BITE alternative investments

Mergermarket

The Tech's Factor:

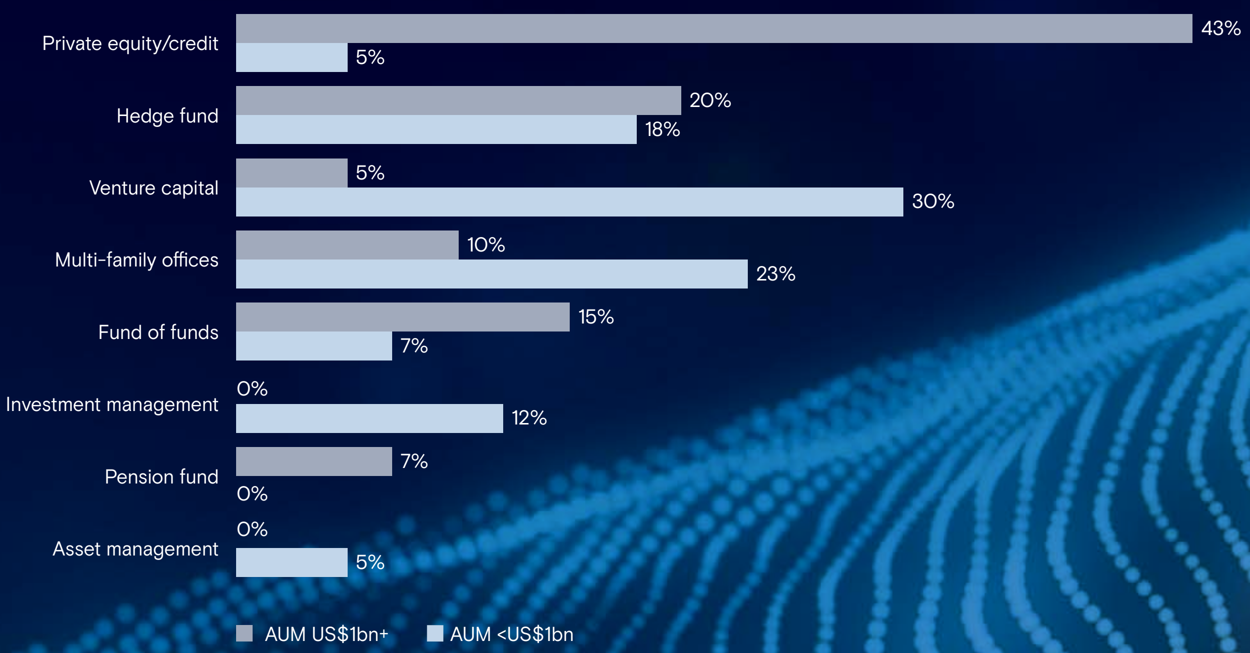
The digitalization of private markets in 2022 and beyond

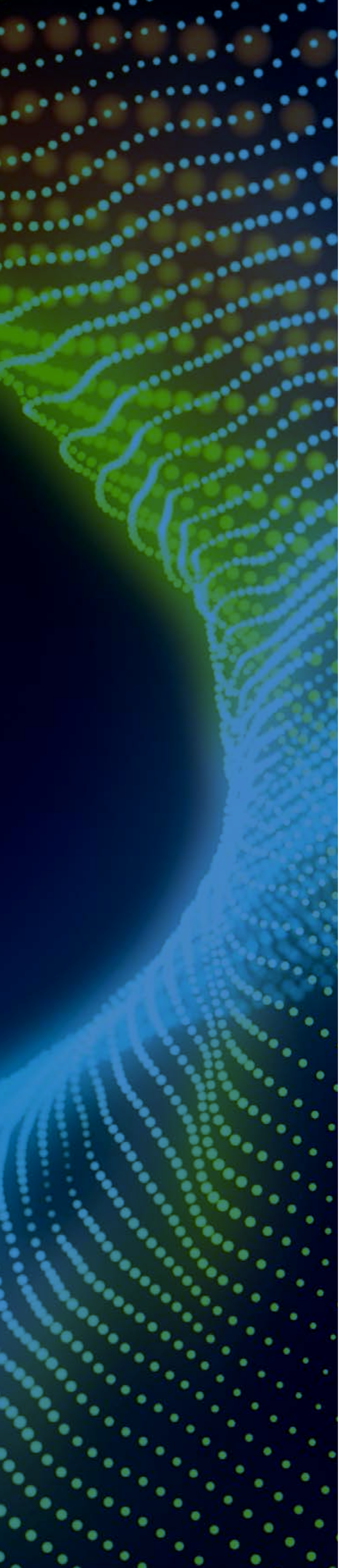
Contents

Methodology

In the fourth quarter of 2021, Acuris Studios, on behalf of Bite Investments, surveyed 80 senior executives from middle market, boutique funds and asset managers based in the US on the topic of digitalization of the private markets. Forty respondents were from firms with AUM of US$1 billion or more and 40 respondents were from firms with AUM of less than US$1 billion.

The survey included a combination of qualitative and quantitative questions. All interviews were conducted over the telephone by appointment. Results were analyzed and collated by Acuris Studios, and all responses are anonymized and presented in aggregate.





Foreword

A seismic shift is underway in the private capital[1] industry. For decades, the raising and investment of funds into private companies has largely been an analog, manual process founded on face-to-face interaction and in-person relationships. The fintech revolution had, until recently, all but bypassed the private capital market. As the saying goes, "if it ain't broke don't fix it". But the pandemic changed the rules of engagement. Business activity was forced online and firms adapted well to the new socially distanced paradigm.

As a wealthtech innovator expanding access to private markets and helping fund managers to automate their entire investment cycle – including onboarding, distribution, subscription and investor relations – we have our own skin in the game. Bite Investments has observed an acceleration of digital adoption across the industry in recent years, catalyzed by the conditions imposed by the pandemic.

To better understand and demonstrate how digitalization is shaping the industry, we partnered with Acuris to canvas fund managers on how they are adopting tech, for what purposes, what opportunities they see and what challenges they face.

Clearly, the digitalization of private capital management is a welcome development and will improve the industry's already good standing with the institutional and, increasingly, high-net-worth investor pool that backs it. This adoption is not uniform across all firms, of course, and there are teething problems such as data access and management issues and the complications that may arise from migrating from long-embedded legacy systems.

However, digitalization is an ongoing transition that is never fully complete, with constant refinements along the way. Above all else, it's the journey that counts. Those who fail to embark on that journey will quickly find themselves left behind amid mass adoption.

[1] *This refers to all respondent groups – from private equity and hedge fund to pension funds and asset managers; see chart opposite for details of respondents. Also, the sector overall is referred to as "the industry" or "the sector" throughout and covers all respondent groups unless otherwise stated.*

Digital adoption: The state of play

We reveal how digitalization is affecting fund managers in the private capital management industry and investigate how the size of a firm can be a determining factor in speed, success and satisfaction

Key findings

01 Big firms are much further along in terms of digital adoption and expectation. This means that smaller firms can still capitalize on a first-mover advantage.

02 Most respondents are generally satisfied with digital solutions across most services, with regulatory reporting, investor onboarding, relationship management and client communications being areas of strength.

03 Larger and smaller firms differ on who leads the digitalization strategy, the former preferring a dedicated Chief Digital/ Information Officer to lead the charge.

04 Enhanced data access and operational efficiencies are the main drivers for digitalization.

05 Increased overhead costs, training staff and legacy systems are the greatest challenges to digitalization.

06 The pandemic has encouraged large firms to dispose of existing systems and increase technological capacity – less so for smaller firms.

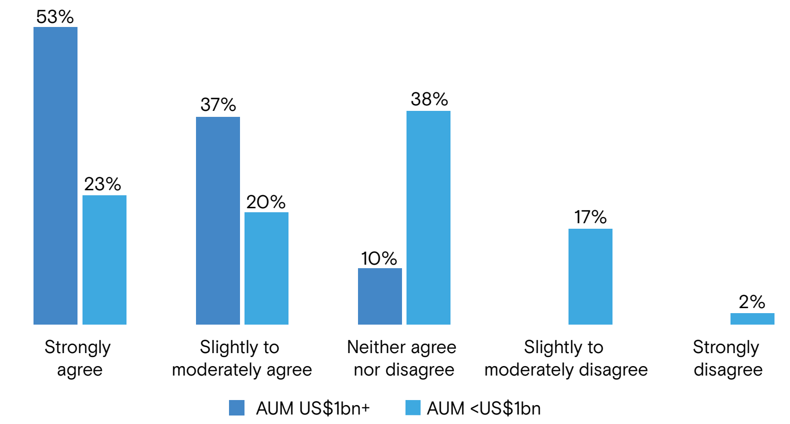
Bigger moves faster

It's no secret that the private capital industry is going digital. However, the size of a firm or fund has a strong bearing on their progress on the journey. This is not only a question of available resources. Our research shows that firm size has a major influence on the extent to which firms are prioritizing their pivot toward more digitally powered operations.

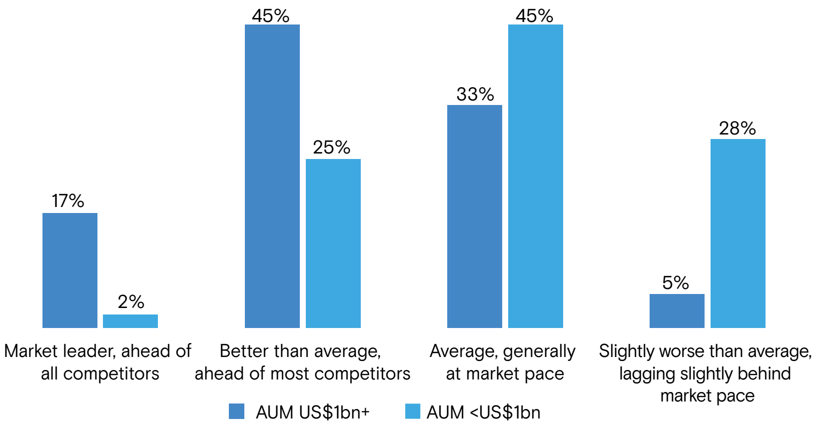
Specifically, we find that 90% of firms with AUM of more than US$1bn agree that keeping ahead of the game in regard to technological capabilities at their organization is a top priority. This is in stark contrast with firms that have AUM of less than US$1bn, with just 43% of this group agreeing with this statement.

