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PRIVATE EQUITY INTERNATIONAL

THE FUTURE OF PRIVATE EQUITY 2019

40 UNDER 40

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The rising stars who will shape private equity over the next decade

PEI Alternative Insight
PRIVATE EQUITY INTERNATIONAL

ISSN 1474-8800
MAY 2019

The shape of things to come

GRAEME KERR
EDITOR'S LETTER

Just who will shape the private equity industry over the next decade? That's what we set out to discover when we opened up nominations for our inaugural Future 40 list in January. The *PEI* 40 Under 40: Future Leaders of Private Equity, as it is formally known, forms the centrepiece of this supplement, and it has caused some spirited debate in the *PEI* offices.

There were more than 130 formal nominations, and dozens more suggestions from our sounding board of senior private equity figures and industry sources.

To be eligible, nominees had to include the name of someone at another firm they felt worthy of inclusion, resulting in a pleasingly diverse list. Nearly one-third are women, and there are representatives from across the globe including Bain Capital Japan's Masa Suekane, described by peers as one of private equity's "top athletes", and the impressively youthful Louis Choy, 32, a principal at CPP Investment Board who is tipped by industry sources to have the potential to one day rank among the likes of industry pioneers Henry Kravis and Jeremy Coller.

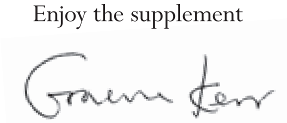
The list hails the new generation, which is apt in a *Future of Private Equity* supplement that asks where we are heading over the next 10 years. There's a strong sense of evolution, most crucially in the LP/GP nexus. Phrases like 'limited partner' and 'general partner' "will not be fit for purpose in the future", says Eamon Develin, managing partner at alternative asset management consultancy MJ Hudson (p. 14), who predicts there will be more shadow capital in the future.

A similar story emerges from conversations with our Future 40. The lines are blurring between LPs and GPs, amid a "merging" of the relationship, according to The Carlyle Group's Louise Dumican, who says LPs have "a much deeper level of involvement, scrutiny and governance oversight than we've had historically". The advent of co-investing and direct investing was a game-changer, says Marcus Frampton, CIO of Alaska Permanent Fund Corporation, making the LP/GP relationship less "bifurcated" (p. 5).

Elsewhere, there are some stellar keynote interviews, including Chris Kojima, the head of alternative investments at Goldman Sachs (p. 11), Michael Granoff, the CEO of secondaries firm Pomona Capital (p. 18), and Aidan Connolly, the CEO of fund services provider Alter Domus (p. 24). Scott Dahnke, the co-CEO of L Catterton, give his thoughts on the future of value creation (p. 30), Thibaut de Laval, chief strategy officer at eFront (p. 36), looks at how today's tech revolution will reshape private equity and RSM partner Anthony DeCandido explains the role that data can play in validating ESG. Other contributions include PwC's Oliver Schulte Ladbeck on whether GPs can sustain the current level of returns (p. 46) and Baker McKenzie partners David Allen and Jane Hobson on the opportunities in the healthcare sector (p. 52).

A big thanks to everyone who nominated someone for the Future 40. Whittling down the final 40 required some tough decisions but the resulting list is a truly impressive rollcall.

Enjoy the supplement



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THE FUTURE 40

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Private Equity International is published 10 times a year by PEI.

To find out more about PEI please visit: **www.thisisPEI.com**

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FUTURE 40

The challenges ahead

What changes can we expect in private equity over the next decade? We asked a panel of our 40 Under 40 Future Leaders of Private Equity for their views

OUR FUTURE 40 PANEL

Audinga Besusparyte
Senior Director, Private Equity
PSP Investments

Ted Cardos
Partner
Kirkland & Ellis

Louis Choy
Principal, Secondaries – Private Equity
CPP Investment Board

Ted Craig
Partner
Dentons

Elizabeth Di Cioccio
Partner
Mercury Capital Advisors

Sandro Diazzi
Director
Praesidium SGR

Louise Dumican
Managing Director
The Carlyle Group

Marcus Frampton
Chief Investment Officer
Alaska Permanent Fund Corporation

Raphaëlle Koetschet
Head of Funds Investments – Private Equity
Caisse Des Dépôts

What's the single biggest challenge facing your sector?

Louise Dumican: Diversity – but I'm so happy to see this being placed firmly on the agenda.

Ted Cardos: Attempts to standardise what are very bespoke secondaries transactions.As GP-led liquidity solutions have become more common, many participants assume that solutions or approaches from prior deals will be suitable or appropriate for others, which is frequently not the case.

Ted Craig: Political uncertainty and the consequential legal and regulatory uncertainty. While the uncertainty remains, we will continue to play what's in front of us.

Raphaëlle Koetschet: Large capital flows to come into private markets, lack of memory (even though most of us have been through at least a cycle), digital disruption if not dealt with, managing generational changes and strong egos.

Marcus Frampton: The challenges of recruiting today is one of the largest. I feel like we provide a terrific learning opportunity for analysts and associates here at APFC, but I have noticed a clear increase in the challenges toward recruiting. I attribute this to today's tight labour market.

Audinga Besusparyte: This is a time of accelerating change where most industries face disruptive challenges, fundamentally stemming from technological change. It is getting harder to predict the combined effect of multiple non-linear trends that a company faces. Combined with globalisation, I think we will increasingly witness "winner wins all" environments.

»


What issues keep you awake at night?

Louis Choy: Ideas. The latest evolution of our secondaries business at CPPIB encourages idea generation as the core of the programme. It keeps me up because I'm constantly thinking, not so much because I'm worried!

Sandro Diazzi: I am often concerned about the impact of private equity on society as a whole. Is our capital going to create value that goes beyond financial gains? Are our investments supporting good businesses who are reshaping our society? The other item that is often on my mind is diversity: we live in a white-male dominated industry and I am a big supporter of increasing gender/ethnicity-parity and being the catalyst for other industries.

Elizabeth Di Cioccio: In all honestly, sometimes my six-month-old son, Galileo, keeps me up! However, for many years before he was born, I was probably even more preoccupied and nervous about the demands of raising a child and having a developing career with a rigorous travel schedule.

MF: Maintaining liquidity and having dry powder to be aggressive with new private equity investments should the cycle turn is my top consideration today.

LD: I'm a lawyer – everything! The reliability of diligence – be it in emerging markets, the less professionally advanced companies or on issues that are hard to get a true sense of in advance – like the culture and tone of a business you're acquiring

AB: I am optimistic about the world and our future, but am, of course, conscious that we are facing some new and important challenges. The two I would single out are environmental sustainability and the rise in social inequality with high levels of job automation expected over the long run.

TC: Trying to keep the pace of my clients, who are all growing at breakneck speed! In a niche market finding, training and retaining talent is a full-time job.

MF: The advent of co-investing and direct investing has really changed things. We have so much more nuanced and deep relationships with our GPs now that we pursue deals alongside them. The LP-GP dynamic was more bifurcated in the past.

EDC: An increasing number of LPs are stating a preference to consolidate their private equity portfolios by establishing deeper relationships with fewer GPs. This is resulting in a competitive dynamic to get into a finite number of private equity funds.

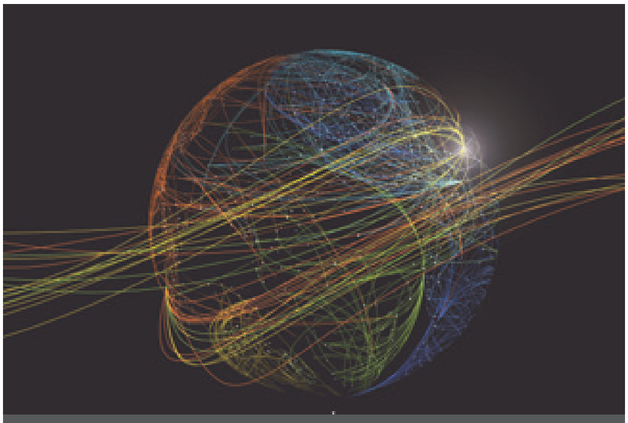
TC: GPs and LPs are collaborating more and more during the fund's life, seeking solutions (both GP-led and LP-led) to issues facing private funds. The dynamics of the GP-LP relationship in these situations really are fascinating.

LC: LPs are now focusing more on conflicts and at times suggesting secondaries solutions to the GPs. This is encouraging.

SD: In an environment where capital is commoditised, GPs care more and more about working with LPs who they can trust, who can be there in good and bad times: having a stable set of LPs is key. GPs are also increasingly looking at value-accretive LPs, where they can add real value to their portfolio companies.

LD: It seems to be merging. We're having many more conversations with LPs as direct co-investment partners, with seats alongside us on the board and with a much deeper level of involvement, scrutiny and governance oversight than we've seen historically.


How is the LP-GP relationship changing?



Which sectors/regions are you most excited about?

LD: I cover all sectors, but, having recently located to New York to cover the Americas, I'm most excited about this region as I am constantly learning so much and it presents a great new challenge for me personally.

EDC: I have always been most excited about managers who invest in truly undercapitalised niches. By deploying capital in areas where there's a relative lack of competition, there should be the opportunity to generate enhanced returns (and usually structure downside protection).Unfortunately, it's usually more difficult to raise capital for these themes as well, since they are unusual and not on the radar of most LPs.

MF: One area we've been really excited about in the past year is co-investing with our private credit managers, while infrastructure and co-investments have become a bit saturated in the past several years.Today the co-investing opportunity in private credit is fairly wide open. At this point in the cycle we also like the prospect of being more senior in the capital structure.

RK: More than sectors or geographies, it is strategies with a clear value-focus, be it transformative buy-and-build strategies on the traditional buyout segment, growth equity which today offers buy-out-like returns without the need for high leverage but also strategies that bear some operational complexity (carve-outs, PtoP, etc.).

LC: For me, it's not any particular sector or region, but it's the general evolution of the market. When I started in secondaries the LP secondary market was starting to grow. Now it's so much more than just LP secondaries and the remit has expanded significantly.

TC: Growth of single-asset transactions, as the universe of possible deals is nearly limitless.

MF: I find managing money for a fund like APFC that is so meaningful to the community in Alaska very inspirational.

EDC: As a Middle East-based placement agent representing global funds, I'm fortunate enough to interact with a wide range of GPs and LPs from incredibly diverse backgrounds and different skills sets. This is a truly unique position, and I inadvertently learn something from every one of these individuals!

LD: Most recently I am inspired by my sons – they keep me in touch with what matters and, being always conscious of what I model to them, that offers a point of reflection that I never had before.

TC: My recently-passed grandmother. She was a whirl of activity, constantly reinventing herself – working until her 90s even after losing her sight in her early 80s. She never slept more than five hours a day; so corporate law would be a walk in the park for her.

RK: It's probably not a "who" but a "what" and it would be reading non-fiction. For me, the most inspirational books are true stories.

AB: I would love to see the world where the best ideas win. We are clearly not there yet, but I try to do my part, from becoming more conscious of my own intrinsic biases to getting involved in industry events around diversity.

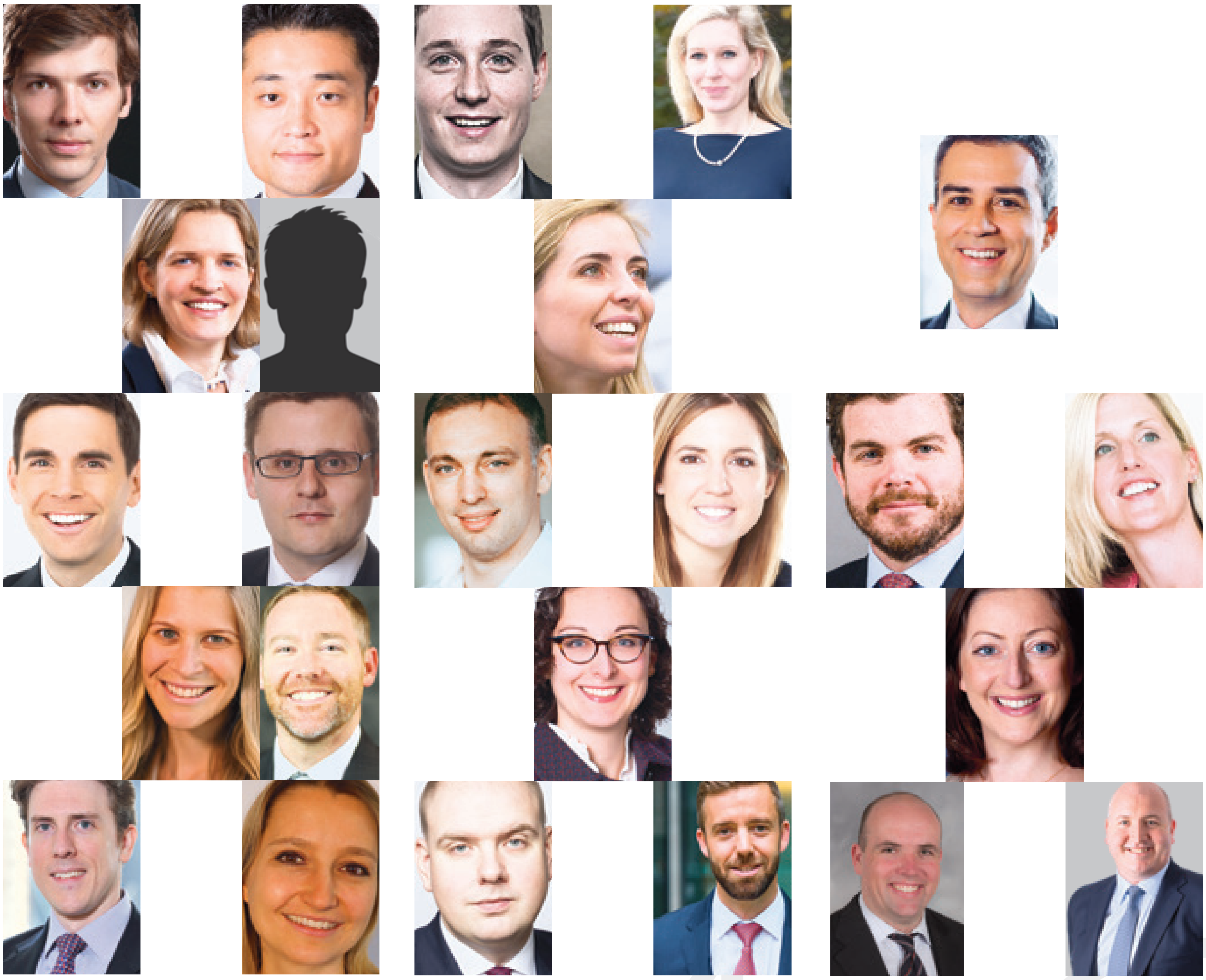
LC: My mother. She has worked really hard to ensure the best future for my brother and me, and it hasn't always been easy. She always focused on education and wanting the best for us.

SD: My father. He never finished high school, was a "rebel" to society and did not believe in belonging to society as we are taught, but managed to become the head of a semi-government-owned company. He spent all his life helping entrepreneurs grow their businesses in good and tough times. He taught me the values of being honest, nice and having a purpose in what you do.

Who is your biggest single inspiration and why?

THE FUTURE

Who are the young guns showing innovation in the industry? Who has the best deal record? Who has the X factor that marks them as a future leader? These were the factors our team used to draw up our list of the 40 individuals aged under 40 set to shape private equity over the next decade



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- **Maxime de Bentzmann**
Eurazeo
- **Audinga Besusparyte**
PSP Investments
- **Louis Choy**
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- **Ricardo Lombardi**
Intermediate Capital Group
- **Ali Mazanderani**
Actis
- **Eli Nagler**
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Centerbridge Partners
- **Marc Lutgen**
MVision
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- **Alex Rayden**
Evercore
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- **Sandro Diazzi**
Praesidium SGR
- **Marcus Frampton**
Alaska Permanent Fund Corporation
- **Jose Miguel Guzman**
NYC Comptroller's Office
- **Laura Hotaling**
New York State Teachers' Retirement System
- **Tanya Kemp**
San Francisco Employees' Retirement System
- **Raphaëlle Koetschet**
Caisse des Dépôts
- **Ben Mahon**
Oregon State Treasury
- **Mathew Powley**
Stonehage Fleming

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Kirkland & Ellis
- **Ted Craig**
Dentons
- **Louise Dumican**
The Carlyle Group
- **Camille Higonnet**
Proskauer Rose
- **John Rife**
Debevoise & Plimpton
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Unigestion
- **Henrik Johansson**
Nordic Capital Advisors
- **Andrew Petri**
Pfingsten Partners

THE FUTURE 40 Investors

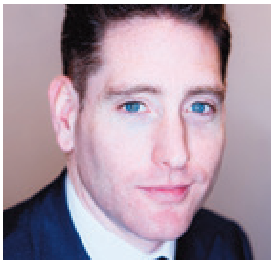
Marcus Frampton, 39 | CIO | Alaska Permanent Fund Corporation | At 39, Frampton is Alaska Permanent Fund Corporation's youngest-ever CIO. His influence at the sovereign wealth fund extends to all asset classes, having overhauled the fund's alternatives programme. Frampton built an infrastructure co-investment programme from scratch – an effort that has generated a 22 percent net IRR since inception. He also restructured the private credit programme to replace its historical fund-of-funds approach with a model of co-investments and primary fund commitments.

