8 DUE DILIGENCE TIPS FOR BUSINESS BUYERS

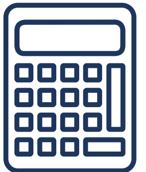
1. Understand that due diligence is different for every person

Due diligence is different for every person because **we all have different risk appetites**. Imagine two people looking to buy a regional heating and cooling business servicing the industrial and commercial market:

- **Buyer 1** is coming from exactly the same sector – they own pretty much the same business in a different geographic location.
- **Buyer 2** is coming from the corporate marketing area of a telecommunications company and has been in an employed environment for 20 years in a capital city location.

Each has a different risk profile regarding this particular business and, therefore, **the detail or otherwise of their due diligence will be calibrated against their risk profile.**
For example, Buyer 1 already has a strong understanding of the industry and probably has relationships with most of the same suppliers this business deals with. Therefore, doing detailed due diligence on the supplier agreements, the depth of those relationships, and the credit terms with those suppliers is, to a large extent, a waste of money.

2. Due diligence needs to relate directly to your requirements for a business



Your due diligence **needs to be framed around your requirements** for a business.

For example, if you require the business to deliver earnings before tax of $550,000 per annum, and you want to get a strong indication that level of earnings is likely in each of the next five years, your due diligence has to be framed around that requirement. As such, it would focus heavily on market dynamics, the competitive environment, the strength of contracts, customers and their purchasing habits, and so on.

3. Be 80% sure you want the business before conducting due diligence

Due diligence processes can be expensive and time consuming.

Don't get into a due diligence if you're still 50-50 about whether you want to be there, because it will cost money, time and effort that may be better spent looking at other opportunities which may be a better fit for your requirements.

As a purchaser you should be about 80% sure you want to buy a particular business before embarking on a due diligence process.

4. Use the due diligence process to prepare for running the business

Due diligence is very useful for a potential purchaser to frame their future business plans.

Treat it as an opportunity to learn more about the business, and not just the hard data in the financial accounts.

Seek out the 'soft' information that might be in the heads of your managers, suppliers, current owners and customers.

The more information you have, the easier it should be to transition into the business.

5. Be wary of parties who get 'cold feet' during due diligence

Due diligence is like the last stage before the 'marriage'.

If, in a due diligence process, the vendor or purchaser is not being forthcoming in their disclosure of information, or they demonstrate they're getting cold feet or withdraw, that is a good sign the marriage may not be a great idea.

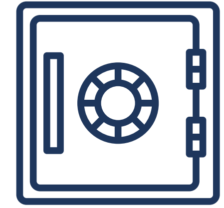
6. Don't be afraid to ask the hard questions

Often purchasers are uncomfortable asking hard questions of a vendor because they 'don't want the sale to fall over'.
Instead they say 'we had better go softly, softly around this'.

Yes, due diligence is a sensitive process because it's going to the next level of detail regarding commercially sensitive and private information, but the bottom line is that what's you do a due diligence for!

If you find you simply don't feel comfortable asking commercially sensitive questions, then engage a good due diligence business advisor who can handle the sensitivity while still getting to the bottom of important issues.

7. Use the 'black box' to obtain sensitive information



'Black box information' is commercially sensitive data the vendor does not feel comfortable sharing with outside parties. Customer names are an example.

For instance, the business owner may say: 'Why would I give a potential purchaser my customers' names? That's the biggest value of my business. If they pull out of the sale they can go and set up their own business and target my customers.'

In this situation the customer names would be 'placed' in the black box.

Data on customers would still be provided, but they would be disguised as Customer 1, 2, 3 etc. Post due diligence the contract would provide for the black box information to be shared prior to completion, once certain conditions are met.

8. Keep detailed records of your due diligence

It goes without saying that often due diligence is a condition of a sale contract: a contract or heads of agreement will be exchanged, and the sale will be conditional on the purchaser's satisfaction with their due diligence.

Most contracts include tolerances and provision for small anomalies, but where you find large, material issues during due diligence you may need to renegotiate aspects of the contract.

It's important to have detailed notes from your analysis to support your position when renegotiating.

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