Determine Why a Seller is Selling

By JoAnn Lombardi, VR Business Brokers/Mergers & Acquisitions, President

When looking for a high-quality company to acquire, it does not take long to discover that it's a seller's market out there at least at that moment. For every business in your targeted industry worth owning, many more will turn out to be troubled, a poor fit or maybe both. That's why due diligence is such an important part of the acquisition process.

Before purchasing a business, it's important to thoroughly understand the company's you are considering and a big part of the understanding is getting a handle on why the current owners are looking to sell their stake. Doing so may help you avoid overpaying for an acquisition or even spare you from making a very costly mistake.

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DO YOUR HOMEWORK

Sellers may have good reasons for wanting to sell with equally good reasons for not wanting to share that information with you. Look beyond the seller's words and search for any unstated motives, including:

✓ **Personal issues.** Has the company lost key executives or employees that were vital to its past success? Can the company continue to be profitable in their absence? Try to determine why those employees left. The same reasons that motivated them to depart might be reasons for you not to buy.

✓ **Cyclical factors.** Is the company in an industry whose best days are behind it? Is the company's business vulnerable to economic cycles and has it recently passed a significant peak? The more you know about the dynamics of the company's business and industry, the less likely you'll be to buy into a long-term unprofitable situation.

✓ **Competitive pressures.** Is significant new competition threatening the company? Are new products from competitors coming to market that will reduce market share? Is the business underinvested in technology, giving other companies an edge in meeting market demands?

✓ **Legal concerns.** Does the company face litigation risks that have the potential to become more expensive than advertised? If so, investigate carefully. A bottomless pit of legal expenses could make you wish you had never heard of the business.

✓ **Regulatory risk.** Have new federal, state or local government regulations been proposed that could seriously affect the company's future profitability? For example, a seller may be aware of a new environmental rule that would impose substantial costs on the business. That's a problem you may not wish to inherit.

✓ **Balance Caution, Interest.** It's important to avoid letting eagerness for a deal outweigh any healthy skepticism about why the seller might be selling. Questioning everything, while keeping your eye on the acquisition's potential success, can be a challenging feat, but one that is well worth making. Listen to the seller's explanations about why they want to walk away from their business. Then, through careful due diligence, verify those explanations as best you can. If they appear to be true, you can continue the acquisition process with renewed assurance in the business's value. If they don't appear to be true, you can end talks or possibly negotiate a more favorable agreement. In either case, you can proceed more confidently and reduce your risk of making a deal now that you may regret later.

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