20 Shortcuts to get through the Due Diligence Process

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Some alleged "experts" talk at length about the financial aspects of Due Diligence and make it into a "larger than life" undertaking. Rest assured it isn't. Since each business is different, your advisor is the best person to formulate the listing of exactly what information must be gathered and the mechanisms by which to do so.

Virtually every conceivable issue that can arise during Due Diligence is solvable. Problems only arise when such issues are left to chance. A strategy aimed at leading buyers to potential trouble spots rather than allowing them to discover problems on their own typically creates a spirit of trust between the buyer and seller. With strong trust in place, buyers are more willing take an intellectual approach to solving due diligence challenges rather than an emotional one. Emotional responses are often the kiss of death for merger and acquisition transactions.

Most acquisitions begin with romance. The buyer and seller become hearts beating as one and this is very compelling when one or both “fall in love” with the transaction. However, as the two sides struggle for competitive advantage, a failed acquisition can damage the financial health of both buyer and seller. For the buyer a failed growth strategy depletes resources, including personnel, finances, morale, and so on.

Acquisitions do not fail because of the unknown. More than half of all the acquisitions fail because the buyer is unwilling to face the known. The focus of Due Diligence is typically on legal and financial aspects of the transaction, this leaves many other risk factors to simmer until implementation begins. But by then, it is too late. Buyers need to identify and examine other potential sources of failure during the Due Diligence process and be willing to walk away if failure is too great a possibility.

With this in mind, it is nearly impossible for the buyer to conduct Due Diligence without the cooperation of the seller’s management team. Even without full cooperation, many buyers move forward with deals because they have put so much time, money and effort into ensuring the transactions happens. Turning back seems impossible. But, this can be a big mistake.

With a strategic approach to acquisitions, all parties are more likely to reach the desired outcome. At the end of the day, applying Due Diligence is not simply to green-light an acquisition, but to help ensure the long-term viability of the company that emerges from the acquisition.

For advisors who have been involved in many acquisitions we can point to more than one reason the deal fell through. However it seldom happens when our clients conduct a strategic-focused Due Diligence process taking the short cuts to get to the issues that really count.

Buyers who neglect the Due Diligence process, or who are less than diligent in their investigations, may hope to rely on the seller’s representations and warranties. Courts have found such reliance to be unreasonable, and therefore denied a buyer’s claim of harm as a result of a breach of those representations and warranties, where the buyer did not sufficiently investigate to discover the seller’s problems.

If done right, 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 for what you must do to make the business everything you want it to be.

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Overview

We have highlighted, in yellow, the shortcuts to get the most out of the Due Diligence process.

This document is designed to help prospective buyers of a business develop a better understanding of the questions to ask, why they should be asked and why so much information is needed. There are also tips on where to find the information.

Due Diligence is the process that allows you as the opportunity the prospective buyer to get a really good insight into the business to determine if it is a good business to invest in.

Shortcut # 1: Start with the history and slowly work through the information until you have enough to plan the future for the business.

In essence by considering several things:

- Are the financial statements that you have received accurate?
- What is the condition and value of the assets?
- How effective and committed are the employees?
- What is the overall picture of industry and the competition?
- What has the business done to market itself?
- How strong is the sales team?
- Will the business 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?

This process needs to be tailored to the business you are investigating.

Shortcut #2: Be sensitive to the seller's concern about confidentiality.

Quite often, sellers will not allow you the type of access that we recommend you ask for as outlined in this section. So the process is something you need to work through with the Seller so your investigation can be completed thoroughly. As an example, while we discuss conducting your review at the business, you may, in fact, have to do it off-site. If that happens, you need to still find a way to see the business in action. That's where each situation will dictate the strategy. You may have to go in as a customer or send in friends etc.

Your approach

In order for you to conduct an effective Due Diligence you need to strive to meet three objectives:

1. Check if the information provided is correct;
2. Find any problems that would cause you to back out or renegotiate the price; and
3. Find out what growth potential there is for the business.

Due Diligence is the best mechanism that you have to truly determine if it is the business for you.

Shortcut # 3: Due Diligence is the time to check out everything, not just the financials.

The Due Diligence period allows you to learn enough so that you can begin to formulate plans once you take over.

Shortcut #4: Don't wait until Due Diligence officially begins to start your work.

Many of the areas can be investigated before you even come to an agreement with the seller. Investigate as much as you can during the information-gathering that you will be doing between visits, during negotiation, etc.

There is one area where you must show restraint: do not allow your enthusiasm to pollute your judgment. It is natural for you to be excited about the business and the prospects for the future.

Don't get passionate about the business yet. You can do that (and you must) once you take over.

Keep a clear head so that you can make a sound decision about the viability of the business and you can evaluate each aspect with complete objectivity.

Shortcuts # 5: You will need at least a month or two to conduct an effective Due Diligence.

The key steps

You will need the help of an accountant or business advisor and it is strongly suggested that you hire at least one person (friend/ family) to help with the "detail" work like counting inventory or helping you chase down information. One or two months may seem like a lot of time but it passes very quickly and the smaller the business the worse the corporate records and files usually are. Much of your time may be spent chasing down information. In order to be successful, you need toknow a few things in advance:

- Make sure that all of the documents required are prepared prior to your start date. If just one document is missing, do not begin. This is a very serious endeavor and you cannot afford to waste time.

- Preparation and monitoring is essential. Compile a list of everything that needs investigating. Regardless of who you hire to help out, their tasks must be monitored daily. If you do not enter this phase with a detailed game plan and mechanism to follow up, you risk having things fall through the cracks.

- Break the tasks down by department (sales, accounting, systems, assets, etc.). Keep a separate list for each. As each task is completed, cross it off the list. Keep the "to do" list current. You will be able to focus better if you eliminate completed items and you can continually monitor the remaining work to determine if any changes have to be made.

- You must be highly organized. Throughout the process, one thing that you learn will lead to another question that must be answered. New tasks will arise continually. If you do not write these down and assign the follow-up' it simply will not get done.

- Every department, every file, every employee has to be available to you. If the Seller is still protective at this stage, it will not work. Sellers must make sure all employees are available to give you their full cooperation. If the seller has any sensitive materials on-site you should ask that they seal them. You need full access to everything. Let the Seller know that if they have something to hide, then hide it well!

Remain sensitive to the fact that the Seller's number-one concern is confidentiality. You may not have the opportunity to meet with all of the employees, suppliers, and customers. Strategies to do so are outlined in this section. However, this can become a major stumbling block and so you must lay out a plan and timeline to do so with the blessing of the Seller.

Set the parameters with the Seller. Be specific about what you will be investigating. If there are any issues, deal with them before you begin! Do not let the Seller "think" that you are investigating everything about the business.

Shortcut # 6: Be up-front and let the seller know in the clearest of terms that you are investigating everything about the business.

Keep the Seller informed of your progress. Keep your guard up. When they ask you how it's going, tell them it's "too early to tell."

Schedule all of the tasks to be covered in three weeks, even though you have asked for a month. This way, you will have ample time to revisit anything that needs more attention.

Allocate no more than three weeks and get it done. Allow yourself the extra few days to revisit certain areas if necessary. If certain employees or the seller stays late, keep on working as long as the people who are there can be of help to you. Do not look at this as a 9-5 operation as you will need every second of the time period to do this properly.

You will need the help of the prospective employees. Chances are they may be more useful and informative than the Seller.
If the business has employees they will be nervous because they will not know what they can and can't show you regardless of what the Seller told them as he/she may have given them an alternate set of instructions. Once a week, with the Seller's permission, buy lunch for the whole staff or with large companies – they key staff. This is a good time to get them to start liking you and it is a good way for you to thank them for their help.