Pierre Abrial, 38 | Partner | Access Capital Partners | Abrial joined Access Capital Partners in 2006 as an analyst and has since risen to the position of partner. Abrial has responsibility for buyout fund selection on both the primary and secondary side and sits on various fund advisory committees in Europe. He previously served as a corporate credit analyst for Credit Agricole in New York.

Sandro Diazzi, 34 | Director | Praesidium SGR | As an investment director at multi-family office Praesidium SGR, which represents some of Italy's largest and most important families, education is a major part of Diazzi's job, something his peers say he excels at. "Sandro spends a considerable amount of time educating Italian family offices and high-net-worth investors about the merits of private equity investing, which is an asset class that is still unfamiliar to many of these investors," says Elizabeth Di Cioccio, partner and co-head of global distribution at Mercury Capital Advisors. "His knowledge of the asset class, professionalism, enthusiasm and patience has been a driving factor in the growth of Praesidium's platform since its inception." Diazzi, who is based in Chicago, is responsible for sourcing, analysing and executing private equity and venture capital fund and co-investments. He has invested in more than 50 top GPs and 15 co-investments since the platform launched in 2016.

Investors

Jose Miguel Guzman, 35 | Investment Officer | NYC Comptroller's Office | Guzman has been identified by his peers as "a true leader of the industry" who "continues to make an extraordinary impact". In his six years of private equity he's already racked up some impressive numbers, deploying more than $2.5 billion across private equity strategies as an investment officer within the Bureau of Asset Management at the NYC Comptroller's Office and has played a "critical role" in ensuring the pension generates returns for its beneficiaries. The Wharton School alum also has experience on the other side of the GP-LP nexus, having previously helped perform financial and operational due diligence at Cerberus Capital Management.



Mathew Powley, 38 | Director | Stonehage Fleming | As director of investment strategy and research at Stonehage Fleming, Powley is responsible for selecting private capital fund investments and managing existing manager relationships. He joined the group in 2009 having previously worked for BNP Paribas in London and State Street Trust Company in Toronto. Peers have noted Powley's contribution to the expansion of alternatives in family offices.

Raphaëlle Koetschet, 36 | Head of Funds Investments – Private Equity | Caisse des Dépôts' | Koetschet joined Caisse des Dépôts' in 2014 as an investment director responsible for selection of GPs in Europe and the US across private equity, real estate and infrastructure. She was promoted to head of fund investments after five years in the role and now covers buyout, growth equity, infrastructure, real estate and mezzanine. She tells *PEI* she's most excited about strategies with a clear value-focus, be it transformative buy-and-build strategies in the traditional buyout segment, growth equity, which today offers buyout-like returns without the need for high leverage, and also strategies that bear some operational complexity, such as carve-outs.

FUTURE

THE FUTURE 40

Tanya Kemp, 37 | Managing Director – Private Markets | San Francisco Employees' Retirement System | "The best way to learn is to surround yourself with people who are smarter than you," says Kemp. She has been part of the team responsible for investing San Francisco Employees' Retirement System's private equity portfolio since 2008. She became a senior portfolio manager in 2012 and was named interim managing director of private markets in 2018. SFERS manages a $3 billion portfolio invested across buyout, venture and opportunistic strategies. Kemp's focus is on venture and growth opportunities, with responsibilities including investment research, portfolio construction, sourcing, manager selection, fund due diligence, legal negotiations and portfolio monitoring. She was previously an investment risk and performance analyst at Missouri State Employees' Retirement System.

Investors

40 Investors

Todd Cohen | Director | New York-Presbyterian Hospital | Cohen has made a big difference in the three years he's been at New York-Presbyterian Hospital, which manages around $9.5 billion of assets supporting capital expansion projects, research and development activities across the hospital system. Cohen primarily oversees the venture and growth equity portfolio for the Office of Investments, as well as making direct investments through the Hospital's venture capital arm, NYP Ventures. "Todd has quickly risen to the highest ranks of [New York-Presbyterian's] investment team and [his] thought leadership is helping the Hospital transform and optimise its portfolio," says Caitlin Brodie, a principal focused on fundraising and investor relations at The Carlyle Group.

Laura Hotaling, 34 | Manager of Private Equity | New York State Teachers' Retirement System | Hotaling is no stranger to leader boards, having broken school records for swimming at Penn State and competed nationally in Division I. After a stint at Switzerland's LGT Capital Partners in New York, Hotaling went back to her Albany roots by joining New York State Teachers' Retirement System as an assistant manager of private equity. The 34-year-old was promoted to her current role in 2017.

Ben Mahon, 37 | Senior Alternatives Investment Officer | Oregon State Treasury | Mahon, working out of Tigard, Oregon, is described by colleagues as "an outstanding talent" as well as "a rising investment leader". He has been with Oregon State Treasury since 2008, first as an investment officer and, since 2016, as a senior alternatives investment officer. He previously worked at RV Kuhns & Associates as a quantitative analyst and research associate. The Oregon State Treasury has AUM of just over $100 billion.

INVESTMENT CRITERIA

In search of 'managerial alpha'

Private equity firms should direct as much energy in maximising the potential of their teams, cultures and business-of-the-business as they do in generating investment alpha, if they want to secure a competitive edge for the next decade, suggests Goldman Sachs' Chris Kojima

Kojima: understanding the human element is essential

"Investors in private equity managers face the challenge of finding the great, while avoiding the bad, in a space with high performance dispersion and imperfect information," observes Chris Kojima, global head of Goldman Sachs' Alternative Investments & Manager Selection Group.

"That challenge isn't new. But what has evolved is the complexity of the investment manager's business. So today we're not only searching for the ability to generate strong investment performance, we're looking for the underlying ingredients, the pre-conditions for success, in what is an increasingly sophisticated and competitive industry. Distinct from the investment alpha, you might call this the 'managerial alpha'."

The AIMS Group currently manages over $200 billion in open-architecture assets, over $60 billion of which is in strategies in the private markets. It accesses opportunities in four different ways: as a primary investor; as a secondaries investor; as a co-investor; and as an investor in GP management companies.

Over its 20-year history, the AIMS Group has met with over 10,000 private equity managers, and today ranks as one of the leading investors in private markets.

Q Broadly speaking, what are the elements you're looking for in today's private equity managers?

Our specific questions and analyses are always informed by the manager's strategy and the current environment, and therefore they change depending on context. But there are some over-arching principles which drive our approach.

We're deeply focused on the manager's ability to create value, in processes that are repeatable, mindful of the future economic environment. When assessing a new manager today, LPs are being asked to commit capital well into the 2020s, perhaps into the 2030s. We have to consider the harsh realities of what you might describe as 'alpha decay', this sense that the things that make you special are impermanent, particularly at a time when disruption is accelerating and competition is more intense. So we need to ask whether today's manager – even if successful in the 2000s and 2010s – is well-positioned to succeed into the next decade.

We're also inclined to regard most private equity firms not as impersonal permanent institutions, but instead as collections of people – human investors, led by human managers, in human teams which age and evolve. Strong personalities emerge from these talent pools. Teams expand and contract, with internal rhythms which change as new leaders emerge. So we see managers more as living 'eco-systems', filled with natural energy, ambition, rivalry, fragility and potential.

The question for LPs evaluating all of this is how to assess whether this eco-system is healthy and thriving. Unfortunately, this is the sort of inquiry which sometimes seems 'soft', less objective than 'hard' performance data. But understanding this human element is essential. A strong culture won't guarantee success, but its presence improves the probability that strong investment performance will follow, and its absence is likely to erode the organisation eventually from within.

Q How much can you rely on track record?

As a signal to predict future outcomes, we've found that historical track records in private equity are really an incomplete signal. A manager's track record »

» generally represents a combination of yesterday's competitive landscape, yesterday's economic environment, and yesterday's investment team. We all recognise these components, but we sometimes under-appreciate the timeframe over which our 'continuity assumptions' are made. To say that the last fund's track record – assembled over some four-to-eight years of sourcing and investing and harvesting – sensibly predicts the next fund's performance is to suggest that the competitive, economic and team circumstances will each persist in the same perfect balance, across a decade.

Historical track records are certainly not irrelevant, but we don't see them as conclusions. Instead, they can provide clues, providing insight to LPs in asking the right questions. Diligence time is finite, and LPs need to efficiently hone in on the right issues.

Q How do you assess 'softer' elements, such as team culture?

We've found it critical to find evidence that the team cares about its future, beyond its current programme. The typical GP-LP engagement is highly transactional, anchored on an examination of the current fund. But narrowing our focus only to this current fund, even if this is the only vehicle in which we might invest, misses the point. Unlike a permanent institution, a collection of humans – each with different ambitions, time frames and risk appetites – is unlikely to remain perfectly stable, focused and motivated if they believe they're in the last round.

The best way to address this human dynamic is to look for signs that the team is in it for the long haul. While there are several indicators of such commitment, there are two particularly useful areas to explore. One question is whether people are contributing to some internal 'public good', something bigger than the current deal or current fund, something which has a current cost in money or time or expediency, but which will benefit constituents beyond the current team.

A second question we explore is how the firm's leader considers his or her eventual succession. In the industry today, the firm's leader is often its founder, and so generational transitions are more complicated given this unique position. We're focused on investing with teams whose best days are in front of them, and in leaders who aim to leave the organisation in better shape than they found it.

Q What does your investment process emphasise today, as you look for the best firms of the 2020s?

Many of our analyses have remained consistent across the decades we've been investing, but there are certainly some notes of emphasis today.

We look for how managers are adapting to the operational complexity underpinning value creation today. This speaks to their need to work fast, effectively starting the deal evaluation process already on second base, with detailed pre-mapping of the target space, 100-day plans pre-composed, and roll-up acquisitions pre-identified. Today's valuation levels demand a daunting degree of confidence in execution, when yesterday's upside case is effectively today's base case.

“When assessing a new manager today, LPs are being asked to commit capital well into the 2020s, perhaps into the 2030s”

We look for signs of collaboration, where deal teams are encouraged to live outside the high walls of their deal-team silos. Within some managers, we see deliberate efforts to convene resident experts to develop shared macroeconomic perspectives, geopolitical outlooks and capital markets insights – intelligence which makes the whole greater than the sum of parts.

We observe clever collaborations between underlying portfolio companies and their executives, recurring idea-generation engagements not just between CEOs, but also between functional leaders in human capital, engineering, sales and marketing, and technologists.

We look for some advanced thinking about data and disruption. At some level, every deal is a technology deal, in the sense that the impact of new technology, insights from data science and the possibilities of AI all have the potential to shape every industry at every point in the value chain.

Some managers have resident domain expertise in digital strategy and data science, based within their firms but deployed to underlying portfolio companies. Others have resources dedicated to specific functions, like inventory management, sales and marketing, demand-curve and consumer-preference research, and optimised product pricing. But we've found that managers are only now beginning to consider aiming the data spotlight on themselves, considering how the current investment processes might be sharpened.

Perhaps most critical for the 2020s, we're looking for an intense and skillful appreciation for the importance of innovation. This isn't just in how the GP thinks about managing a given portfolio company. It's also in the way the GP thinks about evolving its investment process, about how alpha generation might change in the future. This kind of thinking requires a perspective broader than a single deal, and a time horizon longer than the current investment period.

Q Many private equity firms have been growing dramatically, whether in fund size or in strategy extensions. How do you think about this kind of growth?

Many investors historically have been uncomfortable with the idea of manager's growth, asking sensible questions like whether the firm is just asset gathering, or incentivised primarily by management fees, becoming distracted, or losing discipline. To be sure, private equity firms can find themselves in new neighbourhoods for which they're ill-prepared, and can certainly struggle from surprises coming from overly ambitious expansions.

But if we believe that these firms are living ecosystems populated by real people, then we need to accept that the organisation needs to grow. A firm with low ambitions and low expectations, interested only in maintaining status quo, is unlikely to attract new talent, retain key producers, or inspire new leaders to emerge. It can be as damaging for an organisation to aim too low, as it is for it to reach too high.

Q In your view, how are the best private equity firms managing this growth dynamic?

We think the answer lies in the skill with which the firm is managed. This is quite different than asking about investment skill. Here, we're focusing on managerial skill, what you might call the 'business of the business'. This is about corporate strategy,

> ***"Today's valuation levels demand a daunting degree of confidence in execution, when yesterday's upside case is effectively today's base case***

LP capital management, new product development, human capital management and operational efficiency. In good times, when great investment performance washes over the entire organisation, it's easy to forgive shortcomings in the business. But when investment performance is challenged, or when internal and external constituents are restless or frustrated, operational weakness is easier to spot, especially when it has been allowed to compound over time.

As competition and technology disrupt, or even erode, the production of 'investment alpha', we think this 'managerial alpha' is rising in importance, distinguishing the great managers from the average. Of course, managerial skill alone can't make mediocre investors great, but it can increase the probability that great investment performance happens.

Q How do you detect the presence or absence of this managerial skill?

Our starting point is recognising that managerial skill isn't evenly distributed across every investor making managerial decisions, just as investment skill isn't evenly distributed across people making investment decisions. The best investor might very well be the best manager, just as the best doctor might be the best choice to run the hospital, but this coincidence isn't always the case. But whether undertaken by different leaders or assumed by the same leaders wearing multiple hats, we've found it essential that the firm acknowledges a clear distinction between management functions and investing functions, demanding high standards for each.

We then ask a number of important questions. How skilled is the management team in growing its existing business, re-investing in its LP relationships and designing solutions for LPs for the next decade? How thoughtful is the management team in considering new business lines, seeding new ventures and diversifying into new revenue streams?

It can be tempting to explore business-line extensions that happen to be in fashion – internet investing in the late 1990s, credit market extensions post-2008, or anything sounding like data science today. It takes a special blend of discipline and vision to distinguish wise from unwise expansions. We've found that managers who truly capitalise on their growth potential have a clear-eyed understanding of their investment capabilities, and can spot natural and logical places where the team's talent can be scaled and where it cannot.

We're especially interested in how business leaders manage important firm-wide functions which represent the organisation's critical infrastructure. We consider things like human capital management, cross-strategy compliance and legal, communications strategy, physical real estate, the technology and cybersecurity platform.

When well managed, these wide-ranging activities are like oxygen across the organisation, supporting daily operations and promoting real confidence for further growth. When poorly managed, these are the things which distract the entire organisation, disrupting momentum and arresting entrepreneurialism. ■

LIMITED PARTNERS

The future of investing

LPs will push for more transparency and customisation of their investments, liquidity will play a greater role but robo-advisors won't negate the need for trust between LPs, GPs and service providers. By Adam Le

It's a question that drives at the heart of the private equity model as we know it: is the traditional 10-year limited partnership here to stay?

Contained within this simple sentence are a whole host of assumptions upon which the private equity industry is built. It drives at the nature of the relationship between LPs and their fund managers, the effectiveness of alignment and incentivisation, the structure of partnerships and the increasing importance of liquidity in a supposed illiquid asset class.

According to The Carlyle Group's David Rubenstein, the classic 10-year fund is not on its way out, but we are likely to see much more variation. The market is experimenting with different fund formats "in both directions", the private equity titan told an industry conference in Geneva in March.

To pose a question about the future of private equity fund structures is to also ask what a typical LP will look like in 10 or 20 years' time – whether closed-ended fund investments will still play a prominent role in LP portfolios or whether co-investments, directs and separately managed accounts take the lion's share; what fee structures will look like and how technology such as blockchain will disrupt reporting processes.

THE RISE OF CUSTOMISED ACCOUNTS

The desire for LPs to customise their portfolios, cut costs and boost returns has sparked a shift towards more bespoke fund models, such as separately managed accounts. According to data from Coller Capital, 42 percent of LPs held separately managed accounts last year, up from just 13 percent in 2012.

"If you look at the phrases 'limited partner' and 'general partner', those will become not fit for purpose in the future," says Eamon Devlin, managing partner at alternative asset management consultancy MJ Hudson. "It presupposes that your relationship is in a fund, and there'll be a lot more shadow capital in the next 10 years, which is not a GP-LP structure."

Increasing LP consolidation is likely to play a role in the rise of shadow capital via SMAs over the 10 years, with pooled pension groups such as the UK's Local Government Pension Scheme Central a prime example. In January, LGPS, which manages around £40 billion ($52.4 billion; €46.3 billion) in assets for nine UK pensions, established its debut private equity fund. The vehicle is structured via a traditional private equity model with bespoke provisions for the pensions, Alex Amos, a partner at law firm Macfarlanes who advised on the fund, tells *Private Equity International*.

"Pension funds are consolidating, family offices are consolidating, those are all trends leading into bigger pools of money, which will in turn lead to investors having separate account mandates with GPs," Devlin says.

