HOW TO BUY A BUSINESS?

EVERYTHING YOU NEED TO KNOW

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Interested in buying a business? Consider the benefits – and drawbacks – of buying a business that already exists.

Buying a business is a big decision – but when you pull the trigger on buying an existing business, you get the opportunity to become an entrepreneur without starting a small business completely from scratch. Every year, more than 500,000 businesses change hands, and that number is expected to skyrocket in the next several years as millions of baby boomers begin retiring and selling their businesses.

Buying an existing business is so popular because it lets you skip past some of the pain points and costs of starting a new business. But the journey from finding a business for sale to closing the deal can be long and complicated.

Before you begin the journey of buying a business of your own, find out everything you need to know to avoid buyer's remorse. Our buying an existing business checklist will give you a step-by-step guide. We'll also cover the pros and cons of buying a business when you're still just thinking about the idea, and end with how to buy a business when you're ready to close the deal and get the keys.

Buying an existing business checklist

If you're set on the idea of buying a business, then it's crucial to make sure you pick the right business for you. The easiest way to set yourself up for success is buying a business that you're passionate about improving and taking to the next level. But passion alone isn't enough – experience and knowing which questions to ask when buying a business are also important when making your choice. Here is your buying an existing business checklist:

1. Figure out what type of business you want to buy

Narrow down your passions, interests, skills and experience. You'll be happier if you buy a small business that dovetails with what you already like and have some experience in.

For example, if you've been a line cook at a restaurant for several years, maybe you've decided you'd like to own your own restaurant. Or maybe you've been an employee for a long time at a company that's now on the market. In that case, who better to buy the business than someone who knows it as intimately as you?

Although you might just want to buy a business for the financials alone – by its expected return on investment – it's also important to align yourself with the business's immaterial goals. After all, the more knowledgeable and familiar you are with the business's model, products or services, customer, industry and trends, the more innovative and successful your new ideas will be.

2. **Search for business that are for sale**

There are plenty of ways to find the right business for sale that fits the criteria you've decided on. These include:

- Online business marketplaces such as bizbuysell.com, the largest site of its kind with more than 45,000 active listings.
- Craigslist ads.
- Classified newspaper ads under the "Businesses for Sale" category.
- Asking people in you network of small-business owners.
- Going to meetups or industry conferences to ask other business professionals.
- Working with business broker.

Business brokers legally represent the seller, so you should be careful about conveying certain information to them (such as how far you're willing to go in negotiations). However, a broker can help you understand what kind of business you want, prescreen businesses to cut out all the failing companies, keep negotiations civil and smart and help you with all the necessary paperwork. Brokers do earn a commission when a sale goes through, but it's typically paid by the seller.

3. **Understand why an existing business is up for sale**

There are plenty of reasons a business owner might put their business up for sale, including something as simple as an innocuous lifestyle choice like retirement. Or, there might be a more worrisome reason, like a fundamental problem with the business. If you're about to buy a business. You'll want to know exactly why the businesses you're considering are no longer working for their current owners.

You should ask the current owners what challenges they've encountered, what they've done to try solving those problems and how those attempts fared. During every conversation with the current owner, you should ask yourself, "Do I have what it takes to meet these challenges with different or better solutions?"

Be on the lookout for:

- A poorly conceptualized business plan (there's just not a market for the product or service).
- Competitors that are far ahead.
- Existing business debts.
- Location problem.
- A brand issue.

- 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.).
- Bad equipment (it's outdated and too expensive to upgrade).

Make sure you know as much as you can about the existing business's successes, failures, challenges and future opportunities. In addition to speaking with the owner about these concerns, also talk to existing customers, existing employees, locals in the area, neighboring businesses and so on. They'll give you an honest view of how the business is doing, without the bias of the seller trying to convince you to buy.

4. Narrow in on a business that aligns with your budget, goals and resources

Until now, you might have been considering several different businesses, but now it's time to hone in on the best option. The best option is the business that aligns with your budget, goals and resources.

Calculating the ideal size, location, sales, staff, and so on of your prospective business is an important step in your plan of buying a business, since it will give you a scale to keep in mind when you're shopping around. Figure out how much you'd ideally want to change a business, and assess how much that will cost you.

Money isn't the only thing you'll be spending. Look at the time and energy commitments you're planning to invest to make the business your own. Some managers prefer to be "on" at all time, in the weeds with their employees, while other prefer to delegate and, one day, own multiple businesses.

