

Chp 16 Due Diligence.

* Introduction :

↓
Due diligence is investigation before any major ~~invest~~ business deal. (acquisition / investment)

↓
It checks the facts, analyzes risk & uncovers key details.

↓
It helps investors make smart & informed decisions.

* Due diligence process →

- Inquiring about financial & operational data
- Analyzing & studying the data
- Interpreting the meaning of data
- Assessing the risks & identifying opportunities.

Importance : Co. do background checks to ensure full & accurate info. before forming v/s or making transactions.

Case study : In 1998, Daimler-Benz merged with Chrysler for \$36 Billion. The merger failed, Chrysler's value dropped significantly due to poor due diligence, leading to over valuation.

Case study : Bank of America bought Countrywide for \$2 Billion but ended up spending \$50 Billion due to bad debt, showing poor due diligence.

Due Diligence process

- ① Investigate risks & opportunities
- ② Review key factors
- ③ Manage the risks & performance.

* Case study → Amazon & MX Player → (2023)

- Amazon is considering buying MX player, owned by Times Internet.
- Amazon already has (prime video } MiniTV } in India.
- Times internet bought MX player in 2018 for \$140 million.
- Amazon hired an Acting firm for due diligence, expected to take 30-40 days.
- Times internet wanted over \$100 million, but Amazon valued it at \$60 million.
- final deal could be b/w ₹600 - 900 cr.

* Reliance & Disney merger →

- planning a big merger
- Both hired law firms for antitrust checks
- merger could combine two streaming services and 120 TV channels.

* Key points describing due diligence →

- ① focuses on business, not just Acting
- ② Analyzes info. based on actual facts
- ③ considers target company's industry
- ④ Looks at business affairs that impact future prospects
- ⑤ Examines key business practices & models
- ⑥ Reviews the past / present / future of business.
- ⑦ Assesses the advantages & risks of the transaction.

Case study → Etisalat & Swan Telecom. (2008) →

- Etisalat bought 45% of Swan Telecom for \$900 million.
- The govt of India, later cancelled Swan Telecom's 24 licenses for wrong doing.
- Etisalat's due diligence missed this, leading to \$827 million in losses.
- Etisalat's exited the co. and sued Swan Telecom's promoters for fraud.

* Case study → Nirma & Shree Rama multitech →

- Nirma had to make an ^{open} offer to buy 20% of Shree Rama multitech after its stake rose to 24.25%.
- Nirma wanted to change / ~~cancel~~ the offer as the stock price was much lower than offer price.
- SEBI rejected Nirma's request, saying that they should have done proper due diligence.
- SC upheld SEBI's decision and told Nirma to complete the offer.

* Objectives of Due diligence →

- ① identify significant issues
- ② Discover threats & weaknesses
- ③ make informed investment decisions
- ④ Ensure security in the transaction.
- ⑤ develop sth confidence
- ⑥ collect imp. info.

* Due Diligence & SWOT analyses →

- Due diligence involves assessing a co.'s SWOT (incl. financials & intangibles)
- Buyers must be clear on their goals and the value they expect from acquisition.
- legal issues, ee rls & customer loyalty are key factors to consider.

Challenges :

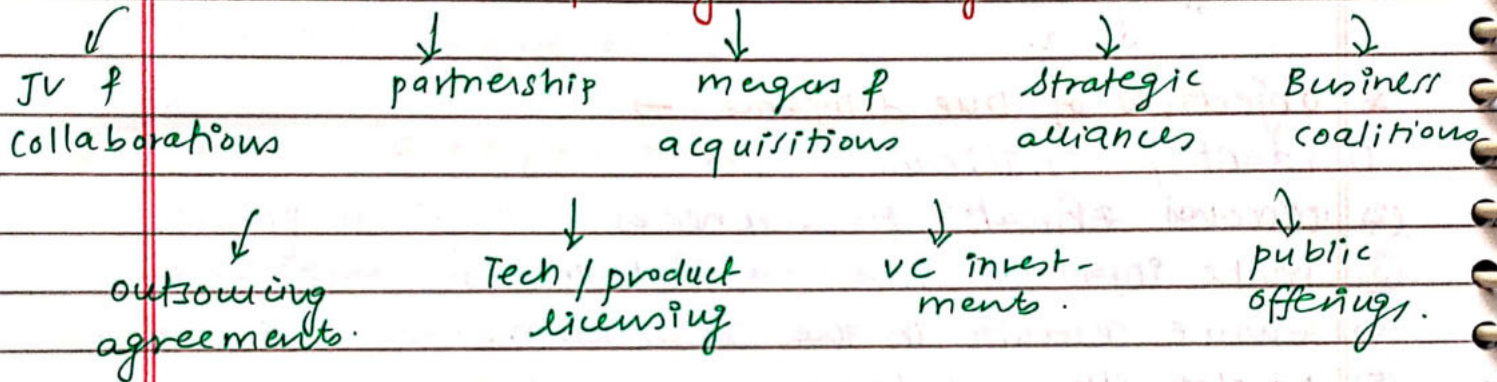
- ① Target co. may be reluctant to share info., fearing it may affect customers / ee.
- ② Confidentiality agreements are signed to protect sensitive details.
- ③ If findings are not favourable: buyer may negotiate / cancel the deal.

Process and goals

buyer & seller agrees on a price, then buyer conducts due diligence

After reviewing the info., buyer decides whether to stick with original price (or) re-negotiate. Goal is to make informed decision.

* Transactions requiring due diligence →



* Case Study : Phonepe & Zest money → (2023)

- Phonepe cancelled its acquisition of zest money after due diligence failed to meet its standards.
- Zest money offers "buy now pay later" loans & phone pe aimed to expand its digital lending!

* Case Study : Hindustan motors & European Partner (2022) →

- Hindustan motors and European partner completed due diligence for an electric 2-wheeler project.
- They plan to launch vehicles next yr and are finalizing JV details.

