Diligent

Building the Future-Proof Private Equity Firm

If it's true that investors crave volatility, then 2020 might eventually prove to be among the greatest years for private equity returns on record. From COVID-19, to the pandemic-driven economic slowdown, to trade wars, political uncertainty and more, this past year has delivered no shortage of volatility-driven opportunities for investors.

This has been a shift from where the private markets entered 2020, with asset prices setting all-time highs in the U.S. and Europe, with holding periods declining as investors sought to avoid a potential downturn, and with returns under pressure in an increasingly competitive segment.[1]

Now, growth is on the table for those private equity firms prepared to leverage their advantages and adapt to meet changing market dynamics. The landscape for private equity in 2021 and beyond will be far different than it was heading into 2020.

Funds that overlook changing market dynamics, ignore investor calls for greater transparency, and fail to support their portfolio companies will fall by the wayside. In contrast, successful firms will be those that adjust to meet these new challenges and embrace new technology solutions to improve their performance.

Private equity success going forward will hinge on three factors:

- **Stronger firm governance**
  Both firm leadership and their portfolio companies benefit when governance is made a priority. In tight markets, establishing better processes and tools around data protection, board communication, cap table management and competitive intelligence can streamline operations while mitigating risk.

- **Better portfolio oversight**
  Firm performance and decision-making will increasingly hinge on gaining better visibility across the portfolio. Portfolio companies in particular are at risk in a COVID-disrupted environment. Investment performance for private equity will be a direct reflection of those that do a better job of monitoring their capital.

- **Deeper investor relationships**
  Transparency into fund structure and performance will be critical going forward, with limited partners pushing managers to become more active in stakeholder outreach and incorporating their voices into oversight and decision-making.

1. https://www.bain.com/insights/hugh-macarthur-letter-global-private-equity-report-2020/

Thriving Through Technology

Technology is the answer to all of these challenges. The right technology empowers and enables private equity leaders to support their businesses in this new reality. From secure meeting technology to market intelligence, the private equity firm of the future will be one that's steeped in tech. It will be capable of moving quickly on new opportunities, and it will take a hands-on role in managing its investments.

> "Operational excellence has always been core for a lot of buyout firms. In a difficult financing market, it will only become more so as the financial engineering piece isn't going to be as easy to execute. Improving margins organically through, for example, technology efficiencies, will be key to sustaining management team and asset performance."[2]
>
> **Ian Lynch**
> *Chief Commercial Officer*
> Intertrust

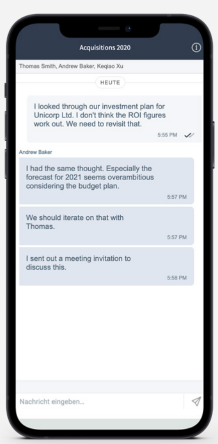
Among the questions that private equity firms should be asking themselves are how technology can help them thrive in three key areas: improving security, streamlining workflows and boosting visibility.

1. How can firms better secure sensitive data?

Private equity is a data-rich business, which means data security is an imperative. The remit of communication data ranges from investment committee communication around prospective deals to portfolio company financials, intellectual property and strategic plans. Not only is this information extremely valuable to firm operations, but the competitive risks associated with any of it leaking out, being intercepted or otherwise revealed is very real. This is true particularly for email communications, as demonstrated by the spring 2020 email hack that cost a trio of private equity firms more than $1 million in total. In that case, the hackers had been "stalking private equity firms, monitoring internal systems, diverting emails, hijacking relationships, interpreting and even initiating wire transfers to steal millions of dollars from multiple organizations."[3]

But private equity decision-making still requires open lines of communication between stakeholders. Secure platforms can address the risk without sacrificing access or flexibility by securing documents, conversations and strategies across firms and portfolio companies.

Key Takeaways



Diligent Messenger is as seamless as texting or email, yet it encrypts conversations and file sharing.

- Firm leaders, boards and investment committees should consider the sensitive nature of their communications and ensure that financial and strategic documents remain privileged with the right encrypted tools.
- Communications between firms and limited partners should be protected according to the same security standards: end-to-end encryption, advanced permissions and a central platform that supports seamless collaboration across groups.
- A secure communication platform can also ease interactions across the firm's portfolio companies, preventing outside access to confidential documents, performance data, conversations and more.

2. https://www.intertrustgroup.com/news-and-insights/insight-news/2020/intertrust-keynote-victoria-robson
3. https://www.forbes.com/sites/zakdoffman/2020/04/23/microsoft-365-hackers-hit-private-equity-in-new-million-dollar-heist-heres-how-it-works/?sh=44d9e3a66767

