DUE DILIGENCE GUIDELINES

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1 INTRODUCTION

The business enterprise has two and only two basic functions: marketing and innovation. Marketing and innovation produce results; all the rest are costs. P Drucker

This quote from one of the world's most prominent business academics may be somewhat prejudiced, but it illustrates the seriousness with which marketing should be regarded, whether in the business activities of the applicant company, or in the evaluation of the viability of that company.

The two elements in the Income Statement which are closely associated with the marketing function, are:

Sales

The total marketing environment, and the applicant's integrated positioning within that environment, will determine the sales which could be generated by the company.

The applicant's Income Statement is the most important document on which investment decisions are based. The Income Statement starts off with **REVENUE** as a top line. Without a reasonable expectation of revenue (or sales) a commercially oriented enterprise has no prospect of a future and its actual reason for existence disappears.

The level of sales also determines the level of activity throughout the entire company. Variable costs are obviously linked to sales levels, but even non-variable or fixed costs will in the longer run be determined by the expected sales levels.

The first and most important step in any due diligence process is therefore to obtain an accurate picture of past and present sales and to compile a reliable, best estimate budget for future sales.

Selling costs

Once the analyst approaches the finalization of the sales budget, he/she will be in a good position to understand which selling costs will be associated with the sales activities of the applicant. These costs may range from relatively insignificant in small engineering companies to hugely significant in the service industries.

A reliable selling costs budget, which is **not** merely based on a percentage of sales, is therefore an integral part of a due diligence study.

All the principles and activities discussed in this guideline document are aimed at a better understanding of the relevant marketing environment, the applicant's competitive position in that environment and, ultimately, the compilation of a reasonable sales budget on which the applicant can base his/her project. They also comply with the requirements of the and are in line with the steps it will take in compiling its own independent due diligence report.

2 NEED SATISFACTION AND DEFINING THE BUSINESS

One of the most important issues on which the marketing doctrine is founded is that of need satisfaction. Essentially a company does not sell products, but it satisfies needs. It is therefore important to understand the basic needs which give rise to the demand for a company's product and to understand how these needs are changing. It is also important to evaluate to what extent the company's products satisfy this need better (or worse) than its competitors' products. The satisfaction of a need is often not associated with the actual product which is offered, but with what can be done with that product (a drill and a bit satisfy the need for a hole in the wall). Furthermore, a need that a product satisfies may have little to do with the functionality of a product but may better relate to certain subjective values attached to it (e.g. a cheap car satisfies the need for transport, while an expensive car is bought for transport, comfort, image, and self expression).

<u>Analysing Need Satisfaction: defining a company's business</u>

The way in which a company defines its business has an important bearing on the competitive strategy which it will follow to survive.

If a company manufactures paraffin lamps, it can be in the lighting business or in the decorative business, or in both. Edison's experiments with electric light may therefore pose a severe threat, or it may be virtually irrelevant, depending on which business the company perceives itself to be in (or what need it tries to satisfy).

Are different needs satisfied by the same product?

If a company sells wood to a timber merchant on the one hand, and to a manufacturer of handmade furniture on the other, two totally different needs may be satisfied.

What is the source of the need for the company's product?

If nuts and bolts are sold to an individual, they will most probably be used for fastening purposes. If they are sold to an assembler of computers, the same individual may eventually buy the nuts and bolts as part of the computer, but he is not the source of the need for those products.

Is the need changing?

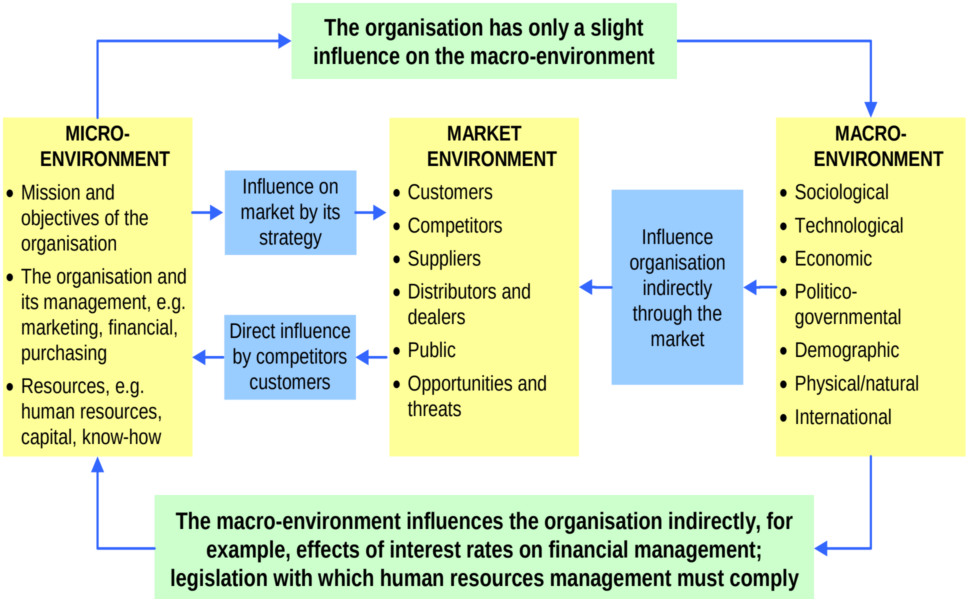
The nature or intensity of a need may change over time, e.g. in 1970 only a select few were using computers, but today almost everyone needs to know how to operate one.

3 THE MARKETING ENVIRONMENT

In a free market system, enterprises never exist in isolation. Events on national and even international level, may have a strong influence on an individual company. Conversely, actions taken by such a company may have an influence, not only on its own competitive situation, but on its market environment consisting of groups like competitors, customers, suppliers and distributors. The marketing environment is thus built on a total system of interdependences, which should never be ignored when one contemplates the future of an enterprise.

The marketing environment can be defined as the sum-total of the factors or variables that potentially affect the marketing of an enterprise's product or service and, therefore, influence the long-term profitable existence of the enterprise. These forces are internal as well as external to the enterprise

The Marketing Environment can be divided into **three sub-environments**, each characterized by a peculiar set of factors which influence the enterprise in different ways. The sub-environments also have an influence on each other, which again affects the enterprise.



3.1. MACRO ENVIRONMENT

The variables within the macro environment have a direct or indirect influence on the fortunes of the individual enterprise in ways that may be profound but sometimes barely perceptible by the company and its stakeholders. Listed below are the eight categories representing the macro environment. Bear in mind that the company has no control and negligible influence over these variables.

3.1.1. Sociological environment

People's life styles, habits and values, often formed by culture, change over time with a resultant change in their buying patterns. Factors such as more liberal attitudes towards religion, more working wives resulting in higher family discretional income and changing recreational demands, have forced companies to have new a look at the 7P's of their Marketing Mix.

3.1.2. Technological environment

It is obvious that technological innovation is the main driver of changes in product offering and that enterprises therefore must understand very clearly how these changes might affect them

It is not only the new competitive product (the calculator replacing the slide rule) which should be guarded against, but also the existing product out of new material (the wooden racquet replaced by the composite material racquet) and the method of manufacturing (the hand-controlled lathe replaced by the numerically controlled lathe).

3.1.3. Ecological environment

The ecology is becoming an increasingly important factor to be reckoned with in an enterprise's marketing strategies. The threat of pollution, the concern for earth warming, the fear of genetically modified foods and the increasing need to use recycled materials are serious considerations.

On the other hand, the use of eco-friendly materials (fake fur) and the production of organic foodstuffs can be to a company's great advantage.

3.1.4. Economic environment

Basic economic factors such as inflation rates, exchange rates, economic cycles and monetary and fiscal policy have a strong influence on the business and its community. Every due diligence should be considered against the background of happenings in the overall economy and any significant deviation from these macro-economic trends should be properly understood and motivated. Sources of this type of information will be discussed later.

3.1.5. Politico-governmental environment

The myriad of legislative prescriptions instituted by Government (sometimes with no political prescriptions and sometimes with strong political prescriptions) can have a profound influence on a company's marketing decisions.

Some examples are import/export control, local content, taxes, labour laws, privatisation and BEE.

3.1.6. Demographic environment

Examples of demographic changes are population growth, changes in compilation of population groups, population migration, changing family sizes and the devastating effect of HIV-Aids.

3.1.7. Physical/Natural environment

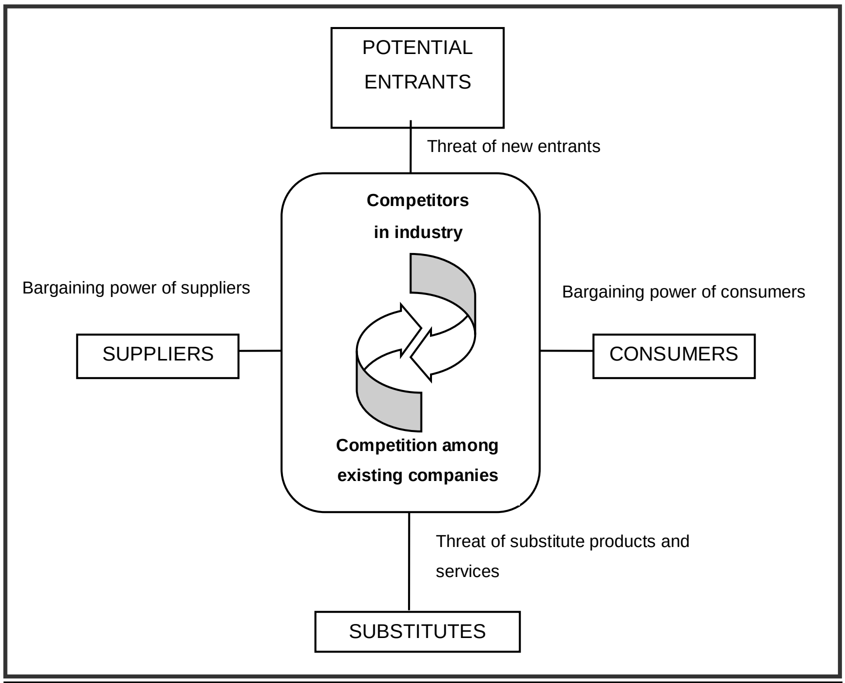
This consists of natural resources such as water, minerals, flora and fauna, as well as manmade improvements like infrastructure.

3.1.8. International environment

An enterprise that wishes to compete internationally must consider factors such as foreign political and legislative trends, the increased complexity of international trade and the competitive institutional strengths and weaknesses within those countries.

3.2. MARKET ENVIRONMENT

This consists of the variables which are present immediately outside the business in the traditional environment within which the business competes. The business has no control over these variables but can influence them to a limited extent by the way that it formulates its strategy.



