Embracing technology
A crucial element in transforming private equity and real estate business operating models

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This article discusses cognizance of the rise of the alternative fund industry, and technology, systems and automation being the focal points in the much-needed transformation of business operating models across private equity and real estate managers, institutional investors and service providers to cope with changing industry norms.

The recent financial turmoil has heavily dented the fiscal health of investment companies and adversely impacted the performance of traditional investments in money markets, bonds and equities. The ensuing lacklustre markets, exacerbated by the persistent economic woes in the United States and the Eurozone, have subsequently amplified awareness and interest in alternative investments, including private equity and real estate, not only as a means of portfolio diversification but as part of core investment strategies. Asset managers and institutional investors predominantly initiated and sustained this trend towards other asset classes and new geographical markets in their quest for higher yields to meet the performance expectations of their end-clients, a justifiable move given how alternatives have fared better than traditional investments in these turbulent times. As a prime example, pension funds, which historically allotted their capital largely to the safer realms of equities and fixed income securities, have in the past few years upped their alternative asset allocation to almost 20%, a threefold increase from levels posted in 2006, thereby giving credence to and signifying acceptance of this shift in investment approach.

While the growing attention to alternatives is immensely positive for the private equity and real estate industry, challenges abound in this sector—from protracted liquidity problems, passive fund raising, sharp decline in deal volume and sluggish deal closing, operational requirements and changes, to intensified demands and more complex queries from investors. Moreover, there is heightened regulatory scrutiny with the introduction by global fiscal watchdogs of several stringent, far-reaching industry laws and regulations championing investor protection and aimed at curbing the mounting problems afflicting the international economy.

The aforementioned developments in this post-crisis economy have undoubtedly altered the alternative investments landscape—the onslaught of extensive regulatory requirements from the information collection mandate of the Dodd-Frank Act in the United States to the transparency provisions of Europe's Alternative Investment Fund Managers Directive (AIFMD), and the burgeoning informational needs of investors such as those embodied in the Institutional Limited Partners Association (ILPA) reporting standards have all compelled private equity and real estate firms and their service providers to assess their existing business operating models in order to identify the tactical and strategic modifications and enhancements needed to cope with these escalating demands and challenges.

In evaluating current organisational set-ups and infrastructure, asset managers and service providers placed emphasis on key focus areas including data management, enhanced transparency and compliance, risk management, industry expertise and proficiency, and technology requirements. In our conversations with market players, many have recognised and acknowledged that the operating models currently in place are certainly inadequate or even outmoded and would essentially need to be restructured, streamlined and updated to boost commercial and functional efficiencies and to reinforce their business' viability, competitiveness and ability to survive and flourish despite these harsh conditions.

At the forefront of an operational model redesign is technology, and private equity and real estate companies, accustomed to the industry's predicaments in terms of limited automation, manual reporting and processing, are focused on this aspect.

In our interview with Lauren Iaslovits, Chief Operating Officer of private equity technology provider SunGard Investran, she stated that *"The increasing reporting requirements both from regulators and investors would necessitate standardisation around the collection, storage and reporting of far more data than historically required of private equity firms in the past. As a result, firms are now rethinking their approach to data management, especially around portfolio investment data that ultimately feeds into investor reports, regulatory filings and key investment decisions. Hence, firms are favouring more robust solutions with workflow and controls for the types of data where a purely spreadsheet-based approach would have worked in the past."*

"Over the past year," she added, *"there have been a significant number of institutional investors adopting a dedicated portfolio management system, enabling them to become more sophisticated and independent in their approach to portfolio analysis and reporting. Investors recognise that it is ultimately in their interest to keep tabs on the underlying portfolio holdings of the funds in which they are invested and putting the proper solutions in place is paramount to providing this level of transparency and to scaling the overall operation of the alternative investment programme."*

