

# Operational Due Diligence in an Era of Change

## COVID AND TECH AS A BLESSING IN DISGUISE

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### INTRODUCTION

These are turbulent times. Recently, the world experienced a challenging pandemic and soon thereafter got confronted with serious geopolitical tensions. Additionally, the tech world is evolving rapidly. These developments have affected our daily lives and, from a professional standpoint, have made us question the impact on the way we perform operational due diligence (ODD). In this article we focus on the effects of the pandemic and tech developments. We will make a case that the challenges faced by the pandemic have revealed the vulnerabilities of the old way of working and made ODD practitioners reconsider their professional approach and routines.

One could debate whether the pandemic has changed the ODD practice for the better or the worse. Obviously, progress in tech is one of the important drivers of change in this respect. We will delve into how technology has played a crucial role in coping with pandemic-induced challenges and how it may further contribute to the ODD practice in the future.

### COVID AND ITS CONSEQUENCES ON OPERATIONAL DUE DILIGENCE

In early May 2023, officials from the World Economic Organization (WEO) announced that COVID no longer constitutes a global health emergency, which can be seen as a symbolic end to the pandemic. Although the authors of this article admit that they are not often reminded anymore of the personal drama and hardship the world had to endure, they believe that there are valuable lessons to be learnt from the experience. Additionally, it is fair to assume that the way we had to cope and adapt is having a lasting impact on both our social and professional lives.

To provide a more cohesive explanation of the impact of ODD practices, it is important to first understand the reason d'être of these practices. Asset managers not only manage assets internally through their portfolio management organization but also engage with external partners who have a great responsibility in servicing the investment exposure entrusted to them. To assess the operational capabilities of these external parties, ODD must be performed periodically. ODD focuses on

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the operational risk profile of these external parties and to what extent they are capable of identifying, managing, and monitoring these risks.

In general, the external party is provided with a tailored questionnaire and requested to respond and provide additional documentation. To supplement this information, interviews with company officers are often conducted, which may take place during onsite visits.

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## ODD FOCUSES ON THE OPERATIONAL RISK PROFILE

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The COVID-19 pandemic has caused a significant shift in the way ODD is conducted. Before the pandemic, onsite visits were the primary method of conducting ODD, allowing teams to assess operational practices, meet key personnel, and gauge the culture and environment of a target company. However, travel restrictions, health concerns, and logistical challenges associated with COVID-19 have disrupted these traditional practices and necessitated a shift towards remote work and virtual interactions. This shift naturally extended to the realm of due diligence, where investors and consultants turned to technology to conduct assessments without physically visiting the target site. Remote assessments, aided by video conferencing, data sharing platforms, and virtual tours, allowed for some level of continuity during the pandemic-imposed restrictions

Some of the challenges that ODD practitioners have had to face due to remote work are:

- **TECHNICAL CHALLENGES**

One had to rely heavily on technology and particularly stable internet connections. This introduced potential technical difficulties that might disrupt the smooth execution of remote due diligence.

Also, the exchange and storage of sensitive information became more important. Businesses had to ensure that robust data security measures were put in place to protect confidential information and adhere to privacy regulations.

- **REDUCED PERSONAL CONNECTIONS**

In-person meetings provide for a wonderful opportunity to foster relationships and build trust. In remote due diligence, while convenient, the interviewers might miss the opportunity to establish personal connections that could enhance collaboration and cooperation.

Additionally, cross-cultural and language barriers can be more pronounced in remote due diligence, making it harder to avoid miscommunication or misunderstandings. In-person meetings, though not perfect, may provide some sense of these intangible elements that play a significant role in evaluating potential

investments. Reading the interviewee and nonverbal communication is difficult in a virtual setting, but these signals can be highly relevant for gauging corporate culture and boardroom dynamics.

- **LIMITED SITE CONTEXT**

In remote assessments, one had to rely heavily on the information and data provided by the firm's representatives. This forced ODD experts to be aware of and pay extra attention to verification and cross-referencing to protect against (un)intentional bias or misrepresentation.

Also, onsite visits provide the opportunity to walk around at the site, see assets and meet with other company officials. Thereby, the ODD professionals can gain valuable context and a comprehensive understanding of the operational environment.

## THE SECTOR DEMONSTRATING ITS CAPACITY TO ADAPT

The above may appear to paint a gloomy picture for the ODD profession. That being said, it also forced industries including the ODD profession to be inventive and pragmatic. As a result, there are notable positives that resulted from this. These were predominantly triggered by technological advancements.

