Information Booklet

Business Startup

4

BUYING AN EXISTING BUSINESS

for SMEs

SMEDA

National Business Development Program for SMEs

Introduction

Small and Medium Enterprises Development Authority (SMEDA) works under the Ministry of Industries and Production, Government of Pakistan and was established in 1998 with the objective to propel economic growth through development of SMEs. SMEDA serves as an SME strategy-advisory body for the Government of Pakistan and facilitates partners in meeting their SME development agendas.

SMEDA envisions growth of a globally competitive SME sector (in Pakistan), through creating an enabling environment and support services for increase in the national economy. SMEDA strives to achieve this vision by providing assistance in employment generation and value addition to the national income, through development of the SME Sector, by helping increase the number, scale and competitiveness of SMEs.

National Business Development Program for SMEs (NBDP) is a project of SMEDA which intends to provide hands-on support services to SMEs. The aim of this business development support provided by NBDP is to advance new businesses and improve efficiencies in existing SME value chains to empower them to contend in global market. NBDP expects to facilitate around 314,000 SME beneficiaries over the period of five years.

Disclaimer

Objective

- To explain the process and factors to be considered while buying an existing business.

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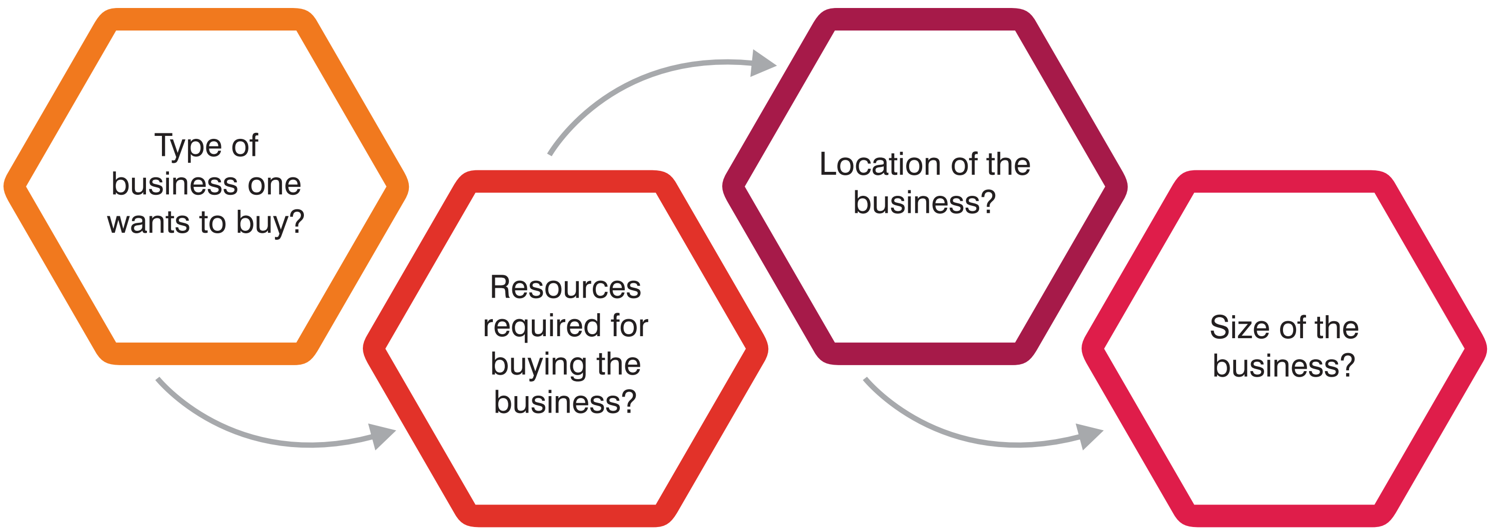
Ask Yourself

Most of the people wish to start their business from scratch and develop their business idea from the ground up. However, in doing so they come across a variety of problems and bottlenecks. To avoid the difficulties of setting up a new business like finding new customers, setting up a marketing base, hiring of staff and managing business startup and cash flows, it is better to buy an operational business that is already generating cash flow and profits. Moreover, an existing business may already have established legal entity and rights, such as registered company name, patents or copyrights for which one does not have to waste time, effort and money.

