Due Diligence: An Introduction and Key Questions to Ask

Overview

Due diligence is the process of investigating a potential investment or collaboration which includes the examination of operations and management and the verification of material facts. In essence, it is the understanding of a partner's successes and failures. Due diligence is conducted when evaluating collaborations with potential partners.

There are many benefits to performing due diligence. Due diligence aids in choosing the right partner. It also allows for management of the partnership from an existing knowledge base. For example, if things do not go as planned, there is information upon which to change course. In summary, it increases the sustainability and impact of partnerships.

The Process

Questions asked during the due diligence process are not meant to make the potential partner feel like they are part of an interrogation, but rather are essential questions to ask in order to determine the quality of the potential partner. Conducting due diligence allows for better management of expectations and should help avoid situations such as poor quality products or timelines that are longer than expected due to lack of the right human and financial resources.

In order to make the potential partner feel comfortable answering the questions, it is important to communicate that many of these types of questions are standard due diligence questions and are not designed for intimidation. Getting many issues out in the open prior to establishing a full-fledged partnership will allow for anticipation of issues that may arise later and make partnerships stronger from the beginning. Apprehension that a potential partner may feel uncomfortable answering some of the questions should not merit avoiding them.

Levels of Due Diligence

Due diligence is always advisable when evaluating a potential partner. Each collaboration is different and will therefore require a different set of questions. Some questions will be more pertinent to one type of collaboration or technology than to another. Simply using the same questions for every due diligence assessment may omit some important questions that may be relevant for a particular partnership.

Other issues that need to be taken into account when determining the appropriate level of due diligence to conduct, and thus the questions to ask, include the scope of the project, the project's risk, the amount of effort devoted to the project, and the project's overall impact. These issues, in combination with the type of collaboration being explored, will determine the level of due diligence that must be done and, likewise, appropriate questions to ask.

Ideally, any due diligence should include a site visit. In order to prepare the potential collaborator, it is always a good idea to send them the questions in advance. In a site visit, the potential collaborator's facilities and practices can be examined in person. The visit will allow for making better decisions about the quality of a partner and for evaluating the manufacturing and/or research and development facilities. Unfortunately, for some due diligence (given time and budget constraints), a site visit may not be feasible, so the appropriateness of a potential partner may need to be evaluated through phone interviews and analysis of materials sent by the potential collaborator.

In all cases, if relations with a partner are likely to continue over an extended period of time, follow-up due diligence should be performed each year. This follow-up due diligence will concern itself mainly with determining if there have been any significant changes at the company since the prior year and to make sure that the current partner is still the right choice.

Due Diligence Key Questions to Ask

The questions below will assist in evaluating a potential partner in each of the categories essential for thorough due diligence. While this checklist is not comprehensive, it provides those essential factors that need to be considered when evaluating each component of due diligence.

Strategy

1. Does the proposed partnership fit with the potential collaborator's current strategy?
2. Will the partner dedicate sufficient financial, human, and other resources to the project?
3. Is the business plan realistic?
4. How extensive is the collaborator's marketing and distribution system in the markets where this product will be promoted?
5. What is the estimated turnaround time for the product, from product order to shipment? Is this timeline sufficient?

Management and Employee Relations

Does the collaborator have the management experience and scientific expertise necessary to make the project a success?

Financial

1. Is the collaborator profitable? If not, are their revenues growing?
2. Is the collaborator's forecast realistic? (Is growth too aggressive?)
3. What are the collaborator's sources of funding? If the collaborator is not financially sustainable, do they have sufficient access to sources of funding going forward so as to maintain enough cash to continue paying bills and operating as a business?

Intellectual Property

1. What products are protected by patents? What do these patents cover and in what countries are they registered?
2. Has the partner ever been sued over intellectual property infringements?
3. Does the partner have a history of intellectual property infringement with regard to third-party contractors?

Legal

1. Are product liability lawsuits common in the country where the collaborator operates?
2. Has the collaborator had a history of lawsuits filed against it?
3. How is the collaborator's relationship with regulators and government authorities?

Employee Relations and Working Conditions

1. Describe the workers in the operation. Are they adults of legal working age (as opposed to children)?
2. What is the standard workweek in number of hours? Does this comply with local laws?
3. What are employee wages like? Are they above or below the in-country average? Does the government set wages? Is there a minimum wage requirement?
4. What other employee benefits are offered? Is health care provided by the company or by the government? If provided by the company, what are the terms of that health care? How much vacation and sick time do employees receive? What other types of insurance do employees receive?

Programmatic

1. Are the organization's objectives aligned with the partner's objectives?
2. Does the partner have a mission statement?
3. Will the collaborator be able to meet a certain supply for the target population?
4. Will they be able to manufacture the product at a reasonable cost and charge an acceptable price?
5. What is the collaborator's experience in working with the public sector?

Technical

1. What is the size and capacity of the partner's manufacturing facilities? Where are these facilities located? (Are they close to the target market?) Is there excess capacity?
2. Is the collaborator ISO certified? Do they have good manufacturing practice (GMP) quality control procedures in place?
3. Would they be able to find a reputable contractor if production cannot be done in-house?

External Environment

1. What external economic factors could affect this partnership?
2. What regulations are placed on the partner, and how do these regulations inhibit its ability to operate efficiently?

Intangibles

1. What is the collaborator's synergy with the organization?
2. What is their reputation?
3. How are the collaborator's connections with customers, suppliers, and government regulators?

Risk

1. What risks exist in the industry where the collaborator operates?
2. What types of control structures exist over contractors who may be carrying out part of the work?