

WE KNOW

# BUSINESS STRATEGY

## BUSINESS SALES AND ACQUISITIONS

QUICK GUIDE

### INTRODUCTION

Buying or selling a business is likely to be one of the major events in the lifeline of a business, and buyers and sellers of businesses will have quite different reasons for why they want to engage in a business sale or acquisition.

For a buyer, an acquisition can provide the following benefits:

- Generating cost efficiencies through economies of scale (of particular note in regards to the Christchurch rebuild).
- Creating an entry point to a new market.
- Enhancing the revenue through gain in market share.
- Lowering the labour costs through staffing efficiencies.
- Providing a method to acquire new technology and intellectual property.

A seller's motives however are likely to be financial or commercial ones or, more usually in a small family business, entirely non-commercial ones such as succession planning, poor health or even simply a wish to do something different. The financial or commercial reasons for selling can be voluntary or involuntary.

- Voluntary reasons include the desire to release funds for other investments or to move out of the business area because, for example, it no longer fits within the seller's long-term strategy.
- Involuntary reasons include the desire to ease financial pressures or to ward off predators who might wish to break up the business.

The reason for a sale can obviously have a significant impact on the negotiation process.

Buyers should have a clear strategy which sets out criteria for finding an appropriate target. They should also have a clear idea of what they can afford to pay and a preference as to the nature, size and type of business they are seeking and a timetable for implementing the acquisition.

Sellers should also have a clear strategy, which focuses on presenting the business in the best light and in a way which will maximise demand and value.

Buyers and sellers will also need to decide on the best way to acquire/sell the business - the most common ways include:

- Acquisition by one party of the business and assets of the target company (most common).
- Acquisition by one party of the shares of the target company.
- Merger of the two companies in accordance with the amalgamation provisions of the Companies Act 1993 (least common).

## ASSET OR SHARE ACQUISITION/SALE

Buyers and sellers can choose to acquire/sell either the assets of a business or the shares of the company that operates the business. The choice will be influenced by a variety of factors:

- With a share acquisition, you are in effect stepping into the shoes of the target company as a legal person, including all the target company's liabilities which the buyer automatically assumes (for example, if the seller is involved in on-going litigation that may result in unquantifiable liabilities - in this scenario, the buyer might prefer a business/asset acquisition).
- With a business/asset acquisition the buyer only acquires agreed and identified assets and liabilities provided these can be specified with sufficient precision.
- A buyer may inherit liabilities with a business/asset and may need to discharge liabilities to protect an asset (for example, leased assets) to protect the goodwill of the business.
- With a share acquisition/sale, the business is transferred as a going concern in its entirety (subject to change of control provisions in relevant contracts). This is not necessarily so with a business/asset acquisition (although in some cases it may be) - the interests of the parties will dictate whether this is an advantage or a disadvantage.
- A share acquisition/sale tends to be a more straightforward transaction. Only shares are transferred as opposed to all of the underlying assets of the business (for which separate transfer documentation with different formalities may be required). However, the acquisition structure will not usually determine the complexity of other commercial issues — for example, due diligence and negotiation of warranties or indemnities.

The following common procedural steps should be considered, irrespective of the type (share or asset acquisition/sale) of transaction:

- Putting in place preliminary agreements with the other side such as a heads of agreement, confidentiality agreements and/or exclusivity agreements.
- For a seller, carrying out pre-sale due-diligence (commercial, legal and financial) on its own business is often very valuable as it identifies problems that a buyer may raise at an early stage and allow a seller to address those issues before a buyer conducts its own due diligence.
- For a buyer, it should also carry out due diligence (commercial, legal and financial) to find out as much information as possible about the target company/other party early in the negotiations.
- Negotiating key transaction documents - in a business or share acquisition/sale the key documents will likely be:
  - the business/share purchase agreement; and
  - the disclosure letter - this letter, given by the seller to the buyer, discloses all known issues with the business as against the warranties given to the seller in the sale and purchase agreement and is used to reduce liability to the buyer for breach of those warranties.

Signing and completing the acquisition/sale.

## LEGAL MERGER

A legal merger, by way of amalgamation under the Companies Act 1993, is not commonly used by small to medium-sized private companies due to the legal requirements imposed on both parties. However, when used, the board of each amalgamating company must resolve that in its opinion the amalgamation is in the best interests of the shareholders, and that the amalgamated company will satisfy the solvency test set out in the Companies Act 1993. Directors voting in favour of the resolution must sign a certificate setting out the reasons for their opinion.

The amalgamation proposal must be approved by the shareholders of each company, by special resolution, and approval of shareholding interest groups may be required. A copy of the amalgamation proposal must be sent to secured creditors and the board of each company must give public notice of the proposed amalgamation.

**PERSONAL ADVICE**

Whether acquiring/selling or merging a business, it is a complex process and you should engage suitably qualified legal, financial and business advisors as early on in that process as possible so as to avoid costly complications arising later on.

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**Information provided by Lane Neave.**

