



When Worlds Collide

**Integrating Financial and Cultural Due
Diligence in Mergers, Acquisitions and
Alliances (M/A/A)**

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Appendix A

12 Practices of Adaptive Organizations

Instructions: Below is a set of a dozen practices, selected from a larger set that characterize adaptive organizations --- those that are most likely to thrive during change. Read the list, thinking about your own organization, and the extent to which those practices are typical of your organization and the people in it.

Then, rate your own organization on a scale of 1-5 for each practice, where 1 means “not like us at all,” and 5 means “very much like us.”

1. We usually listen as carefully to ideas that differ from ours as to those that agree with us. _____
2. The company encourages people to suggest new ideas and improvements, and gives their ideas thorough consideration. _____
3. We create an environment that encourages people to address issues and problems on their own. _____
4. People who want to try out radical, but promising, new ideas can often get the resources and support to do it. _____
5. We hold each other accountable for meeting commitments, challenging excuses in a positive way. _____
6. We focus our energies on the truly important priorities of our business. _____
7. People from different departments and levels, freely pass on ideas and information to each other. _____
8. We are willing to make significant change in the way we do things now in order to meet the challenges of tomorrow. _____
9. People usually feel they have the information, authority and resources they need to take constructive action. _____
10. When things go wrong, we are more likely to try to find out what happened than to try to fix blame. _____
11. We respond constructively and non-defensively when others disagree with our views or actions. _____
12. People have a positive view of the company and its long-term success. _____

Overall Conclusion: Is your organization predominantly adaptive or non-adaptive? Why?

Source: Vector Group, Inc.

Appendix B

Elements of Financial Due Diligence

Elements of Financial Due Diligence

Market assessment

- (1) Business history
- (2) Analysis of the political, legal, industry and competitive environment
- (3) Products and services offered
- (4) Market segments
- (5) Market share
- (6) Major customers and their needs

Review of historical and current financial information

- (1) Audited and unaudited financial statements
- (2) Cash flow forecasts
- (3) Integrity of accounting controls
- (4) Reliability of accounting records
- (5) Key business ratios vs. industry standards
- (6) Tax returns
- (7) SEC and other federal or state regulatory filings

Operations review

- (1) Caliber and integrity of MIS
- (2) Corporate planning processes
- (3) Reputation of the company in its industry
- (4) Competence and commitment of management and other key personnel
- (5) Technology review
- (6) Capacity and capability of key processes
- (7) Performance against critical success factors

What records, information, people will the Financial Manager have access?

- (1) Senior Leadership and interaction between the two merger teams
- (2) Policies and procedures manuals
- (3) Information in the public domain about the partners (SEC reports, web sites, annual reports, press releases, etc.)
- (4) Organization charts
- (5) Review of all legal documents, law suits settled / pending, federal, state or employee complaints
- (6) Contracts with customers and suppliers
- (7) Union agreements
- (8) Process maps / flow charts
- (9) Employment agreements for key personnel
- (10) Insurance contracts: Product liability, general insurance, health/life insurance for employees
- (11) Training and education manuals / new employee orientation
- (12) Quality manuals and Quality certification documents (ISO 9000, etc.)

Appendix C

Integrating Financial and Cultural Due Diligence

Domain #1: Intended Direction And Results

Information Required By Cultural Due Diligence	What Financial Due Diligence Can Deliver
<p>Ascertain what the company intends to accomplish:</p> <ul style="list-style-type: none"> • The intent and purpose of the organization, • Results expected and, • Most importantly, how these things are talked about, described and communicated. 	<p>Questions for the leaders of each organization:</p> <ul style="list-style-type: none"> • Why is the alliance occurring? • What specific benefits do you see coming out of the merger / alliance? • How quickly do you anticipate these benefits occurring? • What needs to happen regarding plant, equipment, products and people for these benefits to accrue? How will this happen? • What sort of involvement is anticipated by mid-level managers in each organization to assure the benefits occur? • What message is to be conveyed, how will it be conveyed and in what timeframe to all employees regarding the alliance? • Will both parties to the alliance be able to speak “with one voice”? How will you assure this occurs?
<p>Outcome: A clear picture of the degree of alignment or misalignment between the leaders of each organization on where the alliance is headed, who will implemented it, how and when.</p>	

Domain #2: Key Measures

Information Required By Cultural Due Diligence	What Financial Due Diligence Can Deliver
<p>What does the company measure? Why? What happens as a result?</p>	<p>Additional questions regarding each organization’s compensation and benefits program:</p> <ul style="list-style-type: none"> • Given the organization’s metrics, how is success measured? What are the rewards for divisions, departments or individuals viewed as being successful? • Given the organization’s metrics, what is a failure? What are the consequences for failing? • How do the organizations’ formal compensation, bonus, perquisite programs support or differ from these commonly held definitions of success or failure?
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization on commonly held views of success or failure and how the formal compensation system supports or does not support those views.</p>	

Domain #3: Key Business Drivers

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • What are the primary issues driving the business strategy? • Is the focus on competitive edge and, if so, how is that defined – price differentiation, quality, market share, service, reliability or what? 	<p>The CPA is obligated to ascertain the underlying drivers that define each organization’s success. These drivers can be determined by asking the organizations’ leaders, reviewing business plans or from the commonly held definitions of success or failure discussed in Domain 2.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization on how they view their industry and their subsequent efforts within the industry.</p>	

