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Why You Can Be The Loser in a Win-Win Deal

If the deal *is* too good to be true, that's the time to check out the dealmaker.

Larry Ross, *President Ross Financial Services Inc.*

By Larry Ross

Many of us are reluctant to suspect our peers of anything less than good faith. This bias may be good for human relationships, but it can be bad for business. The truth is, not every lie is told by an outrageous liar. Some people who have a history of honesty will falter under intense financial pressure. Others lie to themselves; they believe a story that simply isn't true. It's a challenge to protect against such difficult-to-detect dishonesty.

Of course, the best business leaders have a nose for people. Their instincts are usually dead-on. But the best business people also know their limits.

Instincts are valuable. Objective information is priceless.

So before embarking on a deal, such as a partnership, merger, or major investment, a shrewd businessperson brings in a third pair of eyes to go over the fine print — eyes with the training and experience to spot irregularities that can sour a deal, eyes that belong to a private financial investigator.

Investigators are impartial. They tease out tiny inconsistencies on a balance sheet. Question circumstances that look almost normal. See relationships between seemingly unrelated facts. Investigators find discrepancies that a standard due diligence investigation would miss. In short, they can warn a company that is about to fall in love with the wrong target.

At Ross Financial Services (RFS), a private investigations firm with a national reach, we have in the past decade handled cases that would curl your hair. We deal with the kind of stories that make for great cocktail conversation.

Unless your company is the one at risk.

Never Trust a Wooly Wolf

All too often, RFS is asked to conduct a due diligence investigation when there is tremendous pressure to close the deal. At this point, clients already have spent time and money negotiating the package. In some cases, clients hire us at the very last possible moment, hoping to put to rest a nagging sense that something isn't quite right.

In many more cases, of course, people ignore their instincts, don't hire a PI, and live with the consequences.

To illustrate, I will relate a few of our experiences, with the permission of clients and with some details altered for purposes of confidentiality.

One recent case of last-minute jitters involved the owner of a jewelry store who was very eager to sell her business. Its principal asset was inventory, and its owner had located a buyer who proposed to pay a substantial portion of the consideration with a promissory note. The buyer furnished a sketchy financial statement and what appeared to be a legitimate copy of his own credit report by one of the three major credit reporting agencies.

Just before she was ready to sign, the seller asked us to complete a due diligence investigation rapidly and without the buyer's knowledge. According to the literature, consumer credit reports are not reliable. RFS investigators usually pull reports from all three agencies because any one may be flawed. But it's illegal to do that without the authorization of the consumer. So in this instance, we analyzed only what the buyer himself had provided.

For the most part, things looked fine. The buyer was apparently paying his debts within terms, with the exception of a disputed debt under current reinvestigation.

There was just one oddity.

The seller said in his financial statement that he owned a residence and owed a mortgage debt. But his credit report listed neither mortgage nor major debt. Even to our investigators, with their habitual skepticism of consumer credit reports, this seemed a rather gaping omission.

So we switched tacks and, using the same public records that a credit reporting agency would, created an unofficial "from scratch" report. Again, there was no record of real property in the buyer's name. Yet this search wasn't fruitless. It uncovered five judgments and one tax lien against the buyer, where his credit report listed none. And it revealed some bad news: criminal charges had been brought against the buyer in federal court.

Based on our findings, the storeowner chose not to sell her valuable business to this particular buyer. It is lucky that she listened to whatever voice told her to double-check the seller's credentials. Still, she might have saved time, money, and anxiety by consulting us earlier in the negotiations.

Not All Liars Have Long Noses

Many people make the mistake of thinking they will spot the telltale signs of dishonesty — shifty eyes or sweaty palms — before it hits them. In fact, most of us are horrendous lie detectors.

An article in the May 1999 issue of *Psychological Science* points out that lay people detect lies only 54% of the time. That's not much better than a random coin toss. Trained state investigators are a little more accurate, at 67.5%, while federal officers, like Secret Service agents, can identify liars almost three times out of four.

A good financial investigations firm knows what questions to ask. But any interview method has its limitations. So we use document analysis to back everything up. Our accuracy approaches 100%.

