

## **1.0 BUSINESS PURCHASE OR SALE**

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### **1.1 Checklist Of Information Needed In Evaluation (Due Diligence):**

- Profit and Loss Statement for last three years plus latest accounting period
- Tax Returns for last three years with depreciation schedules
- Balance Sheet for end of last accounting year and at end of latest accounting period
- Premises lease
- List of fixed assets with depreciation schedule—including fully depreciated assets
- Detailed list of liabilities at end of latest accounting period—including those in dispute
- Accounts receivable list at end of latest account period, and age - including those disputed; reserves posted for problem receivables
- Contracts with suppliers, customers, partners, shareholders, and/or employees, bids outstanding, prior listings to sell the business and appraisals which were made of the business
- Equipment leases or purchase contracts
- Pending law suits or threats with complaints and responses
- Accounting entries dealing with work in process
- Governmental reports, notices and related correspondence
- List of workers showing tenure, wages and job function—include family members and/or other unpaid persons
- Union contract and current negotiation correspondence
- Schedule of discounts offered and to whom
- List of major competitors and estimated size of each
- Patents, trademarks or copyrights
- Latest inventory. Indicate obsolescent merchandise and detail regarding work in process. Assure that the inventory is not undervalued as a result of overstating cost of goods in order to underreport income (for tax purposes.)
- Worker's Compensation history

### **1.2 Other considerations:**

- What experience does buyer have in this particular field?
- Does buyer have, or able to obtain, sufficient capital for the purchase and working capital, including reserve for contingencies?
- What is reputation of the product(s) being sold? Of the business? Check with the Better Business Bureau, if relevant.
- Reason for sale—how many previous owners, market trends, etc.
- Is purchase price negotiable?
- How much is being charged for "goodwill"?
- What are the purchasing terms available—will seller finance and at what

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terms?

- Do not consider unreported income in evaluation (be alert for possible tax issue)
- Evaluate location. Is neighborhood deteriorating or growing; what are parking, visibility, appearance, and traffic of location? Is a demographic report available?
- Are any licenses or permits required? Do they exist?
- What are condition, age, and adequacy of equipment and/or fixtures?
- Obtain appraisal of any real property, machinery and equipment included in sale
- Is inventory in saleable condition or obsolete? What items are slow moving; what is rate of turnover by item? Develop detailed appraisal estimate based on true worth.
- Evaluate competition by visiting site and all nearby existing competitors, talking to their owners if possible. Does business have any competitive advantage?
- Use an attorney to review purchase contract and lease, if involved. Sublease possible?
- Determine any liens against property or business.
- Include non-compete clause in sale contract.
- Do the existing records show clearly and completely the former operations of the business?
- Special considerations to include in valuation of the business
- EBDITA (earnings before interest, taxes, depreciation, and amortization) is a good parameter to use in setting a value on a business
- Value can be based on adjusted net worth for new or for unprofitable businesses.
- Income valuation approach considering value of tangible assets, fair return on investment in tangibles and fair compensation for owner and owner's labors.

### 1.3 Specific Businesses

#### 1.3.1 Retail and Service

All the above General subjects that are pertinent, especially including **location**, plus

- Will there be competition from a large department store?
- Does the location bring the required traffic?
- Is parking adequate and convenient?
- Is the business located close to the market to be served?

#### 1.3.2 Restaurants

All the General subjects and Specifics of Retail and Services, especially including **location, location, location**, plus

- What requirements are there for controls of the liquor and foods inventories?
- Is liquor license lawfully transferable?
- Have the cook and menu been factored in the profit/loss picture and are they replaceable?
- Are inspection reports available and current?

**1.4 Franchises**

This checklist contains the major questions to be asked in pursuing a franchise.

**1.4.1 The Franchisor**

- How long has the franchisor been in business?
- How long has it been offering franchises?
- Is it a subsidiary of another company? If so, who is the parent company? Has that company ever franchised? Are there other products or services?
- What is the franchisor's current financial condition?
- Are the franchisor's recent audited financial statements available?
- Who are the franchisor's directors and officers and what is their business experience?
- Does the franchisor have a reputation for dealing honestly with its franchisees? With its customers?
- What is the franchisor's standing with the Chamber of Commerce? The Better Business Bureau? Dunn & Bradstreet? Its bank?
- How many franchisees does the franchisor have? What are the plans for future development or diversification?
- What effect will development and expansion have on dealings with the franchisor?
- What innovations has the franchisor introduced since first starting?
- How selective is the franchisor when choosing its franchisees? Have the client's qualifications been reviewed?