* Need for due diligence →

- confirm business as it appears
- Build trust b/w parties
- Assess risks & opportunities of deal
- Reduce post-transaction risks.
- Investigate business carefully

- confirm all key facts about business.
- Negotiate price adjustments.
- Evaluate business opportunity.

- Check condition of physical assets
- Ensure legal & regulatory compliance
- Evaluate legal & financial risks.

* Case study : Bhatti Airtel & Zain Deal → Bhatti Airtel's acquisition of Zain African assets struggled due to low returns and poor due diligence.

Satyam fraud case : Banks failed to properly check Satyam before giving loans totalling to ₹ 1,221.16 crore.

SEBI and Bombay Dyeing : SEBI fined 5 directors of Bombay Dyeing Rs. 59 lakh for inadequate DD.

* Scope of due diligence →

Due diligence involves gathering & reviewing info. about a business's liabilities, assets & risks. It covers :

- ① Reviewing financial info., incl. tax structure & liabilities
- ② Ensuring compliance with laws & assessing potential penalties
- ③ Assessing mgmt quality, key employees & human resources.
- ④ Evaluating assets like real estate, IPR etc.
- ⑤ Checking feasibility of business operations & available resources.
- ⑥ Investigating any ongoing / pending litigation.
- ⑦ Analysing reputation, goodwill & intangible assets.
- ⑧ Addressing cross-border issues like double taxation, foreign exchange risks etc.

* Silicon valley case study → Many silicon valley startups are overvalued because investor skip due diligence. This leads to poor investment decisions & missed risks, highlighting the need for careful research before investing!

Hewlett Packard & Autonomy → HP bought Autonomy for £ 8 Billion with only 6 hours of DD, missing key financial issues. This led to £ 5 billion fraud case, and HP faced lawsuits for neglecting DD.

Daiichi Sankyo & Ranbaxy → Daiichi bought a stake in Ranbaxy, but soon after the FDA banned Ranbaxy's drugs due to violations. Daiichi sued for fraud & in 2016, an arbitration court awarded \$525 million in damages!

* Advantages of Due Diligence →

identifies key admⁿ, owners & operators of the co.

Analyzes the co. & market to assess market volatility.

Researches competitors of target co.

Reviews FS incl. debt to equity ratio.

assesses potential growth of co. & profit maximization.

Case Study → Zee Entertainment - Sony India merger →

Zee Entertainment & Sony pictures are merging, with Sony investing \$1.575 billion. The merger will combine Zee's regional content & Sony's sports channel, creating a larger media co. with potential for growth & s/h benefits. The deal is still pending!

* Case study → ABC Ltd & DEF Ltd merger →

- ABC Ltd plans to merge with DEF Ltd. During the due diligence, ABC reviews DEF's finances and intellectual property, leading to the outcome. The merger will help both co. grow and expand.

* factors to be kept in mind during due diligence →

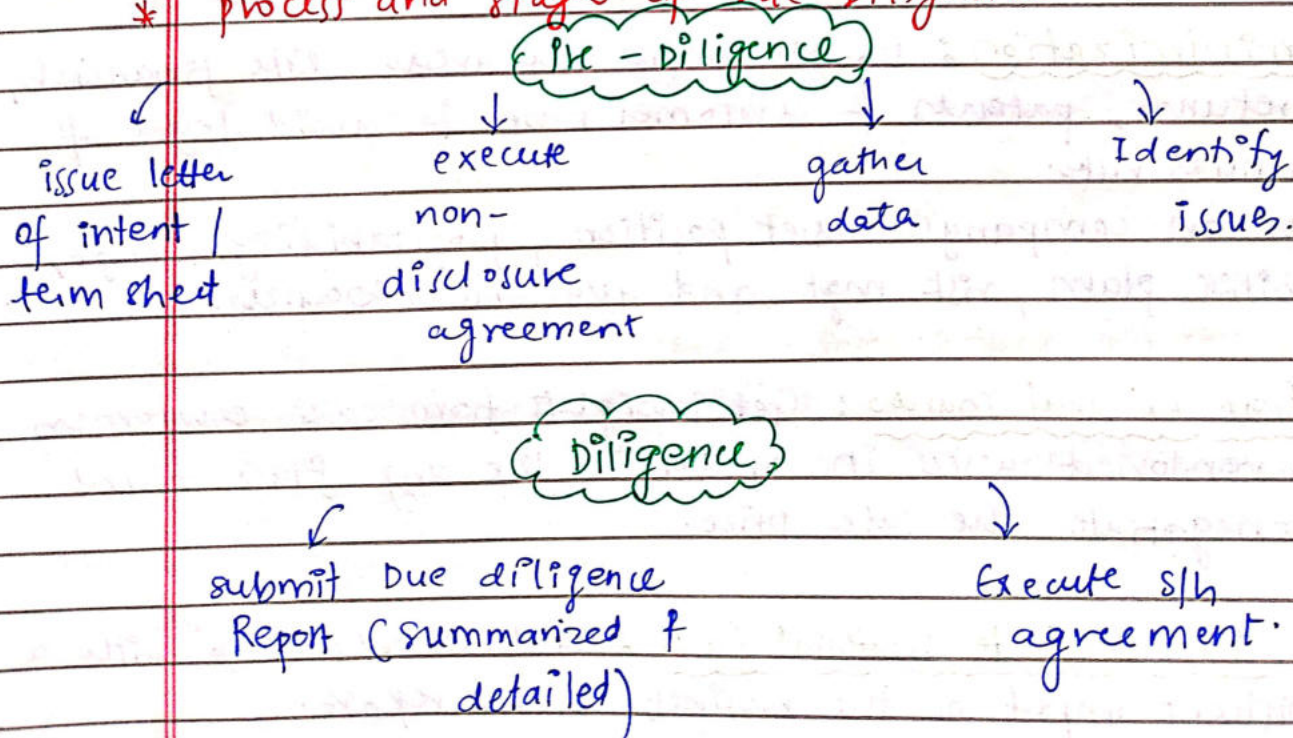
- ① Objectives & Purpose: Understand the purpose of the transaction & set clear expectations for revenue, profits, and business success.
 - Ensure you have the resources & skills to make the business succeed.
 - Research the industry to gather info. from reliable sources.
- ② Planning the schedule:
 - Define steps, areas and aspects to check
 - List the necessary ^{inf.} to request from seller.
- ③ Negotiate for time: Negotiate for enough time to review financial & legal aspects thoroughly, especially if seller wants to hurry the process.
- ④ Risk minimization: Double check key areas like financials, tax returns, patents & customer base to avoid legal & financial risks.
 - Focus on company's asset position, profitability, mgt, business plans, risk mgt and available resources.
- ⑤ Info. from external sources: Get insights from co.'s customers and vendors to assess its reputation. Use any flaw found to renegotiate the sale price.
- ⑥ Limit the report to material facts: Include only info. with a significant impact on the business in the report.