Buying the perfect business starts with choosing the right type of business. For this purpose, one has to do some introspection to find out what are their strengths and which business is suitable to them. One needs to look into a familiar industry that and experience and that can be taken to the next level by their inputs.

So, before taking a final decision to buy a business, the following questions should be asked by the person:



If answers to these questions are generally satisfying, only then the next step should be taken which is to find a business for sale, as per the desired criteria. One can start the search from the relevant industry and talk to the business owners in that area. Start discussing it with a few of them in the beginning as many of them might not have their businesses up for sale but would consider selling if someone makes them a good offer.

Rationale for Buying a Business

Buying a running business is easier to manage than establishing a new business. Following are some of the other reasons for buying an existing business rather than starting new one:

Easier to Secure Finance

Buying an existing business is more likely to lend itself for raising finance than supporting an unknown start-up. Because there is less risk involved in financing a running business that has already proven it is able to operate profitably.

Income from Day One

It takes a while for new businesses to generate profits and during this period, it may be necessary for the business owner to spend money for operational expenses to sustain the business. On the other hand, existing businesses generate revenue from day one.

Established Brand

An existing business already has recognized/established name and credibility with a track record, complete with all the trademarks, copyrights and in some cases a website designed for it. This gives customers, suppliers, lenders and other contacts a confidence in the business that they may not have when interacting with an unknown start-up.

Instant Customer Access

An existing business also has an existing customer list. Various marketing strategies can be used to build on that customer base and there is no need to build it from scratch. It can be a major advantage in a competitive environment.

Established Network of Contacts

An existing business already has a network and contact directory that can be utilized instead of establishing new network of contacts. The reliability and trust of suppliers and others vendors is a major advantage as compared to a new startup.

Focus on Growing the Business

With a start-up, an entrepreneur has to channel all his energies into getting the business off the ground and this can be time-consuming and exhausting. In contrast, taking over an established business can help to focus on business growth. Sometimes the issues of a startup bog down a good entrepreneur more than the normal behavior and opportunities for growth are lost.

Income to Put Back into the Business

An already established business generates steady income that can be utilized for reinvestment to grow the business further.

Trained Employees in Place

In a start-up, it takes time to build up and train a team of employees. However, people are already working in an existing business. This can make it easier to implement strategies for business growth because, there is a trained team that can keep things running.

Less Risk

There is comparatively less financial risk for lenders involved in buying a new business and it is also a safer option for the potential business owner. Provided the business is doing reasonably well, it should continue to do so.

Less Work

Starting up a new business needs time and efforts and those who do not have the patience and energy for the business may find it challenging. In an existing business, business practices are streamlined and with existing employees who know the ropes.

Pros and Cons for Buying a Business

There are many benefits to buying an existing business, but also some drawbacks are associated with this. So, for making the best decision for individual needs and experience, following are some pros and cons for buying an established business:

1

Product/ Service Acceptability; In an existing business, market reaction on the products or services can be assessed. For example, if one buys a restaurant that is well-reviewed and is producing good sales numbers, he/she will know that local customers already enjoy the food.

Price for Quality; Purchase cost depends upon the quality of the existing business. If a business is being sold on a cheap price, there is a risk that the brand is tainted, or that markets have rejected the product or service. Resuscitating a bad brand or a struggling business can be very difficult.

2

Established Product/ Service; In an existing business, products or services are already market tested and sale can be started quickly.

Business or Technical Flaws; There might be issues related to staff, outdated equipment, unreliable suppliers, debt and cash flows in the business. Similarly, at the time of implementing changes, new problems may arise, for example employees may resist policy changes and even quit. So, try to find out as much about the existing business as possible to escape from such issues.

Pros | **Cons**

3

Brand Recognition; In an existing business, there would be less time, efforts and money required to struggle for the brand as the business will have an already established brand and it only needs to grow.

Financial Forensics Requirements; In an existing business, there might be possibility of misrepresentation of information and financial data. To avoid getting scammed, review all legal documents and conduct considerable research prior to buying an existing business.