Most of the abovementioned views have been echoed by Richard Gerritsen, European regional sales director of Yardi Systems, Inc., the software provider for real estate investment and property management businesses, adding that sweeping regulations have driven industry players to refocus attention on internal controls and processes, automation and systems evaluation and how to quickly adapt these to meet multiple compliance and transparency requirements. *"Five or six years ago, it was normal to report almost everything in Excel,"* he said, *"Now, investors require and expect more detailed and automatically generated information, pushing firms to find an appropriate technology platform that would complement their business strategies."*

Business reorganisation and outsourcing

Compliance with new laws and demands from increasingly perceptive investors is undoubtedly quite taxing for general partners, asset managers and institutional investors already embroiled in a quandary of a tightly competitive business environment along with huge pressures on costs and margins. The shift in their focus from portfolio and fund management to operational capacity is a clear recognition by these market players that middle-to-back office functions are also crucial to the operational value chain and integral to the successful implementation of alternative business strategies. Some of the more prominent and larger firms have had success in restructuring or expanding their organisations, setting up specialised teams and in-house infrastructures to handle new developments and requirements affecting their global operations. But for most, the lack of internal resources, expertise and suitable software has compelled them to outsource administrative functions to competent third-party providers, aiming to redeploy resources and refocus efforts on their core fund management business.

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On the fund services front, both SunGard's and Yardi's representatives also share a common view—that the aforementioned industry trends provided significant opportunities for service organisations to look for new growth and revenue drivers and broaden their existing service offering beyond the current outsourced solutions for the middle-to-back-office operations of general and limited partners. On this, Ms Iaslovits added that *"SunGard has observed a growing number of historically purely hedge fund service providers adopt its platform in order to opportunistically target private equity funds as a growth area for their business, or in some cases to serve their existing customer base of asset managers that no longer have only hedge funds, but also, closed-ended committed capital-based private equity funds or real estate funds.*

