

Buying a Business Guide

Many articles offering a guide to buying a business begin with a brief run through of the attributes needed to own and/or run a business. They generally include the desire to work hard, an entrepreneurial spirit, the required skill-set for a specific sector and a degree of resilience. If you're interested enough in buying a business to read an article on what the process actually involves in legal and financial terms, however, then it's probably fairly safe to assume that, at the very least, you've convinced yourself that you have those attributes in full. Taking that as read, any attempt to buy a business - which is already up and running or one which has been placed in liquidation or administration - is far more likely to succeed with an understanding factors such as structuring the sale, arriving at a correct valuation and performing due diligence.

According to [Statista](#) there were almost 6 million private sector businesses in the UK in 2020, a figure which had risen virtually year on year from 3.47 million in 2000. Of these businesses, more than 99.3% were what is considered to be 'small and medium sized businesses', [according to figures](#) collated by the Department for Business, Energy and Industrial Strategy (BEIS). Although definitions vary, a small business is generally regarded, for accounting purposes as being one which has a turnover of under than £6.5 million and employs less than 50 people, while for a medium business the figures are £25.9 million and 250 respectively. There are currently 472,300 businesses with between 5 and 49 employees in the UK and these are the businesses – rather than the 4,457,820 which consists of only a sole proprietor – which are likely to be bought and sold in the immediate future. Finding a business which suits your requirements means searching on the basis of aspects such as where the business is located, whether it can be relocated, what any current asking price is, how long the business has been listed as being for sale and whether any premises are being sold as leasehold or freehold. Deciding you've found a business which you are genuinely interested in means getting the right answers to these questions and then embarking on a process beginning with deciding the structure of any potential sale, valuing the business, agreeing a price, performing due diligence, arranging finance and completing the sale. In addition there will be other issues to consider such as your legal responsibilities to any existing employees and statutory obligations which might apply to specific industries.

Structuring the Sale

In the simplest terms the sale is likely to be either a share purchase or an asset purchase. The choice of which will be dictated by how much of the business the buyer wants to acquire and/or the seller wants to dispose of, a decision which will be informed by aspects such as the tax implications of each type of sale.

A share purchase sale involves the buyer purchasing the business – as a limited company - complete with existing workforce and contracts, in addition to which they will be taking on any obligations and liabilities already in place. An asset sale is far less sweeping, in that it involves the buyer choosing the specific liabilities and assets which they wish to acquire with, in the majority of cases, all other assets and obligations remaining with the seller. The one 'asset' which will always change hands under an asset sale is the workforce, which will usually be automatically transferred to the control of the new owner under current employment terms.

The tax implications of this decision may be a deciding factor. Under a share purchase the seller could make use of entrepreneurs' relief from capital gains tax to pay only 10% on the money made from the sale rather than 20%. If the same company makes an asset sale they will be taxed on the profit made, while the shareholders will be taxed again if and when they draw the money involved from the company. These implications could play a role when negotiating the final price. A buyer may be aware, for example, that making a share purchase will impact positively on the tax burden faced by the seller, which could prompt them to offer a lower purchase price. At the same time, the seller will know that an asset sale will involve contracts having to be transferred to the new owner, a process which might involve the buyer having to negotiate with the parties currently holding those contracts. This complication could see the seller presenting a share purchase as the preferable option for both parties, and therefore not something which should impact on the final selling price. This is just one of the many aspects which are likely to impact on the process of negotiating that selling price.

Valuing the Business

The structure of the sale aside, there are many aspects which feed into calculating a fair price for the business. The complications involved mean that it will often pay dividends to seek professional, expert advice when valuing a business, from someone like an accountant or transfer agent, but whether expert help is sought or not, the first stage of building a detailed understanding of the full value of a business will involve ascertaining precisely how healthy it is. Obvious metrics to look at will include current sales and profits as well as the cash flow, existing debts, budgeting and any forecasts. It's important not to take the situation as it pertains at the time of a potential sale at face value, but instead to look at trends such as whether sales are declining or increasing in the long term, and how this is impacting on profits over a sustained period.

