



DUE DILIGENCE – SOME IMPORTANT PRIMARY ASPECTS

Primary Purpose of the Due Diligence



- The main purpose for a due diligence in any private equity or M&A transaction is to identify the potential roadblocks (red flags), risks, non-compliances and liabilities in connection with the affairs of the target company, which may, directly or indirectly, affect the potential investor.
- Normally, the due diligence starts at a stage when the commercial understanding between the target company and the potential investor has already been discussed and agreed in principle. However, at such stage, the investor is only broadly aware about the affairs of the target company and has not gone into the details thereof.

The Important Practical Aspects of the Due Diligence



- **Business Introduction:**

It is very important before starting any due diligence exercise to have an introduction about the business and affairs of the target company and the promoters. This helps in identifying the activities being undertaken by the target company, which may have various legal, financial or tax implications, which may not be easily noticeable in the documents. It also helps the due diligence team to understand the general way of operations of the promoters/target company and their approach towards the business, legal, financial or tax compliances.

The Important Practical Aspects of the Due Diligence



Explaining the Due Diligence Checklist:

- Normally, the due diligence team circulates a very detailed generic checklist of the documents/information required for their diligence and requests the target company to respond to the same by providing the applicable documents/information. Nowadays, the virtual data rooms have done away with the requirement of physical meetings in many cases. It is more likely that a small/medium size target company is actually inviting the investment for the first time ever. Therefore, its management/personnel are not used to the due diligence process and do not understand the requisitions properly. Consequently, they end-up giving inadequate information/documents.

The Important Practical Aspects of the Due Diligence

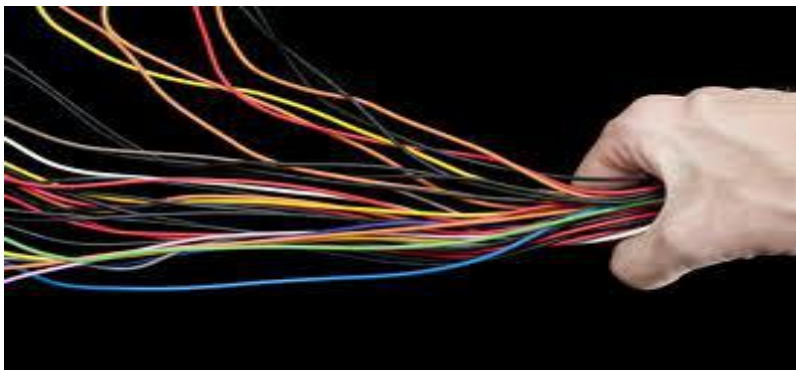


Insisting for Written Response to the Requisitions:

- The due diligence is a vast process, which goes on for some days to a few weeks. During the diligence, a lot of matters are discussed orally with the management and representatives of the target company. Such discussions remain unrecorded in absence of any potential issue. Due to this, such information does not reach to the investor or other due diligence teams viz. finance or tax or environment.
- Advantages of information in writing.
- The Approach.

Show,
Don't Tell

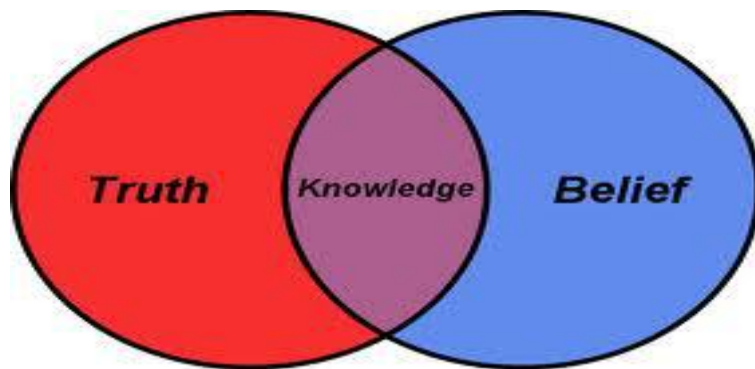
The Important Practical Aspects of the Due Diligence



Streamlining the Process of Due Diligence:

- It is necessary to organize and streamline the process of due diligence to achieve efficient and timely results.
- Method of Streamlining the Process:
 - I. One point contact;
 - I. Proper requisitions; and
 - II. Methodical Approach.

The Important Practical Aspects of the Due Diligence



Interaction between different Due Diligence Teams:

- It is important that the different due diligence teams viz. legal due diligence team, financial/tax due diligence team, environment due diligence team etc. interact, from time to time, with each other to be appraised of the issues/affairs of the target company. Sometimes, a very regular operation of the target company, from a particular due diligence perspective, may turn out to be an important/major issues from the other due diligence perspective.

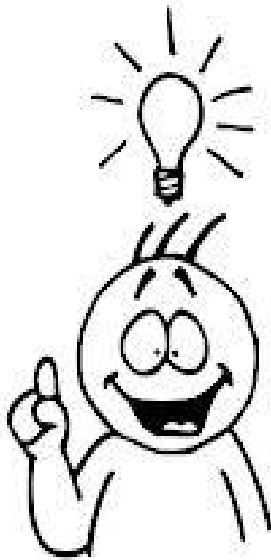
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Communicating the Issues in Simple Manner and Suggest Mitigation:

- While preparing the due diligence report, it is necessary that the issues are being communicated in a very simple and understandable manner. The due diligence team may be expert in its area of practice, but the person, reading the due diligence report, may not be aware/familiar with the language used in any specific discipline. It is, therefore, necessary that the issues are communicated in simple i.e. lay-man language, as far as possible.

The Important Practical Aspects of the Due Diligence



- In most of the cases, the Investors are interested in knowing the issues involved in the transaction and not the contents of the documents entered into by the target company. Therefore, it is necessary that the due diligence report identifies and segregates the issues in such a manner that the Investor can easily find them, which becomes very convenient for them.
- It is helpful to colour code such issues for the Investor to identify whether the risk involved with the issue is very serious, medium or nominal.
- Also suggest the mitigation of each issue.
- E.g. : [Model of Reporting Issues.docx](#)

The Important Practical Aspects of the Due Diligence



Another Important Perspective:

- Finding the legal and financial liabilities and risks are important aspects of a due diligence, but not the only ones. In addition, it is important to find out about the people, who make important decisions. It is also critical to check criminal records, civil litigation, credit history, employment history and culture of the target company. Ultimately, the entities are made of people and it, therefore, important to know the people, one will be associated with.



Presented by:

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