

# **How to Negotiate The Buy or Sell of a Business**

## **A Step by Step Guide to Negotiating the Buying or Selling of a Business**

By BizMove Management Training Institute

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## **1. Negotiation Objectives**

The final objection of the negotiation process is a written agreement covering the details of the proposed buy-sell transaction. Some of the details - price, terms of payment, price allocation, form of the transaction, liabilities, warranties - are matters over which the interests and motivations of the buyer and seller may be in sharp conflict.

**The seller is interested in:**

The best possible price

Getting his money

Favorable tax treatment of gains from the sale

Severing liability ties, past and future

Avoiding contract terms and conditions that he may not be able to carry out.

**In contrast, the buyer is interested in:**

A good title at the lowest possible price

Favorable payment terms

A favorable tax basis for resale and depreciation purposes

Warranty protection against false statements of the seller, inaccurate financial data, and undisclosed or potential liabilities-

An indemnification agreement and security deposit.

The agreement reached by the parties, if they succeed in reaching one, will be the result of bargaining. Depending on the relative bargaining position of the buyer and seller, the buy-sell contract may reflect other compromise or capitulation.

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## **2. Negotiating the Price**

The central bargaining issue in the buy-sell transaction is price. Price is what is actually paid for a business. Value, as distinguished from price, relates to what the business is worth. The decisions of the buyer and seller as to how much to pay or take for each dollar of potential profit are a basis for bargaining, but other factors affect the final price.

In the Regal Men's Store negotiations, The seller was asking \$100,000 for his business. The buyer made his own evaluation of the business and offered \$66,000. After an extended period of negotiations, The buyer and The seller agreed on a purchase price of \$84,000.

What determined the asking and offering prices? How did they finally arrive at the figure of \$84,000?

The process of price determination is sometimes described as horse trading. This element is important, and undoubtedly both The seller and The buyer anticipated it in setting their asking and offering prices. But granting that tactics and compromise play a part in price determination, other explanations often account for the relative success or failure in the bargaining process.

Bargaining position. The price paid often reflects the bargaining position of one of the parties. Is the seller's desire to sell stronger than the buyer's desire to buy, or vice versa? The reason behind the decision to buy or sell is important. This would be true of a seller who must sell because of age, health, or personal financial reasons. If the buyer knows that sale of the business is urgent, the seller is less likely to get a reasonable price for his business, although the reasons bear no relation to the value of the business or the ability of the buyer to pay cash.

The seller's willingness to finance part of the price, or perhaps all of it, will also depend on the urgency of his need to sell. Sometimes a purchase price is agreed upon but later raised because the buyer is unable to get outside financing. The price may also be adjusted in order to get favorable tax treatment or in exchange for more favorable terms in other aspects of the contract.

The time factor. Another important factor affecting bargaining position is the time element. When to sell, when to buy. Economic conditions cannot be overlooked. The seller is more likely to gain his bargaining objectives when business conditions are good, particularly if his business is sharing the property. During periods of recession either general, local, or in a particular industry or activity - the pessimistic outlook of both buyers and sellers tends to depress prices.

The buyer. Still another important factor is, "Who is the buyer?" To a person experienced in business valuation, a business may be worth buying only at the liquidation value of the assets. To another buyer, the same business may be the answer to a long-held dream of owning his business.

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### **3. Liabilities**

A buyer generally refers to purchase assets rather than stock for tax reasons, but his preference becomes even stronger because of liability considerations. In the assets transaction, the legal continuity of the seller's business is broken. The seller's business liabilities are usually not carried over unless the buyer assumes them by agreement.

Buyers often find an advantage in assuming obligations of the seller under leases, mortgages, or installment purchase contracts. The seller may be willing to make some financial sacrifice to the buyer in order to get out from under the payment burden - even though he remains liable for the obligation if the buyer defaults.

But these are known liabilities. It is the unknown that the buyer fears in the stock transaction. Many liabilities, both existing and potential, are unknown at the time of contracting merely because of inadequate investigation. And in any business, there are potential liabilities that neither an honest seller nor a diligent buyer can foresee at the time of the buy-sell transaction. An accident involving a company truck, the fall of a customer on the business premises, or the discharge of an employee may become the

basis of a lawsuit and eventual liability, even though many months have passed since the event.

