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Due Diligence Associated with Risk Management and Linked to Management Control

Abstract

Objective: *Due Diligence* is considered an internal practice that analyzes and identifies the actual situation of an organization. Having a strategic relevance and impact on Mergers and Acquisitions, it provides a solid foundation for the final decision or negotiation. Given this relevance, it is considered an *input* for Management tools to have information precisely collected and oriented.

Methodology: The aim of this article is to confirm, through empirical research, namely a case study, conducted in Portuguese enterprises, the importance of *Due Diligence* and its role in Risk Management, assessing its usefulness as a management control tool and its potential impact on the performance of Portuguese SMEs.

Findings: Managers recognize that there is a lack of empirical research in this area, especially in terms of its impact on SMEs.

Value added: Few studies relate to the practices of *Due Diligence* associated with Risk Management and linked to Management control in SMEs in order to increase transparency and performance.

Recommendations: This study confirms the contribution *Due Diligence* can have to Risk Management and the consequent impact on performance when used linked to a Management control tool.

Key words: *Due diligence*, SME, risk management, management control, performance

Introduction

Currently, the Portuguese business fabric, mainly composed of Small and Medium-sized Enterprises (SMEs), is under intense pressure, with domestic demand falling, mainly due to the impact of the pandemic on the economy, which extends to a global scale. It should be noted that, in article 2, point 3 of the European Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, it can be read that "in the category of SME, a microenterprise is defined as a company that employs fewer than ten people and whose annual turnover or annual balance sheet total does not exceed EUR 2 million". In this way, micro-enterprises fall into the category of SME, even though, for accounting purposes, micro and SMEs fall into different groups and that there are formal requirements for the application of different accounting standards, this study will adopt the definition in line with the European Recommendation, since it focuses on a microenterprise which, as stated above, will always be referred to as an SME.

One of the paths to the recovery of national enterprises must involve management control in order to perceive risks, define objectives, and implement strategies, through practical instruments that effectively promote better levels of performance. On the one hand, SMEs are inserted into a globalized, highly competitive environment and, also because of this, are increasingly exposed to risk factors, on the other hand, the set of values and practices that define their organizational culture and leadership seem not to have characteristics that promote risk analysis. Despite this, it is important that managers are aware of their company's degree of exposure to risks, so that they are able to act in order to minimize their effect and, at the same time, convey confidence and transparency to *stakeholders*. The enterprises that decide to take advantage of the opportunities generated by an appropriate Risk Management will be able to obtain a competitive advantage in relation to the others, since they have explored their risks in a more strategic way, using them as part of the value creation process.

Risk Management enables balancing the operational and financial costs of the adopted protection measures, as such, a review of a company's Risk Management practices and procedures can constitute a significant part of a given

Due Diligence exercise, since this basically materializes into a highly profitable and information-generating investigative process. Thus, it is relevant to study its role in risk management, analyzing its existence and how it can contribute to a more effective management control.

Due Diligence is a complex process, linked to the collection of relevant information for the conclusion of a deal and is often associated with Mergers and Acquisitions (M&A). Even though *Due Diligence* can sometimes be undertaken purely for symbolic, legal reasons or as a result of institutional pressures, it is often the last opportunity for an organization to walk away from a value-destroying business – thus reiterating its strategic relevance, both in terms of Risk Management and management control.

Due diligence's best practices can be gratifying, as they allow a company to do good business and move away from that which is not good. By conducting a careful analysis, it can be concluded that high quality *Due Diligence* can be a powerful source of informational advantage. The literature considers *Due diligence* as risk mitigation, allowing the management control process to be optimized and organizational performance to be better. Several European organizations, regardless of their size, follow these practices, when the objective is to increase the trust and credibility of the potential business partner. Among the various types of organizations, SMEs are in the lead, as currently (November 2023) more than 24 million are active in the 27 EU Member States.

Taking into account the association between risk, its strategic management, and *Due Diligence* as a powerful management control tool, this paper aims to study these themes, investigating their existence and their real contribution, usefulness, and impact on the performance of Portuguese SMEs.

The pure conceptual literature on *Due Diligence* is scarce, especially with regard to SMEs, hence the majority of the most current studies focus on the process, providing, however, a practical approach to the concept, analyzing it from different perspectives, according to the associated theme (e.g., *Due Diligence* in M&A, Customer *Due* Diligence, AML *Due Diligence*, *Due Diligence* in Transactions, and Human Resources *Due Diligence*). Daley et al. (2023) argue that *Due Diligence* is an area little explored in the literature in relation to its prominence in practice. This can probably be attributed to the lack of structured data. However, recent

studies show that SMEs are limited in knowledge and capacity to execute the *Due Diligence* process. Given this gap, the main objective of this article is the characterization of the practices of *Due Diligence* and its role in Risk Management, as well as the assessment of its usefulness as a management control tool and potential impact on the performance of Portuguese SMEs.

