INVESTMENT MANAGER SERVICES

Private market operations: A rising bar.

If private really is the new active, the competition for assets will only get fiercer.

Delivering the best client experience means sweating the details and focusing on making operational excellence a key differentiator.

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Transition game.

Cautiously optimistic after a brutal 2022, many investors are still leery of shocks to the system. Inflation is being held at bay, but the menace remains.

Domestic politics fuel uncertainty. The war in Europe threatens global stability. Memories of the pandemic are still fresh.

Focused on building resilient portfolios, investors are eagerly exploring their options. Private market investments are attracting higher allocations and newcomers as institutional investors, family offices, and individual investors seek alternatives to traditional investments in publicly traded securities. A variety of factors are driving this unprecedented surge in popularity:

- **Enhanced performance:** According to a study by McKinsey & Company, private markets consistently "outperformed their corresponding public markets indexes" over the past two decades.[1]
- **Diversification:** Multiple studies show that private equity and private credit funds have offered effective portfolio diversification benefits, stemming from their relatively low correlation with traditional asset classes like stocks and bonds.[2,3,4]
- **Customisation:** Working closely with a fund manager means investments can be customised to meet the specific investment goals and risk tolerances.
- **Tax efficiency:** Private equity and private credit funds can be structured in a way that is tax-efficient for investors.
- **Unique opportunities:** The universe of potential investments becomes much wider when private assets are included. According to a report by Goldman Sachs, the number of publicly traded companies in the US declined by more than a third since 2000. Meanwhile, the number of private equity-backed firms exploded by more than 500%, leading them to outnumber public firms by more than 2 to 1.[5]

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[1] McKinsey & Company, "Private markets turn down the volume," *McKinsey Global Private Markets Review*, 2023.
[2] Harris, Jenkinson, and Kaplan, "Private Equity and Portfolio Diversification," 2014.
[3] Borensztein, Flandreau, and Valdecantos, "Private Debt: Risk and Return Profiles," 2020.
[4] Butler, Wardle, "Investing in Private Markets," Mercer, 2023.
[5] Moran, Michael et al., "Going Private: Considerations for Investors Allocating to Private Markets," Goldman Sachs, February 28, 2023.

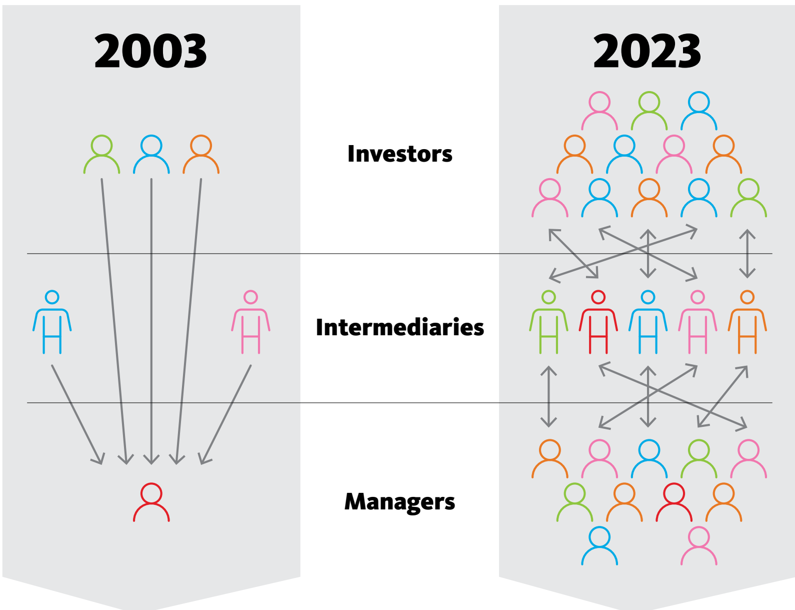
A different world.

From an investor's perspective, there is often little that differentiates one manager from another.

Some gravitate towards those with established brands and track records, while others seek out newer names or novel strategies. Establishing these connections is more nuanced than it is for traditional asset managers: Private equity and credit fund managers are more directly involved in working with their portfolio companies to deliver value to investors. It is also more fraught for investors: Performance dispersion is often greater for private market investments, and less liquidity means potentially getting stuck with underperforming managers.