Domain #4: Leadership / Management Practices

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • What basic value systems about employees are in place? • How are people treated and why? • How does the business plan get implemented through the management system? • How are decisions made? Who is involved in what, and when? 	<p>While these questions can’t be answered from top to bottom without undertaking the full Cultural Due Diligence Audit, the CPA can certainly ascertain how leadership is making decisions about the merger / alliance, the process used and who is involved. In addition, decisions will be made at this point about locations, departments, and which key personnel will be filling what roles in the new combined organization. All this information is relevant as a <u>starting point</u> for documenting leadership/management practices.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding the balance between Leadership and Management approaches with staff.</p>	

Domain #5: Organizational Practices

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • What formal and informal systems are in place and what part do they play in the daily life of doing the work? • How much flexibility is allowed at what levels in which systems? • What is the relationship between political reality and business reality? 	<p>Organizational practices include formal systems such as budgeting and compensation plans. This area can also include how staff groups such as Legal, Human Resources, Public Relations, Purchasing, General Services and such are accessed / utilized by line units and each other.</p> <p>Organizational practices can be further defined by looking at each organization's compensation plan and budget process. Are leaders or mid-level managers compensated and viewed as more successful based on the size of their budget dollars and number of employees or locations they are responsible for? Or, are they rewarded based on the quality of outcomes their area produces, regardless of size? Generally, size of budget and number of employees also denotes which areas/departments are viewed as most critical to the organization's success. The organizational practices review can act as a double check to confirm or deny the key business drivers identified in Domain 3.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding people or functions considered most important to the organization's success. These are people or functions who may be considered above the routine issues of getting the business of the company accomplished.</p>	

Domain #6: Infrastructure

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • How is the company organized, what is the nature of the reporting relationships, how do the staff systems interface with the line systems? • What is the nature of the relationship between groups and units in the organization? 	<p>Financial Due Diligence includes examining each partner's Organizational Chart and Policies and Procedures Manuals. The Charts themselves can provide a wealth of information. A traditional, pyramid shape may indicate hierarchy rules. A flatter organization chart may indicate matrix management where front line people are more empowered to make their own decisions. A review of the Policies and Procedures Manuals can confirm or deny what the organization charts indicate.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization on relationship issues. In particular, determination as to whether relationships are informal or based on formal hierarchies and the degree to which business units assure that they are responsive to corporate needs and check with other units to assure there are no conflicts or unexpected impacts.</p>	

Domain #7: Supervisory Practices

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<p>What dynamics are at play in the immediate oversight of the performance of work?</p>	<p>Because of the constraint of confidentiality, this is one area where the CPA may have a difficult time getting a feel or sense. One surrogate approach is to observe how the leadership group of each company treats each other and themselves. In particular, look at how individuals are treated who are subordinate to the CEO or other senior executive officers but who are still involved on the merger / alliance team.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding supervisory practices which may have a major impact on employees' feelings about the company and the work they do. The nature of the interaction between the employee and the supervisor is one of the primary tone-setters for the culture of the company.</p>	

Domain #8: Work Practices

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • How is the actual work performed? • Is the emphasis on individual responsibility or group responsibility? • What degree of control, if any, does the individual worker have on the workflow, quality, rate, tools utilized and supplies needed? 	<p>The Financial Due Diligence process should include a review of process flow charts for all major organization processes. Questions to be asked:</p> <ul style="list-style-type: none"> • What is the degree of control individual workers have to make decisions in their work area? • Do all employees understand where their work comes from and where it goes? • Is the next person / department viewed as the customer? • What equipment, supplies, and critical thinking tools are used in the process? • How are employees trained on these issues?
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding individual and group responsibility and degree of control individual worker has to make decisions about their own work area.</p>	

Domain #9: Technology Utilization

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • How current is the technology being utilized? • What are people used to in relation to technological support/resources? 	<p>Part of the Financial Due Diligence MIS review includes a review of how the technology is used, both internally with employees and externally with customers and suppliers. This review would include how effective the current technology is in helping the company to meet its objectives as well as how well the technology positions the company for future success.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding technology utilization in relation to internal systems and equipment and the services and products provided to customers.</p>	

Domain #10: Physical Environment

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> How do the workplace settings differ? 	<p>Again due to confidentiality issues, the CPA will probably not be given complete access to the partners' facilities during the Financial Due Diligence timeframe. However, it would be unusual if there were not at least a possibility of a limited inspection: e.g. after working hours or on weekends. In those cases where some opportunity exists for an informal tour of facilities, look to see what type of information is posted on company bulletin boards, reward and recognition walls or cases, and in each person's office or cubicle. Also look for good lighting and housekeeping.</p> <ul style="list-style-type: none"> Does the workplace appear to be pleasant and conducive to work? Do individuals appear to be happy with their work environment, at least as evidenced by the types of things posted in their personal work areas?
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding work space guidelines and underlying beliefs supporting those guidelines.</p>	

