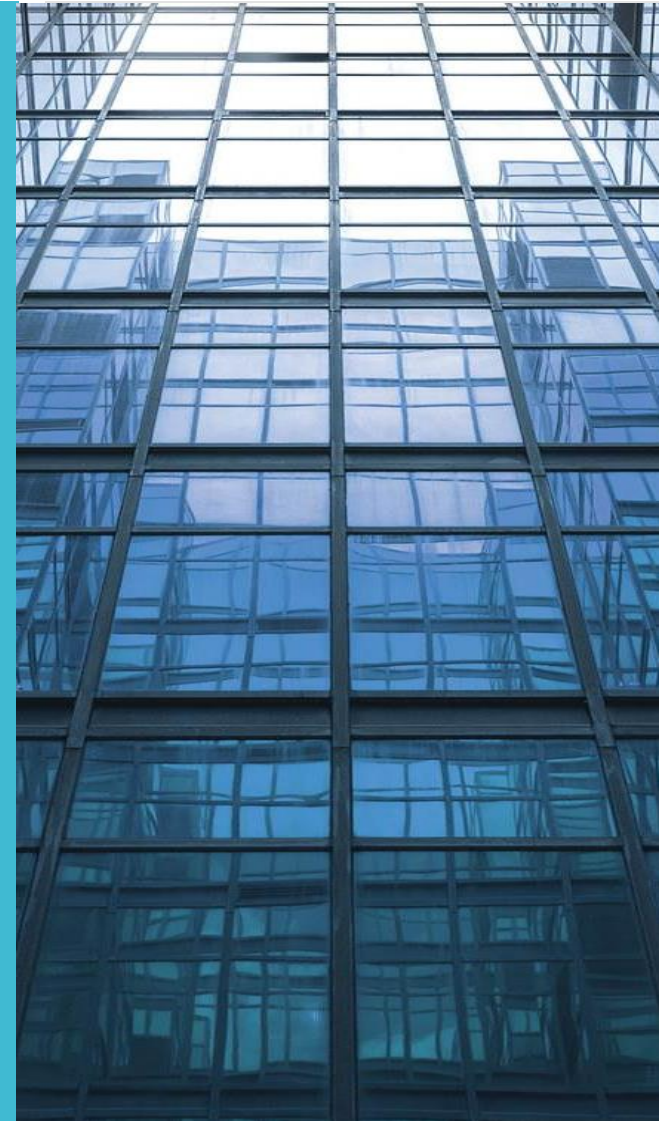# Taking Commercial Diligence to the Next Level

The High Cost of What You Are Overlooking in M&A Deals

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Quoted & Noted

"In B2B transactions, customer relationships are the most critical driver of value."

V.P. M&A
$3.0 Billion Manufacturing Company

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DISCUSSION TOPICS

- ✓ Why So Many Deals Fall Short

- ✓ Customer DD – Good vs. Great

- ✓ Use of NPS® in Customer Due Diligence

- ✓ Customer Interviewing Best Practices

- ✓ Using Insights for More than DD - Craft a Business Improvement Playbook

POLL:

What percentage of deals do you think fail to live up to expectations?

a) 10-25%

b) 26-35%

c) 36-50%

d) 51-70%

e) Over 70%

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70 - 90% of Deals Fail to Live Up to Expectations

Harvard Business Review, June 2016
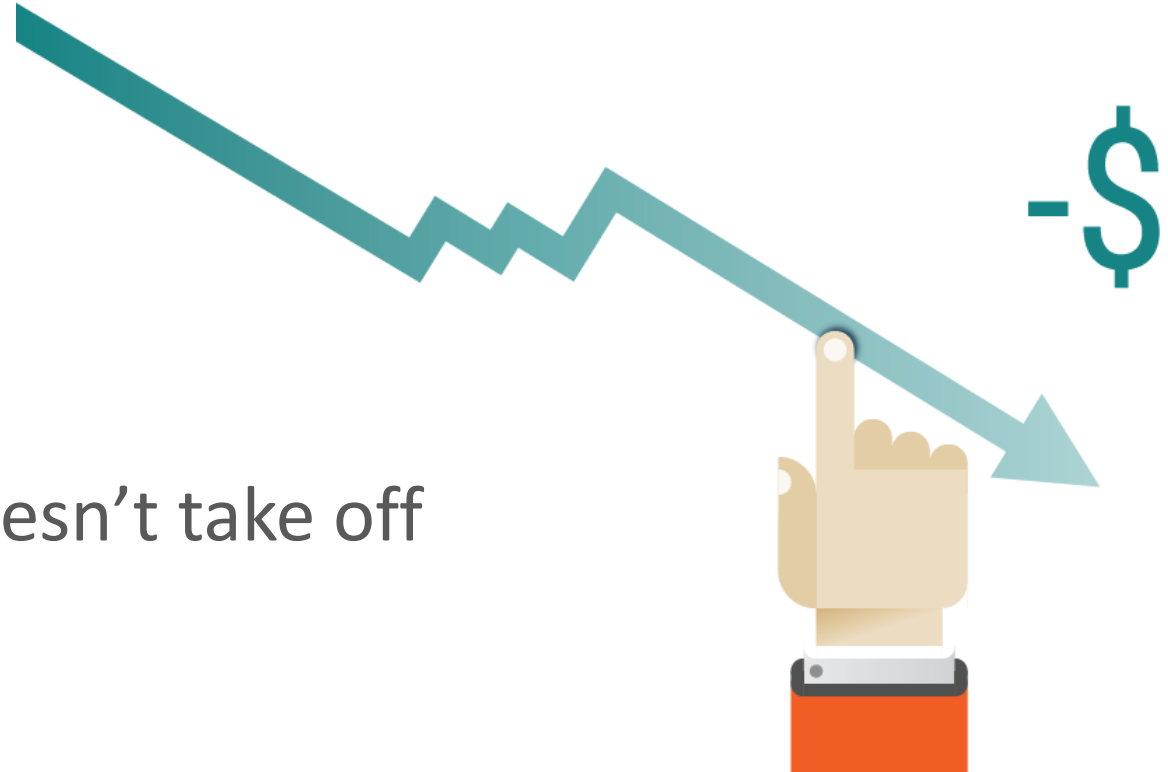
DOES THIS SOUND FAMILIAR?
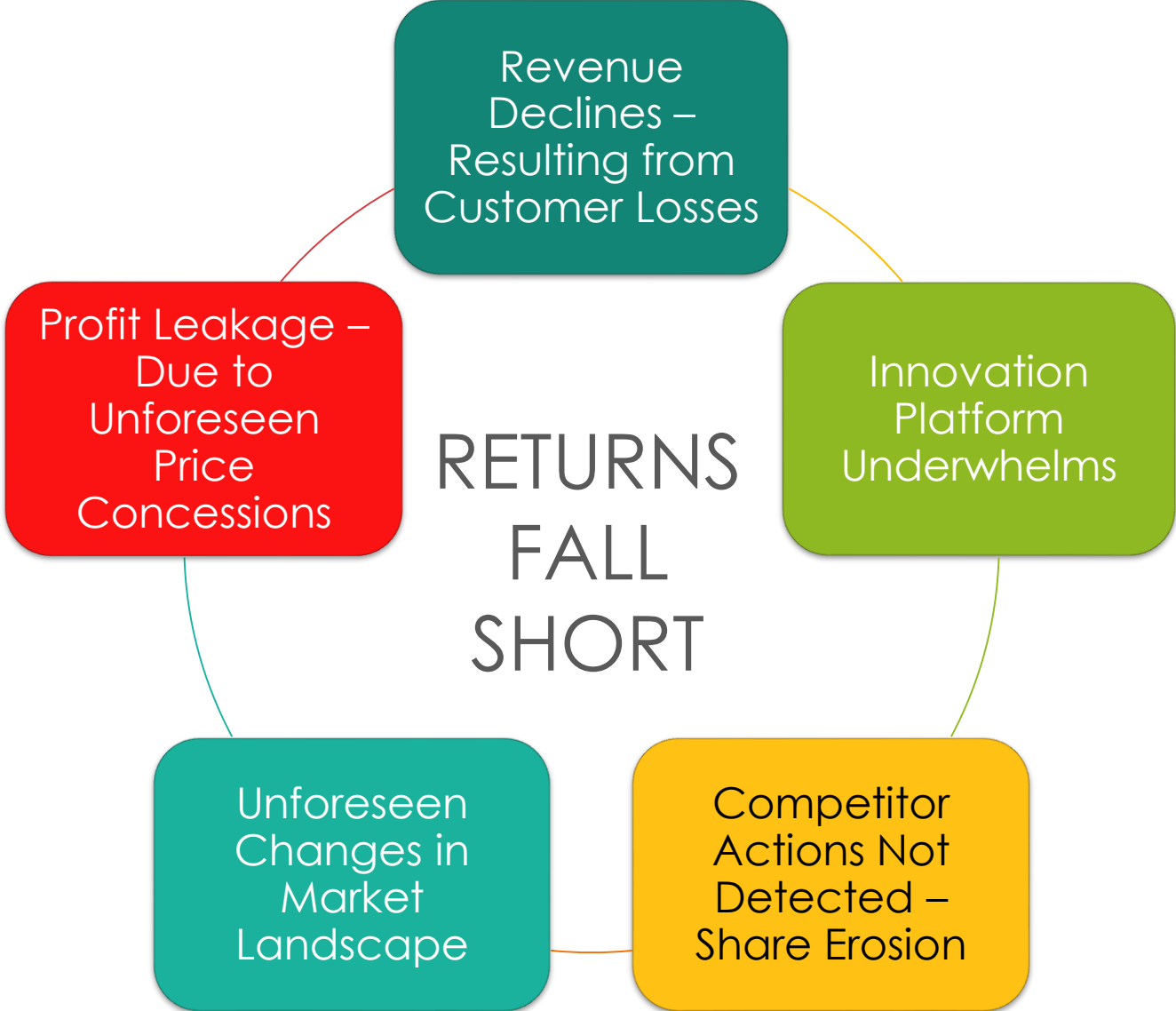
Sellers' Picture – Rosy Scenario

