



Risk: Eliminating that four-letter word from an acquisition

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Buying a business is a risky venture and, in many cases, the potential impact of failure would be catastrophic for the buyer. One of my favorite quotes from the movie *Apollo 13* sums up the position of the buyer: “Gentlemen, failure is not an option.” However, acquisitions sometimes fail to either live up to expectations or, in some cases, survive. In order to minimize the risks of an acquisition, the buyer should, at a minimum, do the following:

- ▶ **Perform thorough due diligence** – Due diligence means to do your homework or, as Ronald Reagan once said, “Trust, but verify.” Due diligence can take many forms, but it generally falls into the following categories:
 - Financial
 - Business
 - Industry
 - Legal

Due diligence involves not only verifying the information and assertions of the seller, but also researching other risks and opportunities of the business and industry. A significant issue with due diligence is that you can’t verify everything, so you must identify and prioritize the areas that need to be investigated. The more thorough and targeted the due diligence, the greater the chance for future success.

- ▶ **Negotiate effective transaction terms** – Transaction terms must be customized to the risk factors uncovered in the due diligence. Examples of risk-reducing transaction terms include the following: lower cash consideration, non-compete agreements, owner financing, performance-based contingent consideration and establishing contingent escrow accounts. Terms cannot replace due diligence or eliminate risk, but transaction terms can reduce the risk to the buyer.

- ▶ **Prepare a comprehensive business plan** – The saying, “Those that fail to plan, plan to fail,” is often true in an acquisition. The buyer must plan not only for growth and other business issues, but also how to mitigate or handle the risk factors that may keep the company from reaching its goals. The latter is probably the most important, yet it is often given the least attention in developing an execution plan.

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- ▶ **Diversify** - The old saying, “Don’t put all your eggs in one basket,” is one sure way to mitigate risk. If you are managing a group of investments, such as a portfolio of marketable securities, this concept is very easy to accomplish. However, if you own or are purchasing a closely held business, diversifying the investment may be difficult. In that case, diversification must be achieved by diversifying the business itself (i.e., the customer base, geography, products, management responsibilities and so forth). Any concentrations within the business should be identified in the due diligence and addressed in the business plan.
- ▶ **Appropriately finance the company** - Financing cannot make an acquisition successful, but it can significantly influence the chance for failure. The financing structure could mean increasing the amount of equity, obtaining adequate financing to fund expected growth or obtaining term loans with longer durations to lower the scheduled payments. The key is to obtain financing that will enable the company to achieve the goals in the business plan while minimizing the financial risks that often accompany leverage.



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- ▶ **Execute the business plan** - As is often the case, execution is the key to minimizing the risks of a transaction and achieving the desired results. Failure to execute not only exposes the company to the risks identified in the due diligence, but will potentially create new problems and future risks.
- ▶ **Hire professionals** - Hiring the right professionals can absolutely help mitigate risks of a transaction. Professionals typically include an attorney, investment banker, accountant, appraiser, insurance advisor or environmental consultant. The buyer may also want to consider other advisors, such as a current or former executive within the industry, to provide insights on the industry and/or the company. The key is to hire well-qualified professionals who will help execute a successful transaction.

One reason acquisitions fail to achieve the desired results is the failure to identify and address risks associated with the transaction. Buyers often cannot see the “forest for the trees” when looking at a potential opportunity: the prospective buyer sees all the opportunity, but fails to recognize the risks associated with that opportunity. In order to prevent such myopia, the buyer should thoroughly analyze the opportunity, structure the transaction to effectively minimize risks and implement a plan to reach the targeted results and mitigate potential risks.