DUE DILIGENCE AS A TOOL OF ENTREPRENEURSHIP RISK

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***Abstract**: The present stage of market relations development is characterized by the increase of business activity of business entities through the attraction of foreign investments, the opening of branches, increase of efficiency of use of resources. This contributes to the increase of employment of the population, an increase of production volumes and its realization, additional sources of financing of activity of economic entities appear. However, such trends increase legal and financial risks: loss of investor assets, weakening of competitiveness, loss of business attractiveness, loss of market share. One way to minimize business risks is to use the Due Diligence procedure.*

***Keywords**: Due Diligence, verification, representative result, the value of the activity, investments.*

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1. Introduction

The two English words «Due Diligence», include the procedure of checking the state of business, its specific parties or a fact by analyzing the relevant documents. Due Diligence has become necessary for exploration of all aspects of the target company, such as the finances, the manufacturing, the legality of operations, information security, human resources, to see if the initial impressions of this company were accurate, to decide whether to continue the acquisition process and at what cost. The application of the tool helps to evaluate how the acquisition will affect the efficiency of internal business processes and create new opportunities, providing the opportunity to promote the strategic goals of the company and increase its value for shareholders. The procedure can be a global nature when specialists study the financial side of an entity, its activities, reporting and compliance with the statutes, certificates agreed to base legislation, and many others. During the examination, financiers, appraisers, lawyers, technical consultants, engineers, and security specialists work. But more often the valuation is needed only for something alone, such as real estate documents when buying or selling it, then they are completely dispensed with by a professional lawyer.

Due Diligence plays a big role in management companies, allowing to execute, reduce or minimize negative consequences. Its use makes it possible to accurately and timely identify threats to the entity's activities and make appropriate decisions within the risk management policies that it has developed. This process makes it possible to establish a trusting relationship between the buyer and seller of a business or asset.

2. Analysis of recent researches and publications

Both foreign and domestic scientists have devoted their attention to the study of entrepreneurial risk assessment tools: J. Bower, R. Waterman, R. Kaplan, D. Norton, I. Blank, D. Ryabikh, A. Nicevich, I. Koltsova, A. Peresada, O. Vovchak, A. Skorobogatov, T. Mayorov and other researchers. Discussion questions regarding the application of Due Diligence caused the choice of the topic of scientific work, its purpose, tasks, methods and directions of research.

3. Setting objectives

The purpose of the research is to study Due Diligence as a means of making informed decisions, as a mechanism for ensuring the successful development of business entities, as a tool for identifying risks when investing projects, as a procedure to verify the legal status of the business.

4. Obtained results and discussion

At the beginning of the XX century. the concept of «Due Diligence» was introduced and was used for legal purposes. At that time, the term meant the procedure by which a broker discloses information to an investor about an entity whose shares are traded on a stock exchange. Due Diligence has changed somewhat today. The tool is now used to collect and analyze information to assess the various risks involved in investing procedures [1].

Due Diligence is a mechanism that ensures the independent collection of objective information and the expert evaluation of the assets of the business being sold. The procedure allows the customer to obtain a reasoned answer in a short time about the expediency of financial investments in the object of investment (verification of the legality and commercial attractiveness of the planned agreement or investment project) [2].

Due Diligence also applies to the merger or acquisition of an entity, the purchase of valuable assets. It is needed in any situation where a professional's independent opinion is needed regarding a future agreement, whether investing, lending or even sponsoring a startup project. In addition, Due Diligence is a way to assure the customer that his or her potential partners are legitimate.

There are several situations in which companies need Due Diligence:

- equity participation of the new owner in the company;
- change of leadership;
- receiving sponsorship;
- loss of intellectual property;
- reduction of competitive positions;
- reducing the efficiency of the enterprise;
- litigation, seizure of the assets of the firm;
- detection of violations during the tax audit;
- labor disputes.

The tool can help you identify ways to improve the legal and financial standing of an entity. Due Diligence is one of the stages of the acquisition of assets, as it helps the investor to form an idea of the product of sale, the possible risks at the time of property appropriation, and the crisis situations that may arise after the conclusion of the transaction. The tool is based on the analytical evaluation of information on changes in the external and internal environment of the enterprise by checking all components of the business, in particular: legal, financial, accounting, tax, marketing, information, management, environmental, technical, operational nature.

