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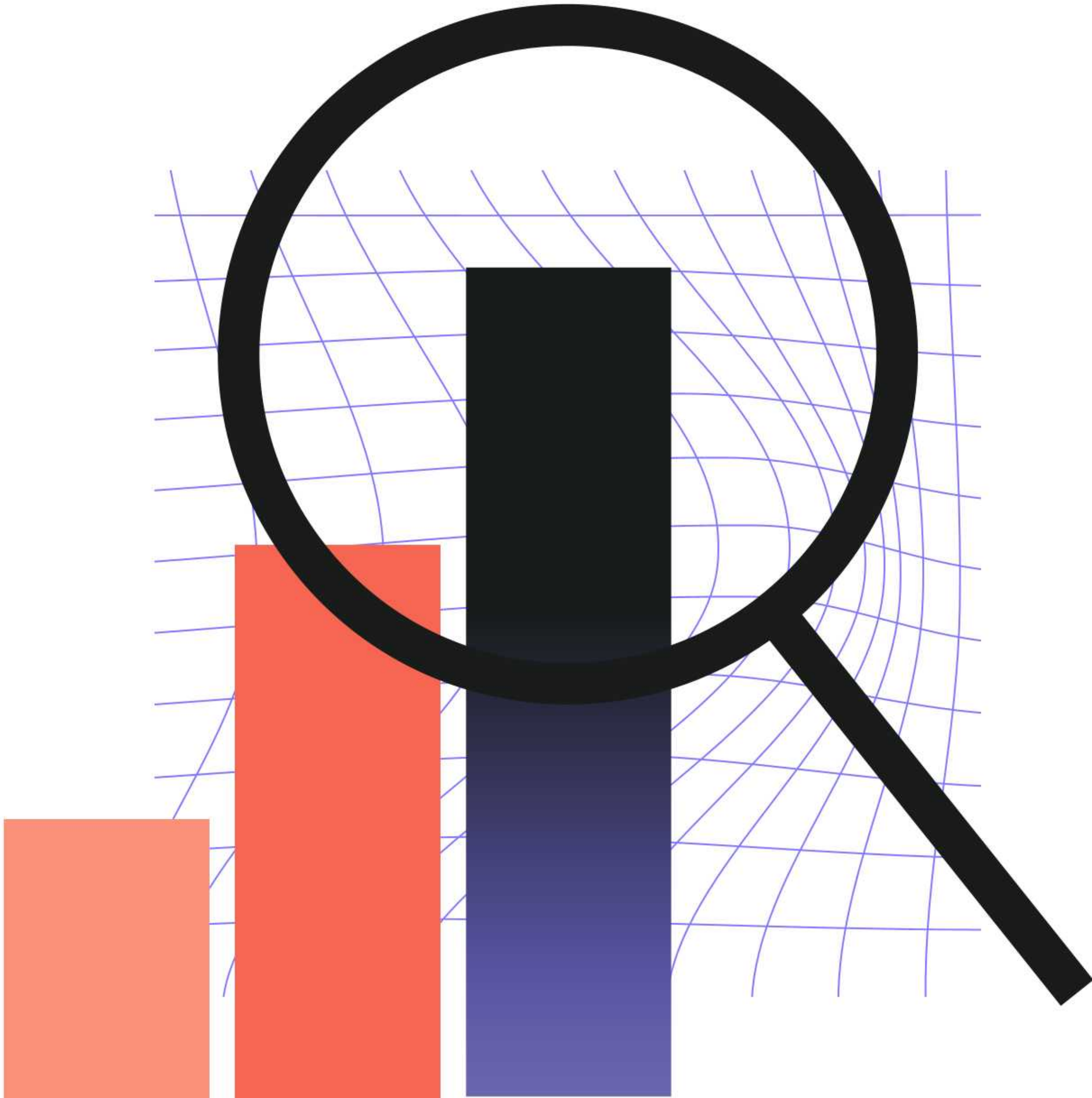
5 Steps Emerging Private Equity & Venture Firms Can Take to Accelerate Growth

Q4 2021



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For Emerging Firms, **Big Opportunities and Big Challenges Ahead**

$157

billion invested in venture capital in 2Q21

It is no secret that money keeps pouring into private equity and venture capital funds. Money follows returns and both segments have done extremely well. Private equity has outperformed other asset classes since 2008 while delivering less volatility, according to a recent report by McKinsey. Investments in global venture capital firms hit a record $157 billion in the second quarter of 2021, KPMG found, paced by a surge in new unicorns, startups worth more than $1 billion.