Domain #11: Perceptions / Expectations

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> How do people expect things to happen? What do they think is important? What do they <i>think</i> should be important, versus what they believe the company feels is important? 	<p>Perceptions and expectations of mid-level managers and front line employees will be difficult to ascertain during the early stages of the Financial Due Diligence Process. Again, leadership in the respective partnering organizations can act as surrogates by observing how they expect things to happen.</p> <ul style="list-style-type: none"> Does each side believe the same things are important? Are their personal ideas of what is important different from what the organization as a whole thinks is important? How do they perceive that their employees will react to the partnership? What are they planning on doing to overcome concerns, confusion and ambiguity within their organizations?
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding employee perceptions and expectations and what they feel is truly important to the organization's success.</p>	

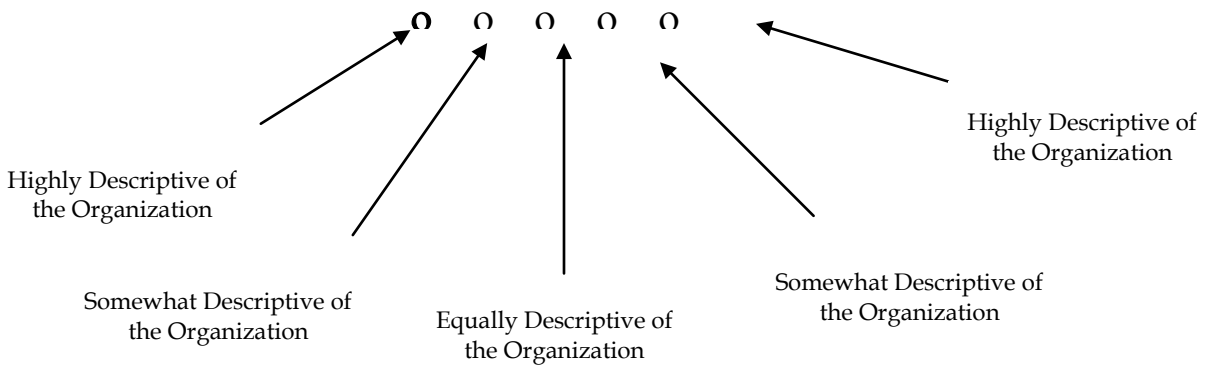
Domain #12: Cultural Indicators / Artifacts

Information Required by Cultural Due Diligence	What Financial Due Diligence Can Deliver
<ul style="list-style-type: none"> • How do people dress and address each other? • What is the match between formal work hours and actual hours spent working? What company-sponsored activities exist and what are they like? 	<p>In this Domain, as in others, the best means to lay the foundation for Cultural Due Diligence is to ask the leadership of the partnering companies to explain what company-sponsored activities they promote and why.</p>
<p>Outcome: A clear picture of the degree of alignment or misalignment between each organization regarding cultural norms.</p>	

APPENDIX D

Cultural Due Diligence Question Format - Example

Capture your understanding of the corporate culture as determined by one-on-one interviews, document reviews, focus groups, or other observations as **described** by these information sources.



This information source described an organization that...

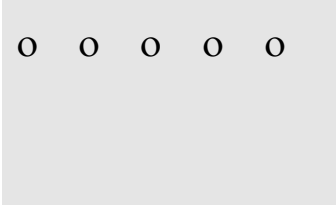
1. Has a set of clearly articulated goals, and routinely plans prior to taking action.	○ ○ ○ ○ ○	Shifts deadlines to accommodate emerging issues, and is able to act without a thorough plan.
2. Pursues a vital few goals; typically headed in a clearly focused direction.	○ ○ ○ ○ ○	Pursues many goals simultaneously; is broad reaching and multi-focused.
3. Is excited about their future. Track record has positioned them well for a future success.	○ ○ ○ ○ ○	Is anxious about their future. Past successes are not sufficient to ensure continued performance.
4. Getting the job done "right" is more important than getting it done quickly, even though it may take extra time.	○ ○ ○ ○ ○	Getting the job done fast makes "roughly right" outcomes acceptable even though we may sacrifice discipline or rigor.

This information source described an organization that...

5. Relies heavily on organized plans for our work. Work processes are clearly defined.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Relies on ability to respond to just-in-time opportunities; continually “turns on a dime” to meet demands.
6. Praise and public acknowledgement from leaders is an important part of how people are recognized.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	The use of contests, cash rewards, bonuses, etc., are important mechanisms for recognition.
7. Leaders provide a high degree of autonomy, encouraging us to take risks and decisive actions.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Leaders provide a high degree of supervision, encouraging us to “check in” before taking actions.
8. Exceptions to policies and procedures are discouraged; generally it is better to act as others do.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Policies and procedures are often tailored to fit the circumstances; generally it is acceptable to act in unique ways.
9. People are involved in the decisions that affect them.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	People are involved in decisions based on their level in the hierarchy.
10. People tend to be more comfortable working individually.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	People tend to be more comfortable working collaboratively.
11. People tend to offer help and support to ensure others are successful; conflicts are resolved by exploring the merits of differing points of view.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	People tend to be focused on their own advancement and achievement; conflicts are resolved by debating until there is a winner.
12. Information is shared openly with people with few restrictions.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Information stays with selected people or groups, shared on a “need to know” basis.

