MACMILLANS WALLER FRY
ACCOUNTANTS

Buying a Business

Your Guide to **Making the Right Moves**

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1. INTRODUCTION AND PRELIMINARY REMARKS

1.1 Introduction

So you're considering buying a business? Buying a business from somebody else is likely to be one of the biggest financial transactions that you will ever undertake. It makes sense to invest time and money to ensure that you acquire an asset that lives up to your expectations.

At Macmillans Waller Fry - Accountants our role is to help you appreciate the issues and make an informed judgement as to whether or not to proceed. Having assisted clients in this situation previously, we would like you to benefit from our experience.

This kit is part of the way in which we want to work with you during this important evaluation phase. Please ensure that all documentation, correspondence and notes are filed in this folder. This will ensure that you are able to locate items as they are required.

Above all else, keep an open mind on the facts as they emerge. Remember, it is a *business* decision and that it is important not to let emotions override rational thinking. One of the original American oil tycoons, J D Rockefeller once said,

"Some of the best business deals I ever did were the ones I walked away from".

1.2 The Starting Point

Let's start out with some basic facts - buying a business means that someone else, the vendor, is going to benefit. The vendor will be approaching this from a self-centred point of view, *not* with your interests in mind.

The vast majority of business owners have an over-inflated view of what their business is worth. This will often mean the starting price for the business is too high. It may also mean that emotional issues intrude into negotiations.

There are many business opportunities both now and in the future. Do not feel that you have to limit your consideration to just one opportunity. Setting up in competition to the business is, in many cases, a less expensive option.

If you have been introduced to this opportunity by a business broker, be aware that he or she will earn a fee from the vendor for the successful sale. That is not to say the broker will not give you valuable advice - he or she almost certainly will. However don't feel pressured or obligated, at the end of the day, it's your money and your decision.

1.3 The Investment Decision

The critical decision to make in evaluating the business is whether it is "a good deal". By that we mean the investment must produce an adequate return, given the nature of the business and the degree of business risk undertaken.

We strongly recommend that you invest an hour with us to become familiar with the methodology that we use in evaluating business opportunities. For owner operated businesses, we use the "Return on Investment" method, also known as the "Capitalisation of

Earnings" method, which produces a value that is based on the expected percentage return to the owners.

The return on investment should be evaluated after taking into account a fair wage for the time and effort put in by the owners. In other words we do not recommend you go into an investment if all you are doing is "buying yourself a job".

It is important that you work *with* us to prepare a realistic model. Keep in mind that it is not so much a matter of what the business has done and how it has been financed to date, but rather, it's what the business will earn *you* given *your* strategies, *your* capital structure and *your* personal wage (if you are working in the business).

Please be aware that we are *not* the fountain of all knowledge about the business being evaluated. It may take some time and several scenarios to determine an appropriate model, from which an investment decision can be made.

Together, we must combine our knowledge to prepare some realistic scenarios upon which to base this decision.

1.4 The Facts About Buying A Business

Let's be brutally honest about what you're getting yourself into.

1.4.1 The due diligence process

You are embarking upon a time consuming process, which will require you to schedule appointments with various advisers etc, often with little notice.

This is usually a time of great uncertainty, as you work towards a decision. Remember, a cool head is required during this time... especially in the negotiations!

1.4.2 Your chances of success

The most recent (June 2007) statistics available from the Australian Bureau of Statistics indicate that 51.4% of new businesses closed within 4 years. Remember - your capital is at risk!

If you are buying a successful existing business, you will have more chance of success by adopting the procedures that exist in the business and ensuring that there is little reliance upon the outgoing owner.

Source: ABS Counts of Australian Businesses, Including Entries and Exits, June 2003 to June 2007 – 8165.0.

1.4.3 The need for adequate capital to get started

For the first few months after buying your business, you will require access to ready capital. This is to pay for the due diligence process, setting up the right legal structure, as well as your initial order of business cards, stamps and marketing.

Whilst you are waiting for revenue to start coming in from your first customers, you will also need access to sufficient capital to support your personal living expenses.

Starting a business in an undercapitalised position will dramatically reduce your chance of success.

1.5 Have You Got What It Takes?

1.5.1 Not everyone is cut out to be in business for themselves.

The stark reality is that being in business for yourself often means long hours, especially in the early years. Your personal capital is at risk, and you will be called upon to make significant decisions on a daily basis. In fact, some people are better suited as employees.

The more you know about the industry/field, plus the more business management experience you have, the more likely you are to succeed.

The support of your family is absolutely paramount.

1.5.2 "The E Myth Revisited" by Michael Gerber

This is available in most major bookstores and is one of the best business books ever written. The central message of the book is that being a skilled technician is not sufficient to sustain a successful business. The other demands of being in business will take over. If you can't handle those demands, your business won't succeed, or at the very least they will spoil your enjoyment of the technical work.

If this sounds like you, buy the book today and read it. Read it again and then let's talk about its relevance to your situation.

2. THE PROCESS OF BUYING A BUSINESS

2.1 Preparing Yourself

2.1.1 Personal issues

The period you are entering into can be one of great anxiety, brought upon by the excitement and uncertainty of the evaluation, together with the financial stakes involved. Be prepared for this.

Many issues and questions will be going through your mind. Keep notes in the section provided so you can be prepared for your meetings.

You are doing yourself a disservice by having a briefcase full of “stuff”. This is a recipe for overlooking something important and missing a vital deadline.

2.1.2 File notes re meetings and conversations

It is important that you keep records of matters discussed, particularly with the vendor. These records form part of the undertakings provided and you may need to have reference to them later.

We will endeavour to provide you with file notes of the meetings you have with us. It is also our usual practice to document matters discussed in telephone conversations.

2.2 Your Team of Advisors

To put the deal together will require co-ordination of a small team of experts, the core members of that team will be:

- Us, as your financial/business development advisors;
- A solicitor who is experienced in commercial matters; and
- Your bank manager.

There may well be other people whom we may involve. These could be recognised experts in a particular business or field of expertise (e.g. intellectual property, franchising). You may also want to seek opinions from family members and acquaintances. All of this is fine, so long as it is controlled and co-ordinated (and you don’t get confused!).

We prefer to be the hub of this activity or at least have access to all information. Without this we will not be able to do the best job possible for you.

2.2.1 Conflicting advice - getting concerns out in the open

It is to be expected that you will receive advice from all quarters during this time. Not all of this will be good advice! It is important that you assess the qualifications of people dispensing the advice before deciding to accept it:

Have they been in business themselves?

- Were they successful?
- Are their financial affairs in order?
- Do they know about this particular industry?

Naturally, if you would like to discuss any points raised by other sources, you are very welcome. We would prefer any doubts, concerns or reservations to be out in the open so that they can be discussed and a decision made.

We don't want to be operating on the basis that all is fine if you have reservations or concerns about the process.

2.2.2 Your authority for us to act on your behalf

It may be necessary for you to provide us with express authority to act on your behalf with some parties, such as your Bank. This will be discussed with you as the circumstances arise.

2.3 What Is It That You Are Buying?

2.3.1 Are you buying the business, or the business structure?

It is important to be clear about what it is that you are buying. At the outset, you need to understand the difference between buying the business, as against buying the business structure (for example, the shares in an existing company).

Broadly speaking, we recommend buying the business, not the structure. The main reason is to protect yourself against legal action, arising from events that occurred before your purchase of the business.

For example, an employee or customer of the business may claim compensation for an injury that occurred months or years before. If the business has been operated through a company, the injured person's claim will be against the company, not the owners at the time the injury occurred. If you are the current owner of the company when the claim is lodged, you will suffer the loss. You have little or no chance of recouping that loss from the vendor.

Of course, there may be situations where buying the business structure does make sense. We will advise you about this when we consider the specifics of your proposed purchase.

2.3.2 What assets are included?

A business can consist of many components, some of them tangible, others not.

The tangible assets will generally comprise plant and equipment, trading stock and sometimes freehold title to real estate.

Intangibles could include:

- Goodwill;
- Business names;
- Registered designs, patents, trademarks;

- Client and prospecting lists;
- System manuals;
- Rights to territories; and
- Leases, or other rights to use premises.

Further information, regarding issues to be aware of when purchasing each type of asset, is provided below.

2.3.3 Allocation of purchase price to individual assets

There is an inherent conflict of interest between the vendor and purchaser of a business, when it comes to allocation of the total purchase price to individual assets.