- Great customer Relationships
- Expanding market share
- Stable, secure pricing
- Improving margins
- New products that customers love
- Competitive but controllable landscape
- Expanding market and market interest

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AFTER CLOSING... REALITY SETS IN

- A top account is lost
- Price concession given
- Competitor making in roads
- New promising innovation doesn't take off

-$

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WHAT'S THE RESULT

RETURNS FALL SHORT

- Revenue Declines – Resulting from Customer Losses
- Innovation Platform Underwhelms
- Competitor Actions Not Detected – Share Erosion
- Unforeseen Changes in Market Landscape
- Profit Leakage – Due to Unforeseen Price Concessions

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QUOTED
&
NOTED

"*Due diligence is inadequate in more than 40% of deals.*"

McKinsey & Company Survey of Dealmakers

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HOLD TIMES

POLL:

Do you believe hold times have grown longer, stayed the same, or gotten shorter over the last few years?

a) Longer

b) Stayed the same

c) Shorter

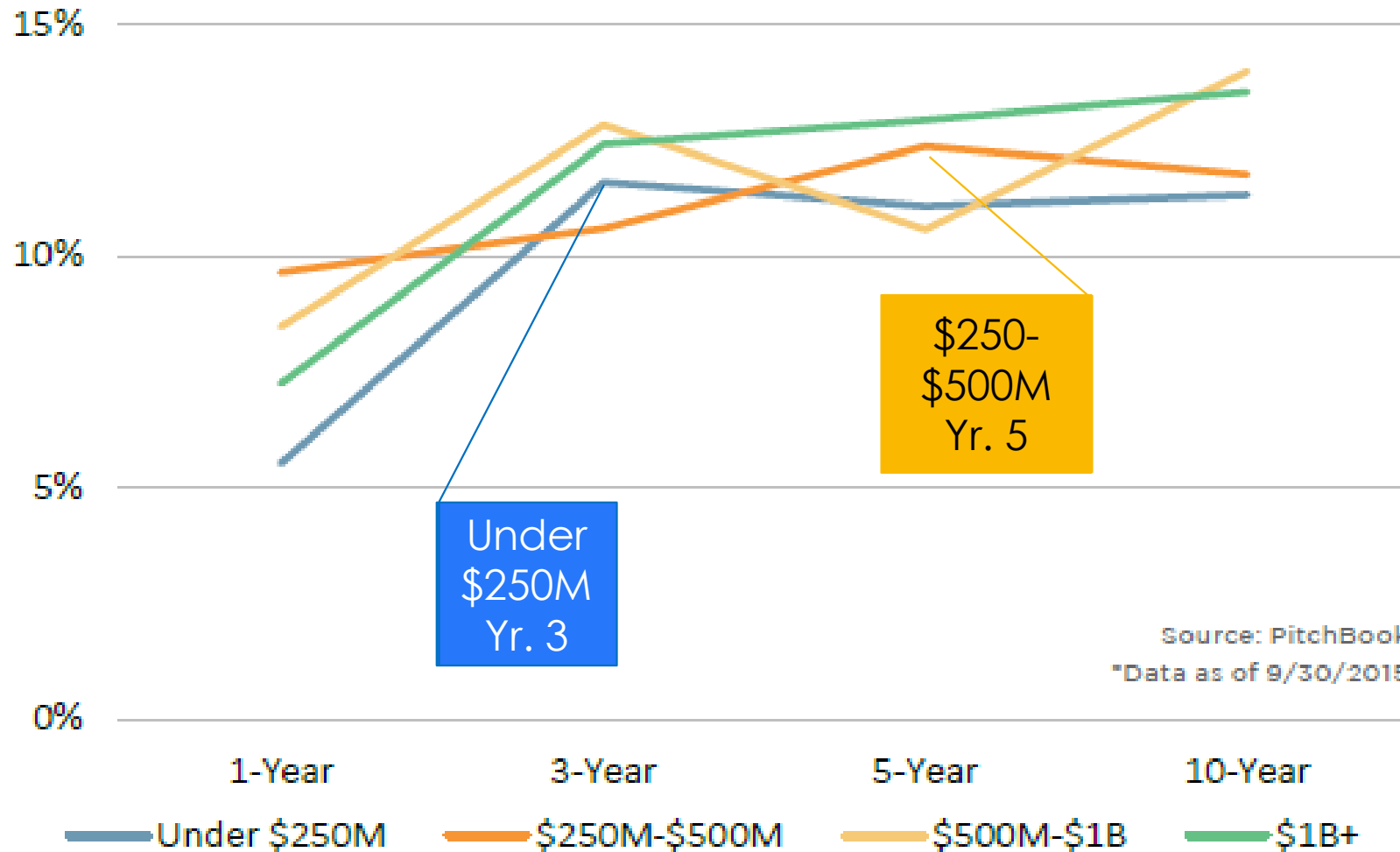Strategex

THE FACTS AS WE KNOW THEM

2010 **average hold time**
4 – 4.5 yrs.