Even more elusive are liabilities that may arise from the manufacture or sale of defective products, patent or trademark infringement, or violations of statutes, and so on. Tax deficiencies may arise out of tax returns filed but audited at the time of the buy-sell transaction.

The price agreed upon in a stock transaction will, of course, take into consideration only known liabilities. The possibility of unknown liabilities need not, however, preclude the buyer from entering into a stock transaction. Such a course of action may, in fact, be necessary in order to retain the benefits of non-assignable contracts, leases, franchises, government licenses, stock registrations, corporate name, and so on.

The buyer of stock should take precautions against unknown liabilities. Ordinarily this would include an agreement on the part of the seller to indemnify the buyer against such liabilities and on some means for satisfying any claims against the seller. Holding part of the purchase price in escrow against such a contingency gives the buyer at least some security.

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#### **4. Contract Terms**

A number of problems in the buy-sell transaction are brought into focus by the necessity of "writing up a contract." At this point, agreement has usually been reached on the major issue - price. Presumably, the buyer and seller have considered tax consequences, assumptions of liabilities, and terms of payment in arriving at a price.

More is involved in drafting an adequate buy-sell contract, however, than mechanically reducing these oral agreements to written form. To protect the interests of both parties, the contract must cover possible problems that are often far from the minds of the buyer and seller at the time.

What if the buyer defaults on his installment payment of the purchase price? What if the seller's financial statements, which the buyer relied on, turn out to be inaccurate or false? What if the seller turns out to have liabilities that have not been taken into account in the price? What if some of the assets purchased turn out not to be owned by the seller or are subject to undisclosed liens? What if material changes in the business occur before the buy-sell transaction is closed? What if the seller opens a competing business of the same type in the immediate vicinity?

These questions reflect the uncertainty of the buyer's position. The seller knows what he is selling and what he is getting (with a possible exception in the case of seller financing). The buyer is getting an unknown quantity. Whether or not the buyer gets the protection he should have as part of the contract is a matter of bargaining.

## 5. A Typical Buy-Sell Contract

Following is a typical buy-sell contract, with comments, covering the sale of the Regal Men's Store. The contract covers the sale of a proprietorship business, but the basic content would be the same in a corporate stock transaction.

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THIS AGREEMENT is made and entered into this 15th day of February, XXX6, between James, hereinafter referred to as the Seller, and Joe, hereinafter referred to as the buyer.

WHEREAS the Seller is the owner of a men's clothing store using the trade name of "Regal Men's Store" in Central City, and the Seller desires to sell to the Buyer his rights, title and interests including the goodwill therein, and the Buyer is willing to buy the same on the terms and conditions hereinafter provided, IT IS AGREED AS FOLLOWS:

(The above statements introduce the parties and the nature of the agreement. If the business is incorporated and a stock transaction contemplated, the stockholders will be identified as the sellers and stock as the item sold. )

1. Sale of business. The Seller shall sell and the Buyer shall buy, free from all liabilities and encumbrances except as hereinafter provided, the men's clothing store owned and conducted by the Seller under the trade name of "Regal Men's Store" at the premises known as 120 North Main Street, Central City, including the goodwill as a going concern, the lease to such premises, stock in trade, furniture, fixtures, equipment and supplies, all of which are more specifically enumerated in Schedule A attached hereto.

(Paragraph 1 incorporates by reference an inventory not shown here of the assets being purchased. A specific enumeration of assets being purchased is important as a basis for recourse against the seller in the event of shortage or title defects.)

2. Purchase price. The purchase price for all the assets referred to in paragraph 1 shall be \$84,000 and allocable as follows:

Lease	0
Goodwill	\$6, 000
Fixtures and equipment	30, 000
Inventory	47, 400
Supplies	600
	<hr/>
	\$84, 000

( The allocations in paragraph 2 represent compromise of the conflicting tax interests of the buyer and seller. )

3. Method of payment. The Buyer shall pay to the Seller the purchase price as stated above, in the following manner:

(a) \$10,000 by certified or cashier's check upon execution of this agreement, the receipt of which is hereby acknowledged by the Seller, such proceeds to be held in escrow by Paul Jones, attorney for the Seller, as provided in paragraph 13;

