



**ÆGIS** e-journal

***Addressing threats that affect your bottom line***

Volume 6 Number 12, December 2003

From the case files of

The LUBRINCO Group  
<http://www.lubrinco.com/>

and

Financial Examinations and Evaluations, Inc.  
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## **1. Due Diligence — Fleecing the foreigners**

A lot of people think of due diligence as something that must be done in large business deals, but is of less importance for individuals in small business deals. If you look at the plight of people who come to the U.S., it is easy to see that this is not so.

Many people come to the United States from abroad, often bringing with them a lifetime of savings and high hopes for their future in the land of opportunity. Unfortunately, their faith in the American way of life, coupled with their unfamiliarity with the system, makes them easy prey for the unscrupulous.

We have seen two cases recently in which families fled their native lands, bringing with them their family's money to invest. In both cases the results turned out badly because of a failure to exercise due diligence.

### ***Case one: Swampland in Florida***

In the first case, prudently working carefully with an attorney, a family ended up buying swampland in Florida. Although in this case the attorney went to jail, the family's money was never recovered.

We don't wish to intimate for an instant that all attorneys are crooks. In fact, most of them respect their profession and diligently carry out their duty regarding their clients. However, it is important to keep in mind that attorneys have a lot of your trust, and, in many cases, a lot of control over your resources, and it is important to keep in mind that without trust there can be no betrayal.

In the swampland case, the attorney was a crook and the family was not prepared for this possibility. There was no exercise of due diligence, and nobody unconnected with the attorney actually looked at the land.

The bottom line is that attorneys are human, and, even if you have a lot of money and pull, you need to make an effort to understand what they are doing, and to make sure that whatever is done is what you want done, and that it is done as you would like it to be done. As Lenin said: "Trust is good, but control is better."

## **Case two: Overvalued franchise**

In the second case, prudently working with an accountant, a family ended up buying a franchise (including in this case the rental of the property and plant) that turned out to be substantially misrepresented and therefore could never make a profit. We are not directly involved in this ongoing case, so we cannot comment further or speculate on what the outcome will be. What we provide, however, are some thoughts on dealing with this type of situation.

Accountants face what you might call the *accounting dilemma* (we don't know the accounting term or art). When accounting is done or an audit carried out the goal is to make sure that the numbers are internally consistent and make sense, but not necessarily to confirm that they are real. In fact, audits are as much about the process as about the numbers. When clients deceive accountants, withhold or manufacture information, and play "timing games" with the books, the numbers may not always represent reality.

Thus, even though the paperwork might be internally consistent, business transactions call for the appropriate exercise of due diligence, which is the verification of claims that have been made **and the recognition, identification, and examination of things that haven't been stated.**

What could this include? If a walk-in business has been legitimately successful, you might want to know about a new highway that will allow most customers to bypass the neighborhood. If you buy a patent you might want to know that it was not current. If you are buying a building you might want to know that the seller doesn't own it (we know of someone – once called the smartest businessman in America by the Wall Street Journal – who thrice sold the GM building). If you are acquiring technology you might want to know if it has just been replaced by some newer technology. If you are buying land you might want to know if it is above or below the water.

In the franchise case, the accountant trusted the financials, and the family was not prepared for the possibility of their being misleading. There was no exercise of due diligence, and nobody unconnected with the accountant actually looked to see if the neighborhood could support the franchise.

The bottom line is that accountants and auditors are not financial investigators, and make some assumptions regarding the veracity of the numbers they are given. It is your responsibility to make sure that the numbers match what is happening in the real world.

Being taken advantage of isn't limited by age, education, nationality, sex, religion, or country of fraud. It can – and does – happen everywhere to

anyone and everyone, sometimes due to lack of familiarity with local or foreign business practices, and sometimes simply because we are too trusting or too embarrassed to ask for confirmation of facts stated. We wish that more people – particularly people at high risk of being taken advantage of – recognized that the key to successful due diligence is to do due diligence!

## **2. OPSEC, Economic Espionage, and Competitive Intelligence — Negligent action lawsuits**

As we have often mentioned in these pages, economic espionage is very costly. The estimates are that economic espionage costs American companies \$300 billion a year, with the cost per incident at \$50 million in a manufacturing firm, and \$500,000 in a non-manufacturing firm. Economic espionage results in lost revenue, lay-off of employees, and even bankruptcy and loss of the business.

