

CRITICAL SUCCESS FACTORS FOR HIRING MARKET DUE DILIGENCE FIRMS

Acquirers are hiring research and consulting firms to conduct market due diligence with increasing frequency. It makes sense to describe what to look for in hiring a firm for market due diligence. There are six capabilities or philosophies to look for in a primary research vendor.

What is Market/Commercial/Business Due Diligence?

In some regions of the world, market due diligence is referred to as commercial due diligence or business strategy due diligence. Unlike other aspects of due diligence, it does not base its findings on information provided by the company. Instead, market due diligence involves gathering data from industry experts, competitors, customers, and sometimes suppliers and other third-party market participants. In niche markets, it is essential to gain the perspective not only of customers, lost accounts and prospects,

but third party market experts, and, most importantly, direct and indirect competitors.

Market due diligence therefore provides a “more accurate, independent, future-centric, and ultimately more reliable view of the...prospects of the business.” (“Counsel: Commercial Due Diligence and Acquisitions”, *The Edge Malaysia*, Issue 759, Marcus van Geysel, June 15, 2009). It is most commonly utilized when the client is contemplating a move, through acquisition, into a market segment that it does not completely understand.

What Issues should be Researched?

The choice of issues, or questions to ask, is critical. Think carefully about the issues that the prospective research firm intends to address with research contacts. Do this as early as possible in the relationship-building process with a prospective research partner for your company. The thought that goes into creating these questions (and sub-questions) can make or break the project. Canned, off-the-shelf, laundry lists of questions do not suffice.

While there are an unlimited number of issues that could be studied in market due diligence, most studies include these primary

questions (and many custom-tailored ones, as well):

- *Customers:* Are customers satisfied? What is the threat that customers will seek another source of supply? How does the target stand up against each buyer's acquisition criteria?
- *Competitors:* Is the target well-differentiated against competitors, in ways that are meaningful to customers? Are the competitors' strategies, intentions, and capabilities viable threats?
- *The Market:* Is the market as attractive (and large) as the target claims that it is? What are the most attractive segments from a growth and profit standpoint? Are market trends threatening or creating opportunities?
- *Suppliers:* What are the chances that a leading supplier might try to forward integrate and enter this market? What are the supplier's perceptions of the target and its competitors?
- *Strategy:* Does the strategic direction of the company make sense, given internal competencies, and external market trends, customer needs, and competitor capabilities?

The research process should not be conducted in a vacuum. The research

process should be iterative, and interactive, leading to modifications of the questions and the targets. The collaboration that takes place should facilitate feedback loops to the research team. In other words, your chosen research and consulting firm should present their findings periodically throughout the study. And you should offer feedback to these interim findings. And their process, methodology, or style of research should change, based on the feedback from you.

Why Not Conduct the Research Internally

Conducting market due diligence activities is difficult, and most of our clients do not have the time or resources to conduct this research effectively on their own. There are difficulties associated with remaining anonymous while gaining candid insights about markets that are often obscure, competitors that are often private, customers that are often large and sophisticated, and brands that often have only limited awareness and equity. Professional competitive analysts leverage the client's time by scrutinizing informational puzzle pieces and developing pictures that shed light (for example) on the direction of a competitor's corporate strategy, marketing plans, production schedules, and more.

Trained, skilled, and experienced researchers recognize that their job is not merely about answering questions. The real role is to gather insights through interactive conversations, that when synthesized in the whole, will help the research firm to answer the client's big-picture dilemma (e.g., should we acquire this company, or should we enter this new market).

The best primary researchers are "Renaissance" men and women. They are knowledgeable about a wide range of subjects and are able to carry on conversations fluently, with interest, and in a way that generates enthusiasm from the conversational participant. Analysts build rapport with phone contacts and develop meaningful, interesting, two-sided, dynamic, and mutually useful conversations with their contacts.

Most professional analysts have years of experience, often in other analytical arenas, and are able to spot trends and identify patterns efficiently. An objective third-party effort can reveal specific, tangible insights to help in assessing the safety of existing revenue streams and the opportunities to expand revenue streams with current (or prospective) customers.

Who Does the Research?