Innovation in SMAs should help LPs deploy in a more efficient manner. In the traditional fund model, LPs are often unable to respond quickly enough to GPs' calls for co-investment capital. To address this, more investment company-type structures are likely to appear with LPs on their boards, according to Shawn D'Aguiar and Ajay Pathak, fund formation partners at law firm Goodwin.

PERFORMANCE

LPs will still expect outperformance from their private equity portfolios to justify the associated fees and expenses. But rather than sticking an absolute number on those expectations, they are likely to judge performance in relation to other investment options, such as generating 200-400 basis points over public equity benchmarks, says

David Fann, president and chief executive at consultant TorreyCove Capital Partners.

LPs themselves are also likely to change how their own investment professionals are compensated. Data from Coller Capital's *Global Private Equity Barometer Summer 2018* show LPs whose remuneration is tied to private equity performance are almost three times more likely to deliver annual returns in excess of 16 percent than their non-performance-tied peers.

Edi Truell, co-founder of private equity firm Disruptive Capital and a key figure behind the UK's public pension consolidation, says low salaries are a significant impediment to UK pensions' success in private equity.

"You've got to be prepared to pay proper money to attract the talent to take on private asset managers on equal terms," he told *PEI* last year.

LIQUIDITY

While the 10-year limited partnership is unlikely to disappear completely, the idea that LPs are locked into illiquid vehicles for a decade or more is likely to become a thing of the past. With the rapid growth of the secondaries market, which has grown more than seven-fold over the last decade to $74 billion last year, according to data by advisor Greenhill, LPs will have no unwanted funds that have outlived their 10-year lives. Portfolios will be devoid of zombies, assets will have been rolled into separate structures, or pre-agreed liquidity processes will have been triggered giving LPs the option to cash out.

GP-led liquidity options for a fund's LPs are already starting to appear in limited partnership agreements. Macquarie Infrastructure and Real Assets' Super Core Infrastructure Fund, which launched last year with a €2.5 billion target, includes a facility for secondaries sales every five years from and including year 10, according to public pension documents about the fund seen by *PEI*.

The savvy use of the secondaries market will also allow chief investment officers to adjust certain investment exposures on a

frequent basis. Over time the secondaries market could become "far more liquid and with less friction from a transaction perspective", says TorreyCove's Fann.

GREATER TRANSPARENCY

LPs will become used to having access to every piece of information about a manager they invest with and a fund they commit to. In 10 years' time, it is likely there will be a completely clear channel between LPs and GPs through which information will flow freely back and forth. If a manager is not willing to open itself up to this degree, there is a high chance investors will take their capital elsewhere.

Transparency and disclosure between GPs and the limited partners that commit to their funds is an area of top priority for investors and regulators alike. Industry insiders agree progress has been made over the last few years, but there's still work to be done to address the perceived double standard between private equity and other forms of investing, such as mutual funds or ETFs, where fee disclosure is explicit.

While technologies like blockchain are likely to aid in areas such as GP reporting, trust between LPs, GPs and service providers will remain key. As LPs continue to cut their number of GP relationships, this will only become more important, says Pablo de la Infiesta, head of private funds advisory for EMEA at Moelis.

"The moment you have trust in somebody, you are OK with them doing your fundraise, your secondaries deal, [and regarding ownership of the GP] generation changes that need to be dealt with at the ownership level," de la Infiesta says.

Will there be robo-advisors in the future? Probably, he says.

"You can trust a robot, but there's also the advice. Advice will always be relevant. The world never gets easier, the financial world never gets easier. Because of the competitiveness of everything, you need to combine advice with trust." ■

OPERATORS

Nadja Borges, 38 | Head PE Front Office Care | Unigestion | Borges takes a tech-forward approach to her leadership position, executing major IT upgrades that are revolutionising how the firm's LPs track their investments. She introduced a new data warehouse fronted by an investor portal with incredible functionality. LPs have online access to all available reporting data for a specific fund and can easily download that info into their own reporting framework. This system also allows for data analysis well beyond the standard number crunching, with the ability to benchmark and monitor risk with various risk ratios. This is not to say she neglects her finance, accounting and operations duties, only that she understands that managing the firm's technology is no longer ancillary to her role of leading the operational side of the firm.

Andrew Petri, 38 | Chief Financial Officer | Pfingsten Partners | Petri has been CFO at Chicago-based fund manager Pfingsten Partners since June 2015. He joined the Pfingsten as controller nearly 11 years ago. Prior to joining Pfingsten, Petri worked with private equity, hedge fund and broker-dealer clients in the financial services practice at EY in Chicago. A Wisconsin native, he holds a BBA degree in Accounting and Information Systems and a Masters of Accountancy from the University of Wisconsin.

Henrik Johansson, 36 | General Counsel | Nordic Capital Advisors | There's nothing groundbreaking when an advisor joins a client as their in-house general counsel, but few make the kind of impact Johansson already has at Nordic Capital Partners. Johansson has overall responsibility for all legal and tax affairs. He was instrumental in establishing a new master structure for the firm's Nordic Capital Fund IX, that closed with €4.3 billion in commitments. And that structure allowed his new firm to complete the €2.5 billion CV1 transaction, which currently stands as the largest GP-led secondary. Before joining the firm, Johansson spent 11 years at Mannheimer Swartling where he was a partner in the M&A group and head of transaction structuring. While there, he advised Nordic on its blockbuster exit of European animal health leader Anicura to Mars Petcare.

THE FUTURE 40

OPERATORS 40

OPERATORS 40

SECONDARIES

Consistent adaptation

Secondaries firm Pomona Capital celebrates its 25th anniversary this year. Chief executive and founder Michael Granoff discusses how the secondaries environment and Pomona have evolved and what he sees for the future

Q What is Pomona Capital's general approach to the secondaries market?

We are willing to commit capital only if we receive an adequate margin of safety, which can come from several factors: purchasing assets at a discount significantly higher than the industry average, quality and maturity of assets, near-term liquidity events and hedging of potential foreign currency exposure. These are all important characteristics we consider at Pomona prior to making an investment.

Q Pomona is 25 years old this year, how have the firm and its strategy evolved?

Since its founding in 1994, the firm has grown to a 40-plus person shop with a global presence in New York, London and Hong Kong. In our 25 years thus far, we have been nimble as market conditions evolved, open to uncertainty, and consistently challenged our own assumptions – which can be hard. As a learning organisation, I anticipate Pomona to continue this trend as we adapt our business in an increasingly complex environment. While our core strategy investing in private equity secondaries has not changed in all this time, our tactics to take advantage of opportunities have.

> ***"In the secondaries market, generally, you are not rewarded for taking more risk. Some managers are buying billion dollar portfolios at auctions at very high prices***

Q Can you give some examples?

The way we source transactions has become increasingly proprietary. Recently, nearly half of the transactions in our current fund represent Pomona providing a complex liquidity solution to either funds of funds, listed funds or other kinds of structured vehicles; 20 percent involve repeat sellers and approximately a third of the transactions are GP-directed. In the prior fund, almost half of the transactions came to us from GPs that are restrictive regarding transfers. Lastly, almost all of the funds we buy are already on the target list of funds we want to own.

The majority of generic secondaries transactions trade in big auctions, and our sourcing has become more customised to find better than market quality assets at lower than market prices. That part of our business has had to adapt over time and will continue to do so.

The second example is on the analysis side. We are doing more and more complicated transactions that have more structure to them. We have to understand what is happening to the underlying portfolio companies to a much greater degree. Overall, our relationships with GPs and the way we use data has evolved quite a bit over the past 25 years.

Q What else is different?

The third part that has shifted is what we do after we buy assets. We have become more proactive about portfolio management post-acquisition in several ways. We have figured out how to effectively hedge currency risk, given that our typical exposure to European assets is around 20 percent. Currencies have been volatile

Granoff: constant change is required

in recent years and, because of our hedging, we have been able to protect investor returns despite double-digit swings.

We have also become more proactive in managing the portfolio and have become sellers of assets, particularly older assets that have already achieved their target return. We did not think there was much growth left in certain older assets as we surveyed the environment, but buyers appeared to be paying high prices in auctions. So, we tested the market and the process. Today, we have sold half a dozen times, totalling nearly three-quarters of a billion dollars in assets over the last four years.

We have become more strategic in what we do after assets are purchased. Each part of our business is evolving in quite a significant way in order to continue to execute the strategy.

> ***If you are going to be dealing with mediocre assets managed by a mediocre GP that you had to pay a high price for, you may be asking to take on more risk for potentially less return***

Q What do you think of the level of risk taking in the secondaries market?

In the secondaries market, generally, you are not rewarded for taking more risk. Some managers are buying billion dollar portfolios at auctions at very high prices, from my perspective, and some are taking large, concentrated bets on assets. Given Pomona's risk conscious approach to secondaries investing, we tend to be very deliberate when making investments and currently, we do not believe the data supports a thesis that elevated risk taking necessarily correlates with higher returns.

Q What other types of secondaries transactions is Pomona avoiding?

We have not been so interested in GP-led restructurings, emerging markets, or stapled transactions. The market is changing, but we generally have not been interested in GP-led transactions, because we believed that there was adverse selection and few good funds needed to be restructured.

If you are going to be dealing with mediocre assets managed by a mediocre GP that you had to pay a high price for, you may be taking more risk for potentially less return. When I look at all these types of transactions, I do not see them generating higher returns. We believe there are better places for our money.

Q Could that change in the future?

If the market develops in a different way, where better GPs are beginning to think about restructuring, then I think it could be an interesting opportunity for us. If the market evolves so that good funds start to reorganise as they get to the end of their lives – and we are able to get involved in restructurings in order to unlock good assets rather than mediocre assets – our »

Q Pomona has focused some of its efforts on courting retail investors. How do you anticipate they could change the private equity world?

If you assume that retail investors include individuals and defined contribution-type plans like 401Ks, it is clear that it is the fastest growing customer segment in the financial world. Companies today are rarely creating a pension fund for their employees. Second, for the most part, retail investors have little to no access to alternatives.

Third, if you look at most of the sophisticated institutional investors in the world, a majority of them have pretty significant exposure to alternatives and, particularly, to private equity. As a result, we believe that these sophisticated investors have the kind of returns that the traditional retail investor has limited ability to achieve.

Retail investors have the potential to be an enormous source of capital for private equity in general if the industry can tap into it. But, it is not as easy to access as institutional markets due to the nature of retail investors and their liquidity expectations – you cannot click a button and get out of a private equity fund. There is a ways to go before you have a fit between the two, but we believe the opportunity exists. It is a little bit like a round peg and a square hole.

Q How is Pomona Investment Fund addressing some of the issues you mentioned?

We are not a square or a round peg, but we have come closer to what fits for retail investors than most traditional private equity, buyout or venture capital funds. We are buying mature assets at a discount and receiving liquidity relatively quickly, and we can provide that to retail investors (perhaps not 100 percent on demand, but more than others are able to).

The Pomona Investment Fund is growing and so far has been performing quite well, outpacing the public markets and other similar products. We believe it is an interesting area to continue pursuing for Pomona.

It may be worth noting that every big financial institution is trying to tap into the retail market. They are talking about it and it is going to be a significant portion of capital flows going forward – it is inevitable. There is such a huge potential, but it is complicated.

The whole regulatory aspect of marketing to retail investors has been a learning process for us. It is not what we are typically used to given our traditional institutional investor base.

We have gone through a learning curve and it is something managers interested in this market will have to navigate.

» investment team may be interested in pursuing those transactions. We require those elements and sometimes we will find them in bits and pieces, but, today, that is the exception rather than the rule. We are involved with the restructuring of funds of funds, listed funds and other complex vehicles and there you have a separation between the structure and the assets.

This is an example of how the way we see the market today may not necessarily be what happens in the future. The secondaries market has grown in the last 10 years at a faster rate than any other part of private equity. There has been a 20 percent growth rate since 2009, and the industry continues to evolve. The reasons investors seek liquidity are also going to be fluid, and we will continue to understand what they are and seek assets that meet the criteria that we have.

> ***"The way we see the market today may not necessarily be what happens in the future. The secondaries market has grown in the last 10 years at a faster rate than any other part of private equity***

Q What are some of the main challenges with stapled transactions?

If we are only able to purchase the secondaries in a fund if we also give primary money to the GP, in our opinion, that is a red flag. It raises the question of why money cannot be raised in a normal way. It also dilutes the secondaries effect of what we are buying. We have done some stapled transactions in the past where the particular opportunity presented was attractive, but, in general, these are not the most desirable transactions. I do not think that is going to change for us. ■

DATA USE

Keeping dealmaking personal

Attempts to look into the future can conjure up images of a disturbing, even dystopian world, but observers of the private equity market offer a rather more reassuring picture. Technology will be important, but so too will human input.
By David Turner

When it comes to technology, many experts regard advances in artificial intelligence as the single biggest factor that will change dealmaking, because it will generate analyses of past and future corporate and industry performance based on pools of data so large that humans using conventional techniques could never cope with. Much of this will be 'unstructured data' – data that does not come in a predefined form, like numbers on a spreadsheet. Unstructured information includes social media feeds, digital pictures and videos; it has until recently been notoriously difficult to manipulate and techniques are still rapidly evolving.

This is partly about big-picture issues. Already, "larger private equity firms are increasingly using AI and data analytics to predict market themes and trends", says Fenton Burgin, head of UK advisory corporate finance at Deloitte in London. "Today, for example, in the financial services and consumer sectors, we are already seeing the accelerating use of AI to predict generation Y and Z's future spending habits. In five years' time, it will be an absolute prerequisite to have access to these high-speed capabilities."

AI DOES THE HEAVY LIFTING

But AI can also do the grunt work of due diligence. Consider a target company in retailing with 150 leases, says Will Shields, co-chair of private equity at the law firm Ropes & Gray in Boston. The private equity firm's lawyers must work out how many of the leases will require the consent of the real estate owner for any 'change of control', including the change of control involved in a private equity purchase. "You can use AI quickly to ferret out the answer by using keywords and analysing the language in the leases," says Shields. "Perhaps more importantly, you can get an answer more cheaply: it would previously have taken 15 junior lawyers three or four nights of hard work to resolve."

Blockchain will also transform due diligence, says Haresh Vazirani, investment manager in private equity at Aberdeen Standard Investments in Edinburgh. He notes it currently takes three to six months to do diligence. However, if blockchain becomes widely adopted for transactions, "all the data could be verified on the day itself". Blockchain produces a ledger of transactions that cannot be changed, for example to flatter a company's results, without this change being recorded in the ledger. Improvement in the reliability of information also "reduces the data asymmetry" between the company and the prospective private equity investor, says Vazirani.

FASTER DEALMAKING

Use of technology is part of a broader impetus to accelerate the speed of dealmaking, which will be much more rapid in 10 years' time, say observers. Shields says the use of technology by insurers to protect target companies against liability for painting an inaccurate picture of themselves is already becoming very common and will become more so.

This trend in insurance is rendering the process of making transactions quicker and easier, says Shields.

Shields believes this offloading of risk to a third-party could see another trend emerging over the next 10 years – "a narrowing of the acceptable starting and finishing points on deal negotiation", since these negotiations at the moment largely cover who has liability for what.

Even in 10 years' time other skills will still be needed at private equity firms »

» beyond data science, say observers. "Private equity investment is 50 percent science and 50 percent art, 50 percent quantitative and 50 percent qualitative," says Helen Steers, partner and head of European investment at Pantheon, the London-based fund of funds manager and private markets investor.

"You will need a twentysomething with the data background, and you will need the older people with the scars on their backs, who know that although data is a really important part of the story, there's a whole bunch of other things that are important as well."

"The data and numbers are one side of the equation, but the other side is interpersonal relationships," says Steers. This includes building teams and impressing target companies. Steers gives an example of how the two halves complement each other. Ahead of that crucial meeting at which the firm is trying to persuade the target company to sell, the data scientists need to supply the negotiating team with a detailed picture of the company, since this will impress the management.

In the future, Burgin thinks European private equity firms will need to focus increasingly on how they differentiate themselves to persuade target companies to side with them – and human qualities will be key to this.

"In the current US markets, for example, where more than 50 sponsors may be reached out to on a deal, it is often the softer people skills that can really make the difference in the owner's decision-making process," he says. In other words, personalities will still win deals.

Private equity investors will be more specialised 10 years from now, predicts Ali Mazanderani, partner at Actis, the emerging markets specialist. Already, "the ability to distil information and distinguish good from bad investment opportunities requires a degree of specialisation that has increased dramatically", says Mazanderani, an authority on fintech, and particularly on payment services.

"Consider a situation in which you go to an investment committee, and you're having to not just tell the story, but to teach them the language. This is almost impossible when you're talking to a group of generalist investors," he adds. It is especially difficult in rapidly developing sectors where "the past is no longer the prologue – you're having to predict the evolution".

Because of this need for highly technical knowledge, Mazanderani predicts a growth in the number of niche firms where everyone understands a particular market. However, he also sees very large managers recruiting more specialists. A large manager has the chance to make the economics of hiring a professional with a narrow focus work, because it will have the war chest to make a large number of deals in that area. In short, Mazanderani sees a "bifurcation" in the market.

