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DUE DILIGENCE – WHAT TO LOOK FOR

When purchasing a business, it is essential that the purchaser carries out thorough enquiries about the business that they are purchasing. It is almost impossible to successfully win a claim against the seller after the sale for non-disclosure. At law, the seller of the business can rely on the principle of *"Caveat Emptor"*, which loosely means – Buyer Beware.

Due Diligence
For this reason, the buyer should carry out "Due Diligence". This is where you and or your team of advisors test every claim made by the seller by analysing every part of the business and every claim made by the seller about their business.

5 of the most important things to be examined and what to look for

1. **The financial records**
   Often you will be provided with company or accountant generated financial reports. It is important that you thoroughly examine the entries and question any unusual entries. Insist that you are provided with the company tax returns and explore any disparity between the two sets of records.

2. **Key Staff and Employment Contracts**
   The success of the business may be largely because of one or more key staff who are able to attract new client work or have certain business skills. If these staff were to leave the business at the time of sale or shortly after this may greatly affect the value of the business.

   When allowed by the owner, speak with key individuals with the view of securing long term contracts with them. We recommend that you use a human resource consultant to help you in negotiations with key staff.

   Once key staff have been consulted and a contract signed, we recommend that training or mentoring program is developed to lessen the reliance on any one individual.

1. **Licences and approvals to operate the business**
   You should not assume that companies have the relevant approvals to do the work that they do. It is our experience that companies with operations worth millions of dollars operate without proper approvals. You should insist that you have the approvals, permits and licences that you require to do the work. The danger if you proceed with the sale without the

approvals, permits, or licences is that the Council or other Government authority may prevent you from carrying out the work.

2. Lease of property and equipment

The premises in which the company operates may be an essential or valuable part of the future success of the business. The buyer should seek a copy of the lease agreement to see whether the agreement will allow the business to continue to operate out of their current premises. The buyer should seek to secure either a transfer of the lease agreement or a new lease agreement before the purchase.

3. **Key Clients**

In some businesses, the success of the business is connected to one or a few key clients. We recommend that in such a business that enquiries be made as to the details of clients and their expenditure. Consideration should be given as to the likelihood of these clients remaining loyal to the business after the sale.

Clients and customers value relationships as well as the product or service. Meet with the Key clients if you can and see if there is a natural rapport that can be developed. Some clients are so valuable to the business that losing them would spell disaster to the business. Over dependence on one client in a non-niche product or service is dangerous.

The sale of business contract can be drafted to include incentives to the seller for the retention of clients and the acquirement of new referrals. For example, the buyer may receive a percentage of profits from certain clients on an ongoing basis or a one off referral fee for new work referred by the seller.

A good business lawyer, with true qualifications and experience will be able to guide you with all that is necessary and protect you from buying an unhealthy business that will send you bankrupt.

At CK Lawyers, we have helped hundreds of business buyers with the diligence process.