Shortcut # 7: No matter what you discover, keep it to yourself.

If an employee points out certain things or bad-mouths the Seller, do not get involved in the conversation. Don't get into any politics. Listen, listen, listen and learn. Do not offer any advice or make any suggestions along the lines of how things are going to change once you take over.

Have the Seller provide you with an office (if possible) where you can conduct private meetings. If this is not possible, find a local café to do so. You will need time alone.

If you need to meet with suppliers, landlords, or others, have them come to you. Avoid lunch meetings. While providing a nice sociable atmosphere it's a waste of your precious time.

Do not leave any of your files lying around. Make sure to take all your documents home each evening and if you remove any company property make sure that you have the Seller's permission to do so.

You are not the boss. You may be soon, but until then conduct yourself with the utmost of respect no matter what you may hear or discover.

Get the Seller to indicate whom you should speak to about what. Some Sellers may want every inquiry directed to them and others will have their employees answer your questions. Whatever the protocol is, be clear about it. If the company's employees will be available to answer your inquiries, arrange to meet with all of them before you start. Provide each with the listing of what information you will need. Explain each task to the appropriate employee and make yourself available for any questions they may have. Let them know that Due Diligence it is not a "witch hunt," but a verification process as part of the purchase agreement.

Keep a separate listing for all of the "things to do" after the purchase. Whenever an idea crosses your mind, write it down, don't trust your memory.

Depending on the type of business, allocate a specific number of days to each category and stick to it. Outline what work must be done on-premises and what can be done when you don't have access to the business (i.e. investigating the competition).

There are some areas that you may not be able to complete. Don't panic. Do the best job that

you can with the time and information that you have available. However, if you plan, prepare and focus, you should be able to complete all of it.
Most buyers do not negotiate a month to do the Due Diligence phase. If you fall into this trap, you must realize the consequences. The saddest part is that if you don't do it thoroughly' you'll probably walk from the deal because you're "not sure enough." Consider the fact that this may be the most important month of your entire business career. What else could possibly motivate you to be sure that you negotiate enough the time to do it properly?

The advisor's role

Your accountant or business advisor must play the lead role investigating the financials. Unless you are purchasing a business that you are very familiar with or if you are an expert in this area' let a professional do the work. Meet with them beforehand and together you must assemble a listing of everything that will be done. Review the timelines and be sure that there is no confusion as to when it will be completed and who is doing what.

Set the guidelines clearly so that they understand your expectations.

Shortcut # 8: You must keep your advisor posted throughout the negotiation period so that they can be available during your Due Diligence.

Although it may be difficult for you to pin down a specific date, if you wait until the last minute and then advise them that Due Diligence is to begin in a day' you may not have them available.

What needs to be reviewed?

In one word - everything! There are common areas between all businesses that need to be reviewed. This list will provide all of what you will need; however, you are reminded to make the adjustments required to make the Due Diligence specific to the business you are investigating.
From the moment you first contact with the business start to compile your Due Diligence. If there is anything that you want to check out, mark it down. Sometimes a Seller may say something in passing that you will want to investigate.

For example, if the Seller states a certain figure for sales or margins for a particular item or anything else, note the fact, repeat the details to the Seller to be sure you've heard it right and then verify it.The areas that you must investigate will include:

1. Financials
2. Sales
3. Marketing
4. Employees

5. Systems
6. Competition
7. Customers
8. Contracts
9. Legal and Corporate

1. Financials

Your objective is to understand the business so well that you can develop a credible budget of what you think you can achieve with the business. Then you will need further Due Diligence to confirm that the figures you have used in your Budget.

Once you have the exact figures based upon your advisor's assessment, it is time for you to redo your view of the business based on actual figures, if they differ at all from the information used previously. The way to go about it is to look for what does not seem right. If it doesn't "look" right there is a good chance that it isn't or maybe it is. Whatever the case, we're dealing with numbers, so it can be verified either way.

Taking customer invoices and tracing them forward' to ensure that a cheque was received and deposited and not credited later on' will verify sales. Going the other way, the product/service that was sold to that customer will be traced backto the source of supply to verify its true cost. Individual items and invoices willbe done like this to ensure that margins are accurate, costing is done correctly, thatall sales are true and that every transaction verified can be traced forward and backwards. All Expenses listed on the Income Statements will be verified to be sure that they are accurate and that nothing has been hidden in order to improve the overall health of the company.

The Income Statement (1/S) Verification

Some alleged "experts" talk at length about the financial aspects of Due Diligence and make it into a "larger than life" undertaking. Rest assured it isn't. Since each business is different, your advisor is the best person to formulate the listing of exactly what information must be gathered and the mechanisms by which to do so. If you did your homework properly, and asked the right questions when you first had access to the financials, then Due Diligence on the Income Statement is a matter of determining:

- Do the financial statements have adequate backup?
- Are the costs correct?
- Has anything been hidden?
- Have the financial statements been properly prepared?
- Is there any questionable accounting?
- Are the financial statements a true reflection of the health of the business?
- What has been the growth rate of the different categories that comprise Revenues?
- Have there been any major shifts in the revenues, COGS, etc., in recent years?

- What expenses, if any, can be reduced or must be increased
- Have there been any "extraordinary" items that are included in the I/S that were one-time occurrences but may have tainted the I/S? (For example, a business may sell a division or part of the business and record as regular revenue with no specific expense recorded. This changes the margins and profits enormously. Only in Due Diligence is something like this revealed.

Prior to this, the Seller may not even bring it up. 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 CRA audit.

You'll also want to verify sales by customer (if applicable) to be sure that there are no customer concentration issues that have not been disclosed. Check the customer order log. This may not apply to all businesses (i.e. not retail). The last thing you want to do is buy a business anticipating certain revenues from the beginning based upon prior history and then find out that there are no orders in house for you.

Unless you uncover a "disaster" you shouldn't think that this is the heart and soul of Due Diligence. The revenues and expenses only tell you about the past, but the past is over. They may provide a glimpse into the future, if certain things remain the same. Only you can determine that through your research. The financials have their place, but as you have learned, they are by no means the sole reason why you will purchase any business.

Checklist

1. The company's Income Statements going back as far as possible. If you have access to five-plus years, you only need the last five.
2. Company tax returns going back as far as possible, but a minimum of 3 years.
3. Comparative report outlining all revenue and expense items from one year to the next. If necessary, your accountant can use the statements and put together a spreadsheet with this information that will allow you to perform individual comparisons (i.e. in Advertising costs) from one year to thenext.
4. Projected operating financing statements, if any available from the Seller.
5. Projected Revenue and Expense statements that you must do.
6. The chart of accounts (a listing of each different item in the financial statements and the internal code that it has been given).

Here is a sample of what your accountant will typically require to complete their financial review:

1. Bank statements for the for past three years;
2. Cash receipts journals for the past three years;
3. General ledgers for the for past three years;
4. Cash disbursement journals/ cheque registers for the for past three years;

5. Copies of all leases and contracts still in existence' including lease for premises;
6. Copies of all insurance policies and related invoices for thefor past three years;
7. Copies of payroll tax returns and all related schedules for the past three years;
8. Copies of owner's T1's for past three years;
9. Copies of corporate tax returns for the past three full years;
10. Detailed list of all equipment and supplies;
11. Copies of GST & other tax returns for the past three years;
12. Detailed schedule of owner benefits;
13. Current balance sheet and Income Statement;
14. Schedule of all current customers' with yearly billing and agreement terms' if any.

NOTE: many people assume that a company's tax returns are infallible.

Shortcut #9. Try and verify everything, even tax returns that could be false.