Australian income tax law provides favourable tax treatment to the vendor, in relation to the proceeds of long-term assets such as goodwill and real estate. The tax advantages are especially generous for vendors of small businesses (defined as annual turnover less than $2 million). In contrast, the vendor receives no tax advantage on the proceeds of plant and equipment or trading stock. The vendor therefore has an incentive to minimise the amount allocated to those assets.

Your tax position as purchaser is almost directly the opposite. The purchase of plant and equipment and trading stock qualifies for large short-term tax deductions. You therefore have an incentive to maximise the amount allocated to those assets. Goodwill and other long-term assets generate few tax savings for you, until the business is later resold.

The allocation of the purchase price can materially affect the returns that you and the vendor will obtain from the deal. It often becomes a matter of hard negotiation, and can be a sticking point that stops a deal from proceeding.

2.3.4 Plant and equipment

The Australian Taxation Office (ATO) requires deductions for depreciation of plant and equipment to be substantiated.

We generally recommend that fixed assets are listed in a schedule to the contract, and a specific amount is attributed to each one. If the vendor is unwilling to provide a schedule, at the very least you should insist on a separate value for total plant and equipment being stated in the contract. You can then apportion that value to individual items of equipment on a reasonable basis. If the value is large, you may need to obtain an independent valuation.

2.3.5 Trading stock

If the business being acquired has stock, special arrangements will need to be made to ensure that:

- You receive what is stated in the contract; and
- You have sufficient stock to commence trading.

It is usual to adjust the stock value on the day of settlement to reflect the actual value of what is being taken over. This is determined by performing a stock-take and costing the stock items.

2.3.6 Premises

If you are buying the premises as well as the business, you should consider these important matters:

When you evaluate the deal, you need to consider the premises separately from the business. Depending on the location, commercial real estate can be relied on to generate a rental return of around 8% pa. You therefore need to deduct that amount of rent as an expense when assessing the profit of the business. If there is no profit remaining after deducting that rent, then the business is worth nothing. You would do better to just buy the premises and rent them to someone else.

The Australian income tax system currently provides more favourable tax treatment when real estate is owned by individuals or trusts, rather than companies. If you intend to operate the business through a company, you should consider buying the real estate in a different name, under a separate contract.

If you are leasing the premises, you should consider these equally important matters:

When does the lease expire? Will you be able to extend the lease, and on what terms?

By how much does the rent increase each year? A fair lease will include annual rent increases for inflation (CPI), with a market review every five years or so. But some leases include fixed annual percentage increases well in excess of CPI, or other unfavourable terms.

If the particular premises are critical to the success of the business (e.g. shopping centre or main road locations), do some research with the local council to ensure that no proposed town planning changes will affect access to the premises by your customers.

A good solicitor will be experienced in all aspects of property transactions and will be able to provide further advice on these matters.

2.3.7 Goodwill and other intangibles

A successful business will have a value that exceeds the value of the tangible assets such as plant and equipment and trading stock. This is because the return generated by using those assets in the business exceeds their resale value. The intangible asset called "goodwill" is perhaps best understood as that excess.

The valuation of goodwill can be complex, and again we will advise you about this when we consider the specifics of your proposed purchase. If the return generated by the business doesn't exceed the resale value of the tangible assets, then there is no goodwill, and you shouldn't pay for it.

The other intangible assets listed in paragraph 2.3.2 above may be important to the continued success of the business, even though they may not have identifiable separate values. You should only pay for those things if you are sure that you can benefit from them. Your solicitor will help you assess the degree to which you can obtain valid, exclusive rights.

There is no sense paying money for something that cannot be enforced.

2.3.8 Are you taking on any liabilities or obligations?

Industrial relations laws allow (or sometimes require) employees of a business to carry over entitlements to annual leave and long service leave, when a business changes hands.

You will be required to pay wages to employees when they take leave, even though some of the entitlement to that leave was accrued before you bought the business. It is usual for the purchase price of the business to be reduced accordingly.

The amount of that reduction is generally straightforward to establish, but it can become a matter for negotiation with the vendor. It needs to be structured properly to avoid unfavourable tax consequences for you as the purchaser.

2.4 Goods and services tax

The sale of a business as a going concern is generally a GST-free transaction, subject to one important condition – the vendor must supply "all things necessary" for the continued operation of the business. That "all things necessary" condition can sometimes be difficult to satisfy.

With micro businesses, a vehicle is often one of the things necessary to continue the business, but a vehicle is not always included. The vendor may wish to keep the business vehicle, or you may prefer to provide your own. The sale would then become subject to GST.

With larger businesses, problems can arise in relation to business premises. The vendor must supply permanent rights to access premises, by either purchase or lease, to the particular entity that buys the business. If you buy the premises in a different name to the business, a formal lease must be entered at or before the time that the property is transferred.

The cost of failing to charge GST falls on the vendor. The vendor may therefore prefer to charge GST rather than take that risk. You will be able to recover the GST in your first Business Activity Statement after the purchase. It is usually possible to arrange delayed payment of the GST amount to the vendor, so that you don't need short-term borrowings to cover it. We can provide further advice on this point if the need arises.

2.5 Legal documentation

We strongly recommend you take the time to read all legal documentation relating to the arrangements. This will typically include some or more of the following:

- Letters of offer;
- Contract of Sale;
- Copy of the lease of the premises;
- Restraint of Trade agreement;
- Shareholders Agreement (if multiple purchasers); and
- Franchise documentation.

Keep these filed in a logical sequence. Not only will this help to ensure you know what you are getting into, but it could potentially save you time (i.e. fees) with your solicitor.

2.6 Restraint of Trade

An important aspect to consider is whether the vendor should be the subject of restrictions, to ensure your new business has the best chance of success.

2.7 Establishment Costs

Here is an indication of some of the types of costs that will be incurred.

Legal fees

- Check the lease of premises by a legal firm;
- Business names search;
- Intellectual property review;
- Review contract of sale;
- Restraint of trade clauses to be considered;
- Clarify your obligations regarding employee entitlements - annual leave, long service leave;
- Relationships with key suppliers customers to ensure continuity of supplies and revenue;
- Royalty payments; and
- Review of your existing Will.

Bank

- Loan establishment fees;
- Mortgage fees; and
- Working account fees.

Setting up a new business structure

- Trust
- Company

3. OUR SERVICES

3.1 Our Services

The services we provide to you will depend upon the circumstances.

Our approach is to act in a step-by-step manner, only proceeding to the next step in the process having successfully completed the previous step and obtaining your approval to go further.

Particularly in the early stages, we will proceed on a meeting by meeting basis i.e. we may say to you, “Based upon what we have discussed today, we recommend getting together for another session shortly to explore this in more detail.”

Although it is difficult to be specific, a typical package of services going through to a successful purchase will involve the following services:

Review of the financial statements provided.

Preparation of “what if” scenarios to provide an initial assessment of viability.

Preparation of detailed cash flow projections, based upon an agreed “what if” scenario.

Preparation of a mini business plan to act as a finance application.

Provide you with a “due diligence checklist” for you to follow up.

Advise on the appropriate legal structure.

Assist with registrations as required:

- Tax File Number,
- ABN,
- GST registration,
- PAYG Withholding registration.

Meetings, “hand holding” and telephone discussions throughout the process.

3.1.1 Your investment with us

The fees you pay to us will depend upon the extent to which our services are required. We will provide you with estimates for each phase as we go.

3.1.2 Meetings

Initially, the fee will be for time spent in meetings together, which will be charged on an hourly basis. These meetings tend to range between one to three hours. Our initial meeting is free of charge.

3.1.3 Completing the purchase

Should the process evolve into a package of services such as those outlined in section above, we will endeavour to provide you with a fee estimate midway through the assignment.

If you have concerns regarding whether you can afford such fees:

- This raises serious concerns about the adequacy of your capital to start a business.

- Consider what you have at stake - a large part of your financial future is on the line!

- Discuss your concerns with us - we want a relationship that is mutually agreeable to both of us.

3.2 Guide to Buying a Business

Your investment in our services includes this Guide, which is valued at $149 plus GST. However, as a gesture of goodwill to our clients, we provide this free of charge.

The guide contains information that you can absorb at your leisure, rather than at an hourly rate in meetings with us.

In the guide, we have included many of the lessons learned over years of being involved in such evaluations. Just one such tip alone could save you many thousands of dollars!

3.3 An Important Message for New Clients

If you are a new client to Macmillans Waller Fry - Accountants, the fee arrangements will be discussed with you at the initial meeting.