As well as the obvious aspects driving valuation, such as tangible and intangible assets, it's important to ask questions such as why the business is being sold, if it is involved in any on-going litigation and whether there are legislative changes in the pipeline which are likely to impact on the operation of the business. While tangible assets – such as stock, plant and machinery and premises – are fairly obvious, intangible assets are, by their nature, more difficult to define, but might include any of the following:

- The reputation of the business
- The goodwill it has established amongst customers
- The relationship it has with suppliers
- The on-going value of any licences which it holds
- The on-going value of any patents or intellectual property

A prospective buyer could also look at the price fetched by any comparable businesses in the sector which have recently sold, and the price being asked for those which are also on the market.

Agreeing a Price

It needs to be remembered that valuing a business is not the same as agreeing a price, and that the valuation reached by a prospective buyer may differ from that which the seller has in mind. A

detailed valuation, particularly if it is prepared by an expert such as a transfer agent, will provide a firm basis for any negotiation, but ultimately any business is worth what someone is willing to pay for it, and the longer the business has been on market, the more leverage a potential buyer might be able to place on the current owner. The buyer needs to have a maximum price in mind and the discipline not to exceed that price during the process of negotiation, and an initial offer should be made by phone and then followed up in writing. The written offer should include any conditions or requirements which the buyer is attaching to the offer, and should be headed 'subject to contract'.

As well as the amount to be paid for the business, the negotiation will establish exactly how payment will be made. In many cases this will be a single lump sum – indeed, the buyer may be able to drive the price down to some extent on the basis of promising a single, one-off payment – but alternatives include payment in instalments. This is also known as an 'owner financed' deal, and as well as enabling a buyer to spread the payments, it indicates a degree of trust on the part of the seller that the buyer will be able to make a success of the business, and will therefore be able to meet future repayments. In some cases the amount being offered will come with conditions relating to the future performance of the business attached.

Due Diligence

Up to and including the point at which an offer is accepted, the information gleaned by the prospective buyer is still likely to be relatively superficial and conditional on a range of suppositions. Due diligence is the process during which the prospective buyers is granted access to the books and records of the business in order to gain a completely realistic and highly detailed idea of the current and future performance of the business. If a buyer is carrying out due diligence on their own behalf, it would be advisable for them to seek the advice of an accountant or solicitor with regard to what they should be looking for, and in most cases it would pay dividends to ask the experts involved to undertake the due diligence on the buyers behalf. The period allowed for due diligence to take place is something else which needs to be negotiated between the buyer and the seller, but anything less than 4 weeks for a small business or longer for a larger business isn't likely to be enough.

During the due diligence process the following aspects of the business need to be examined:

- The full accounts of the business
- The corporate structure and any share ownership
- Major contracts and orders on which the business might be relying in the foreseeable future
- The terms and conditions enjoyed by employees
- The systems, processes and technology on which the business depends
- Any tax disclosures and pension obligations
- Any litigation which the business is involved in, or which may occur in the immediate future
- How the marketing for the business functions
- What, if any, research and development is in place

- Health and safety and environmental issues impacting on the business
- That any permissions and licences which are needed are in place

Due diligence needs to be as detailed as possible on the basis of the fact that UK common law contains the principle of 'buyer beware' – the concept that the onus rests on the buyer to find out any relevant information, and that the blame lies with them if they later discover something which might have impacted on their decision had they known it at the time of purchase.

In general terms the due diligence process can be broken down into legal and financial due diligence. Legal due diligence will cover aspects such as contracts, licences and IT systems, while financial due diligence will concentrate on the economic performance of the business and accounting details which will confirm or undermine the assumptions on which the buyer valuation is based.

Warranties

The due diligence process, and in particular the answers given by the seller to the questions asked by the buyer, will be used to form the basis of any warranties which the buyer demands in a final sales agreement. These warranties offer a layer of protection over and above due diligence itself, by creating a contractual assurance regarding the condition the business is in at the time of any sale. The seller will probably wish to negotiate the details of any warranties at great length in order to ensure that they are not exposing themselves to the risk of having to cover any liabilities which arise due to breaches of warranty after the sale has taken place. The warranties which the buyer wishes to put in place will also encourage the seller to disclose any aspects of the state of the business which might otherwise lead to a breach of warranty. By offering disclosure in this way, the seller is protecting themselves from being sued for breach of warranty at the same time as the buyer is accessing the maximum possible information regarding the state of the business. In many cases the warranties asked for will be indemnities – this means that if costs impact the buyer because a warranty has been breached, the seller will cover those costs. Any substantial issues which arise during the process of the buyer requesting warranties and the seller making disclosures may well be sufficient to impact on the final agreed sales price.