The main contribution of this study is clarifying the relevance of *Due Diligence* practices, associated with a Management control tool, which can help in the commitment of shareholders, providing them with relevant information. These practices generate informational advantage and leverage performance and sustainability, regardless of whether they are implemented in micro, small and medium, or large enterprises.

Literature review

Risk management in SMEs

Increasingly, Risk Management has assumed a key role in enterprises, to the point of being considered an essential element, without which the operation of a company becomes harder (Ecker-Lala, 2010, cited by Krasnikova & Bielenka, 2010). In Portugal, a study was carried out by APQ and KPMG (2013) to identify the risks most relevant to enterprises and to analyze the maturity of their management practices. Despite this being a descriptive study, it was possible to conclude that, whatever the company, for greater effectiveness in risk management, it is necessary to be able to define the propensity for risk and understand the implications of exposure to it.

The concept of Risk Management used in SMEs must be understood in its broadest sense, because only in this way will Risk Management policies cover a diversified set of instruments. The company can implement an active Risk Management policy by contracting insurance, contracting and negotiating with the bank, using financial and legal instruments or even through decisions of an operational nature, such as the change of headquarters or supplier of

raw materials. Financial instruments tend to have a widespread acceptance in the business environment, essentially due to the flexibility and costs of their use. Therefore, SMEs often use “over-the-counter” derivative instruments, such as guaranteed interest rates (Rocha, 2000). Thus, a company’s ability to manage risk is often associated with its ability to diversify, both in terms of the perception and measurement of risk and in terms of the policies and instruments used to manage it.

Lima et al. (2020) showed that most studies on SMEs focus on Financial and Business Risk Management; however, a holistic approach is still not widespread or sufficiently developed, even if the types of risks identified are increasing, namely in the field of Strategic Risk Management. Occasionally, and when faced with their limitations in this field, SME managers become aware that the analysis and application of Risk Management instruments would be beneficial if implemented in their organizational structure; however, they struggle with the difficulty of knowing where to start or what principles should be followed. In this context, Risk Management models or standards emerge that provide a set of guidelines, principles, and theoretical foundations, representing a support base for enterprises to practice effective risk management. Among the most relevant standards or models of risk management, the ISO31000:2009 Standard stands out. This standard, voluntary in its implementation and application, is applicable to any industry and type of organization and its reference presents a set of principles that the company must consider to ensure effective Risk Management and achieve the intended objectives (Knight, 2010). Purdy (2010) assures that if the principles of this standard are adopted, then the different risks tend to be managed more effectively and efficiently. Tavares et al. (2016) underline that Risk Management must create and protect value, be an integral part of all organizational processes; be part of decision making; explicitly address uncertainty; be systematic, structured, and timely; be based on the best information possible; be made to measure; take into account human and cultural factors; be transparent and inclusive; be dynamic, interactive, and responsible for change and consequently be able to facilitate the continuous development of the organization. The same authors also add that the ISO 31000:2009 standard also advocates that a Risk Management structure should be created in the company, which consists

of a set of policies and organizational structures that will later contribute to better development and implementation of the stages of the process. Therefore, the structure and steps of the process are interconnected, and the success of one depends on the effectiveness of the other (Purdy, 2010).

Due Diligence

Ogbonna and Harris (2000) studied the relationship between leadership, culture, and organizational performance and empirically showed that the performance of an organization is influenced by a competitive and innovative culture, they also concluded that organizational culture is influenced by the leadership style. The same study suggests that the relationship between the leadership style and performance is mediated by organizational culture, that is, an organization's performance is influenced by the leadership style through its culture.

According to Ribeiro (2001) cited by Rosa e Castro (2019), *Due Diligence* it is a procedure for identifying economic, financial, and physical aspects, including environmental variables, that affect or may affect the equity situation of a company. For Perez and Famá (2006), in Mergers and Acquisitions, *Due Diligence* practices are carried out as a way of obtaining information that may affect the company's future and consequently its cash flow and economic value; Domingos Ferreira (2017) mentioned that the designation *Due Diligence* was assigned to a set of tasks of universal use and associated with decisions of: mergers and acquisitions of enterprises; partial or full alliances between enterprises or capital restructuring – initial or subsequent public offerings for sale or dispersion; and other similar operations; investments in enterprises; loans; acquisitions of equipment and other material tangible assets.

