



DUE DILIGENCE PRIOR TO PURCHASE OF A BUSINESS

In deciding whether to purchase a business, and before signing the purchase agreement, the buyer should get as much detailed information as he possibly can about the business. This information gathering exercise is commonly referred to as "due diligence". In the limited situations where there is insufficient time to undertake the due diligence before signing the contract, the buyer will need to make sure that the representations given by the seller concerning the business are comprehensive. Further, he should ensure that the relevant acquisition agreements allow him to either terminate the arrangement or adjust the purchase price proportionately in the event that the subsequent due diligence unveils an unsatisfactory situation.

The stage at which a purchaser decides to involve attorneys will depend on the acquisition in question, and will usually be influenced by factors such as size, value, timing, complexity and perceived importance of the transaction. Regardless of when this happens, the need to align the objectives of the client and his attorneys (and other professionals as appropriate) is sometimes underestimated. The client and his attorneys should work closely together throughout the transaction, with the client ensuring that he understands and is satisfied with the deal he is about to make, and the attorneys ensuring that the client gets precisely what he has bargained for.

Conducting detailed due diligence will assist the buyer to avoid the following problems:

- paying a price in excess of the real worth of the business;
- Bad financial decisions;
- Bad management decisions; and
- Pending law suits and contingent liabilities.

A thorough due diligence exercise should generally involve an examination by the buyer of the following areas of the business being purchased;

Corporate Standing

Conducting a comprehensive search at the Companies Office to ascertain matters such as the shareholders, directors and whether there are outstanding charges on the company's assets.

Personnel

Reviewing employees' skills, experience, wages and benefits, payroll procedures, terms of contracts, and other relevant human resource issues.

Financial operations

Examining company's books and records, as well as accounting and bookkeeping methods. Analysis of cash flows, both present and projected, as well as detailed review of accounts receivables. Consideration of debt and bank or other lender relations.

Marketing

Examining the advertising campaigns and public relations programmes (if any) and analysing of marketing and sales strategies and compare with how competitors market and advertise their products.

Property and equipment

Review all appropriate documents of title, leases and/or deeds, encumbrances and liens over property, and other restrictions. Conduct appraisals for all equipment and assets. Consider depreciation in property and equipment values.

Intellectual Property

Investigate the ownership of trade marks, brands and trade secrets used in the business, strategies for protecting brands and trade secrets from infringement, the value of goodwill associated with the business, and the value of any research and development.

Business operations

Consider location, inventories, vendors, suppliers, management, customer relations, insurance policies, and any other topics specifically related to the business you are considering buying.

Attorneys acting for purchasers often specifically require that the sellers provide information to confirm, among other things, ownership of assets, compliance with legal obligations and regulations, taxation obligations or liabilities relevant to the business. The information gleaned from this "legal due diligence" enables the attorneys to decide what, if any, protections must be built into the purchase agreement, and ultimately whether the buyer should proceed with the acquisition.

It is good practice to use a due diligence checklist to help focus the information gathering exercise. Although some checklists may be tailored or more suitable to particular businesses, all checklists are designed with the same intention, namely obtaining for the proposing buyer the information necessary to make a prudent business decision.

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