The greater emphasis on tech progress among big firms is down to two main factors: one, they have more available capital to invest in their operations and, two, they are under greater pressure from their investors than smaller firms. These managers are already more institutionalized and as one adopts new technology it quickly becomes expected, meaning those who have yet to digitalize are under pressure to level up or get left behind. This impetus to adapt is not felt as acutely among smaller cap firms – at least, not yet.

To what extent do you agree that keeping ahead of the game in regard to technological capabilities at your organization is a top priority?



How do you believe your organization currently compares to its competitors in regard to its digital adoption? (Select one)



Similarly, larger firms are also notably more likely to believe they are ahead of their competitors in terms of digital adoption, with a majority seeing themselves as either market leaders (17%) or better than average (45%). A mere 2% of smaller firms believe they are beating their competition in this race and only 25% see themselves as above average; this means they are more likely to see themselves as lagging, with 28% of smaller firms perceiving themselves as behind the curve compared with only 5% of large managers who say the same.

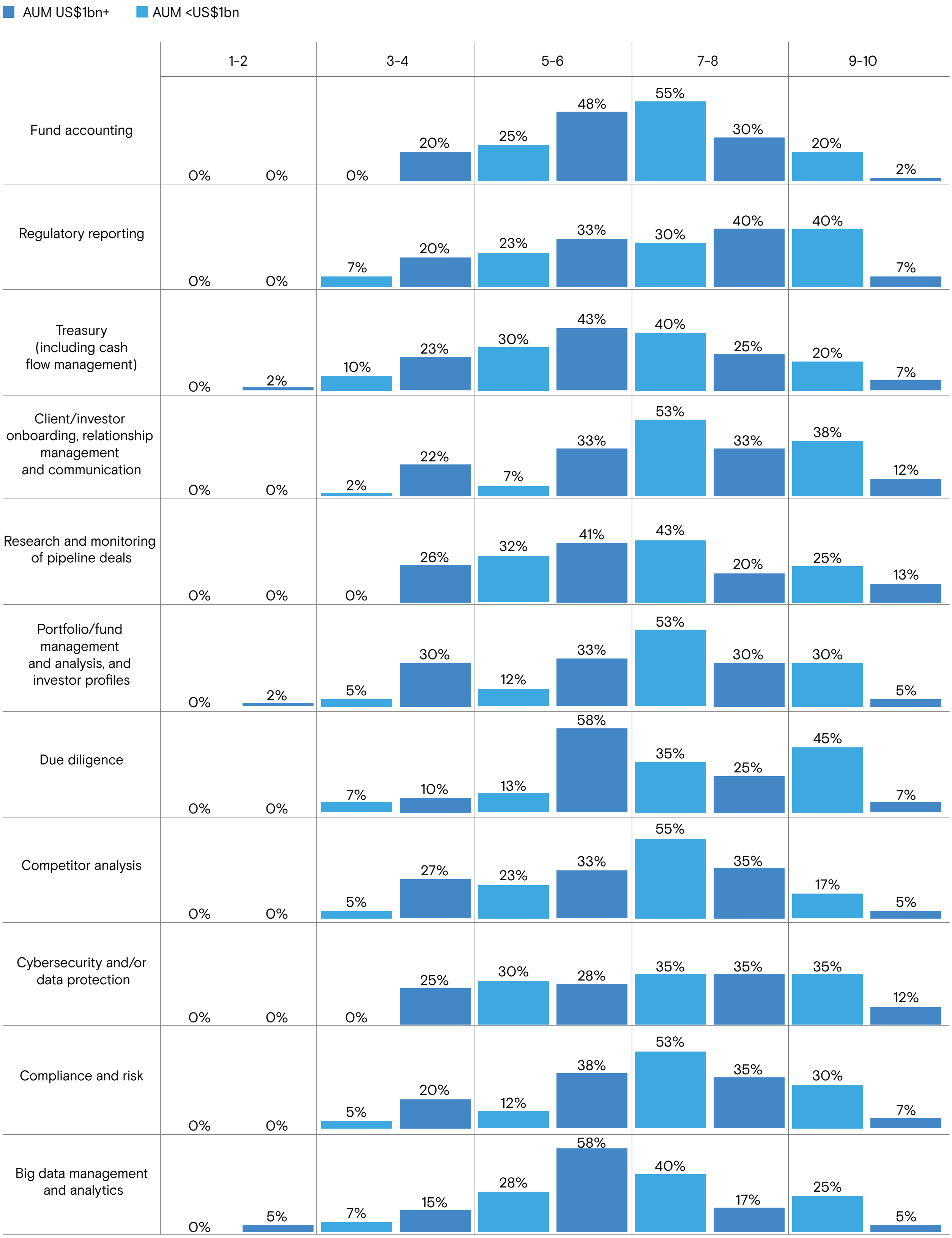
(Can get some) Digital satisfaction

Digitalization touches on all corners of the industry's activities and operations, from workaday tasks such as fund accounting to the cut and thrust of analyzing available deal flow. Areas in which satisfaction is high include regulatory reporting and, to a lesser extent, investor relations (IR) – and this is largely the case regardless of firm size.

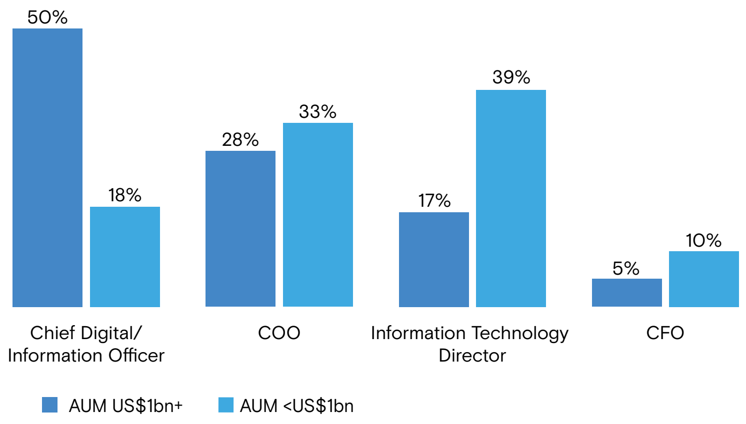
As much as 40% of big firms say they are very satisfied with the digital solutions their organization currently uses for regulatory reporting, while 40% of smaller firms are moderately satisfied. In terms of IR, 38% of large firms are very satisfied with the solutions being used for investor onboarding, relationship management and client communications and as much as 53% are moderately satisfied, while 12% of smaller firms are very satisfied and 33% are moderately satisfied.

Due diligence applications is an area where general partners (GPs) differ. Whereas 45% of large firms

On a scale of 1 to 10, how satisfied are you with the digital solutions your organization currently utilizes in the following areas? (Answer a number 1-10, where 10 is very satisfied and 1 is very dissatisfied):



Who leads technology strategy and adoption at your organization?



say they are very satisfied with how digital tools help them to analyze shortlisted deal targets, only 7% of smaller firms agree, indicating an area that has room for improvement among this group of GPs.

Indeed, it is notable that smaller firms are far more likely to report being either moderately or extremely dissatisfied with how digital solutions are being applied to various areas of their business. For example, more than 20% say that they are dissatisfied with their current digital adoption across a raft of areas including portfolio management and analysis (32%), competitor analysis (27%) and research and monitoring of pipeline deals (26%).

"Fund management solutions are not up to the mark," says the partner of a fund of funds who is dissatisfied with their firm's digital solutions. "There are many problems that we face in everyday use and it requires a lot of maintenance. We have to upgrade these systems soon."

Leading the digital charge

Digitalization is everywhere and organizations must seize upon the opportunity to secure a leading position in what is an increasingly disrupted environment. Doing so requires installing a dedicated person who can articulate the various ways in which the firm will benefit and lead the charge on these initiatives. Most corporates today have a chief digital/ information officer (CD/IO) or head of digital transformation. This role has oversight and accountability for all efforts being made to innovate and adapt and is dedicated to overseeing and upgrading digital capabilities.

Our research shows that larger, more institutional GPs are taking inspiration from this corporate model. Already 50% of this cohort say that technology strategy and adoption at their organization is led by their CD/IO, compared with only 18% of smaller firms. Of these firms managing smaller funds, 39% say these efforts are being led by their information technology director, followed by 33% who say their COO is responsible.

There is a clear positive correlation here between a firm's size, their level of satisfaction with their digital progress to date and whether they have a CD/IO in place leading the charge, emphasizing the importance of creating this dedicated role.

That said, digital solutions can be intuitive, off-the-shelf products that anyone can use and do not require technical knowhow to install or use.

"The CD/IO should really focus on the core competencies of the firm. What Bite is doing is plugging in an ancillary solution to help on the IR side of activities. We're supporting that," says Henry Reynolds, COO, Bite Investments. "That frees up the CD/IO to concentrate on whatever the firm's digital strategy is, whether it's machine learning or big data analytics, the higher-level perspective."

Digital drivers

There are several underlying drivers for private capital's investment into enhancing its digital capabilities. Every year, regulators are asking for more disclosures; investors too are seeking greater insights from their reporting to better manage their portfolios and understand the returns that are being delivered.

Whatever improvements and upgrades are being made, they all rely on one essential ingredient: data. Understandably, then, we find that 85% to 90% of respondents across sizes say that enhanced data access and the increasing granularity of data is one of the drivers for their digitalization investment plans.