Source: M Porter, Competitive Advantage: Creating and Sustaining Superior Performance

The collective strength of the five competitive forces in any industry determines the long-term attractiveness of that industry.

3.3. MICRO ENVIRONMENT

The micro environment is the business itself. Analysing the micro environment is analysing the internal functioning of the business. Top management of the business have control over this environment, whereas marketing management may have control over only some of the factors relating to marketing.

LIST OF A TYPICAL DIVISION OF RESPONSIBILITIES	
GENERAL MANAGEMENT	MARKETING
▪ Business objectives ▪ Business resources ▪ Funding ▪ HR ▪ Production ▪ Acquisition	▪ PR ▪ IT and systems ▪ Marketing objectives ▪ Marketing organization ▪ Marketing mix, i.e. product, price, promotion, distribution, marketing monitoring

Within this environment marketing management needs to identify the strengths and weaknesses in the company to proceed to the SWOT analysis.

4 MARKET RESEARCH

A variety of factors in the macro and market environments will have an influence on the well-being of the company, but information on these will mostly only be available from sources external to the company. A variety of valuable information is normally available from the sources discussed below.

4.1. MACRO ECONOMIC INDICATORS

For the analyst to better understand the macro environment in which South African firms operate, it is imperative for him to familiarize himself with the macro economic indicators pertaining to the country.

Various institutions publish such figures, but one convenient set of forecasts can be found on the website.

Other reliable sources could also be used since they seldom differ significantly in the presentation of macro-economic variables.

Any budgeted figures for the industry or the applicant, which deviate substantially from general forecasts, such as real growth (GDP), CPI and PPI should be backed up by good, reliable more specific considerations which relate to the specific industry, market niche or company.

In addition to macroeconomic forecasts on the internet, the following information is available within the ’s Research and Information Centre (R&I):

- Sectoral level forecasts
- Specific industry overviews or research reports (e.g. The Cement Industry)
- Country risk assessments
- Import/Export Statistics
- Tariff Structures
- Supply Side Measures
- Demographics

NOTE that R&I might not have the relevant information on your specific product or industry and that some of the reports (which can also be seen on the website) are for sale. To the extent that information is readily available, R&I is prepared to assist with enquiries from outside parties where an employer has made arrangements with the relevant personnel.

4.2. THE INFOCENTRE (THE ’S LIBRARY)

The ’s library is not a public one and will not generally make information, such as data bases, available to private individuals. They will, however, be prepared to point analysts in the right direction to obtain industry information.

4.3. THE INTERNET

Most present-day professionals are familiar with internet searches and you should use the opportunity to find information which might have been missed in the abovementioned steps. Some of the salient statistics supplied by the ’s InfoCentre (Borrowed from Brightplanet Corporation) is that (1) the best search engines can only access about 16% of the Web, (2) the Invisible Web is 500 times larger than the Visible Web, and (3) 95% of the Invisible Web consists of accessible information.

If you have a problem with information searches on the Internet, you could approach the Information Specialists in the ’s InfoCentre who have a good understanding of this process and could provide you with some guidelines.

If you decide to “Google” for information, you should at least also access **Google Scholar** (www.scholar.google.com).

4.4. OTHER SOURCES OF INFORMATION

RECORDED DATA	OBSERVABLE DATA	OPPORTUNISTIC
▪ Market research	▪ Competitors’ pricing	▪ Raw material suppliers
▪ Trade press	▪ Promotions	▪ Equipment suppliers
▪ Technical journals	▪ Patent application	▪ Trade shows
▪ Stockbrokers’ reports	▪ Patent applications	▪ Customers (enquiries)
▪ Annual reports	▪ Competitive advertising	▪ Packaging suppliers
▪ Public reports	▪ Sales force feedback	▪ Distributors
▪ Trade surveys	▪ Competitors’ products reverse engineering	▪ Sub-contractors
▪ Trade/Industry associations		▪ Internal newsletters
▪ Yellow pages directory		▪ Disgruntled employees
		▪ Competitors’ ex-employees

4.5. TRADE ENQUIRIES

The information gathered from company accounts, press reports and other published material as described above, form and integral part of the marketing due diligence and should always be brought into consideration. **Trade enquiries**, however, are obtained through personal interviews (either "face to face" or per telephone), usually with people active in the relevant market.

<u>Purpose of trade enquiries:</u>

- To verify (and/or update) information obtained from the analyst’s desk research and from within the applicant company;
- To obtain additional information not available from these sources;
- To obtain a qualitative perspective on the applicant from its current and future customers, its distributors and, if possible, its competitors.

Trade enquiries by an analyst are used mainly to obtain information on the following aspects:

1. Market size and growth. Usually more reliable the smaller the number of manufacturers and/or distributors.
2. Market segmentation by price, quality, geographical, or any other method required. Usually segmentation can be defined by a trade survey, but not as easily quantified.
3. Competition:
   - Current competitive manufacturers.
   - Potential competitive manufacturers (New Entrants).
   - Substitute products.

   In most cases trade surveys can identify these, and often give a reliable idea of relative strength and importance of competitors, and the prestige or goodwill enjoyed by each.
4. Marketing factors and competitive conditions.
   - Relative importance of factors such as price, quality, design, service, advertising, etc.
   - How the applicant rates against its competitors on each of these factors.
   - Degree of competition, trade agreements, (tacit or formal), general inter-industry and inter-trade likes and dislikes.

   The crucial role played by the trade survey is seen here again, where it is the only feasible way to obtain comprehensive information on these aspects.
5. Past, current and (probable) future trends.

   Whether such trends are determined by factors like general economic conditions, technological developments, fashion, government action, or competitive forces in the industry, they are, in most markets, usually best discovered, qualified and quantified through a trade survey.

6. Factors peculiar to the industry sector.

   In many market sectors some factor(s) peculiar to that sector, but unknown (and often unexpected) to the "outsider", may have significance to the marketing investigation. A trade survey will usually reveal or verify such factor(s) and often yield information by which the importance of such factor(s) may be assessed.

7. From customers and potential customers: Contracts, orders, letters of intent, verbal indications of future purchases. This information is used in the determination of the applicant's possible future sales. In the case of contracts, orders and letters of intent the information should be available from the applicant himself, but these should be verified with the customers. In the case of verbal indications, this must be ascertained by the analyst himself.

It is understood that the analyst will normally not have the time to conduct comprehensive trade enquiries, but he cannot only rely on desk top work and information received from the applicant. At least some form of trade enquiries should be used to gain more insight on some of the abovementioned elements which are regarded to be of particular relevance.

In the sections that follow, various combinations of "market research" will be used to arrive at the appropriate information in respect of the applicant.

5 MARKET DEMAND, GROWTH AND SEGMENTATION

A company's sales budget can never be seen in isolation from general conditions and trends in the market and it is therefore important that the company understands us much as possible of the larger market picture. Knowledge of market sizes and trends will enable it to select the most attractive markets and formulate the most appropriate marketing strategies accordingly. It is obvious that the same goes for the analyst in his evaluation of the company's marketing function and determination of the company's sales budget.

Definition: *Market demand for a product is the **total volume** that would be bought by a <u>defined customer group</u> in a <u>defined geographical area</u> in a <u>defined time period</u> in a <u>defined marketing environment</u> under a <u>defined marketing program</u>.*

From the above definition demand is not a nebulous concept but that it needs to be evaluated for a <u>defined customer group</u> in a <u>defined geographical area</u>. These phrases refer to the concept of <u>market segmentation</u>, which will be discussed later.

<u>Is market size important?</u>

Market size is normally the concept uppermost in the minds of people who conduct marketing due diligences and this question will always be asked of applicants for finance. The 's business plan guidelines also clearly require this information. However, the importance of market size tends to be over stressed, both in investigations and in industry. The question that should always be asked by all involved, but which is often overlooked, is **"what use will be made of the information?"**

Exact market size is often difficult to establish with accuracy. Order of magnitude can usually be established with relative ease from official statistics (e.g. production statistics, imports and exports). The margin of error, however, can be considerable. Remember also that the requirement is for demand figures, and not production or imports. A few markets can be quantified with relative accuracy: those where excise duty is payable and accurately recorded (e.g. petrol, cigarettes, etc.) and those where strong industry associations are responsible for compilation of statistics (e.g. new motor vehicles - NAAMSA).

The point to be borne in mind is that although market size is almost always uppermost when thinking of a marketing investigation, it is not necessarily the most important aspect to be covered, and is sometimes of little importance, whereas market growth and trends are usually, but not always, of major importance. Generally, from an due diligence viewpoint, the measurement of market size is more important to the case of a new company proposing to enter a specific industry, than in the case of a company with a history. In the latter case, inability to determine market size and thus the company's market share may not adversely affect the investigation at all.

A further problem relating to the establishment of market size is that the difference between actual and potential demand can be enormous. Any significant change in marketing strategies of existing producers, or new entrants with different approaches, may have a significant effect on demand.

An example often quoted is what happened to the SA ice cream market in the 1950's. Per capita demand was relatively low in comparison with the USA and the UK, prior to the entry by Walls and Dairy Maid who introduced vastly improved marketing techniques (range, packaging, distribution, advertising and promotion). Per capita consumption almost doubled in less than a decade.

5.1. MARKET SEGMENTATION

Human needs, and therefore markets, are not homogeneous and require a different offering for every identifiable group of needs. In an ideal situation a marketer would want to be able to respond to the unique needs of every potential customer with a unique **marketing mix** (the four P's). Since such an approach is totally unrealistic, marketers must generalise about the needs and wants of groups of consumers within a heterogeneous market, select a limited number of attractive segments and concentrate their efforts on those groups with custom designed product offerings. The analyst must endeavour to segment the market meaningfully to assist the applicant in better understanding his market.

5.1.1. Advantages of market segmentation

- It allows more accurate determination of the market size relevant to the applicant;
- It enables marketers better to focus on customer needs and to develop separate market offerings and strategies for different market segments;
- It could assist marketers to identify new market opportunities which might otherwise have remained untapped; and
- It can help with the proper allocation of marketing resources. (Large, growing segments would probably require more resources segments with dwindling demand).

5.1.2. Prerequisites for effective market segmentation

For market segmentation to be meaningful, it should meet the following criteria:

- It must be **measurable**. If the size, purchasing power, growth and characteristics of the segment are not measurable, its attractiveness cannot be compared to other segments.
- It must be **large enough**. If a segment is too small, it is not profitable to pursue.
- It must be **accessible.** A marketer must be able effectively reach a segment promotionally and serve it physically.
- It must be **actionable**. It must be possible for the marketer to formulate and implement different market offerings for different market segments.
- It must be **differentiable**. People in different segments must have different needs and respond differently to different marketing mix elements. If a promotional campaign on a cosmetic range elicit the same response from women aged 30 to 40 and those aged 40 to 55, they do not constitute two market segments.