The amount of resources you'll have to invest depends in large part on the people and processes already in place and on the experience you have in the industry. For example, if you're buying a tech company but lack technical expertise, you'll need to invest time learning the ropes or hiring people who have the experience

5. Do your due diligence

Due diligence is the process of gathering as much information and intel as you can before buying a business, and it is a critical step in your journey to becoming a business owner. During this period, you should work with an accountant and lawyer to make sure you have all the information you need to move forward.

As the buyer, you'll want to have a good accountant on your side to review the business's financials. It's also beneficial to have a good business attorney to represent you in negotiations and to help you understand how the transaction will be structured.

Before you can begin your due diligence, the seller will most likely ask for a signed confidentiality agreement or nondisclosure agreement. By signing, you agree not to disclose any confidential information about the business that's uncovered during the due diligence process. This protects the seller in case you decide buying the business is not for you after reviewing all the documents.

There are many business documents, files, agreements and statements that you'll want to collect and analyze, ideally with the help of a lawyer and accountant. Here are some of the must-have documents when doing due diligence in the process of considering whether to buy a business:

Business licenses and permits

First up is to make sure that the business you're looking at has all the business license and permit it needs. If you’re buying a business, you want to make sure that the current owner hasn't run afoul of any local business licensing laws. Businesses in certain industries, particularly highly regulated ones like food services and childcare, need a valid permit to stay open.

Organizational paperwork and certificate of good standing

If the business you're buying is a sole proprietorship or partnership, there may not be official "founding" paperwork. However, a registered business entity, such as an LLC or corporation, will have organizational documents on file with the state. For an LLC, this is the articles of organization. For a corporation, this is the articles of incorporation.

The secretary of state in your state should also be able to produce a certificate of good standing for the business you're interested in buying. This certifies that the business is approved to operate in the state.

Zoning laws

Check with your area's local zoning laws to make sure that you're buying a business that isn't violating any restrictions. While some localities allow mixed-use commercial and residential zoning, others have tight restrictions on where businesses can be located. This especially goes for businesses like bars and nightclubs that may not be desirable in a residential area.

Environmental regulations

Has this business been secretly dumping chemicals into the nearby reservoir or violating other environmental laws? Make sure the answer is a firm no before moving forward with buying the business. Double-check that this business abides by all of the area's small business environmental regulations.

Letter of intent

or LOI, to the buyer when both sides have agreed on a price point and about which business assets and liabilities will be included in the transaction. The price proposal, along with the terms andconditions of the business sale, should all be included in the seller's LOI.

The LOI is an indication from the seller that they are serious about seeing the deal through to the end. Once you have it in hand, you can feel more comfortable forging ahead with the remainder of due diligence.

Contracts and leases

Half the fun of the decision to buy a business is all the stuff it comes with. Whether that means a lease for the location, equipment or something else, you'll want to make sure the landlord is alright with transferring over these legal documents to your name. Otherwise, you'll need to negotiate a new lease, which can significantly add to your expenses.

You'll also want to review any outstanding agreements that the owner has with vendors or customers. This can be very revealing. For example, if your review indicates that 90% of the business's revenue comes from a single client, you'll want to think twice before buying. If that client parts ways with the business, it could put a serious dent in the business's potential.

Business financials

Before buying a business, make sure to examine its past few years of financials, including:

- Tax returns.
- Balance sheets.
- Cash flow statements.
- Sales records and accounts receivable.
- Accounts payable.
- Debt disclosures.
- Advertising costs.

Double-check that the tax returns and financial statements have passed an audit by a certified public accountant; don't accept those financials from the sellers themselves.

Use the business's financials as an opportunity to analyze its income stream. The business you purchase doesn't necessarily have to be profitable yet (particularly if it's a young business), but there should be a clear path toprofitability.

Be in the know on whether the business's debts and liabilities will be included in the transaction or not, and be wary of taking these on. For example, if some of the outstanding receivables the ex-owner was dealing with are too old – 90 days or more, for example – then they'll be pretty tough for you to collect on. You might be better off asking the seller to insure them or contact the customers themselves.

Organizational chart

If you buy a business with employees, make sure you understand how they rank and relate to one another by asking for a business organizational chart. This should also include compensation data, management practices and processes, benefit plans, insurance and vacation policies.

