Commercial due diligence

Requirements and benefits, also for "strategic" investors

The market for business transactions in Germany has noticeably advanced since the middle of the year. The tenderers in this process include a large number of financial investors who primarily want to leverage their own capital with a more or less high level of external financing. This in turn increases the assessment requirements of the company that a financial investor wants to buy. In the meantime it is common that financial investors also commission management consultants in addition to financial due diligence and legal due diligence. These consultants must thoroughly examine the company strategy and analyse the diverse markets in which the company is positioned. However, "strategic investors", which are tenderers from the same sector as the company to be sold, can benefit from an intelligently developed commercial due diligence.

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A view to the future

The cooperation with a specialized consultant for commercial due diligence is entirely new territory for the majority of companies. Suddenly, one has to comment on their very own business, strategy and markets, which no-one has ever externally questioned in detail. Even if one would gladly forego commercial due diligence, it has key advantages – which have at least been confirmed afterwards by companies "affected".

Yet what really is a commercial due diligence? At its core it is the analysis and evaluation of different aspects of the company and its business field with a clear focus on the future. These range from relevant markets to the performance of the company and a strength and weakness profile. In all, it is a question of critically assessing the business model of the company and ensuring that it truly can be sustainably profitable. The higher risk for the capital investor in comparison to a traditional bank investment (keyword: liable capital) as well as the often complicated financing structure for large transactions with several banks and mezzanine investors explains the high initial analysis expenditures.

Vast amounts of data and little time

Commercial due diligence is much more than just purely compiling data. Within a short period of time – less than four weeks – the consultants must familiarize themselves with a previously unknown company and its business field. In a summarized report they will clearly demonstrate if and why the analysed company "is moving in the right direction". Such a report must therefore correspond with the high standards set by the risk department of the banks, that is, it must also withstand critical questions. It is important that the consultants express their opinion clearly – in the end investors and their banks want to know where they stand.

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If a partner starts a sales process, this, in most cases, brings a lot of work for the management of the company along with it and therefore deviates from their daily business. This includes – almost on a hourly basis – meetings with investor and banks, telephone conferences with the consultants for commercial, financial and legal assessments, so-called Q&A lists to answer more or less detailed questions which are sent back and forth, and the compiling of requested data by the consultants amongst much more.

As a consultant for commercial due diligence, a high level of sure instinct is needed. This requires good and close communication with the company, its management and the "neighbouring" team for financial and legal due diligence, in order to obtain the essential information for the assessment of a company and ensure its plausibility. However, this also serves as restricting the liability of the company. We have often seen that different consultants working alongside each other do not coordinate with each other and often ask the same questions or require the same detailed documents. The fact that this is neither in the interest of the company nor the investor, is evident.

Why not also for industry investors?

The ordeal for the company does indeed end at some point. If experienced consultants were working on commercial due diligence, the management will make their advantages accessible even though it may often be at a later date. In this way, the company receives an experienced, critical partner for the duration of the due diligence. This brings new aspects into discussion and sheds new light on the company. This can also give rise to decisive strategic impetus – the management does not only become irritated by overtime but is open to new ideas. Furthermore, the professional analysis creates a high level of transparency. At best, this can lead to an improvement of the financial conditions, as previously raised question marks can be eliminated.

Commercial due diligence is standard for most private equity investments. However, it is surprising that investors from the same industry as the company being sold, rarely fall back on this comprehensive mechanism. Of course, one knows their own sector, but does one really know the ramifications for the targeted company? Does one know all of their product brands and the regions served? Can this perhaps soon new investment really impose so easily on their own strategy? A large number of progress reports from companies and managers who are anything but satisfied with their new investment or their new parent company and expected everything to be quite different, speak volumes.

Conclusion

A commercial due diligence creates insights in a company which are extremely valuable for a responsible buying and financing decision both for private equity sponsors and strategic investors. The quality of the analysis is only beneficial, if it is presented as open-ended, that is, if commercial due diligence does not confirm a previously made purchase decision, but rather if it should result in a distancing from the investment. In order to make full use of all advantages, including a negative report, in the search for a “trusted advisor”, interested buyers should collect references from other investors and banks. The consultant should hereby have extensive experience in the differentiated analysis of companies and markets and not shy away from clear terms. It is better to have no deal than a bad deal.