If the costs are so high, why does no one pay attention to economic espionage? By no one, we mean that you can probably count on the fingers of one hand – with a few fingers left over – the number of companies with anyone on their executive (or even senior operational) staff responsible for preventing or dealing with espionage (and few active competitors in our area of specialty). There are several possible answers to this question.

One is that while it is easy to see the results of economic espionage – bids lost, market share lost, revenues declining, staff made redundant – it is equally easy to attribute these to causes other than espionage.

Another is that recognizing and dealing with espionage requires specialized skills, training, and experience. As with tax attorneys, the folks who do this sort of thing are simply too specialized to have in-house expertise, even given that a company is aware of this issue, and the normal outside experts to whom you turn for consulting work aren't likely to be much better off. While LUBRINCO has intelligence and counter-intelligence and OPSEC people on staff – this is, after all, what we do for a living – and wide contacts within the field (having a vice president who is on the board of the OPSEC Professionals Society doesn't hurt), virtually no accounting, consulting, investigative, or law firms do.

Another is that companies tend not to take protective actions unless they face some liability.

- If the theatre you go to has a fire-retardant curtain, it is because they face liability if there is a fire and they don't have one, even though gaslights are no longer used.

- If the exit doors in your facility are not chained, it is because of the liability that they face after the 1911 Triangle Shirtwaist Company fire.
- If a brokerage firm exercises due diligence as part of a stock offer, it is because they face liability for not doing so.
- If you go through any sort of security check at an airport or going into a building, it is because someone faces liability if something bad happens and nothing was being done to give at least the impression of taking preventative action.
- If your local police department brings their officers in from time to time to practice night shooting, it is because they face liability if they don't, and someone is shot at night.

Until now companies have faced no liability if they were the victims of economic espionage. Rumor has it that this might be changing. We have, of late, heard talk from a group of shareholder class-action attorneys that economic espionage has reached a level where companies and their board members should know of these risks and take active preventive measures. If these rumors are true, we might expect that in the future, when companies are the victims of economic espionage, the officers and board are likely to be on the receiving end of a negligent action suit on behalf of the shareholders. Once case law is established, economic espionage will be taken seriously.

### **3. Executive Protection — Alternative travel issues**

There are many people now unwilling to fly on commercial airliners. There are various reasons for this. Some people feel that the flurry of government security theatre has made air travel more dangerous.

Others feel that air travel has simply become too unpleasant.

In one case a decision to abandon commercial flying was made after two women on the traveler's flight were handcuffed. The traveler made the decision that this sort of inappropriate behavior should not be supported, and he has never flown again. Why were the women handcuffed? Because they **had** to go to the bathroom, and the illegal potty break was attempted within a half hour of the destination, albeit before final approach.

The problem, of course, is finding reasonable alternatives to the current rules. If you happen to own your own aircraft the decision is easy: You fly. Many who own cars but don't own planes have chosen to drive. Since driving is much more dangerous per mile traveled than flying, this puts us in

the odd position of having a government travel safety policy that actually increases travel deaths!

Some have opted to travel by train, on the theory that the worst train seat is more comfortable than the best airplane seat, and that (on corridors that have effective train service) by the time you factor in the time wasted in security, a train is not much more time-consuming than an airplane. It is also a more civilized and less demeaning way to travel these days, and we, ourselves, opt to travel by train whenever possible. Plus, when was the last time you heard of a train falling out of the sky?

But don't think that trains are risk-free. On 6 July 2002 Arthur Gavender, a retired Civil Engineer, P.E., Commercial Pilot, and Certified Flight Instructor who has flown everything from teeny planes to large corporate aircraft (and, coincidentally, was our flight instructor) took the car-train from Florida to Virginia. During the trip he became convinced that the train was close to (or exceeded) safe speeds for the existing track conditions.

He believed that that the train was more likely to be involved in a disaster than not, and unsuccessfully tried to get either the speed reduced, or himself and his car off the train. He was successful at neither (and, fortunately, the train did not crash).

After arriving in New York, he felt impelled as a safety engineer to do the right thing, and called AMTRAK and a number of federal agencies about what he felt to be, in his professional opinion, a disaster in the making. He recommended speeds more commensurate with track conditions. Two days after the call to AMTRAK, a representative of the railroad contacted Gavender. This man said he was asked to look into the situation by David Gunn, head of AMTRAK. Another voice joined the first on the speakerphone and said he was the AMTRAK Safety Engineer, and that he would look into the matter.