(b) \$40,000 by certified or cashier's check at the date of closing, subject to the adjustments provided for in paragraph 4;

(c) the balance of \$34,000 by a promissory note payable in consecutive monthly installments of \$400 each beginning the first day of April, XXX6, together with interest at 6.5 % per annum. Such note shall contain a provision, satisfactory to the attorney for the Seller, for the acceleration of the balance remaining unpaid upon default in the payment of an installment for a period longer than thirty days. As security for the payment of any such note, the Buyer shall execute and deliver to the Seller at the closing a chattel mortgage upon the inventory, fixtures, and equipment described in paragraph 1, such mortgage to contain an after acquired property clause and such other provisions as the attorney for the Seller may request.

(Paragraph 3 recognizes the financing seller's principal problem: security - or lack of it. The acuteness of the problem results from the fact that the buyer has usually exhausted all acceptable forms of security in getting the bank credit he needs.)

4. Adjustments. Adjustments shall be made at the time of closing for the following: inventory sold, insurance premiums, rent, deposits with utility companies, payroll and payroll taxes. The net amount of these adjustments shall be added or subtracted, as the case may be, from the amount due on the purchase price at the time of closing.

5. Buyer's assumption of contracts and liabilities. In the event this agreement to sell is in fact closed and the business is transferred by the Seller to the Buyer, the Buyer shall be bound by and does hereby assume the terms of the following contracts:

Lease of business premises dated January 1, XXX6. The Buyer shall indemnify the Seller against any liability or expense arising out of any breach of such contracts occurring after the closing.

(Since a going business is being sold, the most realistic approach to the problem of outstanding liabilities may be for the buyer to assume all liabilities shown in an attached balance sheet and also liabilities that arise in the ordinary course of business after contracting but before closing. Such an agreement provides recourse by the seller against the buyer if the buyer defaults, but does not discharge the liability of the seller to the third party.)

6. Seller's warranties. The Seller warrants and represents the following :

(a) He is the owner of and has good and marketable title to all the assets specifically enumerated in Schedule A, free from all debts and encumbrances.

(b) The financial statements which are attached hereto as Schedule B have been prepared in conformity with generally accepted accounting principles and present a true and correct statement of the financial condition of said business as of their respective dates.

(c) There are no business liabilities or obligations of any nature, whether absolute, accrued, contingent or otherwise, except as and to the extent reflected in the balance sheet of January 31, XXX6.

(d) No litigation, governmental proceeding or investigation is pending, or to the knowledge of the Seller threatened or in prospect, against or relating to said business.

(e) The Seller has no knowledge of any developments or threatened developments of a nature that would be materially adverse to said business.

(f) The statements made and information given by the Seller to the Buyer concerning said business, and upon which the Buyer has relied in agreeing to purchase said business, are true and accurate and no material fact has been withheld from the Buyer.

(Paragraph 6 is intended to protect the buyer from the unknown - title defects, undisclosed liens, false or fraudulent information, undisclosed or potential liabilities. If the buyer is becoming liable for all business liabilities through assumption or purchase of stock, he will require more extensive warranties than these.)

7. Seller's obligation pending closing. The Seller covenants and agrees with the Buyer as follows:

( a ) The Seller shall conduct the business up to the date of closing in a regular and normal manner and shall use its best efforts to keep available to the Buyer the services of its present employees and to preserve the goodwill of the Seller's suppliers, customers and others having business relations with it.

(b) The Seller shall keep and maintain an accurate record of all items of inventory sold in the ordinary course of business from January 31, XXX6 up until the date of closing. Such record shall be the basis for adjustment of the purchase price as provided in paragraph 4.

(c) The Seller shall give the Buyer or his representative full access during normal business hours to the business premises, records and properties, and shall furnish the Buyer with such information concerning operation of the business as the Buyer may reasonably request.

(d) The Seller shall deliver to the Buyer's attorney for examination and approval prior to closing such bills of sale and instruments of assignment as in the opinion of the Buyer's attorney shall be necessary to vest in the Buyer good and marketable title to the business, assets and goodwill of the Seller.

