

Winning with customer insight

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Introduction

Insightful customer research can determine whether a buyer should get more aggressive or walk away from a deal. In a recent due diligence exercise conducted on a retail company, customer research helped the deal team see beyond near-term operating issues to the true upside of the target. In this example, the firm had a strong hypothesis that a particular format employed by the company was undervalued. The company had struggled with basic store operations and merchandising weaknesses, but the format was one that consumers viewed as fundamentally unique. A simple research project leveraging 400 'intercepts' - questionnaires administered to customers as they left stores - confirmed the hypothesis. The consumers surveyed confirmed that the issues identified existed, but the vast majority of them felt the format was less expensive than other retailers and was the 'most convenient' for that type of trip. These insights cemented the belief that this retailer's true potential could be unlocked with operational initiatives.

Given the fast pace of diligence, it is easy to overlook customer research. Poring over financials and legal details and assessing competitor strategies and company operations are very important in diligence, but may not yield the 'big picture' insights that can shape the outcome of a deal. Depending on the situation and access to the company, customer research can provide these big picture insights and can be conducted quickly, fairly easily and at relatively low cost.

Executing customer research correctly is not easy. It requires knowing what questions to ask, which tools to employ, how to interpret the data and how

to tie it back to the business strategy and deal model. Each research tool also has its limitations. Nonetheless, building a capability to execute customer research quickly and methodically can shape the outcome of a deal.

Asking the right questions

Getting the most out of research requires understanding what questions you can and cannot answer about a potential acquisition. Some of the top diligence questions that can be answered by customer research are:

- How unique is the value proposition that it offers in the market?
- How strong is the true demand for this business?
- What is the incidence of customers who consider shopping, and then buying?
- Who are the relevant competitors and why are they chosen over the target?
- How loyal and satisfied are the customers?
- What is the price-value perception of the business?
- How would customers respond to various scenarios such as changes in offerings or market changes?
- What are some of the unmet needs of these customers?

A key first step in diligence is to understand a target company's unique value proposition: What does the business truly represent in the consumer's eyes and do their perceptions change? Focus groups and in-depth interviews with both current and potential customers can clarify how they view the target business, what they buy and how the business compares with the competition.

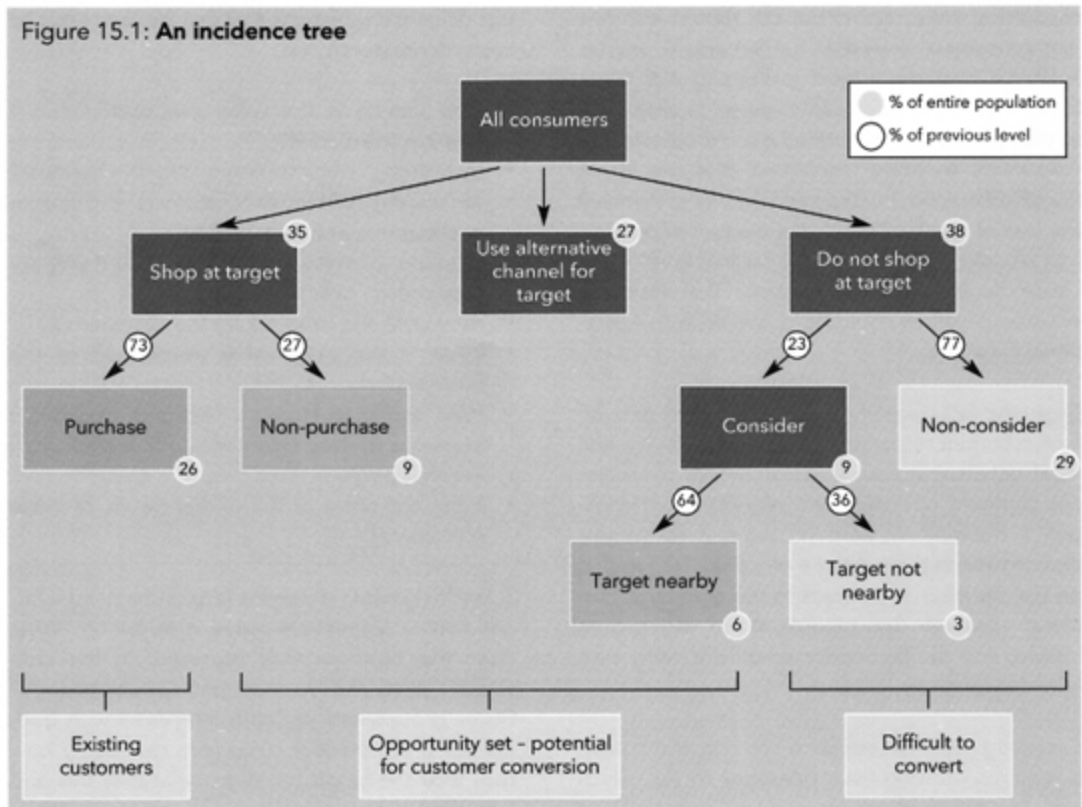
Surveys can gauge demand by providing the percentage (or incidence) of consumers who are thinking about purchasing a product or service, the number who shop for these items and the number who actually buy them. These studies provide important insights into what converts consumers who consider buying to those who actually buy, and why these conversions occur (or do not occur). For example, an incidence 'tree' can quickly assess the current penetration of shoppers as well as growth or expansion opportunities (see Figure 15.1).