If you wish, have the seller sign business consent forms, you can have your advisor request this form because some sellers can get insulted and you can always say: "I trust my advisor implicitly and he/she is the one who wants it... besides, I'm sure there's nothing being hidden so why even worry about him getting a copy to double-check?"

The balance sheet

The next part of the financials is the balance sheet information. This will include a detailed investigation of receivables, payables, inventory and equipment.

Accounts receivable (AR)

You have to determine how long it takes the average account to pay its bills. As you know, this will have a major impact on your cash flow. You may be surprised to learn that the average customer takes 60 days or more to pay. If all of your suppliers require payment in less time than this (and almost all do), then you will be in a situation where you are always behind. In an ideal world, you want to get paid by a customer before you have to pay for the supplier for the goods that the customer purchased.

The key steps to follow

- Trace client invoices to see how long it takes them to pay. Track down each invoice to see how many days after invoicing their payment was received.
- How does each customer pay? Cheque? Cash? Credit card? Can the cheque-payers be converted to credit card payments?
- Verify the amounts owing against the customer's records. This can be done easily by calling random accounts. The reason to do this is because if there are major discrepancies with several accounts it may indicate inaccurate accounting on the part of the business.

- Are there any receivables due from employees? If so, ask them about this. It's amazing how, after the purchase is completed, they may claim that the "old owner said I didn't have to pay this."
- Compare the AR over the past years. Any trends up or down?
- What are the company's general terms of sale? Is it comparable to the competition? Do the customers respect the terms?
- Do any customers get special year-end allowances, volume rebates or any other "bonus" that must be accounted for? If they do, you must reduce the amount of the purchase by what the customer will be getting for sales.

Checklist

1. Reports outlining the amounts due from all customers, employees or any other party;
2. Aged trial balances of each receivable
3. Copies of customer invoices, company deposit books and bank statements;
4. The balance sheet going back several fiscal periods.

Inventory
(This section will vary depending on the type of inventory to be reviewed.)

Furniture and equipment

This can be a tedious process. Start with the highest-value items. Call several suppliers and have them give you a rough estimate of the costs. Then move down to the less-expensive items. You need to know:

- Is the equipment working?
- How long can you expect it to produce revenue?
- What are maintenance costs?
- Have the manufacturers send in a service rep to evaluate it.
- Determine the major breakdowns you can expect.
- What warrantees are still in place?
- What work/maintenance was done on the equipment in the past year? What are replacement costs?
- Can you afford to replace these if required?
- Which items are owned, which are leased?
- Do the leasing companies offer trade-in allowances?
- Remember what was discussed regarding computers and office equipment.
- Employees will generally complain about how poor the copier or fax is, or how slow their computer is. Let them know that, while you will be pleased to do whatever necessary to improve efficiencies, the plan will be focused on areas that generate revenues. Everyone is going to have to do their best with what they have until the business begins to grow.
- Don't let the employees convince you to replace manufacturing equipment that still works. You can always buy bigger, faster, smoother, and newer. Unless there is a

direct link between the equipment purchase and increased revenues or improved customer service, forget it for now!

- Look at the equipment the way you look at a car that is fully paid for. Each day that you drive it without having to make a payment is money in your pocket. If it does require some maintenance, even major jobs, as long as the amount of repairs in a year is less than the payments for a new car, then stick with the one that's paid for. When repairs exceed the payments for a new one, remove the license plate, and go buy a new one.

Checklist

1. Listing of all items;
2. Valuation report;
3. Depreciation schedule indicating accumulated and remaining;
4. Lease contracts;
5. Maintenance contracts;
6. Listing of all equipment manufacturers.

Liabilities

This area should be fairly straightforward. All you need to know is what the obligations are after you buy the business.

- Verify the supplier statements with the company's records.
- Have each supplier send you an updated statement.
- Any obligations that you will assume must have reconciliation an explanation from the party to whom you will have the obligation.

Checklist

1. Accounts Payable listing;
2. Supplier statements;
3. Letter/Documentation from all parties to whom you will be obligate financially.

Matching the financials to the plan

The question, however, remains how do you take financial statements from the past and utilize them to project the future? While you cannot predict the future you must determine whether the business has a viable future, which is the only reason why you would buy it in the first place.

Some Sellers may provide you with plans or budgets that they have prepared.

Shortcut # 10: Do not use a seller's plans or budgets.

Predicting the future is impossible, but you must attempt to do so given the best available information that you can obtain not based upon a picture that a Seller wants to paint for you. Having said this, let's agree that you have to do these. They are important.

Be extremely conservative and use a formula that will clearly dictate the downside. Most people have a tendency to "fall in love with the business" before they own it. They focus their attention on all of the wonderful things that will change in their life once they become the boss. This is a recipe for disaster as the emphasis gets shifted to dreams not reality. When you grow the business you will get all of the benefits, but in considering the purchase of a business, very careful and conservative analysis of the potential downsides must be considered first and foremost.

Shortcut #11: Plan for the worst-case scenario.

After the purchase the business will have added debt coming from the purchase price. This figure has to be added into your statements. Make certain that you have included a provision for your salary.

Take the cost of professional fees and add 20%, as your first year will undoubtedly require added input from lawyers and accountants. Next, allow for a decrease in sales in the first year of 10%, 15 and 20%. Include a provision for unexpected major expenses in case of equipment replacement.

Allow for the seasonality of the business by doing a Pro Forma Income Statement on a month-by-month basis, beginning with the month in which you may realistically take over the business. Don't make the mistake of doing the Pro Forma on a calendar-year basis if you will purchase the business in July. What if the July-to-September period is the slowest time of the year for the business?

You may be predicting a profit in your first year, but will you be able to handle an operating loss in the first few months? Take all of these so-called negatives and work them every which way into the Pro Forma Income Statement to determine what the business will look like. Your advisor will have the spreadsheet to do this quite easily. Have them give you a copy and keep playing with the numbers. Do not make the mistake of playing with the numbers until they look good. Play with them so you can digest how you will be able to deal with them should they be bad. Learn what your monthly break-even point will be and you will want to know how much you have to generate each month in sales so that the Gross Margins cover your Fixed Expenses.

Approach this exercise from a conservative, almost negative, point of view. This will give you a realistic picture. Don't try to convince yourself that any business is great. Let all of the facts add up to reach a logical conclusion. As we stated earlier, numbers don't lie; so don't lie to yourself.

Checklist

Prepare an Excel Spreadsheet with all of the various categories and then "play around" with the numbers. If you are not able to do this yourself' have the accountant do it. Excel is very easy and you can learn to manipulate it after 30 minutes of instruction.

Banking

If the arrangement involves taking over bank accounts' then try to arrange a meeting with the business' current bankers. You may decide to keep them; however, if you borrow from another institution it just makes sense to keep all of your banking with your lender. This is what you want to verify:

- Review all relevant bank statements
- Examine any Loan/Line of Credit accounts. Any trends from year to year? Any seasonality, meaning does the business use the line more at a specific time of year (perhaps in slower seasons)?
- What Interest rates are being paid?
- Are there any loans that are not guaranteed by the Seller that can be assigned to you once you purchase the business? There are cases where the business has a Loan or a Line of Credit secured by the company's Assets. Sometimes' you can have these rolled over to you without much paperwork. Before you meet with any of the banks, look at the loan sheet and see if this can be done.
- Who signs the company cheques?
- Open up brand-new accounts (even if the bank stays the same) for all accounts and be sure that you are the only one in the company that can sign cheques.

On this note, until you are comfortable with your accounting personnel, do not let anyone have access to the company's cheques (even if they did with the prior owner). When they are needed, let them come to you. This is especially dangerous today with the new systems where there are blank cheques with no cheque numbers. Your exposure to fraud today is much higher than ever before.

