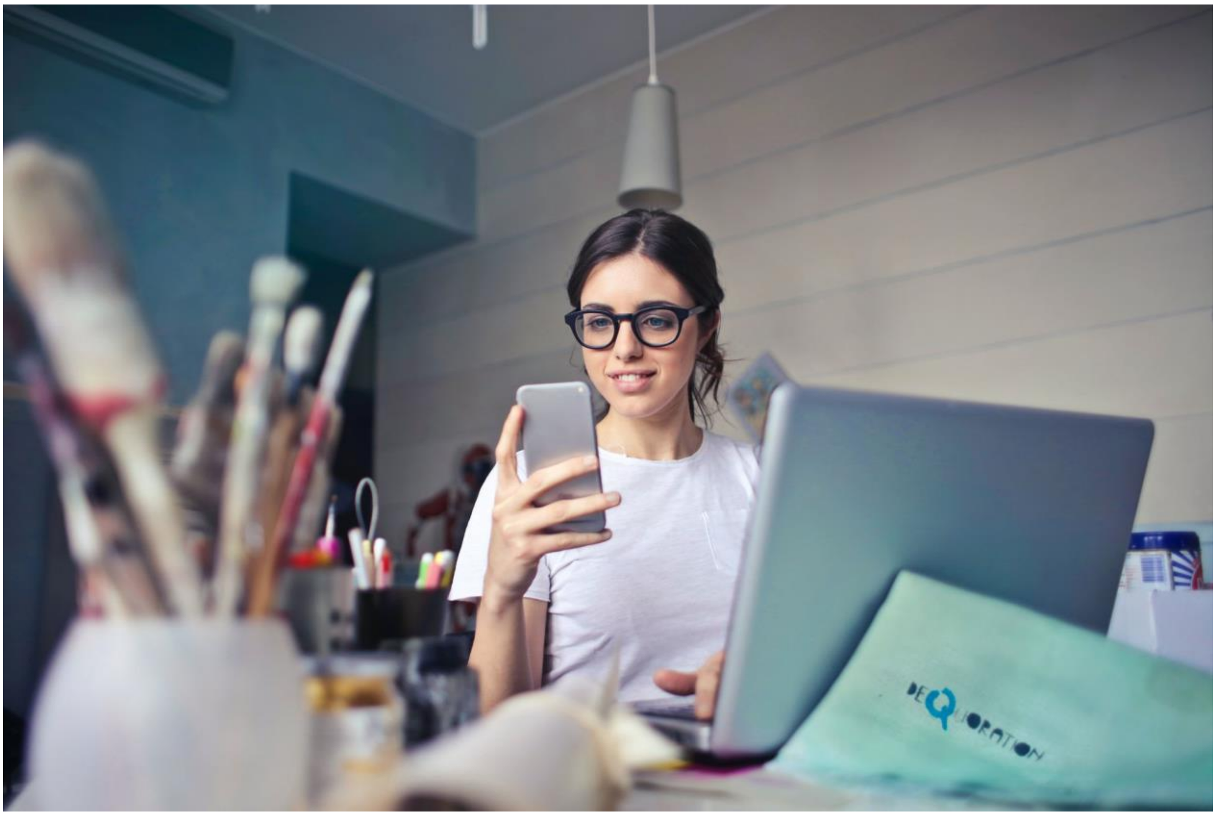
A Comprehensive Guide To Buying A Business

Source: Ava Smith

Abstract

Buying a business is a significant financial and strategic decision that requires careful planning, thorough research, and expert guidance. This guide provides a comprehensive roadmap to navigate the complexities of purchasing an existing business. From understanding your motivations and identifying the right opportunity to conducting due diligence and negotiating terms, every step of the process is explored in detail. Key topics include assessing market trends, evaluating financial health, understanding legal considerations, and securing financing options. Whether you're a first-time buyer or an experienced entrepreneur, this guide equips you with the knowledge and tools to make informed decisions, mitigate risks, and maximize the potential for success in your business acquisition journey.