If we jointly agree to proceed with the due diligence process, then you will be requested to make a payment in advance. This is mainly due to the fact that a considerable amount of work will be performed on your behalf within a short space of time.

Naturally, full details of the services provided to you will be advised as the assignment progresses.

3.3.1 Payment of our accounts

Usually, circumstances dictate that the work we perform is undertaken by a senior member of our team, and is given high priority. It is usual to have meetings at late notice and/or after normal trading hours.

This service is willingly given, all we ask is you give the same priority to paying our accounts.

3.3.2 If you have not previously engaged a professional service firm

Many people using our services to buy a business are utilising the services of a professional service firm for the first time. If you are in this situation, please do not hesitate to ask any questions about the process.

Because what we provide is by and large an intangible commodity, it is important that together we keep the lines of communication open.

Essentially, our remuneration is based upon the hours we spend working on your behalf.

Time spent preparing analyses, in meetings with you and in liaising with other professionals on your behalf is what you will be paying us for.

4. EVALUATING THE BUSINESS

4.1 The Information You Are Provided With

The information you receive from the vendor should be a very good indication of the state of the business.

Many times this information could be difficult to read and interpret; you may be supplied with prior year accounts and some scribbled notes, treat these opportunities with caution.

4.2 Evaluating a Franchise

It is common practice to receive an information kit from a franchisor if you are examining this type of business.

Some of these are excellent, others less so. Frequently overlooked items in financial projections provided by franchisors are:

- Depreciation of fixed assets;
- Interest costs;
- Leasing expenses;
- Wages for working proprietors; and
- Purchase negotiations.

Having determined what you would like to pay for the business, the next step is to successfully negotiate this with the vendor.

In consultation with us, you may decide to make an offer significantly below that which has been determined as the worth to you. How the negotiations proceed and what you offer are important decisions, which can only be determined after consideration of all the particular circumstances.

In the case of a franchise, particularly if you are dealing with a large organisation, there will usually be little scope for negotiation of the purchase price. Sadly, it is all too common for franchise businesses to be structured so that only the franchisor makes any money. This applies even to well known chains. Think carefully before offering too much for a franchise.

5. CHOOSING A BUSINESS STRUCTURE

5.1 Setting up the Right Legal Structure

This is an area that needs to be carefully discussed, in order to find a solution appropriate to your needs. Aspects for your consideration include the following:

Taxation effectiveness

- Keeping the tax expense down and staying within the current rules.

Asset protection

- Protecting your personal and business assets as much as possible from creditors and other litigants in the event that things do not go well.

Business efficiency

- You will need to operate efficiently in your day to day transactions while providing the security your venture requires.

There are five main structures used to operate a small business:

Sole trader
Partnership
Company
Discretionary Trust
Unit Trust

The type of business structure you choose will affect your taxation position, your personal legal liability, the life of your business, and the availability of capital to establish and operate your business.

5.1.1 Sole trader

Depending on the type of business and the projected taxable income, the position of the sole trader may not be the most tax-effective business structure. Generally, the taxable income of the sole trader includes the entire taxable income of the business. There are limited opportunities to divert income to other family members.

If the nature of the business is personal services, which must be carried out by you personally and cannot be delegated to others, specific personal services income (PSI) tax rules may mean that you are taxed as a sole trader anyway, even if you trade through a separate entity, such as a company or trust.

Following tax cuts in recent years, this is perhaps not the major disadvantage it once was. At 2010/11 rates, the marginal tax rate (i.e. the rate payable on the next dollar earned) for a sole trader is less than the 30% company tax rate for taxable incomes up to $80,000. The average tax rate only reaches 30% for taxable incomes above $141,700. If your projected income is below these amounts, trading as a company won't reduce your tax.

Other types of businesses, and some larger personal services businesses, are not affected by the PSI rules. For those businesses, other business structures may provide tax advantages by allowing the business income to be spread between more taxpayers, so that as little income as possible is taxed at the highest marginal rates.

The sole trader is personally responsible for any business debt or loss, and any creditor will therefore have the right to claim against the sole trader's personal assets (such as the family home) to enforce a right of payment.

The operational life of the business is limited. When the sole trader dies, the business organisation will come to an end automatically unless otherwise provided in a will.

The sole trader's access to finance for establishing and operating the business may be more limited than that of a company, although the banks now typically require personal guarantees and/or mortgages over personal assets as security, regardless of the entity type.

5.1.2 Partnership

A partnership is not a legal entity separate from the individual partners. In essence, it is a contract between the partners. The terms of the partnership are usually set out in the partnership agreement or in the absence of an agreement the partnership is governed by Common Law.

One of the advantages of a partnership is the possibility of income distribution. Husband and wife partnerships are therefore common; however the ability to distribute the income equally between the partners is not automatic, particularly because of the PSI rules described under Sole Trader. Please ask for specific advice.

In a partnership, partners pay tax at the ordinary individual rate on their partnership income.

The members of the partnership are personally liable for all partnership debts. Since partners are legal agents for each other, it is important to choose your partner or partners carefully. There is a presumption that partners will be jointly liable for contracts made by any one partner and that they will be jointly and severally liable for torts or any wrongful act committed by one partner.

A partnership can be terminated or dissolved in a number of ways. Subject to contrary clauses in a written partnership agreement, the death or bankruptcy of a partner will automatically result in the partnership being dissolved. In certain circumstances, a partner can apply to the court for a winding up order e.g. if one of the partners is of unsound mind, has been guilty of continuous misconduct, or if the business is continuing to run at a loss due to the actions of the partner.

Partnerships generally have the same access to finance as a sole trader.

5.1.3 Company

A company is a legal entity that is separate from the people who own it. A company is owned by its shareholders and controlled by its Directors, who may be (but do not need to be) the same people.

A company is taxed separately from its owners at the company rate of tax (30% for 2010/11). Company profits paid to the shareholders as dividends are taxed under the imputation system. Tax paid by the company is "imputed" or credited to the shareholder, and reduces the tax payable by the shareholder.

Over the long term, the company's profits will be taxed at the rates applicable to the individual shareholders. The advantage of a company is that tax is limited to 30% in high income years. The company can retain income and defer the payment of dividends, thereby also deferring tax. There can be permanent tax savings from paying dividends in years when the shareholders have lower personal incomes. Note that strict tax rules limit the ability of the individuals to use the retained earnings in the intervening period.

Another important advantage of a company is greater access to tax deductions for superannuation contributions, for family members employed in the business.

Company Directors have many statutory obligations and various common law duties and responsibilities. All companies are governed by the Corporations Law. It is from this that Directors derive these powers, obligations and duties. They must act honestly and in good faith for the benefit of all the shareholders and must exercise care, diligence and skill in performing their duties. If a Company Director breaches these statutory duties, he or she can be fined and or sued by a shareholder.

In general, the shareholders of a company are only liable for the company's debts to the amount unpaid on their shares, or to the amount of any personal guarantee given by them. The Directors can however, be personally liable for the debts of the company if the Directors continue to trade, if they know that the company cannot pay its debts.

A company's business can continue after the death of its owners. The shares become part of the deceased estate, and are dealt with under the will in the same way as other assets. The company can continue to trade unhindered. A company ends by a process called liquidation, under which the remaining assets are distributed among the shareholders in an orderly manner. In simple cases the company can just be struck off the register.

Companies are well established as business structures, which means that banks are generally comfortable lending for a business operated by a company. The banks typically require personal guarantees and/or mortgages over personal assets as security for loans.

5.1.4 Discretionary Trust

Discretionary trusts are popular as a form of business structure because they are a flexible means of distributing income and assets between family members (called beneficiaries), while allowing the business person to retain control over the business assets.

Day to day management of a trust rests with the Trustee(s), who can be one or more individuals, or a company. The Trustee(s) must operate the trust in accordance with a legal document called the trust deed, which gives the Trustee(s) wide discretionary powers to distribute income and assets among the beneficiaries, and the power to carry on the business. Ultimate control is held by a person (or group of people) called the Appointor(s), who can appoint or dismiss the Trustee.

Trusts provide income tax savings by allowing income to be spread among the beneficiaries. Limited amounts of income can be distributed to children under 18 tax-free, which is generally not possible with other entity types. Particular types of income, such as capital gains or franked dividends, can be directed to individual beneficiaries to best suit their individual tax position.

