SUSPICIOUS CASES

The business world is riskier than ever and with regulation increasing are you equipped to cope? asks Mark Townsend

What would happen if you discovered that the prospective partner in a new joint venture agreement had links to corruption or criminal activity? Expressing shock and outrage may make you feel better about the situation – but it won't help your business in an increasingly frenzied commercial environment.

And yet as the economy shows signs of picking up, opportunities to expand, both in domestic and overseas markets, are flourishing.

Last year, UK exports to China rose by 29% according to the Office for National Statistics. And when you view these figures together with China's astonishing 9.1% GDP growth rate in 2003, the signs are strong that greater trade and investment with one of the world's fastest growing economies is on the horizon.

But the advent of this modern day gold rush is not without significant risks, in particular for companies and practitioners new to international commerce.

The temptation to cut corners in the pursuit of profits is a recipe for future casualties in many commercial relationships, not to mention potential losses in investment and reputation. In fact, damage to reputation ranks as one of the most critical risks facing companies and practitioners alike.

Before entering any new market, it is vitally important to carry out an evaluation of the risk using proven business intelligence methods. This includes an analysis often referred to as PEST – the political, economic, social, technological and legislative environment.

In countries and regions such as China, the Middle East and Russia, standards of corporate governance, transparency and intellectual property protection are evolving, but are often lower than the UK. In key growth areas where the UK has global expertise, such as financial services and telecoms, it is important to assess what protection will be granted in the local marketplace.

Additionally, local law can make it difficult to disengage from commercial agreements once they have been formalised.

It is equally important to carry out an integrity check on the proposed business partners and examine their relationship with the local business environment. Carefully consider the accuracy of any claims relating to reputation, business performance and influential links alongside a review of company culture with an analysis of the ethics of key executives.

Once you have got a feel for the company, including some of the less tangible aspects, it is time to look at the books. You should inspect financial statements, paying special attention to the nondisclosure of any pertinent information and identifying any 'red flags' – in particular unusual payment patterns or financial arrangements.

In extreme cases these could signal links to organised crime, corruption and money laundering. Many companies expanding in Russia have fallen foul of these pitfalls.

Much closer to home, the same principles apply, as UK companies find themselves under a tightening regulatory environment where the drive to improve corporate governance appears almost omnipresent.

Aside from the UK's stringent money laundering laws, directors will soon have to certify the effectiveness of internal controls if the Financial Reporting Council gets its way. In practice, areas such as the increasingly cross-border nature of mergers and acquisitions, forensic accounting and expanded due diligence will loom large.

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The recent surge in cases of directors' criminality is well documented, as is the struggling success rate of prosecution by the Serious Fraud Office. Getting a handle on these issues at the start may not eliminate them from occurring, but it will help to significantly reduce the possibility.

The ever-extending arm of US legislation takes the form of the Foreign Corrupt Practices Act (FCPA), and more recently the Patriot Act. The FCPA specifies that US parent corporations may be held liable for the acts of foreign subsidiaries and also extends to foreign firms or persons while in the United States.

Following the terrorist attacks of 11 September 2001, the Patriot Act was devised to regulate the activities of US financial institutions in their relations with foreign entities and individuals. Viewed with the much debated Sarbanes-Oxley Act and its impact on public companies, there is a formidable array of compliance issues to be mangled.

It's a lot to bite off in one go – but planning is everything. The necessity to mitigate risk is often overlooked at the early stages of new market development, particularly when there is a competitive need for quick decisions.

Having a business intelligence strategy and incorporating it into the planning process will ensure authoritative information is obtained about a market and an intended partner.

This will not only reduce the risk of falling foul of expensive commercial errors, but will also eliminate the chances of being associated with a business that has a sideline in suitcases containing generous travelling expenses.

Due diligence now has a wider remit then ever before, and demands a particular skillset to ensure compliance with regulatory requirements. Consider what internal resources are available to fulfil this analysis, as you will have to deal with complex issues.

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