New entrants to the field include some smaller firms that are ready to compete against the industry giants. There are plenty of opportunities for these younger players as the market keeps expanding to grow their own businesses and to feed the mounting appetite for private holdings among institutional investors.

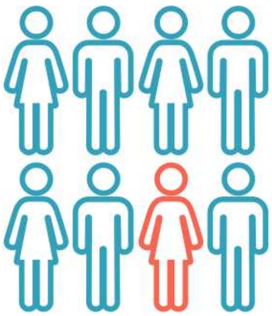
But while there are many opportunities for emerging PE and VC firms, there are also plenty of challenges. These firms need to demonstrate that they have the skills, experience, and the systems to hold their own against the big-name, established players in the market who are often seen as the safer choice.

On top of that, all of these efforts have to be done with the limited staff and smaller budgets emerging managers inevitably have, while also keeping an eye on what it will take to continue their success in the future as they grow.

5 Key Steps **for Growth**

So what it is these companies need to do to take growth to the next level? Here are five key recommendations that can make that happen.

1 Differentiate Yourself



Find a way to differentiate yourself from the pack. In a crowded field, having an edge is critical. Limited partners need a compelling reason to pick one shop over another, so having a clear value-add can enable emerging firms to more quickly attract new business – and thus grow their AUM.

Differentiators come in many forms. Firms can focus on a specific industry or geography, or concentrate on target companies at a particular stage of development. Some private equity firms specialize in investing in founder-led businesses that are taking outside capital for the first time. Others stand out because of the unique histories of the management team. The key is to find a differentiator that's authentic and meaningful to your firm's identity.

Standing out through core values

A commitment to diversity and inclusion can be a strong differentiator, especially when pitching public pension funds and endowments who have made these issues a priority. A report by Coalition Greenwich found that firms that commit to diversity and inclusion are more likely to be recommended by investment consultants and considered by institutional investors.

That's because institutional investors of all kinds are taking ESG very seriously and they expect the firms they invest with to do the same. In a recent survey, investment manager Natixis found that the percentage of institutional investors implementing ESG strategies rose by 18% from 2019 to 2021. As such, they have high expectations when choosing the firms in which to invest.

And yet, the private equity industry continues to lag behind. Notably, BCG found that PE-backed firms are less focused on promoting diversity and inclusion than publicly traded firms. This is despite the fact that there's documented research showing that doing so correlates with margin growth; companies with strong gender and/or ethnic diversity are far more likely to outperform.

As a result, there's a real opportunity for emerging PE and VC firms to differentiate themselves by putting true momentum behind diversity, equity, and inclusion efforts rather than just paying it lip service.

As said in a recent PWC survey, "PE firms putting ESG at the heart of their business strategy will be the game changers in the new sustainable economy. And just as there will be leaders, there will also be laggards. Those firms that fail to embrace ESG will risk value erosion."

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As ESG continues to become a larger focus for investors and the business world, emerging firms that establish clear and actionable ESG strategies from the start will be better positioned for long-term success.

Human connections can be the tie-breaker

Another differentiator – one often overlooked – is personality.

Selecting a private equity or venture partner ultimately comes down to people choosing people. In a close contest, that human connection could be the deciding factor, both with investors and founders of portfolio companies, who need to know that your firm understands who they are and what they are trying to accomplish.

Making that link has been harder in the virtual environment Covid has ushered in, but it remains critical. When it comes to fundraising and business development, what matters in the end is being able to make the case that you can do what others can't.