All of the income of a trust must be distributed to the beneficiaries each year. A trust cannot retain earnings in the way that a company does. This can be overcome to some extent by including a company among the beneficiaries, but complex tax rules may limit the effectiveness of that structure.

A trust provides the same advantage as a company regarding access to deductions for superannuation contributions, for family members employed in the business.

If the Trustee is a company, a trust provides the same asset protection and ongoing existence as a company. If the Trustee(s) are one or more individuals, the Trustee(s) are personally liable for all debts of the trust and must be formally replaced upon their death.

5.1.5 Unit Trust

A unit trust is a particular type of trust, where the ownership of the business is divided between the beneficiaries based on a number of units. It lacks the flexibility of a discretionary trust, but allows for fixed proportions of ownership while retaining the other attributes of a trust structure as described above.

Unit trusts and companies are the most common structures where unrelated parties jointly purchase a business.

5.1.6 Other comments

The choice of the correct business structure can be of critical importance to the success or failure of the business. It is also wise to seek legal advice as to the relative initial cost and ongoing costs of each structure, whether you will have a need for limited liability, how your choice of structure will affect the availability of finance, and whether there is any specific legislation relating to the type of business you intend to operate.

5.2 Which Business Structure?

Structure	Advantages	Disadvantages
Sole Trader	Low costs of entry Easy to set up No big legal costs No separate tax return required No business name registration required (if using your own name).	Personal liability for all debts. When you die, the business dies.
Partnership	Partnership itself does not pay tax Relatively inexpensive to set up and run although a Partnership Agreement is strongly recommended. Possible ability to distribute income between partners.	Personal liability for all debts. Liability incurred by one partner passed onto all partners. Potential relationship problems.
Company	Limited liability (now greatly reduced) Company tax rate is lower than the top personal rate.	More expensive to set up and run than a partnership. Separate tax return and company accounts required. Knowledge of director's responsibilities required.
Trust	Income sharing with family (although there are limitations with respect to personal services income).	Personal liability for all debts. More expensive to set up and run than a partnership. Separate tax return and accounts required.

The above information is intended as a guide only and should not be a substitute for legal advice.

The choice of structure is an important one and may involve multiple entities to achieve all the objectives required – tax effectiveness, wealth creation and asset protection.

6. FINANCE AND BUSINESS PLANNING

6.1 Applying for Finance

There are two main sources of finance to purchase the business - equity and debt. Common practice is that part of the funding will be by debt - typically a bank loan. This will require an application for finance to be made. How you present your application makes a great deal of difference to your success.

What should be included in a finance application? Applications vary from business to business. However, typically your package will consist of the following.

At the very least, a short form business plan - a summary of what the business is your plans for it and how you intend to compete in the market place. We can assist you with the sections to include.

- Full business plan if required - refer to the following section in this Guide.

- Financial details (application form).

  Some banks insist on their own form, a good place to start is the standard pro-forma we provide.

  This form is included at the end of this guide, please complete as much as possible, and we will have the application prepared for you. Some of the sections in this form may best be marked "refer to Business Plan" - we will help guide you in this regard.

  The pro-forma is designed to capture all the information the Bank will require. Having this prepared in advance is great for that vital first impression.

- Cash flow projections - a 12 month (or greater) cash flow projection.

  We will prepare this in conjunction with you. It is important that this reflect how the business will service its loan commitments, provide for tax and pay its proprietors, whilst maintaining approved finance facilities.

A comment from your accountant - endorsement from us as a third party is also an important factor in a successful application.

6.1.1 Vendor finance

An alternative to bank finance is to obtain finance from the outgoing vendor. This is in effect where you take over the business under an arrangement to pay the balance of the price over a period of time.

Although often difficult to obtain, it is nevertheless another aspect to include in your purchase negotiations.

6.1.2 Types of finance

There are many different types of finance, all with different purposes and taxation implications. The package we put together with you and your bank may include some of the following:

- Leasing;
- Hire purchase;
- Principal and interest (term loan);
- Interest only (fully drawn advance); and
- Commercial bill.

6.1.3 Who should borrow?

Most often, the banks will require a mortgage over your house, or other personal assets, as security for any borrowings.

If you plan to buy the business through a separate entity such as a company or trust, this raises an important question. Should you take out the bank loan in the name of the business entity, and provide the bank with a personal guarantee secured over your personal assets? Or, should you take out the bank loan in your own name, and on-lend the funds to the business entity?

The answer will depend on your personal financial situation. Getting it right can make a significant difference to your tax liability in later years. It is important that the taxation implications of the financial package are explained in the planning stages. Please ask for specific advice before applying for finance.

6.2 Existing Business

If you are seeking to raise finance to purchase or extend an established business, you will need to include the following:

- Copies of the business's Financial Statements;
- Copies of latest and previous taxation returns and or company returns;
- A debtors and creditors analysis;
- A copy of the business name registration or in the case of a company a copy of the Record of Registration.
- A complete listing of any stock you are taking over;
- A detailed report on any plant and equipment you will be acquiring; and
- Any feasibility studies, market surveys or consultant's reports.

In the case of buying a franchise business, you will probably need to supply a copy of the franchise agreement and any disclosure document.

One very important point to note: The vendor may try to persuade you that the business is worth more than it seems from the financial statements, because of undisclosed cash income. You cannot include that cash income in an application for finance – the bank would be placed in a difficult legal position due to cash transactions reporting legislation.

It follows that you cannot borrow against that cash income, and you should not pay for it when you buy the business. Treat it as though it doesn't exist.

6.3 The Detailed Business Plan

"No business plans to fail – it simply fails to plan"

In the following section we are going to take you through the process of preparing a plan for your business. While the main reason most people prepare a business plan is to raise finance, your business plan should not just be a tool for raising capital but a blueprint for your business's future. It should also be a way of checking the viability of your business venture.

The steps presented here are intended to form the groundwork for the planning process. If you are going to use this plan to raise finance, it is a good idea to get professional help, particularly with things like profit and loss statements and projected balance sheets. You will find that going through these worksheets first will save you both time and money in preparing your final submission. It will also help you in assessing the feasibility of your project.

6.3.1 The purpose of planning

Imagine if you engaged a builder to build a house for you and he turned up at your block of land and started unloading bricks and building material and then turned around to you and said, "OK. Where do you want the house?"

You wouldn't be very impressed, would you? Naturally, before he started building, you would want to see a plan. Just like building a house, your business needs a detailed plan.

The following section outlines the main components of a business plan.

6.3.2 Preparing a business plan to raise capital

If your new business venture is going to require finance, for example, a bank loan or overdraft facility, you must prepare a detailed business plan. Generally banks and financial institutions will not even consider lending money without one. The more detail and accuracy you can project in your plan, the more chance it will have of being successful.

Raising finance for your business should not be a harrowing experience. If you thoroughly prepare and do your homework properly, you should be able to approach your financier with a sound business proposition that will be considered worthwhile for both parties. Remember, financial institutions make healthy profits from lending money on sound business propositions.

In the case of a business loan, financiers will be looking at your ability to service the loan and your net asset backing. These days they will also want to see some form of repayment plan of the loan as well. Your security takes the form of bricks and mortar (or other easily realisable assets) and they will usually require a mortgage or some form of charge over your assets to cover them in the event of your failure to meet your commitments.

It must be remembered that small business failure rates are extremely high, and banks and other financial institutions are usually very cautious in their approach to lending in this area. Banks do not like the idea of foreclosing on the loan, so even if you have the asset backing, if the business plan and the people behind it do not look sound, there is no guarantee your application will be successful. The bank will usually reject you in your own interest.

If you can't obtain finance from a bank, don't be tempted by other financiers offering "low-docs" or "no-docs" loans.

6.3.3 The plan

If you are starting a new business from scratch, your business plan will need to consist of at least the following components:

- A contents page;
- An executive summary;
- The business objectives;
- Product or service profile;
- A marketing plan;
- Details of repayment of loan;
- Security of loans and guarantees;
- Personal financial status;
- An organisational plan; and
- Appendices.

6.3.4 Contents page

Details of what is contained in your plan.

6.3.5 Executive summary

This should be the first document in your business plan but it is the last one you prepare. It should not be much longer than a page, it should simply summarise in simple terms what your plan entails. It is intended to give a person reading your plan a broad overview of what you are setting out to achieve.

6.3.6 Business objectives

A detailed description of the business strategy and objectives, i.e. what you are going to do and your mission statement – in other words – what is the business of your business?

