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The Bigger Picture

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we need to talk about...

Avoiding common pitfalls when buying a business

Buying a business is often a difficult and time consuming project. Careful planning and management, together with a team of experienced advisers, is often what separates successful transactions from abortive ones. James Worrall, a solicitor in the Corporate team at law firm Withy King in Bath, advises on navigating the risks of acquiring a business, the best way to approach an acquisition and how the right support and guidance can make the difference.

This year we have seen a growing appetite for deals in Bath and the surrounding area with businesses looking to grow their market share through acquisitions. Financing transactions remains challenging and buyers are often taking a cautious approach, conducting thorough due diligence to uncover any issues which could cause cash flow issues post-completion. This means deals are often taking a long time to complete. Time invested at the outset – planning an acquisition, structuring it carefully and allocating responsibilities – is time well spent and will assist in managing the timescale of the transaction.

From a legal perspective, a buyer can choose to purchase the assets of a business or, where the business trades through a company, the shares of that company. An asset purchase means that the buyer can choose what assets it wants to acquire, leaving any unwanted liabilities behind. However, it is sometimes difficult for a buyer to identify all of the desired assets. There may also be a lot of post-completion work transferring contracts to the buyer and the risk that customers object to the transfer of their contract. Purchasing the shares often results in a neater post-completion position as the entire business is acquired.

This means, in theory at least, that the business can continue to operate in the same way as pre-completion and integration into the buyer's existing business can be done in a phased way, if desired. When purchasing shares however, buyers should be aware that they are purchasing all liabilities of the company, known and unknown.

The structure of any deal requires careful consideration of the tax position. Buyers should consult sophisticated tax specialists and corporate finance experts to ensure that the transaction is being structured tax effectively. These specialists will then work alongside the buyer's solicitor to guide the matter through to completion. Purchasing a business involves the buyer carefully identifying where the value in the target is and what the most important issues are. For example, if the target's brand is crucial to the target business, the buyer will need to investigate the intellectual property that the target has, ensure that the intellectual property rights are owned by the seller and that it is adequately protected. It is surprising how often careful due diligence reveals that the seller's website is owned by the developer, for example.

The value of a business is often its employees and the employees will be crucial in ensuring a smooth integration into the buyer's business post-completion.

If the sellers themselves are key individuals within the business and the buyer needs them involved post-completion to ensure a smooth transition, they should be tied down on special terms. The structure of the deal can assist with this. For example, with an acquisition of shares from individuals who will remain involved post-completion, a proportion of the purchase price could be payable based on the performance of the business for a specified period after the sale, providing the sellers with extra motivation.

The terms of the purchase will be set out in an acquisition agreement (either for the business or the shares). An experienced corporate solicitor will draft detailed warranties from the seller regarding the business being acquired. If a warranty proves to be untrue, the buyer can sue for damages. The buyer should also ask for indemnities for specific issues (such as any tax liability of the target). An indemnity provides for compensation on a pound for pound basis. A prudent buyer will look to retain a proportion of the purchase price for a period post-completion so that it has a pot to dip into for any claims for breach of warranty.

Finally, one of the most important points buyers should consider is imposing restrictive covenants on the seller preventing them from competing with the business post-acquisition or poaching customers or key employees. Careful thought must be given to these restrictions to ensure they are enforceable.

THE FIRST THREE THINGS YOU SHOULD KNOW IF... you're considering purchasing a business

Structuring the deal

When purchasing a business that trades as a company, a buyer can choose to purchase the shares of the target company, acquiring the company and all of its assets and liabilities, or purchase the assets of the company, acquiring only the assets that the buyer wants to purchase. Buyers and sellers often have different priorities when structuring transactions and it is important for buyers to consult their solicitors together with tax advisors and corporate finance specialists to ensure that a practical structure is achieved.

Heads of terms

Heads of terms are generally not legally binding but set out the key terms of the deal. This helps to prevent the seller attempting to re-negotiate key terms later on and also helps to flush out potential "deal breakers" early on so that both buyer and seller know where they stand. Buyers should also consider imposing a "lock out" on the seller. This gives the buyer a period of exclusivity in which to negotiate the transaction and during which the seller is prevented from negotiating with other potential buyers.

Due diligence

A thorough investigation into the assets and liabilities of the target business is essential for a buyer. Identifying any issues with the target business at an early stage gives the buyer the opportunity to obtain appropriate legal advice regarding the resulting risks and walk away from the transaction or to negotiate a price reduction, perhaps with appropriate indemnities from the seller in respect of the issues uncovered.

These are just a few of the issues to consider when purchasing a business. James Worrall and the Corporate team at Withy King specialise in business acquisitions and disposals and have advised on significant transactions locally as well as nationally.For advice, please contact James on 01225 730100 or email james.worrall@withyking.co.uk