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Your Global Risk Management Partner

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"2009 Due Diligence Strategies - They Better be Better than Before"

Klink & Co., Inc. - Your Global Risk Management Partner

August 2009

In This Issue

The G-20 Summit is coming to Pittsburgh, PA Sept 24-25, 2009

CEO Jeffrey Klink is acting as an advisor to the G20 Planning Committees

Dear Client,

It looks like M&A is coming back. Klink & Co., Inc. can protect against fraud and overpaying for assets when you make an investment or acquisition. The following tips should help to protect your reputation and capital.

2009 Due Diligence Strategies

By: Jeffrey M. Klink is the Founder and CEO of Klink & Co., Inc.

If the Dreier, Madoff, Stanford, and hundreds of other fraud schemes of the past several years have taught us anything, we now know that pre-deal due diligence investigations are not optional anymore. And we have also learned that it's very risky, if not negligent, to finalize the deal and then do "due diligence" as part of a check the box process at the very end.

In fact, the real lesson of the past 24 months is that comprehensive/robust dd investigations must be completed **before money, time and reputations are spent**. Yet, unless something drastically changes, these fraud schemes will be repeated because most dealmakers don't believe that they will be defrauded or overpay for an asset.

Let's consider the Dreier scheme, where a New York lawyer sold phony real estate notes to hedge funds allegedly worth over $250 million:

Unlike Madoff, where there were suspicions and allegations for multiple years about his conduct and approach to investing, there was no hint of impropriety associated with Marc Dreier, founder and managing partner of a New York based law firm. Dreier LLP had hundreds of employees and multiple offices around the U.S. Marc Dreier looked great, sounded great, and was able to convince former federal prosecutors and others to work for him and give him cover. Only one problem: He was a total fraud, using client's conference rooms to dupe legitimate hedge funds in an outrageous scheme involving worthless real estate notes. As evidence of the extent of the fraud, Dreier is now spending the next 20 years in federal correctional institutes as a result of this scheme. Where did it go wrong for the investors and what steps did they miss?

The funds that made these decisions seemingly never tried to analyze the underlying value of the notes being sold, and trusted Dreier to do the "due diligence" due to his powers of persuasion and stature. If the funds had taken the time to look beyond the nice suit and the nice conference rooms, they would have concluded that the promissory notes Dreier was peddling were worthless.

How could the Dreier fraud and so many like it have been prevented? By simply analyzing the bona fides of the deal and not being held hostage to the charisma of the fraudster.

5 Tips for Avoiding the Drier Trap:

1. Fully investigate all material parts of the deal, including the people, collateral, markets, and other relevant issues first
2. Let the results of the due diligence investigation dictate the terms of your deal
3. Have an independent party look at your deal, do the fact-finding, and identify the risks and liabilities and rewards
4. Remember that due diligence is not pass fail, it's fact-finding for a purpose, and that sometimes it takes weeks and months to be comprehensive , especially in emerging markets.
5. At all times, the deal should be based on the actual, not assumed, facts.

Due Diligence in Emerging Markets - Risk and Reward

We have said it before, but it bears repeating: Emerging markets, such as the BRIC markets (Brazil, Russia, India and China) will be a focal point for multinationals and private investors in the coming years. At some point in the near future, if not at present, dealmakers and risk takers are going to look for greater returns and find them in distressed companies or emerging markets, where GDP growth is 8%, not 1%.

Rewards, however, are always coupled with risk. Therefore, knowing your partners, the local political landscape, and focusing upon details, including the successes and failures of co-investors and principals, will be crucial. Now, more than ever, due diligence is a prerequisite for success when making acquisitions, investments and other deals in emerging economies where there is more fraud and less transparency.

Emerging markets have always been fertile landscapes for crime syndicates. There is substantially more fraud in every emerging market as compared with a mature economy. The court systems and enforcement agencies in emerging economies are lacking, if not totally incapable, and therefore, fraudsters know that they likely will be successful in their frauds. The police and other legal authorities in emerging economies are loyal to the locals, not to foreign investors, and therefore, if it goes wrong, it will go very wrong and there will be limited recourse when problems arise. Often the fraudsters are heavily entangled with the local government, which provides the fraudsters with heavy protection if investors find that they have been duped.

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Effective due diligence strategies, then, must be driven by aggressive tactics, including identification and analysis of the following factors, among others:

- Transparency of the market where the deal is being done -emerging markets are less transparent and therefore, risky markets. Consider this: if Madoff and Dreier could commit massive frauds in the U.S., what can be done in a less mature market?
- Penalties flowing from the Foreign Corrupt Practices Act or equivalent legislation can destroy your profits. Same for Anti-Money laundering directives. So, you must understand the details of the proposed activities and all the key people.
- Legal systems are lacking and corrupt in emerging markets, so what are your recourse strategies? If you invest in a stock in an emerging economy, where do you go to get your money back if defrauded? If your business partner steals your money, where do you go to get it back?
- Political risks are paramount in emerging markets - the government can and will interfere, if it so desires. You must analyze the role of the government and the risks associated with doing business in a specific country. Russia, today, for example, poses certain risks not present in China.
- Have the parties you are dealing with defrauded others in the past? Do they own the collateral being pledged? Have you identified every single country where the principals have done business and completed your due diligence efforts on a global basis?
- Understand the details - If you are buying or will need a manufacturing facility, for example, can you get your goods to market or are the sellers going to block your efforts and then later try and buy the company back from you for less than half of what you paid?

The most critical due diligence inquiry required in emerging markets is often evaluation of the key principals who will run the project or be your partners. Dealmakers must aggressively dig to uncover the principals' industry experience, assets and liabilities, successes and failures, education, former partners, association with organized crime, association with government officials, affiliated companies, conflicts of interest, and whether the parties have a criminal history. Depending upon the findings, you may run away or as in many cases, you will come to realize what a great opportunity is at hand. In no event, however, can you rely upon others to do this work for you. It is your money, or your client's money, and you must do your own due diligence.

CONCLUSION

In the end, appropriate and aggressive factual due diligence strategies will offer a framework to reduce risk, whether your deal is in China or New York state. Further, the knowledge gained from these aggressive inquiries should shape and mold the framework of the deal and can in the end, save you money on the deal. It has been said that knowledge is power, and 2009 due diligence strategies fall squarely within that old saying. Do your homework early, and reap the rewards.

Klink & Co., Inc. is a global consultng firm that advises multinational corporations, banks, hedge funds, and private equity funds on mergers & acquisition, fraud matters, and compliance. Jeffrey Klink has saved clients over one billion dollars by doing the proper due diligence. He can be reached at 1-800-836-8916 or 1-412-201-9123.

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