Status of inventory, equipment, furniture and building

Make sure to critically analyze these aspects of the businesses, since their values will directly impact the cost of the business. You'll want to check:

- What's on hand.
- Its quality.
- How sellable it is, both in terms of market viability and its condition.
- How fast and for how much each type of inventory has sold in the past.
- The present condition of equipment and furniture versus its original selling price.
- Whether it was maintained well or needs repairs.
- Whether the furniture will be useful to you or if you'll need to replace it to be operational or for aesthetic reasons.
- If you'll need to make larger modifications to the building.
- And other similar questions.

Sites like whayne.com can be used to look up equipment and obtain price estimates.

Other important documents

This list of documents will tell you a lot of information about the business, but there's probably more you'll want to examine. Your attorney or accountant should be able to identify additional documents specific to the business you're interested in.

For example, ask the seller for property documents, equipment/asset listing, brand assets for advertising materials, an account of intellectual property assets, business insurance coverage, employee policies and contracts, incorporation information and customer lists.

Once due diligence comes to a close, you'll need to make your final decision about whether buying the business is right for you. If you decide to go ahead, the sales agreement is what ties it all together.

The agreement will enumerate the final purchase price and everything you're purchasing, including:

- Tangible assets (inventory, equipment, furniture, building).
- Intangible assets (goodwill, brand value, etc.).
- Intellectual property (patents, copyrights, etc.).
- Customer lists.

Have a lawyer help you put this document together or, at the very least, review it carefully before you sign.

6. **Evaluate the price of the business with the earnings, assets or market approach**

This is where many deals fall apart because buyers and sellers often place very different values on the same business, and several factors affect a business's value.

Buyers and sellers usually use some kind of pricing model to get a ballpark number and frame negotiations. During this process, it can be very helpful to call in an independent business valuation professional to make an objective determination of value. Valuation services, which can be found online or through word of mouth, cost around $3,000 to $5,000, but they can save you thousands more in the long run by coming up with a good estimate.

Whether you do this yourself or hire someone, it's helpful to have some knowledge of different business valuation methods. To get some insight, we spoke with Mike Bilby, CPA and certified valuation analyst, at Concannon Miller.

Bilby said small businesses should understand three main approaches to valuing an existing company when they're considering how to buy a business:

Earnings approach

Best used for: buying existing businesses that are already turning a profit or have a positive forecast of earnings.

The earnings approach values a business based on its historical, current, and projected profits. Specific methods you may come across that fall into this approach include the capitalized earnings method and discounted cash flow method.

For businesses with a history of fairly stable profits, that history can be used to anticipate future earnings and value the business. Even if a business hasn't generated a profit yet, earnings models can be used to predict how much the business might earn in the future. The disadvantage of the earnings approach is that it relies on a prediction of future earnings, which may not be accurate.

Assets approach

Best used for: buying capital-intensive businesses, such as manufacturing and transportation businesses, and businesses that aren't profitable yet.

The assets approach measures the value of a business's tangible and intangible assets minus debts and liabilities. Tangible assets include things like equipment and real estate, and intangible assets include things like patents, trademarks and software. The assets approach considers the current fair-market value of the business's assets but also the future return on investment that the owner could get from those assets.

Market approach

Best used for: accounting for local factors or confirming a price that you arrived at based on one of the other two approaches.

The market approach measures the value of a business based on how much comparable businesses have sold for.

It's a good way to get a ballpark range for a business's value and to account for local factors that the other approaches may miss, such as the business's location in a particular neighborhood.

It might be confusing to get all these approaches straight in your head, but the point of all of them is to assess the current financial health of the business, as well as its growth potential. In reality, Bilby says, none of these methods exists in isolation. All three of these approaches can be used to arrive at a fair price for a business, and the final price will always be the one that both the buyer and the seller agree on.

7. Secure capital to make the purchase

Once you and seller agree on a number, the next step in buying a business is to get the money. There are a few different ways you can gather the capital you'll need to purchase a business – some specific to buying an existing business, others pretty standard.

Here are some of the ways to finance a business acquisition:

Use personal or family money

If you're able to cover the costs of buying an existing business, that's always an option. This is more likely if you're buying a small business rather than a chain. Of course, you'll want to consult your accountant before ponying up a large lump sum of your own cash. Also, make sure that you're not using all your money buying a business because running a business takes capital, too.

Many businesses are also funded with money borrowed from family. If you go this route, you should understand the tax implications for gifts and family loans. Make sure that you and your family member put 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 – sort of like a lender. This way, they get guaranteed income for the coming months (or years, depending on your plan).