2 Culture is Key

Build a culture that employees find welcoming and challenging. Companies aren't born with distinct cultures; rather, cultures grow out of the priorities of the founders and get passed on to new hires, who pass them on to still newer hires.

Think of culture as the shared values of a firm. A firm with a great culture should be a place:

- That offers a balance of hard work and fun;
- That recognizes the importance of collaboration;
- That encourages employees to make their voices heard;
- That cares about diversity and inclusion;
- That treats ESG as a priority, not an afterthought;
- That wants people to donate time and money to good causes.

The role of leadership

Establishing and communicating these unique values is the job of leadership. This is never an easy task but in today's hybrid workplace it is harder than ever. When people are not under the same roof, leaders need to work harder and communicate more often and more transparently. They need to find ways to get people to work together on projects that create bonds among the staff.

> **"A strong corporate culture can serve as the foundation for future growth and success."**

That is especially true for new hires, who may not fully understand the firm's DNA. If it is built well and emphasized from the beginning, a strong corporate culture can serve as the foundation for future growth and success.

Complicated **by Covid**

The challenges of growing an emerging firm, which are significant in normal times, have been made more difficult under Covid. Firms have to work harder to make human connections with investors and potential portfolio companies when Zoom is the only means of communication.

In the Covid world, firms thus must be creative when it comes to fostering true connection to overcome these challenges. A few ways to stand out and cut through the virtual jumble include:

- **Meet live when possible.** A small, in-person lunch or meeting can go a long way to forging relationships. Find ways to convene in person in the midst of phone discussions to help deepen the communications.
- **Don't just get down to business.** With Zoom fatigue running rampant, it's easy to hop on calls and get to business as quickly as possible, and harder to ignore email traffic and stay fully engaged. Tap into the personal element of in-person meetings by focusing fully on calls, as well as beginning the call by building a personal connection before jumping into the agenda.
- **Step outside.** Particularly during more casual conversations with clients, new contacts, or employees, propose that the calls or meetings be held outdoors. With all parties enjoying some fresh air, the conversation will naturally feel more relaxed and open, helping to foster connectivity.
- **Increase internal communications to maintain transparency.** In remote and hybrid work forces, information flow is much slower than when teams are in-person. Maintain regular and open communication through email and regular all-staff meetings to ensure that employees continue to feel in-the-loop with business decisions and executives.

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3 Attract and Retain Quality Talent

Prioritize quality in the hiring process. Investing is a talent business, so it makes sense that companies that hire the best talent will grow faster than their rivals. Private equity and venture capital firms have a prestige that makes them a magnet for talent, but in the current environment, even they will have to scramble to attract the best and brightest.

In the midst of Covid, talent has become even harder to find and attract. The nation's top investment banks, including Goldman Sachs, Morgan Stanley, JPMorgan Chase, and Citigroup, all recently boosted salaries considerably for junior investment bankers and analysts to hang on to their teams. So offering competitive compensation – both salaries and benefits – is a must. But it is only the beginning.

What matters to prospective hires

The pandemic experience has changed the expectations of those looking for top jobs. In addition to money, candidates now put a premium on things like flexibility – which means being able to split time between the office and remote work – and work/life balance.

> "An investment in technology is also an investment in morale."

And when people don't find what they are looking for, they are leaving for greener pastures. Americans have been quitting jobs at a record level, almost 4 million a month, government data shows.

The Covid experience has also accelerated the development of technology, and candidates now expect to use the latest and most convenient tools. When you have better systems in place, employees are more efficient and happier, so an investment in technology is also an investment in morale.

These things all mattered before Covid, but today they matter even more. Turnover rates have climbed as people are not afraid to make significant career changes if they don't feel satisfied or valued.

Prospective hires also care about the future, specifically what their careers paths may look like two or three years down the road. The more opportunities for growth a firm can offer, the more attractive it will be.

