Creating a Business Intelligence and Due Diligence Framework

Kroll®

Due Diligence

An Altegrity Company

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It is fair to say that a relatively small number of companies have a business intelligence and due diligence model that really works, albeit we are being asked to support an increasing number of clients that are trying to do so. The principal drivers for this are two-fold:

1. Companies are now doing business or prospecting in new markets which, although lucrative, are less transparent, more complex, and carry significantly more potential reputational risk than more familiar markets.
2. Greater personal accountability is being placed on senior management, including executive and non-executive board members for the business which they endorse.

In many cases, this requires cultural change and some investment, which is not easy in the current climate, but those who have been successful have been able to demonstrate the "risk vs. cost" benefit equation and get the appropriate level of senior management engagement, which is critical.

The Risk

Corporations are entering new markets, often without fully appreciating the geopolitical, operational, and cultural nuances of the country concerned. They are also hiring local nationals and intermediaries to help create and exploit new opportunities. Understandably, local national employees' perception of reputational risk in their own country can be markedly different to that of the company. This is not to say that they are reckless, but it is vital that executives and senior managers draw a line in the sand and help define what is/is not an acceptable business risk. Also, regulators are becoming increasingly rigorous in seeking out and exploiting poor employee/client/ intermediary take-on procedures. Recent focus on the FCPA/PEPs/SDNs/AML/Terrorist Financing, and the associated sanctions for malpractice and other shortcomings are becoming extensive, public, and personal.

The Cost

Historically, the cost of due diligence has been perceived by some as unreasonably high. This is due to three factors:

1. Neither the business nor some AML/Compliance departments really understood the various levels of due diligence available and simply asked for a "background check."
2. Neither the business nor the AML/Compliance teams typically budgeted for due diligence inquiries; therefore, the approval process was prohibitively slow, so those responsible for coordinating the inquiry were seen as "barriers" rather than "enablers" to doing business.
3. A few years ago, there were only a limited number of recognized due diligence agencies with true expertise in emerging markets.

This has changed. Companies are aware that there are different levels/degrees of due diligence specific to the context/profile/exposure of the client relationship. Progressive companies are creating due diligence budgets, and there are new and resourceful agencies, such as ourselves, that can undertake a range of inquiries, from initial "red flag" reviews to an in-depth, authoritative analysis of entities and individuals at significantly reduced cost.

The Structure

Our advice to companies in setting up a due diligence program can be summarized as follows:

» It must be properly mandated

» It must have executive/board level sponsorship

» It must be culturally accepted by all functions

» It requires effective monitoring systems in place

» It must be appropriately resourced

» It must be embedded in the employee induction process

» It must be embedded in the client on-boarding/KYC (know your customer) process

In terms of efficiency, we have encouraged a number of clients (normally Business Unit Controllers / AML/ Compliance/Credit Risk/Corporate Security) to ask each of their business units every quarter to identify their top prospects for the period ahead and to categorize them into high priority, priority, and opportunistic. We then conduct initial view (red flag) inquiries for all categories. This often results in a number of red flags, which helps the company know where not to spend further time/effort/cost prospecting. The "flashing amber flag" reports suggest that enhanced due diligence is required prior to the decision point on the prospecting line. The business can discuss with the due diligence coordinator the degree to which any further inquiries are required for the "green" reports (risk profile/exposure would be different depending on the type of relationship, i.e., IPO, M&A, Advisory, Private Wealth). As regards cost for such projects, there are significant discounts for high-volume/batch inquiries, demonstrating that a properly structured due diligence program does not have to be prohibitively expensive.

The Result

No credible organization sets out to be willfully negligent, but they are at risk of been perceived, if not accused, as such by shareholders, clients, and regulators if they venture into new markets without having done their homework. Business intelligence and due diligence should be key components of an integrated risk management model which is endorsed and actively supported by all participating business functions. This is the only genuinely effective way that a company can safely navigate its way through the choppy waters that are new and emerging markets.

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