6.3.7 Product or service profile

A detailed description of the product or service you will be offering. If any machinery or equipment is involved - supply details.

6.3.8 Marketing plan

Marketing strategies, projections and sales forecasts, including market analysis, supplying as much information as possible about the state of the marketplace you will be entering, details of competition, historical information on growth of the overall market, what area of the market you are aiming for and any advantages or disadvantages you are likely to have over your competitors.

6.3.9 Financial plan

A detailed financial plan for the business, both short term (one year) and a longer term projection (say three years) should be prepared. Projecting beyond this is probably pointless, especially in a new business.

Make sure that your forward projections are conservative; don't just predict a 50 per cent increase each year unless you can solidly substantiate it. You are far more likely to be taken seriously if you project a modest annual increase. List details of the capital required to both start up and run the business together with a projected cash flow.

Your plan should also detail the intended use of the capital you want to borrow. For instance, will it be used for working capital or for the purpose of acquiring plant and machinery? Give details, indicate what assumptions have been made in arriving at any budget figures e.g. assume interest rates of 10 per cent and an inflation rate of 4 percent.

It is also desirable to have a projected profit and loss statement and balance sheet, especially if you are going to seek a substantial amount of money. These are fairly complex documents, and you will probably need to seek our advice in preparing them.

6.3.10 Repayment of loan

Financiers are no longer simply concerned with whether you can service the loan; they want to see evidence that you are going to eventually repay the loan. Your business plan should include details of how and when you will repay the loan. It is unlikely that lenders will be very interested in proposals that simply want to borrow money with no indication or plan to ever repay it.

Your repayment strategy should tie in with your cash flow projections. It could, for instance, detail regular monthly repayments of capital reducing the loan over a period of time, or it may be reduced by lump sum payments as the business grows and becomes more profitable.

6.3.11 Security of loans and guarantees

Outline details of any assets that are going to be used as security. If you are going to use your home as security, supply details of any mortgages outstanding or any other encumbrances on any assets used as security. It should be remembered that these days, lenders are not just looking for adequate security; the project must first demonstrate that it is viable and that the interest and capital repayments can be discharged during the normal course of the business. Once this has been established, then the financier will turn to security.

Financiers will not generally lend without adequate security and this is always assessed in a very conservative manner. Banks will normally nominate their own valuer to value your assets. Bear in mind they are usually conservative in their valuations and will often value your property at 20 per cent or more below what you consider to be the ‘real’ market value.

6.3.12 Personal financial status

A personal financial statement for all the principals involved in the business, listing assets and liabilities and ongoing income streams.

6.3.13 Organisational plan

Include an outline of the management structure, responsibility and accountability of office holders. In other words the people behind the business, what they do and to whom they will be accountable. Details of the type of structure the business will operate under, e.g. company or partnership.

List names of directors and company secretary and location of registered office, if a company. Also (if possible) supply details of any employees you may be hiring and their particular expertise.

6.3.14 Appendices

Any information or further details needed to back up or enlarge upon any of the above, such as brochures, market research, press clippings, competitors’ advertisements, statistics, evidence of any trade or professional qualifications etc.

6.3.15 Finally…

After drafting your plan, review it in terms of completeness, objectivity, logic, presentation and ability to communicate your proposal.

It is recommended that you seek our professional advice in the completion of your business plan.

6.4 The Marketing Plan

Marketing is the analysis of customers and competitors, combining this understanding into an overall understanding of what opportunities exist, deciding on targeting the most profitable marketplace, positioning your product, and then doing what is necessary to deliver your product or services profitably.

6.4.1 The SWOT analysis

The first step in preparing your marketing plan should be to undertake what is known as a SWOT analysis. This is an acronym and stands for Strengths, Weaknesses, Opportunities and Threats. Take a sheet of blank paper and draw a line down the middle, on one side, list your strengths and opportunities that are likely to present themselves.

What is it about your product or service that makes it stand out from the crowd?

List any unique selling features or benefits that you will have over your competitors. Are you personally well known and respected by the marketplace? Are there any unique selling points? For example, you could be the only Chinese language-speaking carpet shop in the area.

On the other side of the line, list your weaknesses and any threats to the ongoing health and viability of your venture, e.g. limited capital, unknown in the marketplace, limited buying capacity, etc.

Threats could be things like removal of tariff protection to allow cheap imports into the market or changes to government legislation that could affect your trading and so on.

In compiling your SWOT analysis, list every strength, weakness, opportunity or threat you can think of (no matter how obscure) and then undertake finer analysis later on. This will be most useful in helping to produce your final marketing plan. Your marketing plan should be thorough and well researched and is critical to your business success or failure.

Your marketing plan should encompass all the aspects of your overall marketing strategy and is best summed up by what is known as the 4 P's of marketing:

Product and Prospects

Price

Packaging and Promotion

Place

In other words:

What are you going to sell and who are you going to sell to?

At what price are you going to sell your product?

How are you going to present it to the market and how are you going to promote your product?

Where are you going to sell your product?

7. RUNNING THE BUSINESS

7.1 Preparing to take Delivery of the Business

7.1.1 "Getting shown the ropes"

It is usual to have meetings with the outgoing owner to learn about how the business operates. Avail yourself of this opportunity. It is preferable that this be done as much as possible before committing to the business.

If a phase-out process is part of the post sale arrangements, it is important that this be clearly documented.

7.1.2 Setting up an accounting program

The business you acquire may not have an adequate accounting system. This is the bedrock of all your business decisions without which you will fail. We will discuss appropriate alternatives with you for your new business.

7.1.3 Survival and frequency of accounting reports

Frequency	Survival Rate %
At least monthly	79.7
Quarterly	71.5
Half-Yearly	49.9
Annually	36.0

Source: Williams, A.J, A Longitudinal Analysis of the Characteristics and the Performance of Small Business in Australia.

Don't forget that you will have to prepare a Business Activity Statement quarterly or monthly. This is an ideal opportunity to review your accounting reports.

7.1.4 Miscellaneous

Telephone, fax facilities and electricity should also be organised for a smooth transition from the start.

7.2 Insurance

One of the most important aspects of running a business is making sure you have adequate insurance cover in case something goes wrong. All too often small business owners don't consider all their insurance needs until it is too late. Contact your insurance broker before you start out in business and make sure you are covered for the unexpected.

While insurance requirements vary greatly from one business to another, the following is a guide to the most common types.

7.2.1 Business pack insurance

Your insurance broker will be able to arrange "business pack" insurance that is tailored to the needs of your specific business. This will include cover for some or all of the following risks:

Material damage – this covers the assets of your business such as buildings, stock, plant and equipment against physical loss, destruction or damage.

Burglary – this covers loss of or damage to stock, plant, equipment and other contents caused by burglars. In addition, the policy automatically provides cover for damage to premises sustained in a burglary, costs of temporary security following a break in, and replacement of locks should keys be stolen.

Glass breakage – this insures you against breakage of fixed external and internal glass and other nominated breakable objects such as signs. The policy automatically covers damage to frames, replacing sign writing and ornamentation, damage to stock, and costs of temporary closure.

Money – this provides protection for money while in transit, on your business premises during and outside normal business hours, while in a locked safe, and while in the private residences of authorised persons. Damage to safes and strong rooms may also be covered.

Public products/liability – this insures you against claims, for which you are legally liable made on your business by members of the public as a result of death, injury or damage to property. You can also be protected against claims related to the following events:

- The nature, condition or quality of products you sell or supply;
- Your liability as a tenant; and
- Your liability for the goods of others left in your custody.

Employee dishonesty – this insures you against the risk of employees fraudulently or dishonestly taking money or goods belonging to your business.

Electrical mechanical breakdown – you can insure nominated items of electrical and mechanical plant against sudden and unforeseen physical damage. In addition, refrigerated stock may be covered against deterioration following damage to insured refrigeration equipment.

Computer and electronic equipment – this insures nominated computers and electronic equipment against sudden and unforeseen damage. Coverage may also be arranged to meet data media restoration costs following loss of information and the increased costs of maintaining a substitute data processing system after an insured equipment breakdown.

Special risks: general property – this covers specified property anywhere in Australia against accidental physical loss, destruction or damage. Valuable plant and equipment items taken away from your business location should be insured under this section.

Income protection – this insures against loss of gross profit following damage to the assets of your business. The increased cost of operating your business after such misfortune may also be covered plus outstanding debtors and loss of rent receivable.