13. People are comfortable speaking their minds, or admitting their shortcomings.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	People tend to say the “right thing” that supports “our way” of doing things, or try to maintain the “right” image.
14. Focuses mostly on improvement of internal processes and structures; has moderate awareness of our competitors.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Focuses mostly on pursuit of new markets and customers; is very much aware of competitors and closely follow the moves they make.
15. Is heavily focused on understanding and exceeding customer requirements through delivering great products and services.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Is heavily focused on maximizing efficiency, maintaining strong expense management, and cost reduction.
16. Pursues growth through product proliferation/line extensions and acquisitions.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Pursues growth through product innovation and anticipation of emerging customer needs.
17. Values review of significant events; debrief events to share insights and best practices.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Values a “trial and error” approach; forges ahead without looking back.
18. Looks to the organization’s rich history as a source of knowledge.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Focuses on future possibilities and learn as they go.
19. Takes solutions that worked in one place and applies them in others; “safe bets” are encouraged.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Consistently tries to find new ways of solving problems; risk taking is encouraged.
20. Changes in response to significant events.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Initiates change in anticipation of significant events.
21. Change efforts focus on discreet segments or functions of the business.	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	Change efforts attempt to reach the entire organization simultaneously.

22. When implementing change initiatives, involves many people to coordinate and implement plans.



When implementing change initiatives, involves only key people to coordinate and implement plans.

APPENDIX E

STRATEGIC ALLIANCE MODEL

By: Bob Carleton, Vector Group, Inc.

OVERVIEW

A strategic alliance is a cooperative business agreement between two or more organizations to accomplish strategic business goals for each through some form of association. Organizations are motivated to form such associations when they lack some capability to cost-effectively meet their strategic goals on their own within the required time frame.

The process of creating and maintaining an effective strategic alliance is complex, and the rate of failure is high -- whether measured by the level of satisfaction with the alliance or by the degree to which the alliance strengthens the organization's competitive position. The **Strategic Alliance Model** below is designed to help organizations more effectively evaluate and take advantage of opportunities for strategic alliances. Lack of a systematic model or process is often cited as a key reason for the failure of strategic alliances. In particular, managers involved in strategic alliances have cited lack of clarity about strategic purposes, poor partner selection, and ineffective management of the working relationship as key weaknesses.

Although the Strategic Alliance Model is couched in terms of cooperative agreements between independent organizations, much of it also applies to cooperative working relationships between virtually any groups, whether internal functional teams, or consortiums of many organizations.

Phase 1 Clarifying Purpose: Identifying what the organization wants and needs from a strategic alliance. What do we stand to gain?

Phase 2 Analyzing Parameters: Examining the organization's culture, its resources and constraints, its strengths and weaknesses. What do we bring to a strategic alliance?

Phase 3 Choosing a Structure: Determining the kind of cooperative agreement to pursue. What kind of alliance will work best for us at this point, considering both needs and risks?

Phase 4 Choosing a Partner: Selecting an organization that best meets strategic goals, and complements strengths and weaknesses. What kind of organization will work best with us?

Phase 5 Making it Work: Managing the alliance to effectively accomplish mutual goals. How can both parties get the most out of the alliance during...

- the negotiation?
- the start-up?
- on-going operations?

Phase 6 Taking Next Steps: Assessing the effectiveness of the alliance and deciding whether to continue, modify, or terminate it. How are we doing and what, if any, changes should we make?

STRATEGIC ALLIANCE MODEL

PHASE 1 CLARIFYING PURPOSE: Identifying what the organization wants and needs from a strategic alliance. What do we stand to gain?

Entering a strategic alliance implies a relatively long-term commitment and a significant overall organizational purpose, requiring significant investment of resources. Before making such an investment, the organization should be certain that it is worth the effort. An organization should have positive answers to the following questions before entering a strategic alliance.

- Are we clear about our organizational strategy?
- Are we clear about why we want a strategic alliance?
- Is a strategic alliance the best way to go?

1. Do we have clear strategic goals?

Unless the organization has defined its long-term goals and strategies, it cannot enter a “strategic” alliance. At best, it can join forces with another organization to meet short-term needs -- and hope that the alliance will have a positive effect over the long term. This is a risky proposition, given the high failure rate of such alliances as joint ventures, mergers, and acquisitions. Organizations considering a strategic alliance, then, should have accomplished the following:

- invested in developing a mission/vision and strategic goals;
- formally documented the mission and strategy;
- communicated them widely through the organization;
- begun actively using the strategy to manage the business.

2. Can we state a clear purpose in considering a strategic alliance?

Most studies of alliances find that lack of clarity about purposes is a common reason for failure of the venture -- or substantial dissatisfaction with it.

Below are some typical purposes that organizations have had in entering strategic alliances. The purposes are widely varied; some are extremely broad, and some are often responses to immediate difficulties, rather than strategic in nature. The chances of a successful alliance are increased to the extent that organizations have clear purposes and can directly relate those purposes to organizational strategy.

Improved legal/regulatory position

- Conform to laws, government regulations or recommendations
- Escape from/avoid the need for regulations or restriction

Improved market position

- Entry into new markets
- Increased share of an existing market
- Protection of a market position
- More or better distribution channels
- More competitive products
- Extended product life
- Use of trademarks and other non-tangibles
- Mutual protection against an aggressive third party competitor
- Extended product/service line

New or Improved Expertise or Capability

- Access to vital technology
- Increased research and development capability
- Manufacturing expertise
- Information gathering or processing capability
- Increased manufacturing capacity

Resources

- Raw materials, component supplies
- Financial resources
- Physical resources -- land, facilities, equipment, etc.