Ainsworth (2007) admits the existence of different types of *Due Diligence* which are regularly carried out: 1) on potential customers – enterprises and their managers; 2) on potential employees; 3) on potential investors. The same work also concluded that: normally, the organization will agree, in advance, on a model that explains what information must be verified, according to the concrete situation – here it denotes the open and versatile nature of the *Due Diligence* process, that easily adapts to the size of the organizations. *Due Diligence* practices add

value by identifying which sources of information should be confirmed. In fact, the process is often oriented toward the final objective of the investigation and collection of information, materializing in a work directed towards the identification of all economic, financial, operational, legal, environmental, reputational, and market aspects that may or are affecting (positively or negatively) the equity situation of an organization (Bertoli & Ribeiro, 2006). In the *Due Diligence* process, checklists, which are lists of documents and/or actions to be analyzed, are frequently used, from which information relevant to the conclusion of a deal is extracted; it is still essential that this analysis is carried out by qualified professionals, depending on the aspect that is analyzed and that after a careful analysis and retrieval of relevant information from the verified documents, the *Due Diligence* professional prepares a report, as complete as possible, taking into account one or more defined objectives (Müller, 2021). The process must take into account the business risk factors – financial and operational – in a logic of prior study of these factor, in order to obtain knowledge, which will be the greatest asset obtained through that same process, thus mitigating the mentioned risks (Perry & Herd, 2004). In the same sense, Puranam et al. (2006) reiterate the strategic relevance of the *Due Diligence* process for the acquiring company's *decision makers* and the way they perceive the acquisition through the information obtained, invoking the Signal Detection Theory (Green & Swets, 1966; Peterson et al., 1954; Shapira, 1995) – the *Signal detection Theory* (SDT) shows that decision makers can rationally persist in an acquisition, even in light of negative information provided by *Due Diligence*.

According to Boyle and Winter (2010), the key to a *Due Diligence* effectiveness is rigorous analysis and fact-checking, cross-checked on the spot by a multidisciplinary team. Only this kind of cross-functional and end-to-end approach will adequately equip *decision makers* to ensure a successful transaction or to avoid a costly mistake. Yulianti (2021), highlights the *Due Diligence's* objectives, namely the security level, especially in terms of legal risk aspects that could place organization's assets in danger. The company's ability to internally evaluate the findings made and the correct analysis of information is often limited due to the lack of time and experience. In large enterprises, entire departments are in charge of *Due Diligence practices* in the context of company acquisitions. SMEs usually involve

external partners, as their collaborators usually do not have the experience to perform these tasks (Müller, 2021).

Methodology

This research is based on a qualitative research methodological approach. Benbasat et al. (1987) and Yin (2015) define the case study as an empirical research that investigates a contemporary phenomenon in its natural context, in situations where the boundaries between the context and the phenomenon are not clearly evident, using multiple sources of evidence. The latter adds that case studies are also used as exploratory steps in researching under-researched phenomena or as pilot studies to guide the design of multiple case studies.

The selection of the literature led to the research question and the research design (Dubé & Paré, 2003).

The choice of data collection techniques to be adopted in the case study depends on the type of data needed to answer the research question. These techniques can be: interview, documentation, observation, among others (Oliveira et al., 2009). According to some authors (Dubé & Paré, 2003; MacNealy, 1997), the interview is the most used data collection technique in case studies. Collecting data through documents serves to complement evidence obtained from other sources. Its strengths are stability over time, accuracy, and wide coverage; weaknesses can be biased selectivity, unavailable access, among others (Yin, 2015).

In these circumstances, the case study presented here resorted to the collection of information and data through various methods – participant and non-participant observation, collection and analysis of documents, research and literature review, and interviews, thus using triangulation in order to validate the information collected and contribute to the robustness of the case.

In reference to the interviews, meetings were held with the parties involved, specifically, one in person, at the company’s headquarters, with the administrator, and three meetings via videoconference with each of the participants in the study (administrator, employee, certified accountant of the company, and

lawyer of the company) in order to introduce the circumstances of the study, obtain additional information, and validate the theoretical saturation point. Table 2 shows the characteristics of the four participants in this case study.

Table 1. Table of respondents

interviewee	Occupation at Company	Familiarity with the concept of Due Diligence (None, Little, Some, Very)	Years of Experience at Occupation
1	Administrator	Little	5 as a company administrator, 20 as an administrator /manager of other enterprises
2	Employee	Very	5 years as a company employee, 9 in a similar functions in others enterprises
3	Accountant	Some	37 years as an accountant, 5 as a company accountant
4	Attorney	Some	10 years as a legal consultant, 5 years as a company consultant

Source: Own elaboration.