The authors are careful to identify the target's true competitive set and the reasons customers buy from competitors. Assess price, location, service, inventory and brands, among others. The

authors find that some customers regularly purchase competitors' products because they do not see much differentiation between both businesses or because each business offers something unique. Examining the degree of cross-shopping and the reasons behind it provides an important view of the weaknesses of a potential target versus its competition.

Customer loyalty can occur because they have no other available option or because they are highly satisfied with the product, service or experience. Research can help delineate behavioural versus attitudinal loyalty. Customers that are behaviourally loyal but attitudinally disloyal present a risk. These customers are liable to jump to a competitor when a better or more convenient option pres-

Figure 15.1: An incidence tree



ents itself. For example, during diligence for a contemplated transaction, the authors found that many of the potential target's customers were dissatisfied and did not consider themselves to be attitudinally loyal to the potential target. These customers reported they would switch to any other provider if it was available. A couple of years later, the target filed for bankruptcy.

Understanding customer loyalty requires understanding customer satisfaction, which is driven by perceptions of what the company provides and how satisfied customers are with the key purchase drivers for the product, service or channel experience. For a retail store, assessing customer satisfaction with inventory, brands, store associates, location and ability to find things is common practice. The authors analyse which aspects of the product, service or retail store will make a customer most likely to buy. Once the most predictive is determined, compare how customers view the equivalent aspects at competitor stores. If customers are satisfied only with some parts of that equation, or if they are equally or more satisfied with competitors on the same set of things, then the potential acquisition is not providing anything unique in the market and is at risk of customer defection.

For nearly every product, service or retailer, understanding how customers view price and value - and the target's position in this area - has turned out to be one of the most material areas of insight. In most categories, many customers will pay more if they perceive they are receiving value. Therefore, when researching price, the authors approach price/value inquiries in three different ways. First, identify segments of the market that focus more on *price point* than *price/value*. In many categories, a portion of the population may acknowledge the 'value' of higher priced products, but behaviourally they do not purchase beyond certain price bands. Second, identify a target's *relative* position in terms of price/value versus relevant competitors. The key here is price relative to value. It is important to avoid asking if a

Elasticity research

Researchers are often asked by private equity deal teams to estimate the price elasticity of the product or service. Although elasticity research can be done, it is difficult to do accurately in the timeframe of traditional diligence. Furthermore, the accuracy of 'quick and dirty' price elasticity research is suspect. Experience suggests avoiding elasticity research unless there is a longer lead time or the category is very simple and customers can easily and accurately digest different price scenarios.