Another consequence of this specialisation is that firms will become less geographically restricted, as they seek opportunities to use their specialism throughout the world, says Mazanderani. However, he forecasts the continued existence of some regional managers, including emerging markets specialists such as Actis, because limited partners often want particular regional exposure. ■

REGULATORY COMPLIANCE

Facing up to stricter standards and round-the-clock reporting

The private equity industry is not immune from public scrutiny, as well as demanding investors. Aidan Connolly, CEO of Luxembourg-based fund services provider Alter Domus – and previously CFO at UK retailer Wilko and payment services provider Worldpay – considers what buyout firms need to learn from other industries

Connolly: firms are getting the message

Q As an experienced CFO new to the private equity industry, what do you think PE funds can learn from other industries as they continue to grow and develop their businesses?

There is a contextual issue for private equity houses at the moment. We are in a time where relative inequality is highlighting some of the more egregious aspects of the 'haves' business model, and private equity stands full-square in the middle of that. That is going to impact private equity, and there are lessons to be learned from other industries that have been through the mill.

The more enlightened private equity houses are having a dialogue and understand that changes need to be made. This perception of inequality is not going to go away, and firms are going to have to become much more transparent about the way they do things. Corporates have been forced into disclosure regimes that could be easily adapted for large-scale private funds, many of which are of a similar size to FTSE 100 and S&P 500 businesses. There is no reason why they should not be subject to the same disclosure regimes.

It is only relatively recently that private equity firms have started to get to grips with the concept of diversity and started to address those issues, where even unregulated industries have been quicker to take more radical approaches.

The US has become very active against businesses that discriminate and has started to take that across all sorts of discrimination, beyond much more than gender. But it is still difficult to imagine a picture of the leaders of the top 20 private equity firms containing any more than one or two women, so the industry needs to up its game.

Then, in ESG, it is fair to say that private equity has recently started thinking about its portfolio impact and taking responsibility for that, but that has been a long time coming and it will probably be forced to go further.

It is a challenging landscape, but if firms can address these issues, the alternative funds industry can be seen to be socially additive rather than negative. They do not really have a choice, as regulators become more ambitious in their scope and are pushed to represent the masses. I already see private equity firms getting the message – we are seeing ESG policies coming out that even a decade ago would have been unimaginable. So, things are certainly changing.

Q As reporting and compliance standards for the private equity industry continue to increase, how do you envisage the role of the CFO changing in response to investor demands?

As the industry opens up to greater scrutiny, standards will have to be higher and the CFO is going to be held to a different level of account than he or she has previously been used to.

There is going to be a much more strategic balance sheet issue to address, because increasingly compliance requires capital behind it as a safeguard. Finding the right way to report that is a challenge that banks have grappled with, and by and large the European banks have not been

***Ready for change**: private equity can learn from other industries*

very convincing in their approach to the new scrutiny of regulators.

A lot of parallels can be drawn with the fund industry, where there is increasing pressure to communicate a capital management strategy and the way in which the business model mitigates risk for investors. That creates opportunities for outsourcers to step into that space as a strategic partner to the fund, and through the fund to the investor base.

24/7 reporting will become almost the norm, with funds required to demonstrate compliance at any time, rather than simply at certain key dates, like year-end. That changes the boardroom debate, with different voices becoming required listening. The role of the chief risk officer, the chief compliance officer and the CFO will all become a much more important part of the investor message than they have been in the past, and more of an arbiter of value.

Q Luxembourg has seen a significant influx in private equity funds in recent years and continues to expand as a funds hub. Where do you expect new business to come from over the next decade, and how do you see the industry developing geographically?

Luxembourg now faces the classic dilemma of somewhere that has been very successful. If you go back to Luxembourg in the 1970s and 1980s, it was pricing itself out of the market and other people took that space. Now, with the difficulty in recruiting great talent and the costs of operating, there is a risk of that happening again, and that success starts faltering because of the sheer cost of supporting fund structures »

24/7 reporting will become almost the norm, with funds required to demonstrate compliance at any time, rather than simply at certain key dates

» – a business which is supposed to be a low-cost activity.

This goes back to how you set yourself up to deal with geography, compliance, risk and risk mitigation. For outsourcers based in Luxembourg, we have to look at more global solutions and press regulators to come with us on that. Ever-rising costs simply will not work as a way forward.

For us, clearly Europe is still an important centre for growth with lots of opportunities and lots of wealth being funnelled into investment vehicles that need servicing. Europe is now a pretty sophisticated market for outsourcing, whereas the US is relatively less sophisticated because it has not needed to be. Nevertheless, regulatory pressure will create more need for outsourcing and so we will see growth there.

Then you have to look East, and particularly to the Chinese and Indian economies where there are such emerging depths of population calling out for solutions to help them manage their savings. Businesses will see opportunities in Asia-Pacific and work will flow to those territories seen as the most accessible and safe hubs, such as Singapore and Hong Kong.

Q How do you expect the role of the PE fund administrator to change over the next 10-20 years?

The reliance on technology to do the donkey work will become more and more prevalent. Talent will be attracted into the industry if the drudgery can be taken out of it, so technological development is vital. Whilst there is technology in our industry, the disruptive impact we have witnessed in other areas has not yet reached our shores, but I think it will come.

Because of regulation, the necessity to demonstrate compliance will mean much closer integration with our clients as far more will have to be demonstrated in real time and our role will become continual rather than periodic. One can already see the audit industry starting to think along these lines, and we will have to respond to match that demand. We are going to have to demonstrate that we are on the ball all the time, and people can invest safely into fund structures without risk of malfeasance.

That, in turn, demands more from everybody and requires thinking in wholly different terms – it is like transferring from a horse-and-cart economy to a car economy. Scale will also come into it, because the level of investment in systems and maintenance required will be much greater, driving our industry to consolidate around fewer and fewer players. We can already see that activity starting to occur and I expect we will see more of it. ■

> ***Europe is now a pretty sophisticated market for outsourcing, whereas the US is relatively less sophisticated***

Q A greater role for outsourcing?

There is a real tension between growth, the back-office and regulation. Private equity has been facing a challenge that perhaps other industries have already faced, which is the constraints of the impact of geography and technology as against the regulatory impact of control and supervision.

For example, the natural reflex of any industry where it has an opportunity to reduce productivity costs for the back office is to look to lower-cost environments in which to house those services. We have seen business process outsourcing grow over the years and then decline, as other industries have moved into that space. The issue that private equity firms face is that regulators want funds, and particularly those that have retail money in them, to become much more constrained in the extent to which they can use geography to lower costs. Technology has no geographic boundaries, so there is a tension for the back office.

Similarly, there are increased regulatory requirements around managing risk which constrain the ability of funds to distribute their businesses in the way they would like to. The issue of data control and stewardship, for instance, can be addressed in a variety of ways, very few of which would find favour with regulators. If you are looking to prevent a data disaster, one way would be to replicate data in a number of places, but you are almost immediately at loggerheads with regulators if you start viewing your data as global.

Those are the kinds of places where we are going to see a battle over the next decade. That will lead to a different approach to outsourcing, pushing us to come up with 21st-century solutions to these problems. Outsourcers, because of their scale, are probably better placed to make the investments necessary to provide those solutions, so they will increasingly be seen as strategic partners to funds, rather than a necessary evil.

DEALMAKERS

Maxime Baudry, 36 | Partner | Sagard | After joining the firm as an associate in 2011, Baudry quickly moved up the ranks, being named director in 2014, principal in 2017 and partner just recently. His rise was fuelled by a relationship-centric approach to creating value. While overseeing the investment in Les Délices des 7 Vallées, he was able to help the frozen dessert business expand its manufacturing base, strengthen its sales teams (for both the domestic and export markets), and enhance its organisational structure, all the while keeping its family business culture intact. In December 2018, the food manufacturer was successfully sold to Mademoiselle Desserts. And his hit streak looks poised to continue with the companies currently under his purview, which range from speciality chemicals to heating and air con firms.

Masa Suekane, 36 | Principal | Bain Capital Japan | Suekane is one of private equity's "top athletes", according to his peers. The 38-year-old has some impressive deals under his belt as a principal of Bain Capital Japan, the most notable of which was the $18 billion acquisition of Toshiba Memory Corporation by a Bain-led consortium last year. Suekane spearheaded the deal – Asia's largest-ever buyout – and is now the company's youngest board member. The complexity of the TMC deal is a testament to Suekane's skillset; supporters point to his "unmatched" ability to manage the entire deal process, from origination and execution to portfolio management and final exit. Expect Suekane to play a key role in the future of Japanese private equity.

Eli Nagler, 33 | Managing Director | Blackstone | Blackstone has kept Nagler busy since he joined the firm in 2007. Nagler, who focuses primarily on technology, media & telecom and financial services, has been involved in a large number of Blackstone investments, including Bayview Asset Management, which makes investments in mortgage credit, Paysafe, the online payments company, and Refinitiv, the trading and data business that was spun out of Thomson Reuters, in which Blackstone and other investors bought a 55 percent stake in 2018. Nagler is a director not only at Refinitiv, but also at Paysafe and Lendmark Financial Services, a consumer finance company in which Blackstone has invested. A graduate of Harvard College and Harvard Business School, he is a term member of the Council on Foreign Relations.

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Audinga Besusparyte, 34 | Senior Director | PSP Investments | Besusparyte is a builder as well as an investor. When she joined PSP Investments, the Canadian pension investment manager, she played an important role in building the London private equity team, by hiring and training new members, as well as getting PSP Investments' name known in the European market. Her work in increasing the visibility of PSP Investments bore fruit, with Besusparyte involved in a number of investments in the region. These include the French AI (that's animal intelligence, not artificial intelligence) company Antelliq, which provides identification and monitoring technology to farmers and fisheries, and digital services for pet owners. Antelliq was bought by Merck, the pharmaceutical company, in December 2018 from PSP and other investors.

Ricardo Lombardi, 36 | Managing Director | Intermediate Capital Group | Lombardi isn't afraid of complexity. Recently he led the ICG-backed spinout of Standard Chartered's private equity business, an effort that involved multiple stakeholders, multiple geographies, including Asia, Africa and the Middle East, and a complex legal structure. And he managed all that in the face of financing hurdles and the volatility so common in emerging markets. His peers admire his ability to balance competing interests, knowing when to push an issue and when to show restraint. That formidable skill set helped him build ICG's Strategic Equity business in Europe, and now Asia. In the last 18 months alone, he led six transactions on three continents, with a total value of $1.5 billion, which include spin outs, restructurings, and direct co-investments.

Maxime de Bentzmann, 35 | Principal | Eurazeo | Over his eight years with Eurazeo, de Bentzmann has become a major force in the firm's Paris office, taking part in some of its highest profile transactions. In 2018, he was a part of the team that sold Asmodee, the French publisher of card and board games, to PAI for €1.2 billion, generating an IRR of nearly 35 percent. In addition to his deal work on majority investments, he helps manage iM Global Partner, Eurazeo's asset management platform for minority investments in US and EU asset managers. And in what spare time he has left, he's published an *Introduction to Private Equity* for the Presses Universitaires de France and teaches at the master's programme at Dauphine University in Paris, where no doubt he's teaching the next generation of dealmakers they shouldn't dawdle in making their mark.

Joanna Reiss, 34 | Partner | Cornell Capital | Few raises for first-time funds are as successful as the achievement of Cornell Capital, the New York and Hong Kong-based firm, which secured $1.3 billion in 2018 for investment in the consumer, energy, industrial and financial sectors. Reiss was instrumental both in the fundraise and in building the firm, founded five years before by Henry Cornell. In the years up to this success, Reiss, a specialist in industrials, sourced and co-executed the investments in Talcott Resolution, the life and annuity insurer, and Corelle Brands (formerly World Kitchen), manufacturer of the Pyrex brand of baking dishes. She also made the firm's investments in MRC Global, a pipe and valve maker, and Monolith Materials, which makes carbon black. Reiss is a member of the board of Corelle Brands and Monolith Materials.

DEALMAKERS

Louis Choy, 32 | Principal, Secondaries – Private Equity | CPP Investment Board | Mention the phrase "sophisticated investor" and CPP Investment Board is one of the first organisations that comes to market participants' lips. Its secondaries team is at the cutting edge of that market's development, and one of the leaders spearheading that push is London-based Choy. At just 32, he has been described as "fantastic, creative and street-smart beyond his years" and was ranked number one in sister title *Secondaries Investor*'s Young Guns of Secondaries list in 2017. Choy is known for his creativity – sensing deals where others do not – and has been behind several first-in-kind deal structures including the pension giant's push into preferred equity. Market sources tell us Choy could one day rank among the likes of industry pioneers Henry Kravis and Jeremy Coller.

Haresh Vazirani, 36 | Investment Manager | Aberdeen Standard Investments | Limited partners do not need to be sleeping partners; nor do they need to be unadventurous in always going for the big names. Vazirani, relocated last year from Hong Kong to the Aberdeen Standard Investments headquarters in Edinburgh, shows the truth of this. "As an LP, he has been great at discovering new and sometimes quirky managers, and working closely with them to execute investments that are on track to beat the global benchmarks, delivering returns in excess of 35 percent IRR," says one private equity advisory specialist outside ASI. Over the last 18 months, Vazirani has led or co-led deals in excess of $150 million, making direct investments and co-investments in sectors including real estate, oil & gas, and IT services. He is also a great fan of blockchain, which he thinks could transform due diligence.

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Ali Mazanderani, 36 | Partner| Actis | The word "cosmopolitan" is called into action too often, but only the chariest observer would baulk at its use to describe Mazanderani, born to a Middle Eastern father and British mother, raised in South Africa, and doing deals across emerging markets since joining Actis in 2010. He specialises in fintech, and in particular in payment services. Perhaps his greatest triumph is his role in the rise of StoneCo, the Brazilian payments company and unicorn that reached a value of $9 billion on its first day of trading on Nasdaq in October 2018. The company even attracted the attention of Warren Buffett's Berkshire Hathaway, not known for its tech investing, which bought an 11 percent stake. He sits on StoneCo's board. Other transactions for Actis include an investment in Emerging Markets Payments, the first pan-African payments platform.

VALUE CREATION

Tipping the playing field

Building a bespoke operating model and reinforcing a distinctive culture in which people can perform their best is the path to maximising value for specialised private equity firms and generalists alike, explains *L* Catterton's Scott Dahnke

Three decades after it was formed, *L* Catterton has carved a sizeable niche as the world's largest consumer-focused private equity firm. The group invests via middle market and growth strategies on five continents.

Scott Dahnke, co-chief executive officer at the firm, outlines the trends shaping the consumer sector globally and explains how private equity firms can find new levers to increase portfolio company value.

Q 2019 marks 30 years for *L* Catterton. Looking back on the past 30 years, how has the private equity industry evolved?

The biggest change has been the maturation of the private equity industry, and the impact that's had on the competitive landscape. Like most maturing industries, we're seeing that there are two principal models for success – specialise or scale. The population of truly generalist, middle market funds is shrinking.

Additionally, more money than ever has come into the market and dry powder has been on the rise for years. As we all saw, it hit another record high in 2018. When capital becomes a commodity, it's not easy to consistently deliver high alpha irrespective of market conditions, as we look to do. Therefore, we believe you need to have an arsenal of competitive advantages that are going to help you create real value.

Q You often refer to your approach to value creation as 'structural alpha'. What does that mean?

It's about tipping the playing field to your advantage, in multiple ways. We do that through our consumer focus and resulting deep insights, our global reach and expertise, our operating resources and execution, and our affiliation with key strategic players in the consumer arena, most notably LVMH.

Perhaps most importantly, we seek to maximise the impact of these advantages by creating a consistent culture – both internally and externally – across all geographies. Naturally, you need to hire great people, but you also need to nurture a self-reinforcing culture and a community where they can maximise their talents – so effectively, one plus one can equal three.

In our parlance, structural alpha is about building a set of competitive advantages in our business model and then promoting a performance-oriented and collaborative culture, where everyone is working consistently within that model to maximise value.

Q So how does structural alpha work in practice?

For any one investment, there are multiple levers we can pull to generate outsized returns. For example, at Ainsworth, our insights around the pet food category's consumer trends informed us to double-down in the food, drug and mass channels on the super-premium brand within their portfolio, Nutrish, which turned out to be the right decision. Similarly, our operating expertise served us really well – our operating team went in and helped increase production capacity by 70 percent and decrease costs by more than 30 percent.

For an investment such as Elemis, which we sold to L'Occitane for $900 million earlier this year, we leveraged our strategic partnerships and global reach to support expansion from the UK into the highly attractive US beauty market. These are just a couple of examples of leveraging our structural alpha 'toolkit' of competitive advantages to drive returns. Our objective is to select the right value-creating tools to deploy in each investment to help the management team maximise value.

> ***You need to hire great people, but you also need to nurture a self-reinforcing culture***

***Dahnke**: it is important to build on competitive advantages*

Q What impact does sector-focus have in your value creation?