1. Introduction

Purchasing an existing business can be a transformative step toward achieving financial independence, expanding your entrepreneurial footprint, or diversifying your investment portfolio. Unlike starting a business from scratch, buying an established business offers the advantage of acquiring an operational setup with an existing customer base, trained employees, and proven revenue streams. However, it also comes with unique challenges, such as assessing the true value of the business, understanding potential risks, and navigating legal and financial complexities. This guide aims to provide a clear and practical framework for buying a business, whether you're entering the market for the first time or looking to grow your portfolio. By exploring every stage of the process—from identifying the right business to negotiating a favorable deal and transitioning ownership—we empower you with the insights needed to approach your purchase confidently and strategically.

2. Rules To Quickly Find The Right Business To Buy

The search process to find and buy the right business is both the most time-consuming and generally frustrating part for individual business buyers. Part of the reason is the sheer number of businesses listed for sale, many of which are not worth considering. However, a deeper problem is that business buyers who do not have a lot of experience buying businesses approach the search the wrong way.

It is common for individual business buyers to spend endless hours searching business for sale listings trying to figure out which, if any, may be right for them. This is a backwards approach. Experienced and successful business buyers know the exact fundamentals that any business they consider must have in place and they zero in on their search accordingly.

While the scattered buyer wastes a ton of time looking, the prepared buyer spends their time on realistic opportunities.

Successful Buyers And Private Equity Firms Have It Right

Are you crystal clear about the five attributes a business must have in place for you to consider buying it? Chances are you cannot list them explicitly. Compare this to a PE firm. Ask them the same question and they will tell you the exact fundamentals they want in a business. Now, their list is not all encompassing, and they have a lot to still learn after the initial introduction to a company during due diligence, but in order to weed through the masses of businesses available, they have hard rules at the onset.

For example, they may only look at businesses where there is no customer concentration, the company has year over year growth, it is a B2B company, they already have a platform company in the sector or, they generate sales online and through brick and mortar.

What these hard-set rules allow them to do is to say “no” quickly and move on to more likely opportunities. This is where you can really learn from them. When searching you must learn to say “no” fast and carry on with your search. If not, you will waste months trying to find a good business.

Establish Your Five Golden Rules

You need to compile a set of unbreakable “Golden Rules” that you can stress test with any prospective business for sale. These rules are entirely personal and there are no right or wrong ones. However, you must be reasonable. For example, requiring that a company has been in business for ten years may provide some comfort to you, but think about how many you will be ruling out.

Make a list of all the key fundamentals business must have for you to even consider looking at it further. This should be the list that you use as your first step, whether that is from the business sale ad, or a notice from a broker, or someone suggests one to you. There may likely be a second step to learn more about the business since the online business for sale ads are often sparse or misleading and may necessitate an inquiry. In any case, this list is your guiding set of principles to either say a quick “no” or “maybe.”

Here are my rules, which are personal to me, but will give you some help as you think about yours:

The business must be sales and marketing driven (versus a manufacturing business for example where operational efficiencies may be key)

It must have an element of exclusivity either in its products (something unique) or in the geographical area it services

Demand for the products/services must be in place (a ready market willing to buy)

High profit margins

The business does not compete solely on price (this is not a sustainable model in my opinion)

The key is the list must be personal to you. You may not want a business that requires work on the weekends, or one that is relocatable, or can operate from home, etc., there are no wrong answers.

To assemble your list, write down all the key components a business must have that you can think of as being critical and unbreakable. Your list may be longer than five so narrow it down by prioritizing. The list may evolve for new buyers, but the goal is to establish one that you adhere to and do not breach.

Once your list is in place, then it is time to begin your search. Once you have your top five and you stress test every potential business against them, you will cut through all the clutter and quickly narrow down the group of potential businesses to good ones that make sense for you to consider investigating further.

3. Business Valuation

What Is a Business Valuation?

A business valuation is the process of determining the economic value of a business. It's also known as a company valuation. All areas of a business are analyzed during the valuation process to determine its worth and the value of its departments or units.

A business valuation is often used during the process of negotiating the merger or acquisition of one company by another but it might be used in other situations as well. Owners will often turn to professional business evaluators for an objective estimate of the value of the business.

How Business Valuation Works

The valuation of a business is the process of determining the current worth of a business using objective measures. It evaluates all aspects of the business. Business valuation is typically conducted when a company is looking to sell all or a portion of its operations. It's also used during a merger or acquisition of one company by another as well as when establishing partner ownership, for taxation, and even as a part of divorce proceedings.