There are rules around seller financing, particularly if youplan to use another form of debt financing as well. For example, sellers have to be on "standby" if you're also getting an SBA loan, meaning they have to agree that they won't be paid back until you pay off the SBA loan.

Some sellers might also be willing to trade in some assets, like some furniture they really loved or the company car, for a lower price.

Partner up

By turning to a partnership instead of buying a business solo, you can divide the payments you'll be making while still owning that company.

Taking on a partner when buying a business isn't only useful to cut costs, though: You can also bring someone on board with more specific experience or a different skill set. Just don't forget to draw up a partnership agreement, so co-ownership doesn't cause any problems down the line.

Sell stock to employees

By selling company stock to your employees, you can get a big discount – making up 50% or even 90% of the business price by some measures. You'll probably want to sell non-voting stock, if possible, to retain ownership over the business. In order to issue stock, you'll have to organize the business (or re-organize it) as an S corporation or C corporation.

Start by leasing the business

It might be possible for you to lease the business instead of buying it outright – with the option to make the big purchase down the road once you're able to afford it.

Understandably, not all sellers will be open to this option, since they more likely than not want to wash their hands and walk away from the sale. However, if leasing is something you'd be more comfortable with even though it may cost more money in the long run you might as well ask.

Debt financing

alternative lender with for financing: financial histories, tax returns, employee records, cash flowanalyses, inventory and equipment valuations, and much more. This wealth of data makes business acquisitions a good candidate for loans because lenders aren't working with a risky blank slate.

If you're looking for a small-business loan, here are a few potential financing options that might help in buying a business:

- Term loan.
- SBA loan.
- Asset-based financing.

Getting a business acquisition loan is typically easier because the lender has a history to assess. But just like with any business loan, lenders will scrutinize all of the following:

- Borrower's personal credit score.
- Business credit report and score.
- Annual revenue.
- Time in operation.
- Tax returns.
- Balance sheet.
- Cash flow.
- Outstanding debts.

For term loans and SBA loans for when you buy a business, banks typically require buyers to put down a 20% to 25% down payment on acquisition loans. However, the SBA recently made some changes that make it easier for buyers to obtain SBA 7(a) loans for buying a business. Now, the SBA requires the buyer to put down just 10%, and only half of that (5%) has to come from the buyer's own cash. The rest can come in the form of a seller's note as long as the seller agrees to be on full standby – meaning that the seller won't be paid back on their note until after the bank is paid.

When getting a business acquisition loan to help with buying a business, you'll also have to provide a formal business valuation (like we discussed before), explain your relevant experience, offer an updated business plan, and show financial projections for the business under your command. In short, you'll want to tell a story of how you'llimprove the business.

8. **Close the deal with the appropriate documents**

The last step in our buying an existing business checklist is to close the deal.

When you've finally found the right business, done your due diligence, agreed on a fair price and gathered the capital you need, make sure you (or a broker) have all of these documents, notes and agreements in place before you officially buy a business:

Bill of sale

When buying an existing business, this document will prove the actual sale of the business, officially transferring ownership of the business's assets from the seller 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

If you're taking over the business's lease, make sure your future landlord is in the know. On the other hand, if you're negotiating a new lease, double-check that everyone understands its terms.

Vehicle documentation

Does the business you're buying come with any vehicles? If so, you might have to transfer ownership with the local DMV – make sure to get the right forms completed by the time of sale.

Patents, trademarks and copyrights

Similarly, when buying an existing business, all patents, trademarks, and copyrights might require certain forms to get transferred to you, the new owner.

Franchise paperwork

Check the SBA's Consumer Guide to Buying a Franchise to see if you'll need to file any franchise documents.

Non-compete agreement

It's standard practice – and generally a good idea – to ask for a non-compete from the former owner. This way, the previous owner won't set up a competing shop right across the street.

Consultation/employment agreement

This document should be drafted in the case that the seller is staying on as an employee. Make sure to file this agreement if so.

Asset acquisition statement

The IRS Form 8594 will list the assets you've acquired, and for how much. This document is pretty important in the "buying an existing business" checklist for your tax returns, so don't forget it.

Bulk sale laws

Bulk sale laws have to do with the sale of business inventory and are designed to prevent business owners from evading creditors by transferring ownership of the business to someone else. To comply, prospective buyers usually have to notify the local tax or financial authority about the pending sale.