The data suggests that in the consumer investing arena, sector-focused firms on average achieve a 20 percent higher MOIC than generalist firms. That isn't that surprising to us, as the consumer space is much more dynamic than most folks think. The past isn't always prologue.

Our entire business model is built around not only being focused on the consumer sector, but also being focused exclusively on growth. In fact, many of the things that we do either wouldn't make sense for a firm that wasn't focused on investing in on-trend consumer assets, or wouldn't be economic absent our global scale. Our model is very bespoke.

This approach enables us to do a lot of research and develop pattern recognition, leveraging unique insights around consumer behaviour and trends. It is about "skating to where the puck is going". We also seek to focus on consumer verticals where we have the deepest insight and often, proven success, so that we can pursue a highly developed investment thesis. To »

A NATURAL DECISION

In 2011, *L* Catterton invested in Zarbee's, a natural children's cough brand, after recognising the large opportunity to develop the first-mover in the nascent Natural OTC category. Seven years later, Zarbee's Naturals had secured itself as the market share leader in the natural paediatric cough/cold category and was sold to Johnson & Johnson. Based on published reports, the transaction resulted in an approximately 10x gross MOIC for *L* Catterton

Q What was the opportunity in Zarbee's Naturals?

Our research showed that families – particularly mothers – wanted chemical-free products for themselves and their families, specifically young children. We began to look at specific categories and saw that there was no all-natural, trusted national brand recommended by paediatricians that a parent could reach for any time their child had a cold, cough or flu. It just did not exist.

After scouring the consumer landscape for potential brands that could become leaders in this nascent category, we targeted Zarbee's – they were just a four-person team at the time. In a nutshell, the concept was to build Zarbee's beyond its flagship product – drug-free children's cough syrup – into a suite of all-natural products covering all age segments and health and wellness product categories, and that's exactly what we did.

Q What did you focus on during the hold period?

Our key value creation levers were talent expansion and leadership development, product innovation, branding and marketing, and distribution growth.

Shortly after our acquisition, our in-house talent team helped Zarbee's bring new, highly-experienced talent into virtually every critical function within the company.

In terms of product development, we expanded the brand in two age directions, entering both Adult and Baby. We also expanded beyond the brand's cough heritage, adding immunity, vitamin, wellness, allergy and sleep products to the range. We tweaked the positioning and expanded digital marketing to drive paediatrician recommendations and grass-roots advocacy. At one point Zarbee's had more Facebook followers than any other brand in our portfolio, a huge feat given the scale of some of our brands, and further proof of how important this category is to mothers.

Finally, with the support of our industry relationships, we were able to expand distribution from one major account to all major accounts across several channels – Mass, Drug, Grocery, Discount, Club and e-Commerce.

The result of all of this was over 15x revenue growth, and a strong and commensurate return on invested capital.

Q What are the lessons for the future?

The Zarbee's story underscores the importance of the management team, which was critical to success. It also highlighted the ongoing opportunity in natural, "better for you" products. We have several investments in our portfolio that are oriented towards this trend. The Honest Company, which focuses on all-natural baby and beauty products that keep families safe, is a great example. For us, there is no question that there is pattern recognition. This enables us to wait for pitches that are clearly in our strike zone before we swing.

» continue with my example of the pet food vertical: our first pet investment was made in 2004 (Wellness Pet Food, where we grew earnings seven-fold), and we have been actively investing in that space since. We exited Wellness in 2008 and acquired Nature's Variety that same year, which experienced similar growth in the raw pet food space. We held Ainsworth for four years before selling to JM Smucker's for $1.9 billion, and we are currently applying our learnings at two pet food companies in the UK – Inspired Pet Nutrition and Lily's Kitchen – and three more in the US, which are Canidae, I and love and you, and JustFoodForDogs. We have similar examples in other categories, including beauty, e-commerce, restaurants, health and wellness, and more.

Q What shifts have you seen in the consumer sector and where do you see it going?

There have never been as many opportunities for emerging brands to grow, and the corollary is that we've never seen as much of a threat to incumbents. The power dynamics are really shifting, with increasing control being shifted from the retailers and brands to the consumer.

What this has led to is brands needing to be far more differentiated. Meanwhile, the key metric for branding has changed – it is no longer primarily about brand awareness, it's about brand meaning. Consumers now want brands that they feel define them. Our business partner, LVMH, has a built a remarkable and global business leveraging this insight, among others.

We've also seen a huge shift in distribution, and I'm not just talking about e-commerce. Five or six years ago, few would have said the fastest growing element of the restaurant industry would be food delivered to your home – but today it's almost de rigueur for consumers to order online and pick up in store, or have food delivered. If restaurants can be disintermediated in this manner, you can only imagine how other categories will be impacted by consumers becoming increasingly time-stretched and convenience-orientated.

"There have never been as many opportunities for emerging brands to grow, and the corollary is that we've never seen as much of a threat to incumbents

Q How do you keep improving your value creation approach?

We have built our own algorithms to ensure that we build on past successes and, candidly, learn from our missteps. We also look at our own case studies and those of our peers – what has worked well and what hasn't, what were the underlying drivers, and what we can learn from those real-world cases.

We have also been honing our management assessment tools, so we can go through a detailed talent assessment for management teams. It goes well beyond referencing and gives us a sense of individual strengths and weaknesses, how each of the individuals fit into that team, and how they will work with us. This also enables us to identify opportunities for improvement much more quickly and to ensure that we have – where possible – the best team right out of the box.

We're also increasing our focus on ESG within our portfolio companies. The shift towards brand meaning goes hand-in-hand with consumers becoming more scrupulous about a wide range of ESG-related topics, so it's crucial that we know how our businesses and brands are doing in that regard and how they can improve.

Q Much has been written about the convergence of technology and the consumer. How are you thinking about that convergence in terms of where the future of value lies?

We have seen that consumer products integrated with technology are driving a larger portion of our sector's growth. Technology is impacting virtually every part of the consumer landscape today, whether it be how consumers research a product, how they select a product, or how they choose for it to be ordered or delivered.

We are working on new initiatives that are intended to leverage synergies between our knowledge and that of the VC and tech communities. We learned from our discussions with VCs and tech entrepreneurs that many consumer tech companies are led by engineers who have developed a brilliant product offering from a technology standpoint, but generally do not have the experience with various go-to-market strategies, branding, or marketing. And, in almost all cases, lack the ability to capitalise on the potential for global reach and expansion.

We see the opportunity to marry our consumer skills, experiences and global reach with their tech capabilities and understanding. These types of innovations will keep us at the cutting edge in terms of insights into the consumer tech landscape, with benefits across all our fund investment strategies. ■

FUNDRAISERS

Kirk Syme, 36 | Principal | Brooklands Capital Strategies | Syme "speaks the language of a deal", is what one of his supporters says – high praise indeed. A principal with Brooklands Capital Strategies, which is known for raising capital for opportunities outside the typical fund structure, Syme has successfully executed several innovative mandates involving operating companies, permanent capital vehicles and deal-by-deal investments across a variety of sectors. Among the attributes praised by his contemporaries are his in-depth understanding of individual investment opportunities as opposed to the bigger picture, more distribution-focused perspective of many placement agents. "He's demonstrated a unique ability to build on strong relationships, sequence properly, give thoughtful advice, and execute flawlessly along the way," one market participant tells us.

Marc Lutgen, 38 | Managing Director | MVision | Lutgen has been described as a "truly international fundraising and investor relations professional", having worked across the placement agent's London, Hong Kong and now New York offices. Over his time at the firm, Lutgen has helped raise around $40 billion for brand-name private equity funds, including Nordic Capital IX, Capvis Equity Partners V and Waterland Private Equity Fund VII, as well as funds for Landmark Partners, Gilde and FFL Capita Partners, among others. He is held in especially high regard by new teams for the thorough, patient guidance he offers on attracting their first new capital. According to one supporter, his impressive language skills have allowed him to develop deep knowledge of the Asian, US and European investor landscape and helped open new opportunities for MVision in new sectors and geographies.

Sabrina Malpas, 32 | Principal | Rede Partners | Malpas is a rising star within Rede's Advisory team. Malpas, who joined in 2014 and was promoted to principal in 2018, has taken the reins on some of Rede's most eye-catching successes to date. These include PAI Partners VII, which closed on €5 billion in March 2018 after less than three months of active marketing; Hg Capital 8, which gathered £2.5 billion ($3.1 billion; €2.7 billion) in 2017 after just five months of fundraising; and the €1 billion Apax France IX in 2017. Praised for her "calm demeanour, strategic vision, keen sense of intuition and ability to make tactical adjustments", Malpas is also responsible for the professional development and training of Rede's junior deal team professionals.

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Johanna Barr, 40 | Managing Director and Global Co-Head of Limited Partner Services | Advent International | Barr co-heads Advent's Limited Partner Services Group focused on fundraising and investor relations activities in Europe, the Middle East and Asia. Barr, who joined the firm in 2007 and was promoted to managing director in 2014, co-leads a global team of nine. She has played an integral role in capital raising efforts for the firm's Global Private Equity fund series. Since she joined the firm, Advent has successfully closed three GPE funds, most recently GPE VIII in 2016 ($13 billion amassed in six months), and GPE VII in 2012 (€8 billion, then the largest buyout fund since the financial crisis).

FUNDRAISERS

Eleanor Mountain, 36 | Partner and Head of Investor Relations | CBPE Capital | Mountain has been with UK mid-market firm CBPE Capital for six years and was promoted to partner last year. She is characterised by her peers as a "formidable force in the fundraising world" who has "transformed the investor relations activity of CBPE since she joined in 2013". Mountain presided over the highly successful fundraise for the firm's ninth flagship fund, which closed on its £459 million ($594 million; €530 million) hard-cap in August 2016. Prior to CBPE, she was with Adams Street Partners and Horsley Bridge Partners. Mountain also chairs the mentoring initiative for Level 20, an organisation which aims to increase the participation of women in private equity in Europe.

FUNDRAISERS

Alex Rayden, 35 | Managing Director | Evercore | One of *PEI*'s Rainmaker 50, our list of the best fundraisers in private equity, Rayden's professionalism, knowledge and winning personality have seen him chart again. On global capital raisings across buyout, infrastructure, private debt and real assets, the Evercore managing director has demonstrated in-depth knowledge of his clients' investment needs and a keen eye for detail, and is a great listener as well as a talker. He has also been praised for his project management skills and efficient use of time – an underrated quality, according to one institutional investor. Rayden is a member of the board at software company Selligent and the author of 2007 tome *The People's City: A History of the Influence and Contribution of Mass Real Estate Syndication in the Development of New York City*. Well-rounded, indeed.

Elizabeth Di Cioccio, 35 | Partner and Head of International Distribution | Mercury Capital Advisors | Di Cioccio is characterised as a fundraiser of the highest calibre by her peers. Her most valuable trait: building deep relationships across countries and cultures. Di Cioccio does this from Mercury Capital's Dubai office, covering a broad territory of investors from the Middle East to Scandinavia, to Australia and Central Asia. She is known for raising capital across a broad spectrum of GPs including mid-stage VC firm DAG Ventures, China-focused Trustbridge Partners, mid-market buyout firm Nautic Partners, as well as in real estate and special sits firms. Di Cioccio's expertise is on emerging and specialised GPs, understanding that they represent "the future of our constantly evolving industry", says one industry source.

FUNDRAISERS

Alice Langley, 39 | Partner | IK Investment Partners | Langley joined IK in 2005 as an investor relations associate and worked her way up to the role of partner in January 2019. She has played an instrumental role in the nearly €5 billion of capital raised for the firm's flagship funds from 2007 to 2016. Her "impressive interpersonal skills and acute technical understanding of the market" have led existing LPs to back IK's newer offerings – its debut small-cap fund which gathered €277 million in 2016 and a sophomore fund, which closed on its €550 million hard-cap in 2018. Langley manages a team of five people and has helped expand IK's footprint among North American and Asian LPs, alongside existing relationships with HarbourVest Partners, Pantheon and New York State Teachers' Retirement System.

Constantinos Economou, 39 | Senior Vice-President – Business Development | Capital Dynamics | Economou joined the London office of Capital Dynamics in 2013 charged with growing the firm's UK investor base. In no time at all, the senior vice-president for business development had secured commitments from 50 investors across the UK and Europe, a majority of which were new to the firm, across its secondaries, private equity and clean energy funds. A popular face on the conference scene, he's known for his series of private roundtables, where investors can confidentially debate hot-button topics. He has also played a role in Capital Dynamics' ESG offering, leading fundraising efforts for its annual triathlon event. Outside of work, Economou is a member of the development committee for ThinkForward, a charity helping young people make the transition to work.

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Chloé Lavedrine, 39 | Managing Director – Investor Relations, Europe | Centerbridge Partners | Lavedrine joined New York-headquartered Centerbridge Partners in 2014 after almost a decade of experience at KKR, GIC Real Estate and Goldman Sachs. We've heard her success is because of the humility with which she approaches each situation and the respect with which she treats each counterparty. Lavedrine also has a reputation for responsiveness, thoroughness and thoughtfulness that marks her out as a trusted and well-liked investor relations professional.

ALTERNATIVES

Making alternatives less alternative

Today's tech revolution will reshape private equity in major ways, leading to greater specialisation, transparency and rigour, according to eFront's Thibaut de Laval. That will make it easier than ever to discern the best from the rest and will open up alternative investing

***De Laval**: private equity will grow more innovative*

Technology has been a revolutionary force in many industries including finance. Technology has disrupted the payment industry, stock trading and retail banking to name just a few. While technological innovations may seem like a threat to existing established industry players when they initially occur, over the long run they almost systematically clearly and largely benefit those industries and contribute to their growth and prosperity, says Thibaut de Laval, chief strategy and marketing officer at eFront, although it is early adopters who tend to reap the largest benefits.

The same may well be about to happen to the private equity sector, which shows all the signs that disruptions are underway. De Laval tells us how technology will transform private equity going forward.

Q Broadly speaking, what will the private equity ecosystem look like 10-15 years from now?

It will be less and less 'alternative', in any sense of that word, and be far more mainstream as an asset class. There will be more fund managers and investors with even more capital flooding into a crowded space. There will be a blurring of the line between GP and LP, as they develop direct investment capabilities. There will be more specialisation between direct and indirect investors instead. Retail investors will likely play a greater role as well.

Q With the arrival of retail investors, will that mean an even stricter regulatory regime?

It is almost certain there will be more regulations no matter what role retail investors play. Regulators will be devoting more time and resources to alternatives, but standards will also be more codified, as ILPA, or some other industry body, will eventually force an alignment and levelling-up of industry practices. Capability certifications like CAIA will also bring in more structure and rigour in alternative investment and portfolio management practices.

Q A crowded playing field, more regulation and stricter standards don't make for a rosy view of the future. Is that all GPs have to look forward to?

Without question, we expect the industry will only grow more innovative and sophisticated in response. Managers are going to devise new sourcing and value creation strategies to make use of all that dry powder. And they will do that by becoming more specialised in the pursuit of deep expertise, either in very specific geographies or industry sectors or asset classes, to maintain superior returns and premium fees. Data analytics will play a huge role in developing those more specialised strategies.

There will be greater liquidity as well. Data will become more commoditised and we can expect the emergence of secondaries trading platforms. Data analytics will play a huge role in developing those more specialised strategies as well.

Q If technology is enabling these changes in the future, how should managers be looking at software and systems today?

We see private market technologies mirroring the kind of technology landscape currently in use on the public market side. However, there is an opportunity to learn from what has been developed over the last 30 years on the public market side, to leapfrog some of steps of that evolution to catch up quickly, and even go beyond that.

For example, the availability of granular, timely and digitised investment data is a critical catalyst to the maturation of the private equity industry. As happened for public markets, data will become a commodity.

The development of much more sophisticated analytics to manage not only performance, but also risk and liquidity, on the back of more data availability, will only be an extension of public market practices into private markets. Even more directly, secondary trading platforms will offer a new level of liquidity, not on par with public markets of course, but it will go a long way to removing the illiquidity that kept some investors out of the market.

Advances in artificial intelligence will only speed these trends, by helping the sector gain scale and by creating leverage for currently stretched resources in critical activities like data collection, target screening, due diligence and manager selection. AI-powered solutions will not replace the talent of analysts and managers, but it will help them achieve more by scaling up their skills.

Q So, what will the landscape of private equity technology look like in the future? Are controllers still going to be wrestling with Excel spreadsheets?

Right now, we see an increasing specialisation happening in our industry. Portfolio and operations management systems are getting progressively more sophisticated at what they do. At the same time, front office information exchange and analytics platforms are getting better at their mandates, delivering more sophisticated, insightful analysis out-of-the-box. While the two solution sets operate alongside one another, the data feed is the connecting link between them.

Portfolio and operations management systems need to manage an increasingly growing complexity and therefore will need to offer extremely rich and robust features, while staying agile to adapt to evolving practices and norms. Their value will be in their reliability, in the level of automation and productivity gains they enable, and the compliance they will secure.

