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Scoping commercial business review in an uncertain market economy

COVID-19, coming hard on the heels of Brexit, gives rise to a number of pressing issues for business managers and their financial backers, and presents unprecedented challenges for trade and investment at a time when the future of whole industry sectors – never mind individual businesses – is hard to determine. David McClelland, director of Carlton Strategy Advisors, provides an insight into the process of scoping commercial business review in a very uncertain market economy:

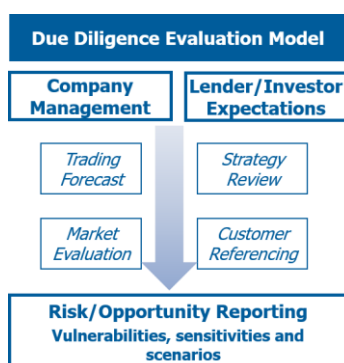
Pent up demand can be expected to see volumes in some markets return at least partially, varying with the details of the eventual timing and shape of the nation’s much hoped for recovery; but there can be no guarantee that newly acquired buyer habits will fully revert as before to their previous models. More fundamentally, both business costs hurriedly cut in the rush to protect cash flows and investments quickly made to ride opportunistic market gains may serve to expose underlying business weaknesses including management overreach and operations stretch, with clear implications for business continuity.

As with all market turbulence there are, and will continue to be, profitable business opportunities. However, given the seismic scale of Britain’s current economic disharmony, business managers and investors will require a fresh and deep-rooted understanding of the reshaped marketplace before committing to new growth plans.

Commercial due diligence (CDD) helps address this need; but where to start, how should it be scoped, and with what outcomes in mind?

CDD programme structure

CDD is a process whereby the due diligence investigator will seek to engage in close ‘question and answer’ dialogue with a company’s senior management team; from which data and other information can be cross referenced and subsequently either validated or disproved. Its scope usually consists of a number of overlapping project phases made up of internal management interview and trading analysis together with external market research, including supply chain referencing and competitor analysis.



Market evaluation: Recessions cease at different times in different sectors. Market research into the sources and drivers of demand can provide information about the anticipated strength of recovery within the addressable marketplace, including its expected phasing or cyclicity.

Management direction: Analysis of the company’s business plan including core competences, USPs and IP examines the central question of the true direction and strategy intended for the business over a number of projected years. Can existing resources be relied upon to take advantage of any envisaged market upturn or is it a case that even a rising tide cannot revive a tired formula? What will be the impact of returning business volumes if

industry pricing remains an issue? Can rising costs be pushed through the industry supply chain?

Trading performance: Due diligence can be expected to analyse the business’s main sources of income and profitability across historical and forecast timelines that are meaningful to the trading environment and any envisaged investment horizon. By charting compound average growth rates (CAGRs) one may report on

patterns of trade segmented, for example, by product, customer and geographical sales region; seeking, in particular, to explain stand-out increases/decreases and peaks/troughs of activity.

Further quantitative analysis might seek to determine the probability of success of a planned new activity against its value if implemented successfully within a given timeframe. By allocating a measure of weighted probability towards new product introduction and customer uptake, for example, it becomes possible for the reporting consultant to model revenue build-up on a line-by-line ‘grass-roots’ basis and to ascribe a level of confidence in the business forecast.

Market references: Key observations garnered at this early stage of the CDD about the business’s primary growth drivers can then be held up for further testing against company references obtained from within the industry’s supply chain (upstream suppliers, downstream customers, agents/distributors and other market participants or their proxies). Customer referencing, for example, can identify how well the company is able to satisfy vendor threshold criteria relative to alternative suppliers named by the customer.

Competitor analysis: By building a profile of each market rival’s activities, including areas of product overlap, geographical footprint and comparative trading performance, it becomes possible to examine the structure of the marketplace in terms of any peer group concentration or fragmentation; and thus the degree to which competition is head-on and price sensitive or otherwise more nuanced.

Emerging themes

A well-developed business and market review will typically pull out several key themes for strategic reporting purposes; for example:

- Leadership: *is management direction rational/logical – are objectives and resources aligned?*
- The business forecast: *is it reasonable – are revenue/profit flows sustainable?*
- Market channels: *are routes-to-market clear, efficient and effective?*
- Customers: *are procurement threshold criteria satisfied – is substitution a threat?*
- Supply chain: *how does supplier/buyer pricing power compare – which party holds the ‘whip hand’?*
- Competitive advantage: *are strengths/weaknesses favourably balanced vs market rivals?*
- Business synergy: *are business units evenly matched with IP and resources shared?*

| Balance of Business Attributes | | | | | | |
|--------------------------------|---|---|---|---|---|-------------------------------|
| Positive | 5 | 4 | 3 | 2 | 1 | Negative |
| Market growth prospects | ✓ | | | | | Macroeconomic uncertainties |
| Customer relationships | ✓ | | | | | Sales/profit concentration |
| Sustainability, scalability | ✓ | | | | | Limited run-rate |
| Management capability | ✓ | | | | | Key people risk |
| Operational synergy | ✓ | | | | | Standalone products/customers |
| Branded differentiation & USPs | ✓ | | | | | Commodity replication |
| Distribution and channel reach | ✓ | | | | | Key dependency/limitation |

In presenting the final written business review, it may be beneficial to introduce a number of descriptive reporting models which serve to summarise the report’s findings and recommendations. For example, a ‘Traffic Light’ chart (shown) can help to portray the balance of the company’s business attributes and strengths. Alternatively, the business’s competitive standing

can be qualified in variant ‘traffic light’ models that serve to map ‘Commercial Risk vs Likelihood of Occurrence’ and ‘Industry Attractiveness vs Competitive Strength’. These provide a readily digestible view of the relative wisdom, benefit and risk associated with any alignment of the company’s trading activities to specific industry verticals and customer groups in competition with third party market rivals.

Demand is likely to remain extensively polarised in 2021 and beyond. Yet, as with all major challenges, there are, and will continue to be, new and profitable business investment opportunities. Given the scale of the continuing dislocation in markets, the need for detailed planning remains at the forefront of all decision making in these turbulent times.

For information about how Carlton Strategy Advisors can help you to assess business and market opportunity and attractiveness, please contact: David McClelland via carlton-advisors.co.uk