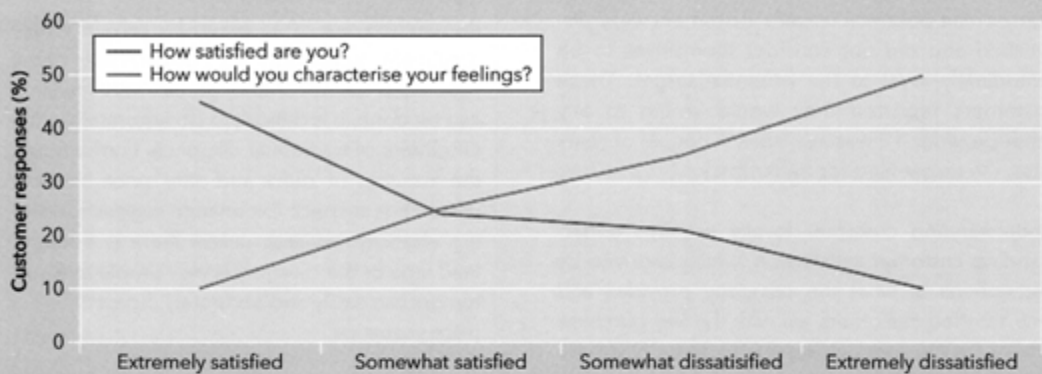
product or service is more or less expensive than alternatives. Few consumers make decisions solely based on absolute price and most are relatively sophisticated in articulating why a higher priced product can have a better value. Finally, take the time to understand what underlying variables 'ladder up' into a perception of value by examining cues on quality, style, prestige and brands that consumers are using to derive their conclusions on price/value. One effective research technique involves separating the questions on price/value from those on product or service attributes and then statistically deriving which attributes are most predictive of price/value within a product, service or category.

Limits to the researcher's crystal ball: data interpretation and methodologies

Although customer research may sound like a panacea, it has its limits and is often extended into areas that produce inaccurate and unreliable results. One major limitation relates to interpretation of data. With every number, there is a fair amount of interpretation that must be applied and seasoned experts who specialise in research can leverage experience to properly analyse the data.

The wording of questions can impact responses greatly (see Figure 15.2) and providing response

Figure 15.2: Customer responses to the wording of questions



Source: Beall Research and Training.

categories that lean in one direction or another can influence selection.

Imprecise response categories, such as 'infrequently', 'somewhat frequently' or 'very frequently', are completely open to interpretation and often produce useless data. The authors recommend asking how many times consumers buy something and how many times they shop for the product or service. Absolute numbers, although not completely accurate, at least give a comparable sense of the actual frequency.

Phrasing questions with a single response versus multiple-responses can also impact the usefulness of results. For example, asking consumers to select *one response* that best represents their attitude toward a specific target might yield data that may or may not suggest a predominant attitude. However, if these same attitudes are measured by asking respondents to select all the attitudes that apply or by using a rating scale that asks how much they agree with each attitude, these approaches can yield very different data (see Figure 15.3).

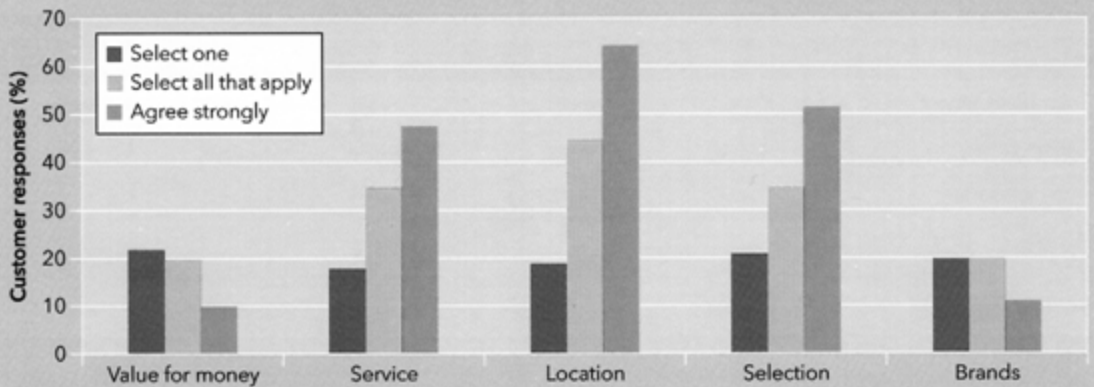
Research has limited utility in projecting consumer behaviours far into the future. Respondents are able to accurately forecast only their current