A "bad" employee can produce cheques and assign numbers to them and by the time you become aware' it could be too late. Watch this area very closely! I am not saying that you cannot trust the employees - you must! BUT' trust is not a "right"; it must be earned over time. You do not want to operate suspicious of any employee' especially those who may be handling your money.

Checklist

1. Copies of all bank statements for the past 3 years;
2. Documentation on any existing loans;
3. Listing of all company bank accounts' numbers' institutions and signees.

2. Sales

There are several parts to the category of "Sales." This period is not going to allow you the time to determine if the sales policies, procedures and strategy are working.

Assume that whatever is currently in place is sufficient only to the extent of the revenues that are currently being generated. Nothing better. Nothing worse.

Begin by having selected salesperson "pitch" you the company's products/program/services as though you were potential customers. Then' you will want to get answers and verify the following:

- What do the salespeople do on a typical day?
- How are new customers solicited?
- Who are the top salespeople?
- How long have they been with the company?
- Will they stay?
- What happens if they leave?
- What are the company's sales policies?
- Are the policies organized?
- Does every customer have a different deal?
- What latitude does a salesperson have with the clients?How long are customers retained?
- Are the company's products/ services a one-time sale?
- Is there repeat business?
- What percentage of the company's business comes from repeat sales? What is the cost to obtain a new customer?
- Does the salesperson do any traveling?
- Are the customers local national international?
- How are out of territory customers handled?
- Are there any remote salespeople?
- Do the salespeople report to head office daily, weekly or monthly?
- Are the compensation arrangements for salespeople inline with industry standards?
- Who does the sales forecasts and budgets?
- Are the budgets monitored daily, weekly, monthly?
- What happens if sales fall below budget?
- Is there a regional sales manager? What is his/her role? Who do they report to?
- How do salespeople get on with the regional manager?
- What training does the company provide for new salespeople?
- What training is done on an ongoing basis?
- How difficult is it to recruit new salespeople?
- How many customer orders are normally booked each day?
- Do the sales have to be chased down?
- Are orders lost or gained based upon price?
- What are the salespeople's biggest challenges?

- What recommendations do the salespeople have for increasing Revenues?
- What is the entire sales procedure from solicitation to closing to final payment?
- What systems are in place for follow-up? Is this a manual system?
- Does each salesperson have their own "way" of doing things or is there a standard sales rep software system in place
- What role does technology play in the sales function?
- How automated is the sales process?
- What costs are involved to fully automate the sales process?
- Could a system be put into place? Has the company previously considered this and what information can you get that will show what was previously done?
- How open are the salespeople to change? (They're usually the worst, by the way!)

As you can see from the questions, your goal is to get an overview of what is being done, determine how can it be done better, whether the potential with each client is being realized, what resistance you will have to change, options available to build the sales force and, most importantly: does the company provide all of the possible tools to make the sales team effective. If not, what are you going to do about it and how much will it cost?

Checklist

1. List of top customers that contribute most of total sales.
2. List of key salesperson's top five customers/referral sources
3. List of pricing structure' gross margins of key customers
4. Sales policies.
5. Discount/pricing structure.
6. Sales reps to provide suggestions in list form of what can bedone to increase the business.
7. Sales Report by key sales rep and what has been their per performance to-date.

3. Marketing

The marketing strategy may not be clearly defined. This is quite common in many small businesses. Unfortunately, owners do not realize how critical this aspect of the business is. It does not matter if you are a one-person electrical contracting company or a Fortune 500 company; it's all in the marketing. Today, successful companies recognize the vast differences between Sales and Marketing and have separate teams devoted to each discipline. To put it in simple terms, Marketing is: "the process of creating customers for your company's products." While it sounds easy, it isn't, but it's not a daunting task, either. It will be difficult for you to formulate a viable Marketing Plan before you take possession of the business. Don't waste your time during Due Diligence trying to compile one unless it is mandatory for your financing.

Shortcut # 11: You want to make sure there are enough customers in the area to grow the business; why they buy from the seller and what would get them to buy more.

This aspect of Due Diligence is something that you must do yourself unless you have a marketing expert to help you. The beauty of marketing is that sometimes the smallest, most inexpensive strategy can yield incredible results. When you tackle this, you will need the input of the employees that are responsiblefor this area. If there are no dedicated marketing personnel, you may have to address this with the Seller. Do not be disturbed to find out that there is absolutely no focus on marketing or it is done in such an apathetic way that it cannot even be called marketing. The smaller the business, the more likely a structured plan is not in place. If this is so, don't worry. It means that there is a wonderful opportunity for you. Do your best to get through all of the questions you need answered. Your goal is to determine how much focus the company has placed on marketing; do they really understand what it is and what can you do to turbo-charge this part of the business?

The areas that you want to address during this stage are:

- Does the company have a Marketing Plan?
- Have they followed it?
- What has been successful?
- What has failed?
- What were the costs of each campaign?
- Does the company have a clear definition of what business they are in? Does the company really know who their customer is?
- How focused is the company on marketing their products or services to the right potential customers?
- What methods are used to sell more products/ services to the current customer base?
- Does the company spend more effort on getting new customers or on increasing their volume with current clients?
- How much money does the company spend on marketing each year?
- Does the company know why their customers buy from them?
- Is the company clear on what its strengths and weaknesses are?
- Are the company's strengths made clear to the customers?
- If the customers were asked to list the company's strengths and weaknesses would these be the same as the company's list?
- Is the company focused on delivering the message of its strengths and improving upon its weaknesses?
- Does the company make it a priority to continually test new marketing ideas?
- Are new marketing programs analyzed in detail to really understand what is and isn't working?
- When the company finds a strategy that "seems" to be working' do they stick with it' or do they keep trying to improve upon it?
- Ask each of the key employees what they believe to be the single biggest thing that their company offers potential customers that is truly unique to the company. Then ask the customers the same question.
- Ask each key employee what they believe is the most important factor that determines whether a customer buys from them or the competition. If the majority claims that it's "price'" you have some work to do. You do not want to compete on

price alone and you must find a better way (don't worry; there are plenty of ways to overcome this). Again' ask the same thing to the customers.

- Are the salespeople selling the same benefits that the marketing team is preaching? (believe me' plenty of companies get their signals crossed)

Checklist

1. Copy of current Marketing Plan (MP) if available.
2. Detailed commentary on the MP - results of each campaign' costs' business generated' etc.
3. Copy of all company marketing materials.
4. Report from employees on marketing activity and suggestions for the future

4. Employees

Evaluating key employees is a difficult part of the Due Diligence process. Because of the sensitivity involved, you may not have the opportunity to truly evaluate them until the purchase is complete. However' this is a good time to begin forming your relationships with them as you will be in contact with them daily for a month. It is usually a good environment to get to know them a bit. It may be a bit tense, but that's fine. Don't try too hard to "win them over." You should know that this is the time where most opinions will be formulated about one another. Don't get "too" friendly. Maintain a very professional approach and focus upon creating an impression that you are hard- working, reasonable' honest and that you expect the same from them. If you do get any questions regarding their status' your only comments should be that all jobs are safe as long as everyone produces.

If you become aggressive or try to play the role of the boss' you will turn them off. Be humble. Listen to what they have to say. You may be shocked to hear some of the things that they may tell you.

Shortcut #12: Do not say anything negative about the current owner or the business itself toemployees.

You can talk about some of the things that you are considering implementing or that you are the type of individual that welcomes their input. Do not give any impressions whatsoever that you are planning any radical changes. Do not discuss anything about: changing reporting functions, computer systems etc. Most people fear change. This is not the time to discuss the plans you may have. Should the topic arise' simply explain that you are committed to building the business and that everyone will be involved in the process of determining the company's focus.