2015 **average hold time**
5.5 – 6.5 yrs.

Pitchbook & Preqin Research 2016

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RISK OF LANGUISHING RETURNS

Returns Improve, Then Flat Line by Year 3 to 5

Source: PitchBook
*Data as of 9/30/2015

Legend: Under $250M — $250M-$500M — $500M-$1B — $1B+

VALUATIONS STAGNATE
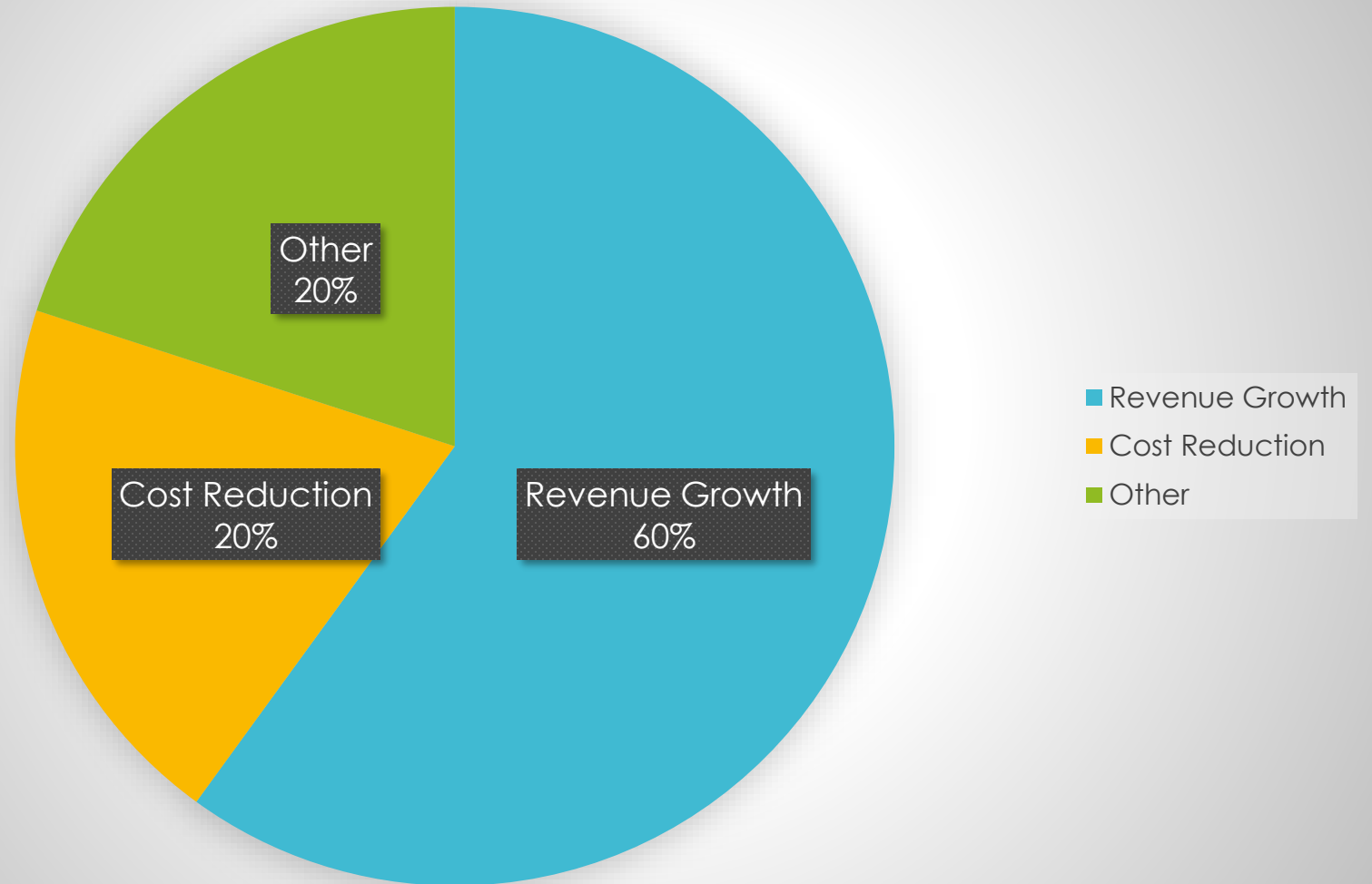
LMM value *stagnates after year 3* but holds average 5.8 yrs.

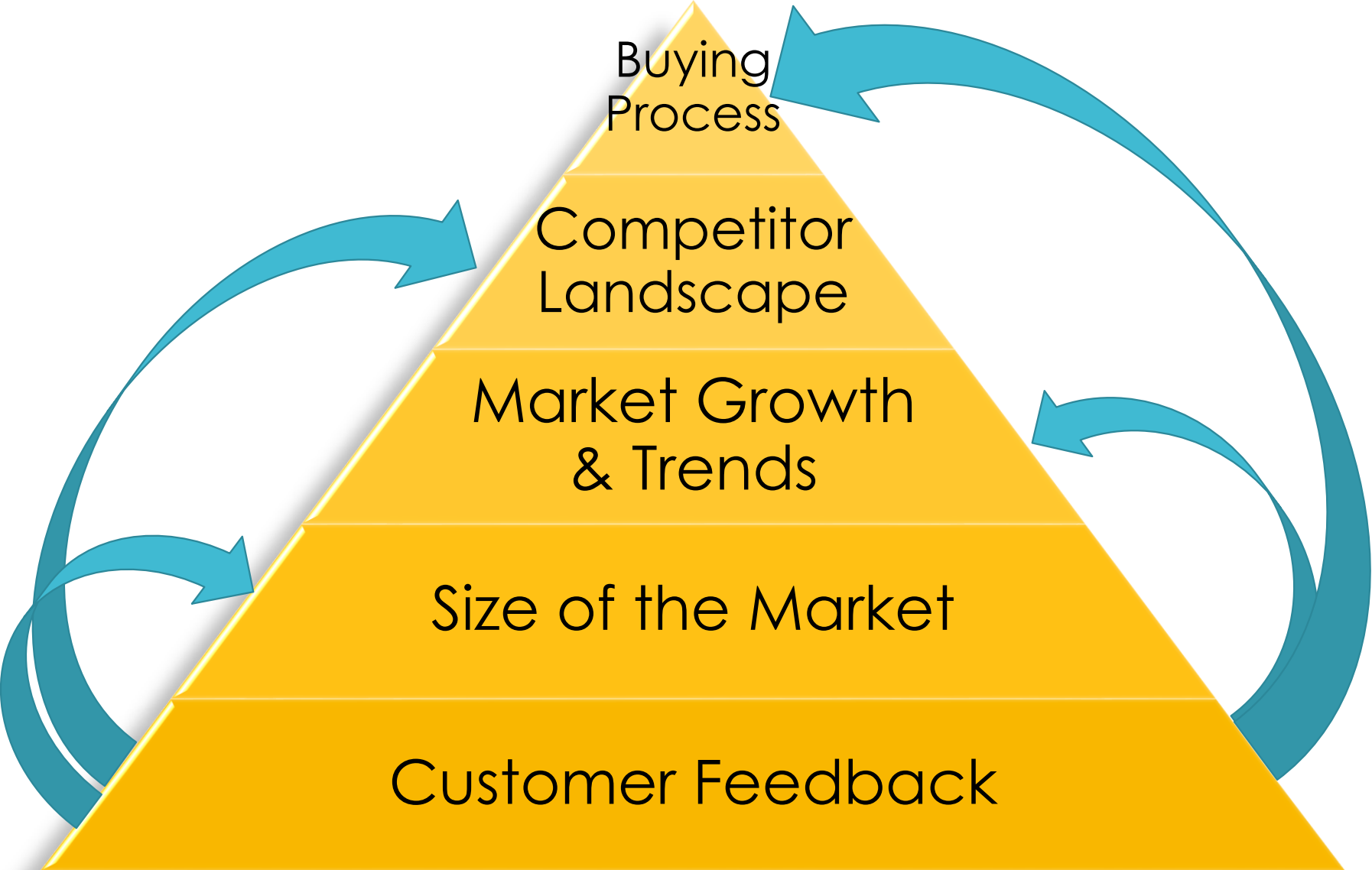MM company value *declines after year 5* while holds average 6.4 yrs.

