Extracts from Acquisitions Monthly (November 1998)

An accident waiting to happen?

With investors currently at their most cautious, can commercial due diligence specialists really uncover bad businesses early, or are they simply charging for common sense? David Rothnie reports

“Corporates and venture capital firms are increasingly acknowledging the need to analyse issues which fall outside the standard remit of an accountancy or law firm. But opinion differs as to whether they should use in-house expertise or pay for a third party to conduct commercial due diligence (CDD).”

“David Small, a director of the industry group at 3i, painted a healthy picture of the potential market for CDD: In 1997, venture capital firms and trade purchasers spent a total of £25 million on due diligence. The due diligence industry is experiencing 20 per cent compound growth."

“Desk research does not help where an acquiror is seeking to evaluate a target's future potential. Specialist firms must therefore add value by only eliciting original information."

“Just as important - particularly from a financial buyer's perspective - is the need to evaluate the competencies of the future management team, given that people are one of the most elusive assets to assign a value to. These conclusions are supported by the results of a new survey conducted by Moffatt Associates, a strategic research and marketing consultancy. The survey explored current practices and trends in CDD, using a sample of 20 BVCA members, incorporating variations in size and speciality. Ninety per cent of the sample stated that the quality of the proposed management team was the most important factor to be considered prior to the transaction and placed this responsibility in the remit of consultants. This was followed by an evaluation of the market and competitive positioning of the target business.”

“Ultimately then, the quality of information which a specialist can deliver is constrained by the access its client is prepared to give to its client base.”

“The issue for acquisitive companies, therefore, is less whether to rely on third parties *per se*, but to whether they cater for companies with varying resources at their disposal and the extent to which they can follow a specific brief. Returning to the findings of Moffatt Associates, 20 per cent of respondents cited the cost of current services and their own lack of resources as the main barriers to a stronger commitment to CDD.”

“Established providers of CDD services now face a competitive threat from specialist research and marketing consultancies. For example, Moffatt Associates is launching a menu-driven service which offers venture capital firms, investment banks and corporate buyers a three-tiered approach to CDD. According to Clive Moffatt, managing partner of Moffatt Associates clients can - at a cost below £10,000 - opt for an initial market overview involving research and analysis of key external market trends and influences (e.g. prospective legislation, etc). Clients can also opt for a more detailed external and internal analysis of the competitive positioning of the business involving original research. Finally, for chosen target investments, clients can commission a comprehensive report, which includes an assessment of internal competencies with detailed recommendations on marketing and communications which can be developed further and implemented post-acquisition."