The things that you must determine regarding the key employees are:

- What are the job descriptions' compensation arrangements are they using?
- Do any employees have special compensation arrangements with the Seller?
- Any disputes?
- Have any employees indicated their desire to leave the company soon after you join?
- What fears and concerns (if any) do the employees have about your pending purchase?
- Do the other employees seem favorable to you joining?
- Identify the "key" employees (yes, they are all important, butsome more than others).
- Has the competition recently hired any of the company's employees orsecured any of the employees to switch? This is important because they may try to solicit others, once word gets out about new ownership. Find out who these former employees left the business.
- Has the business hired/ signed up any of the competitor's employees? If they have, they'll be a great source for competitive information.
- Do any of them mention that they believe the business has a lot of opportunity?
- What are your initial impressions of each key employee?
- How helpful and knowledgeable are they about the questions you ask them?
- Do there seem to be any "groups" within the company?

Checklist

In many small businesses much of the information listed below may not be applicable or available. However' the ones you believe are appropriate should be documented in the Offer To Purchase.

- Organizational Chart outlining who reports to whom.
- Job description, compensation arrangements (royalties, side deals, non-financial compensation such as car allowance, expense account etc.) performance evaluation for key employees with commentary regarding any promises made by the Seller to any of them.
- Copies of all Key Employee Agreements.
- Copies of any Consulting Agreements.
- Employee files with memos for reprimands or any other disciplinary action or warning.
- Listing of any disputes' employee work stoppages' or legal action (pending, considered or otherwise).
- Copy of any Employee Benefit Program (medical, retirement).
- Summary of any company incentive plans' including profit sharing.
- Confidentiality Agreements, if any.

5. Systems

There are many small businesses that still operate without the use of any technology whatsoever. You find this in cases where the owner is older and just could not adapt to the new ways of doing business. Or, in similar cases, where a computer system was put into place because they "had to'" but it is either wrong or underused. No matter what business you are purchasing there is technology available to help you.

Whatever systems are in place' have them evaluated. Your accountant can review the accounting software and you can do the rest even if you are not a computer expert. The best way to evaluate the systems is to understand how the business operates and what role technology/systems plays in making these operations flow quicker and more effectively.

The business' ability to produce accurate and useful reports is a direct indication of the business's overall level of organization. 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. Ask each key employee which reports they would like to see on a monthly basis. Get a copy of the software manuals. Locate the software vendor's websites and call the company. Have them give you the name of a local dealer. Call the dealer and explain what you are doing and arrange to meet with them. While avoiding techno-talk, have them explain what the system can do for you. If the business is not using any systems for sales or operations, you must determine what the costs will be to get these systems in place. They are usually not expensive, but there is a cost.

You will find that most employees will complain about how terrible the systems are, or they need a new computer, and a whole series of other complaints. For some reason, they feel the need to blame the computers, not the users. Listen to what they have to say, but make no promises.

Contact the industry associations and determine if there is any software that is available that is specific to the industry (most have them).

- Does the company have a website?
- Who maintains it?
- How much business is done through it?
- Do the employees use email?
- Do each of the employees have PCs and Internet access? If they did, would it help?
- If they do, are they using it and for what purposes?
- Is there an employee in charge of the systems?
- Does the company outsource for computer maintenance? If so, whom do they use? Arrange to meet with this person and get their input. Usually,these individuals can be a wealth of information once you tell them to speak your language and not in "code" as they have a tendency to do. If you have to purchase new systems, what will they cost?
- Any lease agreements in place for computer equipment?
- Any contractual obligations for computer maintenance?

Checklist

1. Contracts for any equipment leases, maintenance contracts;
2. Software manuals (where available);

3. Website access, pass code (when purchase completed);
4. Copies of all reports currently being produced.

6. Competition

This is really the most "fun" part of Due Diligence. You get to play detective and you will soon see how creative you are' even if you think you aren't. You may be surprised to learn how little the business you may be purchasing knows about the competition. This is so ridiculous but it is often the reality. Business owners tend to go into their own little world of running their businesses. Day-by-day, year-by-year their drive may decrease and with it goes the passion and the ongoing commitment to do better.. So what do you do? What better place to begin than with the sales and marketing team? You can almost bet that the better the salesperson' the more he/she knows about the competition.

Shortcut # 13: Before you buy a business, you need really good information on the competition.

You must maintain this intelligence strategy forever. Right from the start of the process' your goal is to gain an understanding of who they are, how they compete with you, their advertising and marketing strategy' and their strengths/ weaknesses. Don't underestimate the importance of this part of the Due Diligence.

- Have each key salesperson put together the competitive information they have. Don't do this collectively. See what each one has on their own (it will also give you an indication of how informed the salespeople are).
- Meet with the key salespeople and ask them to provide you with a competitive analysis including strengths and weaknesses of each of the competitors and what they believe must be done to beat them. Put together a listing of the leading competitors.
- Get their price lists, catalogs, etc. and contact these competitors. Speak to their sales rep, play the role of an interested Buyer and they will send you plenty.
- Visit the different websites.
- What do they use as their "hook" to get customers?
- What advertising do they do?
- How many of your customers buy from them as well?
- Do they sell based on price, service, availability, selection?
- Who are the owners?
- Are they bigger than you?
- How long have they been in business?
- Number of employees?
- Obtain a credit rating on them.
- On what basis does each one compete with the company you are considering investing in?
- What do they seem to do better?

- Is their customer base the same or does it differ? How?

Checklist

1. All competitive materials available;
2. Listing of all major competitors, phone numbers and website address.

In this section, the focus will be on how to get even more detailed industry and competitive information if you are buying a business outside your industry sector.

The most important thing to remember is that you must begin to gather information on any business, the industry, the competition, the market, the suppliers, the sales strategy and every other possible component to the business as soon as a business becomes of interest to you. In other words, the first time you find out about the business and if you're interested you must begin to learn as much as you can about it.

The beauty is that a ton of information can be gathered via the Internet. If the target business is unique be sure to inquire: "What is this type of business called specifically?" I know this may sound odd, but you really want to be sure. As an example, if you're looking at a manufacturing business that caters to a certain industry, find out the precise SIC code of the industry or what the umbrella name is used to classify the industry.

There is one other reason why you need to begin this phase immediately: when you meet the Seller, you will be a lot more informed and will definitely present yourself as a savvy individual.

You may also find that you will be doing this for several businesses at the same time. Once you begin to move forward with any one business' the time will move very quickly. Therefore, do as much as you can in a proactive manner. The only way you will be able to handle the workload is to have a clear plan of what needs to be done.

The guidelines and the listing of questions that you will need answered should be expanded or narrowed depending upon the business.

Key information

In a "big picture" sense, here is a listing of what you will want to learn:

- How big is the market?
- Is it growing?
- What are the key factors that can impact the business either positively or negatively?
- Is there any looming legislation that will affect the industry, the business? What key publications and other media are being used to advertise? What are the advertising costs?
- Who are the competitors?

- Can your business compete with them? How?
- Where does the Seller's business fit amongst the competition?
- What is the competition spending on advertising?
- Where is the competition advertising?
- Does the industry seem fun?
- Are there any major growth areas?
- Are there any new product trends?
- What are the industry distribution channels?
- What sales/marketing applications are being used within industry? Who is the industry/market leader?
- How is this business ranked within the industry?

