RACCA SOLUTIONS GROUP

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PROVIDING SOLUTIONS FOR PEAK PERFORMANCE

Value of Operational Due Diligence

Many privately held or family owned businesses are key targets for outside investors, such as private equity firms or family offices; particularly those that are experiencing tremendous growth and revenue gains. An influx of cash will go a long way in helping the company gain additional market share. On the surface, from the financial perspective, the outlook is promising. But often these companies have grown so rapidly that operational processes are minimal, the infrastructure is not sufficient to scale, tribal knowledge has not been documented and work is getting completed through brute force. The rapid pace of innovation along with the evolving expectations of customers, stakeholders and employees adds to the organizational inefficiencies.

While financial, legal and strategic due diligence are critical front-end planning and assessment activities for any merger or acquisition, approximately 70-90% fail, arguably because the investors lacked sufficient insight into the inner workings of the companies.

An operational deep-dive pre-acquisition will increase the chances of uncovering operational inefficiencies or flaws that may prove to be costly post acquisition. Having in depth conversations with all the key functional areas, including IT and HR, will provide tremendous insight into the key strengths and vulnerabilities. It will also provide a comprehensive roadmap for key initiatives to be focused on post-acquisition and ensure the acquisition is tracking to the investment thesis.

Through an operational due diligence, a PE firm gets a head start on pursuing savings immediately after the deal closes, having already identified and sized up the biggest opportunities. Freed-up cash flow from expanding margins can be used to aggressively pay down debt and invest in the business strategy.

The interplay between the two streams of due diligence is where cost and growth converge, this approach gives PE funds a better understanding of how much capital could be freed up to reinvest. Thus, operational due diligences can prove to be invaluable.

Case Studies - Vulnerabilities Uncovered During Diligence

- Master chemist has been a contractor for over the past 10 years and that none of their formulas have been documented
- Sales team members did not have non-compete employment contracts in place, the key salesperson, responsible for 80%+ of the sales, did not plan on staying after close of deal
- Payroll and work order labor were not connected, thus true labor productivity was unknown and burden rate had not been recalculated or adjusted in many years
- Finished goods were not readily identified or tracked; confirmed they would sit in WIP until shipment was made to end customer
- ERP system holistically was not functional and did not support the business as required, business architecture was poorly thought through and implemented - multiple instances deployed; making the system extremely difficult to manage
- Winning jobs at all cost was how the estimating team worked; actual cost was not considered and cost overruns were not part of the bidding and quoting process
- Customer change order processes were not fully developed; full revenue capture from customer driven change orders are not always fully realized and money was being left on the table
- No evidence of sales and operations planning methodology or processes being deployed; no true demand forecast given to the manufacturing and supply chain teams for planning purposes putting sales and estimating team at odds and making the ITO/OTR (inquiry to order/order to remittance) processes extremely fragile
- OTR process required reengineering and resource leveling; current processes are failing, process not sustainable nor scalable
- No job descriptions were found, no background or drug testing was being conducted, no performance appraisal process existed and no process existed for employee training record retention; bonus plan was informal and discretionary