Contextualization of the case study

Company characterization

The company was incorporated in 1984 as a limited liability company and transformed in 2015 into a public limited company. The main activity is the wholesale trade of clothing and accessories, namely knitted socks. Financial statements are its individual financial statements.

Relevant information for Due Diligence

The property organization focuses essentially on the purchase of old properties for restoration, later carrying out exterior or interior renovation works and, then, selling these properties or renting them out. Regarding employee's degree of satisfaction toward the factors that can influence the company's performance, the administrator is quite satisfied. The tax load in this sector represents the critical factor with the lowest degree of satisfaction. Nevertheless, the organization does not have any outstanding debts to the Tax Administration or Social Security, or to any other public institutions.

Concerning the issue of risk perception and analysis, a SWOT matrix was performed internally. The company's main Strengths are experience in financing and *know-how* in tax planning, which are closely linked to the practice of *Due Diligence.* In the external environment, Opportunities include the increase in rents in the areas where the company has been investing, namely in the greater Porto area, as well as the increase in demand on the rental market, which has remained minimally constant over the last years. Vulnerability to government policies and the constant entry of major competitors are the main Threats. The following Weaknesses have been identified, limited offer of properties as their purchase and/or remodeling requires huge investments. Another weakness is the fact that they do not have commercial agents.

Financial information

Regarding the financial information, the company is audited annually, with permanent monitoring.

The administration also provided information that the company's annual profit margin in the last three years has been around 30%, with an average value between 10 and 15 thousand euros. As for Investments, information was obtained in the sense that the company has been making investments at a financial level – shares, bonds, and funds – as well as at a real estate level – investment properties.

Investments in subsidiaries and associates are recorded using the equity method, with investments initially accounted for at acquisition cost, which was

added to or deducted from the equity interest in that company, reporting to the date of acquisition or first application of the equity method. Investments in bonds, to be held to maturity, are recorded at amortized cost.

The remaining financial investments are recorded at acquisition cost. Whenever there are indications that the asset may be impaired, an assessment of these financial investments is carried out, with impairment losses that are shown to exist being recorded as expenses.

The Inter-Risk Fund is measured at cost less impairment losses. During 2019, an impairment loss of 22,000 Euros was recognized, in order to match the carrying amount of the holding to its *Net Asset Value.*

As for investment properties, these consist of land and buildings of which purposes are to obtain rents and/or increase the value of invested capital and not for use in the production or supply of goods or services, or for administrative purposes, or for sale in the ordinary course of business. Investment properties are recorded at acquisition cost plus directly attributable expenditure, less any depreciation and any accumulated impairment losses.

With regard to External Financing, management reports that, in the last three years, it has resorted to bank loans at attractive interest rates. Loans are recorded as liabilities at cost, less transaction costs that are directly attributable to the issuance of these liabilities, and are expressed in the balance sheet under current or non-current liabilities, depending on whether they mature within or in more than one year, respectively.

The item *Other loans* refers to financing obtained under an agreement with an investor, for which purpose a vehicle company is created within the company itself, in order to share 50% of the losses or profits inherent to the investment made in four pavilions and a concierge located in the municipality of Guimarães.

The company claims to prepare tax planning, carried out internally by a qualified employee in the area of Management. Income taxes recognized as expenses for the periods covered by the financial statements are corrected for the effect of accounting for deferred taxes. Taxes that have not been paid, either for the current period or for previous periods, are recognized in liabilities at the amount estimated to be paid, based on the rates and tax rules applicable at the balance sheet date. However, if the amounts already paid for these periods exceed the amounts

due, they are recognized in assets to the extent of the excess. The tax effect arising from transactions or any other operations of which effects are reflected in the income for the period is also recognized in the income statement for the same period.

Deferred taxes refer to temporary differences between the amounts of assets and liabilities for accounting purposes and the respective amounts for taxation purposes, as well as those resulting from tax benefits obtained and temporary differences between tax and accounting results. The tax is recognized in the income statement, except when related to items that are moved in equity, which implies its recognition in equity. Deferred tax assets and liabilities are calculated and periodically evaluated using the tax rates expected to be in force on the date of reversal of the temporary differences. Deferred tax assets are recognized when it is probable that future taxable profits will exist to absorb the deductible temporary differences for tax purposes. A reassessment of the temporary differences underlying the deferred tax assets is carried out annually, in order to recognize or adjust them according to the current expectation of future recovery.

By analyzing the relationship between tax expense/income and accounting profit, it can be stated that, in the last two years, despite the accounting profit being higher in 2019, the company paid less taxes due to the relationship between accruals and deductions from the taxable income, which is directly reflected in the income tax paid and in the effective tax rate, which suffered a drastic reduction, in the order of 23%. This positive result for the company is largely due to the tax planning that has been carried out internally, within the scope of a *Due Diligence practice* implemented by the *diligence* Supervisor.

