DUSTING OFF THE COBWEBS: POSITIONING YOUR COMPANY FOR DUE DILIGENCE SUCCESS IN 10 EASY STEPS

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It's no secret that the recent recession and economic downturn have caused a significant stall in investment and entrepreneurial activity. Over the last few years, many companies and individuals have been unable to secure credit, find capital, or sell their business at a palatable price. These challenges, coupled with investor insecurity and uncertainty about prospects for future growth, have hampered, and in many cases deterred, corporate mobility.

First, the good news. We are starting to see a significant amount of corporate growth and expansion, mergers and acquisitions, and financing activity. Increasingly more businesses are seeking new opportunities, entrepreneurs are developing new products and business plans, and investors are providing capital to promising start-ups. The bad news is that the internal mechanisms that hold many businesses together, allowing them to operate efficiently and effectively, may have gotten a bit rusty over the last few years. Downsizing, lost sales and profits, damaged relationships with banks, and problems with employees, represent a myriad of issues for companies looking to get back in the game and, frankly, in troubling times, there is a lot of "deferred maintenance" with respect to keeping decent corporate records and policies current.

Specifically, when buyers seek to acquire a company or businesses seek additional working capital or expansion funding, legal due diligence can seem to be an aggravating distraction. Yet it is an inevitable and necessary part of the process.

During the due diligence process, your company becomes an open book. The story it tells, however, is up to you. We believe that the better you set up the due diligence "story", the easier the process becomes – playing catch up during a transaction is distracting, costly and can lead to renegotiating the transaction terms.

So the question is, how do you dust off the corporate cobwebs and use the due diligence process to tell the most favorable, yet truthful story about your business?

1. *Familiarize yourself with the process.* Before you can adequately prepare your company for the rigors of due diligence, you need to understand the process. Due diligence is a tool used by potential buyers and investors to assess the value and risks associated with a potential acquisition. It involves a thorough examination of a company's finances, products, services, employment history, customer information, marketing, management, and legal matters. If executed effectively, it is a reciprocal process that allows both buyer and seller to make an informed decision as to whether to pursue a particular business venture.

2. *Understand how the process can work for you*. Participation in the due diligence process is not merely an obligation but an opportunity for a company to present itself in the best possible light, sharing its story with potential buyers and investors. While the information presented needs to be accurate and truthful, a company has complete control over the way its story is told. To take advantage of this opportunity, all information about the company must be compiled and presented in an organized fashion and in a way that anticipates the questions and concerns of the investigating entity.

3. *Adapt to change.* The recession has undoubtedly had a significant impact on your company's management, employment practices, financial status, and even on your company's long-term business plan, strategy, goals, and objectives. Now is the time to determine exactly how your business has changed, what your company has done in order to adapt to these changes, and where you see your company heading in the future. These are questions that any potential buyer or investor is going to want the answers to. And they will expect you to know the answers. The due diligence process is an opportunity to demonstrate how you have taken control of these changes and adapted. You should use the process to tell the story, fairly and completely, but demonstrating both how you adapted from the past and how you envision the future.

4. *Anticipate due diligence requests*. Presenting an investigating party with clear and concise responses to their due diligence requests can instill an invaluable level of confidence in your company. At the initial stages of a deal or a potential deal, before a due diligence request is even made, it is important to begin thinking about what types of information the other party is going to need in order to complete their assessment of your business. Formation documents, contracts and commitments, financial statements, employment records, regulatory filings, and litigation-related documentation, are just some of the items that investors and buyers typically request. Pre-assembling these items and beginning to flesh out those areas in which there are questions or missing pieces of information can help move the due diligence process along smoothly and effectively and will help to make it as painless as possible for all parties involved.

5. *Start playing catch-up now*. If you identify missing documentation or key pieces of information, start assembling them now! This includes updating your company's minute book, obtaining copies of any existing contracts (including any necessary signatures), and making filings that might have been delayed or overlooked. The story of your company should have a complete and accurate beginning, middle, and end. Even if you are unable to assemble all that you need in time to respond to a due diligence request, by responding that you are in the process of obtaining the requested information, rather than stating simply that you do not have the requested items in your possession, will help to put buyers and investors at ease. We see this preventative process as a way to ensure you move through due diligence – focusing on what is important and not signaling concern over areas that are secondary to the value of your business.

6. *Know what you don't know.* The only thing worse than not knowing about a critical issue related to your business is to have it pointed out to you by a potential buyer or investor. Whether the issue relates to disgruntled employees, potential exposure to litigation, or existing customer contracts with unfavorable terms, you must either be aware that the issue exists or at least be able to explain why you didn't know. Have an answer to the question and a solution ready. In a subtle way, you can get your potential buyer or investor to "buy into" the solution with you.

7. *Don't fear and ignore issues. Deal with them!* As you begin to assemble your due diligence responses you will start to identify key challenges that your company may be forced to confront in the due diligence process. Make sure you have a plan of attack in place for dealing with these issues. For example, if you determine that there were errors made at the time your business was formed (e.g., failure to obtain the necessary shareholder/board resolutions), start putting these documents together and assembling the necessary signatures. Certainly, if *you* identified this problem, it will *not* go unnoticed by the other side. Your business looks best if it can be seen identifying problems and working towards solutions rather than simply sweeping these issues under the rug. Our experience is that the earlier you address the challenging issues in the due diligence process, the more likely you will be able to mitigate the adverse effect on the deal. Conversely, the longer you delay sharing that information, the usual result is surprise, mistrust and re-trading.

8. *Balance failures with successes.* Obviously, when embarking on a new business venture you are going to want to instill a sense of excitement in your potential buyers and/or investors. However, you are going to have to present your company's strengths *and* your weaknesses. You can't hide the bad news, but you can present it in a way that reveals it to potential buyers and investors in the most positive light possible. The key is to balance any failures with successes. For example, if your business has lost customers due to the recession, present this information with a narrative about all of the new customers that your business has acquired during the last year. Every company has weaknesses. It's how you frame these weaknesses that can make or break a deal.

9. *Strategic Presentation.* How you present the information about your business to potential buyers and investors is almost as important as the substance. Be strategic about your packaging. Organization will carry great weight throughout the due diligence process. Being thorough and organized in your responses instills a sense of confidence in those interested in your company. An orderly, thoughtful, and detailed presentation of your company's data is evidence of an organized, well-run business. The due diligence process is a remarkably effective way to demonstrate to those interested in your company that they are about to make a smart and lucrative investment.

10. *Consult with your advisors.* If you are new to the due diligence process it might be helpful for you to ensure that your business, tax and legal advisors are able to coach

you through specific issues to be presented by your company. Make sure you are working with experienced transactional advisors, who have been through this process many times and know how to get your company due-diligence-ready. In other words, ready to tell the story of your business and its opportunity the way you want it told. While these tips may be a useful roadmap, remember the process itself is highly nuanced.

If you need assistance in a due diligence process or with other business transactions, please contact one of our business transactions attorneys at (410) 727-6600 or by e-mail at:

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