ARGO ASSOCIATES

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Billion dollar whales, Saudi Princes and video games – why fraud, corruption, regulatory and political risks are inseparable

We need to reconsider the concept of "due diligence". This is not to deny that the rigid processes that underpin due diligence are an essential part of any acquisition, merger or largescale investment but the very inflexibility of these processes can prevent companies and investors from seeing the real risks that are inherent in their proposed transaction. This is even more the case today where risks can no longer be separated and treated independently but interact with each other in ways that cannot be understood without being able to grasp the broader picture. The due diligence process should be about an intelligent assessment of risk that enables investors to either structure a transaction to prevent potential pitfalls and enhance opportunities, or to see that the transaction itself risks destroying value rather than enhancing it. In the new world of multiple risks that we live in we look at what can go wrong and why.

Fishing for a billion dollar whale

In the 1990s economists thought we were moving towards a global, liberal, free market dominated by private companies and investors, but it hasn't worked out like that. State-owned companies and state-controlled investment funds have become increasingly important, and they constitute a challenge to the traditional way of carrying out due diligence.

One case that demonstrates the problems in spectacular fashion (and is currently causing great damage to the reputation of Goldman Sachs) is the enormous fraud that took place at the Malaysian state investment fund 1Malaysia Development Bhd (1MDB). This case is a perfect example of the interaction of fraud, politics and business risk. The unprepossessing young Malaysian at the heart of this story, Jho Low (or the "billion dollar whale" as he is called by Tom Wright and Bradley Hope in their excellent book about the saga), didn't ever have a formal role in 1MDB, yet he allegedly managed to use his informal control of the fund to steal an estimated USD 5 billion. Goldman Sachs have been strongly criticised for their work for 1MDB but many other firms and banks also had a role in the 1MDB saga in one way or another. How could the due diligence processes of these various institutions have failed to pick up this extravagantly huge fraud? There are three key reasons: Firstly, Jho Low had no role on paper in 1MDB so if the due diligence was focused only on the individuals in official positions his role and profile wouldn't have been even examined; secondly, the political climate of Malaysia at the time allowed the fraud to take place – the United Malays National Organisation (UMNO), the party that had run the country since independence in 1957 with its partners, had become extremely corrupt and institutional checks and balances were no longer functioning; thirdly, hiding the fraud depended on political corruption both in Malaysia and elsewhere – the use of co-conspirators in the Middle East allegedly allowed Jho Low to obtain fraudulent statements (and funds) to support the cover stories about 1MBD's activities. Any real due diligence into 1MBD would have to have asked (at a minimum): who is really in charge here? How does the political climate of Malaysia operate to make the governance claims of 1MDB credible? Are the partners that 1MDB is engaging with themselves transparent and credible in their statements? Clearly, some institutions were not able to gain the right answers to those questions in their due diligence processes.

A Prince in Silicon Valley

Sometimes, though, the protagonist of deals is all too obvious. No-one dealing with Saudi Arabia's USD 300 billion Public Investment Fund (PIF) has ever been unaware that Mohammed bin Salman, the crown prince of Saudi Arabia, is the driving force behind the fund, which is led by one of the prince's closest lieutenants, Yasir al-Rumayyan. And the fund has been lavish in its spending, particularly in Silicon Valley where Uber, Tesla and Lucid have profited from huge investments. It also put USD 45 billion into Softbank's first Vision Fund, which then made substantial investments into WeWork and Slack.

We don't know how sophisticated the compliance procedures are at the PIF but given the make-up of its board it is highly likely that the policies put in place resemble those at other leading funds. Any due diligence into the fund and its investments could well have failed to identify any red flags. Yet, all this rather pales into insignificance when the person responsible for the fund's creation and direction is accused of ordering a hit squad to murder a dissident journalist in the Saudi consulate in Istanbul. Can conventional due diligence procedures account for the risk of something like this happening? Well, any evaluation of risks that examined the political shifts in Saudi Arabia over the last few years, the leadership style of Mohammed bin Salman and the way that dissidents have been dealt with inside Saudi Arabia would have certainly highlighted a high risk of behaviour that would not fit with the ethical standards of the companies taking those investments. And this kind of evaluation would certainly have been at least as important as more conventional due diligence assessments.