Hiring the right interviewer is as important as finding the right interviewee.

Intelligent researchers do not merely rely on a script of questions. They ask the contact the next logical follow-up question in response to what the interviewee has just said. They are experts in the art of the conversation. Recent college graduates are not ideally suited to this task.

Finding the right person is absolutely critical to a qualitative researcher. For qualitative researchers, the number of contacts is far less important than the quality of the people being interviewed (and hence the quality of what is being learned). When qualitative researchers see a trend, they seize the trend and seek to have higher level conversations to understand the trend better and better with each conversation.

Why Not Hire an Industry Expert?

Industry experience is tricky; it is a lot like looking for a Goldilocks solution. You do not want too much industry experience because the research team will then rely too heavily on historical data which may skew future inputs. But you also do not want too

little industry experience because the research team may spend an inordinate amount of time simply coming up to speed on the industry vernacular, jargon, and basic trends and layout of the industry.

While industry experts are quick (they are already up to speed), they are not necessarily highly responsive or accustomed to working under the tight demands of acquisition processes.

Moreover, the expert's opinions may be limited to one segment, one geography, and/or one customer group with which that expert is most familiar. In other words, while the expert's readily accessible data is correct, it may be relevant to only one part of the market in question.

Even if an acquirer is successful finding an expert for the specific niche sector in question, that expert is often highly biased. This bias is not the result of a nefarious attitude, but rather the natural outcome of the expert's work history. People who become industry experts have spent most of their careers in one industry. In many cases, these experts spent their entire careers in the same region of the country, working on the same products or services, selling through the same channels, dealing with the same segment of customers, and generally

viewing reality through a narrow prism. "Where you stand depends on where you sit."

The downside here is that the experts are often willing to pontificate generally about tactical ideas for operational improvement, but are loath to express these ideas in an organized, well-structured document. Acquirers that are awaiting a Go/No Go recommendation, 100 day action plan recommendations, or even just an analysis of what the data ultimately means for the deal or for the Company moving forward, will be disappointed. Unfortunately, most industry experts are averse to offering much in the way of analysis, options, conclusions, or recommendations. Most industry experts do not think like strategists, nor equity investors or board members.

In conclusion, industry experts typically do not conduct research; they base their opinions on the segment of the market they have observed throughout their career (which may not match the segments that the acquisition target serves). Moreover, industry experts are reluctant to provide written reports. When they do write up their thoughts, they are not necessarily consistent with professional acquirer expectations.

The concept of a hybrid model, however, combining the best aspects of industry experts with generalist consultants, is certainly worthy of consideration. Acclaro Growth Partners has a number of experts in numerous industry sectors ready to collaborate with us on market due diligence assignments.

How Many Primary Research Conversations Should Take Place?

The quality of the conversation is more important than the number of calls made.

Qualitative research and quantitative research are two different animals. If this white paper were about quantitative research, we would be writing about how to determine the statistically significant number of contacts (and the quality of each contact would be meaningless.) In qualitative research, the quality of the interviewee and of the conversation is most important. (For qualitative researchers, conducting 500 interviews is irrelevant – you might contact 500 people who do not happen to be knowledgeable about the subject matter.) The goal is to find the best resources and develop long, interactive conversations with them.

Conclusion

There are six capabilities or philosophies to look for in a market due diligence vendor.

1. Quality over quantity – A huge number of research calls is useless if the contacts are hearing the same thing from each source. Moreover, the quality of the research depends on the researcher.
2. Experienced researchers -- who have been doing primary research for years and are not fresh out of college or working at a call center.
3. Blind approach -- to eliminate the biases that exist when the contact knows which organization you are studying.
4. Collaborative, interactive approach – to avoid having the research head off in the wrong direction mid-project.
5. Actionability – instead of a data dump. The research should lead to intelligence, which leads to analysis, which leads to options, and finally, a recommendation.
6. Hybrid Model – combine the insights of an industry expert with the rigor of a disciplined research-based consulting process.

Market due diligence is a powerful tool for acquirers. The most effective market due diligence results from outsourcing to experts

who conduct primary research on a daily basis. Knowing how to manage the researchers, and understanding the aforementioned critical success factors of the research, is important.

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