behaviour for things that they do frequently and for time periods that are fairly current. Asking customers to envision their behaviour three years from now when the market may be offering different options and when the environment has changed, is asking for spurious data. Apple founder Steve Jobs often quotes Henry Ford to highlight this challenge: "If I'd have asked my customers what they wanted, they would have told me, 'A faster horse'."

Asking customers to think about things that they do not truly comprehend in terms of how they would use a product or service is also a mistake. Customers do not always understand product concepts, especially those that are before their time, and they cannot envision how to use futuristic products and services in their current lives. For example, asking people about their propensity to buy CDs when record albums were at their height in popularity would not have been a useful research exercise. Similarly, asking people to remember what they paid for products several years ago is not unhelpful. Few people can remember how much milk cost five years ago.

However, one area that can be helpful in diligence is 'what if' scenarios. These questions aim

Figure 15.3: Customer responses when given different response categories



Source: Beall Research and Training.

to understand potential impacts of changes in strategy, market dynamics or potential growth areas. For example, with a major product, we can ask how likely customers would be to continue buying that particular product if a de-specified version came out that is less expensive. Questions on alternative scenarios must force real consumer trade-offs. For example, ask consumers about their preference for faster service times with a higher fee structure rather than just asking if they want 'faster service' with no trade-off. Many years ago, the authors researched a retailer that specialised in entertainment. The authors looked at different ways that the product could be delivered and found that the majority of customers would be more than willing to walk away from the target if they could have their products delivered in a different way. That finding killed the deal. This type of research can best be used to get a general feel of the direction of customer trade-offs.

Customer research cannot look to customers to solve the business' problem. Asking customers what would cause them to buy more or what would cause them to become more loyal is an exercise in futility. Customers do not always know why they behave the way they do and they cer-

tainly do not know what would cause them to change their behaviour. It is up to private equity companies to determine how to fix businesses and what their businesses should offer customers. Asking questions the right way, however, can help identify key product or service deficiencies (for example, specific attribute ratings versus competition) that can become part of the operational agenda.

Research project timelines

To work effectively under diligence timing constraints, operating partners can assemble a toolkit of techniques that can deliver quality insights under tight schedules and with limited budgets. To provide context, see Table 15.1 for the typical timeframes of some of the workhorse tools of the research industry.

When evaluating project timelines, experience suggests adding to the time quoted as most researchers without lengthy private equity partnerships are not accustomed to the level of process rigour, hands-on business questioning, real-time data analytics or '24/7 on-call' nature associated with private equity diligence. Most researchers underestimate project times.