4

Established Name; In an existing business, financing is much easier because there is less risk involved in financing a business that has already proven it is able to generate an income.

New Strategy and Goals; In an existing business, there might be a need to make several changes in goals, products, services etc. and all these relate to costs and time.

5

Existing Customer Base; In an existing business, there is an existing customer base that will make purchases under new ownership, so it can be beneficial to buy a business that people know about.

Bad Reputation or Market Dislike; It is possible that the business might have a bad reputation and buying such business has no worth.

Economic and Legal Aspects

There are plenty of business documents, files, agreements, and statements that need to be collected and analyzed, ideally with the help of a lawyer and accountant. Here are some of the must-have documents when carrying out due diligence before buying a business:

1. Business Licenses and Permits

Ensure that the business has all the business licenses and permits it needs and the current owner has not mismanaged or expired any local business licensing laws. Businesses in certain industries, particularly highly regulated ones like food businesses and childcare, need a valid permit to stay open.

2. Organizational Paperwork and Certificate of Good Standing

If the business one is buying is a sole proprietorship or partnership, there may not be official "founding" paperwork. However, a registered business entity, such as a Limited Liability Company (LLC) or corporation, will have organizational documents on file with the state institutions.

3. Zoning Laws

Check with the area's local zoning laws to make sure that one is buying a business that is not violating any laws. While some localities allow mixed-use commercial and residential zoning, others have restrictions on where businesses can be located.

4. Environmental Regulations

Look if the business is secretly dumping chemicals into the nearby water sources or violating other environmental laws. Double-check that this business abides by all of the area's small and medium business environmental regulations.

5. Letter of Intent

While buying a business, the seller issues a Letter of Intent (LOI) to the buyer when both sides have agreed on a price point. This letter also covers which business assets and liabilities will be included in the transaction. The price, proposal, along with the terms and conditions of the sale deed should all be included in the seller's LOI. Always use a business and legal advisor to wet these documents.

6. Contracts and Leases

Ensure the transference of all the legal documents, lease of location, equipment or something else from the previous owner. Always use a business and legal advisor to wet these documents.

7. Business Financials

Before buying a business, make sure to examine its past few years of financials, including:

- Tax Returns
- Balance Sheets
- Cashflow Statements
- Sales Records and Accounts Receivable
- Accounts Payable
- Debt Disclosures
- Advertising Costs

Other Important Documents

Ask the seller for property documents, equipment/asset listing, brand assets for advertising materials, an account of intellectual property assets, insurance coverage, employee policies and contracts, incorporation information, and customer lists and examine them carefully before buying a business.

b Ask the Seller and the Market

Once a decision of buying a business is made, some questions should be asked from the previous owner about the business:

1. What is the reason of selling?
2. How you arrived at the sale price?
3. How many hours a week do you work in the business?
4. Are you willing to agree on a non-competition clause?
5. Who are the key customers, suppliers and staff?
6. Are you willing to stay on for a transition period?
7. What are the biggest challenges in the business right now?
8. What amount the owner used to pay themselves? (That would not be in case of sole proprietorship)

c Inquire Legal and Financial Factors

Once both parties have agreed, always consult the business and legal experts to make final checks and to give a go ahead signal. Once the sale-purchase contract has been signed, the next step is to execute the transfer.

As the transfer process gets started, there are many steps in this process, including legal, financial, physical and organizational hand-off. The signed contract stipulating the terms of the deal is now a legally binding document.

Finally, buying a business is likely the most important transaction. Do it for the right reasons, be patient, resist the urgency of others, conduct due diligence, negotiate the best deal and be prepared to operate what is being bought.

Valuation and Negotiation

Buying and selling a business can seem like a fairly straightforward process. A buyer and seller connect, agree on a price and transfer ownership. Before taking a final decision, there is a negotiation process. A business valuation uses an independent third party who has had tested methodologies to calculate the business' overall worth because the appraiser is an independent party, they have no interest tied up in inflating or deflating the calculated value of the business.

