

Applying Market Research To Due Diligence Audits

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Introduction

I am sure that all of us are aware of the term, “due diligence”. We have heard it used to describe the care and attention one gives to a task at hand. (E.g. I was really due diligent in getting my taxes completed on time). Due diligence is also used in the corporate field in a number of applications. Typically these are done by either management consultants or accounting firms when one of their clients is interested in purchasing another company and needs to know what issues are present before acquiring the company.

Given that carrying out a due diligence audit shares many of the skills (e.g. investigative, analytical, knowing whom to speak to) required to undertake a market research study, why not offer due diligence as an add-on service?

What is Due Diligence?

In a nutshell, due diligence is the collection and evaluation of information that bears on the risks associated with any significant transaction. This is done by conducting rigorous exposure assessments of a potential corporate acquisition, including market reputation, client base and undisclosed liabilities. An exposure assessment translates into investigating a company’s accounting records, financial statements, information technology, management issues and/or business reputation. The goal is to uncover information relating to management styles of key executives, the operating corporate culture within potential alliance partners and ability of the company in question to meet financial commitments.

Due diligence is also used to identify sources (e.g. employees, suppliers, career ads, etc.) who leak proprietary information. Efforts to pinpoint leakage would include interviewing key staff members, analyzing what information, including job functions and duties, is available on the client’s web site, examining how, when and where company business is discussed as well as how sensitive questions are answered by staff. The departments to pay particular attention to are sales and customer service as both are highly visible, have access to a great deal of company information and come into regular contact with competitors. (*One could argue that leakage is the flip side of competitive intelligence. In other words, users of CI tap into information that is leaked from their competitors.*)

What about Market Feasibility Studies, Are They a Form of Due Diligence?

Yes. Market feasibility studies, also known as market due diligence audits, reveal the strengths, weaknesses and planned growth of a particular business or market based on the analysis of the market volume data and the competitive situation.

Market feasibility studies can further be divided into *Internal Company Analysis* and *External Company Analysis*.

Internal Company Analysis is used to assess a potential merger or acquisition of another company. Components evaluated include:

- Products (e.g. competitive advantage and disadvantages, unique selling proposition)
- Distribution channel strategy (e.g. e-commerce, agent/wholesaler and direct to retail)
- Pricing strategy
- Marketing/advertising/PR efforts
- Sales staff (e.g. revenue per sales rep, compensation structure, account coverage, experience and training profile)
- Analysis of the client base and revenue sources:
 - a) Relationship competencies with customers
 - b) Level of recurring revenues
 - c) Breakdown of revenue by geography and/or product/service
 - d) List of customers representing 80% of total business
 - e) Customer attrition record
 - f) Customer satisfaction/perception of company
 - g) Major contracts in progress
 - h) Projected sales in the next five years
- Synergy potential with the purchaser

External Company Analysis is used to assess demand for a potential new product or market. Components include: Market dynamics/trends, Market size, Industry capacity, Growth potential, Trends/issues/outlook, Industry players, Factors for success, market shares, SWOT, Competitor financial performance, products, pricing, margins, technology and benchmarks, Barriers to entry

Where Then is the Real Demand for Due Diligence Services?

There are few, if any, market research firms providing due diligence services to support mergers and acquisitions or pinpoint leakage. Yet those accounting and law firms specializing in mergers and acquisitions, who provide due diligence analysis to their clients, often delegate the task to junior accountants/lawyers. An independent market research supplier could conceivably:

- a. support medium to large-size corporate law firms and accounting firms to assess the risks of mergers and acquisitions (e.g. purchase of an entire company, specific assets/product lines, real estate assets and/or debts from a company) for their clients or
- b. target companies directly to either help them assess the feasibility of targeting a new market or in identify sources of leakage information leakage

Conclusion

Investors today are increasingly aware of the need to perform in-depth due diligence before making their buying decision. Based on this trend, there could potentially be a need for due diligence specialists, and there is no reason why a forward thinking market research firm could not help satisfy this demand ●