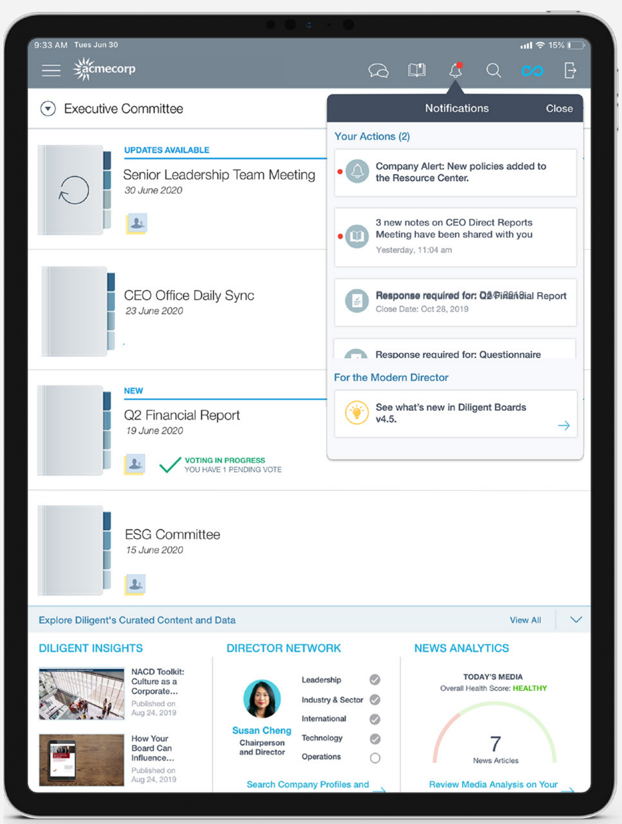
2. How can firms streamline operations and workflows?

In a competitive private equity market, process optimization is about more than simply improving day-to-day results. Those firms that have strong internal decision-making and implementation processes in place are better prepared to capture new opportunities and to take market share from their competitors. McKinsey has found, however, that operational efficiencies within private equity firms can be difficult to manage, with challenges increasing alongside assets under management (AUM).[4] The right technologies can solve for these problems.

Board meetings and materials are one area ripe for innovation – particularly when firm leaders sit on multiple portfolio company boards. A robust board management software not only digitizes board processes (including voting and resolutions, board evaluations, board book archives, meeting minutes and approvals, action-item tracking and so on), but it also allows firm leaders to streamline and secure board activities across a portfolio.

Cap table management is another opportunity for firms to streamline operations across the portfolio. With the right technology, firms can centralize cap tables and track and analyze fund performance in real time.

Key Takeaways



Diligent Boards centralizes all board and committee activity through one central platform, complete with meeting minutes and virtual signatures.

- Board meetings and board communication represent low-hanging fruit for many PE firms. By centralizing board documents and meeting materials on a dedicated platform, firms can maintain a secure archive and digitize voting, meeting minutes, action items and reporting for use in decision-making.
- Specialized committees will also benefit from technology platforms designed to centralize information and secure workflows.
- When equity cap tables are formatted consistently and streamlined across the firm, reporting and decision-making become easier across a large investment base.
- With tools that centralize the flow of information to and from portfolio companies, private equity general partners can maintain an archive of all communications and more easily monitor the health and status of their investments.

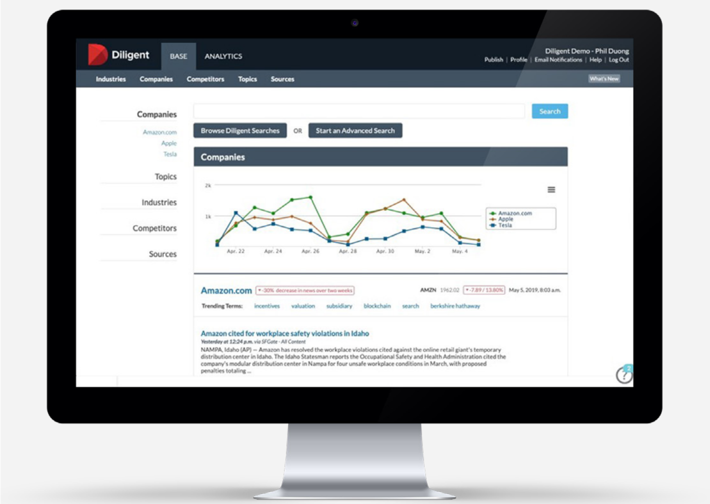
4. https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/how-private-equity-is-tackling-operational-complexity

3. How can firms improve their visibility?

Improving private equity performance requires better visibility on all fronts, into broad investment trends, competitive markets, portfolio companies and more. But it also requires a greater level of transparency between firms, limited partners and other stakeholders who, after seeing the impact of COVID-19, are pushing firms to be more forthcoming with portfolio information and market insights. Intelligence, data sharing and access are becoming a two-way street, and the most effective firms are leveraging advanced environmental scanning tools to ensure their insights and communications remain proactive.

Environmental, social and governance (ESG) initiatives are increasingly important to private equity investors. And, as evidenced by the COVID-19 pandemic, social and environmental issues can impact consumer behavior and business conditions. According to RBC, more than 75% of institutional investors currently incorporate ESG principles into their processes, and some 84% of investors believe that "ESG integrated portfolios perform as well as or better than portfolios that do not integrate ESG."[5] Firms need to operationalize their ESG efforts through data tracking and analysis to demonstrate their commitment and show alignment with performance through benchmarking, sentiment monitoring, etc.[6]

Key Takeaways



Diligent Governance Intel allow firms to track market trends and media activity across their portfolio companies.

