KEYNOTE INTERVIEW

Delivering transparency through digitisation

IHS Markit's Clayton Albertson on how digital tools can help managers address increasing complexity and demands for data, particularly during times of volatility

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In the face of change and new challenges in the US mid-market private equity space, managers are under pressure to increase transparency on many levels. Here, Clayton Albertson, partner and senior vice-president at information, analytics and solutions provider IHS Markit, discusses market trends and using data to inform better decision making.

Q With so much change impacting US mid-market investors, what trends are you observing around their investment in digitisation?
We see the continuing professionalisation of the industry and the resultant desire to create organisational leverage as key themes impacting all investors. When we think about mid-market investors and their investment in digitisation, two broad pressure points drive the need for change.

First, the industry has become more competitive and firms are on the hunt for better ways to deploy their resources, among the most critical of which are their investment professionals. Investors are looking to enable scale without being overwhelmed by the operational demands of running the firm. So, to improve operational efficiency, they must leverage digital tools to free up the team to focus on the things that matter most, which are making great investments and serving their stakeholders.

GPs are always looking for an edge, which includes tapping into more information, improving due diligence and seeking out alternative sources of data. Without technology, that is more difficult to do.

Further, we see best practice firms moving from individual knowledge systems to institutional knowledge systems, seeking to build information platforms to inform and accelerate good decision making around new investments, portfolio companies and stakeholder reporting. They want to reduce the internal burden of time spent loading and reconciling data between systems and to reach a point where data is always on, always up to date and always ready to use.

The second pressure point is the market-wide trend towards transparency, whether that is the LP asking the GP for more information or the GP asking the portfolio for more information – everyone wants to know more about what is going on. Particularly in times of volatility and uncertainty, the desire for transparency increases. Digital tools help to provide and solidify critical understanding into what is going on and to help make that communicable to others.

Q What are the challenges around mid-market fundraising, and how can managers address these?

The market is becoming more competitive as LPs continue to become more sophisticated and more selective. They take an independent, data-driven approach to manager selection, one which is focused not only on the return profile and drivers of investment performance, but also on the operational stability and scalability of managers.

When you add volatility and broad global economic uncertainty into the mix, the burden on the manager to stand out from the crowd only increases. We expect that firms that can continue to tell compelling stories and have built strong relationships with their capital partners are going to be able to continue to raise funds, though the pace of fundraising, and the ability to secure new LP relationships, seems to have slowed somewhat over the last few months.

In March and April, there was more focus placed on portfolio health, but we now see fundraising processes resuming in earnest, just taking longer. Firms that use technology tools to support firmwide operations, including support of the fundraising process, to collect information and help facilitate the production of responses to bespoke information requests, are having an easier time and feel less disruption to the firm as a whole.

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During fundraising, a mid-market GP might be going out to 100 different LPs, some of whom have worked with the manager before, and some that it will have been courting for a considerable length of time. There is a huge amount of information sharing involved, and the conversation is not just about IRR and investment performance anymore. It is now about the story of the firm, its strategy, data on its historic performance, showing how it operationalises its thinking, how it adds operational value and demonstrating proof points to illustrate a sustainable investment and operational approach.

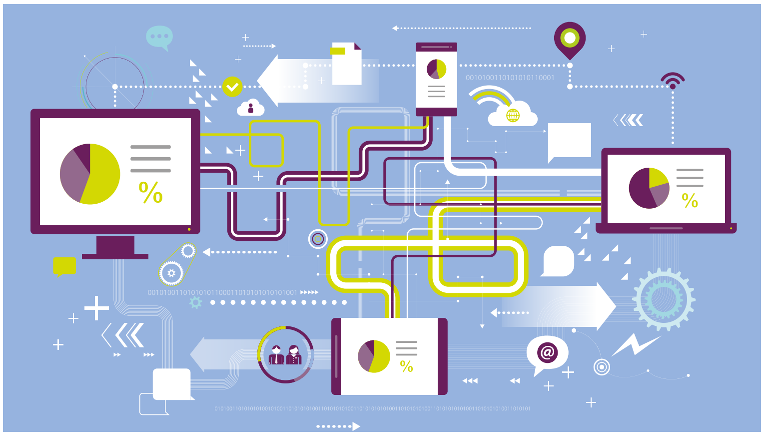
Managers need to have access to a proper toolkit so that they can consistently engage with current and prospective LPs in all market conditions and can readily retrieve portfolio information in order to address LP inquiries with confidence.