Meanwhile, the availability of private market data services will enable even better front-office platforms to emerge. Those platforms will be essential for all private equity investors, whether they are direct or indirect investors, to make investment and portfolio management decisions, to the point that they will become true information hubs.

These hubs will enable the controlled exchange of information between players and integrate advanced analytical capabilities, consolidating a number of tasks that are currently at best delivered through separate, poorly integrated solutions, if not managed manually or not at all: investor reporting, data and information exchange, portfolio management, pipeline management, investment decision-making, performance and risk measurement, liquidity management, benchmarking, advanced portfolio analytics and, ultimately, secondaries trading.

Meanwhile, investors will also be looking at developing an end-to-end 'whole portfolio' view, as alternatives will keep accounting for a larger share of their portfolio, well into the double digits. LPs will seek to integrate their private market technologies with the solutions they use to manage their liquid assets. In that respect, private market technologies will be much more tightly integrated with their public market counterparts than they are today. BlackRock's move to integrate its industry-leading Aladdin solution with eFront is a good illustration of that trend.

"The availability of granular, timely and digitised investment data is a critical catalyst to the maturation of the private equity industry

Q What is likely to impact the pace of this change?

The availability of high-quality, granular and timely data is the single biggest bottleneck. Firms still lag in the digitisation of their records and performance information, but we are seeing this change. There is a greater willingness in private markets to share and exchange data, partly due to LP demands. Soon, the level of data that big funds-of-funds enjoy, that stretches across multiple funds, and all the way down to their underlying assets, will become the rule rather than the exception.

And that means GPs will be able to deploy that data for better deal selection, and LPs can use it for better manager selection. There will be more granular benchmarks among deals, and among managers, better identifying strengths and weaknesses. This could mean a vastly upgraded decision-making process, for both managers and investors, and an overall more effective industry.

This will in turn attract larger volumes of capital and create a virtuous circle. We actually see these technology evolutions as the trigger for alternative assets to definitely break through and become mainstream – a vision that will benefit all alternative investment professionals. ■

TECHNOLOGY

How technology could shape the future of fundraising

Online fundraising platforms could become more common over the next decade, but obstacles to their growth remain, writes Alex Lynn

Twenty years ago, a data room was sometimes exactly that: a place in which reams of critical fund information were stored. Investors wanting to perform due diligence on a manager might have spent hours poring over files in order to find the information they sought.

Today, data rooms are online repositories, revolutionising the way in which limited partners decide fund investments and streamlining the entire fundraising process. The rampant growth of new technologies could mean fundraising undergoes an equally significant change over the next decade.

ACCESS

Some managers see retail investors as the holy grail of fundraising. The relatively untapped market can be lucrative for those with the resources to do so; Blackstone's private wealth unit had more than $60 billion of assets under management as of November and typically contributes 15 percent of each flagship vehicle raised.

Retail investors are a difficult nut to crack. Doing so is time- and resource-intensive as retail advisors are not always familiar with the intricacies of private markets, meaning Blackstone needs to spend time on the road educating the intermediary on the fundamentals of alternative assets and the various liquidity options available before meeting with its clients.

Some believe technology will be key to unlocking this pool of capital on a grand scale. Hong Kong-based Privatemarket Technologies, for instance, is a distribution platform for alternative investment funds that collects and commits capital from family offices and accredited investors that cannot reach a fund's minimum ticket size. It has invested $100 million across seven funds since 2016 and its clients have around $2.3 billion to invest in private equity.

"Fintech could help managers tap the growing retail market," Niklas Amundsson, managing director at placement agent Monument Group, says. "A handful of players already offer private equity to retail investors, but technology could make it more widely available. Private banks may launch asset management apps that would let you access the asset class on your mobile phone."

PLATFORMS

Online platforms could take different forms. "It could be nothing more than a platform where investors are made aware of who's fundraising, or it could evolve into a platform that pools capital to commit to a fund," notes Darren Bowdern, head of financial services – tax at KPMG China, who assists clients on establishing direct investment, private equity and other investment funds in Hong Kong.

Such tools would carry a number of benefits for private equity. "Online platforms will certainly lower the cost of fundraising, for example by minimising the number of international investor roadshows," says James Donnan, managing director at fund administration business Intertrust.

"Online fundraising platforms will also enable better access to information and drive greater transparency on aspects like investment strategy, project information and past performance."

HURDLES

Integrating technology into the fundraising process is not without its challenges. One issue is regulation: those looking to raise capital online would need regulatory approval in each market they operate in – a mammoth task for those wanting to raise at scale from a global customer base.

The rules for fundraising differ by geography. The US – while also the largest – is the easiest for private equity managers to access; anyone with at least $5 million in

STAYING IN TOUCH

The way we communicate has evolved dramatically over the past 10 years. Although mobile phones were once limited to calls and texts, private equity professionals now have any number of ways to converse at the push of a button, be it instant messaging, video calls or email.

"Everything that wasn't done in person was [once] done over the phone; now it's common practice to use video conferencing," Monument Group's Niklas Amundsson recalls. "Whatever the next evolution of video conferencing is – even if it's a hologram – will improve the communication side of fundraising."

> ***A handful of players already offer private equity to retail investors but technology could make it more widely available***
>
> **Niklas Amundsson**

assets including their main residence is considered a professional qualified purchaser.

Although Asia has a similar qualified purchaser rule to the US, the EU has various protections in place, such as requiring those who want professional investor status from their bank to complete 50 securities trades each year.

There are also more granular challenges, like who is using the platform and where their capital is coming from. Know-your-customer might be difficult for asset managers raising capital via the likes of a mobile-app, Amundsson notes.

There are work-arounds; Privatemarkets, for example, uses an external partner to assist with KYC processes. Internal solutions are being developed elsewhere. "KYC issues could be addressed because over the past 18 months in the broader financial services space we've seen some of these processes beginning to be automated," Bowdern says.

But some limitations could disadvantage the end user, rather than the asset manager. Online platforms showing fund profiles or due diligence reports may help LPs with sourcing, but takes away the crucial ability for investors to negotiation terms, Mei-ni Yang, principal at LP advisory Mercer, notes.

PERCEPTION

Uptake of fundraising platforms could be slow for reasons beyond just the technical difficulty. Private equity is subject to strict marketing regulations – particularly in the US – meaning GPs are often tight-lipped about fundraising plans – something at odds with plastering the vehicle on an online fundraising platform.

"GPs are very coy about disseminating information about themselves," Eric Marchand, private equity principal at Swiss asset manager Unigestion, says. "They would tend to favour the more natural feeling of control via providing access to data rooms and depending on placement agents [or] IR departments."

Platforms also suffer from something of an image problem. "A GP may not want to be on an online platform for fear of being seen as struggling to raise funds," Marchand adds. "If you look at the existing platforms, more often than not the population of funds on these platforms are not blue-chip GPs. More established players may not want to be associated with the platform." ■

ESG

How data became an ESG issue

Validated data and reporting excellence are the future of corporate responsibility, says Anthony DeCandido, RSM partner and financial services senior analyst

DeCandido: data drives ESG demands

In Europe, the ability of a private equity firm to demonstrate its commitment to environmental, social and governance issues has evolved from a nice-to-have into a necessity. LPs have demanded reporting keep pace. The same level of attention paid to ESG matters historically had not been as common among the swathe of mid-market managers that comprise the bulk of the US industry. But things are changing. Anthony DeCandido, RSM financial services senior analyst and audit partner, outlines where this segment of the market is headed with its approach to ESG concerns.

Q When you talk to your private equity clients about ESG, what is the one key emerging theme?

In a word, data. There is a growing interest in the market in data and where it comes from. That was not the case five or 10 years ago. If a GP or an LP is uncertain about a data point, they want it to be validated. Today, data is obtained by surveys and self-reporting, which is one of the biggest issues with ESG.

In the case of a publicly listed company, there are filings to sift through and numbers to measure. Private businesses are under no similar obligation. The marketplace, including investors, recognises this, as well as that managers may have an interest in presenting particular data – whether they are fundraising or looking for exposure.

Validation of those numbers is going to be more important than a GP simply saying: "Here is our ESG strategy and this is how we drive it." There is a concern that the numbers could be skewed, making the whole exercise pointless. In general, asset managers and investors are looking for a higher standard of reporting and that is driving developments in ESG.

The state of play in the private equity industry today feels like the early 2000s, when there was a lot of attention given to public businesses and new requirements for internal controls, governance and reporting. The industry knows that it needs to organise in a more productive and suitable way, and yet there is not an ESG reporting requirement.

A whole new market could be uncovered if a regulator with enough credibility emerges and says this is no longer just a nice-to-have, but it is a requirement to report on your ESG strategy and impact. The whole landscape will change when that happens.

Q What does best practice reporting look like?

The GP holds the answer to that. It depends on their goals, objectives and stakeholders. It depends on where the firm is in their lifecycle. An early-stage fund is looking to attract assets and build reputation, so their focus may fall on marketing. A later-stage fund with a track record may be looking more at its legacy and where they are going to be five or 10 years from now. They may be looking to showcase their sustainability effort at a broad level. This could be in a 12-page report that highlights their success stories.

Q Is getting the data difficult?

Asset managers have so much good data in plain sight but the struggle is to accumulate it in a useful way. Sometimes we need to bring to their attention what they have as well as what they are missing. Sometimes it is eye-opening for managers to realise that so much of what they have already been doing can be incorporated into an ESG strategy. It is not all brand new. What is new is the increased interest in

ESG issues, such as workplace safety, emissions control and hazardous waste.

Q How do you get over the issue of managers picking and choosing metrics?

Performance assessments are one solution. We can help companies benchmark one type of investment strategy against another and measure across their suite of investments. If you are a private equity firm with a sector strategy – for instance, in healthcare, tech or industrial products – there will be a common thread whereby we can produce comparable measurements. It's vitally important that the manager understands where they rank amongst their peers.

A manager may also be interested in measuring a managed portfolio in one industry against a separate position investment in another industry. Positive results can be showcased and marketed. Where results are less than ideal, it is a good sign when a GP is sufficiently self-aware to admit they failed.

Q There are ESG reporting templates out there from the Institutional Limited Partners Association, the Principles for Responsible Investment, Invest Europe and the Sustainability Accounting Standards Board. What impact are they having on standardisation or validating measurements?

The two that are having the greatest impact on our client base are SASB and PRI. PRI puts out sustainable development goals, which encompass some key measurement targets, such as diversity, food and hunger, workplace safety, energy emissions – some of the core tenets that are consistent across a lot of different businesses.

That is an easy framework to follow. You can advise using the 17 sustainable development goals in a way that is comparable to a heat map. Not every company is going to show brightest on every one of those initiatives, but they are most likely to have coverage on some of them and you can showcase the progress of one versus another.

Q There seems to be a conflict between generating some useful reporting metrics that are specific to a firm or fund that convey the impact of their ESG initiatives and generating something that you can benchmark against other GPs.

Absolutely. That is where the rubber hits the road. GPs have been focused on driving returns; now they have to drive returns as well as showcase an ESG strategy. Managers need to be sufficiently comfortable in their own skin to acknowledge where they are today regarding their ESG approach and to show their stakeholders where they want to go.

Some GPs work with their investor base to understand what their goals are and how they can help drive that strategy. For our clients in the middle market, the investor base runs the gamut from the largest institutional investors down to local high-net-worth individuals. Their priorities are very different. A high net worth individual may not care so much about a firm's ESG approach.

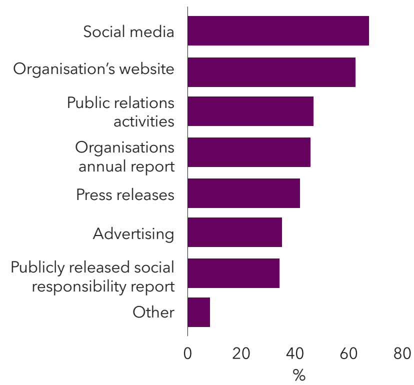
Q Demonstrating a tangible link between ESG and value creation is a persistent challenge for all GPs. Why is this difficult?

A lot of our clients struggle with measuring ESG impact in a way that is useful to their business and stakeholders. As I mentioned, there is a lack of reliable ESG performance data today. In response, many consulting firms are developing their own measurement systems. Our approach is to work »

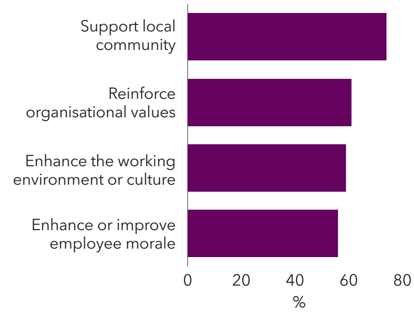
ESG ENGAGEMENT

Vehicles leveraged to communicate achievements or progress on social responsibility efforts

(BASE = respondents who said organisation has formal social responsibility) n=155

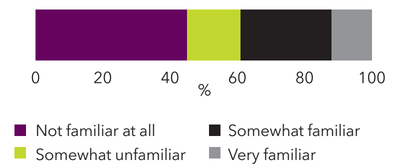


Reasons for engaging in social responsibility planning



Familiarity with using ESG criteria to evaluate performance of organisations, businesses or investments

(BASE = total sample) n=400



Source: RSM US Middle Market Business Index Q4 2018

MID-MARKET IMPLEMENTATION OF ESG

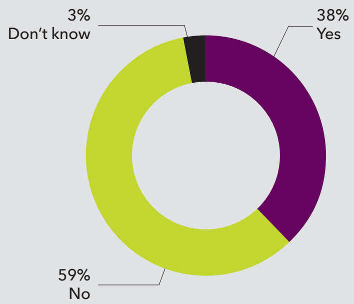
As part of the RSM US Middle Market Business Index – a survey of approximately 700 business leaders – we compiled a fourth-quarter 2018 report on corporate social responsibility, diversity and inclusion. The results showed that nine out of 10 executive leaders believe that CSR is a critical strategic imperative. But only 38 percent of them have organised a CSR strategy.

In private equity, middle market firms are generally first to follow. They are watching the KKRs and the Blackstones to understand what these groups are doing and what is best in class. These are large firms and their activities are scalable. However, for middle market firms to implement a productive ESG programme, they might have to devote half the time of one full-time person in a team of just 10-15 people. There is just not enough scale. Employing external advisors is the way they get over that lack of resource.

Good firms have been interested in ESG for a long time, but in the past their investor base was not as concerned about it as they are today. Now there is equal emphasis on both risk management and value creation, and a growing interest in demonstrating not just what they are doing, but why they are doing it. Businesses in general are more interested in promoting their values and this is key to attracting talent among millennials who want to understand the mission of the company where they work.

Organisation has a formal social responsibility plan

(BASE = total sample) n=402



Source: RSM US Middle Market Business Index Q4 2018

> **GPs have been focused on driving returns; now they have to drive returns as well as showcase an ESG strategy**

alongside the management team to develop measurement tools in a way that is no different from the assurance services we provide when clients ask us to help them with their valuation marks.

Q What is more important to US mid-market managers, the E, S or G?

In the US, there have been quite a few high-profile social movements, such as #MeToo, as well as increased sensitivity to the role of women in the workplace and diversity. So, if a company fails on a social issue it is more likely to lose points than with an environmental one. Right now, making a mistake of the 'E' is more forgivable than on the 'S' and this is why the 'S' gets more attention.

Q Looking forward, do you see the scope of ESG-related topics expanding?

In the US middle market space, not yet, but only because there is such confusion today regarding where to start. A lot of our asset management clients have financial backgrounds and are comfortable with technical frameworks like Generally Accepted Accounting Principles. There isn't a similar framework that is universally accepted as GAAP is on the financial end. I do think that the middle market is looking for a single framework that presents a system, method, and set of objectives and measurements that managers can follow. ■

AUTOMATION

Faster, smarter and still very human

AI and other automation technologies will offer plenty to the operational side of private equity firms, but these cutting-edge solutions will still need in-house expertise to live up to their potential, writes Rob Kotecki

These days, most predictions about technology's impact on working life boil down to two certainties: greater efficiencies and fewer jobs. Some tech gurus caution that half of the world's jobs will vanish due to AI in the coming decades, and that entire industries will shrug off all but a handful of human employees.

In the near term, the operational staff at private funds can breathe easy. Digitisation and automation technologies are busy taking the most tedious tasks off their desk, and in the next five years, AI will only allow their work to be done more efficiently and accurately. Over the next few years, CFOs may actually need to add staff to cope with major IT projects. The next wave of the tech revolution will require experts that can translate the cutting-edge solutions into systems that improve the firm's investment business.

And rest assured, that next wave is coming. "The disruption on the finance function is inevitable," says Jason Bingham, the managing director of product development for the fund administrator Sanne. "GPs and LPs have an incredible appetite for data, and the faster and the more accurate finance teams can deliver that, the better."

That wave may already have begun to hit the industry. "Advances in technology mean that there are software solutions today that allow us to automate the more mundane and routine processes, create efficiencies as well as make significant improvements in more value-add items such as budgeting, forecasting and data analytics," says Lance Taylor, the CFO of HGGC.