Regarding the Legal level, management reported not having any litigation, arbitration, judgment, administrative decision, injunction, or any other pending legal proceedings. However, as far as it was possible to ascertain and will be further explored later, the company does not use *Legal Due Diligence practices*, not even within the scope of the prior collection of relevant legal information in the context of investments made, particularly in real estate investments. There is also no record of carrying out this type of *Due Diligence* in the execution of *checklists*, formulation of the lease contracts of the properties, reporting to the administration that they are carried out by external professionals, specifically, by a lawyer.

Discussion of results

The specific characteristics of an SME have profound implications for its evaluation process also in the context of *Due Diligence*. In fact, reading the Financial Statements, interpreting indicators, and even applying the most common evaluation methods are activities that have to be adapted to a context characterized by a strong interdependence between the *personal sphere* of the entrepreneur and the *business sphere* and for a great freedom of *construction* of the accounting, benefiting from the informality of the relationships and the inexistence of external auditors (Jesus & Viana, 2001).

Over the years, several studies have emerged on the company's incentives to carry out risk management. All of them claim that it increases the value of the company, differing, however, in the way in which this is achieved, thus confirming the relationship between the need to manage risk (implementing tools for this) and the valuation of the company.

In general terms, the assessment of the value of a company can be carried out using different methods, some more applicable than others, depending on the circumstances.

In fact, the genesis of *Due Diligence*, as we have already seen, is the valuation of enterprises for M&A purposes. Therefore, it is worth noting that the assessment of an SME with a view to increase the transparency and effectiveness of management control will certainly be an integral part of any *Due Diligence process* to be implemented in an SME.

In the *case study* in question, right on the first visit to the company's headquarters and in the meeting with the study participants, it was observed and reported by the administrator that the company never carried out a formal evaluation, following a method or a sequence of criteria, but rather an informal assessment, annually, which takes the form of an analysis by the administrator of the material and immaterial heritage and financial reports. However, this type of approach, despite presenting a low degree of credibility, especially if we intend to consider it for the purposes of *Due Diligence* and its possible contribution to the perception of risk and potential impacts. *The owner-manager (usually the same person, in contrast to large enterprises), with a centralization*

of leadership, which is confirmed in this case study. As mentioned by interviewee 2: "(...) (promotion of transparency) happens, it is necessary to decentralize the leadership, which is also not very pleasing, from my experience, to most Portuguese managers and this administrator is no exception" – the fruit of the organizational culture and leadership style that was measured in a literature review, namely with Levy et al. (2005) who indicate a tendency for (managers) to shape the business around themselves, imposing personal characteristics on company processes and employees, and using intuition as the main basis for decision making, which ends up preventing adequate strategic planning.

It is considered that the evaluation of SMEs is preponderant for a *Due diligence* process that can contribute to Risk Management and that serves as a management control tool. As Müller (2021) argues that the company's ability to internally evaluate the findings made and the correct analysis of information is often limited due to lack of time and experience. However, since the company does not and has never carried out a formal evaluation taking into account scientific criteria, it was not possible, as far as the company's evaluation is concerned, to identify issues related to the lack of time or experience, but rather, to the decisions taken by the administration, weighing more, in this sense, the arguments related to the leadership style and organizational culture.

Regarding the conceptual issue, the management is not familiar with the concept of *Due Diligence* – as can be seen from the interview with interviewee 1 who, when asked if he knows the concept, replied "yes, only a little. Now, after its implementation, the performance has improved" and attaches great importance to it as an instrument of management control, referring that he considers it "very important". It is noticeable that the familiarity with the concept of *Due Diligence* is heterogeneous. Among the study participants, interviewees 3 and 4 reveal some familiarity with the concept, saying "Yes, I know the concept in the context of mergers and acquisitions" (Interviewee 3) and "I know it vaguely, more in terms of the legal part" (Interviewee 4). Interviewee 2 reveals to be quite familiar with the concept, having replied that "Yes, I know. It is widely used when a company intends to acquire another, partially or in full. It can be quite fruitful (...)".

With regard to *Due Diligence* in the real estate sector, interviewee 1 only attributes some relevance to it, as well as to the information that is and can be

obtained with these practices. In this way, it turns out that it is precisely the company manager who least values the potential of *Due Diligence* in the sector, with interviewees 2 and 4 assigning a lot of importance to it and interviewee 3 judging these practices in the sector as extremely important. In fact, the literature confirms the relevance of this process as a tool for making decisions in real estate transactions, such as the purchase and sale of real estate or leasing (García López de la Osa & Tendero Caballero, 2021).