Document analysis involves the finding, examining, and correlating of publicly filed papers and other materials that may be readily available but can be overlooked without special search techniques by skilled investigators who know what they are looking for. The analytical process is particularly successful at catching people who have always been honest but deviate from the straight and narrow because of a change in circumstance. As Sonny Manosson of Boston Financial & Equity said in the November/December issue of *Secured Lender*, "Relationships do not seem to make any difference because the person committing the fraud is really in need of funds, and when the pressure for money gets great enough, it breaks down all barriers, even that of friendship."

A case in point: RFS was hired to locate hidden assets that would satisfy a judgment that a court rendered in favor of our client, a plaintiff. The defendant in the case was our client's former business partner, a highly respected lawyer. This man had enjoyed great financial and personal success, including a partnership at a top-notch firm and a sterling reputation in the legal community. His credit was perfect. He seemed positively incapable of nefarious behavior. Even our client never suspected, until he'd been defrauded of a substantial sum.

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The case was, sadly, typical. The defendant had been honest until suddenly and through no fault of his own, he was forced out of his law firm. Despite dwindling financial resources, he was determined to sustain an opulent lifestyle. Perhaps fraud seemed the only way.

Meanwhile, a pending court case unrelated to our client's would hold the defendant responsible for $1 million. A second decision, not yet reported, established that he had committed fraud in a distant state. Neither case turned up on a consumer credit report; only a careful search of public records revealed these legal actions.

An even more careful search revealed a six-figure bank account in another state. The defendant had taken pains to conceal his stolen money. But through our investigation, our client was able to collect his judgment.

The Man Who Told Lies to Himself

In the most difficult cases, people are not even aware that they have concealed something. This kind of person is just a little overenthusiastic. They are so enthusiastic, they become convinced their version *is* the truth.

An entrepreneur recently approached a potential investor with what looked like a dynamite business plan. The plan included a letter from a large, established firm expressing its interest in placing a large order for the entrepreneur's software application.

The investor was interested but cautious. Was the market really there? Were any new competitors on the horizon? He asked RFS to do a careful check, which essentially involved a competitive analysis.

Everything came up roses until we spoke with the executive who signed the letter. At first the executive confirmed an interest in purchasing the software. But in response to more pointed questions, she admitted that although the proposal was very interesting, it didn't have a place in her employer's budget. In fact, she revealed, she was in line for a promotion in a different city. Our investigators concluded that the entrepreneur's project would likely be orphaned.

Without backing from the potential customer, the entrepreneur's deal was valueless. Yet it would be a stretch to say he acted deceptively. He assumed that all would go according to the business plan. The investor was wise to be sure that the right questions were asked, and asked persistently.

Lying for a Living

The habitually dishonest believe it's a dog-eat-dog world, so they are usually busy wolfing down more than their share. These people can be astonishingly brazen, as we learned firsthand when we were both the investigator and the client. In the last year, two different businessmen approached RFS to conduct joint business ventures. Both had degrees from Ivy League universities. Both were prominent in the local business community. Both expected that we would not perform any due diligence on them. Both were wrong.

Our search of local court records revealed that one of the individuals had five judgments and two tax liens filed against him and owned no property in his own name. The other man had a million-dollar judgment against him, based on fraud. When he filed for bankruptcy, the judge dismissed the case, citing misrepresentations and fraud.

These cases are the most telling. If there are people trying to pull one over on a firm like RFS — a company that specializes in uncovering fraud — there are cold-blooded con men just waiting to take you.

Finding the Truth

There are two lessons to be learned. The first is that a person doesn't have to be criminally minded to fleece you. The lion's share of what they tell you may be the truth, but the little bit they omit can make a critical difference to your company or profit margin.

As Allan B. Smithee, the pseudonymous author of *Down and Dirty Due Diligence*, writes, "Never, ever be intimidated by anyone, anywhere, anytime. Never be so intimidated by someone's credentials and convictions that you fail to question and verify their claims. Respect everyone, be intimidated by no one."

The second lesson is that it is always less expensive to find out a deal is flawed before you sign the dotted line. It's not that all of us in the business community should suspect our peers and partners. But at a certain juncture in any transaction, it is extremely useful to find out whether the deal on paper exists in reality. ❐

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