5 Essential Steps to Ensure Due Diligence in Private Company Acquisitions

Chad Byers | October 23, 2017

Takeaway: Don't skip your due diligence. These 5 reasons to do your due diligence will convince you never to skip it again.

Acquiring a company involves an inherent level of risk. As knowledgeable business owners and advisors involved in private-company M&A transactions, that simple fact is always on our minds. Fortunately, the due diligence process helps to mitigate this risk, confirming the value of a transaction and giving us the confidence to proceed. However, as you likely know, due diligence can be time-consuming and tedious; as a result, many of us may elect to skip a step or two in order to save time — or we assume that we have all the information that we need without a truly in-depth pursuit. While finding a prospective investment and getting the final contract signed may be the most thrilling aspect of this business, due diligence is an essential piece of a truly successful transaction.

The key is to create a comprehensive due diligence process that is based on realistic expectations, reduces the risk inherent in the transaction, facilitates more informed decision-making and leads to the potential for higher returns down the road.

Here are the five essential steps you need to take to execute such a process:

1) Construct an Investment Thesis

To start, it's essential that the company you are planning to purchase builds on the fundamentals of your existing business. Developing an in-depth investment thesis will force you to consider the anticipated outcome of the investment, the projected performance of your potential acquisition and how the acquisition will affect every single aspect of what you already do.

We advise starting with an outline of your specific strategic goals, then developing a detailed financial roadmap that illustrates how the deal would help you achieve those goals — make sure you do this in writing. The appeal of empire building can be strong in the M&A world, but if the acquisition doesn't make sense in terms of your goals, do not proceed.

Once set, communicate this thesis with your team and advisors. It must be clear to everyone involved what key financial components are truly driving the deal, what your goals are and what they should expect the acquisition to accomplish.

2) Analyze Your Competitive Position

One of your strategic goals may be to boost your competitive position within your industry, either by acquiring a competitor or by using the acquisition to spur organic growth. If your goal is the latter, then the value of the deal would be dependent on the growth rate of the acquired company and how its projected performance fits into your growth strategy. If this acquisition doesn't strengthen your business' position in the industry, it may be necessary to reevaluate the deal. However, even if this is

not a direct goal of the investment, you should analyze the effect that the deal will have on your standing in the marketplace nonetheless.

3) Measure the Strength and Stability of the Acquired Company

To alleviate the chance of failure, you need to thoroughly examine the health of the potential acquisition — that includes its financial history, company structure, the potential for growth and its customer base.

As is often discussed on this site, companies that are positioning themselves to sell make a concerted effort to increase their revenue and perceived value. So, comparing the company's financial history along with a projection of its short- and long-term financial standing is essential.

If its profitability is deemed stable, you need to then consider the strength of the business' current management. Would its profitability depend upon the existing management remaining stable? It's also crucial to identify if the company's current culture is strong. You'll want the acquisition to go as smoothly as possible between your teams, and an unhappy or unmotivated workforce could negatively infect your existing team.

4) Revenue Synergy

Revenue synergy is achieved when the combined revenue of two companies (yours and the acquired company) is greater than when separate. Determining the potential synergy requires comprehensive research and preparation to accurately project the future performance of the combination of the two companies. This is perhaps the most important aspect of the due diligence process. While you gather data, it's imperative to be realistic and consider potential dis-synergies that would prove unfavorable.

At this point, you should be diving into a deep analysis of financial performance — yours and the acquired company's. This analysis will affect your projected competitive advantage substantially and play a major role in whether or not you move forward with the deal.

5) Integration

The final part of the due diligence process should be to outline the appropriate course for integrating the businesses — and you'll need to consider every aspect from top to bottom. Even if the deal proves financially favorable, you could quickly lose value if you haven't considered how to best combine capabilities, operational processes, workforce and, of course, brands.

Conclusion

By putting in the upfront work to thoroughly examine every aspect of the acquisition, you'll be more likely to achieve your goals and execute a more seamless transition.

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Chad is the Founder and Managing Partner of Symmetrical Investments, LLC. He has over a decade of experience advising on or investing in over 100 transactions. Chad has been active in many professional organizations, including sitting on the board of the Alliance of Merger & Acquisition Advisors in Philadelphia & Southern California, the Emerging Leaders of Chester County and the Chester County Chamber of Business & Industry.