**1.4.2 The Product or Service**

- What makes the product or service unique, and does it satisfy a particular need in the market?
- How much of this product or service is presently sold, and have sales been increasing or decreasing?
- Is the product or service desirable on its own merits?
- How long has it been on the market?
- Is the product or service marketable in the territory?
- Is the price competitive with similar products or services on the market?
- Have the federal/provincial standards and regulations governing the product or service been reviewed?
- Are there product warranties? Are they the responsibility of the franchisor's?
- Is the product patented or protected by trademarks or copyrights?
- Has an assessment of competitors and competitive products or services been developed?

**1.4.3 Sales Territory and Location**

- To what extent is the trading area exclusive? Will the franchisor be opening other franchisee or company-owned outlets nearby?
- Under what conditions can the sales territory be expanded or contracted?
- How will the sales potential of the territory be determined?
- Has the franchisor been able to assist with information such as population statistics and expected growth potential over the next five years?
- Are demographic profiles available for the people in the area, including their age, income, buying habits and occupations?

**1.4.4 The Experience of Current Franchisees**

- Discuss above issues with other franchisees.
- What was the total investment required by the franchisor?
- Are there any hidden or unexpected costs?
- Is the quality of goods supplied by the franchisor satisfactory?
- Is the price/quality relationship satisfactory?
- How reliable is delivery from the franchisor?
- How long was it before operating expenses were recovered by revenue?
- What period elapsed before the franchisee was able to pay a reasonable management salary?
- Has the franchise been as profitable as expected?
- What kind of management and staff training was provided? Did it meet expectations? Where was it held?
- Has there been any serious disagreement with the franchisor? What about? Was it settled amicably?
- Does the franchisor respond promptly and helpfully to questions?
- Are the marketing potential and advertising assistance received from the franchisor acceptable?

**1.4.5 The Franchise Contract**

- Are the rights and obligations of both parties clearly stated? Does the contract protect both parties equally?
- Is the contract specific as to the type and size of operation to be managed?
- Are the nature, duration, cost and extent of training outlined in the contract?
- Are the payments to the franchisor clearly specified, e.g.
  - The franchise fee
  - Any fixed yearly payments the franchisor receives
  - Royalty payments based on percentage of gross sales
  - The monthly percentage of gross sales required for advertising
  - Fees for continuing services provided by the franchisor?
- Must essential supplies be purchased from the franchisor or designated supplier?

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- Is there a minimum amount of merchandise to be purchased from the franchisor each year?
- What happens if supplies are interrupted? Can goods be purchased from alternative suppliers?
- Has the franchisee the right to the franchisor's latest innovations?
- Is there any annual sales quota? Is it attainable?
- What types of reports are expected to provide the franchisor?
- Does the contract cover in detail all the franchisor's verbal promises made during the interview?
- Will the franchisor maintain any necessary federal and provincial registrations?
- Can the contract be renewed? If so, on what terms?
- If leasing the location, will the lease be for the same term as the agreement? Can the lease be renewed with a renewal of the franchise?
- Is the franchisee responsible for the construction or improvement of the premises? If so, will the franchisor provide plans and specifications, and can these be changed?
- Is there freedom to choose the territory or location?
- Are multiple locations within the territory available?
- Can the interest in the franchise be sold with/without the franchisor's consent?
- Can profits made from the sale be retained?
- Can the contract be terminated if necessary? If so, is there a penalty?
- When and how can the franchisor terminate the franchise?
- Will the goodwill built up in the business be reimbursed on termination?
- If there is a default on the contract, how much time is available to rectify the situation?
- Is there an arbitration clause regarding defaults?
- What happens to the business in the event of prolonged illness or death? Have questions regarding succession been clearly addressed?
- Is the franchisee prevented from engaging in any other business activity for the duration of the contract?
- Does the contract prevent establishing, owning, or working in a competing business for a period after contract termination?

#### 1.4.6 The Franchisor's Assistance

- Does the franchisor aid in financing the purchase of the franchise? What will such assistance cost?
- Does the franchisor help select a suitable site?
- Will the franchisor help negotiate a lease agreement with a third party?
- Does the franchisor sign the lease and then sublease?
- Is the franchisor committed to providing an ongoing training program for future employees?
- Will the franchisor work on-site in the actual operation of the franchise during the first few weeks?
- What continuing management assistance will be received?
- Is such continuing assistance included in the royalty fees or is there an additional charge?
- Does the franchisor make available its own qualified personnel to help out in an emergency?

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- What advertising and sales promotion is provided?
- How much control does the franchisee have over the format and cost of local advertising?
- Will the franchisor help with opening inventory? With purchasing? With inventory control?
- What are the credit terms available for inventory purchases?
- Does the franchisor provide designs and specifications for layouts and displays?
- Are the administrative and bookkeeping procedures simple and well run? What manuals and systems are provided?

NOTES: Part of this checklist is extracted from the Royal Bank of Canada's booklet, *Buying a Franchise*.