Pitchbook & Preqin Research 2016

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DRIVERS OF VALUE CREATION

VALUE CREATION OVER A 5-YEAR HOLDING PERIOD

Other
20%

Cost Reduction
20%

Revenue Growth
60%

- Revenue Growth
- Cost Reduction
- Other

TRADITIONAL COMMERCIAL DUE DILIGENCE

Customer Feedback

Buying Process

Competitor Landscape

Market Growth & Trends

Size of the Market

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SHIFTING THE EMPHASIS TOWARD THE CUSTOMER

Buying Process

Competitor Landscape

Market Growth & Trends

Size of the Market

Customer Feedback

CUSTOMER INTERVIEWS

COMMON TRAPS

- ❑ "Reference Check"
- ❑ Brief Interviews
- ❑ "Check the box" exercise
- ❑ Weak Insights
- ❑ Limited analysis

THERE'S
GOT TO BE
A BETTER WAY.

Apply

Voice of the Customer techniques

to Customer Due Diligence.

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Quality of Customers®

SPECIALIZED APPLICATION OF VOC
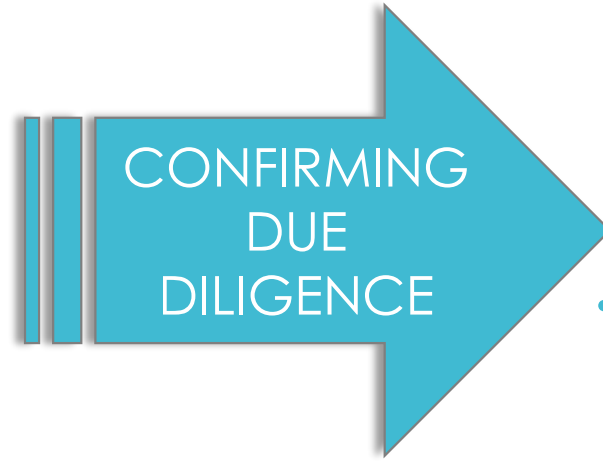
$Q_{of}C$ ®

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SMART QUESTIONING UNCOVERS...

- Satisfaction & Loyalty (NPS®)
- Pricing Risks / Opportunities
- Who's Been Awarded Recent Business and Why
- Growth Outlook for the Market
- Market's Likely Adoption of New Innovations
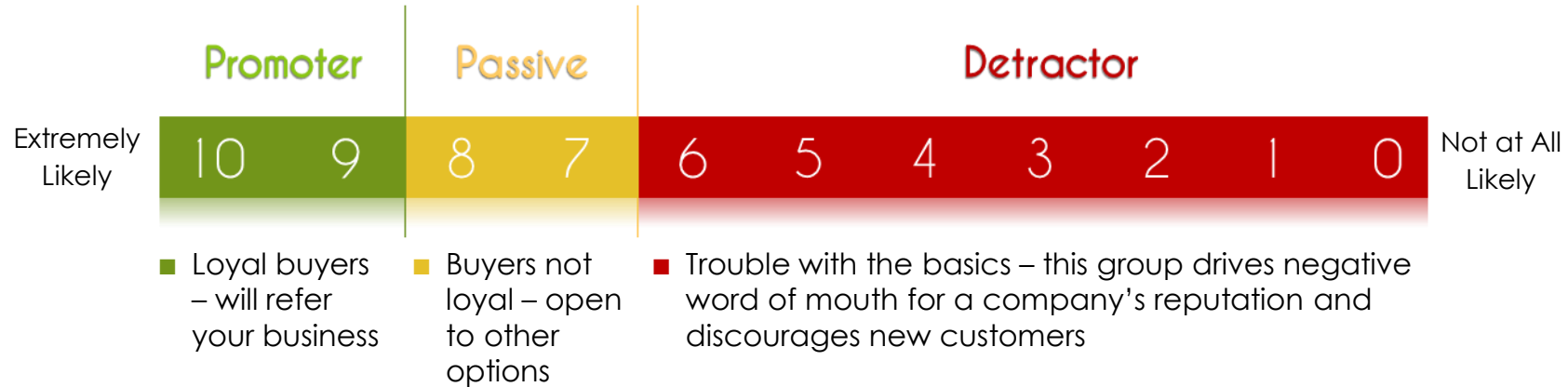- Unmet Needs / Market Trends

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POLL:

Has a company you own, advised, or are attempting to acquire measured their Net Promoter Score®?

a) Yes

b) No

c) Not Certain

THE LITERATURE EXISTS...