⑦ Structure of info. → organize the findings clearly in the report to connect related matters & make decision making easier.

* challenges in conducting due diligence →

- ① Non-availability / incomplete info. → missing evidence / incomplete compliance can be a problem. Professional should look for alternative sources to gather required info.
- ② Lack of time → limited time may prevent thorough checking. In such cases, professional may need to narrow the scope of investigation.
- ③ Non-co-operation from employees → Employees may resist co-operation, fearing it will expose their mistakes. Reporting the issue to relevant authority may help resolve this.

* process and stages of due diligence →



Post Diligence

classmate

Date _____
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Rectifying the non compliance

Appⁿ / petition for various issues

Negotiating w/h agreement.

PRE DILIGENCE → step ① → means mgt of paper, files & paper.

① Signing of letter of intent (LOI) → LOI is a preliminary agreement that outlines key terms of deal, including:

Scope: Defines the areas to be examined during the due diligence (financial / legal etc)

Data collection: Specifies how data will be gathered, managed & shared.

Final work product: List expected deliverables, such as due diligence report, executive ~~sum~~ summary & detailed report.

Timelines: Set timeframe for completing due diligence process.

② Execution of NDA / engagement letter → Investors sign NDA with agencies conducting due diligence.

③ Receive & Review documents → The co. provides documents based on checklist given by due diligence agency!

④ Identify issues → Identify any relevant issues in the docs.

⑤ Organize documents → Ensure all necessary papers & info. are ready for due diligence.

⑥ Create a data room → Set up a secure space to store all collated documents for easy access.

* Key points to consider in data room

- Do not delay deadlines
- make each checklist separately
- Clearly state "NA" when issues don't apply.
- acknowledging unresolved issues instead of ignoring them.
- Assigning a single point of contact to manage due diligence process.
- keeping a register to track visitors entering & exiting the data room.
- organize files properly for easy access.
- Introducing the point person to ensure clear communication.

* During Due Diligence, care should be taken like →

- ① Be welcoming to professionals.
- ② Ask about the due diligence team
- ③ Correct any mistakes quickly.
- ④ Carefully review docs, seek clarifications and ensure timely completion. The co. can address issues that come up!

* getting ready components of deliberative overview includes :

review process that evaluates key factors & issues before making significant decision.

- ① Transaction structure : Define the parties involved, type of purchase, tax considerations and any other restrictive covenants.

- ② **Transaction funding**: Determine how the deal will be funded & identify key funding issues.
- ③ **Regulatory issues**: Consider various restrictions, required approvals, competition law, foreign exchange matters.
- ④ **International aspects**: Decide if overseas advisors are needed.
- ⑤ **Time lines**: Set schedules for various stages of transaction.
- ⑥ **Confidentiality agreements**: Assess if target co. wants to limit data sharing.
- ⑦ **Exclusivity & lock in agreements**: Address any exclusivity terms negotiated b/w the parties.
- ⑧ **Data room guidelines**: Establish rules for due diligence of target co.
- ⑨ **Due diligence strategy**: Review the checklist & plan due diligence process.
- ⑩ **Specialized issues**: Identify industry specific issues.

DILIGENCE REPORT → Step ② → after diligence process, professionals submit a report, which can be summary/detailed report. Report includes:

Executive Summary

Highlights key concerns / critical points for acquirer, starting with most imp. issues.