Interviewee 2 referred to "some resources, financial and human, that SMEs are not willing to provide. First, because, for the most part, the management and administration of SMEs do not have enough knowledge of this concept to value it and much more priority is given to the goal itself than to the path to reach it. Of course, one thing depends on the other (...)". This is confirmed by recent studies, as reported by Daley et al. (2023), who show that SMEs are limited in knowledge and capacity to execute the *Due Diligence* process.

At the Financial level, having collected and deepened the relevant information from the organization in question, it appears that there are some *Due Diligence* practices in effect, namely the execution of strategic planning and market research/study, as well as the performance of rigorous and quite complete financial audits (which existence was confirmed by interviewees 1, 2 and 3, as well as by the documental analysis that was carried out for this study). Despite this, the same interviewees, as well as the documentary support consulted, confirm that the company obtained, in the last three years, external financing – loans – without carrying out any type of *Due Diligence* practice. Diligence, specifically for this purpose. However, according to Reed et al. (2007) *Due Diligence* is described as a process that results from the obligation that an organization has to act in a zealous way, so as not to harm itself or third parties, within reasonable standards.

In this way, it appears that the company that intends to obtain external financing (to achieve the final generic objectives such as achieving a certain profit margin, increasing turnover and/or assets), must carry out a collection, processing, and confirmation of information, taking into account this obtaining of funding and not just the final objective.

The company has also made investments every year. In addition to investing in real estate, due to the company's activity, it has also made financial investments

in shares, bonds, and funds, without any type of *Due Diligence practice*, mainly, it does not execute budget plans (interviewee 1), but interviewee 2 reported that "There is a budget forecast that is made annually in relation to expenses and income, sales, profit (...) but a budget plan is not used as a control instrument management itself". Interviewee 3 said that there is a budget forecast, as far as he knows, internal and informal. But he never had access to it. It should be noted that, despite the conservative nature of the administration regarding investments, mentioned by interviewee 2, in question B5.1. – "management is somewhat conservative in relation to investments" and by interviewee 3, in question B2 – "(...) in order to achieve the goals in a financially sustainable and, normally, conservative way, in the sense of never being too daring in theinanceal objectives", the company executes investments with a moderate to high degree of risk, such as investments in stocks, bonds, and funds. However, this type of investments with high-risk exposure can, at any time, impact the financial health of the company and are paradigmatic of how risk and its perception (or lack thereof) can strongly influence the management control and consequent performance of the company. As Anasica and Batra (2020) argue, it is very important to perform all the analyses of risks that may arise in the future and take the necessary measures to avoid these risks, and the risk analyst can also try to reduce the impact of risks in the future. business. Particularly when it comes to investments, *Due Diligence practices* could prove to be extremely useful in the specific case, before the investment, in a logic of prior study of the variables, in order to obtain knowledge, which will be the greatest asset obtained through said process, thus mitigating the aforementioned risks (Perry & Herd, 2004). Investment in risky financial assets, despite the conservative stance of the administration, as will be explained below, is linked to tax planning.

At the Tax level, the company shows more interest in *Due Diligence practices*, especially with the implementation of tax planning, confirmed by interviewees 1, 2, 3, and 4, in question C1 – "Yes" – which has been positively reflected in performance, as confirmed by the accounting documents consulted, namely, balance sheets and financial audit reports as well as internal documents (reports) relating to tax planning. This practice is carried out internally by a qualified worker of the company and all internal documents in this area are confidential,

so the information to be disclosed on the reports was carefully selected for the scope of this study and reviewed by its author, in order to confirm its validity. The company's tax planning *in studio* ends a phase of verification and collection of relevant information – which varies from year to year, depending on the planning objectives – in allusion to the traditional checklist used for *Due Diligence purposes*. An exhaustive investigation and analysis is also carried out in advance of all relevant legal regulations in this field, since, as interviewee 2, responsible for tax planning, said, "it is necessary to be very careful, a lot of information, a lot of legislative analysis, both national and European, because it is often a matter of interpretation and there is some discretion". Next, there is a reflection on which practices can be adopted, within the legal limits, that promote tax savings. As predicted by Ainsworth (2007), there is a model that explains which information should be verified, based on the specific situation. This is a good example of an area where an information worker can add real value by stipulating which sources of information should be checked and to what detail.

There is a lack of natural articulation between *Due Diligence* in the financial field, which could generate even greater advantage in terms of management control and trigger better performance, leveraging its business value, taking advantage of the management of different types of risks (Lima et al., 2020), exposing it to and validating opportunities.