A business valuation might include an analysis of the company's:

- Management
- Capital structure
- Future earnings prospects
- Market value

The tools used for valuation can vary among evaluators, businesses, and industries. Common approaches to business valuation include a review of financial statements and discounted cash flow models.

Methods of Valuation

A company can be valued in numerous ways. Each provides a different view of a company's value and no method is inherently more correct than another.

1. Market Capitalization

Market capitalization is the simplest method of business valuation. It's calculated by multiplying the company’s share price by its total number of shares outstanding.

Microsoft Inc. traded at $406.02 as of Aug. 9, 2024. The company could then be valued at $406.02 x 7.43 billion or about $3 trillion with a total number of shares outstanding of 7.43 billion.

2. Times Revenue Method

A stream of revenues generated over a certain period of time is applied to a multiplier which depends on the industry and economic environment under the times revenue business valuation method. A tech company may be valued at 3x revenue while a service firm may be valued at 0.5x revenue.

3. Earnings Multiplier

The earnings multiplier may be used instead of the times revenue method to get a more accurate picture of the real value of a company because a company's profits are a more reliable indicator of its financial success than sales revenue. The earnings multiplier adjusts future profits against cash flow that could be invested at the current interest rate over the same period. It adjusts the current P/E ratio to account for current interest rates.

4. Discounted Cash Flow (DCF) Method

The DCF method of business valuation is similar to the earnings multiplier. This method is based on projections of future cash flows which are adjusted to get the current market value of the company. The main difference between the discounted cash flow method and the profit multiplier method is that it considers inflation in calculating the present value.

5. Book Value

This is the value of shareholders' equity in a business as shown on the balance sheet statement. The book value is derived by subtracting the total liabilities of a company from its total assets.

6. Liquidation Value

Liquidation value is the net cash that a business will receive if its assets are liquidated and its liabilities are paid off today.

4. Buying a Business Vs. Starting one From Scratch

The process of starting a business from scratch can be very daunting and time-consuming. There are many things to consider, such as business structure, marketing, R&D/product development (if you're creating something), raising capital, finance, legal matters, etc. One of the first things you need to look at when starting a business is simply the amount of money it'll take to get the business off the ground. For many people, it can be difficult to come up with or raise the initial investment needed to start a business from scratch.

Let me be clear here, I'm not advocating against anyone starting a business or anyone building a new company at all. I've conceptualized at least 15 or so different business ideas and was able to bring a handful of them to life, although many didn't get off the ground or even go to market for that matter.

I think all entrepreneurs, at some point in time, should get their hands dirty in creating something from scratch. I think most will probably conceptualize an idea or two that they want to take to market because it may be the next greatest "thing," in their specific target marketplace, and they'll have an awesome learning experience doing so — and some will inevitably achieve the success that they imagined they would.

The many benefits of buying a business

With that being said, though, I think that the notion of buying an existing business may be a much better option both from a fiscal responsibility standpoint (and pragmatically, for that matter). When you buy a business, you're acquiring a customer base, established systems and processes, potential assets (physical and digital) and much, much more!

Another reason buying a business makes sense is that you can usually get it at a discount. This is because businesses often sell for less than their actual value, since the owner(s) may be motivated to sell quickly due to personal or financial reasons. And lastly, an existing business comes with an established reputation and goodwill, which can save you a lot of time and money in marketing and advertising costs.

These factors alone can give you a significant advantage over businesses that are starting from scratch. But the key to success in purchasing a business is finding "the right business" to purchase. It's subjective, I know, but there are some general frameworks that you can use to guide you and aid in your journey to evaluating and eventually closing on your first business acquisition.

There are more businesses for sale today than there are buyers

As you may or may not know, businesses for sale have grown exponentially in the last decade. There are many reasons for this, including the current state of the economy, retirement and quite a few others.

Business owners are facing financial difficulties in some instances and are unable to continue operating their businesses. While it may not seem like a good thing, in a down economy, there is an opportunity for those looking to purchase a business. I'm not suggesting that it's a time to take advantage of someone, but I am saying that you can acquire businesses for fair prices, in some cases, well under market value.

