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Reputational due diligence in capital markets

Reputation is increasingly important to corporates as the World Wide Web ensures the world shrinks. For some, Google and Wikipedia are now considered go-to resource for truth and wisdom. Also tools such as online translation software will give the casual enquirer an immediate and often inaccurate translation of a website into an alien language, disregarding any linguistic context and nuances. Bloggers are effectively free to write what they like about any subject they choose, and Twitter users are practically unrestrained in what they can allege. The internet, new media and social networks have broken national borders, challenged sovereignty and national security, and according to popular wisdom, have democratised journalism. In doing so, they frequently compromise the truth and discard nuances and context.

It is well-known that a poor reputation, whether it is deserved or not, can derail an investment. Kroll is frequently asked to work for private equity, corporates and other investment funds to ensure that the reputation of the other party in a transaction is sound and potential liabilities are identified. A Google and an online search will give an investor a basic idea of the other party in a transaction, but it should not be a substitute for professional, discreet fact-finding.

What is less well-known is that a poor reputation can have a similarly destructive impact on companies hoping to raise money on the capital markets. Nomads have a responsibility to undertake reputational due diligence enquiries on entities they are looking to list. For instance, in the case of the Alternative Investment Market (AIM), the Nomad is expected to:

- "undertake due diligence to ensure your company is suitable for AIM
- ensure the directors are appropriate and capable of acting as a board for a company"*

AIM is a good case study as it is very often the most appropriate and straightforward capital market for companies from emerging markets to list; and it is very often companies from emerging markets which have the most significant reputational issues. There are a number of reasons why this is the case. For instance:

- Emerging market companies are frequently family owned companies where international compliance protocols originally had little influence or bearing;
- Companies expanding away from their home markets, for instance from Russia and India in the 1990s, and Malaysia and Indonesia in 2000s, were established in unstable and evolving political environments where some aspects of modern-day compliance norms had not taken root;
- Competition and in-fighting between companies, families, business-politicians, and occasionally well-meaning non-governmental organisations, meant that all too often, untruths and exaggerations were reported as 'fact' in blogs and privately owned media outlets.

An emerging market-based company, having been established in an unstable and unregulated environment, combined with the possibility of distorted and exaggerated reputational issues reported on new media, means that drilling down to understand the truth behind the reputation of a company is critical. Kroll always emphasises to its clients that a reputation is not necessarily built on facts.

Hence, Kroll is able to work with Nomads, and occasionally companies looking to list, to undertake discreet, independent fact-finding due diligence projects focused on determining the truth behind a company's reputation. Using discreet human sources and having extensive networks in all emerging markets, Kroll is well positioned not only to identify reputational issues which are circulating in the market – be they true or not – but also to investigate the origin and veracity of stories and rumors which are out there.

* *http://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/a-guide-to-aim.pdf*

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