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Corp21
Services for Entrepreneurs

DUE DILIGENCE CHECKLIST FOR BUSINESS ACQUISITION OR SALE

The process of buying or selling a company requires a thorough due diligence of all key elements of the business. The following is a listing of the major areas typically reviewed. It is intended to be a checklist for sellers to know what to prepare and a checklist for buyers to know what to ask for.

1. <u>Sustainability of the Business</u>
In this part of the review, the buyer will want to understand the potential economic value of the business he is buying. More specifically:

a. What is the financial **Business Plan** for the next 3-5 years?

b. What is the company's **vision**?

c. What are the company's **core competences**?

d. What are the existing **strategic alliances**?

e. Are there **synergies** with the acquiring company?

f. What part of the **product life cycle** is this business in? Is it on the "bleeding edge?" Can it be expected to be a "cash cow?"

g. What **new products** are under development?

h. What **new customers** are under development?

i. What does the current **order status** and **backlog** look like?

j. How stable is the **customer base**?

2. <u>Competition</u>
In this part of the review, the buyer will want to understand the dynamics of the market and the most significant competitors. If this is a manufacturing business, the international aspects of production and competition will also need to be understood.

3. <u>Financials</u>
Typically, audited financial reports will be required and these will be reviewed by a competent outside financial auditor. If this is a company operating outside the US, the local financials will often need to be converted to USGAAP standards. Among the key financial data to be reviewed are:

a. Cash Flow
b. Days Sales Outstanding
c. Tax Returns
d. Obsolete inventory
e. Accounts Payable
f. Long term contracts – Payables
g. Long-term liabilities for pensions, etc.
h. Asset Value – book versus replacement
i. Accounting procedures and policies.
j. Facility ownership structure and any leases related to facilities or equipment.

4. <u>Organization Infrastructure</u>
This is a large category of inquiry that should be made by someone familiar with this type of business. Among the major areas of interest are:

a. **Management Team**. Are they capable or running and growing the business? Will they be staying on after the acquisition? If they are leaving, what is the structure of non-compete agreements?

b. **Human resources** and **personnel policies.** What is the pool of talent versus organizational needs? Is there an employee handbook? What other personnel policies exist?

c. Are **facilities** in good condition, convenient and customer-friendly?

d. Is there a written **quality policy**? What quality certifications are there (ISO 9000, etc)?

5. <u>Potential Liabilities</u>
It is important to understand the risk of any major financial "surprises" in the future. Often this also requires representation letters from lawyers or environmental study firms. Topics include:

a. Warranty issues
b. Environmental (Superfund)
c. Patent infringements
d. Liens/ Lawsuits
e. Pending regulatory issues
f. Unfair dismissals

6. <u>Technology</u>
If this is product company, it is important to understand any patents that have been awarded or

applied for. Is there any other know-how or research and development that could provide competitive advantage?

7. Sales & Marketing

Since the acquiring company is typically interested in growing the business, it is important to understand current activities and results. Among the areas of importance are:

a. **Market potential**. For more information of some ways to do this, see the *Market Size Assessment* brief at http://www.corp21.com.

b. **Distribution channels**. How is the product sold? How good and loyal is the sales force?

c. **Promotion**. How is the product promoted?
   - Advertising
   - Trade shows
   - Web site, etc.

8. Business to Business Fit

Sometimes there is additional benefit to a particular acquisition because there is a good fit between the acquiring business and the company being purchased. Among the characteristics that are important to understand are:

a. **Strategy fit**. How well does the business direction for the acquiring company fit that of the company being purchased? How well do the products and markets fit together?

b. **Personnel fit**. How well will the people and cultures of the two organizations fit together?

c. **Financial fit**. If one business is growing but needs cash, while the other is profitable with limited prospects, this is a better situation than if both are cash cows, or both are cash hungry.

d. **Geographic fit**. If the merger gives the two companies a broader geographic reach, this is good, but it must be balanced against the costs of trying to coordinate to dispersed entities.

Information Gathering

In addition to information available from the company, the following outside resources may be useful in order to make an assessment:

a. Chambers of Commerce
b. Educational Databases
c. Competition
d. Industry Associations
e. Peers
f. Mentors
g. The internet, see the *Industry Structure Analysis* brief on the http://www.corp21.com.

Conclusion

We hope that you have found this brief helpful. Please let me know if you have any questions or suggestions for areas that should be covered in more depth. The following are some references if you like to explore this topic in greater depth:

- Brown, John H. *How to Run Your Business So You Can Leave It In Style.* (c) 1997 Business Enterprise Press.

- Vermeulen, Bert. *Market Size Assessment*. (c)2003 Corp21.

- Vermeulen, Bert. *Industry Structure Analysis.* (c)2003 Corp21.

- Note, this paper is based on a *Due Diligence Outline* originally produced by Bob Thilmont at Mountain Global. Copies of this original outline can be obtained by contacting Bob at http://www.mountainglobal.biz.