5.1.3. The importance of accurately defining a market.

Before attempting to quantify market size and growth, determine in what market(s) the company competes. This is important, although not always obvious. An example will illustrate the point:

A new company intended entering the South African spanner market (open-ended spanners, ring spanners, socket sets, etc). Budgeted sales amounted to about R2.5m p.a. Annual demand (supplied entirely by imports) was estimated at about R17m p.a. The company was aiming to achieve a market share of between 14% and 15%, which did not appear unreasonable. Deeper investigation revealed however that the spanner market was divided into distinct sectors:

<table>
<tr><th colspan="3">Total market (ca R17 mil)</th></tr>
<tr><td>Government Demand</td><td colspan="2">Private Sector Demand (ca R15 mil)</td></tr>
<tr><td>(ca R2 mil)</td><td>High Quality Sector
(ca R11 mil)</td><td>Cheap, Poor Quality Sector
(ca R4 mil)</td></tr>
</table>

The requirements of each sector differed materially:

High quality sector: Dominated by four well-known brands. Brand-name is of importance, as apprentices tend to follow journeymen in this respect. Sets of spanners are usually bought by artisans and replacement spanners are nearly always of the same make, so as not to break the set. Quality (both physical strength, accuracy of design and finish) is of major importance, as is product range. Price is relatively unimportant.

Although the company's product was far cheaper than the brands dominating this market, and quality was physically acceptable (i.e. regarding strength and accuracy of design), the company could not compete in this sector, due to having an unknown brand name, not being able to supply full sets (i.e. product range was incomplete), and the finish of their spanners (chrome plating) being unacceptable.

Cheap, poor quality sector: This sector comprised laymen, requiring odd tools for a single, non-recurring job. This sector was supplied mainly by chain stores (Hypermarkets, Checkers, etc). The sector is characterised by poor quality (both physical, accuracy and finish) and very low prices.

Although the quality of the company's product was far superior to competitors, this was an unwanted feature which did not warrant a relatively high price. The company could not compete in this sector on price.

The company could consequently only compete in the **Government market sector**, for whose requirements it qualified. Budgeted sales of R2.5m pa however, exceeded the total annual demand of this sector, and were clearly impossible.

Many points are highlighted in the above case:

- the example is one where market size is important (primarily because of an absence of sales history);
- the definition of market sectors can be critical;
- marketing is an integrated concept and no one facet can be viewed in a vacuum. In the example, marketing factors (quality, brand name and price) had a definite bearing upon market size determination.
- a company's market share usually depends upon the extent to which it can fulfil market (sector) requirements and these requirements may totally exclude the company from certain markets.

5.2. MARKET SHARE

To make an investment decision it is very seldom necessary to know exactly whether a company's market share is 7% or 10% or 13%. It is, however, necessary to know the percentage range, i.e. the company has a 7% to 13% market share. If the company is a major supplier it becomes more important to determine market share with greater accuracy, because the larger the market share, the more difficult it becomes to gain additional market share. It goes without saying that, if it is difficult to determine the market share of the analyst’s client (the applicant), it is much more difficult determine the market shares of the applicant’s competitors or potential competitors.

What is important, however, is to ascertain whether market share during past years has increased or decreased, i.e. a measurement of performance. This can usually be determined by investigating market growth relative to the company's sales. It is surprisingly often possible to determine the growth rate of a market within acceptable limits of accuracy without knowing its exact size, e.g. where the development of a market is closely coupled to, and directly influenced by the growth or decline of another quantifiable market or economic indicator; or where a good cross section of the players in the market can supply growth rate figures based on their sales of the relevant product.

Market share fluctuations. If the applicant's market share has shown historical fluctuations, it is important for the analyst to investigate the reason for these fluctuations. This might point towards strengths on which the company could capitalize in future or towards weaknesses which it must address. It will also be a determinant in compiling a sales budget.

General hints:

- decide (as always), before embarking on exhaustive research, what use will be made of the information;
- try to assess the limits of accuracy obtainable and relate these to the degree of accuracy required;
- always clearly define what is meant by "market", e.g. actual market, potential market, a specific market sector, etc;
- remember that market size measurement is largely a means towards the determination of growth and evaluation of the figures. Statistics alone have no value - conclusions must be drawn.

6 ANALYSING COMPANY RECORDS

Up to this point the information gathered has not been dependent on the records of the company itself. If the project is a green-fields one, there will be no historical information to analyse and the applicant and analyst must decide on the most appropriate way to prepare a spreadsheet for the company's sales budget. If, however, the company has been in existence for some time, the existing information must be used as a starting point in the budgeting process.

The purpose of this analysis is to use all the hard information in the company to identify trends in the activities of the applicant. The identification of significant changes and the reasons behind such changes could reveal much about the wellbeing of the applicant. These reasons must be considered when the analyst looks at the future of the company. This information could also be used as a basis to build sales forecasts and identify areas of potential risk.

The format in which the requires the information of the applicant, will become clear from this document. If proper records exist, this exercise should be relatively simple, although it is regarded as **crucial.** If the applicant has managed to survive without proper records, the analyst will have to spend considerable time in assisting to do a proper analysis of historical figures.

If the company's records allow it, the spreadsheet should cover at least the previous two years and the current year monthly, or on a quarterly basis. The analyst should attempt to analyse the information in the most detailed way which is still practical in terms of the time available for this exercise. The following information can usually be extracted from an analysis of historical figures. It will also form an integral part of the budget spreadsheet that needs to be submitted to .

- Sales Analysis

Analyses about seasonality, product split and price trends could be incorporated into one spreadsheet from which final presentations could be extracted in summary form. Analyses of customer spreads normally (but not necessarily) need to be done in a separate spreadsheet to avoid too much cluttering. This all depends on the preference of the marketing analyst and his proficiency in Excel.

  - Seasonality

    Although the analyst should attempt to understand the spread of sales throughout the financial year, this aspect is especially important in the case where strong seasonality of demand is suspected. Examples of such industries are textiles, clothing, agricultural implements, gifts and tourism. Such fluctuations not only put a huge burden on the company in respect of working capital, but also require good planning in production and labour requirements. Companies with solid profit margins sometimes go under because of the inability to handle production and working capital fluctuations.

The analyst should attempt to analyse sales figures from the previous two full financial years and the interim period in the current year. If information, dating further back, is readily available, this should also be analysed, always bearing in mind that the most recent information should carry the highest weighting.

If sufficiently reliable sales information is available over a period long enough to establish a sales pattern, this pattern must be used for forecasting sales, for reasons mentioned above. One should, however, always bear in mind that different products may have different seasonality and that new products may bear no similarity to existing ones. If it seems important, overall seasonality might have to be analysed, based on the seasonality of the individual products. Also, seasonality is not a forecasting technique per se, but an indication of how sales should be spread over a period.

The ease with which the information can be accessed, and the time spent on the analysis must always be weighed up against the relevance of the information for the budgeting process. This should also determine the detail in which the analysis is done.

- Product mix

  Discussed later

- Price trends

  The sales analysis, where rand values and volumes are available, will give an indication of the average selling price per product and the changes over time. Comparisons with inflation rates or PPI will be helpful to determine future price increases, especially where projections of those Macro-economic and Sectoral level forecasts are available from outside sources.

  Note that average prices calculated in this way may not agree with published prices, or prices quoted by management, because these will not include discounts to certain customers.

- Customers

  Discussed later

- Advance orders

  The company's current order book and the history of the order book should be examined. The actual sales that resulted from these orders at prior stages should also be calculated. If there is some consistency in this figure, it will be an indication of how to treat current and future orders.

  The sales budget for the first few months of the budget period could sometimes be based on the orders on hand at the time of the investigation. The prerequisites are, of course, that forward orders represent a sufficient percentage of sales and that the examination of previous order books has indicated that a significant proportion of orders do culminate in sales.

  Forward orders, even so called confirmed ones, are notoriously unreliable and they should never be accepted blindly. Confirmed orders could be cancelled legitimately. (e.g. agriculturally related products during periods of drought, and factory supplies during breakdowns

  The delivery times of the orders should be noted, since this might represent a lean short-term sales picture although actual order values might be substantial. Moreover, if the value distribution of the orders is skewed, the company might be too dependent on one or two large orders, with the resultant exposure to risk.

- Geographical spread

  It is important to understand how a company's products are bought on a geographic basis. This consideration becomes more important when the transport cost of the product is relatively high and where factors like quick delivery and after sales technical support point towards locational advantage.

  It is also possible that the buying power in certain target areas is substantially different from the buying power in other areas, and that the buying behaviour differs between areas, to the extent that different marketing strategies must be adopted.

  Although geographic spread may not be the best way to segment the market, a clear picture of applicant's geographic sales should enable the analyst to compile more accurate budgets, both in terms of revenues and costs.

  The geographic variable that will have the most significant influence on the budgets is, of course, **exports**, provided that it represents a significant proportion of sales. Export business should always be split out from local business and its sales and cost trends examined separately. Budgeting for export sales is usually more complicated and based on less information. Every bit of in-company information that is available should therefore be used.

- Analysis of selling and marketing expenses

  This information will form the basis of the cost budget. Make sure what costs will be included in other cost categories (e.g. packaging under raw materials and sales staff remuneration under salaries and wages) so that double counting can be avoided. You should analyse the information from the applicant's financial statements for at least the last two years, and even further back, if possible. If it is a start-up company, these records will obviously not exist.

  Since this information will later be used as a point of departure for the forecasts you need to ensure that you are building on a reliable foundation.

7 PRODUCT BREAKDOWN

Product mix can be defined as the indication of the percentage contribution that each product or product category makes to the turnover of the company.

Kotler and Keller maintain that marketing people are involved in marketing 10 types of entities: goods, services, events, experiences, persons, places, properties, organizations, information and ideas. 's activities revolve only around the first two. In both these arenas an analysis of the company's products (or product groups) on the time basis described above, will yield some very important information. (2 years or more, plus interim for current year)

It will reveal which the important products are and how their contribution to turnover has changed over time. The importance of products or product groups to the company can be evaluated and compared to the effort which the company puts into the marketing of these groups. Their sales growth can be determined and compared to market trends in order to determine whether market share has been lost or gained.

The breakdown of the company's products into individual products or product groups will be a subjective one, depending on the number of products or product lines, and the extent to which their individual characteristics can be grouped together. The analyst should work jointly with the applicant to determine the most meaningful way in which to split product groups.

Any fluctuations in product mix need to be investigated and understood so than an explanation can be presented to . It might be something as easily explicable the introduction of a new product, but it could also point to deeper seated problems with specific products within the applicant company.

As said before, the current product mix will be a starting point for the budget.

