



Jack of all trades or master of none? -The benefits of mutli-disciplinary operational due diligence

Operational due diligence is a multi-disciplinary exercise. In the course of a comprehensive operational risk review of a hedge fund an investor will often come across a panoply of different types of risks rooted in a number of different disciplines including the law, accountancy and information technology. Having the requisite experience and training to evaluate such risks often requires investors performing due diligence to wear multiple hats. There is a strong tendency however, to be guided by familiarity. As such, investors or their due diligence providers tend to focus on a specific area, or groups of related areas, in which the bulk of their previous expertise lies. This tends to be a self-limiting process and can result in the minimization, or even worse complete lack of review, of other hedge fund operational risks which may be outside of the bailiwick of the due diligence analysts. The counter-argument to this line of thinking is that this focus tends to produce more detailed reviews of traditionally important operational risk areas such as legal or accounting. While this may be true, such thinking is backward looking and seems to place the horse before the cart by sacrificing depth for breadth and scope.

Trading one risk for another

When investors performing operational due diligence reviews are focused on digging deep in only one primary area of operational risk, they run a very real danger of ignoring other important risk factors. For example, an investor may hire a chartered accountant to perform operational due diligence reviews. Continuing our example, the investor's operational due diligence process is likely to include detailed reviews of a hedge fund's financial statements. The account however may have no previous experience or qualifications to review a hedge fund's offering memorandum. Consequently, even if such legal documents are reviewed the investor is in essence trading financial statement risk for legal documentation risk. In the operational landscape of a hedge fund it is very plausible that significant operational risks could be just as present in legal documents as they may be in financial statements.

Increasing information efficiency

During the course of the operational due diligence process, often times items learned when covering one area of a hedge fund's operations can highlight operational risk in another part of a hedge fund. Continuing our example, items learned in the review of the financial statements can often be utilized to assist in completing a more thorough review of a hedge fund's offering memorandum and vice-versa. By limiting the depth of review in one area by utilizing limited skill sets an investor is decreasing both the efficiency of their operational due diligence process and limited the scope and quality of the operational review in other core operational areas of a hedge fund.

Conclusion

A more balanced approach to operational due diligence, leveraging on domain specific efforts while still covering a broad palette of operational risks will often produce a more complete operational profile of a hedge fund, as opposed to a limited sub-set of all potential operational risk exposures.

For More Information

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