Carlton Strategy Advisors
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NEWSLETTER

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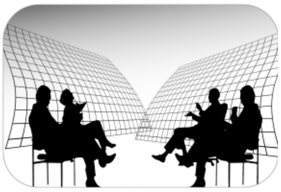
Translating business owners’ vision of opportunity and their backers’ language of risk

Business owners, investors and lenders are often not speaking the same language when talking to one another about company trading opportunity and risk, according to Carlton Strategy Advisors director, David McClelland.

There are three zones of interest that investors and lenders look at when sizing up potential transactions. They are:

- how realistic are the ambitions of the business’s management,
- is the level of strategic thinking in the team aligned and in tune with the market, and
- is the company’s competitive advantage sustainable?



All too often that common understanding between the parties is lost in translation because, where business managers see opportunity, investors and lenders see risk.

The role of the firm of commercial due diligence reporting consultants in an investor/investee transaction is first and foremost to be able to provide an independent ‘translation service’, having taken a pragmatic view of the issues that are truly important to the success of the deal.

Fundamentally, due diligence should always seek to identify the investee business’s competitive positioning within its industry sector supply chain; particularly in terms of relative market buyer-power and supplier-power, including the role and influence of agents and distributors as channel partners.

If business income is dependent on a concentration of key customers, the investor or lender will want confirmation that the commercial interface between the company and its most important customers will stand up to independent referencing? Can the drivers of the sales team’s expectation of a strong customer pipeline on which the revenue forecast, and therefore the investment case, is predicated be confirmed in a conversation with that customer’s purchasing manager or technical director?

An even more elementary question is whether or not those customers are the correct ones being targeted in the first place. Here due diligence would sit with the company’s management to discuss the processes by which business direction and strategy is set. Early questions might be around personal inputs into that process and how consensual it is between company directors and tier-II management. Further diligence will provide analysis of the business plan; how robust and evidenced is it across subjects such as the company’s understanding of the makeup of the marketplace, including the locations of market volumes from specific consumer groups and rival offerings from competitors? Do the rates of predicted growth stated within the context of a business plan or vendor’s memoranda stack up, and with what sensitivity and probability?

However, the scope of a due diligence project should be set to suit the deal’s complexity and the specifics of each investment opportunity.

In cases where the sector faces structural change or an investor, or lender, is not quite familiar with the industry a more broad-based risk and opportunity analysis may be required. Alternatively, early stage work may suffice in situations where an investment opportunity looks promising on the face of it, but a few key questions remain for the client's understanding and comfort before shaping further proposals.

Lastly, there can be special situations where the investee business is in some distress and in danger of breaching its banking covenants or missing a loan repayment, but the company's management believes that the difficulties are short term. Here, the due diligence assignment can be scoped to focus on the specific operational or strategic issues proposed by the management team to resolve the particular issues.

The languages spoken by business owner-managers and their financial backers may never be quite the same. Independent commercial due diligence can bring greater transparency and perspective to the deal process, facilitating the communication of transaction value and attractiveness between the parties - to the benefit of all.

If you would like to know more about how we may be able to support your assessment of business and market attractiveness,
Please contact: ***David McClelland, Director, via carlton-advisors.co.uk***