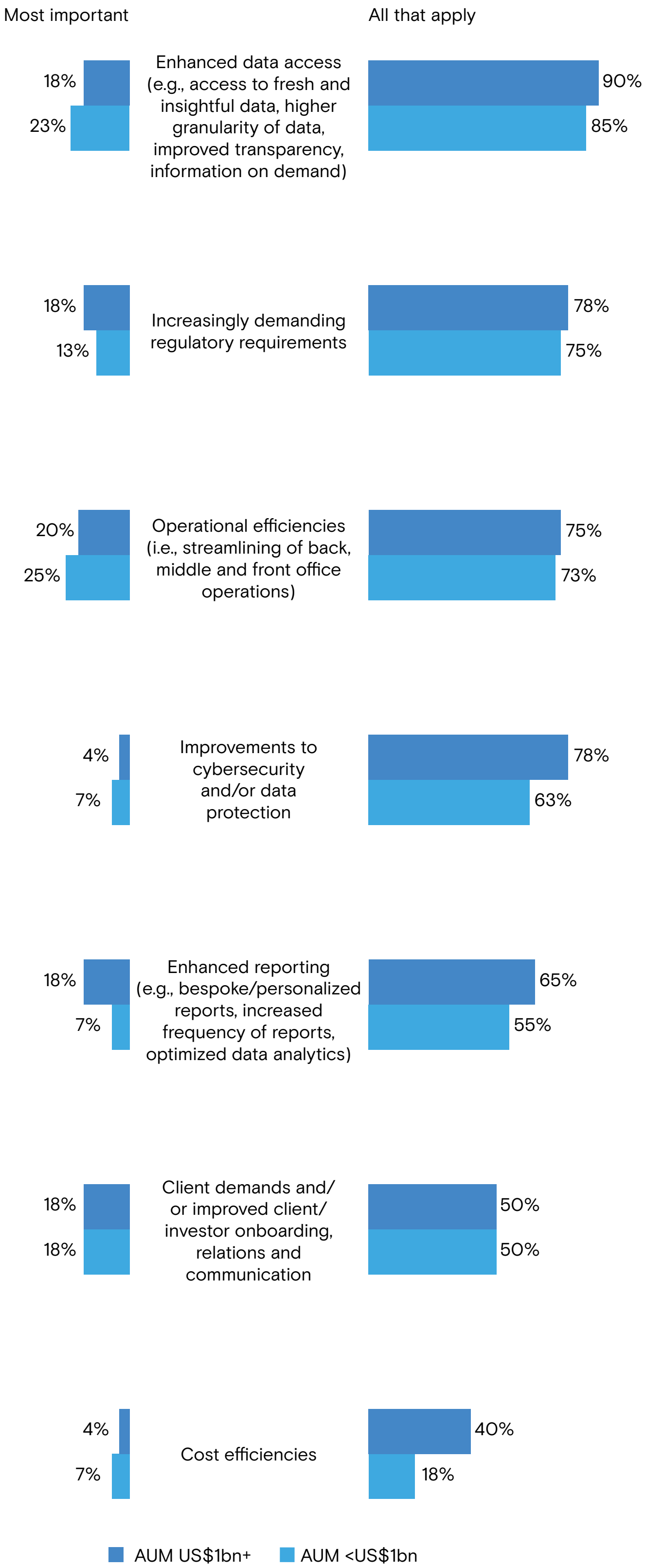
"If GPs lean into digitalization, they will tend to have better access to data. For example, having one platform where you can allow your limited partners (LPs) to be educated on the strategy, conduct their due diligence, create a client profile, invest in a fund and, lastly, use that same site as a place to stay connected with the fund through its life is extremely valuable. Right now, those processes are very fragmented, and those various functions may be carried out in different systems," says Sean Clifford, president, Americas, Bite Investments.

Around three-quarters (75%–78%) of respondents also refer to increasingly demanding regulatory requirements as one of the reasons for investment in this area. Oversight of sustainability and ESG issues in particular is an increasingly dominant theme. In the US, the Securities and Exchange Commission (SEC) has said it is considering rules for private capital funds regarding ESG factors but has yet to take any action.

However, in March 2021, the EU introduced its extraterritorial Sustainable Finance Disclosure Regulation (SFDR), requiring investment managers to quantify sustainability risks and disclose the "principal adverse impacts" of investment decisions. SFDR applies to any firms marketing funds to EU investors under the Alternative Investment Fund Managers (AIFM) Directive, regardless of where they are headquartered, and therefore applies to regulated US GPs too.

Also scoring highly as a motivation for digitalization is operational efficiencies, cited by 73%–75% of respondents. "Achieving operational efficiencies is the main goal of our

Which of the following are driving your plans for investment in digitalization at your organization? (Select most important and all that apply)



digitalization strategy. We have set the largest budget for digitalization in the back and middle office as this supports the company's investment plans," says the partner of a venture capital firm.

When asked which single driver was behind these efforts to digitally transform, 25% of firms with AUMs of less than US$1bn pointed to operational efficiencies, while another 23% saw enhanced data access as the main driver.

Firms with AUM of more than US$1bn by contrast are more mixed on this point. Improving cybersecurity (4%) and cost efficiencies (4%) score low on the list of primary investment drivers. But operational efficiencies, enhanced data access, client demands, regulatory requirements and enhanced reporting are evenly balanced, scoring between 18% and 20% for this cohort. This shows just how comprehensive the benefits of digitalization can be, enhancing all the various activities for a private capital firm.

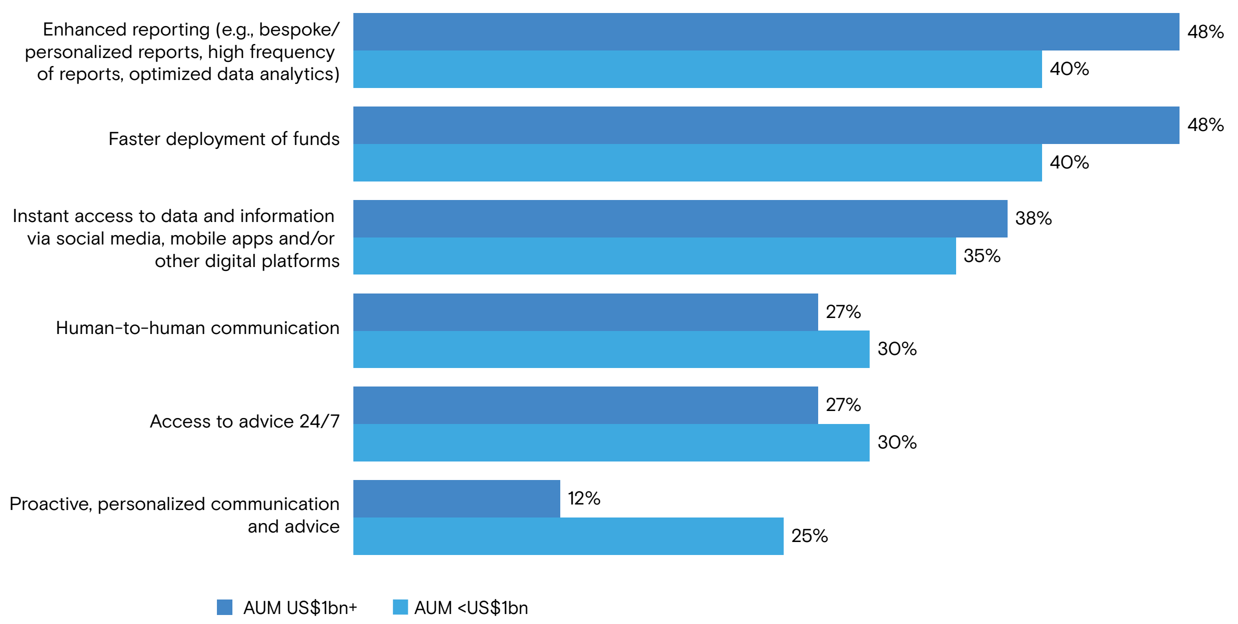
Client demands

Investors are arguably the most important part of the private capital ecosystem. Therefore, catering to their desires and demands is an absolute priority. After all, they can always take their money elsewhere.

Regardless of firm size, respondents most commonly see enhanced reporting and faster deployment of funds as being most important to their clients (40%–48% for each). LPs continue to demand greater transparency from their GPs, who have historically reported in a bespoke fashion. One sticking point for decades has been the lack of standardization in returns reporting, which can make it challenging to discern how effectively investors' capital is being invested. This has been complicated further by the widespread adoption of fund credit facilities which can distort internal rates of return

Investors are arguably the most important part of the private capital ecosystem. Therefore, catering to their desires and demands is an absolute priority.

Which of the following do you see as the most important to your clients? (Select top two)



(IRR), a time-weighted metric. Trade organizations, such as the Institutional Limited Partners Association, have published fee reporting templates to try to address this lack of uniformity.

"Transparency in private markets is something that has come under a lot of scrutiny. There is a lot of awareness around how opaque private market fees are, for example," says Henry Talbot-Ponsonby, co-founder and president of Bite Investments. "There's always a push and pull for the adoption of new technology. Provided there's enough demand from LPs for digitalization so that they have better reporting, GPs will have no choice but to deliver."

On the question of how quickly funds can deploy, the best private equity managers gain an advantage in securing deals by moving at pace. In sale processes, vendors want to see bidders that can execute. Streamlining investor communications with technology can expedite capital drawdowns from LPs. This helps to ensure transaction speed and certainty, enabling GPs to deploy capital fast and opportunistically. This competitive edge is especially valuable in the current environment, global PE deal value and volume breaking all-time highs in 2021 and dry powder levels beginning 2022 at a record US$1.81 trillion. Digitalizing and automating operations can be enough to give GPs the upper hand amid heavy competition.

The barriers to digitalization

Total digitalization may be the ambition, but the journey is heavy with hurdles. More than half (58%) of larger firms say that one of the many challenges they have faced as part of this process in the past two years has been training staff to a sufficient level that they are able to move away from legacy systems and operations to new ones.