It is **<u>important</u>** to understand that a product mix can only be calculated on, and expressed in, Rand values and never on volumes.

Product life cycle

The product life cycle (PLC) is a concept used to describe how sales of a product vary over time from its introduction until it eventually fades into obsolescence. The company must adapt its differentiation strategy and positioning as the market environment changes over the PLC.

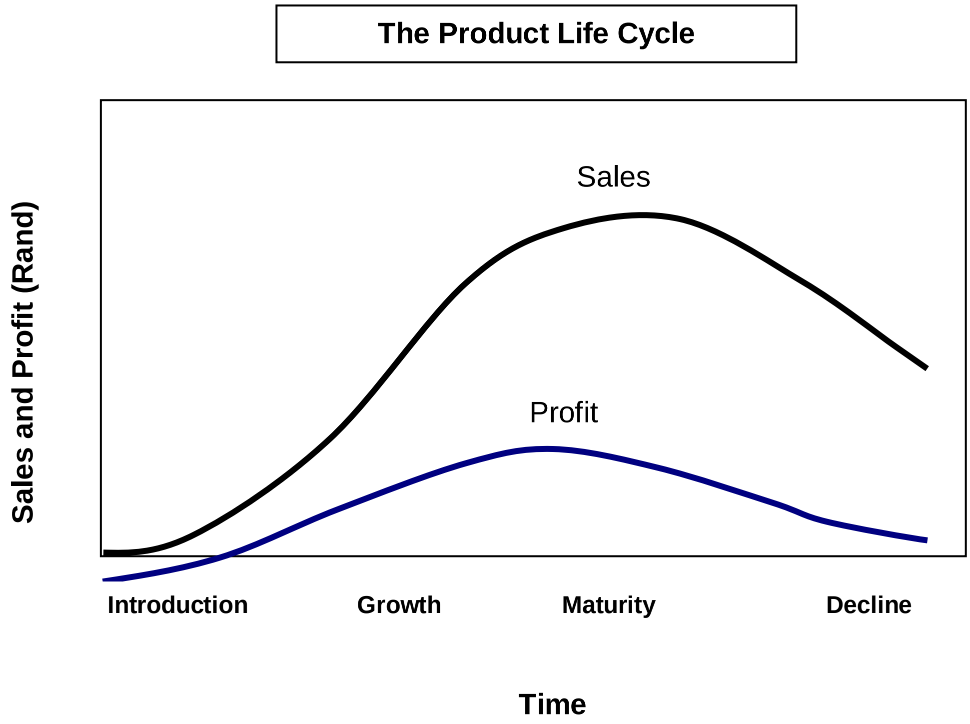
Acceptance of the idea of the PLC implies the acceptance of three associated ideas.

Products have a limited life;

Sales pass through distinct stages, each with its own opportunities and challenges;

Profits are influenced by the different stages of the PLC; and

The figure below portrays the typically accepted shape and the four phases of the PLC.



Introduction. Initial stage of low sales and slow adoption rate, as the product is introduced in the market. Profits are low, or negative, because of the high cost of introducing the product.

Growth. Period of rapid sales growth and decreased costs, resulting in profit improvement.

Maturity. Period of stabilisation, and even decline, in sales, as the product has penetrated the market to most potential buyers. Increased competition will start exerting downward pressure on profits.

Decline. Decline in sales and profit.

The PLC does not only have to be applied to an individual product. It could be used to analyse a product category (liquor), a product form (grape based liquor), a product (brandy) or a brand (Klipdrif). The PLC’s time line could vary considerably. Consider the life span of Ouma Rusks, first baked in Molteno, Eastern Cape, 80 years ago with an loan, and still going strong today. Against this, the PLC of the 5.25-inch floppy disk was hardly five years.

8 SUPPLY ANALYSIS

Competitors

The assessment of the current and future competitive situation in an applicant's market is one of the key issues of the marketing investigation. Although it may appear straightforward to identify a firm’s competitors, the boundaries of competition, and therefore all potential competitors, can be difficult to identify. A definition of competition as only those enterprises that produce similar products will severely hamper the company’s ability to compete in the market. Refer to *Need Satisfaction and Defining the Business.* Competitors can be identified along two axes. The first axis is based on **product characteristics**. Manufacturers of beer do not only compete against other beer companies, but against suppliers of wine, spirits, soft drinks, milk and even water.

The second axis is based on **presence in the industry**. Competitors who are already in the industry can probably be identified with some imagination, even if they supply substitute products. Their actions would normally be somewhat predictable. Latent competitors, who plan to enter the competitive arena, whether with a similar or a substitute product, have the potential to damage the company more severely since their actions cannot always be predicted. The increased competition is also difficult to anticipate. Examples are the introduction of the City Lodge Hotels, which revolutionized the hotel industry, and entry of Wal-Mart in the US which severely affected the fortunes of Sears.

The purpose of this analysis is to understand the strengths and weaknesses of the key competitors and to be able to anticipate their reactions to strategic marketing moves by the applicant. This information will be both quantitative and qualitative

A full-blown competitor analysis should be part of a company’s periodic marketing audit, and re-evaluation and formulation of its marketing objectives and strategies. It will mostly not be possible for either the analyst in compiling a business plan and an application, or the , in conducting its due diligence. The analyst should, however, be aware of all the potential sources of information that could help him to support the applicant and compile more reliable budgets.

This section provides hints concerning the identification of competitive organizations and products.

The importance of indirect competition

The greatest level of competition that a company might experience often does not originate from its obvious competitors (i.e. similar companies producing similar products). This competition could be generated by substitute products or by companies active in another industry sector. The following are examples of indirect competition:

- A foundry supplies brake drums to vehicle assemblers. Direct competition is provided by other local foundries as well as by imports. Under the Motor Industries Development Programme (MIDP) however, all other motor vehicle components provide indirect competition, because the measured local content is based on value, which can be achieved by using different combinations of locally produced components. Products with a higher proportionate unit value to the total value of a vehicle might therefore be preferred to brake drums as local content components.
- A company manufactures steel pipes. Indirect competition will include manufacturers of plastic pipes and of fibre-cement pipes. Both these groups must be included in an assessment of the competitive environment.
- A manufacturer of wooden parquet flooring does not only compete with other manufacturers of the same product, but with manufacturers of all types of flooring, i.e. carpet manufacturers, ceramic tile manufacturers, manufacturers of vinyl flooring, etc.

It is therefore clear that competitors must be identified both from within the company's own specific market sector (direct competition) and from analogous market sectors.

The analysis of indirect competition should, however, be kept within the bounds of practicality, especially in respect of consumer products where a wide range of products and services competes for the consumer's discretionary income. This range expands dramatically the more luxurious the product or service becomes, e.g. with R750 000 the consumer can either buy a relatively luxurious motor car, or a cheap car and an overseas holiday, or furniture, etc.

The number of competitors could give an indication of what might be an acceptable market share when investigating a new undertaking. The new entrant to a market sector already contested by 24 competitors, can possibly expect to gain a 4% market share. This merely serves as a kick-off point. Further investigation will be required to determine how the market is currently divided between the existing 24 competitors. Who has 4%, or 0,4%, or 40% and why? The applicant's competitive ability must be compared qualitatively with the existing prosperous and ailing companies respectively, and from that it must be attempted to estimate an achievable market share.

Location of both the factories and branch offices of competitors. IMPORTED products supplied by competitors, should be given special attention. Geographical location relative to markets is often important, e.g. where regular technical services or regular deliveries on short notice from the customer is required. Local organizations normally have an advantage over overseas competitors under the aforementioned conditions, except if the latter carries stock locally.

Split of competitors' turnover into exports and local sales. It could be important as the largest local manufacturer might export the bulk of its production with only a small amount being marketed locally.

Major sources of information in respect of competitors – Refer to *Market Research.*

Although obvious threats from latent entrants or competitors with substitute products should be taken into consideration (not only to compile a reliable sales budget, but also to assist the applicant in his planning), analyses (spreadsheets) by the analyst will normally only contain competitors. Which supply products in direct competition to the applicant. This is also what the ’s business plan will require. It is often quite impossible to make reliable estimates on market shares, especially in markets where the market size itself is difficult or impossible to ascertain. In such cases competitors should be identified and order-of-magnitude estimates given. For example; *Company A, geographically the applicant’s closest competitor, has grown from very small to about 1,5 times the size of the applicant.* Moreover, in such cases past, current and future market shares are virtually meaningless and there should be concentrated on the current situation. It is better to give rough indications than to preach obviously unreliable figures as gospel.

Barriers to entry

Barriers to entry are those factors which make it difficult, if not impossible, for a company to enter into a new market

EXAMPLES

- High capital cost
- Know-how required
- License or patent right required
- Access to raw material
- Legislative prescriptions (especially internationally)
- Cultural barriers
- Market structure
- Collusion
- Market size
- Language
- Imbalance between orders and company supply
- Infrastructure
- Quality requirements (Japan)
- Geographic

When barriers to entry are high and exit barriers low a sector can generally be regarded as attractive, since new entrants are discouraged while it is not too expensive for existing competitors to exit from that sector. When the converse is true, companies should carefully review their presence in those sectors, since such sectors are normally plagued by chronic overcapacity and resultant low margins.

Product differentiation

A marketing process that showcases the differences between products. Differentiation looks to make a product more attractive by contrasting its unique qualities with other competing products. Successful product differentiation creates a competitive advantage for the seller, as customers view these products as unique or superior.

Product differentiation can be achieved in many ways. It may be as simple as packaging the goods in a creative way, or as elaborate as incorporating new functional features. Sometimes differentiation does not involve changing the product at all but creating a new advertising campaign or other sales promotions instead. ***Investopedia***

When the analyst evaluates the product policy of the applicant the level of product differentiation in the industry sector could provide a good indication of the importance of product differentiation as an element of the product policy. Examples of product differentiation are:

- Lawnmower motors: The price of a 2,6 Kw lawnmower motor may vary between R1 500 and R5 000 which indicates extensive product differentiation.
- Broiler chickens: The price of broiler chickens varies between R12 and R14/kg and all broiler chickens are marketed as Grade A. There is no product differentiation and price differences are related to other elements of the marketing mix.

Differentiation is a prerequisite for products if they are to be branded. Physical products vary widely in their potential to be differentiated. Washing powder, for instance, offer little opportunity for differentiation, yet brands like Omo and Surf feature strongly in the South African consumer market. Products like motorcars, on the other hand, offer a wide range of possibilities for differentiation.

Typical parameters on which physical goods can be differentiated are form, features, performance, conformance, durability, reliability reparability and style.

The analyst should evaluate the extent to which the applicant’s product/s are or can be differentiated from those of competitors, since this will form part of the applicant’s comparative advantage and influence the sales budget.