Improved organizational health, strength

- Profitability
- Growth

- Risk reduction, risk sharing
- Exploit economics of size, experience
- Increased flexibility
- Faster competitive reaction
- Learning -- about markets, processes, technologies, etc.

3. Do we need an external partner to accomplish our purpose - or could we substantially enhance our strategic position through an external partner?

While entering a strategic alliance offers substantial benefits, it also entails significant costs and risks. The organization should be certain that there are potential gains that clearly outweigh them. Often, when an organization has, or can readily develop, the internal capability to fully meet a long-term goal, it should do so.

This does not mean that the “ideal” organization does not use strategic alliances. It means that organizations should be selective about entering such alliances. They should be undertaken thoughtfully, with assurance of their potential contribution to the long-term health of the organization.

A useful test of the value of entering a strategic alliance is to review it against the following questions:

Is it Real? Is there evidence that an alliance could:

- significantly improve competitive position?
- address long-term customer or market needs?
- strengthen the company for meeting future challenges?

Is it Achievable? Is there evidence that:

- there are alliance partners with the strengths and resources we lack?
- an alliance is feasible, given legal or regulatory restrictions?
- we could put together a sufficiently strong alliance in time to address market issues?

Is it Worth it? Is there evidence that:

- the benefits of a strategic alliance will significantly outweigh the cost (monetary and otherwise) of effort?
- the company can learn enough to come out of an alliance stronger?

Before seriously considering a strategic alliance then -- whether the organization has fortuitously “stumbled across” one, or is considering undertaking a search -- senior executives should have clearly defined their own goals and those of the alliance,

identified the capability required in a partner, and reviewed benefits in relation to costs.

PHASE 2 ANALYZING PARAMETERS: Examining the organization's culture, its resources and constraints, its strengths and weaknesses. What do we bring to a strategic alliance?

Before venturing too far into the search and decision-making process for a strategic alliance, the organization should examine itself to establish a base for selecting a partner that can both meet the basic strategic purpose and is an effective "match."

Senior management in the organization, and those who will be involved in selecting an alliance partner, or in early negotiations or implementation, should have clear agreement on the answers to the questions which follow -- or at least clear understanding about where they disagree.

1. What is absolutely required in an alliance partner: What are our strategic purposes? What do we need from an alliance partner?

The first step is simply to identify those organizations that have the competence and/or resources to meet the need. This can often be determined with comparatively little investment of effort -- in some cases, without any need to actively meet with members of the other organizations.

The next questions are equally important, whether there are many organizations that meet the basic requirement, or only one. If there are many, the second- and third-stage screens will help identify the most likely candidates. If there is only one, the questions will help identify areas of concern that will have to be addressed in negotiations and in planning and executing the implementation of the alliance, should it come about.

2. What are our task-related criteria for a strategic alliance partner? What do we bring to an alliance? What are our strengths? What are our weaknesses and vulnerabilities?

The purpose of this set of questions is to clarify the following:

- what the organization is good at: what it can contribute to the alliance; areas in which support is not needed from the alliance partner;
- what the organization is lacking or is not so good at: areas in which support may be needed or valuable from the alliance partner;
- where the organization is vulnerable or at risk.

Below is a list of areas to consider in a review of the organization's task-related issues.

Strengths and Weaknesses: Where are the organization's strong/weak points?

- Capabilities and or competencies in manufacturing, technology, marketing, sales/distribution, etc.
- Resources: market position, financial resources, personnel, facilities
- Prestige/image/reputation
- Skills/knowledge from previous alliances

Vulnerabilities and Opportunities: Where is the organization at risk? What are potential opportunities to benefit?

- How might a partner damage or weaken the organization's competitive position? How might a partner strengthen it?
- What are potential threats or opportunities from situations in the environment, or competitors' action? How might a partner help or hinder the organization in addressing these?

Constraints: Are there biases, preferences, or limitations the organization wants or needs to impose on the possibilities for an alliance?

- Time limits on the alliance, or for the decision
- Geographic limits
- Financial requirements
- Regulatory requirements

3. What are our relationship criteria?

An alliance partner that appears to be a good match in terms of its strengths and capabilities, may not in fact be the best one for developing a mutually synergistic relationship. Studies of alliances have found that participants typically cite failure to adequately consider "relationship issues" as a key factor in difficulties in effectively implementing strategic alliances.

Relationship issues are difficult to clarify before entering into discussions with potential partners -- and sometimes are not identified until after the alliance is well under way. The better an organization understands its own values, and internal "relationship issues", however, the better able it is to identify and resolve potential issues with a partner.

Below are some key questions to consider:

How can we learn from the partner?

- How readily does the organization learn?
- How responsive are people to changing needs and environmental demands?

- What could be done to increase the organization's ability to learn?

What are our key values?

- Does the organization have a statement of values?
- Is there general agreement in the organization on what is valued?
- To what extent are values translated in day-to-day behavior that is consistent with the values?
- To what extent are our values consistent with our strategy?

4. What are the organization's strengths and weaknesses in relation to the overall value chain? What works well -- and what doesn't -- in the overall process of meeting customer needs?