Q What new demands for information and data are managers facing?

The demands are increasing for new kinds of information that have not always been as important or sought out as they are today, such as data on environmental, social and governance programmes. At the very basic level, LPs are asking GPs to show how they are adhering to ESG principals as a firm, as well as within their investment portfolios, what they are doing in the portfolio and what their policies and procedures are across all their companies.

In more advanced scenarios, the ESG discussion is focused on showing granular metrics. In the UK, that conversation may be more about carbon footprint and in the US it may be more about social and governance issues, but as the ESG conversation becomes more of a global imperative, there are many different requirements for information that we see GPs having to comply with. That is a formidable task and doing that in a spreadsheet is really challenging. The data collection and distribution challenge is made complex because of the lack of a standard reporting approach, so we find that firms are looking for help to figure out how to best comply and deploy ESG-related thinking in their portfolio and then to convey that story to relevant parties.

Another area that we are watching closely is regulatory driven demands for information and data. Particularly in uncertain markets like the current one, we would expect to see continued



What challenges have arisen from recent market volatility, and how can those challenges be mitigated?

One specific challenge is the impact that volatility is going to have on portfolio valuations. Market participants are focused on how they are marking their books, how they want to address the volatility and how they are going to communicate that to stakeholders. Firms that have consistent, robust and transparent valuation processes will stand up well and be able to talk their LPs through their valuation approach and outcomes.

Another challenge is on the new deal front. When we see public market valuations go down there is always a delayed reaction before we see the same happening to private market valuations. There is a lag, but at the moment we see our clients finding interesting opportunities to invest, to deploy creative strategies, and underwrite to their unique value. Investors remain very wary, particularly about 2020 performance, when looking at deals for companies in most industries, and that is especially the case in the US.

The industry is growing and evolving, and all these challenges can be met through transparency and institutionalisation. As generational transfer continues to be front of mind, with numerous firms now seeing their founders looking to turn over leadership to another generation, the business is not about individuals anymore. It is about firms, and that requires a set of policies, approaches, metrics and systems – supported by digital tools – that can underpin the business model as a whole.

regulatory interest in the space, as it does not take very many negative stories for regulators to start to focus on the private markets again.

In the US, we have begun to see some questions around further opening access to private markets, including potentially to more retail investors. Firms are starting to think about how they might get prepared for that possibility, which just adds to the potential disclosure burden.

> *"We see best practice firms moving from individual knowledge systems to institutional knowledge systems"*

Finally, we have observed that best practices over the last several months have put a premium on communication, which means communicating early and communicating often about the health of the investment portfolio and what actions are being taken to support the portfolio. The firms that have relevant data available to quickly inform LPs about areas of risk and exposure stand out very positively. LPs really appreciate that communication and may, I suspect, reward those managers with more capital over time.

How are fund structures and strategies evolving, and what does that mean for managers?

One of the broader examples of this evolution is driven by strategy complexity. We see an increasing number of mid-market firms expanding their offerings, most often to include building out private debt strategies to complement their traditional private equity strategies. Supporting diverse fund mandates presents a number of operational and reporting challenges, and investing in digitisation tools can really help managers to look across a portfolio of assets that may include debt, equity and real estate, for example.

As well as strategy complexity, we also see firms dealing with the increasing complexity of investment structures, with growing complication in the relationships between LPs and GPs leading to more side letters, managed accounts, co-investments and so on.

Further, there may be leverage introduced at the fund level, adding additional nuance to the conversation. Lastly, we are also seeing selective examples of M&A going on involving GPs, creating issues around the consolidation and management of legacy teams, processes and technologies. So, fund structures are evolving, LP relationships are evolving and financing structures are evolving, all creating firm-wide issues that need to be addressed. ■