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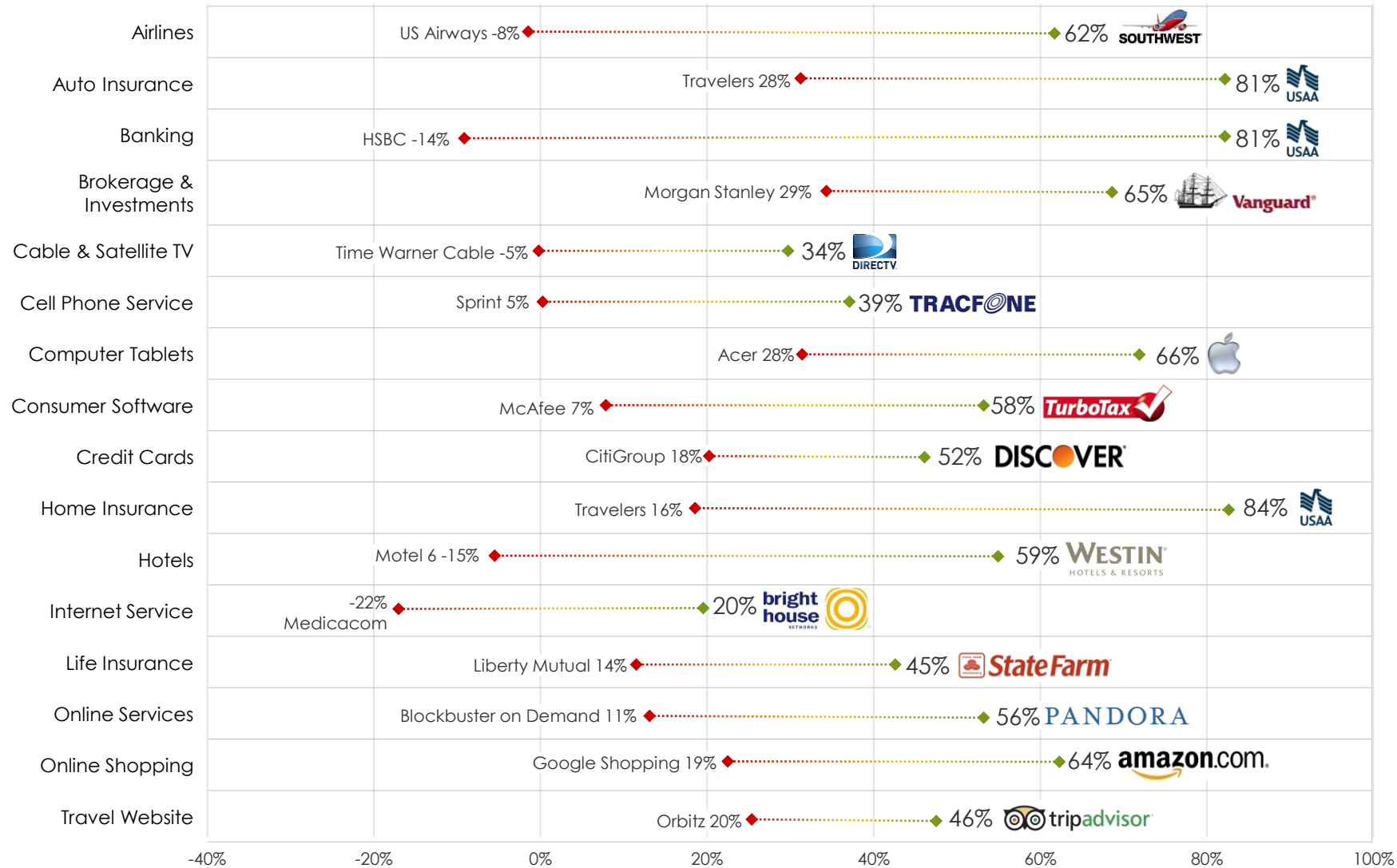
24

THE NET PROMOTER SCORE® EXPLAINED

Q. How likely is it that you would recommend Company X to a friend or colleague?

	Promoter		Passive		Detractor							
Extremely Likely	10	9	8	7	6	5	4	3	2	1	0	Not at All Likely

■ Loyal buyers – will refer your business

■ Buyers not loyal – open to other options

■ Trouble with the basics – this group drives negative word of mouth for a company's reputation and discourages new customers

PROMOTERS % – DETRACTORS % = NPS %

A PROVEN TOOL TO CUSTOMER SATISFACTION AND MEASURE PERFORMANCE

NPS® RANGES AND LEADERS

Category	Low	Leader
Airlines	US Airways -8%	62% SOUTHWEST
Auto Insurance	Travelers 28%	81% USAA
Banking	HSBC -14%	81% USAA
Brokerage & Investments	Morgan Stanley 29%	65% Vanguard
Cable & Satellite TV	Time Warner Cable -5%	34% DIRECTV
Cell Phone Service	Sprint 5%	39% TRACFONE
Computer Tablets	Acer 28%	66% Apple
Consumer Software	McAfee 7%	58% TurboTax
Credit Cards	CitiGroup 18%	52% DISCOVER
Home Insurance	Travelers 16%	84% USAA
Hotels	Motel 6 -15%	59% WESTIN HOTELS & RESORTS
Internet Service	-22% Medicacom	20% bright house NETWORKS
Life Insurance	Liberty Mutual 14%	45% State Farm
Online Services	Blockbuster on Demand 11%	56% PANDORA
Online Shopping	Google Shopping 19%	64% amazon.com
Travel Website	Orbitz 20%	46% tripadvisor

-40%   -20%   0%   20%   40%   60%   80%   100%

WHY NPS® MATTERS

Companies with leading NPS®
results often
OUTGROW
THEIR PEERS
BY 2X +

COMPANIES WITH LEADING
NPS ® RESULTS

NET PROMOTER LEADER 2013

amazon

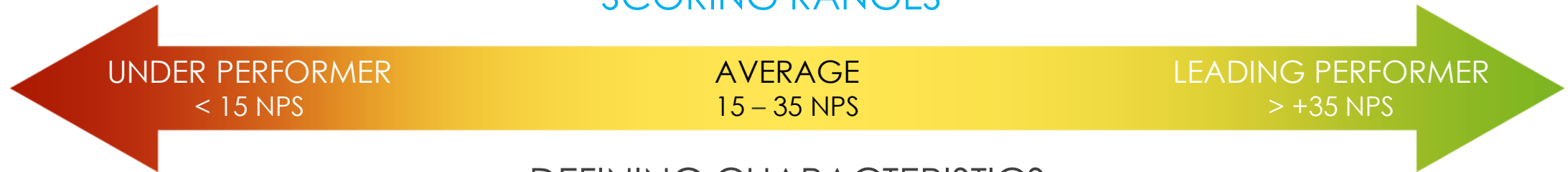AMERICAN EXPRESS

Chick-fil-A

Southwest®

NETFLIX

WESTIN HOTELS & RESORTS

USAA®

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NPS® AND GROWTH

GROWTH (INDEXED)
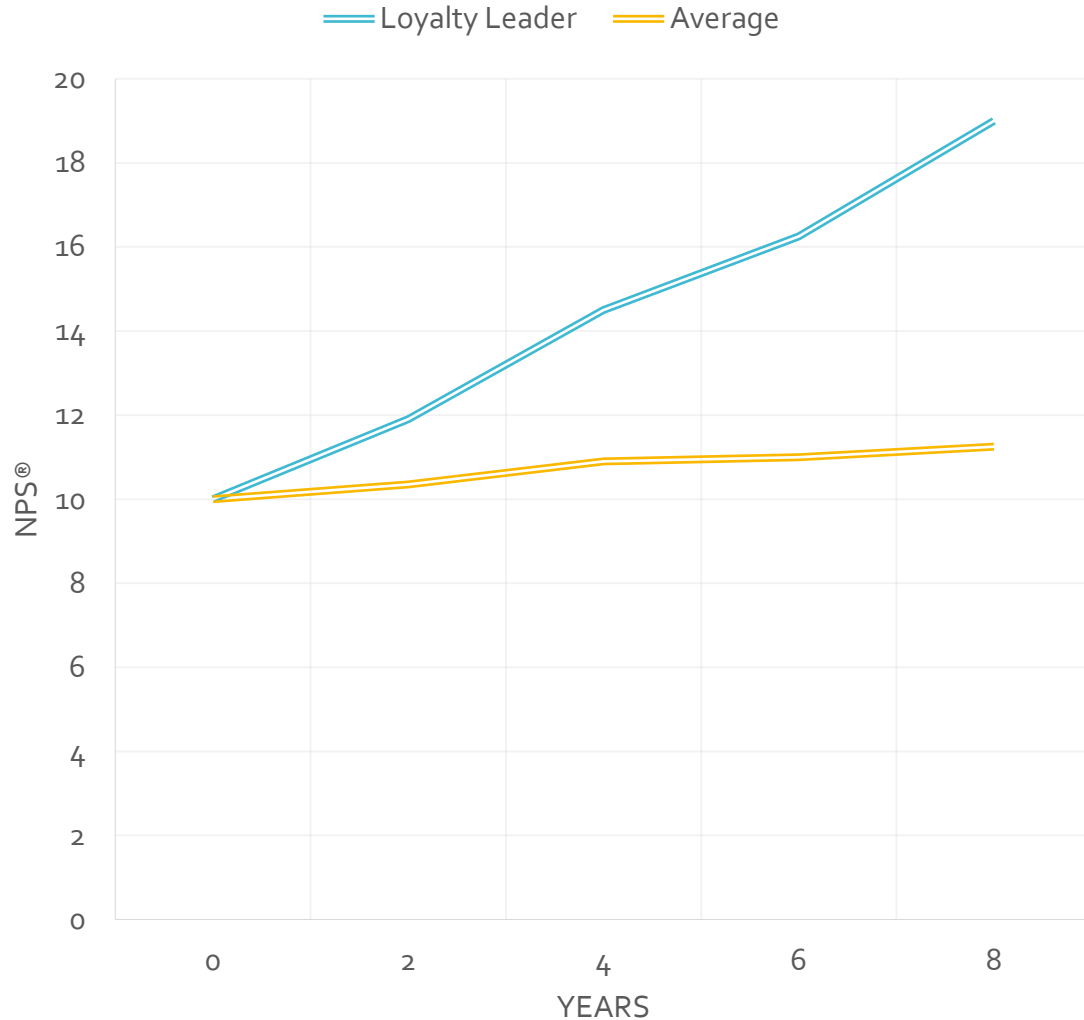
NPS® is
A RELIABLE
PREDICTOR
of a business's
growth outlook.

