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Sidestepping Risk: Getting Started with Due Diligence

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Community Manager, II

With direct private investing amongst institutional investors on the rise (especially in emerging markets), the task of conducting comprehensive due diligence and evaluating risk, including on how to select the right manager, becomes increasingly important. To help II Networkers learn more about this, we consulted the team at ***Gryphon Strategies. (https://gryphon-strategies.com/)*** *Our subjects (Jay Dawdy, Matt Hays, and Richard Finley) kindly shared some insight into the overall process, touching on items such as the differences between various firm types and their services, the future of the due diligence and investigative business, and protective steps and considerations to take when entering a new partnership. (Note: the II Network is a closed community, the Gryphon team does not have access to the forums. However, we invite you to share any questions or comments in the space below the article, which we will share with the Gryphon team, and respond to on their behalf.)*

Matthew Hays
Director, Asia Operations

Jay Dawdy, President

Richard Finley
Head of Business Development

A Focus on Diligence

Q: What, if anything, do you think has triggered a greater focus on this sort of diligence?

A: Since the days of Bernie Madoff, it seems more and more that corporate fraud is in the news daily, proving that it is paramount that investors get a holistic view of the risks associated with an investment or partnership, and the principals involved before it is too late. Consider this:

- Just last year, a hedge fund manager in Massachusetts pleaded guilty to misusing millions of dollars from investors to pay for lavish personal expenses and making Ponzi-like payments to pay off earlier investors.
- A Dubai-based private equity firm was charged with misappropriating more than $230 million of investor's money, which included big names such as the Bill and Melinda Gates Foundation, the African Development Bank and Philips and Medtronic. Investors believed the fund was investing in health care related businesses in emerging markets, but instead the money was used to cover cash shortfalls for their parent company.
- We recently engaged with a client who was about to make a significant real estate investment in the Caribbean. We were asked by our client to do a due diligence deep dive into a CEO at the firm in the Caribbean that they were about to take a stake in. While a public records search revealed no red flags, we contacted several sources who had previously worked with the subject. These sources revealed that the subject had been involved in fraudulent investment activity at a previous firm he worked at, which caused investors to lose millions of dollars. Because of the information that we uncovered, our client avoided investing with a fraudster.

Advice for Getting Started

Q: What are some first steps that an allocator or direct investor should take to be more cautious in the new partnerships they make or fund managers to whom they allocate?

Do your homework. Look into past performance history, speaking directly to new partners/managers about their strategy and risk allocation, and speaking with other investors who have used them.

Create a bullseye questionnaire. Ask targeted questions such as how a fund manager or firm goes about determining the investments they are making. Across what sectors are they making investments? Are they sitting on dry powder? What are their fundraising goals etc.?

Know who can assist with what. Typically, an accounting firm will look at a potential partner/manager's books and records. A law firm will focus on pending or past litigation, and structure of the contracts involved. Our due diligence services go beyond a standard background check to include deeper insight, a longer lookback period on records, and a detailed analysis of the subjects. Particularly, at the executive level, we will conduct thorough public records research, an evaluation of character traits, financial habits and lifestyle, as well as look into their professional record and job performance - including speaking with former employees.

Q: What is your advice for investors seeking to do business in the developing world? Are there additional first steps, or at least initial considerations?

A: Doing business in the developing world raises a whole host of challenges. As investors look for opportunities in emerging markets, we are often asked to assist clients in navigating political, economic and regulatory challenges to be able to make informed investment decisions. For first steps in this area:

Be mindful of additional risk factors. Challenges in the developing world an investor will want to consider include:

- Complex and ever-changing regulations
- Issues of corruption, poor governance - both at the corporate and political level
- Lack of access to public records
- Instances of political violence, which could threaten potential investments and undermine ongoing operations
- Talk to the right people. Macro-level research published by investment banks doesn't get into the level of detail warranted for this important part of the pre-transaction stage assessment. It is important to be speaking with the right people "on the ground" who can provide a thorough understanding of the environment prior to entering a new market.

Q: How do you know whom to hire to help navigate an overseas engagement?

A: The most important thing for investors, regardless of the firm they use, is to receive a high quality and timely engagement to minimize risks and create as much transparency as possible before making a commitment. Most firms (including Gryphon) maintain a network that can deliver the on-the- ground economic, political insight and connections to facilitate market entry decisions and to help safeguard business continuity and personnel. Some firms can cast a wider net as far as geographical coverage and capabilities, while some are specialists in a region and/or in an industry or sector.

The Future of Diligence

Q: Where is the future of this business going and how has it changed since you began working in the industry over 20 years ago?

A: Technology is really taking the industry in a new direction, particularly when it comes to managing and leveraging the huge amounts of information and data that corporations, governments and everyday people are producing and accumulating.
We've noticed our institutional clients are using different methodologies of doing research, which means collecting proprietary data sets from alternative data providers, and from companies that are willing to share the daily capture of data from their everyday operations. Gryphon and others employ data teams to help clients sift through this data and leverage that information to gain necessary trends and insights to make strategic business decisions. Moving forward, we believe that how investors harness, interpret and utilize big data to achieve investment goals will present both the biggest challenges and opportunities.

About Gryphon

Q: Tell us a little about Gryphon Strategies and the services offered, and who can benefit from hiring a diligence firm.

A: We have a 30-year track record and currently offer a suite of services, including investigative due diligence, data mining & analytics, global strategic advisory, litigation support, and insurance fraud and complex corporate investigations. Along with extensive public records research, we offer enhanced due diligence services that include human intelligence gathering and interviews meant to identify reputational risks.

We work with investment banks, alternative investment groups, sovereign wealth funds, family offices and other clients on pre- transaction diligence for public offerings, financing transactions, direct investments, private equity transactions and other deals.

We at the II Network would like to thank the team at Gryphon Strategies for taking the time to share their insights with the II Network community. If you have any questions, or wish to speak with Gryphon directly about diligence for an upcoming partnership mandate, please feel free to contact the team:

- **Jay Dawdy: jdawdy@gryphon-strategies.com (mailto:jdawdy@gryphon-strategies.com)**
- **Richard Finley: rfinley@gryphon-strategies.com (mailto:rfinley@gryphon-strategies.com)**
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