By getting a business valuation as a part of the process of negotiating a business sale, both sides realize significant benefits in the process. They can walk away from the negotiating table knowing that they have done a good job. The valuation process, when completed by a certified business appraiser, helps ensure that everyone is getting a fair deal.

Consult with an Expert

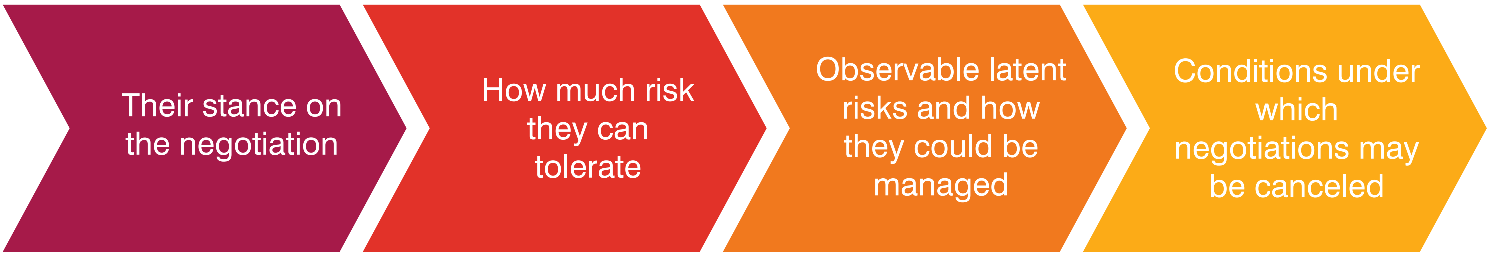
For tactical challenges in buying and setting up a business, there is need to turn to an area expert. Good consultants typically charge a reasonable fee and should be able to tell upfront what they will charge for the specific job/task.

When vetting consultants, get referrals or recommendations from market and the business contacts if possible, and get a firm estimate of the time it will take to do the job. Also, be sure that the person or the firm that is hired will supply documentation allowing to retrace their steps if necessary, to solve a problem or duplicate their work later.

Deal Structure

Deal structure is a binding agreement between parties in an acquisition that outlines the rights and obligations of both parties. It states what each party is entitled to and what each is obligated to do under the agreement. Simply, a deal structure can be referred to as the terms and conditions for buying a business.

It is one of the steps that must be taken for buying a business. It is the process of prioritizing the objectives of a merger or acquisition and ensuring that the top-priority objectives of all parties involved are satisfied, along with considering the weight of risk each party must bear. Initiating the deal structure process requires all parties involved to state:



Developing a proper deal structure can be quite complicated and challenging because of the number of factors that need to be considered. These factors include preferred financing means, corporate control, business plan, market conditions, antitrust laws, accounting policies, etc. Employing the right kind of financial, investment and legal advice can make the process less complicated.