INTERPRETING NPS® SCORES

SCORING RANGES **

UNDER PERFORMER	AVERAGE	LEADING PERFORMER
< 15 NPS	15 – 35 NPS	> +35 NPS

DEFINING CHARACTERISTICS

- Product/Service performance Issues
- Arrogance/Poor Customer Service
- Low value for the price

- Quality and delivery are good, not great
- Service is inconsistent
- Little focus beyond the basics

- Deliver a great customer experience
- Consistently exhibit "Customer First" Attitude
- Collaborative, partnering approach with customers

FINANCIAL / COMPETITIVE OUTLOOK

Lose Share ↓	Maintain Share ↔	Gain Share ↑

** Score ranges are illustrative. Vary by industry.

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A "40" is a good score **only if it is better than the competition.**

NPS® IS NOT A PANACEA

THOUGHTFUL QUESTIONING

OVERALL IMPRESSIONS / NPS®

Results
- ✓ Validated Ratings
- ✓ Clear Areas of Improvement
- ✓ Detailed Knowledge of Issues

CUSTOMER EXPERIENCE RATINGS

COMPETITOR BENCHMARKING

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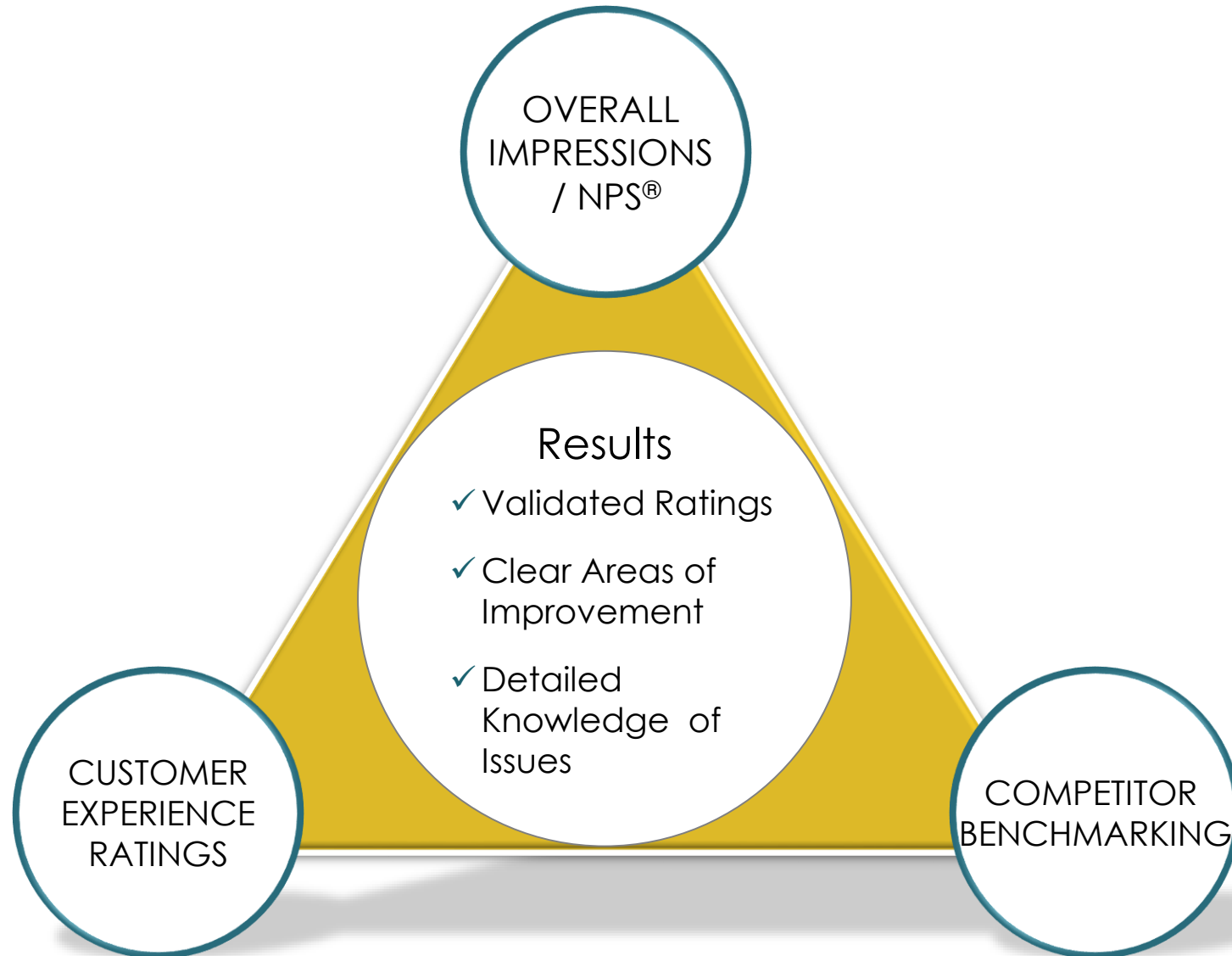
CUSTOMER INTERVIEWING: Effective Methods
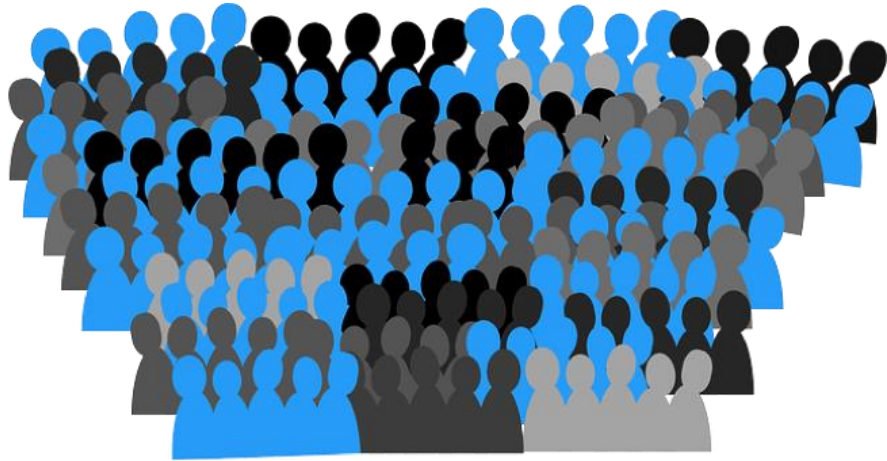
- ✓ Customer Satisfaction Survey Approach

