Protect Yourself from Due Diligence

The job of a buyer's due diligence expert is to identify weaknesses that will lead to a reduction in the purchase price and extension of the payment terms. We at L. Harris Partners work with business owners in advance of a transition to make sure this doesn't happen to them. We help make businesses "due diligence-proof" by advising them through a preemptive process of seller due diligence.

What is Seller Due Diligence?

Many view due diligence as an event. In a sense that's true; due diligence is like getting a report card after a final exam in a course called "business ownership." But due diligence should really be a process an owner regularly engages in, rather than cramming before the final. Doing so will help owners:

- position their business in a positive light,
- maximize business value by focusing on value drivers, and (ultimately)
- attract good offers from all three types of buyers (strategic, financial, and your management team).

Driving Business Value Through Seller Due Diligence

A good seller due diligence process involves more than financial results. In addition to the quantitative financial statements, it also involves the qualitative aspects that drive value. Value drivers that buyers look for and are willing to pay premium prices for are:

1. Stable, motivated management team
One of the most important value drivers in any business is its management team. A solid management team reduces risk for a potential buyer. On the other hand, a weak or non-existent management team can lead to the perception of increased risk and a reduction in the purchase price.

Your job, as a business owner engaging in preemptive seller due diligence, is to create a strong team that will not cause a potential buyer to insist on a purchase price reduction.

2. Operating systems that improve sustainability of cash flows
Having highly efficient business systems in place will help you make it through due diligence unscathed. It's important to develop, document, and continually improve business systems that generate recurring revenue from an established and growing customer base. Focus on creating and updating systems and processes, including how customers are identified and retained, how products and services are delivered, and how employees produce intended business results.

3. Solid, diversified customer base
A small customer list and/or one with high levels of customer concentration spell risk to a potential buyer and will surely have a negative effect on your purchase price. As a general rule, no single customer should account for more than 10% of total sales.

4. Realistic growth strategy
Buyers pay premium prices for companies that have a realistic strategy for growth. That strategy must be communicated to a potential buyer in such a way that the buyer is able to see specifically why cash flow and the business as a whole will grow post-acquisition.

If, during due diligence, a buyer discovers an opportunity that he or she believes you've ignored, he or she will likely attempt to take advantage of that knowledge during purchase price negotiations.

5. Effective financial controls
In order to prove that you have reliable financial controls, consider getting audited, or at least reviewed, financial statements from your CPA. Seek help from your CPA to assess your controls and strengthen them appropriately.

If a seller produces past financial statements that prove incorrect, insupportable, or incomplete, a buyer in due diligence will either walk away or negotiate a reduction in the purchase price.

6. Stable and increasing cash flow

Ultimately, all the value drivers contribute to stable and predictable cash flow. It's the cash flow that determines the value of your business. A buyer is purchasing the future cash flow he or she believes will be generated by your business. You may be emotionally attached to your business, as one of the founders, but your prospective buyers and their due diligence experts are not.

When Should I Start the Seller Due Diligence Process?

Unless you can predict with certainty when you will die, become disabled, get divorced, burn out, get approached with an unsolicited offer, technology obsoletes your business, or the economy deteriorates, you may want to consider starting your seller due diligence process now.

For more information or to learn how L. Harris Partners can help you grow your business:

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