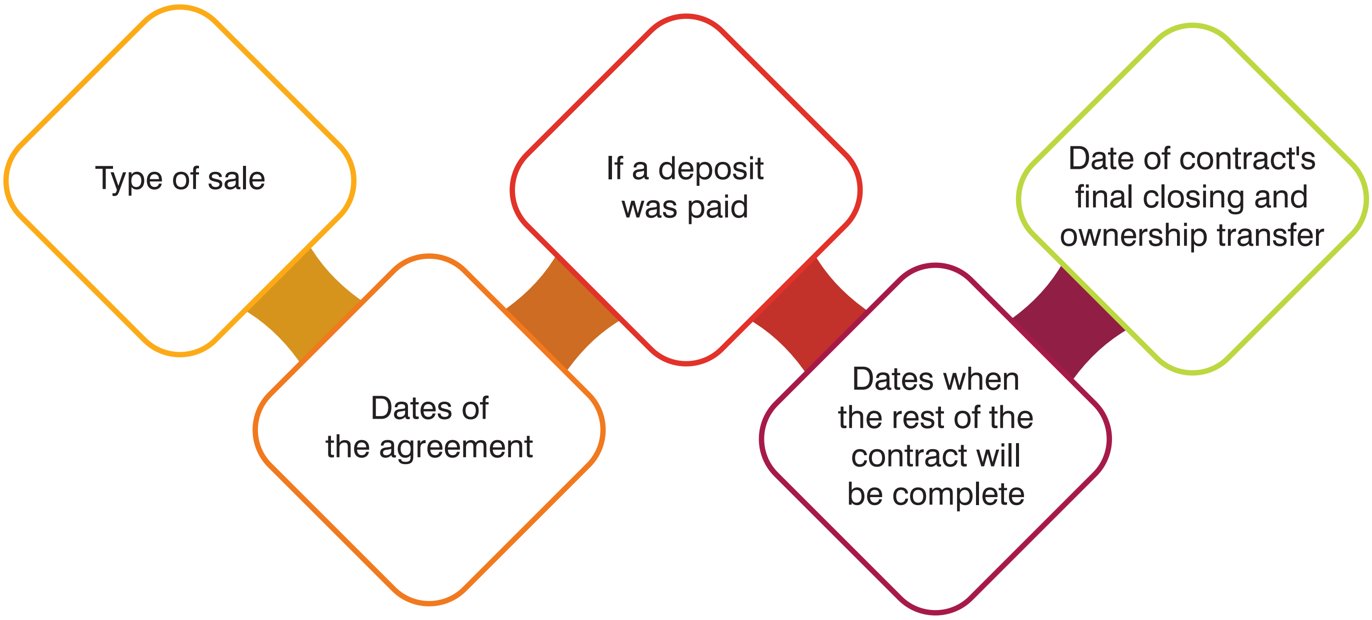
Sale and Purchase Agreement

A purchase and sales agreement is a contract that define the terms and conditions of a business/ financial transaction to buy and sell a running business. Its templates are available at SMEDA website.

What are a Sales and Purchase Agreement?

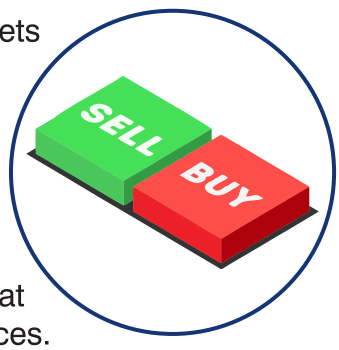
There are contract templates available for use on internet and one can find a useful one at SMEDA website also.

There is detailed buyer and seller information in purchase and sales agreements, including names, phone numbers, addresses, and co-signers, if applicable. The agreement also lists the following:



These agreements are often considered "living" since these are subject to revisions often. Detailed descriptions are also included, including any defects or deficits that are known when the agreement is created. There may be language in the agreement that lets the buyer hire professionals to inspect the business if they wish. Further language can state that if the expectations are not met by the buyer after the inspection or there are defects found that were not expressed by the seller, the buyer can end the contract.

What Buyers and Sellers Should Know?

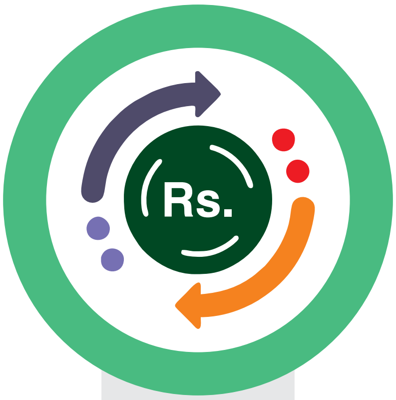


- **The agreement** defines the terms and conditions of buying the business and sets the transaction's timeline.
- **The closing date and purchase price** are included in the agreement, which are crucial items in a purchase.
- **Earnest amount;** How much money the buyer puts down as the earnest money and this money should be put in an escrow account until settlement occurs.
- **List of items/assets;** The parties in the transaction may want to include items that come with the purchase of the business, such as furniture repairing and appliances. Items that are not expressed, can also be stated by the person selling the business.
- **The contingencies and commitment to the business** purchase should also be stated by the seller. There are certain contingencies that can be stipulated to release the buyer from purchasing the business and allowing the deposit to be returned.