As demand for these investments continues to grow, investment firms find themselves competing for assets in a crowded and fragmented market. With an array of intermediaries including consultants, brokers, and platforms stepping in to aid an increasingly diverse universe of investors, presenting managers are confronted with a rising bar. On the hunt for growth, a growing number of managers see operational excellence as an essential way to differentiate themselves from competitors in the private markets space and deliver the optimal client experience.

Figure 1. Evolving industry dynamics from fund manager's perspective



Source: Anzu Research

Adjusting course.

What can managers do to stand out? Given the long-term nature of asset class, even exceptional track records may not be enough.

Instead, brands must be built painstakingly by exceeding client expectations on multiple fronts. Products, investor segments, distribution channels, investment processes, and investor relations all need to be carefully evaluated and reformulated into a proactive strategy that leverages a resilient data platform.

Automation, customisation, and agility will all be required to successfully execute visionary strategies in this newly competitive landscape. Private market investing is a relatively complex business with many moving parts, and an overly simplified view of business processes can be problematic. Long-standing habits are viewed as untouchable. Conversely, steps are eliminated in a bid to shave costs. Instead, managers should consider how all internal processes affect their clients. In aggregate, incremental improvements can have a profound effect.

1.

Deal flow

From sourcing to analysis and multiple stages of diligence before decision-making and documentation, deal-making is complicated. Every firm puts their own unique stamp on the process, but there is always room for improvement. Powerful data analytics can be leveraged to make sourcing, diligence, and valuation more efficient. Transparency can also be enhanced. This is also true on the credit side, which can be even more idiosyncratic.

2.

Due diligence

Standards and expectations continue to shift as platforms frontload due diligence on behalf of their clients. Close communication with intermediaries can be paired with re-engineered data flows to increase adaptability and minimise disruption.

3. Onboarding

Automation and better design enable smoother workflows and more efficient transactions at the very beginning of the client journey. Improvements in efficiency are possible while simultaneously minimising widespread frustration with subscription documents.

4. Reporting

Client reporting and communications should be benchmarked to existing standards or competitor practices. The tailored delivery of real-time data and insightful commentary are crucial. Timeliness, accuracy, and transparency build trust and satisfaction, leading to loyalty, retention, and referrals.

5. ESG

Expectations around ESG integration can shift rapidly. A certain amount of screening is already standard, but investors in private markets might expect a more activist approach. Education and communication are vital.

6. Compliance

Regulatory compliance is a given, but a proactive approach has additional benefits. Anticipating evolving regulations in different jurisdictions conveys expertise and imparts confidence to investors while also building trust with regulators themselves.

7. Cybersecurity

A certain level of cybersecurity is also table stakes, but adhering to a higher standard is a worthy goal, particularly as the scope of threats expands. Dispersed workforces and cloud computing present more points of entry, while newly available AI tools enable increasingly sophisticated schemes. Security programmes must anticipate these evolving threats and more.

8. Risk management

Operational excellence can help investment firms manage risks more effectively. By implementing robust risk management processes and controls, firms can help lower the likelihood of errors, fraud, and other operational risks that can harm clients. This can help build trust with clients and show a commitment to protecting their interests.

Enhanced investment decisions.

Operational excellence is worth more than the sum of its parts.

By streamlining processes, minimising errors, and reducing friction, an intelligently designed operating platform paves the way for greater investment success. Putting data at the fingertips of private markets professionals permits more educated decisions, allowing them to manage cash, source deals, and execute investments more effectively.

Faster and more appropriate investment decisions are one potential outcome. A well-organised front office with advanced data analytics and reporting capabilities can provide fund managers with real-time insights into portfolio performance, market trends, and investment opportunities. This enables fund managers to make faster and more informed investment decisions, leading to potentially better investment returns. Multiple studies have affirmed this finding, including a study by McKinsey Global Institute that found private equity firms with advanced data analytics were two and a half times more likely to outperform their peers.[6] The same study went on to note that companies using data analytics to inform their decision-making processes were also more likely to achieve superior financial performance, customer satisfaction, and operational efficiency.

A study undertaken by KPMG International came to a similar conclusion. According to the study, private equity firms that leveraged data analytics in their investment process saw a median return on investment of 20%, compared to 14% for firms that did not use data analytics.[7] The study also found that data analytics can help private equity firms identify potential investment opportunities, improve due diligence, and enhance portfolio company performance.

