Diligence is the Mother of Good Luck

So you're looking to buy a business.

As long as the business is making a handsome profit based on the most recent financial statements, and the value being asked is reasonable, it should be a safe bet. Right?

Well…not necessarily! Financial considerations only make up a portion of the areas that need to be considered. Let me explain.

Before purchasing a business, it is crucial that the purchaser undertake a comprehensive survey of the business in order to avoid any dangerous surprises which may lurk post-acquisition. This survey is commonly referred to as a Due Diligence process or investigation. Unfortunately many purchasers fail to undertake this step prior to purchase and inevitably discover "skeletons in the closet".

Due Diligence is not just a verification of the company's financial statements. This is the period where you will have the opportunity to immerse yourself completely in the business to determine several things:

- Are the financial statements you have received accurate?
- Is the Inventory in "Good and Resalable" condition?
- What is the condition and value of the Assets?
- How effective and committed are the employees?
- What is the overall picture of the industry and the competition?
- What has the company done to market itself?
- How strong is the sales team?
- Will the company's contracts continue under your ownership?
- What can you do to increase the Revenues and Profits?
- Based upon what you learn, does the business have a viable future?
- Is this a "Good" business?

To put it another way, in essence, it is like an insurance policy, whereby the purchaser pays a premium (the cost of due diligence) by engaging the appropriate experts (i.e. lawyers, accountants, business advisors and/or others) to perform an investigation into the contracts, books of account and other relevant materials pertaining to the target business.

What needs to be examined?

In one word…..everything!

Typically, the information reviewed will include:

- Historical Financial Data
- Current Financial Data
- Forecasted Financial Information
- Business Plans
- Copies of all Leases
- Copies of all Insurance Policies
- Copies of Tax Office Returns
- Detailed lists of assets
- Detailed schedule of owners' benefits
- Minutes of Directors' Meetings and Management Meetings
- Audit work paper files (if available)
- Contracts with suppliers, customers and staff
- Confirmations/representations from financiers, debtors etc.

It should be remembered that a due diligence review should not be limited to reviewing documentation. A great deal can be learnt from discussion with the business's staff and by observation of their daily activities.

Broadly, the areas of the business requiring investigation include:

1. **Financials**
2. **Assets**
3. **Sales**
4. **Marketing**
5. **Employees**
6. **Systems**
7. **Competition**
8. **Customers**
9. **Contracts**
10. **Suppliers**
11. **Legal and Corporate**

Examples of the types of issues/questions which should be addressed under each area are as follows:

1. Financials
- Have there been any "extraordinary" or "abnormal" items that are included in the profit and loss statements that were one time occurrences and which may have distorted the historical results?
- Any legal or professional fees that don't seem in line. This may indicate a pending lawsuit or work that may have had to be done for a Tax Office audit.

2. Assets
Inventory
The two most important things to determine with Inventory are its accuracy and the quantity that is Good and Resalable. In those businesses where there is a definite obsolete date or shelf life, pay very close attention. Some of this merchandise will be completely useless and you will not be able to liquidate it at any price.

Furniture and Equipment
- Is the equipment working?
- What are the maintenance costs?
- What warrantees are still in place?

3. Sales
- What percentage of their products produce 80% of the revenue?
- What role does technology play in the sales function?
- What recommendations do the sales people have for increasing revenue?

4. Marketing
- Does the company have a Marketing Plan?
- How focused is the company on marketing their products or services to the right potential customers?
- If the customers were asked to list the company's strengths and weaknesses would these be the same as the company's list?

5. Employees
- Any labour disputes?
- What fears and concerns do the employees have about your pending purchase?
- Identify the "key" employees (yes, they are all important, but some more than others).
- Has the business hired any of the competitor's employees? If they have, they'll be a great source for competitive information.

6. Systems
- Does the company produce reports that provide financial, sales, inventory analysis on a monthly basis?
- Ask everyone, including the Seller, what reports they use and review them.
- Contact the industry associations and determine if there is any software available that is specific to the industry.

7. Competition
- Put together a listing of the leading competitors.
- Do they sell based on price, service, availability, selection?
- Obtain a credit rating on them.

8. Customers
- What percentage of their customers produce 80% of the revenue?

9. Contracts
- The first thing to check is the transfer/assignment clause in the current lease. Within that clause it will state the terms and conditions under which the lease may be assigned to someone else.
- Are insurance policies transferable? Are they all needed?

10. Suppliers
- If the business you are considering involves contracts or agreements with certain suppliers, seek legal advice to ensure that they will continue under new ownership.

11. Legal and Corporate
- You and the business must be held blameless in any pending legal matters, notification of which must be included in the Offer to Purchase.

If done correctly, Due Diligence will provide you with the insight needed to form the basis of your final decision. It will allow you to begin to develop a clear and concise vision of what you must do to make the business everything you want it to be.

The cost of the preparation of a quality Due Diligence investigation fades into insignificance when compared to the cost of a bad acquisition.

If you would like more information on Due Diligence investigations, please give my office a call.

Yours in Business Development
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