For the last three years, Harbourvest's CFO Karin Lagerlund has been working on upgrading her team's processes. "We looked at where we had cumbersome manual processes, or a lot of Excel spreadsheets, and began prioritising how to digitise and use technology to streamline those activities."

DIGITISE, DIGITISE, DIGITISE

Bingham says that digitisation is now as much a necessity for the industry as a choice, with early adopters driving the innovation of their technology platforms. "We digitised our journal entries and created a system that pulls the back-up data automatically and stores it for us in a cloud solution," says Lagerlund.

That sounds wonderful, but digitisation can be labour intensive, as some service providers note that the initial cost in time and resources can make the legacy processes seem more cost-effective and simply easier than the upgrade.

It helps that new tools, such as optical character recognition technologies, allow firms to scan and populate data easily, instead of relying on manual inputs which not only take time, but are susceptible to human error. For obvious reasons, OCRs are a priority to CFOs with a backlog of legacy data. But they remain a relatively young technology.

Even without OCRs, the time it takes to digitise data and adopt new platforms can pay off in the long run. "The ability to turn this data into usable information and the speed in which you can do that is transformational," says Richard Butler, the COO of ESO Capital.

"We've recently implemented a powerful platform called Ipreo, enabling us to better compare our portfolio company KPIs, even for businesses across different industries." Butler explains that just three years ago, he'd need a team of people to manage this information, and now he can do so at the touch of a button.

Automation will pay a huge part in the next generation of improvements. EisnerAmper's Jay Weinstein, managing partner of markets and industries, explains how his firm is investing the time and allocating capital into producing 'bots' that are capable of automating major processes on the operational side of private equity firms.

As an example, a fund may have month-end reporting for thousands of investors that they are currently recording on Excel spreadsheets. These spreadsheets include numerous calculations, which they spend hours producing, whereas a bot can automate the spreadsheet, and eliminate the manual inputs and reconciliations to validate those investor calculations.

"Those tedious reconciliations can take two or three days to complete," says Weinstein. "And with the bot, the staff is freed up to handle more interesting and productive work, while also enhancing accuracy by limiting input errors." These bots can be implemented quickly, providing an immediate benefit to the client. Weinstein says EisnerAmper has a dedicated bot lab, devoted to building bots to automate these kinds of manual processes.

These technologies allow firms to migrate to an exception-based review and reporting process, so that staff are not looking at every number or calculation, only those that represent aberrations, say when a data point communicates a loss, when the market for a particular portfolio company is booming.

Automation may be a priority now, but it's been part of the industry's tech strategy for some time. "We're starting to see more of a shift of focus from automating routine processes towards technology that creates operational leverage to produce big information advantages from machine learning," says Bingham.

THE LIMITS OF AI'S IQ

Of course, given the manual process of LP communications, AI could play a role there, but that might not be a question of technology. "Unless the industry progresses to a set of agreed-upon standard reporting templates at a much faster pace than today, there's only so much we can automate in reporting," says Taylor.

And the trick about machine learning is that someone needs to take the time to teach that system. "Watson works by being taught your unique experiences and preferences," says Weinstein. "And if you teach Watson incorrectly, it will continue to learn incorrectly, so you need to keep a tight rein on who's educating the machine."

AI also requires an enormous amount of data to learn. "To be effective, machine learning needs millions, if not billions, of data points," says Bingham. "And many firms are still in the process of structuring all

their data into a 'single source of truth'. Much of the 'big data' captured in the past five years does not as yet have a long enough time series to be properly validated and may be more commonly used by firms five years from now."

That means that CFOs may not have the luxury of relying on legacy practices for much longer. And that may require adding more expertise, instead of cutting any existing staff. "If anything, the pressure is on expanding my team to adequately utilise the sophisticated tools we now have," says Butler.

A NEW BREED OF IT MANAGER

In response, some firms are bringing aboard a special class of IT project manager to make the most of today's solutions. These staffers have skills in both IT and project management, and will lead a given initiative. They collaborate with business users and the IT team to decide if a project could be handled by a consultant or in-house, and whether a solution is available off the shelf or would need to be built from scratch. And then they see the project through to completion.

For firms with less tech in their DNA, the revolution may lead to their first CTO, or a different expert altogether. "Data management is only going get more critical and complex," says Taylor. "So, there may be the need for a kind of data scientist, or data expert, who can think about how best to organise and manipulate data for value."

A recurring theme among CFOs and service providers is that this next wave of technology is about maximising what current staff can do. The asset class tends to staff leanly as a rule and every firm aims to do more with less.

"We are looking for how many hours automation can save, not just now but during future growth as well," says Lagerlund. "So, we fully expect to be able to increase efficiency, without necessarily increasing our accounting staff."

And firms don't just want to improve efficiency. "We can do more, and have to do more, with the team we have – it's not about cutting headcount," says Butler. "The biggest weapon in my armoury is information. The more information I have and the sooner I have it, the sooner I can get it in a usable format to act upon it. Better understanding the numbers means we can better influence the investment decision-making process and improve returns." ■

NOT QUITE HAL 9000 (YET)

Today's AI developments are easily misunderstood, often conflated with science fiction terrors. The reality is, machine learning at the moment is a lot like digitisation a few years ago. It will take an enormous amount of time and expertise today to get the most out its capabilities.

But the initial investment today might prove worth it. For one, AI's ability to read, translate and determine sentiment from documents or human speech, can revolutionise contract analysis. EisnerAmper uses IBM's Watson for its AI solutions: a contract which could take a human staffer two to three hours to review may only take Watson a few seconds.

"It can ingest the contract and then produce a summary of important issues, such as revenue recognition trigger points, along with any other issues that auditors and internal accountants identify," says EisnerAmper's Jay Weinstein. He also suggests that this type of contract analysis could work wonders with company pension plan documentation; those 400-page doorstops. AI can now be trained to look for key matters in those documents.

Bingham notes that the application of machine learning data analytics and its predictive capabilities will play a substantial role in other areas including valuation techniques, fraud detection and identifying suspicious activity across bank accounts or any series of data.

"For the finance function specifically, machine learning through software functionality will automate bookkeeping transactions as they happen across bank accounts," says Bingham. This means recognising transactions, even new transactions, posting them, and with machine learning, classifying that data and pulling it through to general ledgers.

GP STRATEGIES

Crystallising returns

With high prices and fierce competition for assets, PwC Germany partner Dr Oliver Schulte Ladbeck, head of business development for PwC Europe Deals, considers whether GPs can sustain the current level of returns

Schulte Ladbeck: GPs are investing more time and money

Uncertainty is now the new normal globally. In Europe, two of the largest and most mature private equity markets are currently bedevilled by it. Almost three years of talks have done little to clarify the UK's route to leaving the European Union, and in France, the Yellow Vest movement is creating turmoil and shows no sign of resting.

This current turbulence combined with tight competition for assets and rising asset prices begs the question: can the current levels of historically high returns last? We asked PwC Germany partner Dr Oliver Schulte Ladbeck to polish his crystal ball and tell us what the future looks like.

Q Looking forward, will we continue to see the same level of high returns?

As an asset class in general, irrespective of the time period, private equity yields higher returns than any other. In the low interest environment, the success of private equity has attracted even more capital. We've seen massive fundraising over the past years. In 2018 there was north of $700 billion of new funds raised ranging from pure play LBO vehicles to adjacent funds – mid-market, longer term and debt vehicles.

Fund managers have always seen volatility and market uncertainty as a chance and opportunity. Currently, every GP will say they need to focus on discipline but none of them are telling investors to expect lower returns. For core funds, GPs are holding on to the 20-25 percent IRR, or a 2x money multiple. There's a very positive outlook for returns, irrespective of the possibility of a softening in 2020 that people within the deal community are talking about. There is abundant dealflow in Europe, with a stable middle market and record levels of large-cap opportunities, good deals and good returns, which is creating a virtuous circle of distributions and LP commitments that contribute to the overhang of dry powder.

Q And for new products?

In the past decade, the private equity industry has recognised the need for diversification in order to be able to put all that capital to work. For adjacent funds, the jury is out on whether returns are sustainable. We will see a bifurcation in the market. There will be some firms that have a "right to win" because their adjacent strategies are closer to their core capabilities, industry or sector focus. And some will fail to live up to their promise.

Q What about LP return expectations: are they rising?

Most of our recent discussions we have with LPs are not about higher return expectations – and what would justify these anyhow? – but about co-investing. The interest and appetite in that field has risen significantly. They are trying to get educated on individual assets and understand the value proposition and work out which GPs in their network they should reach out to. They still trust their GPs to generate promised returns, but co-investing is a function of making sure more funds are being deployed at pace. A side effect, of course, is not having to pay the management fee and avoiding that leakage is clearly a benefit as well.

GPs are willing partners for such co-investing. With dry powder somewhere between $1 trillion and $2 trillion, there is increased competition for a finite number of opportunities. Therefore, GPs are hunting for larger transactions. There are obviously other things they need to provide in order to be successful in a multi-billion dollar process, but getting additional firepower and the right partner is clearly a benefit.

Q In such a hot market, what else do managers need to win the deal?

Today, GPs must spend much more time on generating dealflow. The industry is undergoing a huge professionalisation in terms of deal sourcing and GPs are investing more time and money into building networks and seeking interaction with potential sellers way ahead of a process and often preempting before assets have come to the market. In addition, most GPs are looking at a larger number of information memoranda to spot those businesses where they can make a difference – on the basis of industry focus and experience for example.

In the past they probably had a six-month lead. Now it's probably closer to a year that they will spend building a relationship with a potential seller and examining ways to crystallise deals without going through broad auctions. We see sell-side auction processes where GPs have to qualify before being invited in. Increasingly, GPs need to demonstrate industry expertise and differentiate themselves.

Another phenomenon we are seeing is larger PE funds teaming up with strategic partners to be able to pay a premium for the synergies identified. In that context you need to have developed trust built on industry specialisation. One of the decisive factors is that a manager understands from the outset where the deal should be headed. In the past, making a company better was a game of chance. Now the GP has to really focus on operational improvements. Winning teams are better qualified and have broader value creation capabilities. Up-skilling is the core issue managers face today.

The whole GP world has become much more complex. They need a broader bench of operational experts – be that external service providers, internal industry experts or professional operational teams – that they can bring in earlier to handle a more complex due diligence process.

Before the 2008 crisis, most of the return was managed through leverage and banking on multiple expansion. That has changed dramatically. Now there is a very strong focus on the value creation potential of an asset and holistic, forward-looking business model evaluation encompassing cost saving, digitisation, the disruption risks and areas of expansion.

In the past, due diligence focused exclusively on historical numbers. A week after closing the operational due diligence team arrived. Now we see teams engaged way before the auction actually starts. Before the deal is signed, parties have invested a lot of time and money to prepare for day one of ownership with a full-blown business plan.

Q How has that impacted managers internally?

There are more origination-focused partners. Managers are introducing operational experts much earlier to the conversation. Today, I deal with three guys [from a GP] rather than one, which tells me the complexity is increasing.

Q What does this increased deployment of GP resources mean for future returns?

There are multiple effects. GPs are better prepared and have a much better view on how to unleash value from an investment. In any other environment this would push returns up. But with increased dry powder we also see increased multiples with an average around 11x EBITDA. GPs are having to pay away a little bit of that value creation potential and are holding the asset for longer. Buy and build is an obvious strategy that allows the GP to mitigate these historically high buy-in prices, reach synergies and create a business that's attractive to future strategic buyers. GPs are still hoping to hold onto the same 20-25 percent return.

> ***With dry powder somewhere between $1 trillion and $2 trillion, there is increased competition for a finite number of opportunities. Therefore, GPs are hunting for larger transactions***

Q Given where we are in the cycle, can the level of dry powder be sustained?

What's the alternative? LPs put money back into public equity markets? More LPs will seek to partner with GPs. Fund infill will remain high and GPs will need to find a way to invest that money. It's easy for GPs to raise money. Even funds with average historical performance have not had difficulty in raising new and larger funds. The level of competition for deals is going to remain high.

VALUATIONS ARE A BONUS FOR DISPOSALS, NOT A DRIVER

It is a sellers' market, but if a primary transaction originates from the sale of a family business, the dynamic is not triggered by high valuations. Price doesn't prompt the founder to sell, which is often a decade-long process related to family internal dynamics, and trust in the buyside. None of the corporate boards that we've dealt with have decided to dispose of a trading asset because of the pricing environment. That decision must be embedded into an equity story that the board has presented to its shareholders, is measured against and must honour.

Corporate boards don't focus too much on the timing of the valuation cycle. Large corporate mergers will not be held back by valuations. We see a number of carve-outs that are driven by an overarching corporate strategy and now they have the benefit of doing it in an environment of high valuations, but that's not the deciding factor.

GPs must spend much more time on generating dealflow. The industry is undergoing a huge professionalisation in terms of deal sourcing

Q Is it focused within particular sectors?

There are some industries where we have seen more activity than others. Traditionally, pharma has seen little private equity activity given the lack of debt financing for what has been considered as equity associated risk – ie, R&D. That has changed a bit. There's lots of activity in industrial products, lots in consumer but less focus on bricks and mortar retail, quite a bit in healthcare services by houses with specialised capabilities. With digitisation being a strong trend there's a huge focus on tech deals such as in the area of fintech and software companies, generating superior growth rates mainly by taking away market share from other industries. These are great targets for a buy and build strategy.

Q You mentioned industry concerns about a downturn. What would that mean for returns?

A growing number of market participants seem to believe that we will see a softening of the market in 2020. The general expectation in the industry is that it would be great for prices. In terms of debt financing, if that breaks away completely it will impact deal activity. Will that really be the case with interest rates where there are currently? Will there be a complete breakdown of the LBO market? Highly unlikely.

In any case, the asset class will be much better prepared than in 2008 thanks to the professionalisation of the industry, the focus on the value creation story, and the longer-term perspective. Due to increased scrutiny on the investment from the outset, portfolios are likely to be less harmed by a downturn. GPs may need to hold the asset longer but they are unlikely to fail on return targets if they extend the holding period by one, two or three years. With lower public valuations take private deals become more attractive again.

Q Do you see any hesitation among GPs concerned about buying high and being forced to sell at a lower valuation come any future downturn?

No. We've been told by investment committees that they are doing calculations that include multiple contraction scenarios. It's been factored into their models and investment decisions from the outset. Whether that leeway is big enough to capture what happens in the market is unknown. But there seems to be a relatively prudent approach in the industry.

Q Looking forward 10 years, what can we expect to see in terms of returns?

From a corporate finance theory point of view, technically, at some point in time you would expect there to be an equalisation of capabilities and a new normal for returns. Competition would drive the market to a place that's fair for the risk-return profile and achieving current returns over a long time period would not be sustainable.

However, there is a counter argument. Given past performance, I would expect the industry to find a way to stay ahead of the game and still deliver better returns than those offered by the stock market.

Over the past 30 years, as the corporate environment has changed, the private equity industry has evolved from an LBO model through to a multiple expansion paradigm and is now focused on value creation. Private equity has demonstrated tremendous stamina, creativity and an ability to adapt to market conditions, and it continues to attract a large portion of financial industry talent. ■

Ted Craig, 39 | Partner | Dentons | Industry expertise, pragmatism and perseverance – at least three characteristics market sources say London-based Craig's clients admire him for. It's no wonder it took all of 10 months for the secondaries and private funds-focused lawyer to be promoted to partner after joining MJ Hudson in 2013 following stints at SJ Berwin and having served as in-house counsel at investment firm Capital Dynamics. MJ Hudson has since embarked upon rapid expansion through office openings and acquisitions such as investment consultant Allenbridge and fund services provider Tower Gate Capital, culminating in Craig's promotion to managing partner at the end of last year. The legal gun now serves as a partner at Dentons where he advises on private fund formation, secondaries transactions and fund restructurings.

Christopher Sullivan, 35 | Partner | Clifford Chance | Sullivan, a Clifford Chance lifer, was promoted to partner in the private equity team in 2016 and has made his name on the back of deep, successful relationships with clients including Cinven, Blackstone and CVC. Focused on advising on big-ticket cross-border M&A deals for large buyout firms, his standout work includes advising Cinven on its €1.3 billion acquisition of clinical diagnostics firm Labco and then its €1.7 billion acquisition of Synlab, working for Blackstone on its deals for NEC Group and The Office Group, and acting for Elliot Advisors on its acquisitions of Waterstones and Foyles. An Oxford graduate who grew up in Manchester and has a particular expertise in management equity, Sullivan also acts for portfolio companies on bolt-ons and transformational M&A.