- ✓ Interview accounts representing 60-70+% of sales

- ✓ Conduct multiple interviews at top accounts

- ✓ Capture customer commentary verbatim

KEY TO SUCCESS

ROLL UP THE DATA

IDENTIFYING AT RISK ACCOUNTS

ACCOUNTS AT RISK

ACCOUNT	LOYALTY RATING	SECURITY OF RELATIONSHIP	FUTURE SPEND	COMMENTARY
Ams	8.0	🔴	↓	› Trailing technologies and not being compliant make ACME Company unattractive
HOOTERS	8.0	🔴	NA	› More engagement and customized solutions are needed to grow the business
Service Concepts	8.0	🔴	↓	› Limited portfolio and shifting priorities are cutting ACME Company out
ONE 3 LED	7.0	🔴	↔	› Improve outreach and operations to grow business
JOHN W. KENNEDY COMPANY	4.0	🔴	↔	› Outreach, pricing structures, and portfolio need focused improvement to turn around the relationship with JW Kennedy

"SECURITY OF RELATIONSHIP" IS AN OVERALL ASSESSMENT OF CUSTOMER RELATIONSHIP (SATISFACTION RATINGS, PLUS TONE OF COMMENTS)

● VERY SECURE   ● ISSUES RAISED / ROOM TO IMPROVE   ● SIGNIFICANT COMPLAINTS / BUSINESS AT RISK
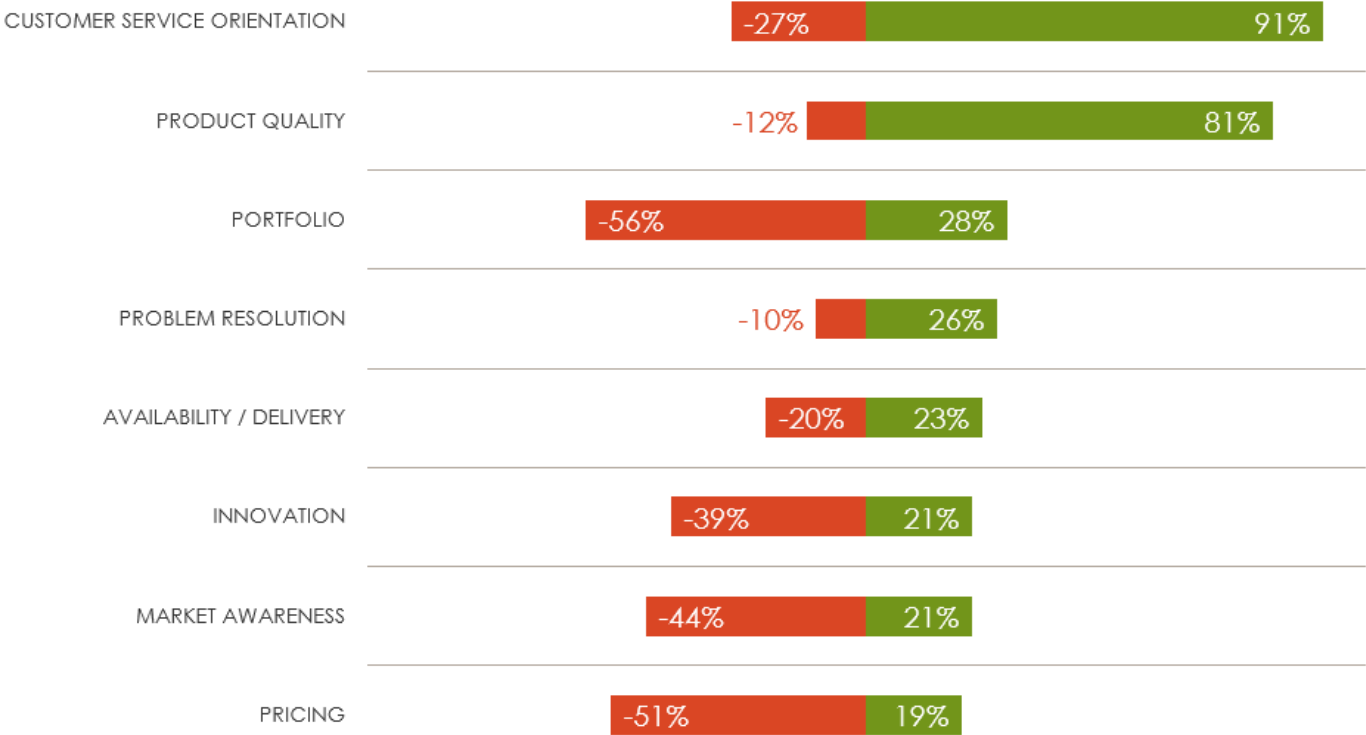
"FUTURE SPEND" REFLECTS CUSTOMERS' EXPECTATIONS FOR FUTURE BUSINESS WITH ACME COMPANY