As mentioned by Yulianti (2021), *Legal Due Diligence* aims to carry out an assessment of the company's security level, especially in terms of legal risk aspects that can expose the organization's assets to danger, illustrating, also in this aspect, the contribution of *Due Diligence* to Risk Management.

Inquiring about the company's practices at the legal level, it is noticeable that there is some interconnection with the *Due Diligence practices* in the tax sphere, taking into account what was mentioned by interviewee 4: "there is a lot of legal advice, when there is any doubt on the part of the administration, they contact me – normally, there are matters of legislative analysis, regarding rules to combat tax evasion and money laundering. This type of legislation is increasingly complete and has a series of inherent policies that shed light on the spirit of the legislator". This is one of the aspects that validates the greater effectiveness of a multidisciplinary team, as mentioned by Martins et al. (1999),

with the purpose of collecting data and information that are not in the public domain and with the wide breadth necessary to understand the real situation in which the company finds itself.

In fact, *Due Diligence* in the real estate sector is preponderant (Reich, 2018), and relevant information about a property in a pre-acquisition phase allows closing a good deal or moving away from a problem, managing the inherent risk and contributing to a better functioning and effectiveness of management control, validating the argument by Rehman and Anwar (2019) that Risk Management partially mediates the relationship between business strategy and SME performance and illustrating the contribution of *Due Diligence practices* to Risk Management.

Conclusions, limitations, and future research

Identifying, evaluating, and mitigating economic, accounting, financial, legal, and administrative risks are essential tasks before concluding a deal and, as far as Portuguese territory is concerned, the weight of SMEs is 99.7% in the total number of enterprises, when excluding financial enterprises (INE, 2010). Thus, the study of Risk Management in SMEs has evolved in the literature while the concept and practices of *Due Diligence* are relatively unfamiliar to Portuguese managers, something that this study confirms and validates, in the sense that, in the specific case studied, the company in question (an SME in the real estate sector), despite applying some practices that are part of the *Due Diligence process*, mainly at the financial and fiscal level, does so in a sparse and unplanned way, which makes the dispersion of the information collected and its treatment less effective, mainly with regard to the objective of contributing to Risk Management, impacting on the Management control and, ultimately, on the improvement of the company's performance.

In the Financial field, it was found that there are some *Due Diligence practices*, however, within the framework of Risk Management policies of the

company's management that are confused with financial audit practices – which, as it can be concluded, although they are also part of the *Financial Due Diligence process*, do not represent it in its fullness as they materialize as an isolated practice, not integrating a dynamic and complex process, within the scope of Risk Management. The company carries out strategic planning and market research; however, it would be relevant, in order to complete the process and provide more solidity to the *Due Diligence practices* already verified, to devise an articulation between the strategic plans and the budget (which this company does not carry out) approved by the administration. There is also no link between the investments made and those to be made in the future with the current capital commitments, thus seeking greater management control through the implementation of a more effective process of collecting, analyzing, and processing relevant information.

Due Diligence carries out tax planning which has a positive impact on financial strength, as it might contribute to Risk Management and performance when aligned with Management control tools. Despite this, this practice is also isolated and is not perceived by management as part of an organized process/chain of *Due Diligence practices*. Thus, information obtained through the aforementioned planning is collected with the sole purpose of providing tax savings, and there is no articulation with other areas and departments, which removes the potential from the information and its impact on management control.

Due Diligence is highly recommended before a purchase or sale of any organization, information should be collected in order to assess its commercial, legal, urban, environmental, and fiscal situation. In this context, it is a common practice in the sector, as the literature indicates, that a *Due Diligence* covers the aforementioned aspects, in order to confirm that the property is not subject to any encumbrances, charges, or limitations (registered or not in the Land Registry Offices) or that, if it exists, its termination is provided and confirmed before or after the deal.

In this way, it is noticeable that the administration has never carried out a formal assessment, which leads to poor perception of the risk and vulnerability of management control instruments. The fact that certain practices are not mandatory contributes to their limited use and increases the lack of transparency in purchase and/or sales transactions in the real estate market.

The practices of *Due Diligence* of the SME under study materialize in work aimed at identifying economic, financial, and fiscal aspects may or are affecting (positively or negatively) the organization's equity situation, which confirms the position of Bertoli and Ribeiro (2006). This is the case of the company under study, which, in an attempt to overcome these limitations, has involved external professionals – namely the accountant and the legal consultant – in the *Due Diligence practices*.

Müller (2021) stating that in large enterprises specific processes are dedicated to *Due Diligence practices* in the context of company acquisitions, in contrast to what happens in SMEs.

Regarding organizational culture, it has been concluded that there is a centralization of leadership in the person of the SME administrator, who determines the main objectives related to Management control, which confirms the studies carried out by Ogbonna and Harris (2000) that indicate that an organization's performance is influenced by leadership style through its organizational culture.

