Due diligence can help minimise common purchasing risks and can help make better purchasing decisions (Goldman and Schmalz, 2005).

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Introduction

Due diligence has been institutionalised as one of the six key principles of the Bribery Act of 2010. Under the principle 4 of the Bribery Act, every firm should have due diligence policies and procedures which should cover the its organisation, operations processes, supply chain and relationships with its partners. The purpose of the inclusion of a due diligence principle in the Bribery Act is to put procedures in place that will help organisations to prevent bribery committed under its name or on its behalf (CIPS: Diligent Procurement).

The need and importance of due diligence are also imposed by some of the current trends, eg. the need for access to (international) capital and the global shift towards better corporate governance following the recent accounting and corporate scandals in the US and Europe. Having appropriate due diligence measures in place helps to satisfy stakeholders and existing and potential investors (Perera and Schwab, 2003). In addition, today firms are expected to have corporate social responsibilities (CSR) which make due diligence activities indispensable (Wild and Zhou, 2011). Due diligence is also important for and is very often discussed in association with mergers and acquisitions (M&A), as the past decade has seen some major failures in M&A that probably could have been prevented had the deals been correctly assessed and evaluated (Harvey and Lusch, 1995; Perry and Herd, 2004). Specifically this applies to insufficient planning resulting in management strife, political interference, employee dissatisfaction and bad financial results. This higher level due diligence (above simply verifying financial side of transactions) is often referred to as 'improved due diligence'. It usually involves a very detailed value assessment, which takes place before signing a memo of understanding and includes both management as well as operations side of risks (Perry and Herd, 2004).

Definition

'Due diligence' is an umbrella term which represents a number of activities that should be undertaken prior to entering a contractual agreement. The purpose of due diligence is to test and verify the understanding of the contract or the deal to be entered into. The testing activities can include the verification of financial information, staff information, deliverables, previous contracts, assets, properties and human rights (CIPS: Diligent Procurement).

Successful Application

An expanded due diligence framework should examine both tangible and intangible company assets. Traditionally only tangible assets such as cash, inventory, or accounts receivable were subject to due diligence examinations. However, 'soft'/intangible assets such as intellectual property rights, quality of management, personnel, corporate culture, or customer loyalty are as important. The practice of expanded due diligence can help a purchasing team to better justify a certain purchasing price or a decision to buy from specific suppliers (Harvey and Lusch, 1995).
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Steps to Successful Application

- Analyse the initial experience with the supplier: professional image, response levels, the ability to present the fit of products with your company’s requirements.
- Examine product quality: technical and operational characteristics, the availability of evaluative data to back up the product and customise it if required.
- Pay attention to individuals who sell the product/provide the service: education, training, qualifications, certifications.
- Analyse the quality of the product delivery and service.
- Perform background checks on the capacity and reputation of the supplier.

*Goldman and Schmalz (2005)*

Hints and Tips

- It is important to be aware of time restrictions that can be placed on the buyer in a seller’s market (Harvey and Lusch, 1995).
- The framework of due diligence should be developed accordingly as it is dependent on the size and value of the deal (Harvey and Lusch, 1995).
- Some situations might cut short the due diligence process in practice, such as hostile takeovers (Harvey and Lusch, 1995).

Potential Advantages

- Due diligence activities can help uncover and prevent corruption, bribery, and other 'white collar crime' (Byington and McGee, 2010).
- Due diligence can act as an enabler of ethical procurement and is a way to improve an organisation’s image and its relationships with stakeholders, including the general public (Wild and Zhou, 2011).
- Due diligence investigations into investments can help determine whether to proceed with the transaction and how much it is worth to invest (Perera and Schwab, 2003).

Potential Disadvantages

- Due diligence measures can be seen by some as burdensome and expensive (Perera and Schwab, 2003).
- There are countries and cultures in which due diligence is still very difficult to implement due to cultural and language barriers and the problems they pose in documentation, or due to some historical factors that may lead to a reluctance to disclose information (Perera and Schwab, 2003).
- Logistics and supply chain issues can be difficult to identify in due diligence checklists (Morrison et al., 2008).

Case Studies

- Hewlett-Packard’s (HP) Procurement Risk Management Group (PRM) has developed and implemented a mathematical model, business process and software for measuring and managing procurement-side purchasing risks. Using the PRM approach, HP realised cumulative costs savings of over US$425m and material cost savings of US$128m (Nagali et al., 2008).
Before every acquisition of a firm or a business unit, the sales and marketing team of Sun Microsystems is involved to analyse the products that will be acquired with that unit. The risks related to each product are identified, as well as the success of the products to-date, projected growth in customer demand or the potential of products to enable Sun to expand its presence in different geographic regions (Perry and Herd, 2004).

When Daimler-Benz bought Chrysler in 1998 the former failed to properly scrutinise Chrysler’s operations before the bid. As a result Daimler-Benz did not realise the level of excessive inventories and did not anticipate problems with intangible (or ‘soft’) assets, such as the waning appeal of the Chrysler brand at that time (Morrison et al., 2008).

Further Reading/References

CIPS Source Downloads
- CIPS: Diligent procurement
- CIPS: Ethical business practices in purchasing and supply management
- CIPS: Contract Management
- CIPS: Good practice in writing contracts
- CIPS: Writing Contracts

Web Resources
- The Guardian: regulating supply chain sustainability: [www.theguardian.com/sustainable-business/blog/regulating-supply-chain](http://www.theguardian.com/sustainable-business/blog/regulating-supply-chain)
- United Nations document: fighting corruption in the supply chain: [www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/Fighting_Corruption_Supply_Chain](http://www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/Fighting_Corruption_Supply_Chain)
- BusinessLink: anti-bribery policies: [www.gov.uk/anti-bribery](http://www.gov.uk/anti-bribery)

References
- CIPS: Diligent procurement.
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Video

Vendor Due Diligence report

www.youtube.com/watch?feature=player_embedded&v=quv-c6-