EXPERT COMMENTARY

The use of more sophisticated, integrated technology by GPs is gaining steam. Rey Acosta, CEO of Allvue Systems, looks at four factors motivating fund managers to move away from Excel

Tech shapes the future for private funds

Over the past 20-plus years, I have seen private equity evolve from what was once a small cottage industry to become an important component in capital markets and the economy.

As we enter a new decade and with private equity assets under management at an all-time high, it's worth looking at how fund managers' own technology, operations and infrastructure are evolving as well.

Once the domain of spreadsheets, advances in technology, particularly around cloud computing and system integration, have provided GPs with the tools they need to efficiently scale their operations. The use of spreadsheets to run fund and management company accounting, not to mention keeping track of investors and deal flow, is finally becoming a distant memory. The drivers governing these transitions are both market-orientated and idiosyncratic.

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1 LPs are driving GPs to adopt new technology

In Allvue's 2019 Private Capital CFO Survey, portfolio monitoring was the number one functional process that GPs were looking to improve over the next year (75 percent of respondents). This is not surprising given the manual and tedious work involved in using spreadsheets to collect and analyze portfolio company metrics and KPIs.

As LPs want more insight into their fund manager's investments, both the back office and IR teams are actively seeking solutions to bring better and quicker information about their portfolio holdings to their investors. If we see a turn in the cycle, and with the amount of dry powder still looking to be deployed, you can bet investors will be doing deeper dives into portfolios. Insights into ESG management practices and adoption only complicates reporting needs.

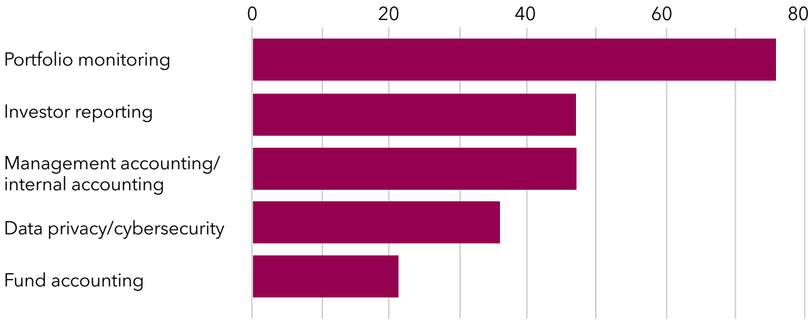
Technology – particularly systems where portfolio monitoring, fund accounting and front office technologies such as the CRM and investor portals are integrated – will play a pivotal role in getting LPs what they need on a timely basis.

2 The era of Excel running the back office is over

Everyone loves Excel. And why not? It's easy to use, most people are familiar with it and it's fairly cost efficient. That is, until mistakes begin to happen, employees get frustrated and, in the worst case, LPs either get incorrect information or capital account statements and notices start to get delayed.

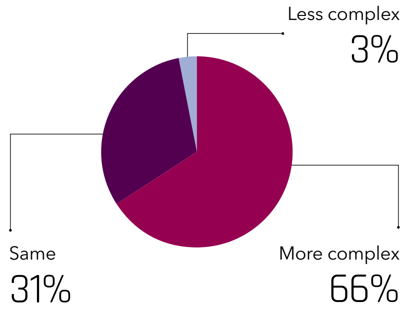
Private equity and venture capital strat-

What operational areas are you looking to improve over the next 12-18 months? (%)



Source: 2019 Private Capital CFO Survey

Are your fund structures becoming more/ same/less complex?



Source: 2019 Private Capital CFO Survey

egies have seen a remarkable increase in assets under management in the last five years. GPs are growing, not only in assets, but in personnel and the number and types of investors as well (think co-investing as well as bringing on new investors from various domiciles). This ultimately results in a substantial increase in the number of entities that need to be created, managed, allocated to and reported on. Again, referencing our 2019 CFO survey, 66 percent of respondents stated their fund structures are becoming more complex.

We have seen many GPs come to us saying, "We're growing, and Excel is just not a viable option for us anymore." These managers ultimately hit a breaking point where the familiarity of Excel as a fund accounting and reporting system is not enough keep up with the complex entity relationships and LP reporting communication requirements they are facing.

Another trend we have seen is that GPs that have moved away from an Excel-based 'platform' have installed various pieces of disparate technologies to run different parts of their operations and processes. They might have installed some type of generic accounting software, like QuickBooks, or a standalone VDR to function as their investor portal. A non-PE specific CRM like Salesforce might also be used.

While an improvement over Excel-based processes, these systems lack the true integration capabilities that GPs will need to scale their firms successfully in the future, particularly as they grow in assets and investors. To address what will ultimately entail more complex processes and workflows, GPs will look to a more unified platform where the various pieces of software are truly integrated, allowing information to flow freely, and accurately, from the back office to the front office, and ultimately out to stakeholders such as investors, operating partners and regulators.

3 Credit strategies create new operational challenges

The private debt market is growing – and fast. Current assets are approximately $650 billion but are expected to grow to $1 trillion by the end of 2020 according to the Alternative Credit Council. What's driving this growth? On the fundraising side, institutional investors continue to be challenged by low interest rates in the traditional fixed income markets, driving allocations to private credit managers. Healthy returns, low correlations to other strategies and further diversification in their portfolios are driving the attractiveness of private debt.

On the GP side, the retrenchment of traditional lenders after the financial crisis (due to asset/liability management and Basel III requirements in Europe) has created a sizable opportunity set for credit managers to provide needed financing. Distressed fund managers, who have long waited for default rates to start ticking up, may finally be seeing the light of day as the global economy slows down. Private equity managers, for their part, have become acutely aware of these dynamics and are ramping up their private debt capabilities.

However, a private equity manager looking to step into the private debt market or even one that already has lending capabilities and is looking to expand its assets must face an inevitable challenge. From an operational perspective, managing a portfolio of credits is very different from a portfolio of equity investments. Significantly different data points and metrics between the equity and fixed income portfolios must be taken into account, as any multi-asset class CFO can attest to.

When private equity and private debt come under the same roof, the technology to support both types of strategies changes the required infrastructure of the GP. This is one of the reasons why AltaReturn and Black Mountain, private equity and private debt technology specialists respectively, have joined forces to address the continued evolution of the capital markets and the operational challenges that will have to be addressed.

4 Data ownership and reverse outsourcing

As GPs grow and look to scale their businesses, they will inevitably face the decision as to what functions to keep in-house and what to outsource. Both have their advantages and disadvantages, particularly when it comes to working with a third-party administrator. While many managers understand the benefits a TPA can bring in helping to scale their businesses, many don't want to give up ownership of their data or processes to an outside vendor.

A new model we have seen gaining traction with fund managers – and we believe will continue to grow in popularity – is 'reverse-outsourcing.' In this GP-administrator working arrangement, the GP 'hosts' or owns the accounting and external reporting data and technology. The administrator utilizes, not their own software, but the GP's in-house system to assist in the fund accounting and investor reporting function. For GPs looking to capture the efficiencies of the outsourced model while maintaining control over their underlying information, reverse outsourcing can provide an optimal balance between the insourced and outsourced models. ■