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PREQIN SPECIAL REPORT: SERVICE PROVIDERS IN ALTERNATIVE ASSETS

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Three Key Disruptors Affecting Alternative Fund Managers

As more managers embrace automation, evolve their investor reporting frameworks and consider big data implementation, the industry finds itself in a state of flux

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Alternative fund managers are experiencing a period of profound change which is transforming the way they interact with investors. Three key disruptors – namely technology, the standardization and digitization of reporting, and big data – are set to revolutionize the alternative funds industry, which has been behind the curve compared to the wealth management industry, for example.

1. Technology on the Rise

Technology is, without doubt, one of the major disruptors of our time, and in the alternative funds industry people have only really woken up to the opportunities within the last five years. We can see that automation of various investment processes is now being embraced, and managers that can effectively implement these tools are now building a significant competitive advantage.

The scale of the likely disruption to come in the alternative funds industry was examined in a report published by KPMG International and CREATE-Research in 2018 titled Alternative investments 3.0: digitize or jeopardize. The report found that 53% of survey respondents anticipated partial disruption from digitization and 10% expected full disruption, while 35% considered that there would be incremental changes and just 2% predicted 'business as usual.'

We can already see that investors are calling upon fund managers to make greater use of technology in reporting, since it also has a positive impact on cost management. While in the past alternative fund managers have relied upon Excel-style solutions, a plethora of fund administration platforms have emerged, with dashboard solutions now able to offer the transparency that investors have been seeking. The operational benefits include real-time data reporting and data analysis on the investment portfolio, which can be accessed through remote or mobile devices. Such dashboard solutions can be customized and operated by outsourced service providers – helping fund managers to meet the demands of their investors without having to develop their own in-house solutions.

We can already see new ways of working emerging with the growing use of data lakes, which are vast pools used for the collection of raw data, and data warehouses, which act as repositories for structured data. This is likely to lead to greater exchanges of data with clients, who may be looking to take the data and create their own data reporting. Standardization will have a key role to play and the speed of data recovery will increase further with the advent of 5G, which will help optimization.

2. Standardization and Digitalization of Reporting to Meet Regulatory and Investor Demands

The push to standardize and digitize reporting and communications between fund managers and their investors has become a major feature on the industry landscape in recent years. As the alternative funds industry becomes more mature and established alongside more traditional asset classes, we can anticipate that the standardization effort will play its part in enhancing transparency and keeping ahead of trends, with a view to satisfying regulatory and investor demands.

This drive towards standardization has been led by the Institutional Limited Partners Association (ILPA), which issued its first set of reporting guidelines in 2011 and most recently released ILPA Principles 3.0: Fostering Transparency, Governance and Alignment of Interests for General and Limited Partners in July 2019. This latest edition has been developed with the input of both GPs and LPs, and will have a significant impact on GPs as they come under ever greater scrutiny and pressure to adopt best practices.

With regard to environmental, social and governance (ESG) policies and reporting, the Principles 3.0 recommend that GPs should consider maintaining and periodically updating an ESG policy to provide to all LPs or to potential LPs on request. The guidelines also recommend the allocation of, and communication surrounding, co-investments; as well as policies and communications on changes in GP ownership and succession planning; and processes and approval for GP-led secondary transactions, among others.

3. Big Data, Big Change?

Turning to our third disruptor, big data: what will it mean for the private equity (PE) industry, which has grown up based on human contact and personal networks? Hedge funds were quick to make the leap into big data, where potential investors are always looking for an edge, and firms are spending increasing sums on 'alternative datasets' to get ahead. The report by KPMG International and CREATE-Research confirms the lag on the PE side. Twenty-four percent of respondents from hedge funds said they were in the implementation phase on big data, 9% said they were close to decision-making and 67% said they were raising awareness. This compares to 18%, 12% and 70% of respondents from PE respectively.

Big data is proliferating at an unprecedented rate, and it is estimated that 90% of the world's data has been created in the past two years. What will be the impact of big data on deal-sourcing, for example? EY anticipates that there will be benefits at different levels, for example in terms of quantitatively increasing the deal flow and enabling PE firms to spot targets outside their traditional networks. EY further considers that big data should help to qualitatively rationalize the deal flow to only include opportunities that meet several predefined criteria and thereby result in more effective targeting.

If it can provide further benefits relating to more rigorous due diligence and value creation through better understanding of the portfolio areas in need of improvement, big data can yet have its day in the sun in the PE industry, with GPs and LPs both able to reap the benefits.

Making the Most of Disruption

Disruption is here to stay. The most successful alternative fund managers will be those that can use strategic thinking and approaches to capitalize on all of the new tools at their disposal: technological platforms, reporting templates or data to support deal-flow sourcing. At the end of the day, the process of making investments is one that relies on trust and accountability, which comes from contact with people and not with machines. Human understanding, instinct, intuition and experience will always be in vogue when it comes to closing the deal.

About IQ-EQ

IQ-EQ is a leading investor services group that combines global expertise with an unwavering focus on client service delivery. With a team of 2,450+ people operating across 23 jurisdictions and over US$400bn in assets under administration, IQ-EQ supports fund managers, global companies, family offices and private clients operating worldwide, including seven of the top 10 global private equity firms.

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