And that's everything you need to know about how to buy a small business. But knowing how to do it is one thing, knowing why you're doing it is another. So let's talk about reasons for buying a business.

Reasons to buy a business

Buying a business is kind of like being in the market for a home. Although some people like the history and character that comes with an older home, others don't want the baggage that can saddle an older home and prefer something turnkey. Similarly, there are plenty of advantages when you buy a business that's already been around for a while, but there are drawbacks, as well.

Pros of buying a business

Proven business concept

When launching a brand-new business, the bulk of your time will be spent on the planning phase. You'll have to write a business plan and figure out how to turn that plan into a reality.

But when you buy a business that's already up and running, you'll typically have all of this in place:

- A building or office space.
- Inventory and equipment.
- An established brand and business brand identity (whether or not you want to change it, people know it).
- Customer base.
- Vendor and supplier base, plus manufacturing resources.
- Existing employees who can share their knowledge and expertise.
- Management processes and policies.
- An understanding of your competition and market.

Granted, each of these things may not be in great condition, and the business might not be turning a profit yet. However, buying an existing business means it has some structure already in place, which will save you time upfront, letting you quickly see what you need to zero in on. Particularly if you're testing a new market or entering an industry that you don't have much experience in, zipping past the difficult startup phase can be a huge advantage.

Lower operating costs

One of the major benefits of buying a business is that the operating costs are lower. For example, startup costs for a brand-new restaurant can run upward of $450,000 for initial supplies, food and beverage, signage and a customized kitchen design. With an existing business, your initial operating costs are lower because unless your acquisition is pretty atypical – many parts of the business are already in place and ready to go once you're at the helm.

You don't need to spend as much of your budget on hiring employees, developing marketing strategies or building a customer base because those come with the transaction. Instead, you can pour more cash into expanding the business and adapting it to your vision.

Easier to obtain financing

While the move to buy a business isn't always a safe bet, lenders and investors see it as lower-risk than launching a new company. This is because there's a history of financial performance that a lender or investor can use to gauge how the business has performed to date and to predict future performance. Plus, there's also existing data around the company's market position, competitors, brand recognition and customer base.

All this makes investors more likely to invest in the business and can make lenders more comfortable in giving you a business acquisition loan. The current owners can even participate in financing the transfer of ownership by giving you a loan.

Intellectual property is on the table

If your business-to-be has patented their products or has a copyrighted slogan or trademarked logo that wins over customers, then that intellectual property value will probably transfer over to you in the acquisition. That means when you buy a business, you sometimes buy more than what the eye can see.

This isn't on the table with every business acquisition, but it could be critical if you're dealing with something thatyou think could be expanded even more. What if you turned this small business into a national franchise? All of a sudden, that patent and copyright becomes a lot more valuable. Patents, copyrights and trademarks are often included in sales of software companies, tech businesses and creative businesses (e.g., music, design and art).

Cons of buying a business

Higher upfront purchasing costs

By buying an existing business, you'll be able to save money on operating costs, such as inventory and equipment. However, you'll probably face some pretty sizable purchasing costs. In fact, those purchasing costs might be greater than what it would take you to start a new business.

That's because, in addition to the obvious assets, you're also buying ownership over the following:

- Customer base.
- Built-out brand.
- Design work, from logo to store interior.
- Business concept and plan.
- Time, effort, and money spent testing out products.
- Refined processes, procedures and policies.
- Income stream (if the business is already profitable).
- Assets and equipment.
- Intellectual property, such as copyrights, patents and trademarks.

All of these items will be the subject of negotiations between the buyer and seller and factor into the final purchase price when buying an existing business.

Unfamiliarity with the details

If you're buying a business you didn't start, you'll understandably be a bit less familiar with it's inner workings and the details of its products, processes, employees and financials than if you built the business yourself. This could be a bit of an obstacle, especially when you're just starting out. This is especially true if you are entering an industry that you lack experience in. You'll need to spend a lot of time learning the ropes, and preparefor the learning curve to be steep.

Risk of a hidden problem

As a prospective business buyer, you'll go through a fairly intensive due diligence process, where you'll gather information about the business and the current owner. But no matter how much information you uncover, you always run the risk of taking on an issue that you're not aware of or that's worse than it appeared. For example, equipment could be damaged, or the brand might have a bad reputation. Once you buy a business, you buy those issues, like it or not.