Alex Woodward, 39 | Partner | Linklaters | Heralded by peers for his role in revitalising Linklaters' private equity practice in recent years, Woodward – who has spent his entire career with the firm – is now co-head of its global financial sponsors group. Renowned for his prolific deal activity, Woodward counts The Carlyle Group, Hg, BC Partners and Oaktree among his list of sponsor clients and stands out for his work on large, cross-border M&A deals. Last year, he acted for Switzerland's Jacobs family on its $2.5 billion acquisition of private schools group Cognita from Bregal Investments and KKR, and advised Hg Saturn and a consortium on the £1.3 billion ($1.7 billion; €1.5 billion) buyout of IRIS Software Group. In what proved to be a particularly busy 2018, Woodward also acted for PSP Investments on its investment in the £2.2 billion Silver Lake-backed offer for Zoopla parent ZPG.

Louise Dumican, 37 | Managing Director | The Carlyle Group | New York-based Dumican relocated from London to the US last year and is now head of legal for investments across the Americas, advising across funds, sectors and geographies. Previously with Carlyle for eight years in London, Dumican began her career as an associate in the private equity M&A team at Clifford Chance and now works closely with deal teams, investment committees and management on deal-related legal issues and risk assessments. She has worked as deal counsel on transactions including the $3.2 billion acquisition of German speciality chemicals group Atotech from Total in 2016, and the $5 billion acquisition in December last year of StandardAero, a leading aircraft engine provider, from Veritas Capital.

LEGAL

John Rife, 35 | Partner | Debevoise & Plimpton | Rife was promoted to the partnership at Debevoise in 2018 and is a key member of the London investment management team, advising both sponsors and investors across a wide range of fund formation and ongoing operational matters. Described by one peer at an advisory firm as having "a real grasp for how to make the complex legal intricacies understandable and penetrable", Rife's practice covers a variety of geographies and asset classes, including buyouts, debt, secondaries, real estate, emerging markets, infrastructure, energy and funds of funds. A graduate of the University of Manchester who studied law at City University, London, Rife joined Debevoise as an associate in 2007 and now regularly advises on co-investments, carried interest, and end-of-life recapitalisations.

Camille Higonnet, 39 | Partner | Proskauer Rose | A partner in the Boston office of Proskauer where she is focused on structuring funds of all types, Higonnet has closed 15 funds in the past year alone, with a combined deal value of $5.1 billion, for clients including Adams Street Partners, Newbury Partners and Scale Venture Partners. Working across buyouts, venture capital, secondaries, funds of funds and natural resources funds, Higonnet spent two years in Proskauer's London office until 2014 and became a partner in 2017, a decade after joining the firm as an associate straight from George Washington University Law School in 2007. A key part of her practice is navigating GP-LP relationships, advising on trends in fundraising terms, fundraising strategy, and negotiation with investors.

THE FUTURE

Ted Cardos, 38 | Partner | Kirkland & Ellis | No other law firm is leading the charge in the growing secondaries market like Kirkland & Ellis. The firm advised on $31 billion of secondaries deals last year – accounting for more than 40 percent of the global market – thanks in large part to Cardos who leads its European team. His clients are some of the biggest names in the industry – think Abu Dhabi Investment Council, Deutsche Bank and Terra Firma Capital Partners. He became partner at just 36 and has set about building a team that boasts 15 lawyers in London alone who work on secondaries. From stapled offerings to fund restructurings, single-asset restructurings to GP-interest deals, Cardos has done it all. When the secondaries market looks back at its growth in 30 years' time, a large part of its development and expansion will have been due to Cardos's efforts.

DEALMAKING

The 'huge potential' of healthcare

Technological advances are creating opportunities in the medical sector for private equity firms prepared to embrace innovation, say Baker McKenzie partners David Allen and Jane Hobson

Investment in healthcare has moved up the agenda of many large buyout firms in recent years, with healthtech emerging as the latest new asset class for the industry. Here, David Allen and Jane Hobson, partners at the law firm Baker McKenzie in London, explain why healthcare transactions are gathering momentum.

Q Why are we seeing private equity investment in healthcare increasing? What is it that makes the sector so attractive to potential sponsors?

Jane Hobson: When we talk about healthcare, we are talking about a very far-reaching industry covering pharmaceuticals, medical devices and healthcare services. Historically, private equity firms have been quite risk-averse and were not interested in anything early-stage or in development, because they couldn't guarantee returns, and so the focus was very much on hard assets such as hospitals and care homes.

More recently, we have seen more interest in medical devices and medtech, with quite a lot of carve-outs and divestments starting about five years ago, when there were really just a few private equity firms in the mix. Now we are seeing a lot more funds getting into the space, with more interest in pharmaceuticals, therapeutics, oncology, diagnostic tools and other more innovative areas.

David Allen: A decade ago, private equity firms that invested in healthcare did so through generalist teams, but we are now seeing the bigger funds developing dedicated healthcare strategies and sometimes raising healthcare funds. Those teams can invest in a broad way across the sector and understand the interconnectedness of the industry. For example, by investing in a hospital you learn about the purchasing decisions a hospital makes. This then makes you better informed when investing in product suppliers to hospitals/clinics.

> ***"Healthtech presents an opportunity to combine the skills of the technology teams within PE firms with the skills of the healthcare teams***
>
> **David Allen**

Another reason that healthcare is so attractive is that these firms' investors are increasingly focused on the ESG impact of investment decisions. The societal impact of investing in healthcare can be compelling, where a portfolio company is demonstrably improving healthcare systems around the world or delivering better patient outcomes.

Q You describe healthtech and medtech as the latest new asset classes for private equity. Why?

JH: Healthtech includes preventative or analytic systems, like fitness trackers or diet planners, as opposed to medtech, which is more about the cure-based technologies used in hospitals. Private equity is getting increasingly interested in both, and everything in between, targeting the sophisticated medical devices and technologies becoming available to treat patients. This trend is particularly driven by a lot of the larger medical device companies spinning out whole non-core businesses that

Q What additional challenges do buyers face in relation to the increased regulation around healthcare transactions?

JH: In recent years, several merger control authorities, including Germany and Austria, have introduced thresholds that depend not on the revenues generated by parties but rather on the value of the transaction. This can trigger in healthcare because when buying technology or R&D-based businesses, there may be no revenues being generated but acquisitions may still require a notification, creating new hurdles to jump through. We also see an increase in foreign investment regimes shining a spotlight on healthcare deals, with most of these businesses being global and triggering filings in several markets because of the nature of the assets in relation to public health. Furthermore, where we are talking about the data of one country's subjects getting into the hands of another, there are added sensitivities.

How easy it will be to do transactions driven by data in the future remains to be seen, and all of those additional regulatory hurdles will have a particular impact when it comes to healthcare deals.

***Hobson**: deals can take two or three years to complete*

***Allen**: easy to articulate ESG impact of health-care*

can quickly allow an incumbent to establish a big footprint through one transaction.

Going forward, there is a further angle to be exploited in medtech around the manipulation of data. Combining advanced data science skills with medical knowledge and commercialisation expertise is a huge potential area for private equity. Such deals are not easy, because different world regions have different approaches to how data can be used, and the challenges are heightened by the involvement of governments paying close attention through foreign investment reviews.

DA: Healthtech presents an opportunity to combine the skills of the technology teams within PE firms with the skills of the healthcare teams, to collaborate and bring different perspectives. Private equity can also add a lot of value through its understanding of the way that the consumer operates across so many asset classes, bringing an ability to triangulate tech, healthcare and consumer insights, which many companies struggle to do.

Q Why are healthcare carve-out deals proving so attractive, given how complicated they are to pull off?

DA: If you speak to any large-cap private equity firm today about the type of deals they are getting excited about, most will point to carve-outs and/or take-privates. Carve-outs are complicated because they involve effectively taking a division out of a larger corporate, where everything was previously entangled and where the corporate had probably undervalued the asset and perhaps neglected it, because it was non-core and the management team was not adequately incentivised. Once an independent management team is running the business, with skin in the game to drive value, then suddenly you can see great results in terms of performance.

Carve-outs are really hard to do generally, and doing those deals in healthcare really takes the complexity up quite a few more notches, partly because private equity does not have the infrastructure required to be absorbing the assets, ie, the newco structure won't yet have any healthcare regulatory approvals.

> ***Combining advanced data science skills with medical knowledge and commercialisation expertise is a huge potential area for private equity***
>
> **Jane Hobson**

JH: The need to set up a global pharma or medical devices business quickly is one of the main sources of complication and explains why these deals typically take two or three years to complete. Add to that the regulatory environment, where new companies need to be set up in new markets and are typically required to be immediately fully licensed, and it gets more difficult; you cannot simply transfer the licenses from the seller because the licenses will still be required in the retained business. Then there are the systems – you need to build an IT infrastructure that enables you to do what you do across the world, setting up all the necessary operating models.

You need a lot of support from the seller to close these deals, which often means delivering a series of local closes that allow you to turn off support from the seller in phases as different markets move faster than others.

DA: In the context of a competitive carve-out process, private equity has that additional execution complexity that it needs to get over compared to a strategic buyer. But once completed, a fund has a portfolio company that is able to behave as a strategic and make acquisitions with that infrastructure already in place. ■

__David Allen__ leads Baker McKenzie's global private equity and funds team. He is primarily focused on M&A and restructurings for private equity funds, infrastructure funds, pension funds and other clients. He is also an expert on equity incentive structures and has extensive experience in Japan.

__Jane Hobson__ heads up the London private M&A group and is a member of the global M&A practice group. She specialises in cross-border mergers and acquisitions, licensing transactions and joint ventures in the pharmaceutical and healthcare sector.

REPORTING OBLIGATIONS

The changing face of the LPA

Calls are growing for the standardisation of the limited partnership agreement, but moves towards uniformity are fraught with difficulties, lawyers say. By Claire Coe Smith

If there is one theme that characterises the past decade in the development of private equity's legal terms, it is the way in which the limited partnership agreement, which sets out the legal basis on which investors come into a fund, has grown in both length and complexity. But with negotiations getting ever more unwieldy, might the next 10 years bring more streamlining to the process, and even more standard terms?

The Institutional Limited Partners Association, which represents the interests of investors in private equity funds, has long called for more standardisation, but lawyers see little change on the horizon. "Fund sponsors believe they have unique approaches to investing, and that they know the secret sauce that needs to be reflected in the agreement," says Peter Laybourn, partner in the private funds group at Ropes & Gray in Boston.

"Whether they feel they need different terms to give them flexibility to execute on their strategy, or their returns outperform relative to the market, thereby enhancing bargaining power and, potentially, justifying different compensation arrangements, I don't see a single sponsor wanting a more standardised LPA. The LPs may want that, but I don't see any movement while those interests differ as much as they do today."

But that is not to say there will not be sections of the agreement that become more uniform. Jason Glover, private funds partner in the London office of Simpson Thacher & Bartlett, says: "I certainly see things getting much more prescriptive in terms of reporting obligations, with investors much more focused on standardised reporting templates that sponsors will have to adhere to. I see much more transparency resulting from that, probably done electronically, and much more conformity around the types of things that are reported, so that investors can finally compare like with like."

He also anticipates market practice emerging in areas such as environmental, social and governance criteria. "The significance of ESG is going to be massive," says Glover. "You are going to find investors being very prescriptive as to the ESG standards that need to be adopted. Investors will be more involved in coming up with parameters that go way beyond the UN Principles for Responsible Investment, and those will be hard-lined into the LPA.

"At the moment, investors are asking sponsors to do things in line with the investors' own policies, and the GPs tend only to commit to the UN principles. But I see investors becoming much more focused on coming up with a collective standard that they will expect everyone to operate to."

DIRECTION OF TRAVEL

The degree to which regulators might become more focused on private equity is anyone's guess. Michael Halford, head of Goodwin's private investment funds practice in Europe and Asia, says: "Currently, private equity funds are not regulated, but throughout my career the regulators have taken a growing interest in the industry and that looks likely to continue. I hope that in 20 years' time private equity funds do not look like fully-regulated investment products, but that does appear to be the direction of travel."

One theme that will undoubtedly force regulators to turn a spotlight on the industry is the growing demand from high-net-worth individuals to get access to private equity. Glover says that is a trend that will shape the industry moving forward: "I predict a shift away from pension funds in favour of more products being developed to enable HNWIs to participate more readily in private equity, and that will require a change in the way the LPA works. There is no question that the sheer amount of paperwork required for funds discourages individuals from coming into these funds – we do a lot of schemes for friends and family and they certainly struggle with the documentation."

Laybourn agrees and, like Glover, predicts a two-tier process emerging. "Individual investors are certainly a constituency that private equity sponsors are trying to better access to facilitate investments into private equity funds, because there's a lot of capital there that sponsors are not really able to access today beyond very wealthy individuals. The standardisation of documents for those investors will depend very much on the regulatory environment and whether the US regulators provide better access.

"I can envisage that there will be two categories of offering, with one to access retail channels that will be standardised and regulated, akin to the mutual funds market in the US, and another for institutional capital that functions much like it does today, but we seem to be ways away from that at the moment."

That retail space is the only part of

the market where Laybourn predicts the Securities and Exchange Commission will increase its intervention: "The SEC so far has been attuned to the sophistication of the institutional market participants and the relative bargaining power of investors, recognising that many of the institutional investors in private equity hire large law firms to do this and it really is a negotiation between two sophisticated parties. My guess is that they will continue to take that approach and not intervene in a well-functioning commercial arrangement between sophisticated parties."

One area where the direction of travel seems determinedly against standardisation is around negotiations on carried interest and the management fee. While the two and 20 compensation structure has been ingrained for many years, lawyers predict more flexibility emerging.

Glover says: "You are likely going to see much more flexibility around the percentage amount of carried interest charged, with different carry amounts being agreed for different funds and in particular outperforming managers being able to command much higher amounts of carry. What will become more common will be carry percentage amounts increasing according to performance, so maybe 20 percent up until the sponsor achieves 2x money back to LPs, then 25 percent from 2x to 2.5x, and maybe 30 percent once they go above 3x."

> ***The significance of ESG is going to be massive. You are going to find investors being very prescriptive as to the ESG standards that need to be adopted***
>
> **Jason Glover**

Laybourn says: "Another area where we have seen a little bit of creativity is around optionality, with some sponsors giving investors a choice between different waterfall options and other bespoke arrangements to address investor concerns."

On the management fee, Glover predicts a move towards drawdowns being varied to mitigate the impact of the J-curve, such that instead of drawdowns being the same year-on-year throughout the investment period of the fund, resulting in a fund showing negative returns in the first few years when investments are in their infancy, larger GPs may be willing to defer management fees in the early years of a fund's life.

Halford predicts that the LPA will adapt over the coming years to allow for more longer-term funds and fund extensions, in recognition of the limitations of the standard 10-year lifespan.

"We are already seeing a major change around the way the industry is dealing with the fact that funds have a fixed term of 10 years and then get extended," he says.

"Solutions for GP-led secondaries, for example, and the transferring of assets into continuation funds, as well as the formation of more longer-term funds, are a recognition that not all assets will get sold within the life of the fund. I see more things being baked into the LPA to do with GP-led secondaries and allowing for assets to be held for longer."

Advisors to both sponsors and investors recognise an opportunity for technology to smooth some elements of the fundraising process, with the potential for anti-money laundering questionnaires and subscription documents – which require investors to fill out lengthy forms documenting their suitability to invest – to be automated, perhaps with the use of barcodes.

Beyond that, few predict the process becoming a whole lot easier. Laybourn says: "These are arrangements that are heavily negotiated, with a lot of time today spent on side letters, which are getting longer and longer. It is not uncommon to get a side letter from an investor that has 40 bespoke provisions, and I don't see that trend reversing any time soon." ■

Q&A

The best advice I've ever received

Whether it is the need to embrace change or the importance of curiosity, our Future 40 rely on a diverse set of guiding principles to spur them to greater things

Done is better than perfect (though I still find it hard!)
Louise Dumican
The Carlyle Group

Be kind - treat everyone well. In a world where being arrogant and ruthless is sometimes a bit too common, my karma is to be kind, within the office to my colleagues, to our investors, to the managers of the funds we invest in. Being kind pays you back a million times. Being kind is underrated
Sandro Diazzi
Praesidium SGR

Worry less about what people think about you and turn off the negative mental chatter: it only restrains one's ability to dare. And as importantly, dare to say yes, including to things you are not completely ready to do – that will make you test and grow your limits
Raphaëlle Koetschet
Caisse Des Dépôts

From one Ted (Roosevelt) to another: "It's not the critic that counts..."
Ted Cardos
Kirkland & Ellis

The importance of curiosity. This is ultimately the driver of lifetime learning and will help to keep you professionally engaged and interested
Elizabeth Di Cioccio
Mercury Capital Advisors

That no structure or valuation can fix a bad company to invest in or dealing with bad partners
Marcus Frampton
Alaska Permanent Fund Corporation

Embrace change. It feels like I've had four different jobs at CPPIB, even though I've had the same role for the past six years. The group has continued to evolve and it regularly pushes me out of my comfort zone and offers great opportunities for me to step up
Louis Choy
CPP Investment Board

I was told that as soon as you find something you care about, you should pour yourself completely into that thing. If you do that, people will notice your dedication and good things will happen. It is simple advice, but it has resulted in an extremely varied and satisfying career up to this point
Ted Craig
Dentons