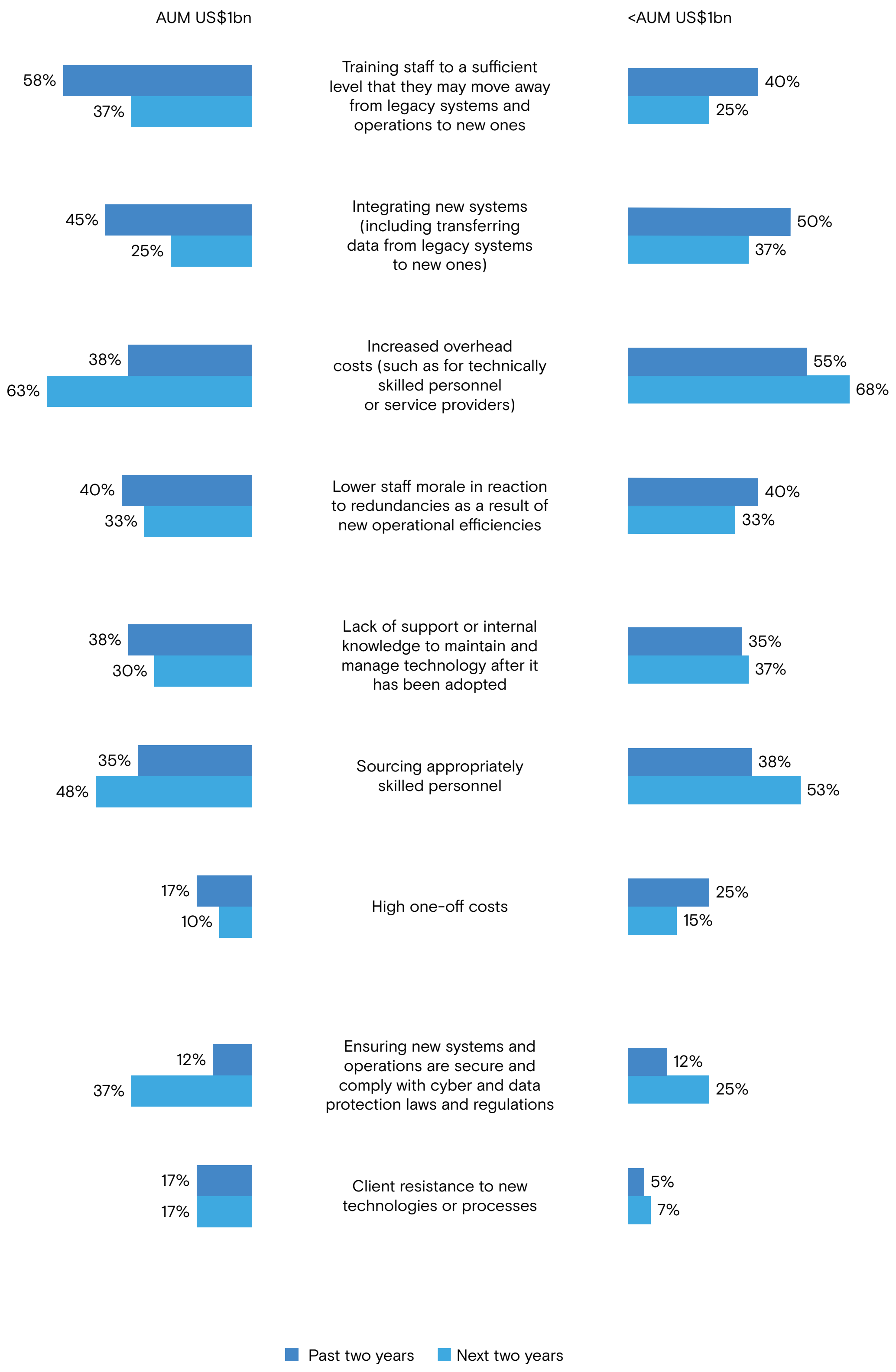
"Unless you use a system every day and are very conversant with it, you're probably only scratching the surface of what's possible," says Talbot-Ponsonby. "There is a generation of 50- to 60-year-olds who are in charge of a lot of private capital groups and the idea that they're going to seamlessly transition into using new technology is unrealistic. But people in their organizations are already using virtual data rooms and advanced Excel techniques and so it's about making sure that the right technology is sold to the right people who are going to make the most of it, whether that's IR professionals or the deal team."

However, looking ahead, just 37% of this group of larger firms expect staff training to be a top challenge over the next two years, suggesting that for the most part they have already overcome this hurdle. This is also consistent with the earlier findings that larger firms are ahead of the digital curve compared with their smaller counterparts, the former having already done more heavy lifting.

Instead, firms with US$1bn+ AUM most commonly expect increased overhead costs, like those associated with paying technically skilled personnel or service providers, will be one of their top challenges over the next two years, with 63% pointing to this.

For smaller firms, costs are even more likely to be a concern. This is likely because they do not have the same economies of scale as larger firms, the latter benefiting from higher levels of fee income that comes with managing more and larger funds. More than two-thirds (68%) of smaller firms say that increased overhead costs will be their top challenge followed by 53% who expect sourcing

What have been the top challenges faced as a result of your organization’s adoption of new technologies in the past two years? And what do you think they will be in the next two years (Select up to three for each)



appropriately skilled personnel is one of the biggest obstacles that lies ahead of them.

"We have to be very careful about increased costs. If we don't calculate this accurately in advance then we may exceed our budget and this would not be ideal for our liquidity management," says the partner of a private equity and credit firm.

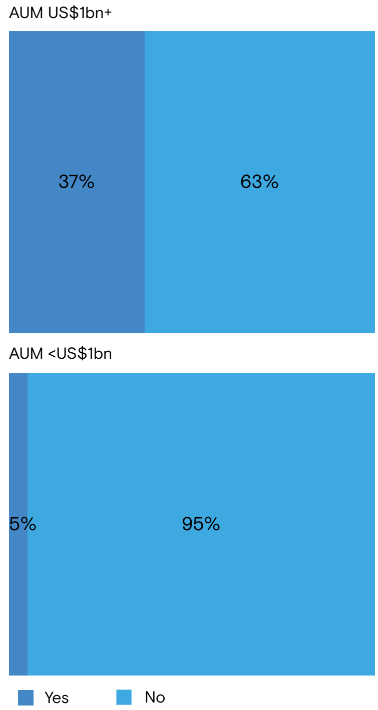
It is important that GPs understand the cost-benefit of any investment into digital tools and carry out research and due diligence on SaaS providers and their level of transparency on product pricing. All-inclusive subscription licenses with guarantees of no hidden costs are common and are a way for PE fund managers to enhance their operational capabilities without taking on undue levels of overheads.

Effects of COVID-19

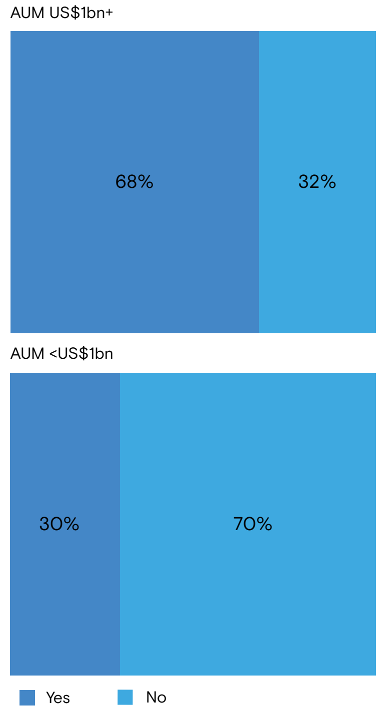
The COVID-19 pandemic has been an accelerant for change. No industries have been unaffected, whether positively or negatively. And those businesses which had already laid their digital foundations or had technology at the heart of their business model coped better with, or even benefited from, the urgent change of play.

Private capital industries were no different. Whether meeting investors or conducting due diligence on target companies, activity has largely had to be carried out remotely over the past two years. Again, we see a split between large and small firms in their capacity to pivot. More than a third (37%) of firms with AUM greater than US$1bn say that COVID-19 accelerated or increased their investment in digitalization. Only 5% of firms with AUM less than US$1bn say the same.

Has COVID-19 led to an acceleration or increase in investment in digitalization at your organization?



Has COVID-19 led to an acceleration in the disposal of legacy systems and/or technologies at your organization?



"The pandemic has really impacted how people transact across the globe," says William Rudebeck, CEO and co-founder of Bite Investments. "There's much more willingness to commit capital to private capital remotely and using technology to facilitate that. A lot of smaller fund managers have struggled in these conditions because they may not have the track record or the relationships. But technology is helping to bridge that gap."

Just over two-thirds (68%) of larger firms, meanwhile, say that COVID-19 led to an acceleration of the disposal of legacy systems and technologies at their organization, while only 30% of smaller firms agree. Once again, there is a clear gap here. This indicates that managers of smaller funds should begin to follow the lead of their larger counterparts, or risk being left behind when their peers act.

Few expect recent pressures to digitalize to be a fix for a short-term problem. Whether COVID-19 becomes endemic or not and whether recent changes to our way of life are permanent or temporary, the pandemic has served as a catalyst for change that was already coming down the pike.

"Over the next ten years, the adoption of technology will be accelerated further," observes a partner at a venture capital firm. "As we saw during the COVID-19 phase, technology is meant to be an essential part of everyday activities. That is not going to change."

37%

of firms with AUM greater than US$1bn say that COVID-19 accelerated or increased their investment in digitalization.

The roadmap for a digital future

The future is digital. That much we know. The more important questions are: what will a digital future look like for the private capital markets industry and who will the winners be?

Key findings

01 Larger firms are looking to invest more in digitalization. The majority of larger firms expect to invest at least US$1 million in digitalization in the next two years. Less so for smaller firms.

02 In terms of business functions that respondent organizations flag as top priorities, large firms are focused on client/investor onboarding while smaller ones are more concerned about due diligence – exploring the type of due diligence or how they want to change due diligence.

03 In terms of investment, most larger firms say this is most needed to help enhance client/investor onboarding (a top three priority). Interestingly, client/investor onboarding came fourth place in the list of priorities for smaller firms, with due diligence being an area most in need of digital investment for a majority.

04 To improve their operations, a majority of firms are expecting to increase investment in cloud/software-as-a-service (SaaS) solutions, social media/mobile/collaborative digital technologies, and/or cybersecurity/data protection.

05 Firms use third parties for a wide variety of services, but the size can dictate the service. For instance, 81% of larger firms use a specialist third-party software service provider for their due diligence, while only 48% of smaller firms say the same. However, smaller firms are more likely than larger ones to say they currently use a specialist third-party software service provider for their portfolio/fund management and analysis, and investor profiles.

06 Operational efficiencies will be the single most important long-term effect of the planned increase in digitalization.

07 When respondents are asked to pick which technology they think is going to have the most impact on how private equity firms operate over the next ten years, the top answer was cloud/SaaS solutions.

Expectations for digital growth
Digitalization has undoubtedly progressed in private capital markets over the past two years, but what does the future hold? Our research reveals, much like the present, that larger firms are in the lead, with a more bullish attitude toward ongoing digital investment. Almost half of this group (48%) expect digitalization investment to increase by 25%-50% over the next two years compared to the last two years. A further 15% anticipate an even higher percentage increase in investment of at least 50%.

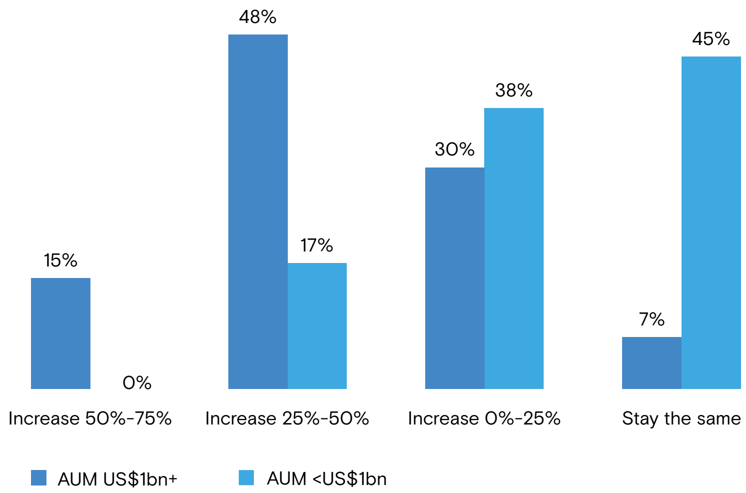
Smaller firms, on the other hand, generally either expect the level of investment in digitalization at their organizations to stay roughly the same (45%) or increase only moderately – 38% of respondents expect the level of investment in digitalization over the next two years to increase by less than 25%.