Due Diligence often involves the following specialists:

- lawyer (responsible for conducting legal and legal expertise of the organization's activities to identify potential risks for the investor associated with its acquisition);
- financial analyst (his work includes the determination of the present value of the investment object and its possible range of value in different options for the use of the asset in the future);
- the auditor (his competence includes the financial audit of the company's activity over several reporting periods, as well as identification of tax risks and possible ways to optimize the tax base).

They are mandatory participants in the holding process, however, other experts may be invited to join the working group. The team must include financial, accounting and legal staff, but it can also include economists, engineers, environmental experts and other professionals. Successful Due Diligence depends on the clear and consistent work of appraisers, auditors and lawyers, as well as on the timely submission of reliable information by the seller [3].

Some businesses, due to their savings, do Due Diligence on their own. Specialists from the relevant units are involved in this purpose. The application of this approach at the enterprise has both advantages and disadvantages.

The advantages of refusing to hire specialists are:

- reducing the cost of the procedure;
- having in-house specialists of deep professional knowledge in the field of activity of their enterprise;
- an opportunity to evaluate your own business from the inside out and more accurately formulate possible risks and recommendations for their elimination.

The disadvantages of refusing to hire external experts are:

- diversion of employees from operational tasks;
- Due Diligence on its own only when acquiring a business in a similar field of activity;
- the risk of bias.

Thus, due diligence is advisable to be conducted in small enterprises, because comprehensive analysis of big business requires not only highly qualified specialists but also high research costs.

There are cases when evaluation companies are involved in the procedure, providing the customer with turnkey research results. Another option is to involve professionals from various law and audit firms specializing in Due Diligence services. The disadvantage of this approach is that it takes a lot of time to search, invite and agree on the terms of inspection with the experts of different companies, and the cost is higher than when ordering a turnkey study since the working group includes financiers, appraisers, lawyers, technical consultants, engineers, security specialists, whose services are paid for separately [4].

Every business faces risks that can threaten its success, so processes, methods and tools must be applied to manage them. The following risks should be taken into account when conducting business activities: strategic risk, for example, when a competitor enters the market; the risk of compliance with the new legislation on occupational safety and health; financial risk, for example, when a customer fails to pay on time or increases interest payments on a business loan; operational risk (breakage or theft of equipment); environmental risks, including natural disasters; employee risk management; political and economic instability in any foreign markets to which the sales product is exported; risks to the health and safety of the personnel of the enterprise [5].

Enterprise risk management is possible subject to effective internal audit. The internal audit task of a risk management system is to provide reasonable assurance to owners and managers that the risk prevention strategy they have developed is tailored to the operating characteristics of the enterprise and is effective.

Internal audit is a functional controlling entity of the entity that reports to the owner and works to evaluate the effectiveness of the enterprise management system and the control system. Its purpose is to protect the interests of the owners in maintaining and efficient use of the resources of the enterprise, as well as to obtain reliable and complete information for making sound management decisions. Internal auditors provide the management of the entity with analysis and evaluation data, recommendations and other relevant information as a result of the audits. According to the results of the control, the previously made decisions, plans, norms and norms are adjusted. Effective control is strategic, goal-oriented, timely and simple enough. In the general management system, control acts as a feedback element [6]. Effective interaction of internal audit and use of Due Diligence tool reduces business risk and even avoids financial costs in case of unforeseen situations that will damage the business entity. Consider the approach to implementing the Due Diligence procedure and how internal audit works (Figure 1).