main Body

Detailed findings based on checklist

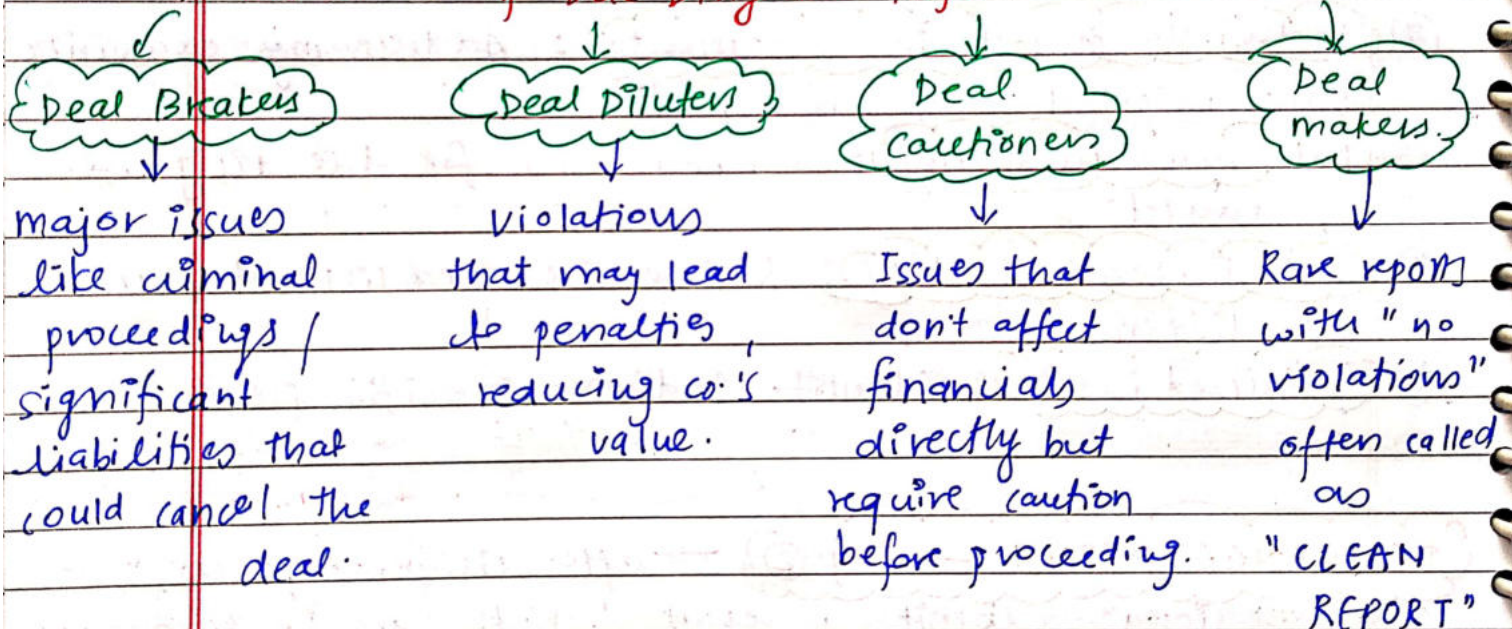
Appendices

Relevant data & documentation for critical issues.

- The due diligence report should clearly identify issues & suggest solutions. key part includes:

- ① General info., FS, agreements, legal issues
- ② marketing, internal control, CSR, HR etc
- ③ purpose of DD & sources of info.
- ④ List of docs reviewed, assumptions made & reliance on certificates
- ⑤ Risk analysis & confidentiality / restriction on report use.

* outcomes of Due Diligence Report →



- After the report, corrections are made and the I/h agreement is signed, including key clauses.

POST DILIGENCE → step ③ → After due diligence, non-compliances are fixed and tasks like negotiating sth's agreement @ addressing offences may arise. Investors may use findings to negotiate a better deal.

* Techniques of Due Diligence & Risk Assessment →

Due diligence & risk assessment are key to successful business practices. Before working with associates, clearly outline expectations. Focus should be on growth & positive industry impact. ① **Evaluation of objective**: Determine main goal of the project to gather exact info.

② ~~Evaluation of objective~~ ^{know your client}: Understand client's business & risks to properly manage them.

③ **Examination of financials**: Review financial records to assess co.'s performance, ind. B/S, income statements, inventories, projections, tax docs & industry comparisons.

④ **Inspection of docs**: Review all available docs to better understand the organisation & assess its growth & value.

⑤ **Actions to control risk**: Once risks are identified, take steps to reduce harm to potential customers. Key actions include:

<p>↓</p> <p>Regularly test & monitor specific risks, such as checking promotion clarity & processing "STOP" commands.</p>	<p>↓</p> <p>Testing frequency depends on risk level - higher risk services require more monitoring!</p>	<p>↓</p> <p>Use mystery shopper testing & whistle blower mechanisms when needed.</p>
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<p>↓</p> <p>Set up internal checks to detect unusual activity / consumer complaints.</p>	<p>↓</p> <p>Establish procedures to address non-compliant behaviour & ensure compliance with regulations.</p>	<p>↓</p> <p>Maintain a compliance file with records of assessment, actions & monitoring.</p>
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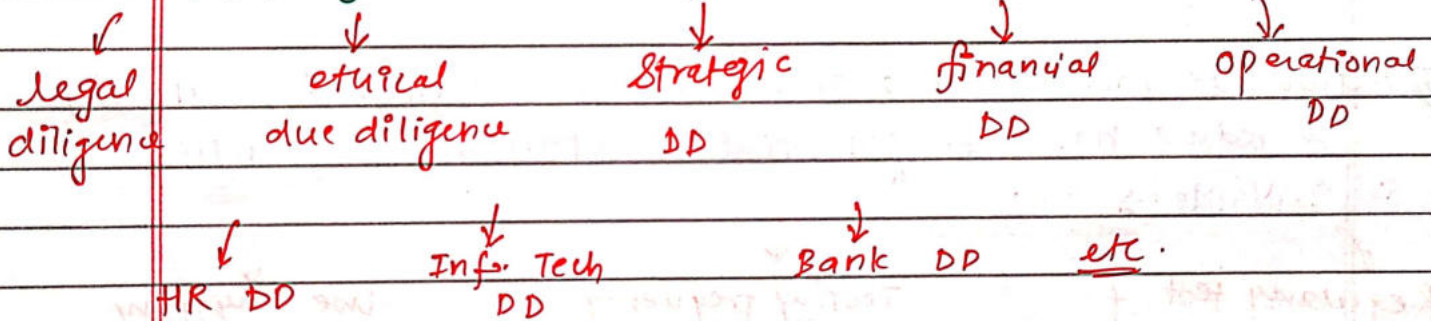
⑥ Responding to incidents: Even with good compliance efforts, issues may arise. Be prepared to respond quickly & calmly, work with regulators & fix problems to maintain high service standards.

* Types of Due Diligence →

Due diligence covers various areas like financial, legal, tax, labour, environmental & market conditions.

Key aspects include:

- Intellectual property, insurance, liabilities & debt
- tax benefits, labour issues & international transactions.
- Assessing co.'s value & transaction risks.