Back-office operations can also improve returns. Advanced cash management systems can help fund managers optimise cash flow and minimise unnecessary expenses. Academic research has found that funds with better back-office operations had lower cash balances and shorter cash conversion cycles, indicating more efficient cash management and potentially improved investment returns and reduced risk.[8]

Tax efficiency can also be improved with higher-quality operations. According to a paper by PwC, private equity funds with well-organised back offices achieved tax savings of up to 20% through improved tax planning and compliance. The study found that funds with superior back-office operations tended to have lower tax liabilities and higher after-tax returns for investors.[9]

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[6] "The Age of Analytics: Competing in a Data-Driven World," McKinsey Global Institute, 2016.
[7] "The rise of data analytics in private equity," KPMG, 2019.
[8] Cole, Kramer, "The impact of back-office operations on private equity fund performance," *Journal of Financial Economics*, 2017.
[9] "Private equity: The impact of back-office operations on tax efficiency," PricewaterhouseCoopers, 2017.

Data-driven strategy.

The impact of a data-driven operating framework extends far beyond investments, bringing the potential to improve the quality of decisions across all aspects of the business.

Product offerings, for example, may need to be revamped. In a crowded product landscape, it may make sense to define and market funds more narrowly. Specialty finance, royalties, litigation finance, IP-focused strategies, asset-based lending, or venture debt are all likely to attract more attention than more generic private credit strategies.

Product packaging is equally important, and it may be time to move beyond limited partnerships to explore other ways to package expertise. Though still few in number, private market 40 Act funds are attracting considerable interest. Cross-over funds? Continuation funds? Interval funds? Tokenised assets? Choosing from the expanding palette of vehicle choices should take the upcoming retail revolution into account. Business development companies (BDCs) offered retail investors a way to profit from privately held businesses as far back as 1980. A well-understood regulatory regime and relatively high yields supply a strong tailwind for their continued growth.

Distribution is not as direct as it once was. With intermediation in full swing, the key is to be visible everywhere. Databases, consultants, and platforms will all require attention from professionals who are not only adept at building relationships but also fluent in the language of data science.

Operational superiority can also help managers in another way: Pricing. Fee pressure may not be as pervasive as it once was, but it has not disappeared entirely. Even if a manager is not inclined to negotiate, more efficient processes enable greater flexibility and a deeper understanding of unit costs and profitability.

Scalability is another benefit. More efficient processes and systems enable managers to handle more funds, deals, and investors without sacrificing quality or performance.

Strategic decision-making can also be improved. In addition to product rationalisation and distribution agreements, most executive teams are likely to consider inorganic growth opportunities from time to time. Rather than considering M&A opportunities on a reactive and opportunistic basis, robust data pipelines lay the groundwork for informed decision-making rather than a series of fire drills.

Looking forward.

None of this would be possible without a corporate culture that embraces and reinforces data-driven decisions.

This sometimes overlooked fact underscores the significance of talent management. Even the most committed team may not be able to design and manage every aspect of a next-generation operating infrastructure.

It is also difficult to build in a piecemeal fashion. There is no shortage of off-the-shelf portfolio management systems, automation tools, and data analytics platforms to streamline processes, improve reporting accuracy, and enhance operational efficiency. Many firms leverage cloud-based solutions for secure data storage and accessibility, as well as reducing operational risks and enabling efficient collaboration. But true operational excellence generally requires a more holistic approach to efficient processes, risk management, and client-centricity. It entails optimising investment workflows, streamlining due diligence and deal execution, effectively monitoring portfolios, enhancing reporting capabilities, being more transparent, meeting liquidity requirements, and ensuring compliance with complex legal and regulatory frameworks.

This is why many managers reach out to specialised providers with whom they can work to build the best solution. Some firms outsource to save money. Forward-thinking managers partner with service providers who add value by helping them deliver the best experience to their investors while also lighting the way forward towards further innovation.

Execution might be hard, but the concept is simple: Investor satisfaction hinges on adopting a client-centric approach. Understanding clients' unique needs, preferences, and goals to deliver personalised experiences. Fostering transparent communication, responsiveness, and tailored reporting to build long-term client relationships and enhance investor satisfaction.

As private market investments rebound and regain their momentum, the pursuit of operational excellence becomes essential. The growing competition for assets necessitates a comprehensive approach to operational efficiency and client satisfaction. By sweating the details, streamlining processes, embracing technology, and adopting a client-centric mindset, investment firms can establish themselves as industry leaders. Operational excellence is not just a requirement, but a powerful competitive differentiator that helps unlock success and fuel long-term growth.

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