To reduce the entrepreneurial risk of Due Diligence goes through the following steps:

1. general information about the object of expertise is collected, meetings with the management of the enterprise are held, preliminary business plans, strategies, documentation are evaluated, hypotheses are made regarding the directions of further analysis of the enterprise;
2. conduct external interviews with experts, clients and sales channel representatives, contractors and partners, analyze customer needs; performs an overall assessment of the market that is within the

business focus of the company and forecasts its development in the short term, as well as provides advice on choosing a promising business model that meets the current market challenges;

3. interviews with clients using competitors' products and services are conducted, contacts with competing companies are conducted under the guise of a client, the degree of quality of customer service is evaluated, the amount of time between contacts and an offer that competitors can provide is determined;

4. an internal analysis of the company is conducted, the adequacy of the existing resources of the company is substantiated to ensure full compliance with the strategy and the ability to execute the set plan for the specified period;

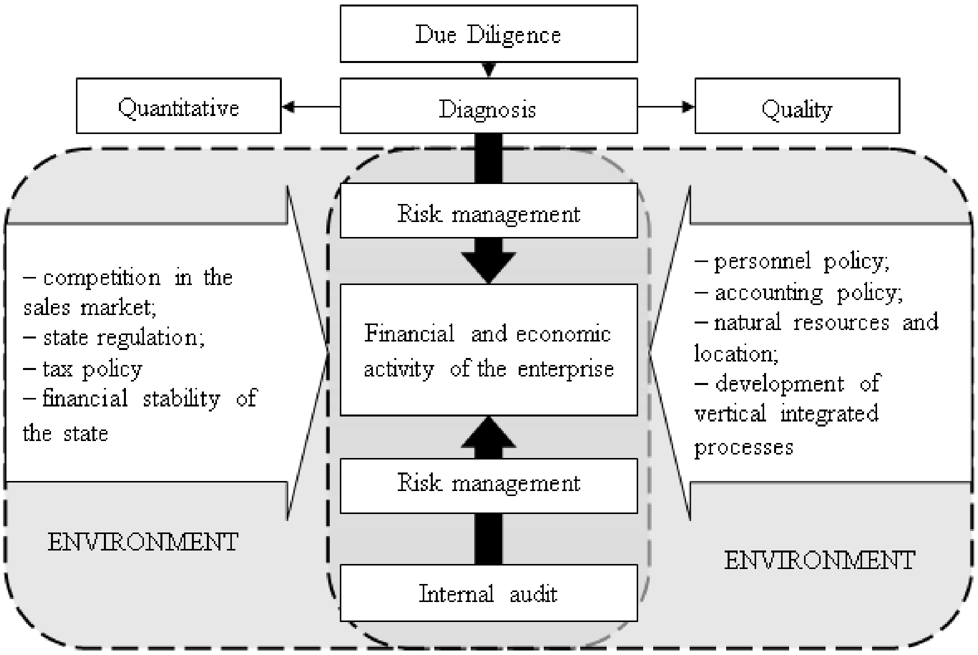

Figure 1: A systematic approach to the Due Diligence procedure
Source: [7]

5. provides a comprehensive assessment of the company's sales, its profits and expenses in the operating period, financing and possible investment from external sources, comparison and consistency with industry-wide indicators and by subgroup of goods and services relevant to the enterprise;

6. analysis of the current assessment using methods of stresses, aimed at determining the possibility of implementation of a given enterprise strategy, checks the compliance of the company strategy with respect to goals and objectives, sales levels set for the financial period and the implementation of planned sales;

7. the conclusion is reached regarding: the market, its competition; introduction of new technologies; prospects for solving strategic issues; the company's existing strategic development plan; key elements of a business plan [6].

Due Diligence plays a major role in managing an enterprise's risk environment. The mechanism under consideration allows to avoid, reduce or minimize the negative consequences. The procedure became a necessary stage of the investment process and it is advisable to carry out the investment before investing the investor in the investment object. Its use allows to identify correctly and in a timely manner the threats during the activity of the enterprise and to make appropriate decisions within the framework of its risk management policy. This process makes it possible to establish a trusting relationship between the buyer and seller of a business or asset.

5. Conclusions

Today, it is necessary to carry out business activities taking into account the risks that may arise in certain circumstances. There is a need for transparency when engaging with stakeholders, investors or partners. This issue is currently relevant for large business entities that have good positions in the market, as well as for business, which is just developing. Any contracting company or investor who plans to invest in a particular business wants to be fully confident in the profitability and security of a future deal. This can be done on the basis of reliable and comprehensive information that can be obtained from a comprehensive Due Diligence audit.

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