Seldom does a single organization control **all** the functions required to go from basic supplies and raw materials to a final product or service. In considering a strategic alliance, it can be very valuable to look at strengths and weaknesses in functions performed by other organizations such as suppliers -- and how a strategic alliance might strengthen (or weaken) the overall value chain.

Organizations should be able to describe the value chain that applies to their own product or service. A review of their effectiveness is useful before entering a strategic alliance, whether or not they are all performed internally, since they nevertheless affect the organization's ability to effectively meet customer needs. Below is an example of a simple value chain.

- Providing supplies, components, or raw materials
- Processing them into a product or service
- Marketing the product or service
- Selling or distributing the product or services to customers
- Servicing the product

In some instances, a review of the value chain may identify the potential for alliances among several firms along the value chain.

PHASE 3 CHOOSING A STRUCTURE: Determining the kind of cooperative agreement to pursue. What kind of alliance will work best for us at this point? Given a first-cut picture of goals and parameters, the organization can identify alliance structures that are most likely to be appropriate.

Strategic alliance structures can vary widely. A key factor in variability is the degree of dependence, independence, or interdependence of the relationship. Structures can vary from the highly dependent (e.g., acquisitions) to the highly independent (e.g., short-term licensing agreements). In addition, organizations can choose

interdependent structures, such as joint ventures. Dependence or interdependence of structures can be modified by specific agreements of the two parties.

Examples of alliance structures: Below are some examples of structures, in rough sequence from independent to dependent. Note, however, that the specifics of an agreement can modify this.

Independent

- right of first refusal licensing agreements
- on-going licensing agreements
- cross-distribution agreements
- joint bidding activities
- sourcing arrangements
- joint marketing ventures
- joint research & development ventures
- minority investment
- self-venturing
- acquisitions
- mergers

Interdependent

- formal joint ventures
- value-added partnerships

Dependent

The nature of the need for a strategic alliance will suggest likely alliance structures -- but often there will be more than one possible structure for meeting some or all of the need. Key factors to consider are:

- **Past experience:** Evidence to date strongly suggests that prior experience with alliances is a key factor in their success. Organizations with little or no experience should look for “low-key” or relatively independent relationships at first, where possible, perhaps with review periods and options for expansion of the relationship built into the agreement.
- **Protection:** To the extent that one or both organizations have core technologies or proprietary information that are critical to protect, they may need to look for either an independent or dependent relationship. The interactive demands of an

interdependent alliance make it difficult to be successful while being highly protective of information.

- **Urgency:** Are there short-term survival needs as well as long-term strategic issues involved? If so, the organizations may wish to consider more than one structure -- or a short-term, limited structure with provisions for modification.
- **Goodwill:** Are all parties positively disposed toward a strategic alliance? Or are there serious questions, reservations, or disagreements about it? If the latter, consider looking for limited, relatively independent relationships at first – with the option to expand.

PHASE 4 CHOOSING A PARTNER: Selecting an organization that best meets strategic goals, complements strengths and weaknesses, and offers the greatest potential for benefits/success. What is the best way to choose? What kind of organization will work best with us?

The criteria below are derived from research and experience, and should be assessed on the basis of the results of the preceding analysis of organizational needs and issues, meetings with potential partners, research, and any reliable source of information one can find.

There are two broad types of criteria: those that primarily affect the potential for synergy in the alliance, and those that primarily affect how easy it may be to realize the potential -- how well the alliance is likely to operate in practice.

Synergy Factors: The opportunity for synergy is in part a function of the **eligibility** or desirability of partners in a generic sense, and of the **fit** between the particular two partners.

Eligibility: The extent to which an organization appears generally desirable to others as a partner, or associate. This includes such things as:

- **Commitment:** evidence of strong interest in an alliance; indicators that it is considered important, of high priority
- **Resources:** quantity or quality of desirable assets, including such things as special technologies, expertise, capacity, finances, etc.; eligibility is enhanced to the extent an organization is strong in more than one area.
- **Experience:** history of success in previous alliances -- and/or evidence of having learned from previous experience.
- **Goodwill:** prestige, reputation for fairness, integrity, being a good organization to work with.
- **Size:** as an indicator of staying power, stability, security.

In addition, an organization's apparent eligibility may be greatly increased to the extent that other organizations appear to be pursuing alliances with it.

Fit: The "ideal" strategic alliance partner is an organization that is similar enough to be easy to work with -- and different enough to offer positive benefits and opportunities for synergy. While alliance partners will still be learning about each other after the agreement has been signed, it is important to start looking for answers to the following questions as early as possible.

1. What are the important similarities and differences?

Questions like this can be helpful: How would your customers describe you? What kind of person is especially respected in the organization? What kind of person is promoted/gets ahead? Why do people join or stay with the organization? If feasible, a neutral third party can often be very helpful in identifying key areas of likeness and difference.

2. How can we learn more about similarities and differences?

All too often, organizations simply don't know where their similarities and differences lie -- and what effect they may have on the alliance -- until too late. If we are unaware of them, differences can "get us" when we least expect it and are least able to respond effectively. It is often helpful to use third parties to gather information: mutual customers, consultants, people who have worked for or with both organizations in some capacity, culture or climate surveys, organizational audits.