Substitute products

Substitute products, serving essentially the same function as the products of the applicant must be regarded as a second source of competition. As illustrated in the diagram on Market Environment the threat of substitute products is identified by Michael Porter as one of the major competitive threats in the market environment.

The existence of viable alternative products in an industry sector will influence the attractiveness of that sector, especially if switching costs are low. Train passengers might consider air travel or bus transport as an alternative, while gym goers might be attracted to running clubs or spinning labs if gyms become too expensive.

A substitute could be an improved product or a different product, for example, milk cartons could be threatened by better designed cartons, or by plastic bottles and plastic bags, as has been demonstrated in South Africa. The threat to the applicant’s product will depend on:

- The buyers’ willingness to substitute

- The advantages of substitutes over traditional products
- The relative price & performance of substitutes
- Image / identity of substitutes
- Switching cost influences sector attractiveness as indicated before

He analyst must investigate the possibility of substitute products which might threaten the future of the applicant’s own products and thus influence the sales budget. This information will be required by the .

9 CUSTOMER ANALYSIS

The starting point of this analysis is the exercise described in: Analysing Company Records. If the sales analysis discussed there, could be further split into individual customers, the analyst would have some very detailed information at his disposal. He would than have the entire recent sales history of every customer for every product, together with seasonality and price trends. Time would normally not allow for such detail. **However**, in the case of large financial deals, where there are relatively few customers, this kind of detailed work may be required.

A spreadsheet should normally show about 10 to 20 top customers (with the rest lumped together) and their % of turnover over the analysis period.

The most important task here is to determine how the applicant’s sales are spread over its major customers or groups of customers, how this has changed over time, and, if so, why this has happened. If a few customers constitute a large proportion of the company’s sales, this presents an area of risk which must be addressed. If this customer mix has changed recently, an even more careful analysis is required.

In cases where applicants are dependent on a few large customers, the relationships with these customers should be investigated. Their views on the market trends, prices, competition and their continued business dealings with the applicant are of crucial importance to the applicant’s future. **Personal contact** with such customers by the analysts is therefore important.

The applicant’s customers and potential customers constitute the most fertile area where outside enquiries can be conducted, and attention should be given to their views. Bear in mind that sales budgets are often partly supported by indications of future purchases by larger customers, especially in the shorter term.

The will require this kind of information and where sales budgets are based on contracts or letters of undertaking form current or potential customers, this kind of analysis is needed.

10 DISTRIBUTION CHANNELS

Marketing or distribution channels serve to move products from manufacturers to consumers. A typical distribution chain will include a manufacturer, wholesalers, retailers, all of which are distribution channels. A significant portion of manufacturers will use marketing intermediaries because it is often costly and impractical to set up own distribution networks.

Please note that a distribution channel is a marketing operation and not the physical transportation mode of the product, i.e. road-, rail- and air transportation are not distribution or marketing channels, they are physical distribution systems.

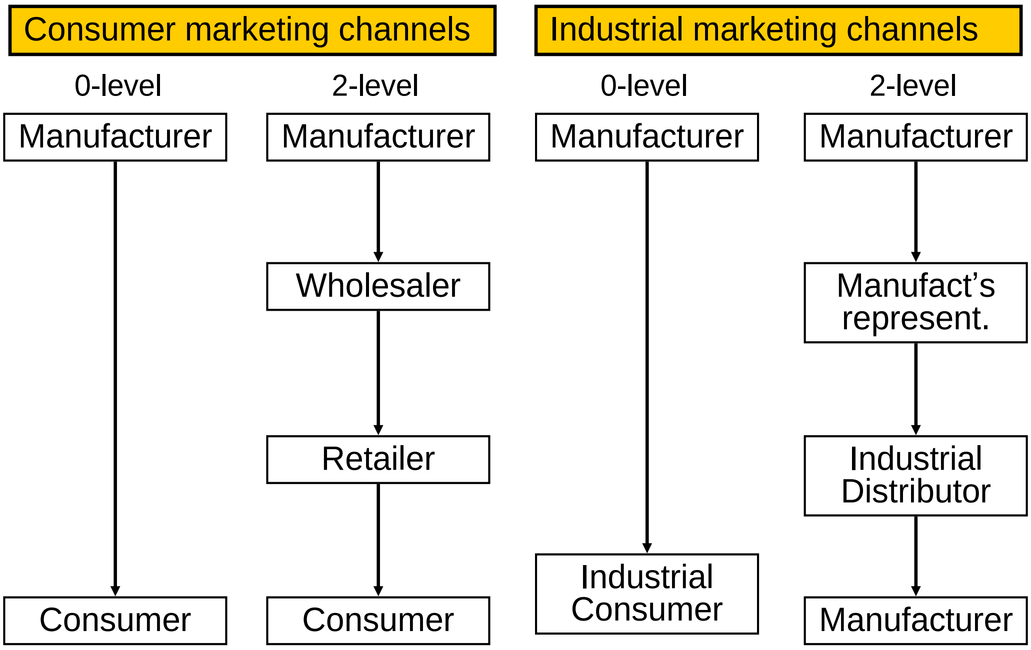
The analyst should determine the applicant's distribution network and, in cooperation with the applicant, decide whether that network is suitable for the industry sector in which the company operates and whether its is adequate for the effective marketing of the product. The , as part of its due diligence, would be interested to understand the distribution channels used by the applicant. The use of certain distribution channels may also be an important part of the marketing mix, i.e. the marketing strategy which the applicant uses, or plans to use, in his competitive drive.

It is sometimes preferable to use more than one channel if there is no clash of interest between channels, e.g.;

a clothing manufacturer selling to formal retailers and at the same time marketing direct to the public through its own retail outlets, could encounter resistance from its retail store customers because of the obvious price advantage that manufacturer would have.

a rose grower could sell blooms on the flower markets to retailers and could also sell substandard blooms direct to the public through a farm stall and to roadside hawkers. The latter two channels sell a different standard product to impulse buyers that might otherwise not have bought roses at all and therefore do not compete head-on with florists and other formal retailers.

EXAMPLES OF DISTRIBUTION CHANNELS



11 THE MARKETING SYSTEM

11.1. MARKETING OBJECTIVES

A company's marketing objectives define where it wants to be in future relative to its current position in the market place Objectives are meaningless unless they are expressed in terms of quantity and time.

The investigation procedures followed by reflect an expectation that applicants will have well defined marketing objectives and strategies. This will not always be the case and has investments in many concerns that have only an intuitive feeling for these issues yet are very profitable. The lack of properly defined marketing plans will therefore not necessarily disqualify an applicant for funding, but it would merely be assessed as a potentially additional risk. If objectives are not explicitly expressed by the applicant, analysts should attempt to assist the applicant in doing this. Such objectives could be optimistic, but they should be reasonable. Well defined objectives will always help the applicant in better devising strategies and plans for his firm. Objectives which bear little relation to reality is of no use to anyone and, if expressed to , will reflect badly on management.

Examples

The applicant wants to increase its market share in the PWV-region from 20% to 30% over a three-year period.

The company wants to export 30% of its production within three years.

The company wants to expand its product range of men's casual trousers to include jackets and suits over the next four seasons.

The company wants to expand its geographical distribution area, currently limited to the PWV, to include the whole of South Africa by 2006.

11.2. MARKETING STRATEGY

Marketing strategy is. by definition, a target market and a marketing mix comprising a specific combination of product, price, promotion, place, and people (See below)

Marketing strategies can also be seen as the actions that a company takes to achieve its marketing objectives. These actions could include, amongst others, the reduction of prices, improvement of product quality, developing closer ties with customers, making products more widely available by increasing distribution channels, speeding up delivery times by improved production planning, or by providing better after sales service.

Strategy is a means of differentiating the company, its products and its service in the eyes of the customer, to attain the set marketing objectives.

THE MARKETING MIX

Element	Example	
Product	▪ New products ▪ Discontinued products ▪ Product characteristics ▪ Technology improvements	▪ Service ▪ Branding ▪ Etc
Price	▪ Price level ▪ Price adjustments ▪ Discounts	▪ Credit terms ▪ Etc
Place	▪ Distribution channels ▪ Physical distribution network ▪ Etc	
Promotion	▪ Advertising & promotion changes ▪ Sales force ▪ Etc	
Marketing organization	▪ Training ▪ New appointments	▪ Organizational structure ▪ Etc

If any of these strategies, or ones not mentioned, are applied by the applicant, or will be applied, the analyst should consider their effect on the sales budget and include them in the business plan submitted to . Such actions will not only affect the sales but will also have cost implications for the applicant.

12 EVALUATION OF MANAGEMENT

It has always been the view of the that it does not invest in enterprises: It invests in management. The entire investigation of a business proposal is in effect an investigation of the applicant's managerial ability. The final decision in respect of any proposition is either an expression of confidence, or the lack thereof, in the management of the company. In view of its development role, will not necessarily walk away from a firm where management is considered weak, but stringent conditions precedent could be set to strengthen management before any investment is made.

Since the management function is essentially the determining factor in the success and efficiency with which production factors are applied in a company, the evaluation of such management is one of the most important considerations in risk evaluation.

A competent management team is the best security for participation in any type of investment. The therefore considers it important that its teams evaluate management to the best of their ability. Management is made up of people who, in turn, must employ other people to run every facet of the organization. A company is therefore comprised of people, and the investment decision is, amongst other things, based on the investigation team's opinion of the collective strength of all these people.

It is not the analyst's responsibility to prevent an applicant from approaching if he considers management to be inadequate. He should, however, assist the company in **identifying and addressing any actual or potential shortcomings**. This would not only facilitate support, but will obviously also be of help to the company itself.

Following below are concepts which might consider in its evaluation of the company's management strength.

What generally constitutes good management?

TANGIBLE ISSUES	FUZZY ISSUES
A complete team	Vision
Industry experience	Leadership
Successful track record	Intelligence
Right age group	Entrepreneurship
Fair split of sweat equity	Determination
	Dedication
	Integrity
	Objectivity
	Energy
	Networking skills

Guidelines

To limit the degree of subjectivity during this evaluation, some guidelines could be used for a more structured approach

Before the due diligence

The quality of the application. The analyst will be able to draw some inferences from the quality of the information submitted to him to compile the application. The will look at the submission and draw inferences on the quality of management, as well as the quality of the analyst himself.

- The historical financial figures. These reflect management ability, since poor management is unlikely to produce good results consistently.

During the due diligence

The 's visit to the factory or the facility from where the business in conducted. This will reveal much about the ability of management in respect of production planning, housekeeping and stockholding.

General management. The management organization and the task allocation.

Leadership. Is there an acknowledged leader with proper participation by other members of management? Is there good team-work?