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## DIGITAL INTERVIEWS HAVE ALLOWED ODDS TO CONTINUE

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The COVID-19 pandemic has accelerated the adoption of remote technologies in various aspects of business operations, including onsite operational due diligence. Video conferencing tools such as Zoom and MS Teams have made real-time collaboration possible, enabling remote interviews to replace onsite ones. Although digital interviews can have some disadvantages, they have allowed ODDs to continue, including the much-needed interviews. Furthermore, remote ODD allows for flexible scheduling, enabling more frequent interactions with target companies. The increased speed of information exchange has also triggered discussions on the need for extensive travel, thereby reducing the carbon footprint and expenses.

Another significant technological development has been the surge in workflow management tooling to digitalize ODD efforts. One of the most significant challenges faced by ODD teams is the overwhelming amount of data and documentation that must be processed and analysed. The introduction of workflow management systems brings structure and organization to this complex landscape, streamlining the entire ODD process. By providing a centralized platform to manage tasks, track progress, and automate routine activities, these systems empower teams to work more efficiently, saving valuable time and resources. These solutions also may enable ODD teams to measure data like turnaround time, quality of analysis, and adherence to best practices. Various

vendors nowadays offer digital solutions to share questionnaires and analyse responses, thereby optimizing the information exchange between ODD expert and subject company.

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## WORKFLOW MANAGEMENT SYSTEMS HOLD IMMENSE PROMISE

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While the introduction of workflow management systems holds immense promise for ODD teams, there are challenges to be mindful of. Integration with existing systems, data security and privacy, and ensuring user adoption are among the considerations that organizations must address. A comprehensive implementation strategy, involving adequate training and change management, is crucial to maximize the benefits of workflow management systems and ensure their successful adoption.

### THE MEDIUM-TERM PERSPECTIVE

While COVID is no longer considered a global health emergency, it has left a lasting impact on the ODD practice. The ODD profession has not fully returned to its pre-pandemic way-of-working. ODD practitioners can now travel again to conduct onsite visits when necessary, but asset managers now have the option to choose between onsite visits or digital interviews. The decision between virtual or in-person ODDs is made on a case-by-case basis, considering factors such as travel cost, travel time, carbon footprint, and the inherent operational risk profile of the subject company. The decision may also depend on whether it is a new investment or an existing relation previously already subjected to an onsite ODD. Ultimately, this approach leads to a better-balanced risk-based approach, in which resources are deployed more efficiently and attuned to the inherent operational risks. However, a caveat remains that information on the ground may be more accurate than information shared by management in virtual meetings.

As this is new territory for all asset managers, another challenge of this new approach is the lack of historical market data to come up with an optimal mix of onsite versus digital visits. Different strategies regarding this mix are still being developed per type of firm, considering the various factors such as the nature of the business, the level of risk involved, the outcome of the latest ODD, how much influence the investor can exercise on the manager, and the specific objective of the ODD. Regarding the latter, the objective of the ODD, it may at times be strategic to include a surprise factor. This could be done by conducting an onsite visit after having conducted multiple virtual interviews in the past. Although the virtual availability of information

might be sufficient, the objective of the onsite ODD could shift more towards boardroom dynamics and balance of powers, something that is hard to gauge virtually. Ultimately, a combination of both approaches provides the most comprehensive assessment while optimizing resources.

Technological advancements will continue to play a crucial role in driving change, particularly with the implementation of workflow management systems. These systems can transform the landscape by streamlining ODD processes and facilitating information exchange between internal and external stakeholders. Furthermore, they have the potential to analyze data across various dimensions, such as investments, investment strategies, and regions, providing an unprecedented level of reporting.

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## INFORMATION ON THE GROUND MAY BE MORE ACCURATE

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Similarly, Artificial Intelligence (AI) can have a lasting impact on ODD practice. AI technology facilitates the processing and analysis of large amounts of natural language data, extracting information and insights from documents or the web. This technology can help ODD practitioners scan large amounts of documents, extract specific information, and make inferences.

### CONCLUSION

Overall, COVID has not only seriously impacted societies on a global scale, but also had a lasting impact on the ODD practice. ODD practitioners were forced to confine to digital meetings as it was practically impossible to hold on-site visits. Virtual meeting platforms enable the sector to replace on-site meetings with digital sessions, but this has its limitations.

Post-COVID, fortunately, ODD practitioners have a choice between performing either onsite ODDs or digital sessions only. While technology has enabled remote assessments and virtual interactions, the value of an onsite visit cannot be overstated. Ultimately, the decision of going onsite will depend on various considerations, including the subject company's anticipated operational risk profile, results from prior visits, travel costs and time spent as well as carbon footprint. As such the profession has been able to adjust to a new reality of a better-balanced risk-based approach.

Not in the least, the sector is also benefiting from technological advancements in workflow management and AI solutions.