ALLVUE

4 Steps Emerging Private Equity & Venture Firms Can Take to Accelerate Growth

Q1 2023

For Emerging Firms,
Big Opportunities and Big Challenges Ahead

$87

billion invested in venture capital in 3Q22

It is no secret that money keeps pouring into private equity and venture capital funds. Money follows returns and both segments have done extremely well. Private equity has outperformed other asset classes since 2008 while delivering less volatility, according to a recent report by McKinsey. While investments made by global venture capital may be trending down against tough comparisons in rough markets, funding activity was a robust $87 billion across 7,817 deals in the third quarter of 2022, KPMG found.

New entrants to the field include some smaller firms that are ready to compete against the industry giants. There are plenty of opportunities for these younger players as the market keeps expanding to grow their own businesses and to feed the mounting appetite for private holdings among institutional investors.

But while there are many opportunities for emerging PE and VC firms, there are also plenty of challenges. These firms need to demonstrate that they have the skills, experience, and the systems to hold their own against the big-name, established players in the market who are often seen as the safer choice.

On top of that, all of these efforts have to be done with the limited staff and smaller budgets emerging managers inevitably have, while also keeping an eye on what it will take to continue their success in the future as they grow.

4 Key Steps **for Growth**

So what it is these companies need to do to take growth to the next level?

Here are four key recommendations that can make that happen.

1 Communicate Transparency

Transparency builds trust with all stakeholders.

Internally, for employees, transparency from leadership helps provide clarity about future plans and decision-making in these uncertain times. Externally, for investors, transparency is crucial in demonstrating that there is no gap between what the firm says and what it does.

Gone are the days of “black box” alternatives shops. Investors now expect insights into where their money is going and the underlying firm strategies and holdings.

Beyond that, transparency reflects confidence in the business and strategy, helping to build connections and establish trust so that your company can grow.

The look behind the curtain

> **"Gone are the days of ‘black box’ alternatives shops."**

Investors want timely reports about their holdings, and it makes a huge difference when those reports have the same professional look as the communications they get from established players.

Emerging PE and venture firms can elevate their external perceptions by delivering branded material that looks consistent and formal. All of that is doable with information systems that can leverage a single source of data to easily generate reports and seamlessly deliver them to clients.

For firms that are looking to go a step further and head off the rising tide of increasing investor demands, self-service reporting *[see Self-Service Reporting: The next evolution in investor communications]* can allow teams to deepen client relationships while decreasing their workloads.

Spreading the message

Beyond investor communications, today's PE and VC firms are often looked to as thoughtleaders and brands. As the market has gotten bigger and more competitive, firms have become more proactive about building broad, external brands and platforms. Market share can help drive new business, and thus ultimately growth.

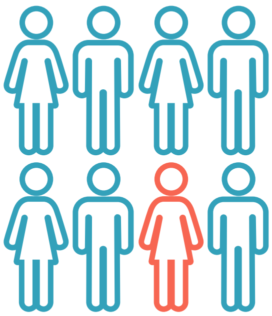
Well-done thought leadership—on key issues in investing or around sectors like healthcare and technology—can have an outsized impact. Smart commentary can enable an emerging firm to punch above its weight and make valuable new connections with potential partners as well as prospects.

Self-Service Reporting: The next evolution **in investor communications**

There has been a major sea change in the level of transparency and access required by investors. LP's, once satisfied with PDFs, no longer want static files — they want to be able to receive data on demand — and oftentimes, to be able to manage it themselves.

With self-service reporting, GPs grand their LPs direct access to data, often via their client portal. LPs can then go in and pull down the data the way they choose to consume it, and create their own reports and dashboards to slice and dice the data in order to answer their own specific quesions or extract insights directly.

2 Differentiate Yourself



Find a way to differentiate yourself from the pack. In a crowded field, having an edge is critical. Limited partners need a compelling reason to pick one shop over another, so having a clear value-add can enable emerging firms to more quickly attract new business – and thus grow their AUM.

Differentiators come in many forms. Firms can focus on a specific industry or geography, or concentrate on target companies at a particular stage of development. Some private equity firms specialize in investing in founder-led businesses that are taking outside capital for the first time. Others stand out because of the unique histories of the management team. The key is to find a differentiator that's authentic and meaningful to your firm's identity.

Standing out through core values

A commitment to diversity and inclusion can be a strong differentiator, especially when pitching public pension funds and endowments who have made these issues a priority. A report by Coalition Greenwich found that firms that commit to diversity and inclusion are more likely to be recommended by investment consultants and considered by institutional investors, resulting in higher AUM.

That's because institutional investors of all kinds are taking ESG very seriously and they expect the firms they invest with to do the same. A recent ESG survey conducted by Allvue Systems found that 90% of limited partners believed that ESG investing led to better returns in addition to other benefits, such as social responsibility and reputation management. No surprise, then, that 74% of GPs cited LP expectations as a key driver of their movement toward ESG investing.