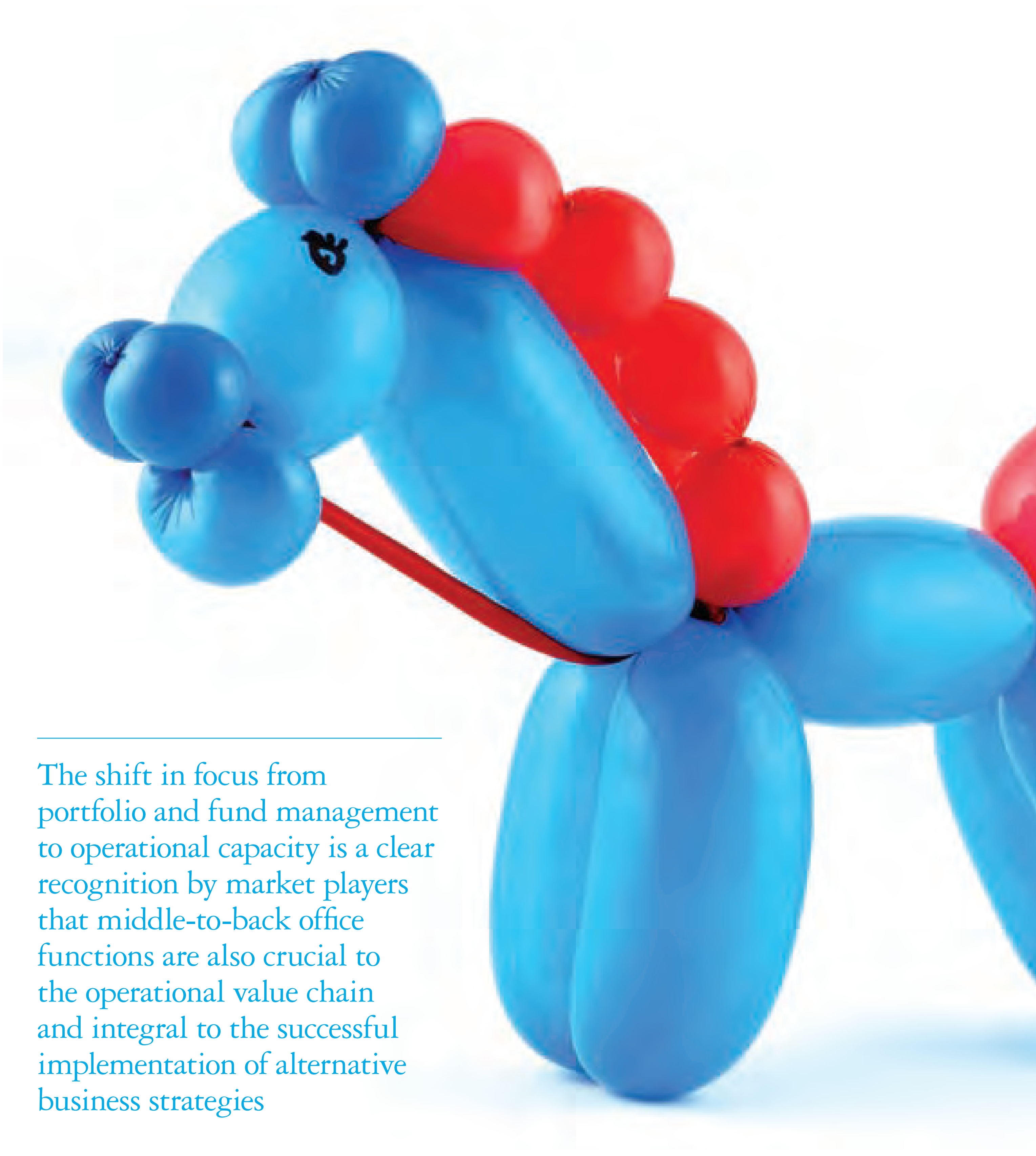
Mr Gerritsen inferred that leading investment firms seeking outsourcing partners have a preference for larger service organisations. With their own set of integrated and modern technologies, customised and varied services, coordinated internal procedures and skilled personnel, larger service firms are perceived as reliable and essential business partners supporting investment firms to cope with increased and changing industry requirements, while offering competitive fee structures to an increasingly cost-conscious clientele. *"What may happen, in the future,"* he concluded, *"is the consolidation of niche and smaller-sized fund administration, transfer agency, tax and reporting service providers in order to achieve the size, capital and scale that would enable them to compete with their larger and more established competitors".*

Key considerations in transforming operating models

The growth and development of the private equity and real estate business is expected to continually be fuelled by demands from investors and regulators for more transparency, risk management and asset diversification, the increasing flexibility in alternative strategies allowed for regulated funds, the increased competition among managers to attract reallocation from funds held in traditional asset classes and the progressive and gradual institutionalisation and globalisation of this sector. Transforming operating models to adapt to new norms is not an overnight process—it can require a considerable amount of time and resources and focused project management commitment, from the initial enterprise-wide assessment phase to the management decision-making process up to the full implementation of adopted changes and enhancements to current technology and existing organisational structures. Whether choosing the right platform or software, setting up specialised teams or selecting a reliable third-party service provider to support business operations, it is extremely important that firms take the time to analyse key elements ranging from costs, efficiencies, business requirements and functional analysis to third-party due diligence, and to vigilantly oversee all infrastructure modifications and manage the integration of outsourced processes to ensure that these are all aligned with business objectives and strategic plans. Indeed, this can be a burdensome task that can take months or years to fully realise or implement, but it has become an inevitable prerequisite to success and prosperity in this evolving industry.

To the **Point**:

- The financial crisis has unpredictably benefitted the alternatives industry—with increasing awareness and acceptance of this asset class as part of core investment strategies
- Investors and regulators are driving the trend towards a transformation of operating models in investment firms, institutional investors and service providers
- The developments in the industry and the refocusing on operating infrastructures has renewed interest in outsourcing functions to reliable third-party service providers
- Transforming business operating models is vitally important for firms to remain competitive and to succeed in the alternatives market



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