When it comes to the amount they are willing to spend to achieve those future ambitions, larger firms are generally out in front once again.

Almost three-quarters (72%) of AUM US$1bn+ firms expect to put at least US$1m into internal digitalization (e.g., new in-house systems and talent recruitment) over the next two years, 28% expecting to set aside between US$2.5m and US$5m and 13% anticipating investment of US$5m to US$10m. No large firms in our research are earmarking more than US$10m for investment.

Meanwhile, 39% of smaller firms see themselves investing between US$100,000 and US$500,000 on internal digitalization, followed by 33% who expect investment of just US$100,000 or below over the next two years.

By how much do you expect your organization's level of investment in digitalization to increase or decrease over the next two years compared with the previous two years?

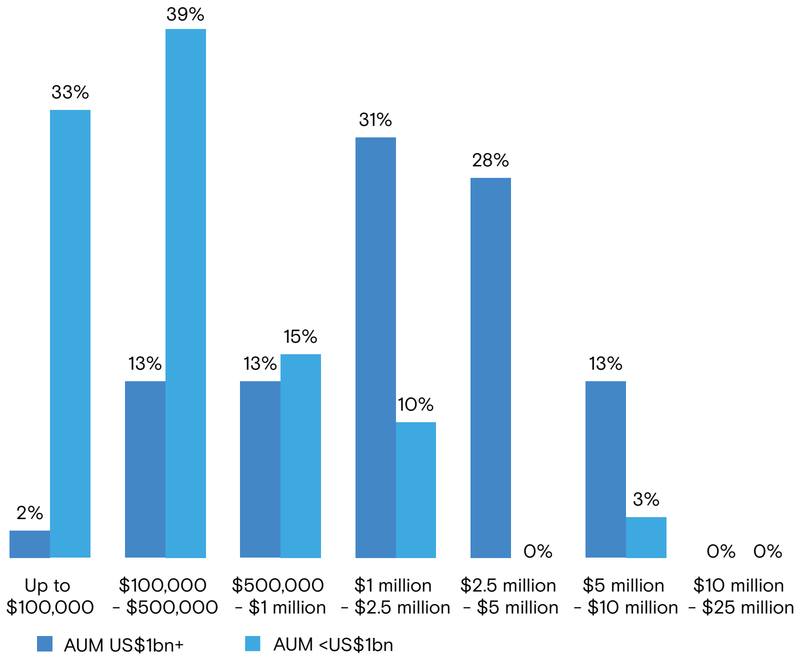


The same trend can be seen for plans regarding external digital investment (e.g., advisors and services providers). Over three-quarters (80%) of larger firms expect to make investments north of US$1m, with 33% anticipating investments of between US$5m and US$10m. Smaller firms expect to make commensurately smaller investments into external digital investment.

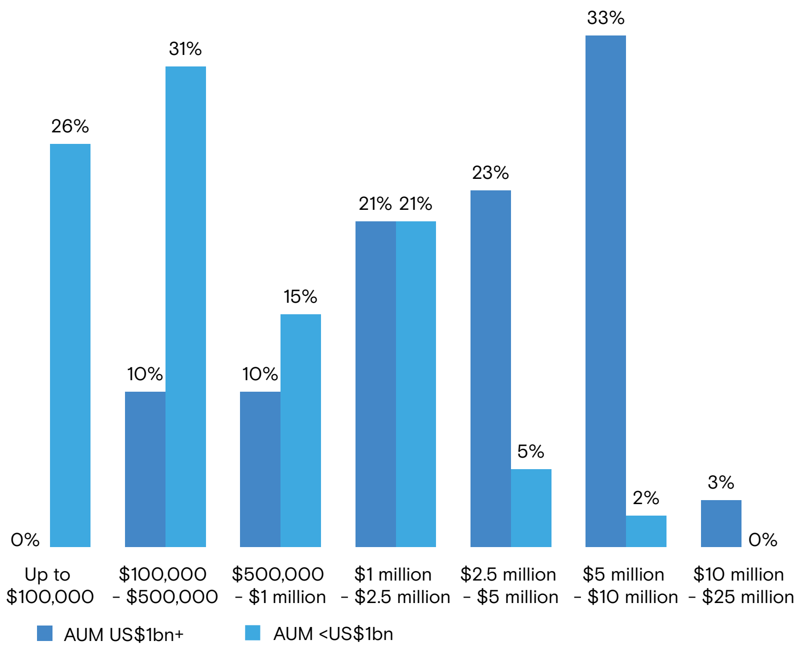
"Larger firms tend to have more budget to invest into digital solutions. They also tend to have multiple funds and wider investor bases and are generally more global," says Clifford. "With digitalization, firms can streamline the whole investor relations and distribution process and the more complex that process is, the more impetus there is to invest in simplifying it. But this streamlining is something that firms of all sizes can achieve."

Over three-quarters (80%) of larger firms expect to make investments north of US$1m, with 33% anticipating investments of between US$5m and US$10m.

What level of investment do you expect your organization to deploy for internal digitalization over the next two years?



What level of investment do you expect your organization to deploy for external digitalization over the next two years?



Future digital priorities

In regard to the business functions that respondents flag as the top priority for digitalization or that would most benefit from this investment, larger firms most commonly picked investor onboarding, relationship management and communication (53%) and portfolio/fund management and analysis (50%) as among their top-three priorities.

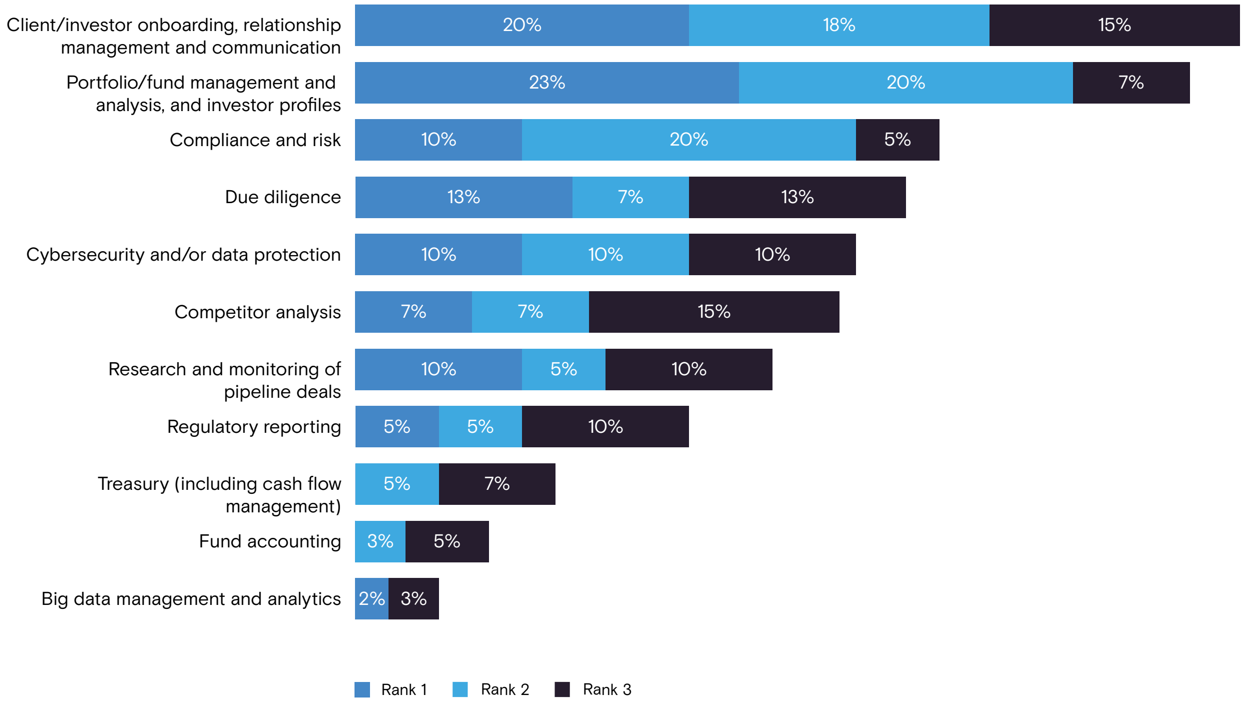
The first point of contact with new LPs can be considered as a view into a firm's shop window. Many investors will judge the extent to which asset managers have progressed on their ongoing digital journey from how they interact with them on day one. First impressions count.

"New client onboarding solutions will be beneficial for the organization. We can use the marketing tools to attract new clients and also prepare information to be provided to them in an innovative manner," says the partner of a hedge fund with private assets.

