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The Process of Buying a Small Business

Generally, the purchase of a business that buyers prefer will be in the form of an asset purchase, where the buyer purchases some or all of the seller's assets. This transaction is favored by buyers because you can get the assets, like equipment and inventory, without taking on the seller's debts and liabilities.

Regardless of how the transaction is structured, however, the deal usually flows like this:

1. Pre-negotiation issues
2. Preliminary negotiations
3. Drafting a formal agreement and pre-closing review
4. Closing

Pre-Negotiation Matters

It's important to know and review some things before you actually begin to negotiate with the other party, including:

- ❖ The price the seller is willing to accept, and the maximum price the purchaser is willing to pay.
- ❖ How the value of the business was calculated.
- ❖ The seller's financial condition, that is, look at balance sheets, income and expense statements, and profit and loss statements.

Preliminary Negotiations & Discussions

In the initial phase, the parties need to discuss and decide several matters, such as:

- ❖ Documents that are needed but were not examined in the pre-negotiation stage, such as federal and state income tax returns for the past five years, real property and equipment leases, union contracts, and employment contracts for key employees.
- ❖ If shareholders' and/or board of directors' approval is required, such as in most asset sales determine the latest date on which approval must be had.
- ❖ If any government approval is required, such as a certificate of good standing- which indicates that a business was properly created and authorized to do business--determine which party is responsible for obtaining the approval.
- ❖ If any key employees of the seller will be retained by the buyer. If so, the buyer might have to draft new employment contracts, and if not, the seller might have to compensate those employees, all if the deal goes through.
- ❖ If any contracts require third-party approval before the buyer can take them over, like leases or loan agreements, set a time by which approval must be obtained.

"**Due diligence**" is also done at this stage, which is an intensive in-depth investigation of all the aspects of the seller, like its assets and liabilities. The idea is to make sure that the company is everything its says it is and appears to be.

"**A letter of intent**" is usually written at this time. It shows that the parties are serious about the deal. It helps make sure that you don't waste time and money performing due diligence and negotiating a formal agreement. Usually, they're non-binding, that is, you can't force the other party to buy or sell based upon the letter.

Nonetheless, you can make parts of the letter binding and enforceable, and it's a good idea to do so. Typically, the letter should contain:

- * How long the buyer and seller are willing to keep the deal open.

- ❖ A binding promise by the purchaser not to disclose trade secrets, like recipes and customer lists, and other sensitive company information, called a confidentiality agreement.
- ❖ A binding promise by the seller not to negotiate a sale with any other prospective purchaser for a certain period of time.

Formal Agreement & Pre-Closing

A formal, final agreement is the culmination of the negotiations. Obviously, it contains all the details of the deal: the price, when the business will be turned over, etc.

In pre-closing, there are many details to attend to, such as:

- ❖ Count and inspect inventory, if it's being sold.
- ❖ Make sure all leases, contracts, and loans are assigned (or subleased) to the buyer.
- ❖ Make a bill of sale for assets, if they're being sold, like fixtures and equipment.
- ❖ Arrange for escrow, which is where a third party holds the purchase money until all conditions of the sales agreement have been met, such as the actual transfer of the assets to the buyer.

Closing

Closing is when the deal is completed, and it's a paper-intensive process. At this time, you will have to do things like:

- ❖ Make sure all documents are signed, and notarized when required, such as for deeds and lease assignments.
- ❖ Disburse sales proceeds by paying (1) the escrow agent, if applicable; (2) creditors; (3) unpaid sales taxes; and (4) the balance to the seller.
- ❖ Record documents such as deeds and certificates of title to motor vehicles, etc.