Goods in transit – gives you a choice of insuring nominated property while in transit by land or air against either accidental damage; or the more limited risks of fire, flood, collision, or overturning of the conveying vehicle

7.2.2 Motor vehicle

Motor vehicle insurance may be included in your business pack, or it may need to be arranged separately. It covers specified motor vehicles against accidental damage and theft plus your legal liability for damage insured vehicles may cause to the property of others.

7.2.3 Personal accident and illness

This allows you to insure any number of specified persons (usually proprietors or partners) worldwide, 24 hours a day, seven days a week. You may nominate the coverage required for weekly benefits payable for up to 104 weeks in the event of accident or illness and lump sum amounts in the event of death or major disabling injuries caused by accident.

7.2.4 Key person insurance

Most business people are aware of the need to insure against loss of property or assets through fire or theft but they often overlook their most important asset. Key people are the most valuable assets of a business and you should insure them.

What would happen to your business if a key person was permanently disabled or died?

There is also the possibility of any of the following scenarios:

- Profitability decline due to the loss of key sales or production team members;
- Money would need to be outlaid to find a suitable replacement;
- Pressure would be placed on remaining employees and/or family members;
- Credit may be affected if the bank becomes aware of the impact on the business; and
- The remaining employees might feel that their future is insecure.

Life insurance arranged on the life of your key employees and owned by the business, will provide cash infusion on the event of the death or disablement of those employees.

7.2.5 Business insurance life plan

A life insurance plan will provide the cash required to repay a business loan on the death or disablement of a principal. Such loans are usually secured by a charge over the business assets and the guarantees of the principals. Cash provided by life insurance will discharge the business's liability, protecting the business assets and the estates of the guarantors.

7.3 Unravelling the Legislative Requirements

Trading entities need to be aware of the legislative environment, which imposes restrictions both on them in their individual capacities and on the entities they represent when promoting goods and services.

Small businesses will encounter a wide range of legal matters in their everyday operations. Knowing where to start in identifying the issues and deciding when to seek professional advice is an essential part of the role of a successful business operator.

7.3.1 Trade Practices Act

The Trade Practices Act 1974 encourages fair trading at all levels from the manufacturer through to the consumer. It provides for regulation of anti-competitive and misleading or deceptive trading practices, and for protection not only of consumers but of their sources of supply.

Restrictive trade practices prohibited by Pt IV of the Trade Practices Act include:

- Contracts, etc, affecting competition;
- Price fixing;
- Boycotts;
- Misuse of market power;
- Exclusive dealing; and
- Resale price maintenance.

The Trade Practices Act 1974 is administered by the Australian Competition and Consumer Commission. The Commission receives and investigates complaints and may instigate proceedings in the Federal Court of Australia for contravention of restrictive trade practices provisions found in Pt IV. It may also bring prosecutions in that Court for offences against the consumer protection provisions.

In addition to regulating trade, the Trade Practices Act 1974 aims to improve the position of the consumer in his or her dealings in the market place. Broadly, it covers the following areas:

- Unfair practices - such as misleading or deceptive conduct;
- Misrepresentation, together with other unfair conduct;
- Product safety and product information;
- Conditions and warranties in consumer transactions;
- Actions against manufacturers and importers of goods, and
- Strict product liability.

7.3.2 Fair Trading

The fair trading legislation which applies in each of the various States and Territories is summarised below:

- New South Wales: Fair Trading Act 1987 (NSW);
- Victoria: Fair Trading Act 1999;
- South Australia: Fair Trading Act 1987 (SA);
- Western Australia: Fair Trading Act 1987 (WA);
- Queensland: Fair Trading Act 1989 (Qld);
- Tasmania: Fair Trading Act 1990 (Tas);
- Northern Territory: Consumer Affairs and Fair Trading Act 1990 (NT); and
- ACT: Fair Trading Act 1992 (ACT).

The legislation covers such items as:

- product safety standards;
- product recall;
- product information;
- misleading or deceptive conduct;
- unconscionable conduct;
- false representations and other misleading or offensive conduct;
- misleading conduct in relation to employment
- referral selling;
- accepting payment without intending or being able to supply as ordered;
- misleading statements about certain business activities; and
- harassment and coercion.

The legislation of the various States also covers areas like trading stamps, lay-by sales, door-to-door trading, enforcement and remedies.

7.3.3 Corporations Law

The Australian Securities and Investments Commission (ASIC) administers the Corporations Law and regulates Australian companies. Information on all aspects of running a company can be accessed on the ASIC website, www.asic.gov.au.

7.4 Employment Issues

7.4.1 Recruitment

When recruiting new employees, be aware of the rules and regulations that apply at both State and Federal levels. Listed below are the areas of legislation that may have an impact on the recruitment process.

Anti-discrimination and equal opportunity.

Industrial relations – the Workplace Relations Act 1996 and Fair Work Act 2009 (both Federal laws) contain provisions which affect recruitment. A Fair Work Information Statement must be provided to all new employees. Industrial relations laws in each State may also apply.

Trade practices legislation – under Federal trade practices legislation and State and Territory fair trading legislation, misleading job advertisements may attract significant penalties.

Taxation legislation – you will need to register for PAYG withholdings and possibly fringe benefits tax in respect of the employment of employees.

Workers compensation – every employee in Australia must be covered by workers compensation insurance, you must obtain a policy before commencing employment.

Apprenticeship and industrial training – industrial relations law makes special provision for the employment and training of juniors.

Government subsidies and assistance to employers as a means of encouraging employment.

Psychological practices – certain psychological practices and tests are outlawed or require qualified persons to carry them out.

Tradesperson registration – to legally work as a tradesperson a certificate from a recognised training institution is necessary.

7.4.2 Documents relevant to recruitment

Documents that are related to the recruitment process may in fact be crucial to the operation and enforcement of laws relating to recruitment. Some of the numerous documents relevant to the recruitment process and the legal issues associated with them include:

Advertisements - employers must be careful not to breach equal opportunity laws.

Instructions to employment agents - employers should put their instructions to employment agents in writing so that any confusion over what is required and the authority of the agent is avoided.

Application forms - equal opportunity laws should not be breached and certain personal information should be carefully handled.

Offer of employment - offers of employment should be carefully worded. Once the offer is made and accepted, then a contract is formed and certain rights and obligations arise.

Medical examinations - certain positions require employees of a particular level of fitness or require employees who do not suffer particular conditions. Results of medical tests should be handled in confidence.

References - written references requested and received by management require careful handling. Defamation of an individual is possible if these documents are not properly handled.

7.4.3 Wages and conditions

The laws in Australia regarding employees' wages and conditions underwent enormous upheaval in the period from 2005 to 2009. Following the enactment of the Fair Work Act in 2009, the uncertainty was more or less resolved, but at the time of writing (May 2010) the system continues to be in a transitional phase.

The system is summarised as follows on the Fair Work Online web site (www.fairwork.gov.au), which we strongly recommend that you consult for detailed and current information:

- 10 National Employment Standards (NES) apply to all employees;
- A Fair Work Information Statement must be provided to all new employees;
- Employers that may have previously been covered by State systems are progressively moving into the national system;
- 122 modern awards replace old awards in most industries; and
- There is a transition to modern award pay rates.

An employer is obliged to pay wages, where an award exists, at the appropriate rate of pay dictated by the award, which is enforceable under the relevant industrial legislation, but only to the extent of the minimum amount prescribed by the award. Any agreed amount over the minimum is a common law debt recoverable by civil action. In the absence of an award provision there is almost certainly an obligation to pay wages during an absence due to illness, unless the contract of service is terminated.

7.4.4 Reimbursement of employees for expenses incurred

This obligation at common law is recognised in the practice of expense accounts and other trappings of more senior and responsible employment, but it should not be overlooked that every worker is owed this duty.

7.4.5 PAYG withholdings

Failure to do so means that an employer can not only be convicted and fined but will also have to repay the unremitted tax.

7.4.6 Superannuation guarantee scheme

The Superannuation Guarantee Scheme, administered by the Australian Taxation Office, requires all employers to provide a prescribed minimum level of superannuation support (currently 9% of ordinary time earnings) for each of their employees, subject to limited exemptions.

You are required to give each employee the right to choose their own superannuation fund to accept contributions, but you can select a default fund if an employee fails to choose within a time limit.

Contributions must be made at least quarterly. Employers who fail to provide the prescribed minimum level of support are liable to a superannuation guarantee charge, equivalent to the amount of the shortfall plus an interest component and an administrative charge.