Determination of objectives and strategies. Does the company have systems and procedures by which these are set and monitored?

Information systems.

- What is the quality of information systems and availability of information? These are the most important quantitative tools in the hands of management and influence decision-making directly.
- Are the systems used to do budgeting and budget controlling?
- Are they used for monitoring performance against objectives and strategies?

Balanced judgement. Does management have the ability to make judicious and correct decisions?

Specialist knowledge.

- How good the know-how of the different members of management in their specialist areas, viz marketing, financial, technical.
- What is their experience in their specific disciplines.
- Are extraordinary qualifications needed for their jobs and are they in possession of those.

Management involvement. How involved is management with the enterprise? Are they informed about the happenings on the ground of all the respective functions (marketing, technical, finance, admin, etc)?

Personal information.

- Age
- Qualifications
- Health
- Track record

<u>Some red flags</u>

Lack of industry background in the team

One-man management teams

Inventors doubling as chief executive

The analyst turned entrepreneur

Teams that have not worked together

Old managers

High salaries

Equity not shared around

Family management teams

13 KEY SUCCESS FACTORS

Key success factors are those elements (e.g., price and quality) that will be decisive when a customer makes the decision to buy a specific product from a specific supplier.

The key success factors must be discussed in a step by step analysis, pointing out the company's relative advantages and disadvantages in relation to its competitors.

All the foregoing sections of the marketing annexure were primarily concerned with the collection, interpretation and stating of facts. In "KEY SUCCESS FACTORS", however, the analyst must evaluate the applicant's ability to succeed within his specific sphere of operation/industry sector.

The sales budget depends on how the applicant rates in respect of the relevant key success factors, and all the factors that could have an influence on the continued existence of the company must therefore be evaluated in this section.

Do not only revert to the standard price/ quality/ service combinations, but consider all other possibilities such as product range, capacity, flexibility, design ability, and image, to name but a few. It requires thorough work and innovative thinking to determine the truly critical factors within the parameters of the investigation.

It is often the case that more than one set of key success factors apply to an applicant, e.g. for different products or where the same product is sold to different customer groups.

The relative position in terms of the identified key success factors, and not necessarily the absolute position, is important, i.e. it is important to know whether product quality is better or worse than a competitor’s and not whether the product quality is "good" or "bad". Differences should be qualified where possible, e.g. the applicant's price is 5% cheaper than that of its next nearest rival, or the applicant can deliver two weeks sooner than its rivals.

The concept of KSF’s is a different way of expressing the concept of **comparative advantage**. In addressing this concept, **two very important factors** should be kept in mind:

A KSF or comparative advantage is only that if the customer regards it as important in his decision to buy from a supplier. It is not a comparative advantage if a company sells its product 10% cheaper than its competitors if price is not an important consideration in the buying decision. It is NOT a KEY SUCCESS FACTOR.

Despite what textbooks say about comparative advantage, it is often possible that companies can be successful in the absence of a clearly defined comparative advantage. A whole combination of factors might enable the company to compete successfully and there could be no good reason why customers would not want to buy from such a company. Although it is very desirable that comparative advantages do exist and are identified as such, marketers and analysts should not dream up such advantages. This will just mislead the company in overestimating its own competitive situation.

Below is an example of the evaluation of KSF’s.

KSF survey for company XYZ (Product = small fasteners for high tech equipment)

FACTOR	REASON	COMPANY VERSUS COMPETITORS
Quality	Crucial part of equipment. Low quality material outside specs = breakdown	Quality on par with competition
Range	A wide range of fasteners required from one source for convenience	Company’s range wider than competitors
Service/Delivery	Customers require personal attention, response to requests and prompt delivery	Sales visits weekly & delivery in 12 hours (½ of competitors
Price	Not a KSF because value of fasteners very small in comparison to value of equipment	N/A

14 SWOT ANALYSIS

A SWOT analysis is the process by which a company endeavours to identify its **S**trengths and **W**eaknesses, which are **internal** factors, and the **O**pportunities and **T**hreats which it must face from the **external** Macro and Market environments.

Strengths represent specific capabilities inherent to the company which can be used to give it a competitive advantage in its sector.

Weaknesses represent the opposite of *strengths* and since exploitation of a company’s weaknesses by other players in the market can lead to its demise, this factor must be approached with great care and honesty by top management.

Opportunities represent those situations where a specific current or latent buyer need exists, which can be profitably satisfied by a company given its strengths and weaknesses.

Threats represent unfavourable situations in the market which could result in lower profits to the company (or its demise) if some defensive marketing action is not undertaken. Potential threats in a specific market where a company intends to enter must also be considered carefully. It is possible that the company through its marketing mix and with its specific strengths and weaknesses cannot mitigate such threats. The company should refrain from entering those markets and financiers should not be prepared to invest in the enterprise.

A SWOT analysis is not a theoretical exercise, but an effort to understand the applicant's competitive position and to evaluate how its marketing plans could result in its sales forecasts The analyst should cooperate with the applicant to do a comprehensive and honest SWOT analysis since this will not only satisfy one of the requirements of the business plan, but it will assist the applicant to better understand his competitive position in the market and to aim for those markets where there is the best fusion of its own internal characteristics and the total marketing environment.

Example:

STRENGTHS	OPPORTUNITIES
▪ Strong financially ▪ Distinctive competence ▪ Patented process ▪ Committed employees	▪ Rapid market growth ▪ Mishap of rival firm ▪ New foreign markets open ▪ deregulation
WEAKNESSES	**THREATS**
▪ Weak R&D spending ▪ Poor marketing skills ▪ Internal operating problems ▪ Higher costs	▪ New substitutes ▪ New foreign companies ▪ New technologies ▪ Declining Product Life Cycle

15 THE SALES BUDGET

The sales forecast is a quantitative representation of the "marketing analyst's" background research and evaluation of the relevant market, the applicant's competitive position in the market, the marketing ability of management and the marketability of the company's current and intended products, given the company's stated marketing strategies.

It embodies all the quantitative and qualitative information collected from the applicant himself, and from trade enquiries and other external sources, and intimately combines this with the historical performance of the applicant, as obtained from the analysis of the company records.

Within the macro, marketing and micro environments, a myriad of factors could have an influence on the applicant's future sales. It is clearly not possible to cover all these eventualities in this exercise, or, in a sales budget, for that matter. It thus is the task of the analyst to identify those factors that are sufficiently important to investigate, to evaluate them and then factor them into the sales budget. Identification and analysis of the relevant dynamics require far more than the statistical treatment of a bunch of hard figures and the extrapolation of those into the future

Since the future cannot be predicted by anyone, an accurate sales forecast is a very difficult task that can, in any case, only be verified in retrospect. It will be a mere coincidence if two sales budgets for the same company, compiled by different individuals, agree closely, because they will be the result of the subjective interpretations of these individuals, of a multitude of market influences. The bottom line is that the sales budget must be a motivated, realistic representation of a scenario which has been appropriately researched, following a logical, time-tested methodology.

This document up to this point contains the elements which are regarded as essential in the compilation of a realistic sales budget. Some of them will be discussed under background information, whereas others will come to the fore during the analysis of company records and the construction of an appropriate spreadsheet. Contact with and enquiries to parties external to the applicant will play a role in compiling background information as well as in considering the company's competitive situation and future sales.

The steps described here are not necessarily sequential, since the analyst is one person attempting to keep several balls in the air, but they are logical steps that need to be taken to arrive at some feasible form of a sales budget. The key is that, while it is not expected from the analyst to act as the conservative investor, it is his duty to see that the applicant's sales budget has some connection with reality. If not, the application will have no chance of succeeding at the and everybody's time (including the analyst's) will be wasted.

While by no means fully comprehensive, all the steps addressed in this document will consume considerable time and it is therefore **ESSENTIAL** that the analyst evaluates beforehand which the important marketing aspects of the due diligence are and concentrates on those. It will, and should, then be possible for the analyst to explain to why certain issues have been ignored.

Deciding on the budget period and intervals

The overall due diligence which the analyst carries out on behalf of the applicant, is an integration of all the relevant elements of the business, such as marketing, technical, financial and legal. It is therefore important to liaise with the applicant as to when the actions for which the application is made, are expected to take place, for example, new building, new equipment, new product lines, or new company. The financial implications of such actions are the heart of the due diligence and the budget periods should cover that time.

Ideally, the following time line should be used for budgeting:

Per month for the first ± 6 months to 1 year

Per quarter for the year thereafter

Per year for the year thereafter and to the end of the budget period

15.1. GATHER BACKGROUND INFORMATION

Refer to the above section on MARKET RESEARCH as to the *SOURCES* of this information. Although some of this information could come from the applicant himself, it is not historical information derived from the company's records. Background information will be applicable whether it is an existing company with an existing product, a new product or a new company. Information is gathered in respect of issues like the marketing environment, market demand and growth and the competitive situation.

Background information gathered in this way would be both quantitative and qualitative.

15.1.1. Quantitative

There are two types of quantitative information which could be used to compile the sales budget.

Factual information is about events that either happened in the past, are in force now, or will happen in the future. **Examples** of such information are:

Historical economic information. (Macro Environment) Variables such as economic cycles, inflation rates, exchange rates, imports/exports, PPI, PCE, and demographics could significantly affect the company's performance. These trends must be compared to the company's performance history, which should be a part of the sales budget spreadsheet. Any correlations, or even lack thereof in obvious cases, should be studied and used in looking at the future.

Legislation. (Macro Environment) Some laws could destroy the future of the company, some might stymie its activities and other could be to its advantage.

Technological change. (Macro Environment) Technological improvements may be a known fact and technologically improved competitive or substitute products may be at the very beginning of their Product Life Cycles. Evaluate whether the applicant's product still has a future in view of other marketing factors, or whether technology is just going to render it obsolete. (Hand drills still survived when electric drills were invented because of portability. Now, with rechargeable hand drills, is there still a market for hand drills?)

Changes in competitive environment. (Market Environment) Some competitors may be taken over by others, or by large customers in a backward integration strategy. Some competitors may be wound up because they are not core business to their owners. Similar changes may take place among suppliers or customers.

Database of competitors in the industry. (Market Environment) It is self evident that this will afford a better understanding of the industry structure.

Applicant's own records. (Micro Environment) Some historical information on the applicant will not be reflected in the sales budget spreadsheet but would have had an influence on the company's sales levels. Consider factors like advertising & promotion, distribution channels, sales force and pricing, and evaluate their influence on historical sales.

Derived information is that which is based on past factual information to forecast the future, and that which is aggregated based on opinions or factual information from various sources. Examples of this type of information are:

Economic _indicator forecasts_. (Macro Environment) This information, which was factual for the past, will now become derived for the future. Although they are forecasts, they are built on historical facts and they reflect insights into bigger economic pictures, insights which may not always be possessed by the applicant or the analyst/marketing analyst. Companies do not operate in economic vacuums and these indicators should enjoy serious consideration from the analyst, **especially** where correlations between these indicators and the applicant's past performance can be established.