* Legal Due Diligence →

Legal DD identifies legal risks in a co.'s structure, assets, contracts and intellectual property to ensure a smooth transaction. It covers liabilities & potential legal issues.

NCLT highlighted that a Co must ensure proper DD & alert the Board about any governance concerns.

* Legal DD checklist → legal DD involves preparing regulatory checklists, meeting with personnel & verifying tools such as:

- ① MOA
- ② AOA
- ③ BM minutes (last 3 yrs)
- ④ 8h meeting minutes

- ⑤ Register of members / changes / share transfer deeds etc.
- ⑥ material contracts / loan agreements, bank financing etc.
- ⑦ Court orders, pending litigation, ROC returns.
- ⑧ reports filed with stock exchange, RIT and contracts with Directors.
- ⑨ various compliances under applicable laws.

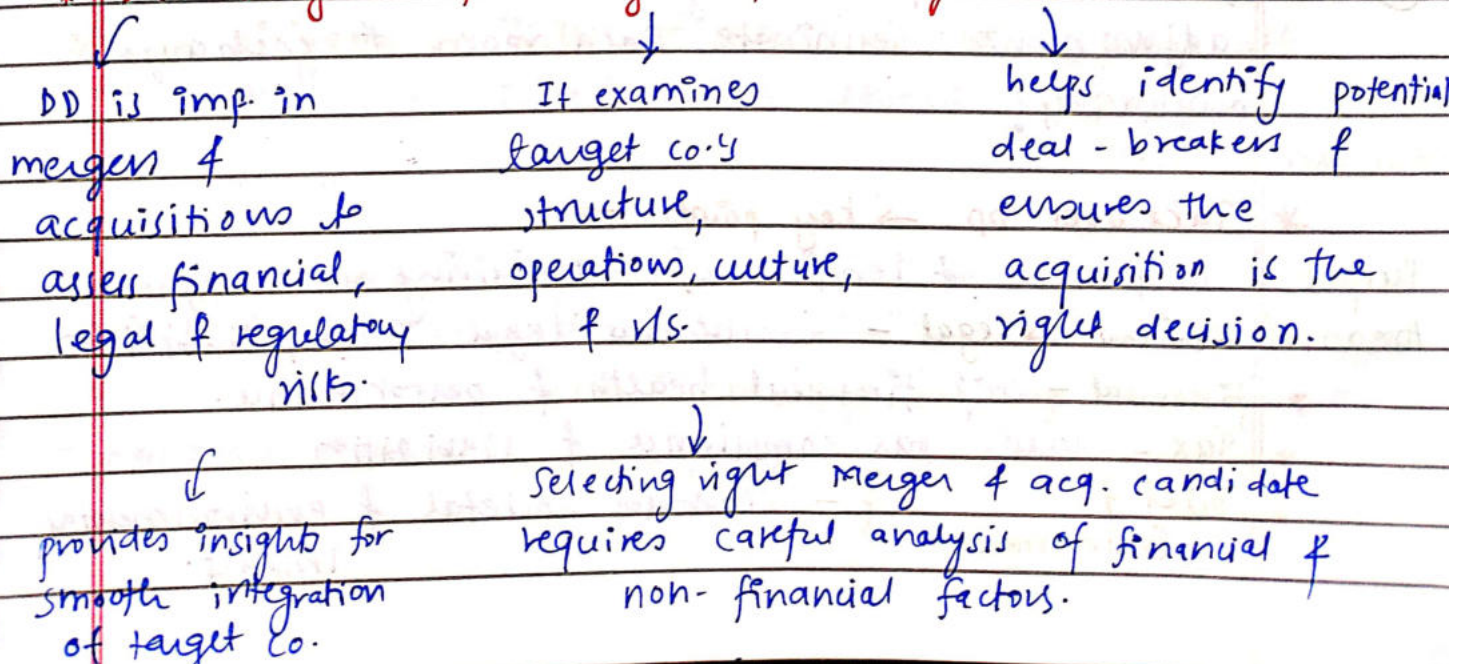
* Transactions covered under legal DD →

- IPO / FPO / QIP
- merger & acquisitions
- commercial agreements.
- private equity.
- corporate restructuring
- leveraged buyouts.
- JV
- corporate governance
- compliance matters.

* Scope of legal DD →

- Co. law
- IT Act
- Labour law
- RCRA
- SEBI
- RBI
- FEMA
- Insurance Act
- Intellectual prop. law.

* Due Diligence for mergers & amalgamations →



* Due Diligence process in M & A strategy →

FOR BUYER → ① Preparation : formulate strategy , list potential target co. , appoint external advisors & create DD team.

② Pre-DD → approach target co. , negotiate terms , execute NDA & compile data required.

③ DD → Inspect data room , analyze docs , evaluate risks.

④ Negotiations → make a final offer , agree on terms.

⑤ Documentation → execute M & A agreement.

⑥ Regulatory approvals → obtain necessary approvals from Board , sth & regulatory agencies.

⑦ Integration → Integrate operations , structure , system , and cultures post - transaction.

FOR SELLER → ① Preparation → list of potential buyers , appoint external advisors & shortlist buyers.

② Pre DD → Approach buyers , negotiate terms , execute NDA.

③ DD → Ascertain in data room & set deadlines for offers.

④ Negotiations → Compile & select best offer.

⑤ Documentation → execute M & A agreement.

⑥ Regulatory approvals → obtain necessary approvals from Board , sth & regulatory agencies.

⑦ Post DD → Handle post - merger integration & culture adjustments . Terminate data room & exchange ownership!

* Take over DD → key points →

Purpose : Assess risks & benefits before acquiring a company.

Areas of Review : * Legal - ensure no legal issues / liabilities

* Financial - check financial health & performance.

