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# Growing Secondary Market Highlights Value of Due Diligence on New Shareholders

By Michael Karran



Startups are staying private longer now than they did twenty years ago: in 1999, the median age of a company going public was four or five years; in 2021, it was eleven. This has caused a build-up of value in the private market for these companies' shares, and both employees in need of liquidity (particularly those whose options expire after ten years) and investors looking to diversify are eager to cash in. But what does this mean for private companies that suddenly find themselves with a host of new, unknown shareholders on their capitalization table?

Many organizations are taking a proactive approach in screening proposed secondary market transactions, which present a distinct set of complexities.

Most secondary stock transfers are subject to restrictions that can be exercised by the company, such as a right of first refusal (ROFR). Mintz Group works closely with the legal and compliance teams at these firms to provide due diligence on proposed stock purchasers.

Purchasers of private shares on the secondary market often create special purpose vehicles (SPVs) to facilitate their trades, allowing multiple parties to pool their investments in a particular entity. These SPVs can obscure the ultimate beneficial ownership of the shares, potentially exposing private companies to compliance, political or reputational risks.

To help our clients understand who is really interested in buying their shares, Mintz Group combs through a host of open-source and proprietary databases,

corporate filings, court documents and other public records, as well as social media, press reports, and other Internet sources to determine not just which individuals are behind each SPV, but also how they operate as investors more broadly.

Mintz Group also digs deeply into the profile of each entity and the background of each individual involved in such transactions. We look to identify red flags - such as a history of regulatory actions against individuals, their companies or their employers; or inclusion on U.S. and global watchlists - that could indicate that the investor poses a material risk to the company.

Even among those who have not been sanctioned by regulators or named on watchlists, we're on the lookout for indications of financial mismanagement, criminal activity, misrepresentations or other misconduct - all possible indications that a would-be purchaser's ethics may not be aligned with those of the company.

For example, private companies may have to evaluate the implications of situations in which there are risks associated with a potential purchaser by way of the purchaser's other corporate ventures or business partners, especially as investors and the public give environmental, social and governance (ESG) concerns more scrutiny.

Together, all of this information paints a picture not only of who the potential new shareholders are, but also why they are interested in investing - thereby enabling our clients to take a more proactive and robust approach to managing shareholder risk.

<https://observer.com/2022/06/the-stagnant-ipo-market-has-also-hurt-trading-in-private-company-shares/>



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**Michael Karran** is a managing director in the New York office. Michael has extensive experience in conducting complex domestic and international corporate investigations and background checks for major corporate clients in a broad range of sectors, including finance, technology, real estate, private equity and healthcare, among others.

Since joining the firm in 2007, Michael has overseen and worked on hundreds of cases involving issues related to consumer and securities fraud, transaction-related due diligence, insider trading investigations, asset traces and product liability.

In 2018, Michael was based in the firm's Toronto office, where he focused on accelerating the integration of an acquired company; hiring and training new and existing staff; and advising on methods to help facilitate integration of Canadian business. Earlier in his career, Michael served as an investigator in the firm's computer forensics practice.

Michael's most significant matters have included: managing an investigation into allegations that a U.S. entity illegally misappropriated borrowed funds into Sri Lanka; serving as a key investigator on a multi-billion dollar document fraud case on behalf of a foreign government; and revealing the identity of an individual behind a website making defamatory comments against a high-profile client.

Michael earned his Bachelor's degree from Queens College, where he majored in accounting and minored in economics.

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For corporations, investors and the legal, financial and talent advisors who need actionable facts to assess risks, protect reputations and win disputes, Mintz Group is the partner of choice for due diligence, investigations and background screening anywhere in the world. Since 1994, Mintz Group has developed a uniquely transparent and practical approach to fact gathering before hires and transactions, during disputes and after allegations.

We provide impartial facts that are comprehensively researched, properly sourced and stand up to the toughest scrutiny in the boardroom or the courtroom. To learn more, please visit [www.mintzgroup.com](http://www.mintzgroup.com)

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