The due diligence process

Some investors may decide to commission external technical support, to reduce transactional costs of investment, many investors do their own due diligence drawing on their own knowledge base and key business and professional contacts to support their investigations. If they are investing as part of a syndicate, this is normally shared between the investors, each taking on areas where they have the knowledge or expertise or key contacts, generally with a lead investor who will directly interact with you and your business.

There are five key areas where investors will focus their due diligence and where you should be as helpful as possible and provide clear responses to their questions and relevant evidence. It will help to speed up the process:

Management

This covers key issues about checking out the teams' experience and competence; what you and your team are bringing to the business and your own capacity, passion and commitment to execute the business plan and take the business forward to high growth. It always comes down to the 3 P's: The People, their Passion and their Perseverance. Some of the key points to consider are:

1. Investors want to make sure they are comfortable and can work alongside you – investment can be long term and a good relationship with trust on both sides, is key. This is the "gut" feel.

2. Investors will conduct some research on you and your team and may take personal references, conduct credit checks and search Company House records. They will also go through Google, Facebook

and LinkedIn to reveal common connections and a real reference rather than a recommended one. Investors appreciate that a previous failure is not necessarily a bad thing – if you have learned from the experience.

3. Investors will want comfort that you understand your business. Entrepreneurs are ever the optimists but if you cannot identify the weaknesses and threats in your business plan you will be ill prepared to address them should things go wrong.

4. Investors will want to know that your team understand (and accept) your limitations. But also, can your team sell and market in the early stages without assistance? Will you keep track of your financials? Will you accept that support may be required in certain areas and that you may not have the right skills to manage a global business?

5. Investors are investing to make a return on their investment, so will want to make sure that you really have an exit plan and do not hope to simply remain in control and have a lifestyle job.

6. Investors may want to know how much you stand to lose if the business fails - too little and you could walk away with investors losing their money - too much and you may be desperate. Can you survive on a limited income? Could education fees and mortgages tempt you to abandon the business in favour of secure employment?

7. Investors will look to see if the business plan and market research was done by you or a professional and, if outsourced, was it outsourced for quality input or laziness or lack of knowledge about how to go about it. Also, was the market research based upon making sure the numbers stand up or were the numbers based upon the actual market research.

8. How together are your team? how long have you known each other and have you worked together or just friends? Can you survive the pressures and what happens if one falls by the wayside?

Finance

Investors will be wishing to ensure there are no “black holes” in the accounts of your business; or areas of the finances of the company that will have an impact on the investment and ongoing growth of the company (such as existing debts); ensuring the projections and forecasts are reliable. Some of the key questions investors will want answering include:

1. Have you prepared detailed and accurate financial projections that substantiate the potential return you have intimated to the investors?

2. Have you used an outside, independent accounting firm to compile, review, or audit the financials?

3. How good are your assumptions? (rate of growth, acceptance rate, pricing, multiple revenue streams, costs, timing of cash flows)

4. Are revenues realistic; how much can be supported by contracts or orders and to what extent is income “blue sky”?

5. When will you reach cash flow positive, and what cash requirements will it take to get there?

6. Have you already received funding, and, if so, how much; what were the pre-money valuation and terms?

7. What are the follow-on funding requirements and sources? Have you properly anticipated future needs, and are you already working on those?

8. What are your on-going financial commitments (leases, debt repayments, salary costs) and to what extent are overheads variable to mitigate the impact of a slump in performance?

9. Is your balance sheet strong, are creditors being paid on time and have proper provisions been made for all liabilities?

10. Are the assets on your balance sheet stated at a reasonable value?

11. What is the planned exit route and to what extent does it rely on factors outside the control of management?

Legal

Legal due diligence covers key aspects of the business establishment; ownership and shareholding; employment contracts; ownership of IP; existing commercial contracts.

Investors would generally expect a company to hand over copies of key documents such as:

- Employment contracts
- Board minutes, resolutions and any minutes of shareholders meetings
- Signed confidentiality agreements
- Licensing agreements and assignments including any agreements with employees
- Articles of Association and Memorandum of Association
- Terms of Business
- Any litigation-related documents
- Any patents, copyrights, trademarks and other intellectual property-related documents

Commercial

This covers issues relating to the product and technical issues but also to the market and competition.

Market and competition due diligence areas could include:

1. Can you identify who the customer is and why they are going to want the product/service?

2. Who is going to pay for the product/service? The buyer can be different to both the customer and the end user.

3. What are the Unique Selling Points for the product? What makes this different from what could be bought from other providers?

4. What is the specific need that the future proposed product/service is meeting? What is the size of that need?

5. Who and what are the competitors – companies and products - to the product you have developed?

6. What is the position in the sales channel? Are you selling direct to the customer? Through a distributor? To a business?

7. Where are you going to sell the product? What is the size, location and accessibility of the market?

8. What is the time and cost to market?

9. What is the selling price of the product and how can that price be justified? Will customers pay the price that you are asking and what is the elasticity? What price does the customer currently pay to resolve this problem?

Technical

1. Is it a stand-alone technology, or does it rely on other technology/businesses? If it is reliant on other technologies/businesses, then how reliant on them are you to buy?

2. Do you need to license in technology from other providers?

3. Is it a platform technology that can be used for many applications? If so, have you identified and prioritised a particular application as a development focus?

4. Can the technology be protected by Intellectual Property rights? If so how and through what mechanisms and in which markets?

5. Is this an incremental improvement of an existing technology or a disruptive innovation? Incremental improvements would suggest that there is a reduced technological risk and perhaps an established market, whereas a disruptive innovation may need evidence around both the technology and potential market adoption.

6. Is the technology ready to go to market? If not, can you identify and realistically quantify the major developmental obstacles?

7. Who are the major companies active in this space and what are they currently working on? If an industry is working on a particular technology platform solution and they are powerful members of an existing supply chain, then a new solution may prove difficult to get into the supply chain.

8. What are the current technology trends? Is this idea going to be overtaken before it even gets to market?