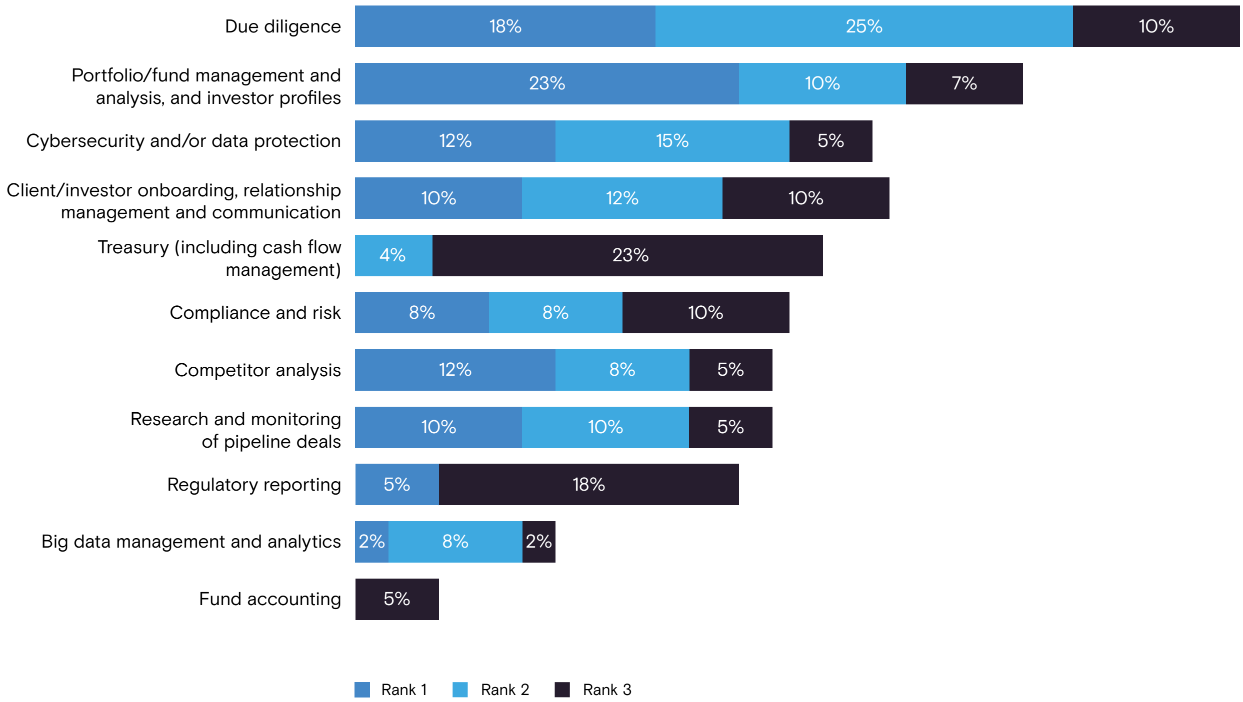
Investment into portfolio/fund management and analysis, and investor profiles is also seen as a top-three priority for 40% of smaller firms. Notably, however, due diligence – the process of examining everything from financial records to contractual intellectual property rights before entering into a proposed transaction with a vendor – is viewed as a higher digitalization priority for smaller firms than for larger firms, putting it above investor onboarding; 53% of respondents at smaller firms chose this as one of their top three priorities, compared with 33% of those at larger firms.

"This is something that I've seen in the placement agent industry among certain smaller firms. Not every GP always wants to

AUM US$1bn+: Which of the following business functions have been flagged as top priority for where digitalization investment is needed or would provide the most benefit at your organization? (Select three and rank 1–3, with 1 being the function of highest priority)



<AUM US$1bn: Which of the following business functions have been flagged as top priority for where digitalization investment is needed or would provide the most benefit at your organization? (Select three and rank 1–3, with 1 being the function of highest priority)



increasingly scale their fund size because they know that their particular strategy doesn't suit a bigger fund," says Talbot-Ponsonby. "They just want to refine what they currently do and want to use technology to do that, and that might include improving their deal sourcing and diligence processes."

This indicates that GPs want more of what they already know works. The primary benefit of using cloud/SaaS platforms, which are inherently wide-ranging, is to streamline operations.

Automation, big data and cloud to cyber: The ABCs of digitalization

There are countless ways in which private markets can adopt technology to achieve more accurate, automated and efficient operations and delivery of service. Some of these are the easiest pickings and have been widely adopted for a number of years already. Our research shows that most respondents currently use cloud/SaaS solutions, such as virtual data rooms, e-subscription and investor reporting services, compliance tools and digital marketplaces (88%–90%), as well as social media, mobile and collaborative digital technologies (68%–80%). Existing digitalization could be as straightforward as having migrated from offline Excel spreadsheets stored on internal servers to Google Drive.

At the other end of the scale are emergent applications that hold much potential like blockchain. In this area, private markets are at an earlier stage in their journey.

We find that blockchain technology is already being used by 45% of larger firms but only 10% of smaller firms, with an additional 53% and 73% of these respondents respectively expecting to incorporate blockchain within the next two years.

Essentially, blockchains are secure, immutable systems of public record. Their primary use case currently is to track transactions and ownership of cryptocurrency assets such as Bitcoin and they are revolutionizing copyright in the digital context with artifacts being backed by non-fungible tokens, or NFTs. As just one example, the blockchain can be applied to record-keeping of limited partner agreements, capital drawdowns and distributions back to investors, this information being secure and available to all stakeholders, from LPs to GPs, regulators to auditors.

"Blockchain will completely change methods of contract management and documentation handling over the next 10 years," says the partner of an investment management firm.

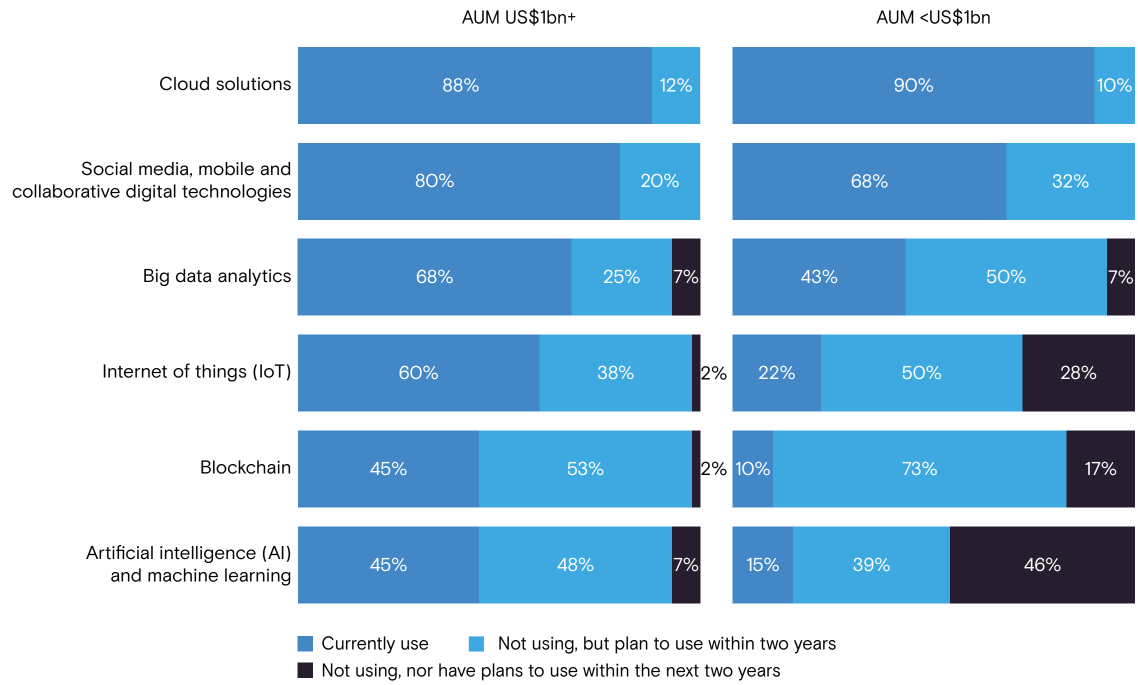
Looking ahead to future operational improvements within their own organizations, a majority of firms are expecting to invest further into areas in which they have already made progress. These include cloud/SaaS solutions (78%–80%) and social media, mobile and collaborative digital technologies (75%–83%).

This indicates that GPs want more of what they already know works. The primary benefit of using cloud/SaaS platforms, which are inherently wide-ranging, is to streamline operations. Embedding this kind of software can automate otherwise time-intensive reporting and compliance processes, freeing up resources and personnel for more value-add activities such as personal client interaction and management.

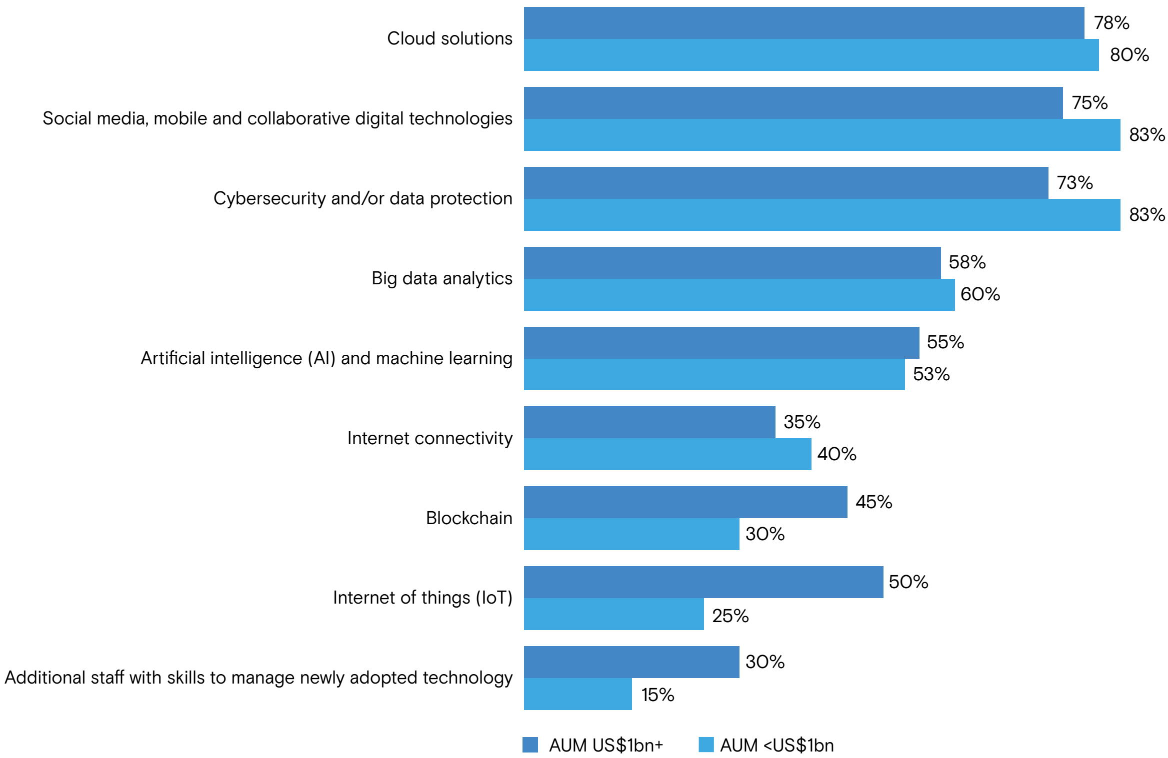
Another area that is expected to see increased investment is cybersecurity/data protection (73%–83%). Data is widely considered to be the most valuable asset of any business. The failure of fund managers to properly secure that data can have a major impact not only on the value of their investments, but also on their reputations as trusted fiduciaries. "Protecting the business value and the business name can be done with the help of cybersecurity tools. Even with cyber threats on the rise, we are functionally protected from the investments we have made and will continue to make," says one partner of an asset management firm.

According to the Financial Crimes Enforcement Network, a US government agency, financial institutions filed 635 suspicious activity reports in the first half of 2021 related to suspected ransomware activity. These reports referenced 458 suspicious transactions amounting to US$590m, exceeding the value reported for the entirety of 2020 (US$416m). The same story can be seen across the globe.