How technology can improve **the work experience**

At a time when hanging on to the best people has never been harder, offering the latest technology can make a notable difference. Substituting cutting edge tools for traditional processes means employees can:

- **Work with less stress** because they don't have to worry about making the simple but costly mistakes that come with doing tasks manually. This will also help de-risk operations, benefiting the firm as a whole.
- **Feel a part of something exciting and innovative** – cutting-edge technology brings the "cool factor." This gives them valuable career experience, encourages creative ideas, creates a culture of continuous improvement, and makes for more enjoyable and satisfying work.
- **Spend their time on higher value projects** since they have been freed up from the mundane jobs that can eat up so much of a workday. Instead, employees will be able to focus on the big-picture work that sets your company apart – and gives your workforce a reason to wake up in the morning.

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4 Communicate Transparently

Transparency builds trust with all stakeholders.

Internally, for employees, transparency from leadership helps provide clarity about future plans and decision-making in these uncertain times. Externally, for investors, transparency is crucial in demonstrating that there is no gap between what the firm says and what it does.

Gone are the days of "black box" alternatives shops. Investors now expect insights into where their money is going and the underlying firm strategies and holdings.

Beyond that, transparency reflects confidence in the business and strategy, helping to build connections and establish trust so that your company can grow.

> **"Gone are the days of 'black box' alternatives shops."**

The look behind the curtain

Investors want timely reports about their holdings, and it makes a huge difference when those reports have the same professional look as the communications they get from established players.

Emerging PE and venture firms can elevate their external perceptions by delivering branded material that looks consistent and formal. All of that is doable with information systems that can leverage leverage a single source of data to easily generate reports and seamlessly deliver them to clients.

For firms that are looking to go a step further and head off the rising tide of increasing investor demands, self-service reporting can allow teams to deepen client relationships while decreasing their workloads.

See page 10: Self-Service Reporting: The next evolution in investor communications

Spreading the message

Beyond investor communications, today's PE and VC firms are often looked to as thoughtleaders and brands. As the market has gotten bigger and more competitive, firms have become more proactive about building broad, external brands and platforms. Market share can help drive new business, and thus ultimately growth.

Well-done thought leadership—on key issues in investing or around sectors like healthcare and technology—can have an outsized impact. Smart commentary can enable an emerging firm to punch above its weight and make valuable new connections with potential partners as well as prospects.

Self-Service Reporting: The next evolution **in investor communications**

There has been a major sea change in the level of transparency and access required by investors. LPs, once satisfied with PDFs, no longer want static files – they want to be able to receive data on demand – and oftentimes, to be able to manage it themselves.

With self-service reporting, GPs grant their LPs direct access to data, often via their client portal. LPs can then go in and pull down the data the way they choose to consume it, and create their own reports and dashboards to slice and dice the data in order to answer their own specific questions or extract insights directly.

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5 Position Yourself for Future Growth

> "The time to implement a back-office system is when you are about to raise your third or fourth fund"

The day-to-day pressures of running and growing a private equity firm can be all-consuming, particularly with a small staff. Still, leaders need to keep an eye on the future, which means imagining and planning for when the business is a lot bigger. Like a builder laying a foundation, the firm needs to invest in infrastructure, including technology, that is scalable and can be adapted to someday support a larger entity with minimal cost and hassle.

A PE firm can launch its first fund with a modest amount of technology, but soon will need to add more people or implement a comprehensive IT system, according to Joachim Satchwell, associate director at Polaris, a leading PE firm.

"The time to implement a back-office system is when you are about to raise your third or fourth fund," he said. " You could still get by on your legacy systems at that point, but since you already have several active funds and varying groups of investors, the complexity and administration processes will increase rapidly. Migrating to a back-office platform then – instead of later on, once three or four funds are live – will significantly simplify the implementation process and ensure you continue to have an efficient back-office."

Why data management is critical

A data management system that can be easily upgraded is a must; an ideal system is one that will grow along with the business, eliminating the need for increasingly cumbersome and risky workarounds.

It is just as important to start off with a robust accounting system, one for example that can manage detailed financial statement reporting, multi-currency general ledgers, cash management, automation of complex processes, and workflow standardization.

These functionalities will both help firms make better investment decisions across the business and streamline back-office operations. But, even more importantly, they'll set firms up for growth. So that, as your needs expand, you already have the infrastructure in place to meet them.

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