Items Included in the Purchase and Sale Agreement

Following items are included in the purchase and sales agreement:

The final sales price is the purchase price that is agreed upon by the seller and buyer. (This may change somewhat during negotiations prior to the final closing date. For example, if there ends up being an issue with the inspection, the buyer can try to negotiate a lower purchase price).



Details on the earnest money deposit, including instructions and the amount for making the deposit. (This will be held until the deal is completed by a neutral third party).

On the closing date, the purchase is completed and the transference of business is recorded with the government. The seller will then be paid for it. All the paperwork will be signed a few days before the closing date.

Commercial Contract

BUYING / SELLING AGENCY AGREEMENT

S M E D A

Small and Medium Enterprises Development Authority

Ministry of Industries & Production
Government of Pakistan
www.smeda.org.pk

HEAD OFFICE
4th Floor, Building No. 3, Aiwan-e-Iqbal Complex, Egerton Road, Lahore
Tel: (92 42) 111 111 456, Fax: (92 42) 36304926-7
helpdesk@smeda.org.pk

REGIONAL OFFICE PUNJAB	REGIONAL OFFICE SINDH	REGIONAL OFFICE KPK	REGIONAL OFFICE BALOCHISTAN
3rd Floor, Building No. 3, Aiwan-e-Iqbal Complex, Egerton Road Lahore, Tel: (042) 111-111-456 Fax: (042) 36304926-7 helpdesk.punjab@smeda.org.pk	5TH Floor, Bahria Complex II, M.T. Khan Road, Karachi. Tel: (021) 111-111-456 Fax: (021) 5610572 helpdesk-khi@smeda.org.pk	Ground Floor State Life Building The Mall, Peshawar. Tel: (091) 9213046-47 Fax: (091) 286908 helpdesk-pew@smeda.org.pk	Bungalow No. 15-A Chaman Housing Scheme Airport Road, Quetta. Tel: (081) 831623, 831702 Fax: (081) 831922 helpdesk-qta@smeda.org.pk

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*The templates can be downloaded from SMEDA's website: https://smeda.org

1. INTRODUCTION OF SMEDA

The Small and Medium Enterprise Development Authority (SMEDA) was established with the objective to provide fresh impetus to the economy through the launch of an aggressive SME development strategy. Since its inception in October 1998, SMEDA had adopted a sectoral SME development approach. A few priority sectors were selected on the criterion of SME presence. In depth research was conducted and comprehensive development plans were formulated after identification of impediments and retardants. The all-encompassing sectoral development strategy involved overhauling of the regulatory environment by taking into consideration other important aspects including finance, marketing, technology and human resource development.

After successfully qualifying in the first phase of sector development SMEDA reorganized its operations in January 2001 with the task of SME development at a broader scale and enhanced outreach in terms of SMEDA's areas of operation. Currently, SMEDA along with sectoral focus offers a range of services to SMEs including over the counter support systems, exclusive business development facilities, training and development and information dissemination through a wide range of publications. SMEDA's activities can now be classified into the three following broad areas:

1. *Creating a Conducive Environment*; includes collaboration with policy makers to devise facilitating mechanisms for SMEs by removing regulatory impediments across numerous policy areas
2. *Cluster/Sector Development*; comprises formulation and implementation of projects for SME clusters/sectors in collaboration with industry/trade associations and chambers
3. *Enhancing Access to Business Development Services;* development and provision of services to meet the business management, strategic and operational requirements of SMEs.

SMEDA has so far successfully formulated strategies for sectors, including fruits and vegetables, marble and granite, gems and jewellery, marine fisheries, leather and footwear, textiles, surgical instruments, transport and dairy. Whereas the task of SME development at a broader scale still requires more coverage and enhanced reach in terms of SMEDA's areas of operation.

Along with the sectoral focus a broad spectrum of services are now being offered to the SMEs by SMEDA, which are driven by factors like enhanced interaction amongst the stakeholders, need based sectoral research, over the counter support systems, exclusive business development facilities, training and development for SMEs and information dissemination through wide range of publications.

