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Advisory Alert: Due diligence can lower risk when buying a business

When buying a business, conducting enterprise due diligence ensures you look at the business in a holistic way to cover all issues and opportunities in the deal. Here's what to look out for and how to minimize the business risk.

What is operational due diligence?

Old style operational due diligence identifies the operational risks and performance in a transaction. This is too narrow in its approach, as it fences off operations without thinking about how this impacts the rest of the business.

Due diligence should be viewed holistically, ensuring that issues within a business function are not considered exclusively. This is called enterprise due diligence as it looks across the whole business.

You should still include traditional operational due diligence issues such as performance improvements, capital expenditure plans and asset assessments. But when taking a more holistic approach it naturally throws up all sorts of new questions, such as:

- how a capital expenditure plan could be more tax efficient
- how the back office will be impacted by the growth plan and how the performance improvements could be used to maximize cash

What does enterprise due diligence look for?

Traditionally, operational due diligence focused on risks and performance of assets or functions.

It is really important for buyers to understand the risks with the asset they are buying, and buyers should look more closely at the potential of the business.

It is really important to put as much focus on the opportunities as the risks. In our work we often see opportunities with a much larger financial impact on the future performance of the business than the identified risks. These opportunities effectively offset the risks. This gives the business confidence that it has options should the risks arise, and allows them to bid more competitively.

Contact us

For assistance in this matter, please contact us via ojel.rodriguez@pr.gt.com

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Buyers wary of over optimistic business plans

We are seeing vendors becoming more savvy in their approach to grooming businesses for sale. We are seeing increasingly optimistic business plans where firms are looking for ways to maximise the deal headline price. To some extent this has always happened, but vendors are now articulating and presenting their business plan in an ever more convincing way.

This results in buyers having to dig even deeper into the business to ensure they are comfortable with the plans. Where there are risks to the plan this can be factored into the deal price, but there may also be opportunities that the vendor has missed or are unique to individual buyers.

Reducing the risk of buying a business

An example of this included a buyer who did not believe the aggressive performance improvement plans presented by the vendor, where the planned delivery of financial opportunities was greater than in previous years. Consequently, the buyer wanted to reduce the price.

However, we offset this risk against additional performance improvements that we found in the logistics function and had implemented in another similar business. This reduce the risk for the buyer but maintain their competitiveness in the auction.

What kind of challenges does this present to practitioners in the market?

Clients are demanding a broad range of specific experiences and skills from their advisors. For due diligence advisors they are looking for financial robustness, but also sector and business experience to give them the best advice and possibly an edge in a deal.

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