PURCHASING AN ESTABLISHED SURVEY FIRM

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MANY OF you will eventually face the agonizing decision of maintaining the status quo as an employed surveyor or casting care to the winds and going out on your own as a Surveyor in Private Practice.

I still recall with absolute clarity the phone call which ultimately changed my life and that of my family. I was settling very happily into what most young surveyors would consider to be a fine career with a large consulting firm in Toronto. As a family, we were living comfortably in a good area of the suburbs and we had been steadily building equity in our home and as well had spent the better part of the past year renovating our modest house to the one of our dreams.

The year before, I had casually mentioned to a man in private practice that if he ever wanted to sell his practice to please give me a call. That life changing phone call came at 7:00 a.m. on a Tuesday morning and all the security, comfort and peace of mind which we enjoyed as a family was swept away, in what now feels like an instant of time.

The man on the other end of the line simply asked, "Are you still interested in buying my business?" We agreed to meet on the next weekend to discuss his plans and within three weeks we had prepared a mutually acceptable draft agreement which we then took to our lawyers in order to have the rough edges smoothed out.

My personal story is probably of little practical interest but what I feel must be pointed out in the very beginning is that if you are going to be in your own business you must be prepared to make sacrifices, and these may include your time, your home, your family and your money. If it is going to be successful, you must be totally dedicated to the project and your family must understand the sacrifices which will be made and they must be willing to support you in this endeavour.

We moved from a four bedroom home in Toronto to a one bedroom apartment located behind the office in a tiny town in eastern Ontario, and this with two small children and a dog! All of the equity from our home in Toronto was put into the business without reserve.

To be honest, I did not know how much the business was worth, or whether or not I was making a good decision or a bad one. I asked various people for advice but no one really seemed to know how to calculate its worth. I talked to my father about it and he said to me that he expected any good business had to pay for itself. This was perhaps the best advice I could ever have received and I would pass it on to you as an essential.

To know whether a particular practice will pay for itself, you must know a few important details about this business, namely:

1. How long has this business been in operation?
2. Does the firm have a reputation for quality work?
3. Are field notes and records properly filed and of good value to the business?
4. Does the business have assets which will be of immediate value to you when the purchase is made?
5. Does the firm have steady and reliable clients (e.g. developers, lawyers, corporations)?
6. Is the firm growing or is it declining?
7. How many employees are with the firm and what is their experience?
8. Does the firm rely on a particular type of work for the bulk of its volume?
9. Is the existing business location visible to the public?
10. What was the gross dollar volume for each year of operation?
11. What profit has the business shown over the past five years?
12. How much competition is in the area?
13. Is the market for surveys expected to change in the near future (e.g. if the business is in a small single industry town, will the closure of this industry adversely affect your business).
14. Is the existing owner staying in the area and will the existing owner sign and abide by non-competition agreements?
15. Is there work in progress, and if so what is its value?
16. Can phone numbers and post office box numbers be transferred?
17. How accessible are Land Registry Offices?
18. Is the vendor willing to sign waivers protecting the purchaser from any liabilities for previous errors?
19. Is the business being sold at a time of the year when one would expect to have a good cash flow to carry through a slow period?

When you have become reasonably familiar with the business for sale and you have considered the questions above, you will still have before you the ultimate question - how much should I pay and under what terms.

Your ultimate goal should be to buy the business with as little actual cash investment as possible. If at all possible, use the money of banks, relatives, and the vendor to acquire the business. Remember, the business should pay for itself and should carry itself. You will probably use your own cash (about 25% of your estimated annual volume) to get you through the first few months of operation. These months are critical and you should not leave yourself short. Remember that your cash flow will lag behind the business by about 3 months.

Now let us suppose that you are about to acquire a business which has been operating for 12 years and has had a mean gross volume of about $200,000 for at least each of the last three years and has enjoyed profitability of about 10% for each of those years. The business has three full-time and one part-time employee all with good experience. The business has a good reputation in the area for high quality work and the field notes and plans are properly indexed.