With regard to the team that performs the *Due Diligence,* it has been concluded that there is a need for it to be multidisciplinary, as Boyle and Winter (2010) put forward, which is the key to a *Due Diligence process.* An effective approach is a rigorous analysis and fact-checking, cross-checked on the spot by a multidisciplinary team. Only this kind of cross-functional and complete approach will adequately equip *decision makers* to ensure a successful transaction or to avoid a costly mistake. Organizations should invest in Management control tools to report, internally and externally, on the organization's performance. As the practice of *Due Diligence* has inherent costs, this is often a cause of resistance to additional reporting and procedures, causing organizations to avoid their implementation. In addition, the main problem identified, due to the low implementation of *Due Diligence practices*, is linked to the fact that there is no knowledge of the related benefits. Reciprocally, Management control tools benefit when linked to *Due Diligence practices*, since its transparency allows access to accurate information, which consequently allows a systematic monitoring of the fulfillment of the defined objectives and strategy, assuming a relevant complement for organizations.

Study limitations

Given the fact that it is an innovative topic, its complexity and diverse aspects to which the process can be applied, some practical issues remain to be explored, such as, for example, the implementation of an appropriate *Due Diligence process* regarding the specificities of the organization in question and the sector in which it operates.

There is also a *gap* in the international literature regarding the subject presented here, so more case studies would be needed within the scope of *Due Diligence* in SMEs as well as further studies that assess the relationship between this and Risk Management.

At the same time, the methodology used, the time frame in which it was carried out, and the constraints and contingencies experienced in times of a pandemic are also limitations to this study.

It seems relevant to study the relationship between risk perception/management and organizational culture and leadership of SME managers. It would also be pertinent to elaborate more case studies that would allow a comparison between SME managers and managers of large enterprises, with regard to the leadership style and approach to management control tools and their implementation.

It would also be relevant to elaborate a model for the implementation of *Due Diligence practices* in SMEs, taking into account the specificities of this type of organizations, their limitations and insights into Risk Management.

The composition of the multidisciplinary team responsible for the *Due Diligence process*, the possibility of this team being composed internally at the SME level, without the need to hire external services, and the study of the advantages that would arise from it are also issues that can serve as a theme for future studies.

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Annex – Interview guide

A. General information

1. How many employees does the company have?
2. How many years have you been working in the real estate sector?
3. Does the administrator have industry experience?
4. What is the administrator's level of satisfaction with:
   - **4.1.** Customers (0–10)
   - **4.2.** Human Resources (0–10)
   - **4.3.** Real Estate Market (0–10)
   - **4.4.** Company finances (0–10)
   - **4.5.** Tax Burden in the sector (0–10)
   - **4.6.** Profits (0–10)

B. Financial Information

1. Does the company make budget plans?
   - **1.1.** Short/Medium/Long Term?
2. Does the company do strategic planning and/or market research?
   - **2.1.** Short/Medium/Long Term?
3. Are the Income Statements audited?
   - **3.1.** How often?
   - **3.2.** What do they show about the company's performance?
4. What is the company's annual profit margin? (Last 3 years)
5. Has the company made investments?
   - **5.1.** What kind?
   - **5.2.** How often?
6. Did you obtain any external funding for the activity in the last 3 years?

C. Tax and Legal Information

1. Does the company do tax planning?
   - **1.1.** Is the person responsible for the company?
     - **1.1.1.** What kind of professional do you hire for this task?

2. Does the company have any disputes, arbitrations, judgments, administrative decisions, injunctions, as well as any other pending proceedings or inspections? *If yes, include 2.1 and 2.2.*
   2.1. Which?
   2.2. Can they have material harmful effects on the activity of society?

D. Information about Due diligence

1. The company has already resorted to some type of *Due Diligence* (Prior Due Diligence) as a guiding business process? *If yes, include 1.2 and 1.3.*
   1.1. Do you know the concept?
   1.2. What are the areas of the *Due Diligence process procedure* that were investigated? (e.g., Financial, Legal, Tax, Commercial, Environmental, HR, etc.)
   1.3. What level of impact do you think this process has on the business? (Very Low, Low, Medium, High, Quite)
   1.4. What is the importance you attach to *Due Diligence* as a management control instrument? (Very Low, Low, Medium, High, Quite)
   1.5. What is the importance of *Due Diligence* in the real estate sector? (Very Low, Low, Medium, High, Quite)
   1.6. What is the degree of relevance of the information obtained? (Very Irrelevant, Slightly Relevant, Medium, Very Relevant, Quite Relevant)