Table 15.1: Sample research project timelines

Quantitative method	Survey design	Programming/testing	Data collection	Data analysis	Total time
Telephone survey	1 week	1 week	2-3 weeks	1-2 weeks	5-7 weeks
Online survey	1 week	1 week	1-2 weeks	1-2 weeks	4-6 weeks
Intercept survey	1 week	N/A if using paper surveys	1-2 weeks	2-3 weeks	4-6 weeks
Mail survey	1 week	N/A	2-3 weeks	2-3 weeks	5-7 weeks
Mystery shops	1 week	N/A	2-3 weeks	2-3 weeks	5-7 weeks
Qualitative method	Recruitment screener and discussion guide design	Recruitment of respondents	Moderation of groups or interviews	Analysis of qualitative findings	Total time
Focus groups	1 week	1-2 weeks	2-3 weeks	1-2 weeks	5-7 weeks
In-depth interviews at a facility	1 week	1-2 weeks	1-2 weeks	1-2 weeks	4-6 weeks
Intercept interviews	1 week	N/A	1-2 weeks	1-2 weeks	4-6 weeks
Telephone-depth interviews	1 week	1-2 weeks	2-3 weeks	1-2 weeks	5-7 weeks
Shop-alongs*	1 week	1-2 weeks	1-3 weeks	1-2 weeks	4-8 weeks

* Shop-alongs* is a research technique in which the researcher goes shopping with the customer in order to understand how the retail environment is perceived and to determine what impact environment has on behaviour.

Understanding what tools to use

Qualitative research can provide rich insights about common motivations, decision processes and emotions about a target, but it does not allow researchers to quantify these findings. Therefore, when trying to answer open-ended questions about the target such as why customers shop there, how they feel about that target and what needs that target fulfill, the authors suggest using qualitative methods such as focus groups, in-depth interviews and shop-alongs. In these cases, teams want rich information about a potential target and want to probe how customers make decisions to dissect the underlying motivations for customer behaviour.

Quantitative research is needed if the team needs greater precision and wants to quantify the size of

a market, percentage of customers who prefer the target, percentages who shop with competitors and average price customers pay for items. Although quantitative survey research provides numerical data about a group of customers, it often does not provide in-depth information about why people behave the way they do and what their decision process looks and feels like.

Focus groups

Focus groups are an underutilised tool in private equity diligence. They are perceived as soft and fuzzy and may not provide 'facts' fitting for a deal model. However, almost every private equity firm spends thousands of dollars and justifies key investments on 'expert interviews' that are as qualitative as focus groups. In our experience, when

Case study: Using focus groups

The management of a private brands programme wanted to understand what size of price changes – both up and down – would be noticed by its consumers. Quantitative research would be expensive and price simulations are notoriously difficult to design. The private equity firm worked with a research firm to quickly establish a set of focus groups with regular customers. These customers were provided little background on the research, given \$50 and asked to spend half of the money at the portfolio company and the rest at any other competitor. At the session, the customers were asked to describe their purchasing experiences and then were suggestively led by the moderator towards a discussion on price. To everyone's amazement, the shoppers began to systematically communicate the exact prices they had paid for common items.

More importantly, they had similar recall of the prices of those items at the competitive options and over time, even formed opinions on sale patterns and coupon opportunities. Overall, consumers in this space were incredibly sophisticated in terms of observing, recalling and comparing competitive pricing. This basic, fundamental insight needed little of the additional nuance that quantitative research might have provided. As a result of the research, the programme manager held off on implementing 'margin' opportunities, expanded his competitive price shop programme and increased the number of items priced at parity with competitors.

used properly, focus groups can provide incredibly valuable insights on a short timeline and for less than one week's billing of a top-tier consulting

firm. Often, focus groups can reveal most of the answers sought and quantitative research serves to reinforce and 'quantify' these insights.

A practitioner's guide to focus groups

- For most problems, target no less than six groups, spread over two to three cities.
- Occasionally, recruiting firms will fill focus groups with 'serial respondents'. Have the moderator quiz respondents with a relevant question to see if they are legitimate (for example, "You say you shop at Target, what is the address of the one you went to last?")
- Have someone from the private equity firm go to the sessions and debrief the team afterward.
- Have someone from the private equity firm observe the group who has a trained eye for recognising and synthesising insights to address the key diligence questions. Focus group reports provided by research providers take time and lack deep insight, and videos are seldom watched.
- Explore a breadth of issues instead of repeating the same exercises over many groups. The point of the focus group is to focus in on what is important over time – hence its name. Hire an experienced moderator who has worked in these categories and make sure he/she understands your business issues and responds to the group in real time.
- Write a detailed script or discussion guide for the focus group before the session so the moderator knows which key issues to explore.
- Plan two to three breaks during each session to give the moderator feedback and adjust the sessions on the fly.
- Moderators will want to 'warm up' the group with a personal exercise; ask your moderator to limit this time to five to ten minutes and get to the content.