Do you currently use or plan to use the following technologies at your organization over the next two years?



In which of the following technologies and/or related resources do you plan to increase investment over the next two years for the purposes of improving your organization's operations? (Select all that apply)



81%

of firms with US$1bn-plus AUM use, or plan to use, a specialist third-party software service provider for their due diligence.

As cybersecurity breaches continue to grow in volume and frequency, firms will have to take the necessary steps to secure their data, a key consideration as they increasingly digitalize, scale their operations and expand their SaaS adoption. “Cybersecurity benefits cannot be ignored. Today, there are many external threats and investors have to be assured that there are no loopholes in our cybersecurity techniques and guidelines,” says the partner of a fund of funds.

Bringing the outside in

Third-party software services are commonly used across the operations of fund management firms, for various purposes. One area of activity that has benefited from this is the mission-critical pre-investment process of due diligence. Once again, it is larger firms that are more likely to be relying on third-party SaaS providers for due diligence purposes rather than managing this process completely independently. As much as 81% of firms with US$1bn-plus AUM report using such a provider for their due diligence. While only 48% of smaller firms say the same, a further 48% intend to use a third-party service for this purpose over the next two years.

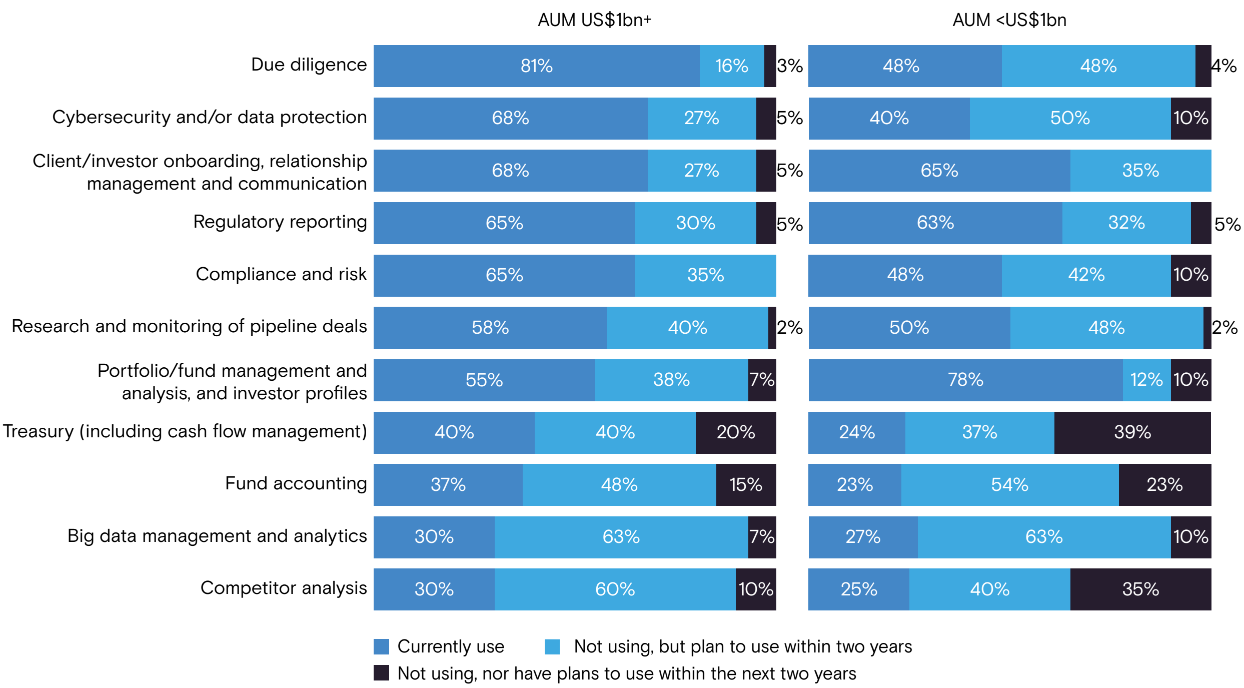
Diving deep into the specifics of an asset is a critical part of the PE investment process, especially in today’s environment of high private-market valuations. It’s estimated that EBITDA multiples stretched to above 12x in North America in 2021, an inevitable consequence of the mass of dry powder seeking deals. With GPs under more pressure than ever to scrutinize companies to justify entry prices, service providers that can facilitate this process in a safe, secure and transparent manner are more important than ever.

“By prioritizing due diligence, we want to check if today’s market valuations are appropriate. We can use the virtual data rooms to share and pass on information to relevant parties, to be as transparent and responsive as possible,” says the partner of a hedge fund with illiquid investments.

Interestingly, smaller firms are more likely than larger ones to say they currently use a specialist third-party software service provider for their portfolio/fund management and analysis, and investor profiles, with 78% saying this compared with 55% of larger firms. This demonstrates the fact that there is no one-size-fits-all approach.

Bigger firms benefit from economies of scale such that they may be able to justify managing a process such as portfolio management entirely in-house, employing their own resources across a family of multi-

For each of the following business functions do you currently use, or plan to use a specialist third-party software service provider?



billion funds. For a firm with a single mid-market fund, it may make more sense to outsource these kinds of administrative tasks to a dedicated service provider. Every firm, large or small, should carry out a cost-benefit analysis before upgrading any of their systems or processes.

Long-term impact of digitalization

Operational efficiencies at the portfolio company level are essential to a private capital firm's value creation playbook. However, those same efficiencies are achievable within the firm itself. Time and cost savings can result in leaner, more agile organizations that can potentially beat the competition to the punch on coveted deals.

At least a quarter of respondents say that operational efficiencies will be the single most important long-term benefit of their planned increase in digitalization. For smaller firms, access to new investors is of high importance – 18% reporting this as their greatest expected benefit.

Unlike large, name-brand players, lesser-known firms are having to work hard to raise capital, even as more of it pours into the asset class. One of the trends observed through the pandemic period is that investors have gravitated to familiar, institutional mega firms. This is because they already have relationships with these firms and the travel restrictions made conducting due diligence and building new relationships more challenging. Therefore, money flowed where relationships had already been established. In what may become a COVID-endemic world, smaller firms will need to leverage every possible opportunity to grow their LP base.

"Investor onboarding and relationships with investors are areas we need to improve on a regular basis. The new generation of clients are more inclined to remain loyal if we can deliver high-quality digital services," says the investment manager of a pension fund.

Other long-term benefits respondents most commonly expect from their digital investments include access to enhanced quality and quantities of data (78% of all respondents). Digitalization projects will not succeed without good, clean data. More than that, with strong data governance virtuous circles can be achieved. High-quality data inputs in turn produce high-quality data outputs, building positive feedback loops that can deliver exponential results.

Using technology to tap new investment opportunities will become increasingly popular. Firms continue to broaden their horizons, moving into new areas and building on their core strategies as competition in the buyout space increases. In the past 10 years and more this has largely centered on the adjacent private capital asset classes such as private credit, real estate and infrastructure. More recently, GPs have been adapting the PE model, for example with permanent capital vehicles for longer-term investments to broaden the scope of deals they can make.

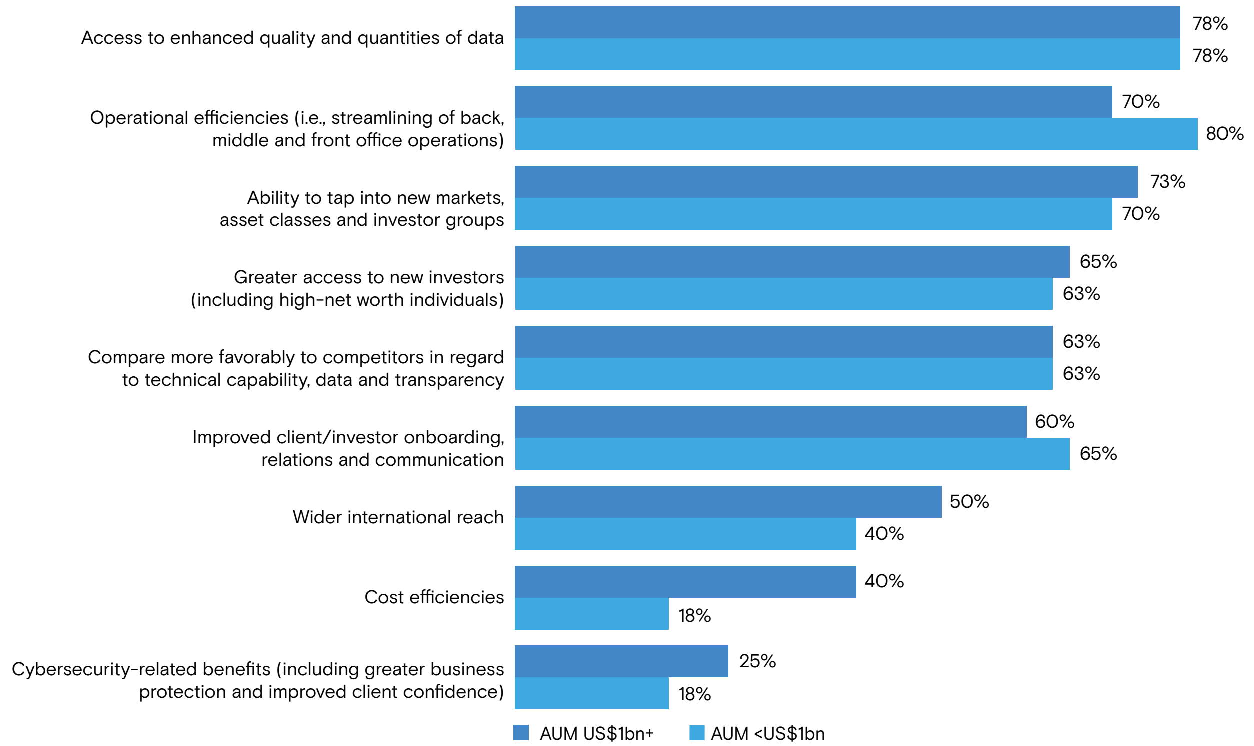
Accessing new sources of capital is another benefit of tech adoption. We find that the majority of respondents (70%–73%) point to the ability to tap into new markets, asset classes and investor groups as a long-term benefit from their investment into digitalization.

One largely untapped trove of capital that can be accessed through technology is the wealth management industry. For decades, fund managers, private banks and placement agents have brought PE opportunities to the attention of large-scale institutional LPs such as pension funds and endowments. But high-net-worth investor capital has been comparatively overlooked. That is beginning to change, with tech creating a conduit for capital in-flows, according to Rudebeck.