Industry Surveys. (Market Environment) The term "survey" is used broadly. Such surveys could range from isolated reports on sections of the industry to global overviews compiled by internationally known analysts. They normally contain certain factual information, gathered by means of limited surveys, extrapolated to industry-wide levels for elements such as market size and growth, industry structure, key success factors and prospects for the future.

Market information from the analyst's trade survey and other relevant publications. (Market Environment) This includes all the information put together from the publications and the views of the interviewees during the trade survey. (including inputs from management) It represents **views** on quantitative issues such as market size and growth, market structure and segmentation, customers, competitors, distribution channels and product spread and substitution.

The analyst should consider all the information gathered along the abovementioned lines, compare similar information gathered from different sources and decide on final values for quantitative information which is deemed sufficiently important to factor into the sales budget. **Remember** that, although the information you use will be quantitative, the actual effect of the various elements on your sales budget will still call for a subjective value judgement from your side. On rare occasions a reasonable correlation may be found between historical external trends and the applicant's performance, but such correlations can never be blindly extrapolated into the future without due consideration of management's marketing plans and the potential influence of external qualitative factors.

15.1.2. Qualitative

This type of information will have no factual or derived quantitative basis to work from, since it consists of the subjective views and attitudes of people in the company, in the external environment and of the analyst himself. It is the most obscure part of the due diligence, because it requires a subjective assessment of the nature and intensity of a qualitative factor, and then again, a subjective assessment of how that factor might influence the company's sales budget. Examples of such qualitative information are:

Need satisfaction. Discussed elsewhere in this document.

Key Success Factors. Without understanding the KSF's and the applicant's competitive position in respect of these factors, you do not possess the essential knowledge to compile a reliable sales budget!

Customers' attitudes and indications. Even if only limited communication was possible the analyst should have some appreciation of the reputation of the applicant amongst its current and potential customers. Indications about possible future purchases can be used quantitatively (like the order book) as one of the building blocks of the sales budget.

Product life cycle. The PLC and the effect it could have on a company's sales growth, was discussed under Section 2.8. The PLC concept may not be relevant in a specific case, and even if it were, it would normally be quite difficult to identify the phase of the PLC within which the applicant finds itself. However, any reliable conclusions in this respect could have a significant effect on the marketing analyst's view of the applicant's future.

SWOT Analysis. Discussed under Section 2.15. This exercise needs to be carefully considered now, since it summarises the applicant's competitive position in the market and the threats that it faces. The extent to which the company can be successful in the market will to a large degree depend on how it can capitalise on its strengths, overcome its weaknesses and plan against potential threats. This is another judgement call that the analyst must make.

BEE. The extent to which a company's sales levels could be influenced by its BEE credentials needs to be evaluated.

15.2. PREPARE HISTORICAL INFORMATION

If the applicant is an existing company, the historical information will be the obvious point of departure for the sales projections. Based on the information extracted from the company's records the analyst should now construct as complete a model as possible of the applicant's activities, always remembering that the level of detail to which he drills down, should be practicable.

15.2.1. Build or finalise an Excel spreadsheet

The spreadsheet should contain fields for the following information, constructed in such a way that they are sufficiently manoeuvrable to allow for calculations, iterations and comprehensible extracts.

Historical sales for the last two years; longer into the past if feasible or relevant. If not possible for two years, for as long as is available.

- Per month, and if not feasible,
- Per quarter, or
- Per year

If possible, the same time/period breakdown should be used for the analyses below.

Historical sales per product, product group or a combination of the two. The 80/20 rule, where 80% of the turnover is derived from 20% of the products, may apply. In such cases a few products may be specified individually, and the rest lumped together into one or more generic groups. The product groups would be defined by some logical common characteristic, normally best identified by the applicant's marketing management.

Historical sales broken down per customer or customer group.

Historical sales broken down between manufactured goods, traded goods and services.

Historical sales broken down by geographic region.

Historical sales broken down by local sales and exports.

All historical sales analyses to be stated in value, as well as volume.

Historical orders on hand, indicating the relevant date of the order book.

It should be clear that the above information could vary tremendously in complexity. On one extreme you might have only total rand sales per year, while, on the other extreme, you could have thousands of budget lines when you stack up the variables. Think of a situation where you break down monthly sales by customer, which you break down by product, which you break down by geographic area, all stated in values and volumes! In practice a historical analysis and a sales budget never work like this.

The analyst must, from his knowledge of the applicant and its market, decide which budget categories are reasonable. Normally these categories should be such that they assist to better understand the performance and structure of the company and to budget more accurately. For example, it does not help to do a customer analyses of 100 customers if they are not going to be used in budgeting for them all individually. It will suffice to list the few largest ones. Moreover, if the company has many different product categories and there is no way to budget different sales growths for the different categories, they should be lumped together.

Derived information

Given that a spreadsheet has been constructed with budget lines which are practicable and rational, the worksheet can be expanded to derive the following important information:

Product mix in % over time. Depending on the initial analysis, this could of course, be broken down by (1) physical product or product group, (2) manufactured goods, traded goods or services, (3) geographic spread and (4) local sales and exports.

Unit costs which can be compared with stated or published prices.

Price history per product over time.

Growth rates of sales per product or other budget category.

Growth rate of overall sales.

Seasonality of sales per product or other budget category.

Seasonality of overall sales.

% contribution to sales by customer. This analysis would normally be on a different axis from the rest, and obviously, all the analyses that can be done for the company, can also be done per customer. The detailed breakdown of individual customers will rarely be possible or relevant, but the overall customer profile could be very important, especially when a small number of customers dominate the profile.

15.3. THE SHORT-TERM BUDGET USING THE HISTORICAL INFORMATION

If the abovementioned information has been gathered as far as was practically possible and the spreadsheets with the information regarded as relevant for this due diligence have been drawn up, the analyst is now at the point of departure for compiling the sales budget. It is assumed that the most appropriate way of breaking down the sales has been agreed with the applicant. You might use a specific product mix or some of the other breakdown methods discussed above.

The historical sales growths (including price levels) and seasonality could be used for short term projections, **provided** that there has been no significant change in the product mix. If it is important, seasonality should be investigated on a budget line level as well as for total sales. If there has been a change in the product mix, historical seasonality may not be useful, and you must consider a new pattern. If a new product is being introduced into the applicant's mix, this may have a totally different seasonal pattern which has to be considered.

Any significant changes in the historical patterns of the variables that you have selected to investigate should have been identified by now and, if possible, the reasons understood. Such changes should be brought into account if projections of historical figures are to be used in budgets.

Analyse the order book. This could be broken down into;

- Contracts with current or potential customers
- Confirmed orders

Letters of undertaking from current or potential customers

Verbal indications from current or potential customers

Contracts and orders will mostly only represent a portion of total budgeted sales and can only be used as one of the building blocks to compile the sales budget. In most cases you will not be able to obtain orders, letters or indications from all customers and the company's current sales performance, position in the market and momentum must be combined with the above.

A stage has now been reached where the budget is only based on the impetus from the past and customer feedback. The influence of external factors and qualitative evaluations has not been factored in and the forecast will thus be a short-term one. (Normally less than one year)

If a new product is being introduced, you will not have the luxury of historical information and different methods (to be discussed later) will have to be employed.

You often will have a combination of existing and new products in which case you need to employ a combination of the two methods.

15.4. THE EFFECT OF MANAGEMENT QUALITY

The effect of the quality of management on the business is very important, because it is said that a company has a better chance of survival with a bad product and good management than with a good product and bad management. Moreover, the role that bad management has played in the demise of many (probably the majority) of 's unsuccessful clients, has been identified and stressed repeatedly over the years.

As discussed before, it cannot be expected of the analyst to discourage an application for finance because he has reservations about the quality of an applicant's management, but obvious shortcomings in the management structure should be tactfully discussed with the applicant.

15.5. BUDGETING FOR A NEW PRODUCT

In instances where an existing company requires finance for the establishment of a new product line, the approach to the due diligence needs to be somewhat different. All the information discussed so far, is still potentially available for the company's existing products, but since no new capacity is created in that area, sales patterns will probably not deviate much from the historical data. Consequently, it probably does not require the same depth of investigation as the new product.

For the new product line there is no historical information that can be used as a point of departure for the budget. The point of departure here would thus be the applicant's production capacity. This figure should be compared to the sales budget which should take the envisaged production capacity into consideration. This does not imply that the production capacity (or even the production output) should represent the sales budget; it merely provides an order of magnitude for possible sales.

The evaluation of the company's existing performance and competitiveness (even for existing products which may be unrelated) is very important, since it will provide pointers of what can be expected in future in respect of the new product line. The quality of the company's management is also of importance since it is independent of the introduction of the new product line. A positive assessment on these issues will provide some confidence for the marketing prospects of the new product.

For this budget exercise a "from-the-top-down" approach must be followed. From all the potential sources discussed earlier, a marketing survey will be conducted to estimate the size and growth of the relevant market segment. The position that the company might hope to occupy within that market will then have to be determined.

The marketing survey will then have to concentrate on factors like the following:

The company's reputation based on its current activities;

The need in the market segment, for a new product, or a new entrant with the same product;

The envisaged KSF's in respect of the new product and the company's expected performance in those areas;

Any indications of future purchases of the new product; (See Section 2.16.3 on existing products)

A feasible market share that the applicant could get, given its proposed marketing strategy. **Important**. Always remember that market share is a **derived** figure which is used here as a **primary** input. See the discussion later under Guidelines.

Often the sales for a new product will have to be budgeted on a combination of customer indications and possible estimated market share. For instance, indications which yield an unrealistically high market share must be tempered to retain some contact with reality.

All the external factors of the Marketing Environment are still valid, but the evaluation of the qualitative issues gain greater importance and will thus require closer attention.

The ramp up period for new products is one of the areas where teams err most often. This will be discussed later.

With the introduction of a new product the applicant may wish to keep its plans secret and may therefore not be prepared to allow outside enquiries. In such cases, where outside enquiries may be very important, the analyst must decide whether he has enough information from other sources to compile reasonable budgets. He then must budget on the conservative side, since this is what will, if they don't abandon the due diligence due to lack of information.

15.6. BUDGETING FOR NEW COMPANIES.

All the external influences considered in the Marketing Audit are applicable in the case of a newly formed company applying for finance from the . The only difference is that there is no historical performance and management, and company reputation to evaluate. In such cases the evaluation of the proposed management becomes particularly important to , since investment decisions must be based largely on faith in management.