There's a significant cohort of business owners who are about to enter or seeking to enter retirement. They may not have family members or children to pass their business on to, so in some cases, businesses simply go out of business or cease to exist. Herein lies an opportunity, for you, as someone seeking to become a business owner.

It's easier for existing businesses to generate cash flow

Simply put, cash flow is the lifeblood of any business, big or small. It's the money coming in and going out, and it needs to be managed carefully to ensure the business is healthy and profitable.

It is generally easier for an existing business to generate cash flow than for a startup business or brand-new company. This is because an existing business typically has revenue streams from customers and other sources, while a startup or new company may not yet have any of those things. An existing business should be generating income through existing channels or specific sources that it currently employs.

Increasing cash flow is just as important as reducing expenses when it comes to boosting profitability. A business can only grow if it has enough cash on hand to invest in new opportunities. Remember: Increasing cash flow is essential for long-term success in any business.

You're purchasing a proven model

When you're starting a business, one of the inevitable questions that you'll be asking yourself is "How am I (or how are we) going to make money?" Fortunately, this isn't necessarily one that you're going to have to answer if you're buying an existing business. Existing companies typically have proven revenue models. This means that they've successfully sold and continue to sell its products or services. The repeatability of this model is what you're looking for when you're purchasing a company.

A startup business, on the other hand, may not have a proven revenue model because it has not yet sold its products or services. This can be due to a variety of reasons, such as the company being new and therefore having no track record, or because the products or services are not yet ready for market. Either way, a lack of a proven revenue model can be a major obstacle for a startup business.

There are many reasons to buy an existing business instead of starting one from scratch. Perhaps (as I've mentioned), the most compelling reason is that you're buying a proven business model. The riskiest part of starting a new business is figuring out whether your business model will actually work and be profitable. With an existing business, you know that the business model works and that the business can be profitable.

Hopefully, I've inspired you to jump-start your journey toward acquiring your first existing business! Remember, you need to completely educate yourself in business before you start trying to acquire them. There are inherent, built-in risks associated with business ownership that so many fail to recognize or understand. This isn't meant to discourage you, it's simply to let you know that the details really do matter in business, so don't overlook them!

5. Tips To Buy An Existing Business

If you're considering buying an established business, there are steps you should take before making an offer. Learn the pros and cons of buying a business, check if you're ready and find out what to do to before you buy.

Choosing the right business to buy depends on your needs and lifestyle. You should make sure you take time to research and understand the business and industry.

Buying an already established businesses can have advantages. Businesses that have a good business history are likely to understand how to run successful operations. It's also easier for these businesses to get financial backing from banks.

However, established businesses can also come with disadvantages. This can include outstanding contracts that you will have to address or a poor public image inherited from the previous owner.

Doing your research to ensure you're making the right decision is essential. You will need to check the businesses records, plans and operations and familiarise yourself with your competitors and the industry.

You should consider talking to a business adviser to help you through the process.

1. Check if you're business ready

Running a business is hard work and requires a lot of discipline. Before taking on a business consider the following to see if you are business ready:

Do you have the right skill set to start a business?

How much time will you need to invest in a business for the business to be successful?

Are you physically and emotionally ready to deal with unusual work hours and time pressure?

What are your personal goals and will starting a business help you achieve them?

Do you have the capital to invest in a business for it to be successful?

2. Find the right business

Finding the right business to buy can be time-consuming and challenging. Take time to consider your interests and background experience. This may help you narrow your search to an industry and marketplace that's right for you.

Once you've found a business that you're interested in buying you may want to consider:

Does the business have the potential to be successful?

What value can you bring to the business?

Is it in a good location?

Do you want a business that is already up and running and has an established customer base?

3. Do your research

Before you consider buying a business make sure you have done all your research first. Researching the business that you want to buy will allow you to understand its reputation and potential.

Market research can help you to understand the business's customers and the market it operates in.

You may also want to talk to existing customers, employees and neighbouring business owners to get a view on how the business is doing.

4. Value the business

Before you commit to buying you should determine the current value of the business and its potential growth. You may also want to get a professional valuation of the business's assets and liabilities.

5. Conduct due diligence

Gather as much information you can on the business you're interested in before you sign the contract. It's essential that you review all:

financial records

business operations

legal documents

These documents help you identify and manage any risks associated with buying the business.