* Tax - verify tax compliance & liabilities

* Social & Environmental } - consider societal & environmental impact.

Process: conducted after agreement / letter of intent.

Benefits: Helps in informed decision making, negotiating better terms & understanding target's value.

Risks: Identifies potential risks that could harm the acquisition

Regulation: Governed by SEBI (SAST) Regulations, 2011 for listed co.

Importance: Essential for minimizing risks & ensuring successful takeovers.

* **Case Study: Nirma Ind vs. SEBI** →

↓
Nirma wanted to withdraw its open offer, citing fraud by target company!

↓
SC ruled that Nirma was responsible for its investment decisions & had to conduct DD. Plea of ignorance was rejected.

* **Total Energies vs. Adani Group** →

↓
Total Energies invested \$3.1 billion in Adani group after thorough DD.

↓
Total Energies confirmed that investment followed all legal requirements & best practices.

* **Due Diligence for issue of securities** →

- A public co. can issue securities through public offer
- private placement
- Right / bonus issue

- listed co. / co. seeking listing must also comply with SEBI Act 1992 & related Regulations.

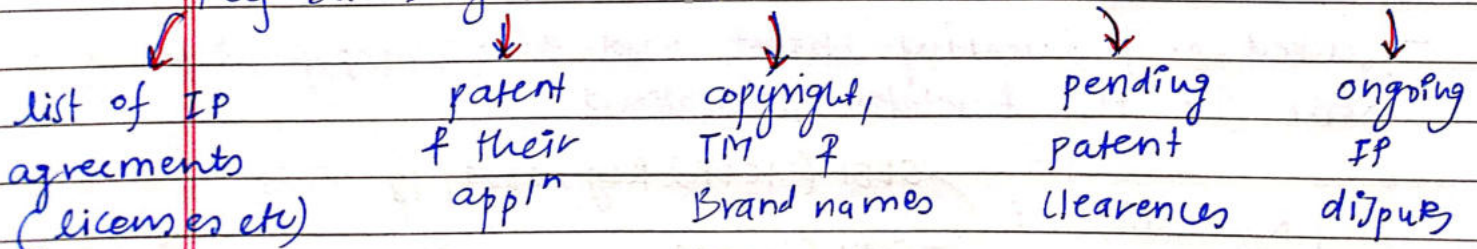
- **Key Regulations:** SEBI (ICDR) Reg, 2009/18
- SEBI (LODR) Reg, 2015

- put. co. can also issue securities via
 - ↳ Right issue
 - ↳ Bonus issue
 - ↳ put. placement
- Due diligence is critical to:
 - avoid legal liabilities
 - protect co.'s reputation
- Non compliance / misleading info. in prospectus can lead to:
 - liab. for co. & participants
 - possible cancellation of securities issue.
- careful preparation of offer docs is essential for compliance & risk mitigation!

* Intellectual property law →

- IP helps co. stand out in the market & can be traded like tangible assets. Many Indian co. don't manage their IPR well.
- IP Due Diligence goals
 - ↳ check co.'s ownership & validity of its IP.
 - ↳ Ensure no IP disputes / infringement issues.

- key Due Diligence areas:



↓
Details of Indian / international patents.

* Environmental law →

Key environmental protection laws in India →

- National Green Tribunal Act, 2010
- Air / water pollution control Acts
- Environmental protection Act, 1986
- wildlife / forest protection Act
- Public liability Insurance Act, 1991
- Biological Diversity Act, 2002.

Environmental DD → identify + assess environmental risks before mergers, acquisitions & restructures!

Key areas for review →

- Environmental permits / licenses
- use of hazardous substances
- communication with environmental authorities
- ongoing environmental litigations / investigations
- Environmental liabilities / indemnities
- compliance with environmental laws.

Mgt review checklist →

- validity of environmental permits
- correspondence with environmental agencies
- compliance with waste disposal regulations
- any potential environmental liabilities.

* labour laws →

Key labour laws →

- | | |
|-------------------------|--------------------------|
| - EE compensation Act | - factories Act |
| - Payment of wages | - Gratuity Act |
| - min. wages Act | - Payment of Bonus Act |
| - maternity Benefit Act | - EE state Insurance Act |
| - Trade unions Act | |

labour due diligence → ensure compliance with labour laws & identify issues before regulatory audits.

↳ Imp. during Mergers & a/c, IPO, co. closure.

Key areas to review :

- ↳ labour regulations / agreements.
- ↳ ee contracts / changes
- ↳ job description & ee details.
- ↳ Termination agreements.
- ↳ Record maintenance

* Competition law Due Diligence →

- Checks if co. follows competition laws & identifies potential risks.

- Key steps : ① Review co. docs

② Interview KMP

③ Identify risky business practices

④ Result may suggest changes to compliance / deal terms.

- areas to focus on -

① Review agreements - current / proposed

② check abuse of dominant position in market.

③ assess the impact of mergers & acquisitions.

DD on agreements : → Review agreements related to prodn, distribution & supply.

→ check deals with competitors, customers & distributors.

→ look at purchase agreement, non-compete clauses & tech transfer agreements.

DD on Abuse of Dominance : check if co. is dominant in market & if there's any abuse.

DD on mergers & acquisitions : - Review type of M&A

- assess asset value, TLO & valuation.

- Check merger notification status with CCI and its impact on market dominance.

* **FEMA Due Diligence** → FEMA regulates the foreign currency transactions in India to support trade, payments and foreign exchange market.

Why it is important? - Ensures compliance with cross border transactions to avoid penalties.

- monitor inbound & outbound funds & investment limits.

Key areas : ① Capital & current A/c transactions.

② currency transactions.

③ RBI Rules & FDI approvals

④ Setting up business through various offices / foreign investment.

⑤ compliance for NRI's & Person of Indian origin. (PIO)

* **FCRA Due Diligence** → FCRA regulates foreign funds received by NGO in India.