Relevant experience;

Demonstrated skills;

Demonstrated successes;

Age;

Qualifications;

Reputation in the market;

Team work as demonstrated during the due diligence.

The research that can be done in respect of the product and the departure point for the sales budget are like those for a new product in an existing company. The same goes for ramp up periods and restrictions on outside enquiries.

15.7. THE RAMP UP

The ramp up period for the applicant's new project is extremely important, since it represents probably the most common error committed by "budgeters" and it influences the sales levels for the rest of the budget period. Almost invariably the time required to reach the envisaged sales levels is underestimated, with the resultant overestimation of turnover.

This situation arises from mainly three areas where the company's performance is misjudged:

The time it takes to sort out the technical problems and start with the full production of products of acceptable quality;

The time it takes to penetrate the market and reach the budgeted sales volumes;

Overestimation of initial prices which can be achieved.

A conservative view must be adopted when evaluating the influence of all, or any combination of, these factors and sales. Unless there are compelling reasons not to do so, sales volumes, as well as prices should be phased in over a period.

15.8. GUIDELINES

Beware of **the hockey stick syndrome!** This is the situation where the sales pattern follows the shape of a hockey stick, i.e. sales, displaying a downward historical trend, suddenly (and often miraculously!) experience an about turn and show healthy and consistent growth into the future. It is one of the most common mistakes made by marketing analysts in their sales forecasts. It is obvious, as discussed before, that an enterprise which approaches the for funding has some kind of expansion, with resultant sales growth in mind. It is also true that the applicant must take a positive view of the future of the company and that his sales budget will reflect that optimism. Future sales should therefore normally be expected to show some growth into the future. The analyst should guard against a situation where a poor or deteriorating sales history is suddenly replaced by a growth budget without sound reasons. Such a change in fortunes will usually require a drastic change in the internal organisation and/or the marketing strategies of the applicant. The analyst should ensure that he understands and agrees with these changes, and that he can explain why this specific case would be an exception to the many other cases seen by over many years. A plausible explanation should be included in the due diligence submission as a matter of course.

Never assume that 100% of the order book, or indications from customers, will materialise. It has been demonstrated many times over the years that not even confirmed orders can be assumed as certainties. You must look at the history of the order book for specific customers and scale down the indications of future purchases to conservative, defendable levels. Indications from customers are even more uncertain and should be treated more conservatively.

A company's activities in the market are never in isolation. Any moves it makes in terms of its market strategies are likely to cause some reaction amongst its competitors. Always consider the potential implications.

If you do not have historical performance on which to build the sales budget, the "from-the-top-down" approach needs to be followed. You still need to do the marketing audit to evaluate the relevant factors This is important because **a market share is always the result of sales, not the primary cause**.

Interviewees during outside enquiries are people with subjective views. These people have opinions about conditions, size and growth of their specific markets, just like the applicant has of his market. Do not elevate those opinions to gospel but treat them with the same circumspection as you treat the opinions of the applicant. In the end, put all this information together, compare it with the quantitative information you might have collected, and form your own duly considered opinion of the future of the market and of the company within that market.

Market segmentation is one of the most important external determinants in your due diligence. Without a proper appreciation of the segment of the market within which the applicant operates, you will not be able to evaluate the market size, growth and competitive situation.

It must be appreciated that the evaluation of the factors that influence the budget, is not an exercise where a bunch of variables are mathematically applied to some base line. Some factors are amorphous, and some can be quantified, but their effect on the budget is always a matter of subjective opinion. Moreover, not all the possible factors discussed in this presentation, will have a significant influence on future sales. In practice, therefore, you will never have so many factors to consider during a single due diligence.

The trait of the good marketing analyst is to identify those factors which are relevant and to evaluate their effect on the sales budget in a realistic fashion.

15.9. PREPARE A SELLING COSTS FORECAST

The selling costs forecast should be prepared at the same time as the sales budget and must reflect the anticipated marketing and selling costs incurred to realise the sales budget. The analysis of the historical selling cost from the company records would provide a good basis from which to start budgeting. Although an analysis of the cost history will provide a basis from which to budget, it is important that **these costs should not be routinely projected as a % of sales**. These costs should be examined historically, discussed with management, expanded or deleted if necessary and then critically reviewed in the light of expected changes in sales patterns.

In general, though, one could consider three types of expenses for this budget:

1. ***Variable costs***. These costs will broadly vary with sales levels and could be budgeted as a percentage of sales, provided that a good basis for this has been established, either by analysis of company records or discussion and careful consideration. Examples are bad debts, commission and royalties.

2. ***Fixed costs***. These costs can be expected to remain at approximately the same level for the

budget period and can be budgeted on an inflationary basis. Examples are travel and R&D.

3. ***Once off costs***. These costs may be expected to occur infrequently and irregularly during the budget period, in which case you budget only for the specific occasion. An example is advertising cost during a once-off campaign.

The rule, again, should be that the magnitude of this expense category should determine in what detail it should be analyzed, and how much time can be allocated to this.

Commissions to sales staff or agents often vary according to product, agent, customer, area…etc. Where appropriate, theoretical commissions should be compared to actual commissions paid out. Anticipated changes in product mix, distribution channels, customer profile, sales levels and commission rates may render the use of historical guidelines and fixed percentages quite inaccurate.

Discounts. The general rule is that any discounts reflected on the invoice (such as cash discounts, quantity discounts and trade discounts) are reflected in turnover figures, while discounts given retrospectively (such as settlement discounts) are reflected in selling costs. It has become more popular in recent times for large buyers to negotiate special discounts at the end of the year, in return for including the applicant's products in special promotional campaigns. This will be a selling cost that appears infrequently, and care should be taken that it is not overlooked.

Bad debts should be analysed from the historical financials and used as a basis to budget. Budgeted levels of bad debts should be discussed with management, since its marketing strategies and its approach to delinquent customers could materially influence this level.

Packaging costs would normally be included under raw material costs, but in certain cases, like special packaging for promotional campaigns of consumer goods, such costs will be reflected here.

Delivery costs (including warehousing and depots) could be significant where the applicant is responsible for rail costs out or speed delivery services. Changes in geographical sales spread could materially affect this cost.

Market R&D*.* This is a discretionary cost and you should rely on the applicant's plans.

Advertising and promotion costs*.* The same comment as above applies here.

16 INDUSTRIAL AND CONSUMER MARKETS

Industrial marketing can be described as the marketing of goods and/or services in industrial markets essentially for use in the production process or the provision of services, as well as marketing between organisational buyers and organisation users. Industrial marketing is also often described as business-to-business marketing. In the case of industrial marketing we note that a major difference compared with consumer marketing is the fact that the goods or services are not acquired by the buyers for purposes of their personal gratification.[1]

Industrial goods can be classified in various ways, but academic textbooks mostly classify these goods by nature of usage.

CLASSIFICATION OF INDUSTRIAL GOODS	
Description	**Examples**
Raw Materials (forming part of the final product)	• Farm products like fruit, livestock, wheat • Natural products like iron ore, crude oil
Manufactured materials and parts	• Component materials like steel, cement, textiles • Component parts like small motors, tyres
Installations	• Buildings like offices, factories • Fixed equipment like lathes, generators, elevators
Accessory equipment	• Portable light equipment like hand tools • Office equipment like computers, desks
Operating supplies	• Industrial supplies like typing paper, lubricants • Maintenance and repair items like paint, brooms
Business services	• Maintenance and repair like cleaning, copier repair • Advisory like legal, advertising, management consulting

CLASSIFICATION OF CONSUMER GOODS	
Description	**Examples**
Convenience goods	• Bought frequently, immediately and with little effort. o ***Staples*** are bought on a regular basis, like tea, sugar and cereal o ***Impulse goods*** are bought without planning or much thought, like sweets glossy magazines o ***Emergency goods*** are bought without much thought when a need is urgent, like an air freshener when the car smells of smoke, or an umbrella when in a rainstorm.
Shopping goods	• Goods where the consumer will take time to compare based on factors like price, quality, style and suitability. Examples are clothes, white goods and furniture.
Specialty goods	• Goods which are sufficiently unique for buyers to make a special effort to buy such goods. Outlets do not need to be conveniently located, but buyers need to know where to find them. Examples are exotic cars and specialised audio and photographic equipment.
Unsought goods	• Goods which the consumer would not normally think of buying, like encyclopaedias or funeral policies.

Differences between Industrial and Consumer Markets.

- ***Derived demand.*** Buyers acquire products or services for further production, use in their operations or resale to final consumers. Demand is influenced directly or indirectly by demand in the consumer market. **What are the implications**?
    - *Firstly,* the industrial marketer must closely monitor the buying behaviour of the relevant ultimate consumers, to be able to do marketing analyses and sales forecasting.
    - *Secondly*, direct demand for industrial goods cannot be easily increased by aiming advertising at the direct customers. Advertising at final consumers, on the other hand, might require large, expensive marketing campaigns.
- ***Inelastic demand.*** The demand for a specific product will not be influenced much by a change in its price, especially if the product represents a small percentage of the cost of the final product. For example, the demand for shirt buttons will not really be affected by a **general** change in their price. Demand would rather be affected by a change in demand for shirts. A change in the price of a company's own product might affect sales significantly, especially if alternative suppliers can be accessed by the buyers.
- ***Fewer, larger buyers.*** The industrial market consists of fewer buyers with much larger individual buying power than consumer markets. For example, the relatively few motor manufacturers will do the purchases of catalytic converters in large quantities.
- ***Geographic concentration.*** Purchasing power will be concentrated in areas where hubs of economic activity exist. For example, 70% of the sales of a cardboard box manufacturer is in Gauteng.
- ***More people involved.*** The buying decision will involve more people with several buying influences. Buying committees, consisting of technical and financial experts, as well as management representatives might decide on the purchase of major goods.
- ***More time consuming.*** Since more people are involved and deals can be complex, clinching such deals are often more time consuming, requiring multiple sales calls.
- ***Customised manufacturing.*** Buyers are more likely to have needs which are unique and require manufacturing to specifications.
- ***Supplier-customer interdependence.*** Long-term relationships, where customers have large power bases and require suppliers to customise products for their needs, often develop. This creates inter-dependence, especially where it is difficult for the customer to switch suppliers.

- ***Technically complex.*** The industrial product and the purchase negotiations are usually technically more complex.
- ***Professional purchasing and rational needs.*** The needs of industrial customers are often more rational and buying is done by trained purchasing agents. These buying agents are knowledgeable and often must follow purchasing guidelines set by their companies.
- ***Direct purchasing.*** Industrial buyers often buy direct from manufacturers, especially in complex deals like mainframe computers. This means much more personal selling on the supplier's side.
- ***Post purchase process.*** After sales processes like installation, maintenance and user support are often very significant.