



## A Framework for Operational Due Diligence in Mergers and Acquisitions

Porsgaard, Chris Berg ; Haubjerg, Mathias ; Herbert-Hansen, Zaza Nadja Lee

*Publication date:*  
2017

*Document Version*  
Publisher's PDF, also known as Version of record

[Link back to DTU Orbit](#)

*Citation (APA):*  
Porsgaard, C. B., Haubjerg, M., & Herbert-Hansen, Z. N. L. (2017). *A Framework for Operational Due Diligence in Mergers and Acquisitions*. Paper presented at The 24th International Annual EurOMA Conference, Edingburgh, United Kingdom.

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# **A Framework for Operational Due Diligence in Mergers and Acquisitions**

**Keywords:** Operational Due Diligence, Operational Assessment, Due Diligence Framework

**Topic(s):** Operations Strategy

**Word count:** 969

## **Purpose**

The number of mergers and acquisitions (M&As) has over the last five years increased greatly (Institute of Mergers, Acquisitions and Alliances, 2016). Furthermore, private equity professionals point to operational performance gains to drive an acquisition decision and attribute cost reductions as the most important lever for value creation, after a private equity firm acquires a company (PwC, 2016). However, the overall success rate of M&A activity remains low and the approach to understand an acquisition target's operating model remains non-exhaustive and unstandardized. This paper investigates the pivotal determinants for assessing operational performance and identifying improvement potentials in an acquisition target.

The research question is: "What are the fundamental operational determinants influencing the acquisition decision for private equity firms in the due diligence phase?"

This paper presents an end-to-end framework which functions as a dynamic platform that simplifies the approach to conducting an operational due diligence (ODD). The framework focuses on identification and assessment of current operational performance and improvement drivers in the pre-acquisition phase.

## **Design/Methodology/Approach**

This research aims to build a normative framework of how to conduct an operational due diligence. Due to the complex nature of the research objective, a qualitative approach is used to provide rich and in-depth data. The explorative nature of the study allows for thorough understanding of the research area. Therefore, the case-study approach is the most appropriate research methodology (Yin, 1989; Oakley, 1999).

To ensure a sufficient empirical foundation, an online survey will be developed. Furthermore, to get in-depth data multiple cases were selected and analyzed based on interviews – and in some cases workshops - with private equity professionals (acquirer) and private equity advisors. The acquirers, their acquisition targets, and the advisors – as well as the overall companies to which to send the survey and select as cases - were selected based on several parameters (i) the acquirers and advisors have experience with operational due diligence, (ii) the acquirers and advisors express a need to better understand the operational due diligence, (iii) the acquisition target is a medium-sized or large companies with or without a global footprint, (iv) the acquisition target has a

production of physical goods and a supply chain, (iv) the advisors have deep operational expertise, within sourcing, logistic production, and distribution.

The research is divided into five key phases (i) an extensive literature review of research papers and industry publications; (ii) survey design and analysis of the responses (iii) semi-structured interviews, and workshops in the case companies; (iv) structured comparison of the literature review and the empirical data; and (v) development of a novel and dynamic framework that assists the performing acquires and advisors that conducts operational due diligence.

Data from the acquirers and advisors will be gathered from prior operational due diligence cases, meaning M&As which have been concluded. The research team will be working in close collaboration with the advisors since they are the executing part of the operational due diligence. The project will be concluded in early spring 2017. Data will be collected through interviews, survey and company documents. The survey is conducted using an explorative survey approach which builds on the broad academic foundation established through the initial literature review. The explorative approach is again applied to obtain key insights through the semi-structured interviews and workshops with the private equity professionals and private equity advisors. In this manner the project ensures a high degree of industry relevance by linking theory and industry practice.

## **Findings**

Initially, this paper clarifies what is meant by operational due diligence and how it fits into the entire mergers and acquisitions process. Furthermore, the paper presents a value chain approach to structuring the identified operational determinants that influences the acquisition decision. This perspective ensures a suitable and systematic approach to understanding the supply chain components of an acquisition target, including; Sourcing/Procurement, Transportation/Logistics, Production/Manufacturing, Warehouse & Distribution. The identified operational due diligence determinants assessed across all supply chain components and are as follows:

- People & Organization – Capabilities and competencies, corporate culture, organizational structure and personnel infrastructure.
- Facilities - Factory, machinery, human resources, capex requirements.
- IT & System – Data, Systems, Tools and documentation
- Operating Cost & Capital – Cost and capital structure: fixed costs, variable costs and asset.
- Scalability & Risk – Capabilities, technologies and external environment.
- Improvement Potentials – Rationalization and Efficiency.
- Synergies - Facility consolidation, Overhead reduction, purchasing power, other redundancies.

The operational determinants are supported by the literature study and the empirical findings which ensure that both quantitative and qualitative insights in the target company are obtained. Lastly, the paper presents a structured procedure for how to use the framework to promote industry relevance and applicability.

### **Relevance/Contribution**

This paper contributes with a structured literature review and empirical research within a specific area of M&As within the field of operations and supply chain management which has seen limited research. This paper links the areas of operations management together with mergers and acquisitions due diligence in order to provide comprehensive insights and a holistic view into (i) what is operational due diligence, (ii) what operational determinants affects the merger and acquisition and (iii) how the operational due diligence should be performed to maximise the operational gains of the operation.

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