What's It Worth?
Business Valuations, Mergers, Acquisitions, and Consulting
NEWSLETTER ARTICLE ARCHIVE

What are the steps involved in negotiating the purchase of a business?

Lately, I have had many calls from owners who were being courted by outside buyers. The question that is asked most often are: What should I expect? What are the typical steps in the process? Below you will find the typical steps that a buyer will work through.

If you are an individual, or a management team backed by investors, here are just a few of the first questions that need to be answered before you begin your business search, additionally we have listed the Steps of Purchasing a Business after you have determined that owning your own company is the right thing for you.

- What return on investment, return on equity and personal salary do you wish to obtain?
- How many hours do you wish to work each week and how long do you plan to own the business before you cash out?
- What personal fulfillment do you wish to obtain?
- What is your range of liquidity for a down payment and working capital? Are you willing to use debt financing?
- If an individual, do you have money set aside to handle your personal living expenses while a business is located and a deal is struck?
- Do you have the necessary money set aside for due diligence once a target business is found?
- What are your interests and skill sets?
- Does your spouse and family support your goals and objectives?

These are just a few of the basic questions that need to be covered to help you determine what businesses, if any, are suitable for your goals and aspirations.

Steps of Purchasing a Business

Buyer Criteria Defined: From the questions above, your acquisition criteria should become defined in order to help develop the target acquisition markets. Also, you must develop a Profile Summary to provide Sellers once a business has been located and has an interest in selling. This profile will be a blend of a resume/company history and a personal or corporate financial statement

Financing Approval: If you require debt financing, you should meet with a financing institution prior to your search in order to become pre-qualified as much as possible.

Acquisition Search: With the buyer acquisition criteria defined, a search is begun. This can be through professional broker networks, broker multi-lists, direct mail letters to target markets, etc.

Summary Review: You can obtain limited information from Sellers depending upon the source of the potential seller. Examples of information included would be; Total Revenue, Seller Discretionary Cash Flow, Reason For Selling, Number of Years In Business, Number of Employees, and other limited information. Generally, (unless the Seller has allowed it), you will not know the name or location of the business at this stage if you are reviewing a summary from a Seller who is using an intermediary. If you decide to move forward, then you will review a broader summary on the company generally under the guidelines of a non-disclosure and confidentiality agreement.

This summary (also called portfolio, confidential memorandum, etc.) generally should include: a normalized balance sheet and normalized income statements for 3 to 5 years. It will also have all the information in a basic business plan. The summary should answer most of your questions so that you can quickly determine whether to proceed further. If the Seller is not already on the market, this information will be provided in a piece meal fashion.

Meeting the Seller and Touring the Physical Location(s): Once you have chosen to move forward after the provided information, generally a meeting is scheduled between the Seller and you. Depending on the business, it may be necessary to develop a Letter of Intent before meeting the Seller. This can be requested to prevent both parties wasting time if agreement on the basic terms is unbridgeable. The employees rarely know that the business is for sale, and therefore, you must come after hours or meet off the business premises. If the meeting takes place during business hours, it will probably be necessary to take measures to prevent employees from becoming aware of your intentions.

Key Employees are brought into confidence once a deal has been signed but not closed, or late during Due Diligence. The reason employees and customers are not made aware of the sale is that their questions about changes cannot be answered until you have made decisions concerning the future directions of the company.

Term Sheet; Letter of Intent; Offer to Purchase: Generally, after a few more limited questions are answered, the time has come for you to produce a Term Sheet; Letter of Intent or Offer to Purchase. As the phrase goes, the Term Sheet basically lays out the terms of the deal. Once these have been accepted by the Seller, a Letter of Intent or Offer to Purchase can be presented.

A Term Sheet simply goes over the basic facts; price, cash or terms, what is being purchased-assets (which assets) or stock, etc. If a Term Sheet is used, this is presented to the Seller. Once the parties have agreed upon these basic facts of the Term Sheet (if used), the next step would then be a Letter of Intent or Offer to Purchase. Both the Letter of Intent and the Offer to Purchase have listed contingencies that must be met. If these contingencies are not met, then the Buyer or Seller has the option of walking away from the deal. Contingencies include items such as: Buyer's approval and acceptance of the Books and Records; Financing; obtaining a lease with the same or satisfactory terms from the landlord, etc.

The difference between a Letter of Intent and an Offer to Purchase is basically in the fact that once all the contingencies are met the Offer to Purchase becomes binding, whereas the Letter of Intent is not binding. Both documents, however, may have earnest money tied to them.

Many times, the earnest money agreement can be a complete separate document. Most earnest money agreements state that if the Buyer does not purchase the business, the Buyer will forfeit their earnest money unless the transaction does not close due to no fault of the Buyer.

Seller's Acceptance of Purchase Terms and Due Diligence: Once the Seller and Buyer have agreed upon the terms in a Letter of Intent or Offer to Purchase with contingencies, Due Diligence begins-generally lasting 30 to 60 days. During this period, the Buyer will present a detailed list of items for review. These items generally include any supporting documentation that the Buyer wishes to review to verify the representations of the Seller. At this stage of the transaction, a Buyer generally has accountants and or certified public accountants assist in this process. Any environmental issues would be addressed during this period as well. This process is typically done in a fashion which will not develop concern from employees.

Purchase Contracts and Closing Documentation: Towards the end of the Due Diligence period or afterwards, both parties begin preparing the purchase agreement and closing documents. Generally, the Buyer is responsible for producing the purchase agreement and the majority of the closing documents. Attorneys for you and the Seller work with the intermediary to coordinate efforts and reach the desired closing date.

Closing: The closing is generally held at the buyer's attorney's office, though closings can actually be conducted through the mail and electronically. The Seller is responsible for the business up and through the date of closing. The day after is the beginning of your new adventure.

Transition Period: Depending on your background, it can be very important to you that the Seller stays on for a transitional period. Depending upon the situation and the company, this period can be from two weeks to 2 years. On some occasions, there is no transitional period if you are already an industry player. Compensation for the Seller during the transitional period is negotiable, but it is traditionally included as part of the transaction for a period of two to four weeks.

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