

# BRIEFING MEMO

## AN ALTERNATIVE TECH EDGE

Learning by failing and applying this experience to win deals, to then positively transform a business, is not every industry's mantra. But it certainly works in the alternative investment industry of Private Capital. Private Equity and Venture Capital professionals are generally the first to admit what they don't know, openly and plainly. It is therefore already old news to you that technology is a disruptive force being put to use in order to gain a competitive advantage, and you are probably among the first adopters of automation tools.

***"Everybody has to pay attention to the digital revolution" –  
David Bonderman***

The culture of an investment firm is a reflection of its founding general partners. As the Millennials steadily rise within the management ranks however, change is most definitely underway. The early partners are for the most part relishing the fresh insights brought to the table today, as they themselves pressed the start button when the words "digital transformation" became buzz 5 or so years ago without really understanding the technology per se. Very few of us actually did and yet **we were all going digital**.

Digital natives don't necessarily understand the technology either, but they certainly know how to hammer it, in other words they have no fear in applying it. Technology is changing quickly, never too quickly, and the skill lies in simply knowing how to apply it.

Smart technology is first and foremost useful technology!

## Data Management Systems

Before launching into next-generation analytics, let us first review where we stand today in our technology evolution within the business operations of Private Capital, be they fund inception, portfolio management, accounting and reporting. These areas still involve many manual processes using spreadsheets and documents in different file formats exposing your firm to inaccuracies and inconsistencies. Exciting new data management systems are steadily being adopted in the following fields:

**IT Infrastructure:** Private Capital is naturally inclined toward cloud-based delivery models, in particular Software as a Service (SaaS) or rather **Software as a Subscription**. You look at this in your acquisition targets where best-in-class customer service and continued product development goes hand in hand with the predictability of recurring revenue streams of customer subscriptions. This model features in your own firm's business management tools too and you are cognisant of the reliability of cloud services for the integration of different technologies versus rigid local servers requiring up-front purchases of licensed software, along with in-house IT staff.

**Regulation:** Private Capital is no stranger to a radically new regulatory regime with greater data capture & reporting obligations, examples being the **Foreign Account Tax Compliance Act (FATCA)**, **Alternative Investment Fund Managers Directive (AIFMD)** and the **Common Reporting Standard (CRS)**. You require oversight of a variety of investment vehicles with filing obligations spanning a vastly increased number of data fields. As a caretaker of data your firm faces responsibilities that if not upheld will be sanctionable.

**Finance & Accounting:** Private Capital investment portfolios are diverse and you require coherent financial information in order to produce reliable performance reporting, transparent fee & expenses calculations, and accurate fund valuations. There will never be a unified source of data - staff turnover is a given, teams grow, processes change. Data remains on servers but the risk is that it is managed in different departments and its relevance is never the same to individual users. Access and transparency need to be more liquid to serve the demands not only of the regulators but also of your investors who are demanding more frequent up-dates.

In short, your accounting department is happy to sweat the details, provided they have ready access to the information that allows them to calculate management fees, carried interest and make accurate expense allocations. Errors introduced at this level will translate into incorrect fund valuations disclosed in investor reports and regulatory filings. More robust data management will also enhance your liquidity position by limiting the frequency of reconciliations and shortening settlement cycles.

**Client Information:** Data management systems play a crucial role in the on-boarding process of your clients involving **anti-money laundering (AML)**, **know-your-client (KYC)**, **politically exposed persons (PEP)**, **adverse media checks**, **source of funds** including source bank account checks, and **electronic signing** of the terms and conditions. With the minimum information stored, you will want to personalise the data you hold on your limited partners reflecting fund commitments, capital calls, along with any other more granular information your investor may require. Efficient client data management will have immediate spill-over effects for your investor relations department when attracting new capital.

## Next Generation Analytics

The Private Capital market is seeing unprecedented buyout activity at record high valuations. General partners are not having difficulties finding transactions, rather it is the need to identify the right transactions to go after in the first place. Strategic buyers will have their innate industry knowledge in valuing a target and pay higher multiples to capture synergies, versus Private Equity and Venture Capital firms who will need to rely on data substantially externally sourced. It is precisely here where pioneering use of data science will make the difference by undertaking deeper fact-based analysis of exponentially expanding structured data.

It is useful at this stage to remind ourselves of the extent to which captured information - largely unstructured - is growing. One Zettabyte (ZB) of global data is where we stood at a decade ago. If you imagine the average storage capacity of the smart phone you are holding to be 32 Gigabytes (GB), it would require 34.4 billion smart phones at full capacity to be equal to 1 ZB. The world is expected to have computed and stored fully 175 ZB of data by the year 2025. It's worth pausing for a thought here....what possibly can all this information contain? Crucially, how can one extract meaningful and relevant data?

Your transaction staff will include traditional analysts with amazing Excel and PowerPoint skills together with strong familiarity of traditional internet search engines. The vendor information memorandum will include company information that we all know to be highly curated. The acquisition time-line is tight and you are competing against a number of other bidders.

Private Capital professionals know that the hidden value is not always present in rows and columns of numbers and are increasingly employing the skills of **data scientists** who are capable of **taming big data**.

**Machine learning** techniques are deployed to identify rich unstructured sources of information and find connections to other sets of data. The process requires large amounts of computing power which is efficiently obtained through cloud-driven business models. Data scientists turn data streams into insights and explain the result in simple ways. For Private Capital the implications are powerful for each stage of the acquisition cycle - pipeline screening, in-deal execution, and post-deal value realisation.

With growing corporate use of social media, mobile communication, and cloud data warehouses, your list of potential acquisition targets can literally be **fingerprinted** by your technology engineers to spot both hazards as well as hidden value all based on externally available information. Data mining and text searching techniques allow you to find out what is in the public domain. Having structured what was once unstructured data, this now proprietary information sharpens the outcome and gives you an automatic advantage in any due diligence situation.

The raw transactional data given to you by the vendor and their advisors will be familiar ground and certainly there are software solutions that essentially automate the traditional analysis at speed, giving your deal team more time to draw their conclusions on pricing. Deeper company research really begins once you are in the bidding phase and attempting to model future value realisation. The cash flow projections you are modelling to price the deal will need to reflect a growing array of variables really only limited to the extent of your imagination, given the likelihood of relevant information being 'out there'.

Once the company is part of your portfolio, the opportunity of next generation analytical tools to create economies of scale on a portfolio basis, in addition to gathering & analysing more data on the acquired entity as it continues to operate, is very real. **Value lies idle** on company storage servers but is certainly not lost and its electronic footprint is expanding. The luxury of space gained by electronic storage devices has brought with it the reality that you are now staring at onerous reams of electronic folders, and countless virtual files in myriad formats.

These storage servers, however, contain precisely what you believe to be important information and **data science brings this value to light**. From suppliers to clients and all the intermediaries your portfolio companies interact with, you possess a data set that can literally be monetised to optimise marketing and distribution channels, identify clients' net value, bucket client types to maximise profitability, and target new business.

## Qualitative Edge

The nature of the Private Capital industry is to **hunt for value** in an inefficient market and take risk to achieve rewards with a firm grasp on the handle of leverage. Private Capital managers are steadily embracing **sophisticated technology as a business management tool**. Storing and processing data in cloud-based management systems puts you in the position of being able to report in real-time to the fund managers, investors, third party service providers and, when audited or inspected, to your external accountants and regulator.

The special skill set is a mix of having good relationships and mastery of tried and tested quantitative analytical tools that assist in the origination, due diligence and value enhancement of an investment. **Your qualitative edge is your respect and quest for the unknown, as you pioneer the use of data science in investing.**

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