Due Diligence Preparation

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Due diligence is the process buyers and investors undertake to understand fully a business they may want to own. It is typically completed in two phases: preliminary and confirmatory. Preliminary diligence is conducted to understand the business, determine a valuation, structure a transaction, negotiate a deal, and allow the buyer to draft a letter of intent or term sheet. Confirmatory diligence, completed subsequently, goes into more depth and includes a review of contracts, intellectual property, employment agreements, tax filings, auditor notes from years past, litigation and threatened litigation, EPA certifications, insurance issues, corporate formation documents, business processes and systems, competitive analysis, quotes made to customers, sales funnel, win/loss analysis, support team logs, among others things, all to assure the buyer that they fully understand the issues facing the business, how it would fit into their portfolio, and the areas where they will need to focus if they move forward.

Preparing for Due Diligence in advance is essential for the seller. First, it ensures that all necessary documents and information are organized logically and efficiently, making it easier for potential investors, lenders, or buyers to find the information they need to understand the business, make decisions, and determine what areas need additional work. The materials can also be useful to the management team in running the business. In a typical transaction, time is wasted waiting for due diligence materials and responses to questions. Once the transaction execution is underway, the seller wants to avoid delays because information cannot be found.

Secondly, preparing the data room in advance gives the seller time to review and update any necessary documents and to work with third parties (attorneys, partners, employees, and accountants) to retrieve missing information. More importantly, gathering due diligence material usually takes time and often requires reaching outside the organization to locate vital elements. That process takes time and can be distracting and inefficient. Recently, we worked with a client that had filed a document with the IRS in the 1970s and, not surprisingly, could not find it. The buyer needed the document so the process paused for two weeks, waiting for a reply from the IRS. The sale process is challenging, creates tension, and can be contentious. Sellers must respond to questions, provide analyses, and address issues that arise while continuing to run the business. Adding information collection for a potential buyer on top of everything else is not the best use of time.

During the due diligence process, the expectation is that all additional information will be consistent with that already received. The end game must be considered when creating the forecast, the executive summary, and the teaser. When subsequent information supports the forecast, which supports the executive summary, it builds the buyer's confidence in the business. Assembling the due diligence materials at the outset of the process establishes a strong foundation, allowing management to address questions posed by the Buyer as they arise while continuing to operate the business.

Thirdly, having the information ready and organized conveys that the company is well-run, organized, and efficient. Some of the due diligence materials will need explanation and supplementary information. Organizing as much of the information in advance as possible allows the Seller to focus on explaining the business and resolving outstanding issues. Answering questions before they are asked delivers a compelling message - “We have it handled; we are well-managed.”

We strongly recommend using a virtual data room service to affect the delivery of due diligence information. Using a virtual due diligence data room conveys professionalism and provides a secure online platform where companies store and share confidential documents with approved parties. It allows for a controlled and organized process of due diligence, tracks user access, provides updates as items are updated or added, and allows questions and answers to be tagged to the information, giving access to information crucial to making informed investment decisions. Particularly when multiple potential buyers evaluate the company simultaneously, allowing potential investors to access the information in a centralized location instead of sifting through mountains of physical documents or emailing back and forth.

In conclusion, a virtual due diligence data room is crucial for companies seeking to raise capital through debt or equity financing or executing a merger or acquisition. It provides a secure, streamlined, and professional platform for the due diligence process, ultimately benefiting companies and investors. Finally, by ensuring that the data room is secure and only accessible to authorized users, you can help protect your business and its sensitive information. Overall, preparing the data room in advance can help ensure that the due diligence process runs smoothly and that potential investors or buyers have all the information they need to make informed decisions.