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James Berkeley's Profitable Growth Notes:

Nine Due Diligence Own Goals

Why does the due diligence process reveal so little about integrating the seller within the business and so much about the buyer? If the objective is to increase the value of the business, then we should first start by asking the right questions of the right people, at the right time. I am reminded of this talking to the Head of Mergers and Acquisitions of a very acquisitive global professional services firm.

"We are able to close deals quickly and address the immediate needs, where we really need to get our act together is in the integration of top management, their people, their technology and their intellectual property." When asked "why" this is an issue? She states, "The boss is getting frustrated at the time it is taking and the diversion from his and our key peoples' core responsibilities." Dig a little deeper, "The boss has told us we have to figure this out internally, he is not willing to look externally although I think that is short-sighted." Sound familiar?

There are many reasons acquisitions don't create the projected value. What my best clients have learned is that there is 9 self-inflicted shortcomings by the buyer that cripple the best performed due diligence process.

1. **The buyer doesn't have a trusting relationship with the seller before launching into the due diligence process**. Driven by the fear of losing the deal, the buyer rushes to the due diligence stage (The seller's most intimate fears and concerns -personal identity, relationships with clients and employees, waning passion and so on - are largely overlooked).
2. **The buyer's due diligence process (scope, duration and access to people and information) is poorly defined**. Overly labour intensive, important questions or areas of investigation are omitted and frequent delays arise.
3. **The buyer's focus is on perfection not success.** The buyer insists on finding or answering every question and thereafter sits back in the vain belief that they have "all the bases covered". No deal has perfect assumptions about market growth, demand patterns, loyalty to the buyer's firm and so on. Let's face it you are going to be wrong and you need to prepare the boss in advance.)
4. **The buyer's own people and systems dilute the effectiveness of the due diligence process.** Powerful vested interests project their biases. Key people are pulled on and off due diligence team. Turf battles arise (no accountability and a lack of ownership). Diverting relationship management, accounting, IT and payroll "firewalls" creates additional obstacles.
5. **The buyer is ignorant of their own firm's default culture.** The core values and operating beliefs that inform key middle manager's attitudes and behaviour are poorly aligned. If the core value is "we will put all customers first", yet the operating belief of the buyer's middle manager is "I must look after my own clients ahead of others." You end up with situations where the acquired firm's clients and people are marginalised. They are seen

as an after-thought and the impact is a weakening of the ties to the buyer's organisation and the greater the appeal to competitors promising a more seductive relationship.

6. **The buyer's judgement is overly swayed by quantitative analysis, at the expense of the qualitative findings**. The natural disposition of many people in due diligence teams is analytical ("give me the numbers", "give me the retention ratio", "wow look at the aged debt beyond 60 days"). Of course, it is essential to have a firm grasp of the financial metrics but not to the point that the qualitative judgments are submerged to P.47 of the report. Value creation happens in the real world, not on a white board. It is about talented people with the skills and volition to achieve impressive results. It is not what you hear or read that counts but what you see with your own two eyes. Strong anecdotal insight (the boss's relationship with subordinates or a key client) can have a greater impact on success or failure than any financial spreadsheet. In SME and family businesses that is an even higher likelihood.
7. **The buyer uses the due diligence insights to extrapolate the present to the future rather than the future to the present.** Value creation and profitable growth is not a linear or vertical line in most businesses. It is largely a diagonal upward progression, resembling an "S" curve. A gradual uptick (early-stage) to a faster period of growth (mid-stage) to a cresting period (mature-stage) and even a gradual or rapid decline (retrenchment-stage) in most business sectors. The buyer must first decide where they are today on their growth curve? Where reasonably would the combined business place them at a future date on the same or a new growth curve? Then ask, what changes are required in the key strategic area of the business (sales and marketing in an advisory business or product manufacturing in an insurance company) to proceed rapidly along to the desired future state?
8. **The buyer applies a distorted view of their firm's attractiveness to others**. Overly optimistic assumptions are made about the combined entities' brand power, strategic profile, people, technology and "know how", which proves to be incorrect. This is a common error in businesses with powerful leaders in insular organisations, who are in a period of impressive growth. The belief system refracts hard evidence collated in the due diligence process. For example, a seller's clients who have shown a reluctance to buy through digital channels are automatically assumed to be impervious to the charms of the buyer's digital distribution sales team. "There is no need to ask "why", they'll fall in love with our technology."
9. **The use of external expertise is curtailed by the buyer to save money**. In mid-sized businesses, which have grown rapidly through a high volume of small ticket acquisitions, there is often an over-reliance on internal competencies and a fear of spending money on appropriate external expertise. There is an in-congruence between the buyer's "nickel and dime" mentality and their image of a high growth organisation. It is largely a relic of the firm's hand-to-mouth days. The most common omission is not a reluctance to hire expensive bean counters from a prominent audit firm, why would you? Rather it is hiring successful people with the skills, knowledge and volition gained from past experience at firms, who are at more advanced stages of growth. Individuals, who can readily form peer-level relationships through their *own* network. An ability to bring impressive "help" (intellect, language, social) and have a high impact on the speed and quality of identifying the relevant issues, asking the right questions, collating the

relevant information, formulating alternatives and implementation along the path of least resistance.

Look at your due diligence, closing and integration process and take the test. If you spot any one of these attributes in your own approach, you have immediate corrective work to undertake. Why would you wait unless of course, you intentionally wanted to add greater risk to the prospective transaction and put yourself in the line of fire?

If you would like to discuss this personally, contact us at telephone: +44 203 440 5072 or email: james@elliceconsulting.com