8. Risk of loss. The Seller assumes all risk of destruction, loss or damage due to fire or other casualty up to the date of closing. If any destruction, loss or damage occurs and is such that the business of the Seller is interrupted, curtailed or otherwise materially affected, the Buyer shall have the right to terminate this agreement. In such event, the escrow agent shall return to the Buyer the purchase money held by him. If any destruction, loss or damage occurs which does not interrupt, curtail or otherwise materially affect the business, the purchase price shall be adjusted at the closing to reflect such destruction, loss or damage.

(Paragraphs 7 and 8 are concerned with the period between contracting and actual transfer of ownership. The provisions stated anticipate such risks as depletion of inventory, injury to goodwill, creditors' actions, and casualty loss. In 7(c), the disruptive effect of a transfer of ownership is reduced by providing the buyer with the opportunity to become familiar with the details of the business operation before he assumes the responsibility of operation.)

9. Covenant not to compete. The Seller covenants to and with the Buyer, his successors and assigns, that for a period of five years from and after the closing he will not, directly or indirectly, either as principal, agent, manager, employee, owner, partner, stockholder, director or officer of a corporation, or otherwise, engage in any business similar to or in competition with the business hereby sold, within a fifty mile radius of Central City.

(Paragraph 9 anticipates the possibility that the buyer would suffer a loss of the business goodwill he has purchased if the seller opened a similar business in competition with the buyer. Such provisions are enforceable if the restriction is reasonable. What is considered reasonable will depend on the circumstances of each case. )

10. Conditions precedent to closing. The Buyer's obligations at closing are subject to the fulfillment prior to or at closing of the following conditions :

(a) All of the Seller's representations and warranties contained in this agreement shall be true as of the time of closing.

(b) The Seller shall have complied with and performed all agreements and conditions required by this agreement to be performed or complied with prior to or at the closing.

(Paragraph 10 raises a problem that is inherent in the traditional contracting with a closing at some future date. In the period between, the buyer sometimes uncovers facts that would constitute a breach of warranty and grounds for canceling the contract. Because of this, transactions are finally closed, if at all, largely on the good faith of both parties. It is possible, if both parties work together toward the common goal, to sign the contract and close the transaction at the same time.)

11. Closing. The closing shall take place at the office of Paul Jones, 100 South Main Street, Central City, on March 1, XXX6, at 10: 00 a.m. At the time of said closing, all keys to the business premises, the bills of sale and other instruments of transfer shall be delivered by the Seller to the Buyer and the money, note and mortgage required of



the Buyer shall be delivered to the Seller. Upon completion of the said payment and transfer, the sale shall be effective and the Buyer shall take possession of the said business.

12. Indemnification by the seller. The Seller shall indemnify and hold the Buyer harmless against and will reimburse the Buyer on demand for any payment made by the Buyer after closing in respect to:

(a) Any liabilities and obligations of the Seller not expressly assumed by the Buyer.

(b) Any damage or deficiency resulting from misrepresentation, breach of warranty or non-fulfillment of the terms of this agreement.

13. Seller's security deposit. As security for the indemnities specified in paragraph 12, the Seller's attorney, Paul Jones, shall hold in escrow, for a period of one year from the date of closing, the sum of \$10,000 which has been paid by the Buyer upon execution of this agreement.

Said escrow agent shall upon application of the Buyer apply all or any part of such to reimburse the Buyer as provided in paragraph 12, provided the Seller shall have been given not less than ten days' notice of such application and has not questioned its propriety.

14. Arbitration of disputes. All controversies arising under or in connection with, or relating to any alleged breach of this agreement, shall be submitted to a panel of three arbitrators. Such panel shall be composed of two members chosen by the Seller and Buyer respectively and one member chosen by the arbitrators previously selected. The findings of such arbitrators shall be conclusive and binding on the parties hereto. Such arbitrators shall also conclusively designate the party or parties to bear the expense of such determination and the amount to be borne by each.

(Paragraph 12 obligates the seller to indemnify the buyer to the full extent of any cost or damage sustained by the buyer as a result of the seller's breach of warranty or contractual obligations. Paragraph 13 backs up this agreement with a requirement that part of the purchase price be placed in escrow as security for the seller's performance. Paragraph 14 provides a means for resolving without litigation any buyer-seller disputes that may arise from the contract.)

IN WITNESS WHEREOF, the Buyer and Seller have signed this agreement.

Seller

Buyer

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