Acquiring a Company

Checklist Description

This checklist outlines ways to help understand the implications of a company acquisition, whether it is structured as a business or share purchase.

Definition

The acquisition of a company involves buying the company's shares. The expression is also used when the business of a company is acquired. In legal terms, the consequences of an acquisition of shares or an acquisition of business assets are different. One of the key differences is that an acquisition of shares involves buying the underlying business of that company, with all of its assets but also its liabilities. By acquiring the business only, the assets are transferred but in principle the liabilities are left with the seller. There are some exceptions to this rule so it is advisable to seek specific legal, financial, and commercial advice before taking any decision.

The process starts with the identification of the business to be acquired. The commercial price of the shares is linked to the value of the business of the company. Usually, negotiations will take place between the buyer and the seller, with a purchase price agreed upon. The next stage involves the investigation of the business to be acquired, a process often called due diligence. In order to reassure the seller, a confidentiality agreement should be signed to protect the seller against any leaks of sensitive company-specific information to third parties. The process involves: a legal due diligence (undertaken by the buyer's lawyers), which investigates the legal rights and obligations affecting the business of the company; a financial due diligence (undertaken by the buyer's accountants), which looks at all the financial, accounting and tax affairs of the company; and a commercial due diligence (usually undertaken by the buyer's own team), which looks mainly at the integration and practical aspects of the business following the acquisition. These final aspects could include: the integration of key members of staff in the buyer's operations; and the revision of commercial and insurance contracts to facilitate the planning of logistical aspects of the buyer's operations and to avoid any unnecessary duplication of suppliers or insurance.

Following the due diligence process, the legal documentation is drafted, agreed upon, and ultimately signed. In practice, negotiations can break down as a result of the discovery of underlying liabilities that seriously devalue the business of the seller's company. The sale and purchase agreement will incorporate certain warranties and indemnities that the seller will be required to give to the buyer. Warranties are factual statements regarding the state of the seller's business affairs, while indemnities provide the buyer with rights to obtain a certain payment in specific circumstances. Warranties can also result in a payment by the seller to the buyer, but actual proof of a loss is required before any payment is due.

Advantages

Advantages of a business-asset acquisition, rather than a share acquisition:

- An existing business can be improved by acquiring certain assets without the difficulties and costs involved in acquiring the seller's company.
- The assets will be acquired at the current market value, which will give them a high base cost in terms of capital gains tax. The purchase will, therefore, attract maximum capital allowances. The seller can obtain certain reliefs against capital gains tax.
- Overall, a less complicated and less thorough investigation is required than in a share acquisition. The latter would involve the valuation and assessment of all the existing rights and liabilities of the seller's company, including all contractual agreements.

Disadvantages

- In the United Kingdom, for example, VAT is chargeable on an asset sale but not on a share sale.
- Stamp duty for an acquisition of shares is paid by the buyer. In the United Kingdom, Stamp Duty Reserve Tax is charged at a rate of 0.5% of the price of the shares, while for assets involving property Stamp Duty Land Tax must be paid at up to 4% depending on the value of the property.

Action Checklist

- Study carefully any business you might acquire. Obtain as much information from as many sources as you can before committing to an expensive due diligence process.
- Know your market and make sure that you have analyzed the consequences for your own business of the acquisition of another business.
- Be prepared for a long and complicated due diligence process, which could prove time consuming as well as costly.
- Economize by negotiating a reasonable rate with your legal and financial advisers, but remember that it is better to incur costs by conducting a thorough investigation than to accept a level of service that may fail to reveal potentially costly liabilities.

Dos and Don'ts

Do

- Involve your solicitors and accountants in the evaluation of both the risks and potential benefits of an acquisition, as well as the due diligence process.
- Negotiate your rates and make a contingency plan for any cost overrun.
- Plan carefully the integration of the new business within your own.

Don't

- Don't be attracted by a business that has not been thoroughly investigated.
- Don't overlook the importance of negotiating complex warranties and indemnities that would protect you in the event that underlying liabilities are discovered.

More Info

Books:

- Dewhurst, John. *Buying a Company: The Keys to Successful Acquisition*. London: Bloomsbury Publishing, 1997.
- Lajoux, Alexandra Reed. *The Art of M&A Integration: A Guide to Merging Resources, Processes, and Responsibilities*. New York: McGraw-Hill Professional, 2005.
- Rao, P. M. *Mergers and Acquisitions of Companies*. New Delhi, India: Deep & Deep Publications, 2002.

Article:

- Rowan-Robinson, Jeremy, and Norman Hutchinson. “Compensation for the compulsory acquisition of business interests: Satisfaction or sacrifice.” *Journal of Property Valuation and Investment* 13:1 (1995): 44–65. Online at: dx.doi.org/10.1108/14635789510077287

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