In my opinion, the value of goodwill (being the notes, plans, clients records, files, phone numbers, post office box numbers) for a business should be calculated from a combination of gross income, years in business, and profits for that company. It seems reasonable to me that goodwill value is enhanced each year a firm remains in business and the expected result of quality goodwill is higher volumes and increased profits.

I have developed a formula which incorporates these factors and results in a figure for the value of goodwill which could be used as a starting off point in your discussions. It is only developed through experience and has no value as an accounting tool or in actually determining the worth of a business. The variables and formula are as follows:

GW —Goodwill

GV — Mean annual gross volume for previous 3 years

YB — Years in business in excess of 5 years

P — Mean annual profits in each of last 3 years

$$GW = (20\%\ GV) + (1\%\ (YB \times GV)) + (20\%\ P)$$

In this example then, the goodwill for the company may be worth as shown below:

$$\begin{aligned} GW &= 20\%\ (200{,}000) + 1\%\ (7\text{x}200{,}000) + 20\%\ (20{,}000) \\ &= 40{,}000 + 14{,}000 + 4{,}000 \\ &= \$58{,}000 \end{aligned}$$

Keep in mind, this is my rule of thumb and may not be valid for the business you wish to acquire.

Having established a price for goodwill, you must now make a complete inventory list of the assets which you wish to acquire, right down to the pencils, pens, erasers and rulers. If you have money available don't be afraid to buy the assets because you will probably pick them up at bargain basement prices compared to the cost of replacing them with new equipment. The existing owner is usually hoping to get rid of most of the company assets during the sale and will probably be willing to sell them to you at very reasonable prices.

Now that you know the total cost of goodwill and assets you must determine the value of work in progress. I prefer to pay the owner up front for the actual time he has spent on work which is in progress and that which will be subject to invoice. I would suggest that you use a basic rate of not more than 70% of normal tariff (i.e. 1.5 x actual salaries) to establish the value of work actually done while the job is in progress. Do not pay for work which is still dependent on client approval to proceed or which may be in doubt. These jobs must be considered as part of the goodwill which you are purchasing.

With the final figure established (except for additional work in progress accumulated between the signing date and the date of take over) you may now begin discussions with the vendor as to how payment of this amount is to be made.

The vendor will very likely be willing to cover a portion of this amount as some type of mortgage on the business, however you should be prepared to pay the owner at least 50% in cash at closing. You may of course be borrowing some of this amount from lending institutions, friends or relatives and this must be accounted when calculating your monthly budget. One of the reasons I have stressed the use of private money to finance your business is that lending institutions are very uneasy about lending money for the purchase of goodwill. Many banks will not even consider goodwill as a business asset. I will agree that in many businesses this is the case but not so in surveying. The value in the business is in fact the notes, plans, client files and satisfied clients. It may be necessary to have a frank discussion with your banker so that you can explain to him why the notes and records are the integral part of the purchase of an established firm.

During your discussions with the vendor you will probably have touched on matters concerning the vendor's activity with your firm after closing of the transaction. I would suggest that you spend one week prior to closing with the vendor, working as an unpaid assistant. This will give you the opportunity to learn the filing system and meet the staff and some of the major clients. After closing, the vendor and purchaser should part ways immediately. You should insist (however politely) that the vendor's role is complete and his presence is no longer required. Plunge into the work on your own. The vendor's presence will only undermine your efforts and make you less effective and less efficient.

In any business transaction, there must be a certain amount of trust and understanding. The vendor is probably reluctantly parting with something which he has built with his own hands over many years. The purchaser is probably concerned that he spends every penny wisely and that he buys a business which will repay his investment and support his family. It is essential that the individuals involved display the same care, concern and professionalism in dealing with each other as they would with their most valued clients.

There are great potential rewards in operating your own business but unfortunately there are also many pitfalls which must be avoided. The rewards come in the form of satisfaction with a job well done, added financial opportunities and the privilege of being your own boss. In order to avoid the pitfalls, have your wits about you and don't be afraid to ask for professional advice.

If I could somehow turn back the clock to that moment when the phone rang at 7:00 on Tuesday morning, I would - even now - without hesitation, pick it up and go through it all again. ●