Key points : → NGO must be registered under FCRA (i) get special approval to receive foreign funds.

→ NGO must follow FCRA rules after regn.

→ They can be registered as societies / trust / co.

Regulatory Bodies: IT Department & Ministry of Home Affairs manages regn. NGO must file annual tax returns and audited etc.

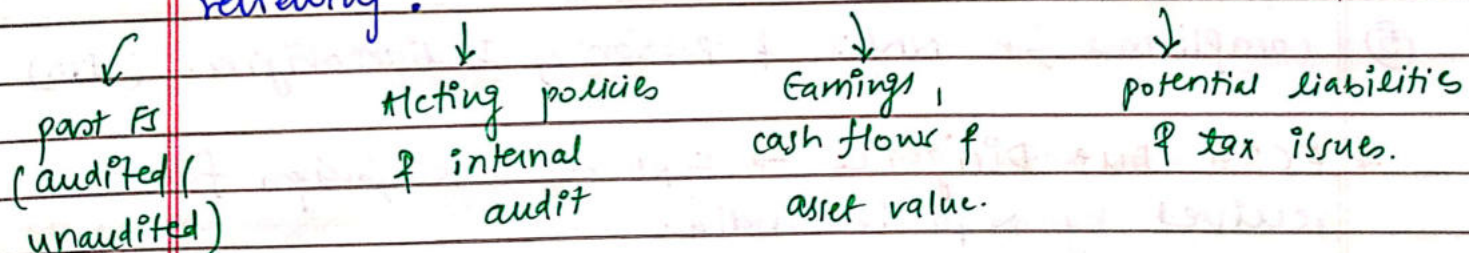
Reporting: NGO must submit annual returns to Ministry of Home Affairs within 9^(dec) m of FY end!

* **Other business laws** → Businesses in India must follow various laws beyond corporate & tax regulations

Key areas: - Required regn & approvals

- pollution control compliance
- property & title deed issues.
- Compliance with FEMA | insurance laws.
- factories Act
- Real estate & construction laws.
- labour & employment laws.
- International business laws.

* **financial due diligence** → financial due diligence checks the accuracy of co.'s financial info. It includes reviewing:



↓
ensures that financial data is reliable.

- financial DD is the process of analyzing co.'s FS & operational data to help buyers assess risks & opportunities in a potential deal.

- It involves →

Reviewing
projections,
capital plans,
inventory &
debt.

analyzing
customer etc.
cost structure,
profit margins
& contracts.

Examining
internal
controls, order
books etc.

validating
financial,
operational &
strategic
assumptions.

- it also includes: ^{tax due diligence}
- checks tax compliance, risks & planning!

Key components of financial DD includes:

- ① Earnings, sale trends & profitability.
- ② Cost, assets, liabilities & working capital.
- ③ unrecorded liab. & financial commitments.
- ④ Acting policies & mgt controls.
- ⑤ Debt mgt & cash flow.

Illustration → ABC Ltd agreed to^a purchase price of ₹ 2860 million based on ebit of ₹ 572 million. During DD, it was found that Rs. 84 million of EBIT came from land sale. This led to reduction in purchase price by ₹ 380 million.

Key focus areas of financial DD →

Earnings, margins &
cash flows.

asset quality
& working
capital.

Debt &
liabilities

RPT

↓
Structuring / integration challenges.

Earnings, Margins & cash flows →

identify
seasonal
changes

growth
rate in
gross
margins

impact of
standalone
costs.

GAAP
applⁿ

Impact of foreign
exchange rate
fluctuations.

recurring /
non-recurring expn

revenue
recognition.

assets on lease / used
but not owned / owned
but not used.

Quality of Assets - working capital →

Inventory
Tlo Ratio

Current
Ratio

Debtors ops
for > / <
6m

cheques issued
but not
cleared

valuation
of WIP.

Net debt →

transactions on
credit / cash basis.

loan
agreements.

complying with debt restructuring
schemes.

Potential liabilities & commitments →

contingent liab.
& B/S items.

pension &
related obligations

conservative
policy

Aggressive policy

off B/S items.

RPT →

transaction at arm's length basis

- Resources & cost sharing with related parties
- financing agreements with RP.

Separation / Structuring / Integration Issues →

changes in
supply chain
mgt.

MS &
accounting
system

standalone
considerations

transition service
agreements.

* **Bank Due Diligence** → conducted when a co. wants to borrow money from a Bank. The main objectives are →

verifying
details of
directors /
promoters.

checking co.'s
compliance with
legal
requirements.

Reviewing any
existing / past
charges to
loan.

assessing
default
status of
directors.

- PCS certifies compliance, based on RBI circular. DD report is made every 6 m.
- Co. must provide the PCS access to its records for reporting. PCS can request info from co. and may ask for letter of representation when verification isn't possible, such as for legal notices / director interests.

Reporting with Qualification → If PCS has many concerns & cannot form an opinion on a specific issue, they must clearly state this in the report. Any qualifications / issues should be highlighted in **BOLD** / *ITALICS*.

- If co. limits access to docs / records - PCS should note the limitations in the report. If this prevents PCS from providing a full report - they must state that they are unable to report compliance due to missing info.
- PCS should also refer to RBI circulars in the report.

Professional responsibility & penalty : CS hold significant responsibility when issuing these reports. If they make errors / provide false reports - they could face penalties, disciplinary action or legal liability from any harm caused due to negligence.

- ∴ it is essential for PCS to follow high standards of professionalism & care when preparing these reports.

Disqualifications of CS in whole time practice :

PCS cannot accept assignments for giving a DD Report to a Bank if - they:

- are Body corporate
- are officer / ee of company
- partner / ee of officer / ee of co.
- owe more than ₹ 1000 to co. (or) have provided a guarantee or security for someone else's debt over ₹ 1000
- Holding voting rights in co.'s securities.