The private equity industry is making progress, but it is slow. McKinsey & Company reported that US private equity firms have a higher proportion of women and people of color at lower-level positions than corporate America, but the ratio becomes lower at higher levels. PE firms promote men at a higher rate, and women in PE are likely to cite their gender as a career hinderance. This is despite the fact that there's documented research showing that promoting diverse employees correlates with margin growth; companies with strong gender and/or ethnic diversity are far more likely to outperform.

As a result, there's a real opportunity for emerging PE and VC firms to differentiate themselves by putting true momentum behind diversity, equity, and inclusion efforts rather than just paying it lip service.

As said in a recent PWC survey, "PE firms putting ESG at the heart of their business strategy will be the game changers in the new sustainable economy. And just as there will be leaders, there will also be laggards. Those firms that fail to embrace ESG will risk value erosion."

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As ESG continues to become a larger focus for investors and the business world, emerging firms that establish clear and actionable ESG strategies from the start will be better positioned for long-term success.

Human connections can be the tie-breaker

Another differentiator – one often overlooked – is personality.

Selecting a private equity or venture partner ultimately comes down to people choosing people. In a close contest, that human connection could be the deciding factor, both with investors and founders of portfolio companies, who need to know that your firm understands who they are and what they are trying to accomplish.

Making that link has been harder in the virtual environment Covid has ushered in, but it remains critical. When it comes to fundraising and business development, what matters in the end is being able to make the case that you can do what others can't.

Operating in a **World of Uncertainty**

The financial markets are agitated by overlapping geopolitical problems and economic crises, a situation that economist Adam Tooze calls a polycrisis. While volatility creates plenty of investment opportunities, it also upsets employees, worries investors, and scrambles a firm's strategy.

It's compounded because people in the investment industry are hyperconnected. Venture capital managers may not face the same minute-by-minute fluctuations as their public markets counterparts, but neither can they unplug from their newsfeeds. Here are some things that might help:

- **Acknowledge the uncertainty.** You and your colleagues will have an easier time focusing on work if you don't also have to pretend that all is right with the world. It's better if people can discuss negative events that affect them, the portfolio, and the firm as a whole. Without that honesty, people will not feel comfortable finding opportunities and identifying future scenarios that are important to the firm's sustainability.

- **Communicate with clients, even if—especially if—the news is bad.** The more information you can share and the more open you can be with limited partners, the greater their long-term confidence in your abilities.

- **Find ways to identify opportunities in the volatility.** Research by McKinsey & Company finds that the most resilient organizations have a mix of offensive and defensive positions to generate above-average performance while avoiding catastrophic failures. Teams that are able to do this develop insights into their operating environment, commit to making necessary changes, and then execute well. One way to check your organization's ability to do this is to think back to its response to the early days of the Covid-19 pandemic. How easy was it to move to remote operations and make portfolio adjustments?

- **Develop an internal strategy that reflects turbulence.** Risk is accommodated by traditional strategy models. Uncertainty calls for wild imagination. Research published in Harvard Business Review suggests that in turbulent times, managers identify extreme but plausible scenarios, develop options and hedges, and then run experiments. Rather than tweak your portfolio and business based on anticipated trends over the next year, this exercise forces a long-term focus.

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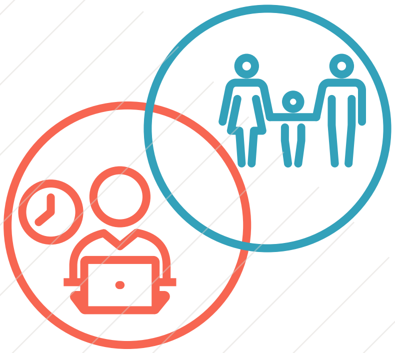
3 Attract and Retain Quality Talent



Prioritize quality in the hiring process. Investing is a talent business, so it makes sense that companies that hire the best talent will grow faster than their rivals. Private equity and venture capital firms have a prestige that makes them a magnet for talent, but in the current environment, even they will have to scramble to attract the best and brightest.

The labor market is changing. It may not be as tight as it was a year ago, but employers must make their case. Offering competitive compensation – both salaries and benefits – is a must. But it is only the beginning.

What matters to prospective hires

There was a 650% increase in search volume for "hybrid jobs" and a 174% increase for "remote jobs" in the first nine months of 2022. While some financial executives are trying to push people back to the office, workers are not interested in giving up their new-found flexibility.

Research firm Gallup surveyed 13,085 US employees and found that the most important issues for job searchers were:

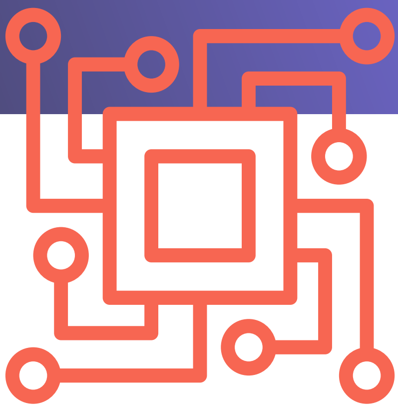
> "An investment in technology is also an investment in morale."

