchase Agreement must be satisfied.
 - Financing Commitment from bank, Lease Assignment from landlord, utility transfers, new business entity established, etc.
 - Be very aware of the deadlines in your agreements and your responsibility to provide notice that you cannot fulfill any conditions required (like obtaining financing). *Follow the guidelines and requirements you have agreed to in the various agreements—or you could lose your earnest money!*
- Review the BizByOwner **Closing Checklist**, included in the Buyer's Tool Kit.

11. Go to escrow and closing.

- The day has arrived – your dreams have become reality!
 - It doesn't necessarily matter what day you close on, but don't close late in the day as that does not allow time to make adjustments or revise documents if last minute changes take place.
 - Many sellers and buyers like to close on Fridays or Mondays or on the last or first day of the month. Just determine what works best for the operational cycle of the business.
 - Have your cash equity in place and available the day before closing (don't lose your cashier's check!).
 - The day of closing typically belongs to the buyer, even though the purchase transaction may finish after the opening hours for the business.