3. How can we exploit the potential benefits of similarities and differences?

A key factor in exploiting potential benefits is to approach the alliance explicitly as a *learning experience* as well as a *working partnership*. This should be a stated value or goal of the staff of the alliance, and specific mechanisms to encourage learning should be built into the alliance. Studies of ventures in which one party did extremely well -- and the other was seriously weakened -- indicate that a key difference is that the successful partner actively used the experience to learn.

4. How can we prevent, or minimize, problems that arise as a result of similarities and differences?

A useful approach to potential *problem* differences is a process that allows people to address them in a structured way. For example, regular progress reviews might be scheduled to deal with cultural issues as well as the more traditional goals and objectives. This can also help people deal with issues that might otherwise become too clouded with emotion to effectively resolve.

Operational Factors: Other factors that will affect how well the alliance will operate in practice can be difficult to determine with assurance until after the alliance is under way. To the extent that they can be assessed during early discussions and negotiations, however, they can be powerful predictors of the alliance's ultimate success or failure.

Partnering Values: The more the values of both organizations include, or are compatible with, the values of partnering, the more likely that the alliance will be effective, with reasonable investment of effort:

- **Openness:** willingness to discuss any issue in the spirit of cooperation
- **Respect:** treating differences as stemming from legitimate points of view;
- valuing different types of contributions, perspectives, philosophies
- **Trust:** behaving so that others have confidence in people's judgment, the information they provide, their execution on commitments

Resource Reliability: This factor is related to trust, and deals with the likelihood that the partners can and will deliver on both explicit and implied promises:

- Is the technology good enough to do the job the alliance needs?
- Are resources of adequate quantity and quality available in the alliance?
- Will both parties be able to deliver/provide resources on a timely basis?
- Will both parties provide resources to the alliance at an acceptable cost (in time, money, effort)?

PHASE 5 MAKING IT WORK: Managing the alliance to effectively accomplish mutual goals. How can both parties get the most out of the alliance?

Making a strategic alliance work is in large part like making any kind of major venture or organization work. It has the added complexity, however, of bringing together groups which may have very different skills, knowledge, values and expectations -- and may have little or no history together.

The guidelines for this phase are divided into those dealing primarily with negotiation, with start-up of the alliance, and with on-going operations. The guidelines for the negotiating process may also function in part as selection criteria.

NEGOTIATING THE ALLIANCE

- **Involve the doers in the decisions:** Ensure that those who will be critical in making the alliance work are involved in the decision-making process. If they are not actively involved in selection and negotiation, they must at least be kept fully informed and consulted. This will help ensure that participants in the alliance are committed to it, and have a common understanding of its intents and purposes. Failure to do this is often cited as a contributing factor to the failure of an alliance.

- **Strive for equity:** Work toward both actual and perceived equity; both parties should see the deal as good for them, and fair -- and should see the other party as fair and willing to share risks and effort as well as control and ownership. An alliance that starts out with one party feeling unfairly treated, or suspicious of the other is probably doomed to failure. Apparent greed, or taking an excessively “hard line” in the negotiations is cited as a contributor to difficulties in alliances.
- **Explicitly preview the working relationship:** The selection and negotiation process provides an excellent opportunity to preview working relationships and review them against the expectations for on-going work together.
- **Explore issues fully:** Address all key issues during the selection and negotiation process. To the extent that organizations do so, they derive two significant benefits: first, mutual clarity; second -- and perhaps even more important -- full exploration of issues provides an opportunity to test the working relationships and uncover both opportunities for synergy as well as problem areas early on. The key areas which should be covered represent the “core” of the alliance agreement:

Control: Who gets to make the decisions: share in decision-making or approval authority -- involvement in controlling key business decisions or on-going operations

Ownership: Who gets the immediate, tangible benefits: share in the ownership of the alliance if it constitutes a separate entity; share in the profits

Risk: Who takes the risks: share in the consequences of failure; extent to which the alliance includes protective restrictions on each others' actions

Effort: Who does the work: extent of shared investment of resources in the alliance -- people, material, money, facilities, products, etc.

THE START-UP

Studies and experience with strategic alliances, and other working relationships in organizations suggest that there are process guidelines and principles of working together that significantly contribute to the success of such ventures. These should get special attention during the start-up stage of an alliance:

PROCESS

Communicate broadly and extensively at the beginning: Make sure everyone understands the alliance's goals, any operating agreements which have been made in advance, and the overall intent of the venture.

Staff the alliance with good people: make it worth their while. Managers sometimes use a strategic alliance as a "dumping ground" for trouble-makers, or offer fewer benefits within the alliance, or create expectations that it will be career-limiting to be part of the alliance operation. This does not set the stage for success. It is far better for the alliance -- and often, the overall organization -- to staff it with high quality personnel who will not only make it succeed, but will use it as a learning experience for themselves and the organization.

Review and test process and progress often: against the original purposes, and against partnering principles. All too often, organizations will work very hard to set an alliance up properly -- and then find, later, that it isn't working at all as they'd expected. Built into the alliance operating procedures should be systems for regularly testing how people are working together -- and how the alliance is doing against its original purposes.

PRINCIPLES

OPENNESS: Openness is important to any working relationship. In a strategic alliance between two organizations, it is critical. There should be no "sore points" that can't be raised, nor should there be withholding of information relevant to the alliance's goals. While this may need to be qualified to protect certain core technologies, that issue, too, should be openly discussed.