↑ INCREASE SPEND   ↔ FLAT   ↓ SPENDING DECLINE LIKELY

COMPARING RELATIVE STRENGTHS AND WEAKNESSES

SUMMARY OF ACME Company's PERFORMANCE

Q. Top of mind, name the top two to three strengths and improvements for ACME Company.

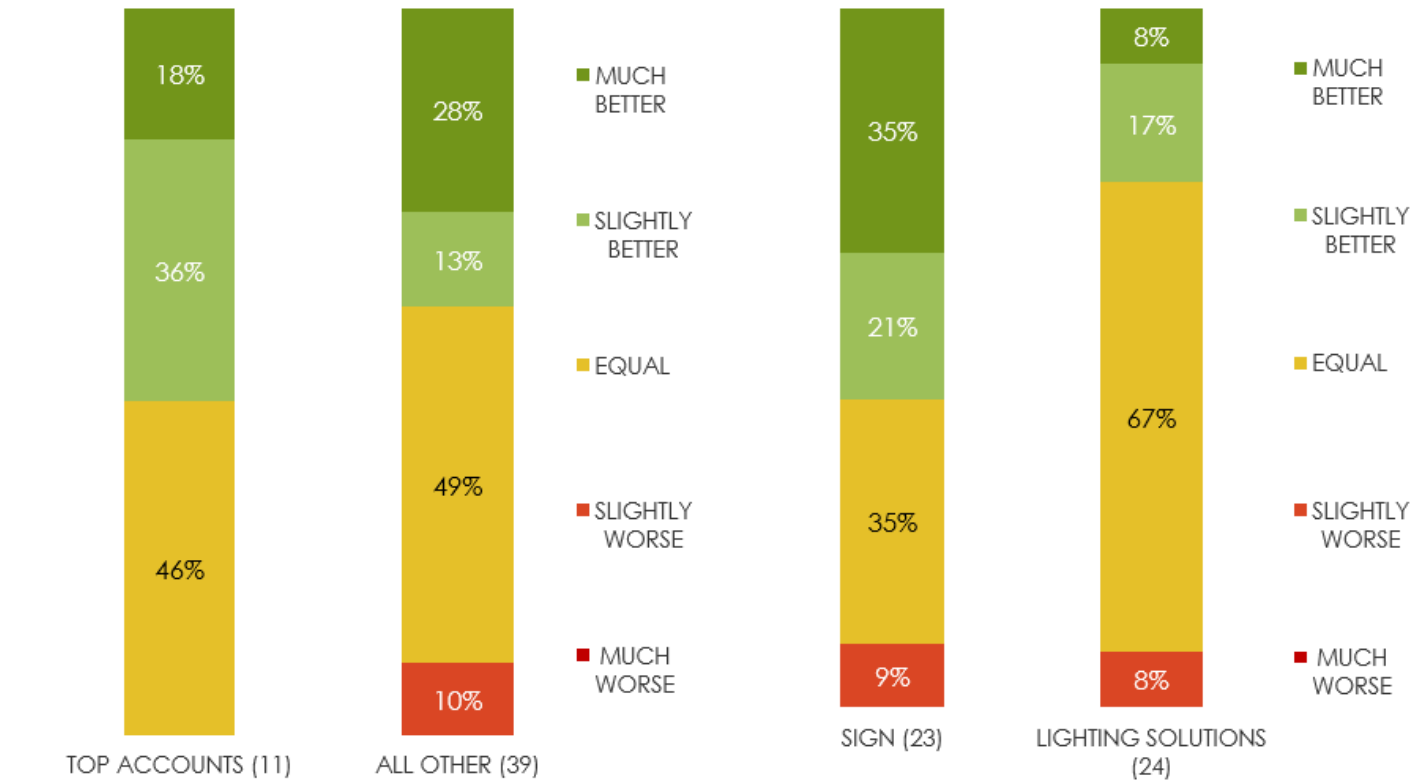|	
CUSTOMER SERVICE ORIENTATION	-27% / 91%
PRODUCT QUALITY	-12% / 81%
PORTFOLIO	-56% / 28%
PROBLEM RESOLUTION	-10% / 26%
AVAILABILITY / DELIVERY	-20% / 23%
INNOVATION	-39% / 21%
MARKET AWARENESS	-44% / 21%
PRICING	-51% / 19%

Customer service and quality are exceptionally positive. Limited portfolio, pricing and market awareness need attention.

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ASSESS TARGET VS. COMPETITION

Comparing Competition to Acme

Q. How does Acme compare to the competition?

	MUCH BETTER	SLIGHTLY BETTER	EQUAL	SLIGHTLY WORSE	MUCH WORSE
TOP ACCOUNTS (11)	18%	36%	46%		
ALL OTHER (39)	28%	13%	49%		10%
SIGN (23)	35%	21%	35%	9%	
LIGHTING SOLUTIONS (24)	8%	17%	67%	8%	

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Acme is an industry leader, but more can be done.

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DEFINE SWOT THROUGH THE EYES OF THE CUSTOMER

ACME Company SWOT OVERVIEW

STRENGTHS

△ SUPERIOR CUSTOMER SERVICE

△ EXCEPTIONAL PRODUCT QUALITY

△ BROAD PRODUCT PORTFOLIO

△ CUSTOMER LOYALTY BUILT THROUGH HANDLING OF RECALL

WEAKNESSES

▽ LACK OF NEW PRODUCTS IN RECENT YEARS

▽ HIGHER PRICED THAN SOME ALTERNATIVES

▽ LACK OF MARKET ENGAGEMENT & AWARENESS

▽ UNDER-RESOURCED – LACK OF SPEC'ING TEAM

▽ NOT TITLE 24 COMPLIANT

OPPORTUNITIES

△ EXPAND OFFERING OF NEW LED TECHNOLOGY PRODUCTS

△ INTRODUCE LOWER COST LINE OF PRODUCT

△ INVEST IN FIELD TEAM TO INCREASE AMOUNT OF WORK THAT'S SPEC'D

△ INTENSIFY MARKETING EFFORTS TO RAISE BRAND AWARENESS

△ BECOME TITLE 24 COMPLAINT TO PENETRATE CALIFORNIA MARKET

THREATS

▽ PRICE PRESSURE WILL INTENSIFY WITH INDUSTRY MATURATION

▽ CHINESE / LOWER-PRICE SUBSTITUTES WILL GAIN GREATER MARKET ACCEPTANCE

▽ COMPETITORS' INNOVATION EFFORTS OUTPACE ACME COMPANY

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WHAT QofC® DILIGENCE HAS UNCOVERED

PRICE REDUCTION REALIZED

CLIENT:
South African packaging company was identified as well-run, with good quality and reasonably good service.

QofC® FINDINGS:
However, lower cost imports were entering the market. **16 of 17 customers threatened to move business unless price concessions were made.**

RESULTS:
Final price reduced by 30%, deal completed. Renewed emphasis on innovation to regain price-value.

OFFER WITHDRAWN

CLIENT:

LED Lighting Manufacturer – Majority of top accounts (12 of 20) complained of late deliveries and poor service. Even owner called out for poor customer relations, "*There's nothing I like about them.*"

QofC® FINDINGS:

Further discovery uncovered **competing supplier was preferred and likely to win future business.**
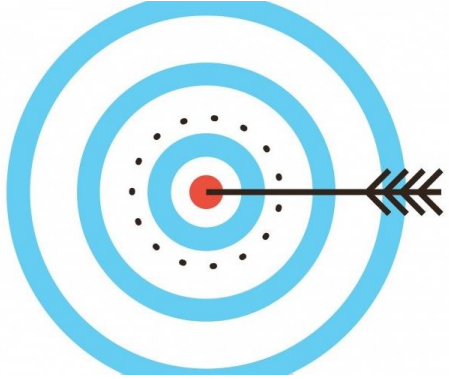
RESULTS:

Offer was **withdrawn**.

3 COMMON APPROACHES TO FOCUSING ON TOP LINE GROWTH

1) Strategic Planning Exercises

2) Board Reviews

3) 3rd party experts

Growth planning often takes a backseat to profit maximizing.

DEAL CLOSED, PLAYBOOK DEFINED

CLIENT:

Strategic acquisition in automotive identified engineering priorities required by customers to increase business going forward. The company was able to isolate immediate synergies that enabled the integration plan to move forward rapidly.

QofC® FINDINGS:

Full slate of improvements prioritized & actioned.

RESULTS:

Integration plan **executed in advance** of first 100 days.

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USING CUSTOMER DD POST-CLOSE: An Early Roadmap

- Customer insights are very actionable

- Clear roadmap of improvement priorities

- Immediate steps to win business / gain share

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CLIENT PERSPECTIVE

Baird Capital BAIRD

Rob Ospalik,
Partner, Co-Head of
Global Operations

"On the front end, insights into customer relations is in many ways the most important thing that we want to understand about a company that we're investing in. The value is created at the customer relationship."

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Thank you for your time.

Questions?

Strategex

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