The legislation governing the Scheme is the Superannuation Guarantee Charge Act 1992 and the Superannuation Guarantee (Administration) Act 1992.

7.4.7 Workplace health and safety

Each state has legislation regarding workplace health and safety. This legislation places an obligation on every person to ensure their own workplace health and safety, and the workplace health and safety of others.

An employer is a person who, in the course of his or her business or undertaking, engages someone else to do work, other than under a contract for service.

Employers are required to ensure the workplace health and safety of themselves, their workers, and any other person at a workplace. This includes people like visitors, salespeople and passing pedestrians. There is an underlying liability at common law on an employer to provide safe working conditions and to compensate an employee in damages for injuries sustained as a result of the employer's failure to do so.

7.4.8 Workers compensation

If an injured worker applies for compensation, you must complete your section of the Compensation Claim Form and return it to their State's authority within 10 days of:

- knowing about the injury; OR
- having the injury reported to you; OR
- The relevant authority requesting this information from you.

You must also take all reasonable steps to help with rehabilitation and suitable duties while a worker is receiving compensation.

7.4.9 Other taxes

State pay-roll tax (calculated as a percentage of the total cost of employment, including wages, superannuation contributions and fringe benefits) will need to be considered if wages exceed about $500,000 per year. The rates and thresholds are different in each State.

Fringe benefits tax will need to be considered if non-cash benefits, such as company cars, are provided as part of employees' remuneration.

For non-employees or contractors the PAYG system may impose an obligation to deduct tax from the contractor's income.

7.4.10 Obligation to provide work

In the case of a 'piece worker' (where the employee's remuneration depends upon results), the employer is required to provide work. Or if the performance of an employee's work involves particular skills which should not be allowed to waste away (such as those of research scientist, a toolmaker or an actor), the employer is required to provide work.

However, the general rule is that the employer normally has no greater obligation to the employee than the payment of wages.

7.4.11 Useful references

www.business.gov.au
www.ato.gov.au
www.fairwork.gov.au
www.dir.qld.gov.au
www.wairc.wa.gov.au
www.vic.gov.au
www.nsw.gov.au
www.tas.gov.au
www.nt.gov.au/wha
www.workcover.qld.gov.au
www.workcover.wa.gov.au
www.workcover.vic.gov.au
www.workcover.nsw.gov.au
www.workcover.tas.gov.au
www.workcover.sa.gov.au

7.5 Enhancing the Chances of Business Survival

Our advice to any client seeking to establish a small business covers five "must have" personal qualities and resources.

A commitment to hard work and personal sacrifice;

Enthusiasm, tenacity, and the appropriate level of self confidence;

A product, skill, or service which is marketable;

Managerial, administration and marketing skills; and

Adequate personal financial resources.

For all the rewards of being your own boss many things taken for granted as an employee will disappear: job security, set hours of work, known and guaranteed income, holiday and sick pay, and long service leave.

Business start up statistics are worth considering. 24% of all Australian businesses that started in the 2003/04 financial year had closed by June 2005. Some 51% had closed by June 2007. While the reasons for business failure are many, the most common appear to be:

- Under capitalised;
- Poor management;
- Inadequate records;
- Stock – too much, or too little;
- Failure to plan;
- Misuse of time;
- Neglecting marketing; and
- General management incompetence.

Yet excuses for business failure are too often levelled at "business climate", finance costs and difficulties, demand slumps, and regulations – not at the five "must haves".

Well managed businesses will:

- Weather economic and business storms;
- Have proper financial information;
- Use a written business plan with future development and expansion guide lines;
- Have an adequate product mix;
- Do not rely too heavily on one, or a limited group of customers or clients; and
- Know their operating environment.

7.5.1 Insufficient capital

Insufficient capital makes it difficult to purchase stock and materials which in turn means lost sales. Invariably the business will fail to meet its commitments as they fall due.

7.5.2 Lack of management expertise

A detailed business plan is essential, not only for the purpose of raising capital but to act as a blueprint for your business's future growth. Make sure you have the necessary expertise in your chosen business field; don't think you can get away with learning on the job.

7.5.3 Cash flow

Any business that fails to forecast its cash flow appropriately is headed for trouble. Without proper and accurate cash flow projections, management is unable to identify future cash requirements and hence lacks vital information about the financial direction of the business.

That's why we strongly recommend the preparation of a 12-month cash flow budget *before* you start the business. Ideally each business should have a budget showing expected future income and expense levels and the minimum return to the owner.

There are many "tricks of the trade" that can be used to preserve your cash flow - leasing particular assets as opposed to buying them is a good example.

It is vital for each business manager to know the point at which the business will break-even. This is the point at which the gross profit (revenue less direct costs) equals total fixed costs. Knowing these revenue levels and monitoring them regularly will equip the owner to know from month to month how his or her business is performing.

There are many signs on the road to failure and if these are addressed then survival is more likely to be assured.

7.5.4 Profit v cash flow

It is often not fully appreciated by business people that making a profit do not necessarily mean cash flow will be positive.

A wise man once said, "Profit is an opinion, but cash flow is a fact."

The long term trend of both must be positive. Hence it is vital to appreciate the importance of the interaction between profitability and cash flow projections. Low profit months will generally impact on cash flow in the current and following periods. Therefore the ups and downs in turnover will usually be mirrored in cash flow projections.

The following is a list of items that often contribute to there being differences between profit and cash flow.

- Debtors;
- Work in progress;
- Stock;
- Fixed assets;
- Shortened supplier terms of credit;
- Change in sales mix, with an increasing proportion of credit sales as opposed to cash sales;
- Loan repayments;
- Taxation;
- Dividends; and
- Depreciation.

The cash flow budget and the other scenarios we will prepare on your behalf will take these factors into account. However, please do not hesitate to ask us if you require further clarification in this important area.

7.5.5 High gearing

Borrowing excessively means a greater portion of gross profit is directed towards finance costs. Cash flow is also drained by repayments.

7.5.6 Incorrect pricing policies

Too often prices are set to market determinants rather than to cost recovery and profitability generation. Efficient service or added value may be more important than price alone. Unless you can make an adequate margin of profit, you are doomed to failure.

7.5.7 Marketing

Many small businesses go broke simply because they don't sell enough product or they fail to keep abreast of market, operating and technological changes. In business, nothing is constant. You must continually update your product or service to stay in tune with market demands.

7.5.8 Partnership problems

Partners should be selected in the same way as employees are selected – that is, on the basis of their ability to contribute effectively to the business and help achieve its goals. Too often a partner is selected simply because he/she is a relative or friend or is willing to contribute an amount of capital.

7.6 Checklist of Issues to Consider

7.6.1 Sales

Is the product or service likely to maintain or improve its marketability, or is it in danger of becoming over-sold, out of style or obsolete?	
Is the business in a good location or is this the reason why it is for sale?	
Are prices competitive?	
Are competitors gaining strength?	
Are there reliable records for all sales?	
Are the total sales broken down by product line, if applicable?	
Are bad debts deducted from sales, or are they still shown as receivables?	
Is the percentage of bad debts acceptable according to industry standards?	
What is the sales pattern year by year and month by month?	
Is the pattern seasonal or related to some business cycle (such as home construction or other uncontrollable variable)?	
Are some goods on warranty?	
If so, will a financial allowance be made for possible warranty commitments?	
Are some fluctuations in sales due to lucky one-shot sales?	
Is a particular salesperson critical to success? Will you be able to retain that person in your employment?	
Is the seller's personal role critical to success?	
Are you sure all sales are for the business and the seller hasn't added sales from another business?	
Are you sure that the rate of stock turnover is in line with the industry practice?	
Are you sure that the existing stock does not include slow moving items from another business?	
Will you be able to continue buying the products from existing suppliers?	
Can you increase sales with current resources?	

7.6.1 Sales

Are new developments going to be commenced or opened in a nearby location that could affect your trade?
Is the Industry in which the business operates expanding, contracting or remaining static?
What does the business offer that is unique?
What is the product sales mix, that is, the number and value of sales by product or by customer?
Do a small percentage of customers represent a large percentage of sales?
Have you looked at the effect of increased or decreased sales on profit?
Do you know the minimum likely sales?
The maximum likely sales?