Understanding focus group limitations allows for high quality execution. The biggest advantage of focus groups is timeliness. With the right approach, focus groups also uncover how consumers think about decisions, their level of sophistication (that is, what do they notice), the vocabulary customers use to describe the market and the propensity or risk of switching. Unfortunately, the biggest concern with focus groups is human nature's natural inclination to transform qualitative findings into quantitative results.

Intercepts

Intercept research involves meeting respondents during or directly following the act being researched. It is rare for research to catch respondents 'in the act' and allows questions to be asked while the experience is fresh in their memories. The authors' teams have used intercepts to understand

ATV riding habits, pet food purchasing, parking metre price elasticity, convenience shopping trips, surf/skate fashion preferences, mall trip behaviour and large land purchases.

Intercepts can be excellent tools to understand the reasons and motivations behind the particular time of an action, and to allow for immediate scoring or satisfaction of detailed variables that are hard to capture conceptually (for example, the politeness of a repairman).

Intercepts are easy to organise and fast to execute. However, intercepts can be difficult to execute and should be conducted with the help of an experienced researcher. More than other forms of research, high quality store intercepts require early planning and attention to detail.

Phone surveys and Internet panels

Phone surveys are declining in popularity but remain staples for primary consumer and specialty B2B research. The cost of phone research is often highly correlated to the length of the survey and total field time. Phone lists are generally less public than before and substantial incentives may be needed to entice callers to stay on the line. Unfortunately, addressing these speed bumps often has inadvertent side effects. Increased incentives may produce material bias to lower income or price-sensitive households. Increasing the number of phone banks will often force research providers into lower quality phone lists. Because of these constraints, high quality, medium-scale¹ phone research is difficult to accomplish in less than six to seven weeks.

Online panel surveys are currently the mainstay of current private equity diligence research. These panels are fast, inexpensive, flexible and convenient. However, for all but the simplest surveys and most ubiquitous target respondents (for example, households that have watched American Idol), the process will take four to six weeks. The steps

A practitioner's guide to intercepts

- Keep the survey short, simple and in layman's language; most respondents have a two to three minute attention span on intercepts.
- Use the opportunity to ask open-ended questions (for example, "Beyond the list I mentioned, why you did like your insurance agent?"). Intercepts have inherently lower sample sizes so you should be able to handle the open-ended 'write-in' data.
- Try to avoid incentives and keep them modest if you must use them. The authors' experience suggests they are not needed and can induce bias if asking about price/value.
- Use researchers experienced in intercepts. They will have a network of experienced surveyors in most major markets.
- Conduct 10 to 15 sample intercepts before committing to the final rollout. This provides an opportunity to test timing, tweak the survey design and improve instructions to survey teams.

involve designing the research instrument, building the online survey, giving respondents time to take the survey (field time), compiling/checking the results and mining the data. Be very wary of shortcuts, as online panels have substantial set-up time in coding and testing the sites. Once in field, online panels are difficult to change and it may be impossible to reconcile the data.

Omnibus surveys

Most online or phone survey providers maintain an omnibus survey protocol. In this methodology, research providers establish a consumer call or online survey schedule that repeats on a regular basis, say every Tuesday, Thursday and Saturday. The provider sets up the infrastructure for the research and then 'rents out' questions. The typical customers are firms who want to track data over long periods of time (for example, trend satisfaction each month over many months). However, under the right conditions, the approach has advantages for private equity teams. Because the research methodology is pre-established, questions can be formulated, programmed, fielded and answered in a matter of a few days. Fees can often be below \$1,000. Sample sizes in omnibus surveys are limited by the established procedures of the research company, but many providers can deliver statistically robust results (sample sizes over 1,000 responses).

