

Guide to: Due Diligence

Due diligence is the process of investigation carried out by a prospective buyer as part of the purchase of a business. It is an essential safeguard for the buyer during the transaction and can provide them with a level of comfort by giving them insight into the business that they may not have already had.

Structure of due diligence

The first stage of the due diligence process is the preparation of the Due Diligence Questionnaire (DDQ). This is usually produced by the buyer and sent to the seller's solicitors for them to complete with their client. DDQs will vary in length usually to reflect the size and nature of the target business. The DDQ will include questions on a wide scope of topics e.g. customer contracts, supplier contracts, financial information about the business etc. in order to extract as much information as possible. The questions will often require evidence to support the answers given.

The DDQ Replies will usually form several pages of answers with supporting evidence corresponding to the questions in the DDQ. The seller and their solicitor will be responsible for collating the relevant documents and producing the replies. The supporting evidence is normally kept in either a separate physical file or commonly in an online data room. A data room is a term used to describe the online system where documents will be stored. This is often a dedicated online data room provider or sometimes simply an online file storage platform such as Dropbox, both options providing a place where the supporting documents can be uploaded to for ease of reference.

An illustration of how the due diligence process works would be to consider a common question about ongoing disputes in the business. This question would be contained in the DDQ and in the DDQ Replies, the seller would be expected to provide an answer detailing all ongoing disputes together with any supporting documentation.

Why is due diligence important?

Many buyers feel that due diligence is not required as they believe they already have a clear understanding of the business. This is often the case if an employee or anyone else involved in the business is buying the business. However, it's important for buyers to remember that there may still be aspects of the business which they don't know much about and these are the areas where it would be wise to ask for information about.

The issues uncovered from the DDQ Replies and supporting documents can be used in the structuring and negotiation of the purchase agreement, particularly in relation to any warranties or indemnities being given.

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