How to Manage "Off-Balance Sheet Risk" – *Investigative Due Diligence*

By Steve Vickers

Recent highly publicised scandals in Singapore, the United States, China and Italy have highlighted the unfortunate fact that a major risk to business comes from "off-balance sheet" issues. These factors cannot readily be seen by merely conducting a study of the balance sheet and books of the company or by a cursory examination of legal documents. The lesson of Enron, Euro Asia and many other financial disasters is that in a global business environment, the need to know your partner and how they actually operate is more vital than ever. Specifically the goals of ***Investigative Due Diligence*** should be:-

- To unmask mispresentation
- To reveal the undisclosed
- To clarify who you are dealing with
- To assess associated political and security risks

To avoid major problems it is critical to examine not only spreadsheets and legal documents but also to closely examine people and organizations.

Managers of companies are under considerable pressure to move from more expensive operating bases to other emerging markets and locations, where their core costs can apparently be reduced. International Risk Ltd (www.intl-risk.com) have noted that in a large number of such cases that key decisions are made based on incomplete or poor quality information, especially as it relates to people and politics.

Investigative Due Diligence should be a critical part of the evaluation process before any major transaction. Essentially this identifies issues that have not been disclosed or other business and political risks that are not visible or obvious. The key focus must be on people and the actual entities involved in any given transaction or potential joint venture; their background, reputation, track record or litigation history. In China (and elsewhere) today there are many new entrepreneurs who have excellent qualifications, skills and the appropriate connections. Unfortunately the opposite is also true and it is therefore vital to know the bona-fides of people in business.

Due Diligence leads to better deals

Whether a potential business partner is a listed company, private firm, former state-owned enterprise or an entrepreneur, focussed inquiries need to be conducted to gain a deeper insight into possible risks. Companies require a level of comfort to support strategic decisions. Issues such as the party's reputation, history, business ethics, and individual officers' integrity, business acumen and their actual influence in their local environments can be the key to a successful deal. Unfortunately it is also necessary to identify potential problems, labour troubles, criminal issues, undisclosed indebtedness, and potential regulatory or environmental breaches. Equally important are any bribery-related considerations or potential money laundering exposure.

Investigative Due Diligence involves the collection, collation and analysis of information from a wide variety of sources. It starts with extensive multilingual data mining of publicly available material, specialist trade publications, online resources, media, public records, and corporate filings. This should be supplemented by in-depth and discreet investigative field inquiries.

The very minimum, to be achieved through such an exercise, should include the following:-

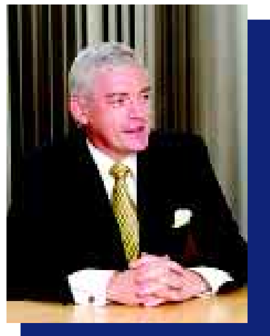
- The real corporate structure – key officers, shareholders & subsidiaries as compared to filings
- The background & current activities of the subjects
- The reputation of your potential partner
- The company's reputation with associates in the same industry
- The activities & background of the professional management
- The character, integrity & reputation of key individuals, owners, key officers
- The level of political support

Practically this exercise should also help identify any liabilities which do not appear on the balance sheet and other undisclosed issues such as the use of "sweatshop" labour or significant environmental issues which could lead to future losses or difficulties with licensing or permits.

Apparently "negative" information acquired through the ***Investigative Due Diligence*** process need not be a deal killer. Such information often offers opportunities for deals to be negotiated on more favourable terms and structured to mitigate the risks identified.

International Risk Ltd suggest that ***Investigative Due Diligence*** is particularly cost-effective when undertaken in the early stages of a project, as it will identify issues to be addressed before a commitment to invest considerable financial expenditure and management resources is made. It can identify potentially serious disclosure failures which might lead to expensive delays, cancellations or most costly of all, damage to the corporate reputation.

"Off-Balance Sheet Risk" is manageable if companies are willing to adopt a robust approach to *Due Diligence*.



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International Risk Ltd is the leading provider of comprehensive business risk solutions, including 'off balance sheet' investigative due diligence, business intelligence and investigations in Asia and worldwide.

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