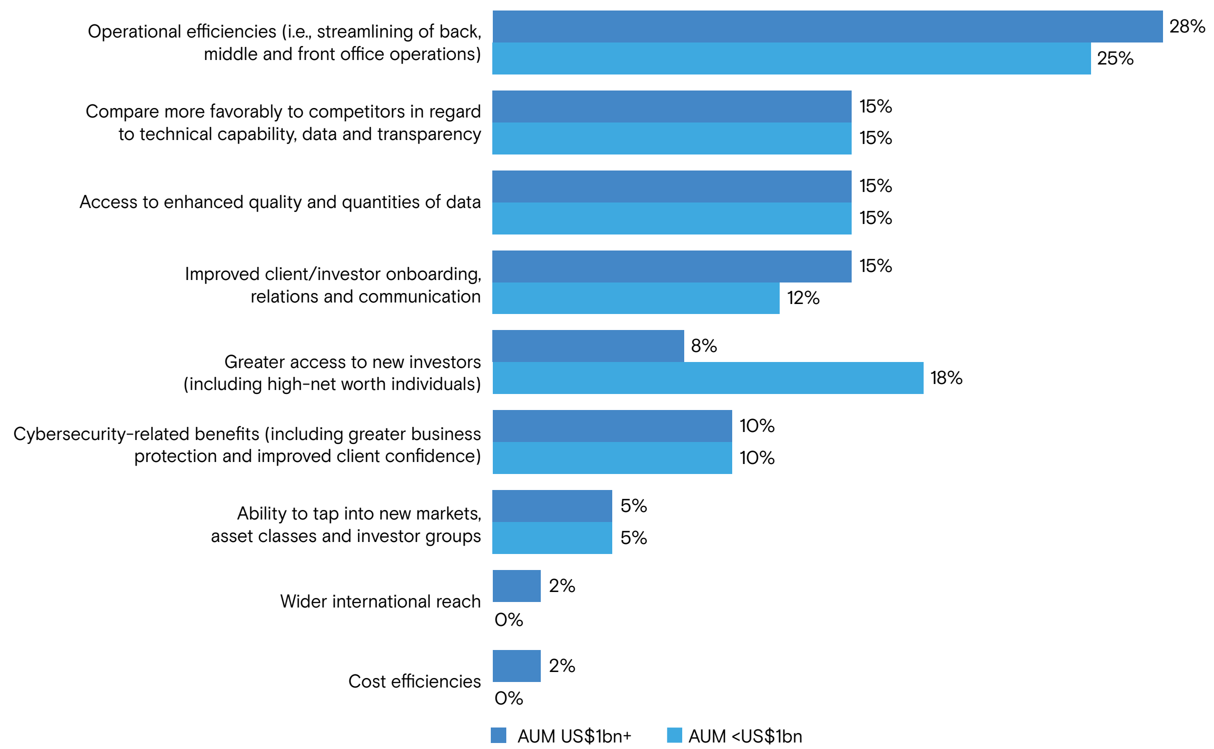
The majority of respondents (70%–73%) point to the ability to tap into new markets, asset classes and investor groups as a long-term benefit from their investment into digitalization.

"No matter how good or how oversubscribed a fund manager is, they are always looking to diversify their LP base," he says. "That is why we are addressing the wealth management market as a new source of capital. As well as providing an end-to-end solution to fully digitalize client onboarding, investor reporting and investment management processes, we have a regulated asset management business that has distribution agreements with large, well-known, leading firms globally."

What do you expect will be the long-term effects of your planned increased digitalization at your organization? (Select all that apply)



What do you expect will be the long-term effects of your planned increased digitalization at your organization? (Select the most important)



The impact on PE

Cloud/SaaS solutions, which cover everything from LP onboarding and investor reporting software on the client-facing side to dealmaking tools, are more universally expected to have the biggest impact on how PE firms operate over the next ten years than any other technology. A quarter of larger firms and one-third of smaller firms expect this to be the case.

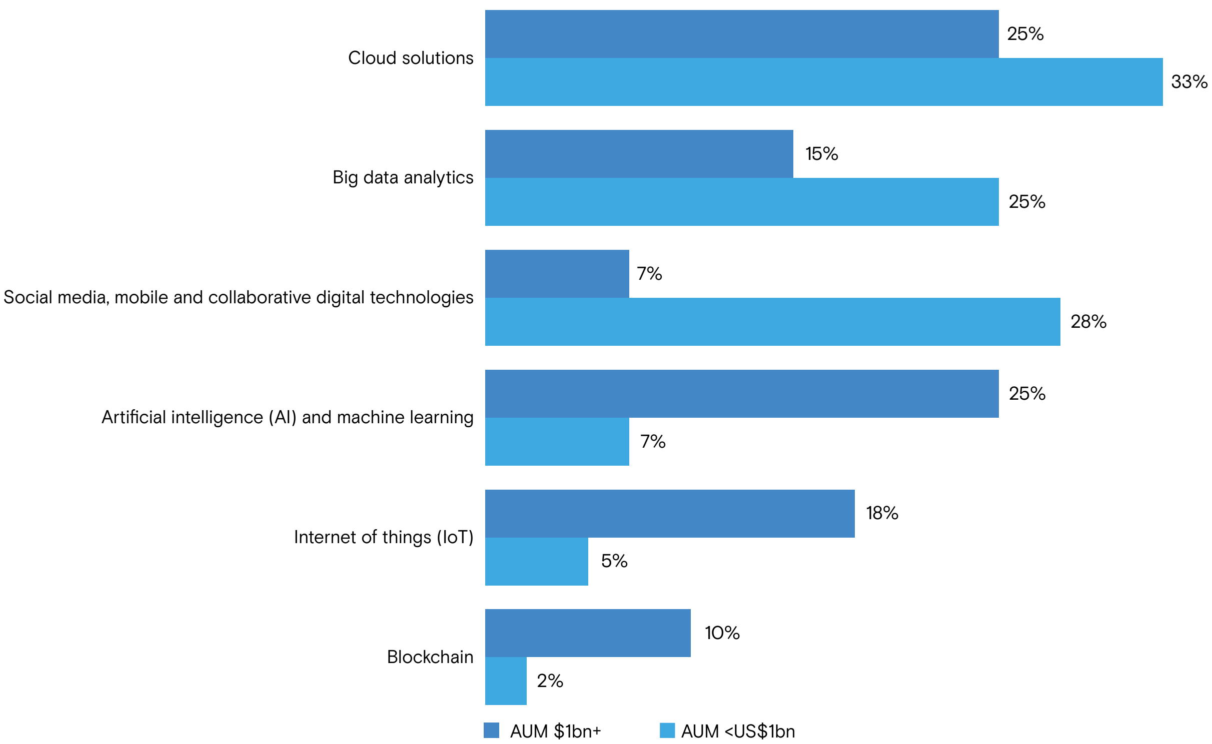
Tying up capital in costly on-premise IT can be resource-intensive and put restrictions on a firm's ability to scale up and evolve. This has been driven home by the pandemic and the transition to higher rates of home working, which benefits from a less centralized operational approach. Another SaaS digitalization driver is the growing appetite among new investor types for access to private equity. This demand is being met by new platforms offering streamlined and smooth digital experiences, funneling additional capital into the industry and expanding PE's investor base.

In addition to cloud/SaaS solutions, smaller firms also point to social media, mobile and collaborative digital technologies (28%) and big data analytics (25%) as being technologies that will shape their operations over the long term.

Larger firms take a different view that suggests a greater level of ambition: 25% expect the most change to come from artificial intelligence, compared with just 7% of smaller firms. AI in private equity is still in its infancy, but that could soon change. Professor Thomas Åstebro at the Paris business school HEC has observed that at some PE firms which are early adopters of AI, they are already hiring fewer junior team members. This is because the technology is being used for filtering deals, a function typically reserved for more junior staff.

"I feel that advancements in AI will be well-suited for the complex sourcing, due diligence and completion of deals," says the partner of a multi-family office. "There will also be new asset classes which can be analyzed using AI. The potential application of this kind of technology is broad."

Which technology do you think is going to have the most impact on how private equity firms operate over the next 10 years? (Select one)



Conclusion: Five steps to a digital success

The private capital management industry of old is no longer fit for purpose. As digitalization accelerates, sweeping across industries, fund managers will have to continuously adapt. Those taking a proactive, intelligent approach to improving and doing so ahead of their competition will see the biggest gains.

For those that have not yet fully embarked on this journey, it is necessary that they carry out end-to-end reviews of their operations and look for ways to improve data capture and management, migrate from sub-optimal legacy systems and enhance the quality of services provided to their valued investors.

With this in mind, we draw from our own experience and the insights gleaned from this research to offer five takeaways:

01 **Time to move on.** The pandemic has been a catalyst for digital adoption in the private capital industry. But regardless of what happens with COVID-19, the realized benefits of this change are here to stay. We are not going back to the old ways of doing business.

02 **Take the plunge...now.** Larger investment firms are taking the lead, while smaller firms have been slower to adopt digitalization. That will soon change and there is a huge first-mover advantage for smaller firms to capitalize upon right now if they take action before their competition.

03 **Keep it simple. If you can.** Investment into technology need not be costly or require extensive training. It is possible to move to a simple, end-to-end secure investor-facing system that streamlines your client onboarding and automates the entire investment cycle, from client suitability and targeted distribution through to subscription and consolidated reporting, in a fully automated and customizable way.

04 **Spread the net wide.** For institutional investors, private capital strategies already make up a large percentage of their portfolios. However, there are vast untapped pools of capital among wealth managers, high-net-worth individuals, and other investor types. Technology is democratizing access to private asset classes, opening up channels to these previously overlooked sources of capital.

05 **Know your tech.** There are numerous technologies that fund managers can adopt to improve their operations and deliver cost efficiencies, from cloud/SaaS solutions to data analytics. As financial markets weigh up the potential of distributed ledger technology, private markets are set to benefit from this rapidly emerging technology. The same is true of AI, which is in its earliest stages of adoption. In the future, expect investor documentation and drawdown/distribution records to migrate to the blockchain, while AI will increasingly be used for sourcing and filtering new deal opportunities in a more automated and systematic way.

About

Bite Investments is a global financial technology company created to expand access to alternative investments. The company's enterprise solution helps fund managers utilize a digital platform to streamline their clients' diligence, compliance, distribution, onboarding, investor relations processes, and workflows.

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