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Your guide to due diligence when buying or selling a business

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Your guide to due diligence when buying or selling a business

1. What is due diligence?

This is an audit process undertaken by a buyer of a business, to enable them to get a full knowledge of the business before they commit to an acquisition.

When considering buying a business, it's important to find out as much information about the company as possible to protect your investment. Similarly, if you are considering selling a business, it's important to disclose information fully and accurately, to limit your future liability to the buyer.

2. What are the issues that a buyer should consider?

Crucially to carry out full legal and financial due diligence prior to investing. This provides you with insight about the business's financial stability and any liabilities that come with it. It is particularly important to consider the following:

- Who owns the shares in the company and have any share options been granted to employees or third parties?
- Is there any current or potential litigation against the company?
- Do any customers or suppliers have the ability to terminate a contract as a result of the sale?
- Is the company fully insured against all relevant risks?
- How many employees/workers are employed/engaged by the company and what terms apply?
- What lending facilities does the business have and are they secured?
- Does the company own or lease its assets
- Does the company own or licence any intellectual property rights?
- On what basis does the company occupy its premises?

3. I've been provided with a warranty - do I still need to carry out due diligence?

A seller usually provides the buyer with warranties about the status and history of the business. These are true statements covering a range of issues relating to the company providing the buyer with an element of comfort. If the warranties prove to be untrue the buyer can bring a claim against the seller for breach of contract.

However, it's still important to carry out a full due diligence exercise so that, if necessary, any issues can be identified and actions taken prior to the sale, such as negotiating a price reduction, asking for an indemnity about a specific issue that has arisen, or the complete withdrawal from the acquisition because the company may not be as viable as it previously seemed.

4. What is a disclosure letter and why is it important?

This letter is an important document for both the seller and the buyer. It provides an opportunity for the seller to disclose any facts that contradict the warranties. If, after completion, the buyer attempts to bring a claim that a warranty is untrue, if the seller has fairly disclosed information in the disclosure letter, then the buyer will have no claim.

For the buyer, a disclosure letter is important because it can alert them to possible issues they may inherit, before they are committed to the sale – allowing the buyer to seek a price negotiation if necessary.

5. What action should a seller take before starting the sale process of their business?

Any potential buyer will scrutinise your business via due diligence, so it is advisable to ensure all relevant paperwork is available and up to date. This includes:

All contracts, preferably signed (!) that the company is a party to including supplier contracts, agency agreements and distribution agreements

The constitution of the company including its statutory registers (register of members, register of directors)

Insurance policies and certificates

All property-related paperwork including asbestos reports, leases and licences

Employee contracts

Banking facilities and lease or rental documents

Making sure these are all in order gives a great first impression to a buyer about the organisation of your business and the way it is run.

Would you like to know more?

Please contact one of our expert lawyers in this sector:

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