To conduct due diligence you'll need to review items such as the business's:

Licences and permits – Does the business have all the correct licences and permits required to run the business? Are they up-to-date?

Contracts and leases – Will the landlord agree to the transfer of the lease into your name? Will you have to negotiate a new lease?

Agreements – Are there any outstanding agreements between the seller and suppliers?

Status of plant, equipment and fixtures – What kind of equipment and machinery does the business own? Are they in good working order and licenced?

Assets – What assets does the business have? Does it have any intellectual property?

Inventory – Is the inventory on-hand being included in the purchase? How is the inventory managed, stored and distributed currently? What is the current state of the inventory?

Financial due diligence

You need to independently collect and check the financial information about the business. Make sure you examine the past three to five years of financials including:

tax returns

business activity statements (BAS)

records of accounts receivable and payable

balance sheets

profit and loss records

cash flow statements

sales records

6. Make an offer

Once you have valued the business and conducted due diligence on it, you'll need to make a final decision about whether to make an offer to buy it. You may need to negotiate the purchase price with the seller before you reach an agreement.

After you and the seller have agreed on a price, you'll need a contract to give legal force to your agreement. The written contract ensures that both you and the seller clearly understand what each person agrees to.

5.1. Business For Sale Liverpool, Sydney

Liverpool, Sydney, New South Wales

$250,000

Located inside the westfield shopping center in the southwest region, near coles and an asian supermarket, with a prime location. - weekly revenu located inside the westfield shopping center in the southwest region, near coles and an asian supermarket, with a prime location. - weekly revenue: $18,000 on average. - high gross profit: resistant to downturns in eco...

Lanzhou Beef Noodle Shop

Cafe For Sale in Sydney NSW

Coffee Shop For Sale Liverpool Area NSW Cheap Entry Quick Sale NSW...

New South Wales

$15,000

Make an offer today! walk in walk out offers considered first! follow the prompts and enquire immediately so you do not miss your chance to snap this make an offer today!walk in walk out offers considered first!follow the prompts and enquire immediately so you do not miss your chance to snap this business up!situated next door to a retail powerhouse and in a high exposure loc...

Cafe and Coffee Shop Cafe and Coffee Shop

Coffee Shop For Sale Liv

Cafe For Sale in Liverpool Sydney NSW

Pizza/ Kebab Shop for sale in Sydney - 1SELL ID: 1AU0121...

Liverpool, Sydney, New South Wales

$60,000 + SAV

Pizza/ kebab shop for sale in sydney - 1sell listing number: 1au0121 pizza/kebab shop in south-west of the sydney. asking price $60,000 ideal pizza/ kebab shop for…

Conclusion

Buying a business is a major milestone that can unlock new opportunities, whether you're looking to embark on an entrepreneurial journey, expand your portfolio, or secure long-term financial stability. While the process involves various challenges—such as evaluating risks, conducting due diligence, and negotiating terms—a well-informed and methodical approach can significantly increase your chances of success. By following the comprehensive steps outlined in this guide, you can make confident, strategic decisions and ensure a smooth transition into ownership. Remember, the key to a successful acquisition lies in thorough preparation, expert advice, and a clear understanding of your goals. With the right mindset and tools, you can turn the process of buying a business into a rewarding venture that aligns with your aspirations and sets the stage for long-term success.

References:

The Golden Rules To Quickly Find The Right Business To Buy | Forbes, Retrieved 27 Jan 2025, from

https://www.forbes.com/sites/richardparker/2021/04/25/the-golden-rules-to-quickly-find-the-right-business-to-buy/

What Is a Business Valuation? | Investopedia, Retrieved 27 Jan 2025, from

https://www.investopedia.com/terms/b/business-valuation.asp

Why Start a Business When You Can Buy One? | Entrepreneur, Retrieved 27 Jan 2025, from

https://www.entrepreneur.com/starting-a-business/why-start-a-business-when-you-can-buy-one-heres-what-you/432348

Buy an existing business | Business Government Australia, Retrieved 27 Jan 2025, from

https://business.gov.au/planning/new-businesses/buy-an-existing-business

Business For Sale Liverpool, Sydney, 2170 | Business2Sell, Retrieved 27 Jan 2025, from

https://www.business2sell.com.au/businesses/nsw/sydney/liverpool