

The best and worst of deals

One of the original American oil tycoons, J D Rockefeller, once said, "Some of the best business deals I ever did were the ones I walked away from." In this article Eddie Aickin, of PKF Francis Aickin, gives some guidance on what needs to be done to determine whether a business proposition is one to embrace, or one to walk away from.

Let's start out with a basic fact: buying a business means that someone else, the vendor, is going to benefit.

The vendor will be approaching this from their point of view, not with your interests in mind.

The business is an extension of themselves, and there will therefore be an emotional attachment and value to it.

Due diligence is the process that specialist advisers use to assist buyers to ensure that the buying decision is as well informed as possible. It should be a thorough exercise.

Although my due diligence questionnaire can include about 100 checkpoints and questions, it is essentially a process whereby an intending purchaser sets out to answer just five essential questions —

- Why am I doing this?
 - Do I really want to do this?
 - Have I asked the right questions about this business?
 - Have I been given the right answers?
 - What is this business really worth?
- The purchase of a business is a big

commitment, and you need to be fully aware about what you're getting yourself into.

That's why I always ensure that the first step in the due diligence process has nothing to do with numbers, and has everything to do with the buyer and his/her personal nature, skills and lifestyle.

Owning a business is not like having a job, you can't just resign when you've had enough, so it's important at the outset to ensure that you and the business are going to suit each other.

The information stages are like an audit process; we ensure that the right questions have been asked, and we'll then walk through the information to evaluate whether it is true or not.

Sometimes there will be sensitive information that shouldn't be shared until negotiations are advanced, and it is reasonable for a vendor to require that a "subject to" commitment be made, perhaps even including a confidentiality agreement before things like customer lists, recipes and formulas are provided.

But if a vendor is not prepared to provide everything that is asked for it is a clear warning sign.

You wouldn't buy a used car if the salesman wouldn't let you look under the bonnet. Nor should you buy a business if there is a reluctance to provide information.

The critical decision to make in evaluating the asking price is whether it represents reasonable value. By that

we mean that the investment must produce an adequate return, given the nature of the business and the degree of business risk undertaken.

Goodwill is often misunderstood by both buyer and seller. This can lead to unrealistic expectations for both.

In effect, goodwill should be seen as a premium, paid for a business purchase to reflect future "super" profits.

A super profit is what's left over after providing the owner with a salary for working in the business, and a return on the funds that the owner has invested in the business.

If there's not enough to provide for the owner's effort and interest on funds invested, then there's no super profit. And if there is no super profit, why would you pay goodwill for the right to earn nothing in return?

We always caution against placing too much reliance on what is known as "industry rules of thumb" for business sale prices.

A price such as turnover times a percentage is a rule of thumb, which may be a good starting point in valuing a business, but rules of thumb should never be relied on without testing the profitability to determine whether there really is adequate super profit to justify the price asked.

If you're buying a business we do wish you good luck, but more importantly we urge you to be diligent, and take great care. Ensure that you get expert advice, and don't hesitate to give me a call for assistance with this.

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