

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?

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- How much is being charged for “goodwill”?
- What are the purchasing terms available—will seller finance and at what 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?

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- 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?

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- Must essential supplies be purchased from the franchisor or designated supplier?
- 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?

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- 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?
- 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*.