Finance

The process of due diligence and agreeing warranties will probably make it easier for a buyer to access finance, as they create a sense of certainty in terms of what the money is needed for. A bank which is approached for a loan to finance a purchase, for example, will want to see the accounts for the business, a fully referenced business valuation, cash flow projections and details of the buyer's personal liabilities and assets. In some cases a bank may provide finance on the basis of personal guarantees or security against the premises, stock or plant of the business. An alternative means of raising the money to cover the agreed asking price would be equity financing, which involves accepting investment in the business in return for a stake in that business, often in the form of angel investors or venture capital firms. While equity financing offers the advantage to the buyer of not having to risk personal assets or go into debt, coupled with the experience and contacts which many investors also bring, it does come with the caveat of the investors owning a stake in the business, and thus having input into decisions made and taking a share of the profits.

Further Issues

Although due diligence, warranties and financing are the main issues to be dealt with once a price has been agreed in the vast majority of cases, there are sometimes other factors to take into account. Some businesses may require the buyer to negotiate with third parties in order to ensure that relevant contracts and licences roll over to the new ownership, while if a business is regulated by the Financial Conduct Authority (FCA), prior approval from the FCA will be required, a process which generally takes up to 60 days to complete.

The most common additional factor to consider when buying a business which is a going concern is the responsibility borne by the buyer to any employees of the business. Any such employees are protected by the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) in the event of an assets purchase of a business. In simple terms, the regulations state that the employees should enjoy the same terms and conditions after the purchase as before, having been consulted by the seller before the sale goes through. Upon purchasing the business the buyer takes on liability for any claims based upon the existing contract of employment, up to and including claims for discrimination or unfair dismissal.

Completion

Completion of the sale – involving the transfer of the legal ownership of the business – can only take place after the stages outlined above have been completed. The processes from structuring the sale onward should guarantee that all questions have been answered, both parties are satisfied with the terms of the deal, and a Sale and Purchase Agreement setting all of the terms of the contract has been created. Once this has happened the finance can be transferred from the buyer to the seller, and the relevant contracts and licences transferred in the other direction.

Buying a Business in Liquidation or Administration

The administration process is designed to create a breathing space during which a failing business is offered relief from the pressures applied by creditors in the form of a moratorium on legal action. During this period a plan to 'save' the business can be drawn up, and in many cases the best course of action is to sell the business. While the relative desperation for a sale might result in the asking price for the business being lower than for one which is a thriving concern, any prospective buyer will have to ask themselves whether they have the skills, market knowledge and capital to turn the business around. Coming up with a useful answer to these questions will involve carrying out the kind of due diligence needed for any business, with added emphasis placed on discovering exactly what reputational damage the business has suffered and whether the market itself has shifted in a way which makes recovery difficult to envisage. If the buyer decides they want to purchase a business which is in administration they will not only have to come up with an acceptable price, but also to put together a plan for taking the business forward which is detailed and impressive enough to convince the administrators that the sale is a viable option for the business.

The issue of TUPE, as outlined above, will also apply to any employees of the business who have been kept on by the administrators after an initial 14 day period during which they can be made redundant. Many administrators, feeling that a sale would be the best route forward for a previously profitable business which is now experiencing difficulties, may opt to keep employees on in this way, particularly if the skill-set of the employees is a large part of what makes the business a viable option. If employees are kept on in this way, then any buyer purchasing a business in administration

will be liable for terms and conditions such as salary, holiday entitlements, notice period etc. As well as having a legal obligation to apply TUPE, any buyer would be sensible to consult with the employees of a business which is in administration in order to explain their plans for the business and ensure buy-in on the part of those employees.

If the company has been liquidated then it can't be purchased in this manner as it no longer exists. What can be purchased are the assets of that company, such as the premises, goodwill and client base, and the first point of contact for a prospective buyer will be the Insolvency Practitioner handling the liquidation. They will put any buyer in touch with the person(s) charged with valuing and selling the assets.