Sources of information

The good news about this process is that there are many resources available to you. The best resource to begin this search is with the seller. Have them provide you with names, contact numbers, website address, telephone/fax numbers, copies of publications and any other information possible for you to get information. You will want to evaluate the following resources:

- Industry Associations
- Local Associations (they may or may not be members, but find out who these are in any case)
- Industry "Bible" (every industry has at least one main trade publication) Copies of any industry subscriptions they receive (get copies... it's good reading and pay attention to the ads)
- Previous trade show materials (from any trade shows that the business has exhibited or attended and even if it is from a few years ago) Sales/Marketing material from the Seller's company Sales/Marketing material of the Seller's competition (be wary if the Seller doesn't have any!)
- The names, addresses, website and phone numbers of as many competitors as possible
- The Internet & websites where you can search for additional information
- Key customers (they may not want to do this so you must do so discreetly. Check shipping cartons during your tour or note any names that they may refer to during your conversations).

The industry

Like the Industry Association, there will be one publication that is the leader of the industry. Whether it's "Carpenters Monthly" or "HVAC Quarterly," they all have a publication that focuses all of its advertising and editorial content on the industry. While these may not be the slickest publications, they are a wealth of information in many areas. You can get advertising information, identify competitors, gain industry insight and discover related books, Websites and other resources. The best strategy is to contact the advertising sales department of this publication. Why? Salespeople love to talk, and they are hopeful that they are going to sell you something.

As a guide, here are some of the questions that you may want to discuss with them:

- Who are industry leaders?
- What are the current trends in the industry?
- What is the size of the market?
- Is the market growing?
- Is your area a growth area?
- What are the competitors doing?
- If they owned this type of business what would their advertising and marketing strategy be?
- Would they buy this type of business?
- Do they sell their subscriber list?
- Are there any publications or other resources they recommend?
- Any industry consultants they can suggest? If there are any, call them ASAP. Go through the same pitch, let them know that you will be interested in their services once the purchase process moves along... but in the interim: "Can I ask you a few questions...")
- What trade shows should you attend?
- At which trade shows should you exhibit?
- Have them send you lots of back issues and try to get hold of their annual Directory Listing (you'll see all of your competition).

If you establish a good rapport with them you will be able to keep calling them with questions. This will be a great education. Prepare yourself beforehand with as many questions as possible. One last thing - if they prove to be helpful and accessible and you invest in the business; try to buy an ad from them if it makes sense.

Industry Associations
Nearly every single industry has an association of some sort and the Franchise Owner/ Seller may or may not be a member. If they are, ask them for the association's most current package. If not, get the name and number of the association and call them. Remember: speak to a salesperson if possible.

Shortcut # 14: Get key information from industry associations.

Associations can be extremely helpful. Tell them that you are in the final stages of purchasing a business and you will want to join their association. There is no need for you to disclose the business's name. Tell them that you have signed a Non-Disclosure and you cannot reveal the name; they will understand. Pump them with as many questions as possible. Make sure you get their name of the person you are speaking with and their direct number and email address for future reference. The questions you will want to ask include:

- Can you access a membership kit online?
- What is their website address? (Visit their website and navigate around.)
- What qualifications are needed for membership?
- Do they have an annual industry trade show? When? Where?
- Do they have a monthly or quarterly magazine that is distributed to members and potential member customers?
- What are the rates? (Make sure a recent version or two is included in the membership kit.)
- Do they publish an annual directory? How can you get it quickly? Where else would they recommend for you to search for information? Do they know of any industry consultants that may be of help to you during this investigation period? (If they do, call them ASAP.)
- Can you call them in the future with other questions?
- What advice can they give you about buying a business in this industry?
- Is there anything that they can suggest for you to do to improve your investigation? Any suggestions that they have will be helpful (and tell them so).

If they want to charge you for any materials, the best tact is to say that you will absolutely join their association and advertise once the purchase is complete, so if they can give you a break, it would be helpful. Most probably there will be no cost to you, but if there is, it will be minimal. Based upon your discussion, if it will be helpful, then you should purchase it.

Local associations/media

If you are buying a business that relies on the local community to generate Revenue' then get a grasp on the local associations such as the Chamber of Commerce, discount books, newspapers and flyers. With these you should be able to determine some of what the competition is up to' what your/their advertising costs may be' where you should be spending marketing dollars' and what promotional vehicles are available to you within your community.

Industry magazines

Some industries have several competitive publications. While there is usually one clear leader' the others are generally helpful and cheaper to advertise. Call these as well. Use the same strategy to solicit information from the ad sales department.

Trade show materials

Since your mission is education, the collateral materials from trade shows are very valuable. If the Seller does not have these available, get in touch with the exhibit company that does the shows (your advertising rep will give you this). Call the exhibit company and ask for someone in the sales department. Tell them you may be interested in exhibiting in the next show. Some shows require that you be a member of a specific association in order to exhibit. Tell them that you are inthe midst of purchasing a business and you've decided that you will join the association immediately. However, you are in the stages of Due Diligence. You are developing the marketing plan, so you need to know costs to exhibit and any other information that they can provide. You want to get a list of exhibitors from the last show, preferably in a directory format. These directories are sorted 25 different ways, so you will be able to quickly locate many of your competitors and other new potential suppliers.

Seller's marketing materials
Every business that you will visit, be it a local oil lube outlet or major distributor, will have (some) marketing materials. The material's content, presentation, layout and dating will give you a good indication of how aggressive the Seller has been in marketing the business. Don't criticize; simply analyze. Determine how recent these are, what the reaction has been, how frequently they are mailed, distributed or advertised. Determine if the Marketing Plan (if there is one) hasbeen followed and monitored.

Competitors marketing material
Knowing the competition better than they know themselves has always been atop priority for above average sales people. Anyone who does not have an ongoing program in place to constantly monitor the competition is bound to be put out of business by them! If the Seller does not have information on the competition, watch out! Again, this does not mean that it is a bad business, but it almost always dictates an element of being "out of touch" with the marketplace.

If you are looking to buy a florist, shouldn't the Seller know exactly what the competition sells its roses for? How much do they charge for delivery? What are their Mother's Day promotions?

Who are their major corporate accounts? What is their specialty? How are they different from them? What are their strengths/weaknesses?

There are plenty of other things that should be known. Knowing the answers to these questions is just plain common business sense.

The Seller should be able to provide you with the names' addresses and website information on all competitors. If the Seller does not have this information, then you can get it yourself. The yellow pages, Internet, Industry Publications and other resources we've covered will give these to you.

Be certain that you learn who the competitors are. Then call them and role-play a bit. Depending on the type of business your "role" will adjust accordingly. For example, let's say you are looking to buy a distributor of industrial vacuum cleaners and the business caters to hospitals and schools. Call the competition, ask to speak to a sales rep and tell them you are buying a nursing home and you want to get information on their product. Pound them with questions on price quality, service' company size, history, strengths and weaknesses.

The thing is for most salespeople when they get a Buyer asking all kinds of questions' they think that have a real "live one" on the line. Ask them to mail it to you. Also ask them for their Website. When on the phone' tell them you are also looking at another product and mention the brand that the Seller represents. Ask the salesperson for their assessment' what do they (the competitor's rep) know about the competition (in this case the business you are evaluating) and why do they think that you are better off buying from them instead of from the business you are evaluating? You may be amazed at what you will learn from this.

Remember to get their name and find out when they are available and if they are the only salesperson. If they say that there are others' call back and speak to them also another day. Another thing to do is to actually visit the competitor's premises. Again' "play the role" and you probably can get a tour of the place (in addition to as much information as you could possibly need).

Regardless of what business you are evaluating, contact the competition directly and, if you are creative, you can get all the information you need directly from them.

However, no matter what, NEVER EVER disclose any facts about the business you are thinking about buying. This would be the utmost breach of the confidentiality agreement you signed' and more importantly' it's wrong. If at any point you feel that you may say or do something that could somehow reveal that the business is for sale' extract yourself from the conversation immediately!