→ If PCS becomes disqualified after appointment - they must vacate their position. This disqualification also applies to subsidiary / holding co. of co.

* Format of Diligence Report - (Annexure 3 to RBI circular) →

To,
The Manager
ICICI Bank (Bank Name)

If we have reviewed co.'s records of compliance with laws as required by RBI and Co. Act, 2013 for period ending 31st March 2024.

~~By~~ We report the following in respect of aforesaid period :

- ✓ 1. Board composition & any changes during the review period have been confirmed.
- ✓ 2. Share holding changes are detailed in the report.
- ✓ 3. Any changes to memorandum / Articles have been made in compliance with Co. Act, 2013.
- ✓ 4. Transactions with companies where directors ^{have interest} are listed.
- ✓ 5. Loans / guarantees provided to RP are in compliance with applicable laws.
- ✓ 6. Co.'s borrowings are within limit.
- ✓ 7. Co. has not defaulted in loans / deposits.
- ✓ 8. Charges on assets / overseas investment are reported.
- ✓ 9. Foreign exchange exposure & foreign borrowings are detailed.
- ✓ 10. All secured assets are insured.
- ✓ 11. Co. has adhered to loan T & C.
- ✓ 12. Dividends have been declared / paid as per legal requirements.
- ✓ 13. All statutory dues have been paid.
- ✓ 14. Borrowed funds have been used for intended purpose.
- ✓ 15. IEPF requirements have been met.
- ✓ 16. any prosecutions @ legal penalties are detailed.

Any qualifications / issues are stated where applicable.

Signature :

Name of co's firm :

CP no. :

Place :

Date :

* Ethical Due Diligence →

Ethical DD checks a co.'s ethical standards & risks like reputation & governance.

It helps to decide if a business partner is a good ethical fit.

It also looks at how ee align with co. values & affect promotions

ethical assessments during DD provides valuable insights when done accurately.

* Strategic Due Diligence →

it checks if a deal makes sense & is commercially viable

It looks at value, competition & key strengths

It assesses if deal's value is achievable

It connects legal, financial & long-term factors.

It asks if biz plan can succeed in market.

* Operational Due Diligence →

- it examines a co.'s past & current operations, cost structure and potential synergies.
- It assesses how well co.'s operations function, incl. technology, efficiency & financial impact.

Benefits of operational DD →

uncovers operational weaknesses & control gaps

shows potential expansion cost.

Ensures all costs are reflected in financials

verifies assets & facilities

Assesses impact on operational efficiency.

* Human Resource Due Diligence →

- HR DD looks at a co.'s structure, HR policies, compensation & ee flo.
- It focuses on people issues, like key talent leaving & cultural differences which are imp. for successful venture.

* Case Study → ① a manufacturing firm wants to merge with a co. that makes battery cases to produce complete battery systems.

- ② They focus on HR DD because the work is labour intensive.
- ③ They review HR policies to ensure they align with the merger.
- ④ They analyze ee details such as salaries, skills & work hours.
- ⑤ They check for legal issues like contract breaches & compensation claims.
- ⑥ They ensure everything is in order before moving forward with the merger!

* Elements of HR DD →

- a. list of ee, their roles & strategies
- b. Employment contracts, incl. non-disclosure / non-compete clauses.
- c. Analysis of ee status, vacancies & retirements.
- d. Review of legal issues like wrongful retirement / harassment
- e. Salary, bonus, service history → last 3 years.
- f. Details of health benefits & insurance.
- g. HR policies on leave & pending labour disputes.
- h. ee benefit schemes & ESOP options.

- i. Et harassment reports (if any)
- j. Cultural issues in cross-border transactions.

* Case study →

- Microsoft faced internal issues & stagnation despite success with windows & office, struggling to compete with Google & Apple due to internal conflicts.

Changes under Satya Nadella →

In 2014,
Satya
Nadella, CEO
restructured
Microsoft
to eliminate
internal
competition.

unified teams around
3 main goals:
① reinventing productivity.
② building a cloud
platform
③ personal computing.

In 2016,
merged teams
to form
an AI &
Research
group, focus
on Artificial
Intelligence.

New Mission →

Nadella introduced the
mission - "To empower
every person & every org.
on planet to achieve
more."

This gave ee purpose,
improving morale &
engagement.

Impact → Microsoft's stock price increased, Azure
became profitable & by 2019 co. reached a
\$1 billion valuation.

* Info. Technology Due Diligence →

- IT DD helps look at systems, policies, processes related to technology. It helps by:

understanding org.'s
tech. capability.

Identifying
tech related risks

assessing the impact
of technology on
business deal.

- Info. security DD is done during IT procurement process to uncover risks & regularly review security systems.

It helps identify security gaps & improve co.'s security standards. It covers →

info.
security
measures

Data protection
& sharing
policies

Network &
system
design

wireless &
remote access

incident mgt

* Essentials of IT DD →

analyzing org.'s
IT processes &
systems

Determining
current IT costs
& investments.

Analyzing co.'s
IT infrastructure
& security.

analyzing efficiency of business system/software.

- IT DD is imp. to prevent costly risks. In 2022, avg. cost of data breach was \$ 4.35 million, ~~upto~~ up 2.6% from 2021.

* Refer chp. ③ of DPA.
* Non-Disclosure agreement →

legal contract that creates a confidential reln b/w person holding a trade secret & person receiving it.

NDA serves 3 main purposes →

protects sensitive info from being shared.

Helps investors maintain patent rights by preventing public disclosure.

Defines what info is private & what can be shared.

* Contents of NDA →

Definitions & exclusions of confidential information

Specifies what info is confidential & what is excluded, like common knowledge & pre-existing data.

Obligations & time periods

outlines the responsibilities of all parties involved & time frame for keeping info confidential, which can be negotiated!