Three weeks later, on 29 July 2002, there was a derailment of the AMTRAK Capitol Limited passenger train, in Kensington, Maryland, en route from Chicago to Washington, D.C. This derailment apparently pushed some buttons, and finally produced some action in regards to Mr. Gavender's concerns:

- Mr. Gavender was telephoned by the AMTRAK police, who said that they understood that he had made a threat against AMTRAK. He asked if they had read his letter, which they hadn't, so he faxed them a copy. The upshot of the conversation appeared to be that while his

letter was not a threat, he was apparently on the AMTRAK terrorist watch list.

- He got a call from the FBI, who had previously told him that they couldn't deal with the problem he wished to report, as it was not terrorist related). They said that they understood that he had made a threat against AMTRAK. He asked if they had read his letter, which they hadn't, so he faxed them a copy. The upshot of the conversation appeared to be that while his letter was not a threat, he was apparently on the FBI terrorist watch list.
- He got an in-person visit from the NYPD Terrorist Squad, who said that they understood that he had made a threat against AMTRAK. He asked if they had read his letter, which they hadn't, so he showed them a copy. The upshot of the conversation appeared to be that while his letter was not a threat, he was apparently on the NYPD terrorist watch list.

Something over a year later, on 11 September 2003, Mr. Gavender finally heard from a representative of the Federal Railroad Administration, who said that "the FRA has conducted inspections of these tracks and any defects found have been rectified." Hopefully this has in fact solved the problem of the car train.

However, we note that when David Gunn, President and CEO of AMTRAK, was interviewed on the 24 July 2003 taping of the John McLaughlin show ([http://www.mclaughlin.com/library/moo\\_transcript.asp?id=12](http://www.mclaughlin.com/library/moo_transcript.asp?id=12)), Mr. Gunn said, in regards to the car train:

MR. GUNN: The train? The equipment is pretty good. It's not brand new, but it's -- the passenger equipment is in good shape, and the auto racks are old. They are old, and actually --

MR. MCLAUGHLIN: You're going to work on that?

MR. GUNN: We're replacing -- it's in the eight-- billion-eight. (Laughs.)

AMTRAK is under-funded, largely because of the bizarre assumption that American railroads, unlike every other railroad in the world – and unlike air transport or highways – should be self-sustaining. This means that there is insufficient funding available for some of the basics, like track maintenance (although in fact the stretch of track traversed by the car train is handled by CSX, not AMTRAK). While the accident rate for railroads is quite low, we will continue to see accidents that should not be happening, particularly if speeds are in excess of what track conditions will support.

Finally, this should be a cautionary tale to remind you that no good deed goes unpunished. If you see a possible danger – whether it be an accident looking for a place to happen, such as we have seen here, or even a potential terrorist threat – and report it as you ought, you should not be surprised if you are treated about the same as Art Gavender or any other whistle blower.

#### **4. Technical Issues — Choosing the appropriate PR firm**

Public relations firms serve a number of purposes, the most obvious of which is getting you publicity. This is so important that most large companies have internal corporate communications departments, which are supplemented by outside PR firms.

PR firms also help deal with unexpected crises. After any sort of disaster – whether it be an accident, a crime, or some embarrassing situation involving an officer or employee – a public relations preparedness plan makes the difference between an unsympathetic perception of events, with a resulting drop in business and share price, or a sympathetic reaction, in which sales and stock price remain stable or go up. We at LUBRINCO tend to deal with corporate communications and PR companies in three situations.

The first is during planning for a crisis. Whether it be planning for a natural or un-natural disaster, or any other sort of crisis, we are rather insistent about having the various communications players, both corporate communications staff and outside PR consultants, involved.

The second is during testing of crisis plans. As with anything else, if you make a plan you need to test it, and testing through a simulated crisis requires the participation of the full crisis management team, including internal and external PR people. The kicker here is that none of the participants in the test can run it. Thus, while crisis management plans, and even the crisis management tests, are often designed in some part by the outside PR firm, they cannot run the tests. This is because the objective of the test is to see how *all* the participants will react, and the PR firm needs its reactions tested, too. If the people running the test are the people doing the testing, the result is not valid: They are always heroes who never make a mistake. We are sometimes brought in to run the show as independent experts with no axe to grind or point to prove. And no, even we can't run the simulation if we are also participants in the solution.

The third area is in helping smaller firms, with little experience in PR, and something less than multi-million dollar budgets, find appropriate help in this area. Why would we be involved in this decision? We are involved

when the initial concern is PR in a crisis, but we believe that PR is too valuable a tool to be ignored for general use, so we make the recommendation that the company look at the broader – and more traditional – benefits of PR, as well as part of crisis management.

