



## Important things to consider when buying a business

### Introduction

Mr. Prakash Raniga and his team have acted for numerous clients contracting to purchase businesses, and these businesses have ranged from restaurants, franchises including Spudbar, Subway, Pizza Hut, Dominos, convenience stores, petrol stations, Tatts outlets, bakeries and other similar businesses. The initial contact for most of the interested purchasers is business brokers, and we have seen in recent times that most business brokers are preparing their own contracts, or getting purchasers to sign binding Heads of Agreement. It is important to note that business brokers act for the best interests of the vendors, and relying on them without securing independent legal and accounting advice could be risky.

There is also a tendency amongst clients, especially from the Sub-Continent, to assume that the only major transaction in taking over a business is to secure the Transfer of Lease. In some instances, clients have already taken over control of the business prior to even securing a Transfer of Lease, including making full payment of the agreed price. These individuals have put themselves into a very risky position, whereby the landlord could refuse to transfer the existing lease, and take advantage of the position by forcing a new lease with increased rent and other onerous conditions.

### Checklist

If you are considering buying a business there are many things you need to do from a legal, financial and general business perspective. Getting the right advice from the start is important. The structure of and issues involved in the sale are quite different if you are buying the business assets only, compared with the shares in the company that owns the business.

In this article we will highlight some of the key issues to be considered.

Making sure you follow the right process before signing any documents is a key component of a successful business purchase.

The main things to do before signing a contract are:

- Research
- Get professional advice
- Review & understand all documentation

## Research

Proper research involves checking the records of the business and other information to ensure:

- Sales are as good as the owner says they are
- The business systems are sound and documented
- The business does not have any problematic legal obligations or liabilities
- All necessary information, rights and assets will be included in the sale
- Cash flow is sustainable
- Employees will be happy with a new owner
- Customers will remain loyal once you take over
- You understand the operation of and opportunities in the market/industry
- In relation to any cash businesses, the vendor will try to impress you that the gross takings do not reflect the real business takings as there is a cash component
- If you are purchasing a business, over and above the business's value based on the tax return, then it is prudent to purchase the business on the condition that there is a trial period, on the condition that if the business does not secure that amount in a two week period, then you have the ability to terminate the contract with full refund of the deposit.
- Needless to say that a purchaser will have difficulties relying on representations made in relation to cash components or undisclosed components of the business.

Research should, where possible, be carried out before you sign any contracts.

## Professional advice

You should always consider briefing and engaging legal and accounting advisers to assist you in conducting due diligence and documenting the transaction, to avoid legal and financial (including tax-related) "surprises" and arguments down the track.

You might also consider whether there are any industry specific experts that may be useful.

Professional advice will not be able to assist you if you purchasing a business such as a restaurant or convenience store, and the vendors are purporting to sell the business at a premium price, on the basis, that the business secures gross takings over and above what has been disclosed. A professional accountant would not be able to assist you, and the only way you will be able to verify the accuracy of the representation is by ensuring

that the business indeed has a gross taking to the extent matching the representation rather than the disclosed tax records. Again, it is prudent to purchase the business on the condition that there is a trial period with an option to terminate the contract.

## **Review and understand the documentation**

When purchasing a business there is a lot of documentation to be gathered, read and understood.

The seller may require you to sign a confidentiality agreement to stop you from using confidential information for any purpose other than buying the business. You should make sure you fully understand the agreement before you sign it.

Some of the information you should gather and review is outlined below.

### **Financial statements**

It is sensible to obtain current and historical financial records for the business, including:

- Profit & loss statements
- Balance sheets to identify assets and liabilities
- Lists of debtors and creditors
- Copies of any BAS's lodged by the business

### **List of plant, equipment, assets and stock**

You should obtain a list of all plant, equipment, assets (including fixtures and fittings) being sold along with current valuations, proof of ownership and information on applicable warranties and guarantees.

Details of any stock sold with the business and how it will be counted and valued at settlement should be discussed and agreed with the seller.

You should also undertake thorough searches of the Personal Property Securities Register to, for example, ensure that security interests necessary for the business have been registered (such as over sale equipment leased to third parties) and to check whether any relevant security interests are held by third parties.

### **Lists of customers and suppliers**

Customer and supplier relationships form part of the goodwill of the business and a list of all available contact details should be supplied so that you can make contact and ensure an ongoing relationship.

### **Employees**

If the business is being purchased as a going concern and the buyer is assuming liabilities for employees then a list should be provided – setting out the

employees, their job descriptions, salaries, years of service, any disciplinary issues and accrued entitlements like holidays and long service leave.

### **Important Contracts**

Any major contracts necessary for the operation of the business should be provided and reviewed, including copies of the lease of the premises and any plant & equipment leases. Term, assignment, change of control and termination provisions, in particular, should be checked.

If any sale assets are financed the financier's consent will be necessary.

If the business is a franchise the seller is required to provide a franchisor's disclosure statement.

## **Documenting the transaction**

After completing your due diligence you will need to have the transaction documented with a legally binding contract. There are many issues to consider.

### **Structure**

You will need to decide on the structure of the transaction and it is crucial to get advice on the legal, financial and taxation consequences of the structure you adopt.

The types of things that need to be considered include:

- Whether you are buying the assets of the business or the shares in the company that owns the assets.
- The price to be paid and when it is to be paid.
- Who will the buyer be - an individual, company, trust or partnership?

Deciding on whether to buy the assets or the company is a critical issue when buying a business. There is no simple or right or wrong answer to this question as it will usually depend on the business being purchased and the individual circumstances of both the buyer and the seller.

Things to consider when making a decision include:

- The amount of flexibility and control you want over what you are buying.
- Do you require all of the assets of the business, or all of the employees?
- Do you want to be responsible for past liabilities (known and unknown) of the business which might relate to employees, suppliers or customers?

## Price and Terms of Payment

Once the price is agreed you will need to determine how and when the price will be paid.

For additional protection you may want a portion of the price to be held back for a certain period to ensure that information given by the seller is accurate or that profit projections are achieved.

You may not want to pay the price in a lump sum and may be able to negotiate to pay in monthly or annual instalments.

You will need to take into account that the business will probably be continuing right up to the sale date, which means stock, accounts receivable and other items will need to be finalised at a certain time and in an agreed manner.

## Legal Contract

The main legal document is a contract for sale of business. The sale contract sets out the various terms agreed to by the parties, including for example:

- the rights of the parties if things go wrong;
- the seller's representations and warranties, which are designed to ensure that:
  - the seller remains responsible for the information given to you about the business; and
  - you get what you pay for;
- a non-competition provision which prevents the seller from creating a competing business after the sale; and
- (if a lease or franchise is involved) the consent of the landlord or franchisor.

## Section 52 of the Estate Agents Act 1980 (Vic)

Vendors selling a small business valued at less than \$350,000 has to provide the purchaser with a section 52 statement in writing, and if this is not provided to the purchaser, then the purchase can avoid the contract provided the purchaser has not taken over the business.

In relation to the purchase of restaurants and cafes, this condition would not apply if there is a liquor license held by the business.

The section 52 statement is in a prescribed form, and must disclose information including historical data of the business, trading hours, gross takings, outgoings, and the like.

## **Conclusion**

Buying a business can be a complex transaction. You need to make sure you have done adequate research, understand the risks and have received the right advice.

Mr. Raniga, and his team have been acting for both vendors and purchasers of businesses for more than 30 years.

If you are considering buying a business and would like some help please contact us on 03 9387 2424 or email [info@rrrlawyers.com.au](mailto:info@rrrlawyers.com.au).