7.6.2 Costs

Are all expenses shown?
Will you as a new owner have the same level of expenses?
Is there a chance the owner has paid expenses through another business?
Has the owner avoided some expenses that could be delayed such as equipment maintenance?
Will you pay for poorly maintained plant later?
Are there annual expenses coming due soon?
Are there new or increased expenses you should anticipate?
Is an adequate salary allowed for work done by the owner and his family in addition to an adequate profit margin?
Is interest paid for money loaned to the business?
Is depreciation claimed for the equipment and if so is it reasonable (particularly for the price you'll be paying)?
Is depreciation based on accounting or tax method?
Have you checked the terms and conditions of the lease and discussed these with your solicitor?
What effect would decreased or increased sales have on your costs?

7.6.2 Costs

What expenses do similar businesses have?
Do you know what costs are allocated to which product, and how a change in product mix would affect costs?
Are some expenses prepaid by the seller?
Will you have to reimburse the seller for your share of any prepaid expenses?
Has inventory been accurately shown at true current value, for calculating actual cost of goods sold?
Are the employees adequately paid, or do they expect wage increases soon?
Are the employees paid according to award conditions?
Which party is responsible for previously accrued entitlements on long service leave, holiday pay, superannuation and other benefits to employees?

7.6.3 Profits

Have you considered what effect inflation will have over the years to come? (On sales? on costs?)
Are profits adequate to warrant taking the risk?
Have you analysed the financial records for the last three years including balance sheets, profit and loss statements, tax returns, purchases and sales records and bank statements?
Have the records been well kept?
Based on past financial results have you projected the future cash flow and profitability of the business?
What is the break-even point?
Do you know exactly what you are buying and not buying?
Are there lists and have you checked them?
Are some goods on consignment, with the right of being returned for full credit?

7.6.4 Assets

Has any customer paid for items not received?
What is the book value, the market value and replacement value of the fixed assets? Which will you pay?

7.6.4 Assets

If inventory or work in progress is to be included has a value been agreed upon at the time of offer?	
Have you agreed on how it will be adjusted at time of closing, and within what limits?	
Have you decided what intangibles you want – mailing lists, business name, exclusive rights, leases etc?	
Can they be transferred?	
If you need new licences do you know what is required to get them?	
Are you buying the accounts receivable?	
Do you have a listing of these accounts by age?	
Have you determined doubtful debts, and has adequate provision been made for them?	
What could you sell the accounts receivable for to a factoring agency (bank or finance company)?	
Is the equipment in good repair? Is it efficient?	
Is it in danger of becoming obsolete or difficult to service?	
Could it be sold easily?	
Is any equipment leased?	
Do you know the terms and the cost of each lease?	
Will you get ownership on maturity?	
What is the residual value?	
Will you have to build up your own accounts receivable?	
Have you considered how this will affect your cash flow?	
If the business is a limited company, are you buying the shares or the assets? Be sure to consult a lawyer or accountant on this point.	
Have you consulted your accountant on how to value the various assets for the best tax advantage?	
Are the assets you're buying free of debts and liens?	
Have you investigated this carefully?	
If you are assuming some debts, do you know the exact terms of repayment? Is this in writing?	
Are there any contingencies such as warranties, court actions or guaranteed debts or accounts?	

7.6.4 Assets

Are you assuming any risk of being liable for the previous owner's actions (as might happen when buying a limited company)?	
Will you be expected by customers to make refunds or warranties, even though you're not legally obligated to do so, or risk losing their goodwill?	

7.6.5 Liabilities

Has the previous owner received any payment in advance – deposits, etc which he or she should turn over to you?	
Have you checked the business' credit rating with suppliers?	
Will you receive an established rating (or be treated as a new account)?	
If buying part of a company or entering a partnership do you know what limits there are on one person making a commitment on behalf of the business?	
Will your cash flow from operations be enough to pay your debts?	
Do you know the real reason why the business is for sale?	
Is the seller being co-operative in supplying the information?	

7.6.6 The seller and you

Is the seller willing to sign a non-compete agreement (Restrictive Covenant)?	
Will the seller train you and assist you after purchase? If so, for how long?	
Is this the type of business you were actually looking for?	
Is the type and size of business compatible with you interests, experience, personality and capital?	
Are you ready to negotiate? Remember a business is worth no more than the highest price someone will pay or no less than the lowest price the seller will accept.	

7.6.7 The purchase agreement

Does the draft agreement cover what assets are to be purchased, what liabilities are to be assumed and when the business is to be taken over?	
In drafting your offer, have you included escape clauses covering obtaining finance, inspecting all records, receiving necessary licences and rights, other transfers, and minimum trading levels being met during the trial period?	
Have you arranged for total control over the recording of cash sales and banking for the trial period?	

7.6.8 Legal

Have you consulted a legal representative in regard to the terms and conditions of any applicable lease agreement and your obligations and rights under that agreement?	
Are you responsible for any corporate body expenses related to the business?	
Has a recent change in the Landlord taken place? This could point to such things as an impending increase in lease payments or possible redevelopment proposals.	
Does your solicitor’s search reveal that no notices in regard to health, water and sewerage or other government requirements have been served on the business requiring work to be carried out?	
Has a rezoning application been lodged in regard to either the intended business location or nearby locations?	
Are major road developments or public works going to proceed in the near future, which may affect your business?	
Do you understand your obligations under the intended business legal structure? You should consult a solicitor and an accountant in this regard.	

7.7 And Finally, Some Good Old Fashioned Advice About Success In Business

Set yourself work performance and income goals for each day, each week, each month and each year. Don't allow yourself or anybody else to side-track you from those goals.

Always be reliable, punctual and totally professional in everything you do. Remember that customers want more from you than just the provision of goods and services.

Never forget that you're most important and valuable business asset is satisfied customers. Any fool can start a business; satisfied customers and hard work keep you in business.

Don't make promises you know you cannot deliver on. Always let people know if circumstances beyond your control mean that a promise you've made must be broken.

Be totally honest in your business dealings but don't trust anyone else except your family. Never lie to bank managers, accountants or the tax authorities.

Save tax money as you earn income it isn't yours to spend or 'use' until payment is due.

Never resent the fees you pay to a good accountant.

Generally speaking most people will envy your successes and rejoice in your failures. Don't talk about business success or failure to anyone except your professional advisers.

Always spend much less than you earn, always keep at least three months income in reserve. Adjust your overheads to match your income when circumstances demand that you should…and they will.

Work hard; forget about the 40 hour week, your business income will relate directly to the number of hours you work and the amount of effort you expend.

Specialise. If you become an expert in your chosen field of business, you will reduce the level of competition and increase the value of your labours.

Think ahead, plan ahead. Dare to be different to your competitors. Be prepared to make 'change' your friend or it will become your worst enemy.

Never be too proud to ask question of wiser men but only act on advice which 'feels' right to you. Don't worry about the mistakes you will make, but always be determined not to repeat them.

Try to keep business in perspective with your personal life. Your wife, children, family and friends will be lost to you if business becomes an obsession and you cannot 'buy' those things back once they are lost!

Choose your life partner carefully if you seek long-term success in business. More people have been ruined by their spouses then by competition or economic downturn.

If your primary goal in business is the acquisition of money you will surely fail. If you love your work and make customer satisfaction your key goal, then financial success will follow.

Be polite, courteous and friendly towards both customers and suppliers. Smile for everyone….nobody wants to do business with a miserable or negative person.

Be determined, be committed and don't give up. The only true failure is giving up when things go wrong…and you will face problems and difficulties which seem to be impossible to overcome.

Value your integrity and reputation above all else. When trust between two people is lost, the damage to the relationship can never be repaired.

Cover yourself with paperwork. Commit all agreements and business arrangements to paper and keep a copy on file….verbal agreements aren't worth the memory they have been stored in!

Take your time and take the 'long' view on everything. If you try to grow your business before your have the finance or experience to build on, you will cease to enjoy your work and your life.

Always over estimate costs by 100% and under estimate income by 50% and you'll probably be right on budget. Try to make all your business decisions with your head and not your heart. Never ask a bank manager for business advice, few bankers are successful businessmen.

With new ideas and business projects spend more time trying to find reasons why it 'won't work' than you spend convincing yourself that it 'must' work….always try to have a 'plan B' in place, in case you do make an error in judgement.

Don't be afraid to make decisions. Some you make will certainly be wrong and you'll pay a price for that. Just try to minimise the risks and remember that the man who doesn't make mistakes, doesn't make anything of value.

Finally, don't include luck in your business plans. In my experience luck has little to do with business success or failure. You'll find that the harder you work, the luckier you'll get.

We look forward to working with you to achieve your business success.

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