The Internet

You could probably spend the rest of your life searching the Internet for information. It's a great tool if you do not allow yourself to get "lost" in it. Do the search based upon what you know (competitors' brands' etc.) and review those Websites. Then' explore general areas via keyword searches. Instead of spending endless hours lost in cyberspace' contact these companies by phone and not email. Ask them lots of questions. Be creative and you will always get information. Again' you are trying to educate yourself' so ask questions and don't be afraid. Remember' if you are speaking with someone who thinks they may sell you something' they will flood you with information.

Summary

- Begin to gather information the moment a business becomes of interest to you.
- Be sure you identify the precise business category.
- Do your homework and work quickly.
- Get as many resources as possible from the business owner.
- There are tons of resources available to you' but you have to go after them.

- Evaluate everything, because you never know where it can lead.
- Don't be afraid to contact these resources and ask questions, lots of them. Be creative in your approach. (You can be anybody you want!) Play the role of "hunter" and information is your "prey."
- Salespeople love to talk, so speak to them whenever possible.
- Take great notes and, when going "undercover," remember to note yourstory in case you want to call some of these people back.
- Establish a clear set of questions that you want answers on and focus on getting those answers.
- Enjoy the process; it really is quite fun.

7. Customers

This category may become a "sticky" issue during Due Diligence. In a retail environment (store, restaurant etc.), you will have full access to the customers as you will see them each moment you are on premises. In other situations where the customers don't come in to do their business, the Seller maybe very concerned about you having access to them. If word gets out that the business may change hands or a competing business is opening the Seller may worry that it could affect their business if the sales fallsthrough.

Often no matter how tightly guarded a Seller is about selling word does get out. If you encounter a situation where the Seller is fearful of you having any customer contact you have to be sensitive to their concerns.

Likewise, they have to realize that you cannot possibly purchase a business without access to the customers at least the larger ones. They may try to limit this by having you see what the company has in its files. While this will give you a glimpse it will not reveal the whole picture. So here you are again facing a situation of what to do? There is an alternative that works. Have the Seller arrange meetings with the top customers. You will find that no matter what the business is a small percentage of customers or referrals often make up the majority of the volume (the 80/20 Rule... 20% of the customers or referrals provide 80% of the business).

Have them bring you to the meetings as a "Sales Trainee." Be prepared to answer any of their questions regarding your background. Don't make up stories. Tell them exactly who you are and what you've done. Even if your experience has no sales background, tell them you've always wanted to get into sales and the Seller is giving you an opportunity. Your goal is to observe the interaction and to get a "warm and fuzzy" feeling that everything is OK between the customersand the company.

When you buy into the business, meet with them again. Apologize for the pretense of your last meeting and explain that you had no choice because those were the wishes of the owner and you had to respect them. They'll understand.

Checklist

1. Report with sales-by-customer for current year and previous year.

8. Contracts

A business may have many contracts that need to be examined. These include leases' insurance policies' customer agreements and supplier contracts.

Leases
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. The language you want to look for is that the assignment/transfer: "will not be unreasonably withheld."

Arrange to meet with the landlord to get direct answers from them regarding a new lease and renewals. Don't rely on the Seller's opinion. You want to ensure that the premises are right for you and the terms and conditions will not suddenly change because of a change in ownership of the business. This may cause you to enter some negotiations with the landlord. Like everyone else' they want assurances that the rent will be paid. Whatever arrangement is made' be sure that a new lease is drawn up or' if transferable' get a letter acknowledging this from the landlord.

You will find that unless the landlord wants you out to make room for someone else, you will have no problem coming to terms with the landlord, but the process may take some time. Their agenda is simple: keep the space filled.

As long as you can pay the rent' they'll be flexible. By the same token' if you have to play hardball' the chance that you may leave is not an attractive option for them.

IMPORTANT: take note of the amount of security deposits the Seller has in place with the landlord. You will have to come up with this money at closing to replace the Seller's deposit. On this note' you will be required to do the same thing with other deposits such as utilities.

Another factor that must be investigated is the importance of location.
If the business is strategically located because of drive-by traffic or if the location in any way contributes to the revenue of the business' you must understand why this is.

For example' a retail store in a plaza generally relies on the big anchor tenants to draw people.

In reviewing the lease, the things you need to learn are:
- What is the lease term?

- Is it transferable?
- What are the renewal options?
- What are the actual costs?
- What's included? Excluded?
- Is the rent current?
- Can you negotiate a new lease as previously outlined (1 or 2 years with one or two 5-year renewal options)?
- If the business relies on other tenants or other nearby businesses for traffic (i.e. a retail location) are they committed long-term to their locations? Get this in writing if you can from the landlord. If they will not do so' get a clause that allows you a reprieve or concessions in the lease should certain tenants vacate within a year or two of your purchase.
- Does the landlord own other property and where?
- Check out the landlord's reputation with other tenants.
- Ask the employees if they are aware of any problems with the premises(leaks, broken AC etc.).
- Does the landlord respond quickly to problems?
- Do they have their own "handyman"?

Insurance policies

The business needs insurance coverage and the type of business will dictate what kinds of policies are required. The business may be paying for a life insurance policy on the Seller. Offer them the right to take over the policy directly. For the other policies in place you must learn:

- Are they transferable?
- Do you need them?
- What are the costs to replace the non-transferable but required ones? Check out any customer or supplier contracts as they may require that you carry a minimum amount of liability insurance.
- There may be certain laws that are specific to your products/services where insurance policies must be of a certain type and coverage amount. Check this out.

Customer contracts

You may be obligated to respect certain prices' terms' conditions' delivery guarantees' etc.' with certain accounts. While these are usually in place with major corporations' if the business sells to large customers' be sure to learn about these contracts. They may even go so far as to restrict the amount of price increase you can get from them.

Supplier contracts

If the business you are considering involves contracts or agreements with certain suppliers, pay very close attention to this section. Supplier Contracts will refer to any agreements in place, whether written or verbal, that involves the business having a relationship with a third party whose products or brands the business represents in any way, shape, or form.

These contracts may represent the entire product range that you will be marketing. This is very much the case with distribution companies, manufacturers' representatives, licensing deals and even retail environments where you sell highly recognizable brand-name products.

There is also a huge difference between transferable and assignable. In a transfer, the license/rights would be given to you, perhaps with a fee to the Licensor/Master Distributor and upon their approval. If the contract is assignable, then it can be done between the buyer and seller. You will find that most contracts, whether licensed agreements or distributorship contracts, are very one-sided and are almost entirely in the other party's favour. In general, they can be terminated at any time with little or no notice and no compensation for you. This shouldn't be a big worry as long as you can take over the contract.

A Master Distributor/Licensor has only one goal, and that is to sell more products. If they believe that you can do the job, they'll give it to you and you'll keep the contract for as long as you perform. If at all possible, get these suppliers to document that the relationship will continue as before.

The technical part of the investigation is all the same. However, Supplier Contracts may be more important than any others in place. You can always find other premises, you can get new insurance policies, but if you don't have product to sell, there is no business. You must arrange to meet in person with any suppliers whose products represent over 20% of the sales of the business. Be prepared to not only answer their questions, but to walk them through your background, areas of expertise and plans for the business. You must prove that the business will be in good hands with you as the owner and that you have the ability and drive to sell more of their products.

Shortcut # 15: If one supplier or one customer represents more than about 30% of the business, then you need an ongoing commitment from that supplier and/or customer.

When looking at a business where one or two key suppliers, you need full assurances, in writing, by the supplier that under the right conditions, they will be glad to continue the relationship. Be certain that they spell out these conditions.

You have to know if you are going to be able to keep selling these particular products. How can you close on a deal where the major supplier contracts are not transferred to you?