The aftermath of the Khashoggi affair has already caused problems for planned investments by the PIF. The Endeavor talent agency has reportedly backed out of a USD 400 million investment, while Virgin Galactic, a space tourism venture, has also suspended its partnership. Nonetheless, some investors may feel that the accusations against Mohammed bin Salman will ultimately be forgotten and they do not need to be concerned in the long-term about PIF investments. They should bear in mind that the accusations have damaged the Crown Prince's credibility at a time when his actions have also created many enemies among the royal family and the business elite. If someone with a wholly different vision for Saudi Arabia eventually takes over, what will happen to the PIF? No-one is accusing the PIF of fraud, as was the case in 1MDB but the impact of political decisions on its investments and on its investee companies is important and measurable.

When regulators cost you USD 20 billion in one day

Both 1MDB and the PIF are sovereign wealth funds, so arguably special cases in the business world compared to private companies and investment funds. Yet, the idea that private companies can also be evaluated without knowledge of political context and climate is a fallacy. Just think of Tencent, which lost USD 20 billion in value in one day last August. This fall was in response to a plan published by the Chinese Ministry of Education to prevent myopia in children and teenagers, which stated that regulators should restrict the number of total online games as well as that of new releases, and limit teens' playing time. Well, you may argue, regulatory risk is always present and is separate from political risk, although Tencent had also suffered in March when regulators froze new game approvals without any explanation. Yet, the actions of the regulators have undoubtedly been driven by the attitude of the communist party more broadly, which has been critical of video games for their allegedly detrimental effect of young people's ethical standards and behaviour. This might seem a minor example of the interaction of regulatory risk and political risk, but it can have a much wider impact. For example, Qualcomm's proposed USD 44 billion takeover of Dutch chipmaker NXP was reviewed by the Chinese Ministry of Commerce (Mofcom) in connection with supposed antitrust issues. Mofcom never actually turned down the takeover but its lengthy delay in approvals effectively killed the deal. That delay could have caused by antitrust concerns, but most commentators believe that the U.S. – China trade war was the main cause of the refusal. And we shouldn't just single out China. Regulatory approvals globally are increasingly affected by a political agenda rather than a neutral assessment of the technical issues raised by the deal.

A new methodology based on an old definition

So, to go back to that maligned phrase "due diligence" – etymologically it comes from the Latin words *debere*, "to owe" and *diligentia* "attentiveness, carefulness". Ironically given the above remarks on Crown Prince Mohammed bin Salman, the first recorded use of the phrase was around 1600 in a poem by Richard Carew called "A Herring's Tale" in which he spoke of the need for subjects to obey their monarch with "due diligence". In a sense this meaning was the opposite of our current understanding in which "due diligence" should reflect an objectiveness and scepticism in its appraisal of individuals and entities as opposed to blind obedience. Yet, if we focus purely on the idea that due diligence consists of the attentiveness owed by investors or managers to any commercial endeavour that they may be involved in then we can see that such attentiveness may be required to many different forms of risk – financial, reputational, legal, political, regulatory - and that each of these risks informs and changes the others. Given this, due diligence providers should be able to address multiple areas of risk in a holistic fashion and anyone co-ordinating the due diligence process should ensure that individual practitioners or companies are not kept in separate siloes but are able to interact properly with each other. Too often modern due diligence efforts demonstrate an inability to see the wood for the trees, the very opposite of the attentiveness required in such situations.

About Argo Associates

We seek to provide our clients with the information and intelligence that will allow them to navigate acquisitions, investments, disputes, or frauds in a clear-sighted and rational way, minimizing risk and maximizing opportunities.

Information gathered may clarify the profile and background of key business people and managers; it could illuminate the operations of a company or demonstrate a history of fraud or mismanagement; or it could help our clients to assess the political situation in a given jurisdiction and how it may affect their investments or business operations.