- An increase in pay and benefits
- Greater work-life balance and personal wellbeing
- The ability to do what they do best
- Greater stability and job security
- An organization that is diverse and inclusive

How Technology Can **Improve the Work Experience**

At a time when hanging on to the best people has never been harder, offering the latest technology can make a notable difference. Substituting cutting edge tools for traditional processes means employees can:

- **Getting up to speed quickly** because the applications work smoothly. For example, trying to understand someone else's spreadsheet can be a major headache. Enterprise software saves major onboarding time and no end of minor annoyances.
- **Work with less stress** because they don't have to worry about making the simple but costly mistakes that come with doing tasks manually. This will also help de-risk operations, benefiting the firm as a whole.
- **Feel a part of something exciting and innovative** – cutting-edge technology brings the "cool factor." This gives them valuable career experience, encourages creative ideas, creates a culture of continuous improvement, and makes for more enjoyable and satisfying work.
- **Spend their time on higher value projects** since they have been freed up from the mundane jobs that can eat up so much of a workday. Instead, employees will be able to focus on the big-picture work that sets your company apart – and gives your workforce a reason to wake up in the morning.



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4 Position Yourself for Future Growth

> **"The time to implement a back-office system is when you are about to raise your third or fourth fund."**

The day-to-day pressures of running and growing a private equity firm can be all-consuming, particularly with a small staff. Still, leaders need to keep an eye on the future, which means imagining and planning for when the business is a lot bigger. Like a builder laying a foundation, the firm needs to invest in infrastructure, including technology, that is scalable and can be adapted to someday support a larger entity with minimal cost and hassle.

A PE firm can launch its first fund with a modest amount of technology, but soon will need to add more people or implement a comprehensive IT system, according to Joachim Satchwell, associate director at Polaris, a leading PE firm.

"The time to implement a back-office system is when you are about to raise your third or fourth fund," he said. "You could still get by on your legacy systems at that point, but since you already have several active funds and varying groups of investors, the complexity and administration processes will increase rapidly. Migrating to a back-office platform then – instead of later on, once three or four funds are live – will significantly simplify the implementation process and ensure you continue to have an efficient back-office."

Why data management is critical

A data management system that can be easily upgraded is a must; an ideal system is one that will grow along with the business, eliminating the need for increasingly cumbersome and risky workarounds.

It is just as important to start off with a robust accounting system, one for example that can manage detailed financial statement reporting, multi-currency general ledgers, cash management, automation of complex processes, and workflow standardization.

These functionalities will both help firms make better investment decisions across the business and streamline back-office operations. But, even more importantly, they'll set firms up for growth. So that, as your needs expand, you already have the infrastructure in place to meet them.

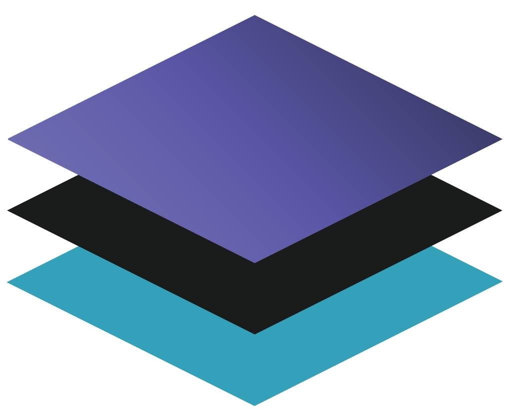
The Allvue Solution: **Supercharging Growth**

New and emerging venture capital and private equity firms need a solution built for their needs, both short- and long-term. Allvue's turn-key Essentials solution sets offer just that—a comprehensive software suite to support private equity and venture capital firms from front-to-back as they execute on their growth strategies.

Allvue's tools provide comprehensive accounting, reporting, and investor communication solutions that are designed to alleviate operational challenges for emerging venture capital and private equity firms, which often have limited staff and resources. The fully integrated platform streamlines workflows and unlocks access to extensive reporting solutions, empowering users to quickly provide sophisticated and personalized communications to their investors. Firms can select and immediately implement the specific solutions they need, and then, as they grow, easily opt-in to additional functionalities to serve their evolving businesses.

Allvue's software-as-a-service model is built on Microsoft's enterprise framework, allowing our clients to avoid costly upgrades, operate on a highly secure and self-sufficient environment, and stay on the cutting edge.

The Essentials solution set is designed specifically to meet the needs of new and emerging companies, whether they are just starting out, heading towards $1 billion under management, or have already crossed that threshold. Get started today to learn how Allvue can help you supercharge your growth.



To learn more about Allvue:

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