Omnibus surveys have two main drawbacks. First, only a few questions can be asked and the ability to link questions ('skip patterns') are limited. Second, because they generally sample broad populations, they are less useful in reaching targeted respondents (for example, left-handed medical students). While omnibus surveys have limitations, the authors have found several areas where omnibus surveys can provide significant value to a diligence process:

- Very effective for limiting the scope of inquiries or framing the problem. For example, verifying the competitive set for a product or service

before launching other diligence work. An omnibus survey can answer that question with statistical rigour in 48 hours.

- Getting hard data on specific, narrowly defined issues.
- Checking incidence rates (that is, how difficult it may be to find a particular target group) which can often be helpful in determining if more sophisticated research is practical.
- Following up on an issue that was 'missed' in another area of diligence (or past research).

Picking the right research partner

Most traditional research providers are ill-equipped for the fast-paced and analytical private equity environment. They require a level of hand-holding that deal teams are often unwilling to provide. Some large firms - the authors' included - have the luxury of dedicated operational executives with substantial research experience. Other firms have cultivated preferred partners who have learned over time to work in a private equity environment. However, for firms less experienced in research, Table 15.2 provides guidelines to keep in mind when selecting a research partner.

Whichever the provider considered, keep in mind the following criteria when selecting a research provider:

- *Business acumen.* Is your research provider a competent partner that understands the business context of the task, or does he/she just take orders? Finding someone who can understand your specific diligence issue and translate that into a rigorous research approach is a rare differentiating capability.
- *Confidence and independence.* Is the research provider willing to stand up to the deal team? Do they propose independent solutions? It can be dangerous when private equity executives are overly prescriptive in dictating the scope of a research project. The right research professional must push back and explain what can

Table 15.2: Benefits and drawbacks of consumer research providers

Research provider	Description	Potential benefits	Potential drawbacks
Independent research consultant	Single proprietary or small operation that works directly with client but outsources actual research	<ul style="list-style-type: none"> • Strong client service • Strong talent, especially principals • Agnostic to research method • Creative • Cost-effective 	<ul style="list-style-type: none"> • May struggle with large or global projects • High variability in quality among firms • Less 'polished' outputs
Direct research provider	Firm specialising in designing and executing research	<ul style="list-style-type: none"> • One-stop shop • Typically deliver rigorous research methodologies • Capacity for large, complicated projects 	<ul style="list-style-type: none"> • Can be biased to specific approaches • May lack business aptitude to anticipate issues
Strategy consultant	Major consulting firm that usually embeds research into a broader scope of work	<ul style="list-style-type: none"> • Stay integrated with the big picture • Highly analytical • Ability to rapidly respond to new requests • Reduces number of research vendors 	<ul style="list-style-type: none"> • Highest cost solution • Some work may not be done by research professionals

and cannot be done in research and the ideal approaches for achieving the objectives.

- *Breadth in methodology.* Make sure that your research partner has experience across a broad set of potential research techniques such as focus groups, online panels, phone interviews, intercepts and immersion interviews. Each diligence problem does have a 'best' research approach, so be careful in limiting your effectiveness through your choice of partners.
- *Private equity experience.* The pace and pressure of a private equity engagement is not for everyone and is very different from the majority of other research customers. Avoid partners

who cannot demonstrate a seasoned track record in this industry.

Conclusion

Customer research is a valuable diligence tool that can provide a winning edge in the competitive private equity deal world. Knowing strengths and limitations, ability to interpret data, and picking the right partners can provide real insight that can make or break a deal. Having the capability to complete quality customer research quickly and methodically is a key success factor when the diligence sprint starts. ■

¹ For example, a desired survey sample of 500 respondents who may occur naturally in 20 percent of households (the incidence rate).