- ☑ Environmental scanning of investment trends and the competitive landscape increasingly involves advanced monitoring tools to track and synthesize news mentions and competitor movements. These new technologies often come with health scores for early risk identification.
- ☑ Meeting expectations around ESG requires the right data in order to understand how your firm stacks up to peers and competitors across environmental, social and governance metrics.
- ☑ Maintaining centralized records for each portfolio company and the firm at large can offer new visibility into compliance and regulatory matters, across complex and even global company structures.

5. http://www.rbc.com/newsroom/news/2020/20201014-gam-investing-report.html
6. https://www.bain.com/insights/esg-investing-global-private-equity-report-2020/

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Technology as a Differentiator

Private equity enjoyed a banner year in 2019, with investors dedicating a record $361 billion to buyout firms, but suffered in 2020 due to COVID-19 and the pandemic-related economic slump.[7]

But in this volatility, there is opportunity.

Those private equity firms that are best prepared and equipped to adapt to the changing private capital market – one that's more focused on transparency, investment oversight and process optimization – will be those that emerge the strongest.

Next Steps for PE Firms

- ☐ **Review current processes**
  In order to reap the greatest benefit from technological transformation, funds should take a holistic view of how their processes currently function in order to identify potential areas for improvement. How secure are your current communications protocols? What platforms are you using to interact with investors and portfolio companies? Where are you continuing to rely on outdated, manual processes?
- ☐ **Talk to stakeholders**
  The days of the private equity "black box" are over. Today, investors, portfolio companies and other stakeholders demand greater transparency into both the firms they work with as well as their internal dealings. Ask them what they expect and how the firm can best deliver it. Develop a list of stakeholder expectations as a guide when planning updates and improvements.
- ☐ **Identify shortcomings**
  Private equity as a whole has been slow to adopt new technologies, leaving many processes ripe for update.[8] With an eye toward improving internal operations, review everything the fund does on a day-to-day basis with key stakeholders to identify areas for improvement. Which tasks and processes are particularly problematic? What slows down operations on a regular basis?
- ☐ **Take steps to protect sensitive data**
  Even within the confines of the firm, sensitive data and confidential communications are exposed to cyberthreats and other avoidable risks. Corporate email accounts, personal email accounts and text messages are particularly vulnerable, as are legacy general-access platforms like Dropbox and Slack. To prevent the significant financial and reputational damage of a data breach, invest in a secure platform for firm committees and leadership with end-to-end encryption and workflows that mirror the functionality of email, text messages and file-sharing systems.
- ☐ **Streamline firm operations and workflows**
  Consolidate board and committee communication on one centralized platform that provides all the core functions: secure document sharing, collaboration tools, virtual signatures, voting and questionnaires, etc. Eliminate errors and redundancies by managing cap tables in a secure online platform. Encourage self-service by permissioning users to access only the materials they need, when they need them.
- ☐ **Improve visibility of environmental factors**
  Implement technological solutions that provide curated, A.I.-driven analyses of industry trends and market factors that will have an impact on the firm or portfolio. Operationalize ESG principles across the firm and portfolio companies, and benchmark against standardized metrics.
- ☐ **Focus on key improvements**
  Immediate efforts don't need to address everything all at once. Highlight the areas that need the most improvement and start there. What efforts will pay immediate dividends? Once those steps are addressed, move on to lower-priority needs.

Better governance is unlocked with the right technology. That's why PE firms are leveraging Diligent solutions to build the modern governance framework they need to thrive and grow in the months ahead.

7. https://www.bain.com/insights/year-in-review-global-private-equity-report-2020/
8. https://www.privateequitywire.co.uk/2020/07/27/287929/private-equity-steps-its-technology-adoption

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About Diligent

Good governance is a competitive advantage, but implementing it doesn't need to be difficult.

The right governance technology empowers your organization to act strategically while maintaining compliance, mitigating risk and driving efficiency.

- Companies with better board and governance operations report **stronger financial performance** than organizations without those processes.
- New challenges and opportunities arise every day. Organizations with strong governance operations in place can **adapt to the evolving landscape** – faster and with more agility than their competitors.
- Modern governance empowers leaders with the **technology, insights and processes** required to fuel good governance.

At Diligent, we produce the modern governance tools to help you maintain security, ensure visibility and act with agility in order to mitigate risk and seize new opportunities. Our platforms facilitate seamless board and committee management, secure collaboration, C-suite efficiency and improved compliance with access to industry trends and insights that help you make data-driven decisions in real time.

With the largest global network of corporate directors and executives, Diligent is relied on by more than 19,000 organizations and nearly 700,000 leaders in over 90 countries. With award-winning customer service across the globe, Diligent serves more than 50% of the Fortune 1000, 70% of the FTSE 100 and 65% of the ASX.

Ready to see Diligent in action? Schedule a demo today.

Contact Us | Info@diligent.com | +1 877 434 5443 | diligent.com