RESPECT: One of the most damaging behaviors for any relationship is to treat the other party's differences as if they were evidence of inferiority or evil intent. Both parties to the relationship should respect each other's differences. Even where there is a need to protect sensitive information, people should, as far as feasible, make the initial assumption that (1) differences stem from legitimate reasons and positive intent and (2) there is something useful to be learned from them.

TRUST: The probability of the success of a strategic alliance is dramatically increased to the extent that both parties have a well-founded trust in each other's information, judgment, and execution on commitments. Since the partners will often come from quite different cultures, a critical factor in building and maintaining that trust will be clear understanding of how each culture perceives and executes on trust-related behavior.

ON-GOING OPERATIONS

A key issue in managing on-going operations of a strategic alliance is to remember that the alliance was put together to meet specific needs of the partners -- and that those partners have many other goals and needs. The alliance needs regular review to determine the extent of continuing strategic and cultural alignment -- or misalignment.

Strategic Alignment Test the goals of the alliance and the partners; key questions include:

- What are the mutual goals for the alliance? Are they being met? Have they changed?
- Have conflicts arisen between one partner's goals for the alliance and another's (e.g., is one interested in profit, the other in market share)?
- Do the individual goals of one or both partners conflict with those of the alliance?
- Are there goals of either partner which could be further supported by the alliance? -- or which could support the alliance?

Cultural Process Alignment Test the values of the alliance and the partners; key questions include:

- What positive values do the organizations want to build/encourage in the venture? Are those currently in place and supported?
- What "negative" values do the organizations wish to avoid? Are there factors that currently support those negative values that should be changed?
- Do the partners have values that are in actual or apparent conflict with each other?
- Do the partners have values that offer opportunities for mutual support or synergy?

Cross-Alignment Test the goals of the venture against its values; key questions include:

- Do any of the venture's goals strongly imply the need to have certain values in place -- e.g., risk-taking for certain kinds of goals?
- Do the partners both support such values?
- Has the venture been staffed with people who represent those values?

PHASE 6 TAKING NEXT STEPS: Assessing the alliance, and deciding whether to continue, modify, or terminate it. How are we doing and what, if any, changes should we make?

Decisions about next steps in a strategic alliance should be a natural outgrowth of on-going reviews. They should not be based on one-shot assessments made at lengthy intervals. "Taking the next steps" in fact requires recycling through preceding five steps at the review level, at least. Key factors in decisions about taking next steps with a strategic alliance are:

- **Expect things to change:** Many, if not most, strategic alliances are undertaken in response to, or in anticipation of, change. We should expect, then, that the alliance itself will need to change over time, and that it should be reviewed regularly.
- **Test both purpose and process:** All too often, reviews and decisions about next steps focus exclusively on how well things are working against the original purposes. In the current climate of change, it is fully as important to test the original purposes themselves. All too often, effort is wasted trying to fix something that is to serve a purpose that is no longer relevant.
- **Consider all options:** Sometimes, when things are not working as planned, meetings are held to decide whether to continue or terminate the alliance. Any review, whether in response to problems or not, should consider all options:
 - continue as is;
 - continue in changed form;
 - expand or diminish scope;
 - modify purpose;
 - terminate

WHAT ORGANIZATIONS WANT IN STRATEGIC ALLIANCE PARTNERS

A recent study of over 300 joint ventures identified two sets of factors managers in the organization considered in putting together the ventures.

- **Partner selection factors:** the features that organizations sought in partners.
- **Critical success factors:** the characteristics organizations considered critical to the success of the venture (whether or not they had been sought in the partner).

The factors are briefly described below, and listed in order of the frequency with which they were mentioned by managers of the organizations involved in the joint ventures.

PARTNER SELECTION FACTORS

- **Knowledge of local market:** evidence that a partner had intimate access to and knowledge of a local market.
- **Similar firm with local government influence:** evidence that a partner was culturally similar, with the potential to enhance the venture's position in relation to governmental policies.
- **Compatible partner:** general similarity in size, structure, culture; commitment to the venture; compatibility of top management.
- **Low-cost production:** evidence that the partner had the capability to implement low-cost production in the venture -- e.g., access to raw materials or components, low-cost labor supply.
- **Shared development:** partner's ability and willingness to share facilities or costs.
- **Sales and service experience:** evidence that the partner had skilled personnel, particularly in marketing, distribution, or post-service sales.
- **Strategically critical manufacturing capabilities:** partner's possession of strategically located facilities, particularly for manufacturing.
- **Opportunistic neighbor:** partner in a related industry, in close geographical proximity
- **Similar respected firm controlling inputs:** evidence of similarity in culture, size and reputation, with access to key raw materials or components

CRITICAL SUCCESS FACTORS

- **Experienced personnel** (particularly technical personnel and management)
- **Strong market presence** (including valuable reputation/trademark, access to marketing or distribution systems, ability to offer a full product/service line)
- **Rapid, self-financed market entry** (including post-sales service capability)
- **Low-cost, low-price position**
- **Local identity and governmental policies** (sales to government and/or ability to influence)
- **Favorable site**
- **Governmental promotion** (via subsidies or sales to government)

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