If there are agreements that are scheduled for renewal within a year, the suppliers may say that they want to wait until the expiration before deciding ifthey will be renewed. In this case, you are paralyzed (or are you?). Your two choices are to buy the business and keep a huge amount of money in escrow that will only be released upon the contract being renewed with you, or walk from the deal because the consequences of non-renewal make the business undesirable.

What about the cases where the business has a supplier but no contract? There are many such situations. Often, these suppliers just don't have contracts withtheir distributors. What can you do? First, you can meet with the supplier and let them know that you understand they don't do contracts. Be upfront in explaining that you are not asking for special treatment. Then, ask them in all sincerity to understand your situation and ask them what they can possibly do to offer you some assurances.

What if you cannot get assurances from all of the suppliers? Use your common sense. As long as you have contracts and comfort level with the suppliers who make up 75- 80% of the revenues, you are fine. For the others, factor it into the purchase price. You can even go so far as to pay the Seller more down the road if the contracts get renewed. I have dealt with numerous situations similar to this and have found the best line, without fail, is for you to ask the supplier: "What would you do if you were me?"

On a final note, you must be reasonable enough to understand that in those businesses where there are many suppliers some may not sell you. That's OK, as long as the ones that won't will not affect the business more than 10 or 15 percent. Regardless of their impact to the bottom line, you will factor this into your purchase price. In these cases, remember to do your Valuations without their contribution.

Checklist (For All Contracts)

1. Copies of all contracts in each category;
2. Do a spreadsheet listing all contracts, terms, expiry date, follow-up to be done.

9. Legal & corporate issues

Shortcut # 16: Have your lawyer review all legal documents.

You want to know what, if any, legal issues are pending or may be arise. Examine every aspect. In the Offer to Purchase, the Sellermust disclose all of this and if they don't, they are in severe breach of the contract; so you will be protected. You and the business must be held harmless in any pending legal matters, which must be included in the Offer to Purchase. If the business is currently involved in a lawsuit, have it reviewed by your lawyer. You want to be sure that the business will not be held liable for something that happened prior to your purchase.

Have the business itself verified from a legal standpoint to be sure that it is an active corporation, the shareholders and directors are disclosed to you, and all filing fees and licenses are current. Again, your lawyer will be able to handle this for you. Have them provide a listing of everything they must do and provide a firm quote to do this.

IMPORTANT: if there are any laws that relate to the operations of the business, you must obtain satisfactory proof that the business is in full compliance. This can range from health department inspections in restaurants to environmental issues. You may need to spend a bit of money with a lawyer to research all of the potential legalities associated with the business but it will be money well spent. Additionally, you'll want to learn if there is any pending legislation that may not be "grandfathered," which could impact the business after you own it.

On the subject of environmental issues, some leases have clauses whereby you, as the current tenant, are responsible for any environmental problems that are found on the property even if you are not directly responsible. If the business conducts any activity that could possibly be affected, you must get a release from this clause from both the landlord and the Seller for any occurrences that happened prior to your ownership.

Checklist

1. Copy of company minute books;
2. Incorporation documents;
3. Copies of all documents related to any ongoing or potential legal proceeding.

The final word

Never lose sight of the fact that this period is the time to determine what opportunities exist for the future growth of the business. Once you verify the financials you must put all of the other pieces of the puzzle together to see what you come up with. Not everything is going to fit. For example, the Marketing may be horrible, but you have an idea of what can be done. |

Perhaps the systems are primitive and somewhat useless. As long as you investigate what it will cost to implement new ones, then you know what you will be dealing with. Your Due Diligence for non-financials has to indicate that the business' future with you at the helm looks bright. You must be able to see through the clutter and realize that there is clarity on the other side.

Secret # 17: You must come away with a confirmation that the business is viable or walk from the opportunity.

From a financial perspective, you want to investigate the business to determine the accuracy of what you have been told. Redo your valuation, if necessary, based upon the formula discussed earlier. Determine if the valuations are still correct based upon the Due Diligence figures. Take the time to review them with your accountant and get their feedback on the purchase price, terms and conditions. If there is anything that you have discovered that has you concerned, discuss this with your broker.

Shortcut # 18: If any renegotiation needs to be done, let one of your advisors be "The Bad Guy."

There will be an endless amount of ideas that will run through your mind of things that you want to do once you purchase the business. While you must not tie yourself to the business emotionally until the purchase is completed.

Shortcut # 19: Remember to approach the Due Diligence with the philosophy that "If buy the business then, this is what I want to d o ."

Be organized to a fault. Write down each and every thought that comes into your head. Put your ideas to paper in the categories for which they apply, be it sales, marketing, systems, etc. Write these down in a way that you will understand what they mean when you review them later on. If you are thinking that what is being presented here is obvious and even simplistic, if you have never experienced a Due Diligence period it is hectic, tiresome, exhilarating, frustrating and almost any other emotion you can name. It is easy to become overwhelmed and if you do not understand this in advance,,it will not produce the desired results.

If done right, 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 for what you must do to make the business everything you want it to be.

Shortcut # 20: Most businesses that change hands experience a downturn in the first three to six months.

While this can certainly be attributed to the very change itself, more often than not it is because the new owner was not prepared to truly take it over. Instead of spending the first quarter getting used to the business, you can hit the ground running by educating and preparing yourself during the Due Diligence phase.

Focus upon one task at a time and, bit-by-bit, it will all come together. Due Diligence is not something that requires any special expertise. It only needs your time and attention. As long as you devote the time, it will accomplish exactly what you need it to do. Look at it from the perspective that you now know what has to be done, and within one month you will have a true "feel" for the business. Then you can move forward with the task of growing the business and realizing all of the benefits as planned.

Summary of the 20 Shortcuts

The 20 shortcuts to keeping on track during the Due Diligence (Due Diligence) process to purchase a business are:

Shortcuts	
1	Start with the history and slowly work through the information until you have enough to plan the future for the business
2	Be sensitive to the seller's concern about confidentiality.
3	Due Diligence is the time to check out everything' not just the financials.
4	Don't wait until Due Diligence officially begins to start your work.
5	You will need at least a month or more to conduct an effective Due Diligence.
6	Be up-front and let the seller know in the clearest of terms that you are investigating everything about the business.
7	No matter what you discover, keep it to yourself
8	You must keep your advisor posted throughout the negotiation period so that they can be available during your Due Diligence
9	Try and verify everything, even tax returns that could be false.
10	Do not use a seller's plans or budgets
11	You want to make sure there are enough customers in the area to grow the business; why they buy from the seller and what would get them to buy more
12	Do not say anything negative about the current owner or the business itself to employees
13	Before you buy a business, you need really good information on the competition.
14	Get key information from industry associations
15	If one supplier and/or customer represents more than about 30% of the business, then you need an ongoing commitment from that supplier and/or customer
16	Have your lawyer review all legal documents
17	You must come away with a confirmation that the business is viable or walk from the opportunity
18	If any renegotiation needs to be done, let one of your advisors be "The Bad Guy."
19	Remember to approach the Due Diligence with the philosophy that "If buy the business then, this is what I want to do
20	Most businesses that change hands experience a downturn in the first three to six months.

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Background

Stuart completed a B.Sc. in Agricultural Economics and then an MBA from the University of Cape Town, South Africa.

- Management Consultant with Deloitte in South Africa and Canada
- Co-founded the Canadian mid-market investment bank, Crosbie & Company
- Interim President of Cutler Brands Inc., Handover Case Goods, Imperial Surgical Inc., and Alta Can Telcom Inc.
- Co-manager of Quebec Equity Capital Fund
- Co-author of "Weather the Storm. Survival Guide for Your Mid-Market Organization"
- Past President of the American Marketing Association (Toronto Chapter). Guest lecturer at Georgian College, Ryerson University and Wilfred Laurier University