2. ROLE OF SMEDA LEGAL SERVICES CELL

The Legal Services Cell (LSC) is a part of Business Development Division of SMEDA and plays a key role in providing an overall facilitation and support to SMEs. The LSC provides guidance based on field realities pertaining to SMEs in Pakistan and other parts of the world. LSC believes that information dissemination among the SMEs on the existing regulatory environment is of paramount importance and it can play a pivotal role in their sustainable development.

In order to facilitate SMEs at the Micro Level LSC has developed user-friendly systems, which provide them detail description of the Laws, and Regulations including the process and steps required for compliance.

The purpose of this document is to provide SMEs, Service Providers, Companies and Firms with information pertaining to requisite format and content of a business to business commercial contract. Entrepreneurs interested in enhancing their understanding about the nature and form of a Buying / Selling Agency Agreement can also use this template.

3. DISCLAIMER

Form of this document and the contents therein are provided only for general information purpose and on an "as is" basis without any warranties of any kind. Use of this document is at the user's sole risk. SMEDA assumes no responsibility for the accuracy or completeness of this document, its form and any of the information provided therein and shall not be liable for any damages arising from its uses.

Buying / Selling Agency Agreement

This Agreement is made on this ________ day of ____________ (year)

Between

A B C (**Give Name of the firm / company etc**.), having registered office at _____________ (**place of office**) through its authorized partner / representative namely __________ (herein after called the "Principal" which expression shall mean and include its successors and assigns) of the one part.

And

X Y Z, etc. (**Give Name of the firm / company etc**.), having registered office at _____________ (**place of office**) through its authorized partner / representative namely __________ (herein after called the "Agent" which expression shall mean and include its successors and assigns) of the second part.

WHERAS the Principal is a firm / company registered under the laws of ________ (**Give name of the country**) and is engaged in the business of manufacturing of _________ (**Give nature of the business**).

AND WHEREAS the Agent is a firm / company registered under the laws of __________ (**Give name of the country**) and is engaged in the business of brokerage services.

AND WHEREAS the Principal intends to hire the services of the Agent to act as a selling / buying agent for the principal in (**Give name of the country or countries**) subject to the terms and conditions set forth herein.

AND WHEREAS the Agent has signified his consent to act as a buying / selling Agent for the principal in (**Give name of the country or countries**) subject to the terms and conditions set forth herein.

NOW THEREFORE the parties have set forth their hands as follows:

1. Term of Engagement

The term of engagement of the parties as a Principal and Agent shall be for a period of __________ years commencing from the date of signing if this agreement.

2. Payment for Services

As a consideration of the services, the Principal shall pay to the Agent _____% (**give percentage of the commission**) commission on each transaction of sale / purchase materialized through the Agent. This amount of commission shall become due immediately on conclusion of the sale / purchase transaction between the Principal and the Seller and be payable by the Principal on demand by the Agent.

3. Expenses incurred by Agent

All the expenses including but not limited to traveling, maintenance of office equipment, entertainment, clerical etc. that may be incurred by the Agent shall be borne exclusively by the Agent and the Principal shall not be liable for such expenses.

4. Surety Bond

The Agent shall furnish a surety bond to the Principal from a company acceptable to the Principal to ensure due performance of the duties by the Agent as listed in the agreement.

5. Duties of the Agent.

The Agent shall be responsible to perform following duties under the agreement viz the Principal:

i. To compile particular market information as per instructions of the Principal,
ii. To promote the best interest of the Principal,
iii. To gather samples of the products required by the Principal,
iv. Inform the Principal of the desires of the seller / buyer,
v. To place orders based on the interest and requirements of the Principal,
vi. To assist the Principal in negotiating the procurement / sales,
vii. To ensure packaging and inspection of the merchandise in accordance with the agreement,
viii. To make arrangement for shipment and payments
ix. To do the translations, wherever required,
x. To make proper and effective liaison,
xi. To fully disclose to the Principal all facts that might effect or influence the Principal's decision to tender an offer to purchase / sale,
xii. Not to disclose information to third parties regarding transactions of the Principal.

