The EWM view **Fund managers must break free from spreadsheets to maximize performance**

Expert analysis by **Kelley Gustafson**, chief client officer and **Lee Khandelwal**, chief technology officer of EWM Global

Technology has fundamentally changed the business world and private equity is no different. Digital transformation provides an attractive investment opportunity for many firms. Yet there can often be a disconnect between having a forward-thinking investment strategy and applying it to the adoption of new technologies for the firm itself. This publication addresses how technology can be used to help with one of private equity's other key pressures – attracting and managing talent.

Changing times

This year's *Global Private Equity* report from EY highlighted four key priorities for private equity CFOs: technology, talent, outsourcing and talent management. But our experience at EWM Global tells us that firms are missing out on opportunities to address these challenges. The systems firms are using today are simply not good enough to keep up with the demands of arguably their most valuable asset: their people.

Private equity has undergone a staggering transformation in the decade since the global banking crisis. What was once a relatively niche and informal corner of the international financial ecosystem has blossomed into a major destination for investment. Institutions are increasingly turning to alternative sources of revenue amid a sustained paucity of yield across traditional markets.

This growth, which shows little sign of slowing, has been accompanied by a necessary increase in sophistication as the industry matures. With regulators and LPs alike hungry for far more frequent and granular data on alternative investments, the old days of emailing a brief PDF report once a year are largely gone. Far higher regulatory scrutiny, along with the need to impress ever more discerning investors, has led what was once a comparatively low-tech sector to start embracing change. Firms are adopting digital investor platforms and other third-party tech solutions to make information secure, comprehensive, reliable and accessible.

Yet, while change, in this instance, is a good thing, it has also been overwhelmingly geared to the side of investors and investments. Firms have understandably had to focus most of their transformation time and attention on adapting to new reporting regimes such as AIFMD and MIFID and drastically improving investor communications. This has left some of their most vital transformation opportunities untouched. Worryingly, those opportunities are those that benefit their members.

The systems in place at most firms continue to resemble the pre-crisis private equity industry of old.

Carried interest plans are usually dealt with in-house, and typically revolve around nothing more sophisticated than a collection of Excel spreadsheets. In cases where third parties such as fund administrators do lend assistance, systems still tend to be highly manual and spreadsheet-orientated.

These antiquated systems carry significant risk. Virtually every client we on-board has errors in their spreadsheets, some tiny, some significant. These systems can be very messy and time-consuming from an administrative perspective. Two or three seemingly simple spreadsheets soon balloon into 20 or 30 as investments are realized and new funds launched.

The manual element of spreadsheets means that information can be incorrectly inputted and altered, or irregularly updated, which puts untold – and we would argue unfair – pressure on HR and finance to 'get it right.' Beyond the risk of human error, there is another human risk – that often the complexity and lack of documentation means that only one or two individuals truly know how to operate their 'system.' This might seem unproblematic – until that individual is promoted, or leaves.

> "Virtually every client we on-board has errors in their spreadsheets, some tiny, some significant"

Churn on the member-side leads to additional complications in ensuring that forfeited carry points are properly reallocated. Points can easily be misallocated or orphaned, and these mistakes can multiply to the point where millions of dollars risk being misallocated or lost.

Changes in complicated regulation and taxation structures, both over time and between territories, add yet another dimension of complexity. The risk to proceedings only increases if all the calculations are sitting in a master (or dare we say it, monster) spreadsheet.

Again, we ask, why does it matter? This is not just about making sure a firm's systems are running smoothly. It is also about ensuring their people know the true value of their package.

The art of the possible

Firms that do not start to look at this side of their operations could find themselves at a disadvantage compared to first movers. Attracting and retaining the right staff is a crucial element to success in the world of private equity. Getting remuneration systems right can therefore lead to considerable upside.

> “Regulatory scrutiny, along with the need to impress ever more discerning investors, has led what was once a low-tech sector to start embracing change”

With competition for the most talented professionals growing increasingly fierce, ensuring that carry systems are reliable and correctly administered provides transparency. It also allows team members to understand the value of their allocation.

Having a system that allows members and administrators to see, at a glance, an up-to-date snapshot of the current status is becoming increasingly the norm. We have already seen the shift from requiring an annual to a quarterly update. We expect, in time, that members will want to know where they stand at any given moment in time. They receive this in other parts of their life, from Facebook to Amazon, so why not from their firm?

Digitized platforms automate the process and provide users with convenient access to information whenever needed. They can capture carry plan rules such as allocation and reallocation of carry, vesting, partner termination rules, valuation changes and payout information in a transactional database, rather than offline through disconnected spreadsheets.

A digital platform can be adapted for the unique set-up that every firm creates. These truly bespoke systems ensure that all the detail in the complex spreadsheet is managed more readily online. Not only does a system reduce the propensity for error, but it also provides a vital audit trail. This, after years of movements and transactions, is virtually impossible without systematic management of the data.

What should firms look out for? Given the sensitive nature of the data, information security is key. Systems should be secure from unauthorized access by external parties, through methods such as two-factor authentication and encryption in both rest and transition states. They should also deliver rigid partitions of information within the teams to prevent unauthorized access to other people's information. Executive participants should have access to all their carry and GP information, from LPAs and subscription agreements, to vesting, valuations and historical data. Some systems can capture electronic signatures for documents and bank account details for future distributions.

Those we see working with these systems most successfully use them as part of talent acquisition, on-boarding and ongoing management – rewarding members with information and understanding to build trusting long-term relationships. Our hope is that in embracing outsourced technology solutions that support talent management, forward-thinking GPs will be able to break free from the limitations of spreadsheets and focus on delivering value. ■