Headquartered in Hong Kong, Argo Associates assists clients across Asia and – through international partners – globally.

Intelligence Gathering

"Intelligence" is central to making sense of the world and to decision-making. Argo Associates has developed a network of well-placed human sources across Asia and – through our partners outside Asia – globally. This network provides insights beyond what is available publicly – into leadership, operations, strategy, corruption, red flags, political connections and so on - and is supplemented by extensive research and analysis of publicly available sources – corporate filings, litigation filings, regulatory communications, media articles, social media postings and so on. In a world in which information is increasingly commoditized, high-level intelligence and analysis provides the insights that give our clients an edge over their competitors.

Fraud, Corruption and Disputes

Our intelligence-gathering techniques and in-depth research and analysis have also helped our clients uncover frauds within their operations or in those of a portfolio company or recent acquisition. Our professionals have provided numerous reports for arbitration or legal proceedings to recover the proceeds of fraud. We have also assisted clients in tracing assets globally when bringing a high-value claim against a company or individual. In high-profile disputes we have assisted top law firms in gathering information, evidence and intelligence in support of their clients' cases.

Political Risk

Our political risk work has developed naturally out of our intelligence and investigative capabilities. We see political risk as an important part of the evaluation of many investments, mergers and acquisitions, as well as a key element of commercial disputes in many markets. We have helped our clients look at political risk in a new way, not just in terms of the broad outline of potential political developments in various countries, but with a focus on the impact on their businesses. For example, will growing frictions between two countries lead to tariffs that could impact the specific sector in which a portfolio company operates? Or, how will rising protectionism in a country alter the possibility of a fair result in an ongoing commercial dispute? Frequently, politics is local as much as national and we understand the importance of drilling beneath the widely-circulated opinions to a real understanding of what is happening.

Jason Wright, Managing Director of Argo Associates

Prior to founding Argo, Jason was a Managing Director in Hong Kong for Kroll, having previously run the company's business intelligence operations in Southeast Asia. In addition to assisting clients on numerous transactions, investigations and disputes in Asia and Europe, - particularly private equity funds, banks, hedge funds and special situations investors - Jason has also specialized in the analysis of political risk, whether that has involved examining the role of local politicians, regulators and other stakeholders, or broader geopolitical concerns. Jason is a scholar of St. Catherine's College, Oxford, having been awarded a Master of Arts (Oxon) in English Language and Literature, as well as a Master in State Management and Humanitarian Studies from La Sapienza University in Rome, Italy.

Yulingbo Mao, Head of Greater China

Before joining Argo, Yulingbo worked in the Business and Client Intelligence Unit of Deutsche Bank where she advised the deal teams and the management board on existing and potential high-risk clients and major transactions. Prior to that, she was a case manager in a number of leading international corporate intelligence and investigation companies.

Yulingbo specialises in enhanced due diligence, business intelligence, asset searches, fraud investigations and other types of complex investigative projects. She has assisted numerous financial services, legal, regulatory and corporate clients in making informed decisions related to potential and existing investments, mergers and acquisitions, IPOs and de-listings, senior management and board appointments, market entry, internal investigations and disputes and litigation. She is a native Mandarin Chinese speaker with fluency in English and Cantonese. She holds a Master of Finance from the Hong Kong Polytechnic University.

Lina Gautama, Director

Lina Gautama is a South-East Asia expert, focusing particularly on Indonesia, Malaysia and Thailand. An Indonesian national, she has advised clients on political, commercial and integrity risks across the region. As well as handling complex investigations in sectors such as mining, oil and gas, and the automotive industry, Lina has also delivered anti-bribery and anti-corruption assessments for foreign investors and overseen pre-transaction investigative due diligence projects across the region. Prior to joining Argo Associates, Lina worked with Control Risks, Keppel and ConocoPhillips. She holds a bachelor's degree in Business from Singapore Management University. Lina is fluent in Bahasa Indonesia, Bahasa Melayu and Mandarin, and speaks some French, Spanish and Thai.

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