Why “Red Teaming” is Critical When Selling a Business

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The military spends a lot of time planning, updating plans, scrapping plans and replanning. If you’ve ever served, you can attest to the amount of time and effort required to nail down every variable that is considered and planned for to achieve an objective.

In many ways, your company is like the military. You spend time and effort creating business processes, tracking data, evaluating, and refining those processes to increase profitability and the value of your company. You know your company so well, in fact, that when it comes time to sell, your intimate knowledge of your own company can be as much a hindrance as a help. You know so much about how you do what you do that you might not realize potential pitfalls and traps that are blindingly obvious to a third party.

What are Red Teams?
The military recognizes this problem and creates “red teams” or “red cells” specifically staffed by people with outside perspectives – members of different branches or specialties, different ranks, or even civilians – whose sole purpose is to expose flaws and weaknesses in your plans. You might have heard of the red cell formed by former SEAL Team 6 commander Richard Marcinko who led a red cell team that was reported to have driven a truckload of fake explosives onto the airport tarmac, right up next to Air Force One.

Reverse Diligence
In the M&A world, we have a similar concept called “reverse diligence” – think of it as a red team for your business. The goal of reverse diligence is to look at your business from the perspective of a potential acquirer. What does your customer base look like to an acquirer, for instance, if they’re in the same industry? Or a different industry? Or even a PE fund? What would an acquirer think about your ongoing litigation – should you settle it now, or let it plan out? Do you even have all the documents you need close at hand to prove to a potential purchaser that your business is an attractive acquisition candidate?

Elements of a Good Reverse Diligence Process

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A good reverse diligence process should answer four fundamental questions:

1. Is your company worth what you think it is, or are there things about your company or your markets that an acquirer will use to reduce their purchase price?
2. Are you ready to provide all the information that a buyer will want as part of their own diligence process in a timely fashion?
3. What unknown or unexpected liabilities are out there that might cause a buyer to pass on your company?
4. What can you do to fix any problems you find – or if you can't fix them, how can you explain them to get a buyer comfortable?

To effectively answer those questions, you will need to include people that know your business well – as well as people who don't know your business well. Including outsiders lets you get a fresh perspective into your business.

Finally, the reverse diligence process will give you time to collect all your information and begin to populate your own "data room" ahead of time. By collecting necessary documents early in the process in a controlled and orderly fashion, you'll avoid later disruption to the company in a pre-sale fire drill.

Why Reverse Diligence is Important Even if You're Not Thinking of Selling

Even if you have no plans to sell now, you should still undertake a reverse diligence process (perhaps scaled down) once every few years for two reasons. Firstly, because you never know when you might get an unsolicited offer to sell your company. Some studies suggest about 80% of businesses get an unsolicited offer once every five years.

Second, the benefits of getting an outside perspective on your business in a formal, organized manner cannot be overstated. How often have you solved a vexing issue by chatting with a friend over a beer – a friend who is in a completely different industry. Reverse diligence is tool used to identify problems before they start and run out of control.

At the end of the day, we all, as business owners, make, assess, and remake plans. Adding a formal process to evaluate your business from an outsider's perspective just makes sense.