

Basics of Buying a Business

Adapted from content excerpted from the American Express® OPEN Small Business Network

Buying an existing business can be a much less risky and more quickly profitable venture than starting your own business from scratch. But it's not entirely risk free and your success will depend heavily on how wisely you choose and evaluate the business you buy.

Here are the "tires to kick" as you begin investigating a prospective business purchase. These items are not meant to substitute for an in-depth evaluation - which you will want to conduct once you've gone through this first step. **Check on the item listed below to learn more about what you should be looking at.**

- 1. Financial statements*
- 2. Payables and receivables*
- 3. Employees*
- 4. Customers*
- 5. Location*
- 6. Appearance of facilities*
- 7. Competitors*
- 8. Registration, licenses, zoning*
- 9. Image*

1. Financial Statements

Look at both financial statements and tax returns from the past 3-5 years to judge both the current fiscal health and financial trends. Make sure you see figures that are accompanied by an audit letter from a reputable CPA firm.

Don't accept a simple financial review or a compilation, because those are based on figures supplied by the company. Is the business in sound financial condition? Do financial statements match tax returns? Are sales and operating ratios in line with the industry average? Your accountant can help you analyze these figures to determine the net worth of your company.

2. Payables and receivables

Check the dates on invoices to see the business is keeping up with its bills. Normal payment times vary from industry to industry, but generally 30 to 60 days is standard. If bills are being paid 90 or more days past the invoice date, the owner may be struggling with cash flow. Also find out whether any liens have been placed against the business because of unpaid bills.

Inspect the accounts receivable with a skeptical eye; often their stated value is somewhat inflated. Take a close look at the dates on them to determine how many are delinquent and by how long. This is important because the older the receivable, the lower its value and the greater the chance that it will never be paid. While you're at it, make a list of the business's top ten accounts and run a credit check on them. If the majority of customers or clients are credit worthy but late to pay, you may be able to solve the problem with a more rigorous collections policy. If the clientele is financially unstable, start looking for another business.

3. Employees

Key personnel are an important asset to many businesses. You need to determine how critical the employees are to the success of the business. You also need to look at their work habits to determine if these are people that you can work with. How long have these key employees been with the company? Will these people remain with the company after a change of ownership? What incentives will you have to provide to get them to stay? Can any key employees be easily replaced? What are their relationships with customers, and would customers follow any of these employees if they were to leave? Also look at the role the current owner plays in the company. Is this a role you want to play? Are there any current employees who can take over those responsibilities if necessary?

4. Customers

These are the most important asset you may be buying with the business. Make sure they're as solid as the other tangible assets you'll be acquiring. Does the clientele have a special relationship with the current owner (long-time friends or relatives)? How long have these accounts been with the business and what percentage of the income do they represent? Will they leave or stay when the business passes to new hands? Does the current owner or manager seem to have good relationships with the customers? Is there a written policy for handling customer complaints, returns, disputes, etc.? Has the owner supported the local community or the industry?

5. Location

This is especially important if you are buying a retail business. How important is location to the success of the business? How good is the location of this particular business? Is there sufficient parking to make it easy for customers to visit? How dependent is the business on walk-in trade? What does the future hold for the area? Is it in the process of rapid change from new residential or business complexes on the way? Will the location become more or less desirable because of contemplated changes in the neighborhood?

6. Appearance of facilities

The environment in which a company operates can tell you a lot about it. Take some

time to eyeball the company's physical location. How does this place look to you? Did you have a good first impression when you entered? How well is it maintained? Is there any outstanding maintenance work to be done - leaky roof, peeling paint, poor signage? Is the place well organized out front and in the back where inventory is kept?

7. Competitors

When you're buying a business, you need to understand the competitive environment in which it operates. Pay attention to industry trends, and how they might affect the company you're considering. How competitive is this industry? Who are your competitors and what are their tactics? Are price wars common in this business? How has the competitive environment changed recently? Have any competitors gone out of business? Why? You can track this information by contacting an industry association or reading trade publications.

8. Registrations, licenses, zoning

Make sure that key business licenses and other legal documents can be easily transferred. Determine what the process for transfer would be, and what it would cost, by contacting the proper state and local authorities. If a company is a corporation, what state is it incorporated in? Is it operating as a foreign corporation in its home state?

9. Image

How a company is perceived can be a serious asset or a liability that can't be judged from a balance sheet. There are a wide range of intangibles that you need to consider when you're evaluating a company -- everything from the way it services its customers to how it answers the phones to whether or not it supports the community or the industry. This category is often referred to as "goodwill." Talk to customers, suppliers, competitors, banks, and owners of other businesses in the area to learn more about this firm's reputation. Remember that it is very difficult to change a negative perception.