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October 24, 2003

## **Sales and Marketing: Asking the Critical Questions**

by *Ellen B. Richstone*

Acquiring companies often hire outstanding lawyers and accountants to help with due diligence. That's fine for the legalities and the historical numbers. But what about the due diligence on the *business*? The normal assumption is that the acquirer should be able to handle that side of things.

However, it's been my experience that the right questions are either not asked or not asked correctly. Even if they do know what to ask, acquiring companies often don't pose the questions in the right way or follow up on the nuances of the answers they are given. The weaknesses in due diligence show up on all operational fronts – from sales and marketing to product design and development. For this article, I've highlighted sales, marketing, and product-related areas because they are a good proxy for the kinds of question depth and questioning techniques necessary everywhere and because the customer end of the value chain is arguably where the due diligence of acquiring companies can make the most difference - either way.

I've viewed the customer-focused areas through the five lenses that follow. I've added the accompanying checklist to help you dig more deeply than before. Of course, my grid can never point you to *all* the issues. It's up to you to customize the questions to suit your business and the business you intend to acquire. Let's look at the first factor:

### **Revenue Growth**

Acquirers absolutely must examine all available market data if they're to successfully evaluate where revenue growth will come from. If there's an assumption of significant strategic shift needed to win new customers, the prospective purchaser has to understand the implications of delayed market acceptance on the company's financial expectations (and ultimately cash flow).

It's crucial to determine whether sales are predominantly relationship-based and if so, for what kinds of contracts would the acquiring company have to keep the current sales force. If the target company's product is "designed into" another one, e.g., into the customer's product line – then the potential purchaser must review this design-integration process, evaluate the relevant timeline, and estimate what happens if the customer decides to "design out" the products of the company being acquired. It is important that the acquiring company interview the target's top six to 10 customers – involving objective third parties when necessary – to find out how happy they are with existing products and services and to get a sense of acceptance of planned new products. The questioning should also give clues to the quality of the products and to how well the target company keeps its commitments.

### **Pricing/Customer Commitments**

Pricing of products is critical, as is a full understanding of where the revenue growth (or decline) will come from in the future. A first step is to learn how the target company makes decisions on pricing. If a big customer calls the CEO, does the price change? If so, then have all customers been trained to call for extra discounts as the word spreads about making direct appeals to the CEO? Is the pricing policy adhered to by company officials? Are there any "verbal" or "side letter" commitments between the CEO (or salespeople) and the company's major customers? Perhaps one large client has heard about new product features in development, or has learned that price cuts could be forthcoming. How does the target company respond to that client's information advantage?

Better questions will help reduce risk to the revenue stream. For example, the acquirer should delve closely into whether the target expects any customers to request credits for sales already invoiced. Likewise, the right questions will help evaluate (1) whether there is risk related to quality issues; and (2) whether shipments have been either delayed or missed, and if so, what the impact has been on the customer base. Similar queries will get at quality issues from the customer's viewpoint – for instance, questions about sales force effectiveness, the process of product improvement, and customer satisfaction surveys.

### **Commissions/Sales Rep Issues**

Another line of interrogation will explore the sales commission programs – how they are set and how they're paid. Do the programs really align the sales force with the company's goals? It's no use trying to move customers to a new product line if the sales incentives reward a percentage irrespective of what product is being sold. Why is this such an important part of good due diligence? Frequently, a company is being bought for its future contribution. If newer products are not selling well,

it's crucial to understand all elements of (1) the market; (2) the selling mechanisms; and (3) the costing of the products.

The acquirer also has to ensure that sales commissions are being paid out appropriately. Take a careful look at the agreements with the sales reps and distributors. Examine any non-competition agreements or non-solicitation agreements for both reps and distributors so there's a clear picture of the implications. Finally, a diligent acquirer will learn a lot by closely scrutinizing sales-rep productivity statistics and looking for trends.

### Costing

When product costing is discussed, acquirers must ensure that costs are presented as "fully loaded" (with all known costs, including allocations from appropriate areas), as well as using the "incremental" methodology. Make sure that if pricing is done from time to time on an incremental basis, the overall price-versus-cost relationships are well understood.

### Customer Profitability

The best line of questioning will reveal the profitability of the top customers. It's vital to look for and evaluate trends within that customer set as well as within the pioneering customers who buy the target company's new product lines. If a decision has been made to go to market with unproven products and to take losses to win market share, the acquirer must scrutinize those market categories and customer subsets with extra care. There may not be an easy way to reverse such pricing decisions.

### Conclusion

The key to effective due diligence is to ask truly searching questions – not just the usual polite "boilerplate" inquiries. Practitioners must ask the same question from different angles and constantly probe for nuances and variations in the answers. Sometimes the acquiring company's staff can be too close to the issues or the business to be fully effective in due diligence. They may also "want to do the deal too much." It's in those situations that the pairing of an internal person with a trained due-diligence professional can help a company fully grasp all of the target company's business issues.

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### DUE DILIGENCE CHECKLIST

MARKETING and PRODUCTS		
	Data requirement	Status
A.	Provide a summary of major customers (minimum of 10) with associated percent of company's total sales for the last six quarters. Then conduct interviews (preferably by independent third party) with top six to 10 customers.	
B.	Provide a summary of sales backlog by major product line for current date and the comparable date from the preceding year	
C.	Provide a summary of company's pricing policy, including discount structure, OEM and end user pricing policies, and international pricing policy.	

D.	Provide for each product line/major product bookings and billings by quarter for the past eight quarters: 1. Profit and loss performance; 2. Major profit and loss line items	
E.	E. Provide an analysis of the possible loss of customers which may result from this acquisition.	
F.	F. Report on sales dollars and sales expenses per salesperson over the last three to five years, including a description of the compensation structure.	
G.	G. Report on customer service costs over the last three to five years.	
H.	H. Provide marketplace matrices by customer and products including captives, showing size, share, and competition.	
I.	I. What is the sales pipeline for new customers and/or sale of new products ( separate older vs. newer product lines)	
J.	J. What long-term contracts are in place?	
K.	K. Are you expecting any customers to request credits?	
L.	L. Where and at what level are customer's procurement decisions made?	
M.	M. How do you quote new business?	
N.	N. How is price established and negotiated?	
O.	O. What customer operating functions provide input to procurement decisions?	
P.	P. Do you have a contract review process?	
Q.	Q. On what basis are prices changed; how often; and are material and labor changes passed through to the customer?	
R.	R. How is non-recurring engineering (NRE) handled?	
S.	S. What risks are associated with present and projected customer base (describe the mix)	
T.	T. Identify new products planned for the next three years.	
U.	U. Evaluate remaining life of major products and technologies.	
V.	V. List marketing and sales department incentive programs.	
W.	W. Assess status and aging of company's catalogs, sales tools, service manuals, pricing sheets, part lists, and application	

	engineering manuals for customers.	
X.	X. Identify strengths and weaknesses of the marketing and sales departments and major improvements needed.	
Y.	Y. What are standard lead times quoted to customers for each product line?	
Z.	Z. What major factors determine lead times?	
AA.	AA. Do you have any ship-to-stock relationships with customers?	
BB.	BB. Do you have any just-in-time programs in place with customers?	

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