6. Duties of the Principal

The Principal shall be responsible to perform following duties under the agreement viz the Principal:

i. To make timely payments of agreed Commission to the Agent,
ii. To keep proper and effective liaison with the Agent,
iii. To issue clear and legible instructions to the Agent for purchase or sale of Products,
iv. To fully disclose to the Agent all facts that might effect or influence the Principal's decision to tender an offer to purchase / sale.

(In addition to the above you can list out any other duties of the principle as agreed)

7. Covenants by the Agent

i. To devote the whole of his time, attention and energies to the performance of the duties as enumerated above,

ii. Not to be either directly or indirectly connected with or engaged in any business competing the business of the Principal,

iii. To give true and proper account of the information required by the Principal,

iv. Not to disclose any information to third parties pertaining to transactions of the Principal.

v. Not to convey any consent or refusal regarding a particular transaction without approval in writing by the Principal,

vi. To pass on all or any information desired by the Principal promptly and without fail.

vii. To make itself available to the Principal through any means of communication during the business hours.

viii. Not to engage in un-fair business practices detriment to the business or reputation of the Principal.

8. Correspondence

All correspondence or communication between the parties shall be in writing either or in combination through e-mail, fax, or courier addressed to the mutually agreed places of business of both the parties.

9. Remittances by the Agent

The agent shall promptly remit the payment received through any means for the Principal to the designated account of the Principal. The Agent shall in no manner utilize such amount to defray its own expenses.

10. Examination of documents

The Principal shall have the right to examine the documents and accounts of the agent to ascertain as to whether the business of the Agent is being conducted in accordance with the provisions of this agreement.

11. Dispute Settlement

If any dispute arises between the parties regarding the understandings expressed in this agreement, the same shall be settled amicably through bilateral negotiations.

12. Non-Disclosure

The Agent hereby expressly undertakes not to disclose any information regarding purchases / sales by the Principal or its customers or any other information that may be passed on by the Principal regarding business thereof to any third party.

13. Modification of the Agreement

This agreement may be modified and or amended by the parties through mutual understanding.

14. Termination of Agreement

Either party hereto may at any time terminate this agreement by giving to the other three calendar months notice in writing. Provided that in case of willful neglect or refusal or failure of the Agent to perform his duties under this agreement without any justifiable cause or of any other act of misconduct on the part of the Agent, the Principal may terminate the agreement without giving such notice.

IN WITNESS WHEREOF the parties have caused this Agreement to be duly executed and delivered as of the day of year first above written.

A B C	X Y Z
Witness	Witness
____________	____________

Conclusion

Before buying an already existing business, a few things should be checked thoroughly including the type of business being bought, area and location, size of the business, the resources required for it and why is it being sold. Before purchase of a new business one must get its valuation assessed from a third party. It is also crucial that all the financial and legal requirements are carefully drafted and complied to by both parties as they sign the sale purchase agreement.

HEAD OFFICE

Address:	3rd/4th Floor, 3rd Building, Aiwan-e-Iqbal Complex, Egerton Road, Lahore
Tel:	(042) 111-111-456, 99204701-12
Fax:	(042) 36304926-27
Email:	helpdesk@smeda.org.pk

REGIONAL OFFICES

Balochistan

Address:	Bungalow No. 15-A, Chaman Housing Scheme, Airport Road, Quetta
Tel:	(081)-2831623 - 2831702
Fax:	(081)-2831922
Email:	helpdesk.balochistan@smeda.org.pk

Punjab

Address:	4th Floor, 3rd Building, Aiwan-e-Iqbal Complex, Egerton Road, Lahore
Tel:	(042)-111-111-456
Fax:	(042)-36304926, 36304927
Email:	helpdesk.punjab@smeda.org.pk

Khyber Pakhtunkhwa

Address:	Ground Floor, State life Building, The Mall, Peshawar
Tel:	(091)-111-111-456, 091-9213046-7
Fax:	(091)- 5286908
Email:	helpdesk.KhyberPakhtunkhwa@smeda.org.pk

Sindh

Address:	5th Floor, Bahria Complex II, M.T. Khan Road, Karachi
Tel:	(021)-111-111-456
Fax:	(021)-35610572
Email:	helpdesk.sindh@smeda.org.pk