In some cases a large PR firm is an appropriate choice, but, frankly, if you have millions to spend on PR you are already spending it, and won't be asking us for advice.

For many smaller companies, however, a large PR firm is not appropriate. The reason for this is that a large firm has senior people whom you'll meet during the sales cycle, and junior people whom you will see on a daily basis. While this is fine for a large client of a PR company, where a junior person can do a lot of the day-to-day work, a smaller client really needs more high-level services than they can pay for.

An alternative approach for these clients is to go with a senior person who has left a large firm to start their own business.

As an example, Nancy Tamosaitis, a senior person in anyone's book, formed her own company, Vorticom (<http://www.vorticom.com/>). She takes a small number of clients, but her clients are getting the full attention of a senior person, without the added cost of huge overhead. (Remember that with a large firm of any sort some part of the fee goes for the overhead, and big fancy offices cost a lot of money.) Her clients regularly appear in top-tier media outlets like *The Wall Street Journal*, *The New York Times*, *USA Today*, *Fortune Small Business*, *Entrepreneur*, *CNN*, and other national and regional broadcast opportunities. (An article she wrote on generating successful media relations was published by *Brandweek*: [http://www.brandweek.com/brandweek/search\\_display.jsp?vnu\\_content\\_id=1983844](http://www.brandweek.com/brandweek/search_display.jsp?vnu_content_id=1983844).)

Startup companies may need PR, beyond what is covered by their retainer, and can't afford the required additional charges. In these cases Vorticom is sometimes amenable to trading additional work for a small piece of equity. This essentially gives the client high-powered support on a contingency basis. It gives Vorticom the incentive to truly be a partner in their client's success. For the small business, Ms Tamosaitis, and others like her, represents the best of all possible worlds from a PR perspective.

## **5. Real Stories from the Field — California forest fires**

This October California suffered two major forest fires. The two fires started quite far from each other, but somehow joined together to make one giant fire, which has destroyed hundreds of thousands of acres of forest, burned down thousands of homes, and tragically killed a number of people.

It appears from what we read that a hunter inadvertently started one of the fires. Lost and fearing for his life, he set off a flare. The flare unfortunately set his forest on fire.

We have a problem with people burning down large amounts of forest by accident when there were other alternatives available. While we recognize that the fire could just as easily been started by lightning, or, for all we know, by a smoking deer, in this case it wasn't.

How could this particular fire been avoided? Obviously, an inexpensive handheld GPS system would have allowed him to find his way out. But what if it was a real emergency and he was injured, and couldn't walk out? In the October 2003 *ÆGIS* (<http://www.lubrinco.com/ejournal/ej200310.pdf>) we reviewed Personal Locator Beacons, which are GPS-equipped electronic devices that, within about a minute, make it known both that you are in trouble and where you are located. While PLBs are more expensive than flare guns, I'd bet that right about now the man who accidentally set the fire, and who is trying to avoid prosecution, would consider that, had he purchased the world's most expensive PLB it would have been, in retrospect, a bargain. It also seems likely to us that probably many of the people who died in the forest fire, or whose homes were destroyed, or who simply don't like seeing hundreds of thousands of acres of charred wasteland, would have cheerfully chipped in to buy him a PLB.

While it is too late in this case, it might not be a bad idea for the California legislature to be looking at PLBs. PLBs cost as much as they do because so few people buy them. If, under the impetus of the California legislature, some incentive was provided for hunters, and others at risk, to provide them – an incentive perhaps aided by other states that have trees, or hikers and boaters and pilots who sometimes need to be rescued – the increased volume of sales would force down the price of PLBs, and future needless accidents would, in fact, be avoided.

## 6. Book and Product Reviews

### *Business Valuation Blue Book*

Chad Simmons

Facts On Demand ISBN: 1-889150-32-0 280 pages \$24.95

<http://www.brbpub.com/> 1-800-929-3811

The *Business Valuation Blue Book* is not a guide to values. It is, rather, about how to approach valuation, written for someone who has no idea about how a business is to be valued. It is well written – it is actually an engaging read – and makes it easy to apply what is in the book to real-life situations. It is filled with examples of how to work through all of the math problems that occur in valuation. It also has strategies for buying, selling, and preparing a business for being valued. The book has hints for the seller, hints for the buyer, and hints for those professionals that often get involved in the business valuation process. It is appropriate for attorneys, lenders who work with businesses, and brokers. More to the point, it is especially appropriate for business owners and buyers.

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